



A year of
achievements

Unlimited. **DSM**

DSM is active worldwide in nutritional and pharma ingredients, performance materials and industrial chemicals. The company develops, produces and sells innovative products and services that help improve the quality of life. DSM's products are used in a wide range of end-markets and applications, such as human and animal nutrition and health, personal care, pharmaceuticals, automotive and transport, coatings, housing and electrics & electronics (E&E). DSM's strategy, named *Vision 2010 – Building on Strengths*, focuses on accelerating profitable and innovative growth of the company's specialties portfolio. Market-driven growth, innovation and increased presence in emerging economies are key drivers of this strategy. The group has annual sales of over € 8 billion and employs some 22,000 people worldwide. DSM ranks among the global leaders in many of its fields. The company is headquartered in the Netherlands, with locations in Europe, Asia, Africa and the Americas.



Web link

Detailed group strategy information can also be found at www.dsm.com : About us

DSM at a glance

DSM's activities have been grouped into business groups representing coherent product/market combinations. The business group directors report directly to the Managing Board. For reporting purposes the activities are grouped into three strategic clusters – Life Science Products, Performance Materials and Industrial Chemicals – plus DSM Nutritional Products. In addition, DSM reports on a number of other activities, which have been grouped under Other Activities.

Life Science Products



€1,479m

- Pharma restructurings yield clearly improved profitability.
- Food ingredients portfolio profits from innovations.

DSM Fine Chemicals

Produces chemical intermediates for the agro-chemical, food and pharma industries. Products include: *glyoxylic acid, fumaric acid, aspartame, benzoic acid, sodium benzoate.*

DSM Pharmaceutical Products

Provides custom manufacturing services to the pharmaceutical and agro-chemical industries. Products: *active ingredients, advanced intermediates, monoclonal antibodies, sterile and solid dose manufacturing and packaging.*

DSM Anti-infectives

Produces penicillin equivalents and other active ingredients for the antibiotics industry. Products: *penicillin G, penicillin intermediates (6-APA and 7-ADCA), side chains, semi-synthetic penicillins, semi-synthetic cephalosporins.*

DSM Food Specialties

Produces dairy, savory, beverage and functional food ingredients and enzymes for food industries. Products include: *starter cultures, flavor enhancers, baking and brewing processing enzymes, arachidonic acid, probiotics and peptides.*

DSM Nutritional Products



€1,914m

- VITAL program contributes further to improved results.
- Significant steps taken to secure competitive position.

DSM Nutritional Products

The world's largest supplier of vitamins, carotenoids and other biochemicals and fine chemicals.

- Human Nutrition & Health

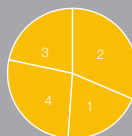
Producer of functional food ingredients for the food industries and personal care ingredients for cosmetics and skin care product manufacturers. Food products include: *total vitamins range, carotenoids (pigments and anti-oxidants), probiotic strains, green tea extract.* Personal care products: *active ingredients (e.g. vitamin C and E forms) for skin, hair and oral care; UV filters.*

- Animal Nutrition & Health

World market leader in vitamins, carotenoids and feed enzymes for the feed industry. Products: *animal performance products (e.g. for gut flora, bone health).* Includes 35 premixing facilities for feed across the globe.

Supplies 2005

1. DSM Fine Chemicals	303
2. DSM Pharmaceutical Products	482
3. DSM Anti-Infectives	330
4. DSM Food Specialties	416
Total	1,531

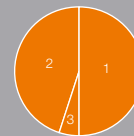


EBITDA/Net sales (as a %)



Supplies 2005

1. Human Nutrition & Health	973
2. Animal Nutrition & Health	875
3. Personal Care	96
Total	1,946



EBITDA/Net sales (as a %)



Performance Materials



€2,447m

- Strong performance in all business groups in 2005.
- NeoResins acquisition strengthens coating resins business.

DSM Elastomers

Manufactures synthetic rubbers (EPDM) and thermoplastic elastomers (TPVs) for the automotive, construction, and white goods industries.

DSM Dyneema

Produces the world's strongest fiber (based on ultra-high molecular weight polyethylene). Dyneema® is used in life protection products and by aircraft, shipping, leisure, sports and medical industries.

DSM Engineering Plastics

Produces polyamides, polyesters, polycarbonates, ultra-high molecular weight polyethylene and extrudable adhesive resins for automotive, engineering, electrics & electronics and extrusion industries.

DSM Coating Resins

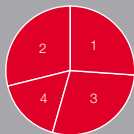
Manufactures resins for coating systems, including powder coating, liquid coating and UV-curable resins, and waterborne, solvent-borne and solid. Most resins find their way in industrial applications.

DSM Composite Resins

Manufactures unsaturated polyester resins for marine, leisure, construction and automotive applications.

Supplies 2005

1. DSM Elastomers (incl. DSM Dyneema)	646
2. DSM Engineering Plastics	705
3. DSM Coating Resins	698
4. DSM Composite Resins	410
Total	2,459



EBITDA/Net sales (as a %)



Industrial Chemicals



€1,687m

- Supply/demand balance favorable for fertilizers and fiber intermediates.
- Melamine faces oversupply.

DSM Fibre Intermediates

Producer of caprolactam and acrylonitrile, which are raw materials for synthetic fibers and plastics. Caprolactam is the raw material for Nylon 6, which is used in a wide range of applications.

DSM Melamine

Produces melamine, a product used in impregnating resins and adhesive resins for the wood-processing industry. Applications include laminate flooring, flame retardants, bank notes, car paints and durable plastic tableware.

DSM Agro

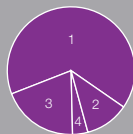
Producer of ammonia and high-nitrogen fertilizers for grasslands and agricultural crops.

DSM Energy

Participates in the exploration and production of oil and gas on the Dutch Continental Shelf.

Supplies 2005

1. DSM Fibre Intermediates	1,243
2. DSM Melamine	212
3. DSM Agro	370
4. DSM Energy	74
Total	1,899



EBITDA/Net sales (as a %)



New structure – Vision 2010

At the end of 2005 DSM started its new five-year strategy for 2006-2010: *Vision 2010 – Building on Strengths*.

With this strategy DSM focuses on accelerating profitable and innovative growth of its specialties portfolio. The overall objective is strong value creation, to be accomplished via three main levers:

1. market-driven growth and innovation;
2. increased presence in emerging economies;
3. operational excellence.

To leverage the capabilities of the various business groups, the organizational model of DSM will be aligned with the new *Vision 2010* strategy. As of Q2 2006 there will be four clusters:

Nutrition

- Human Nutrition & Health
- Animal Nutrition & Health
- DSM Food Specialties
- New Business Development
- parts of DSM Fine Chemicals

Pharma

- DSM Anti-Infectives
- DSM Pharmaceutical Products
- parts of DSM Fine Chemicals

Performance Materials

- DSM Engineering Plastics (incl. DSM Dyneema)
- DSM Resins
- DSM Elastomers

Industrial Chemicals

- DSM Fibre Intermediates
- DSM Melamine
- DSM Agro
- DSM Energy

DSM key data for 2005

Net sales (x million)	CFROI	Workforce (at year-end)
€ 8,195	9.1%	21,820
Operating profit (EBIT) (x million)	Net profit excluding exceptional items (x million)	Net profit (x million)
€ 808	€ 563	€ 527
Capital expenditure and acquisitions (x million)	Net earnings excluding exceptional items (per ordinary share)	Dividend (per ordinary share)
€ 974	€ 2.87	€ 1.00

Forward-looking statements

This annual report contains forward-looking statements. These statements are based on current expectations, estimates and projections of DSM management and information currently available to the company. The statements involve certain risks and uncertainties that are difficult to predict and therefore DSM does not guarantee that its expectations will be realized. Furthermore, DSM has no obligation to update the statements contained in this annual report.

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Key financial data

Throughout this annual report:

1. Operating profit, EBITDA and EBIT do not include exceptional items.

2. Net profit is defined as *Net profit attributable to equity holders of Royal DSM N.V.*

(consolidated)	2005	2004
key figures (x € million):		
net sales	8,195	7,832
operating profit plus depreciation and amortization (EBITDA)	1,311	1,067
operating profit (EBIT)	808	562
net profit excluding exceptional items	563	423
net result from exceptional items	-36	-130
net profit	527	293
dividend	207	190
depreciation and amortization	503	505
capital expenditure	401	348
acquisitions	573	-
cash flow (net profit plus amortization and depreciation)	1,066	928
net debt	832	339
shareholders' equity	5,474	5,068*
total assets	10,025	9,626
capital employed	6,221	5,558
per ordinary share in €:		
net earnings excluding exceptional items	2.87	2.09
net profit	2.68	1.41
dividend	1.00	0.875
shareholders' equity	27.45	25.19
ratios (%):		
operating profit / net sales (ROS)	9.9	7.2
EBITDA / net sales	16.0	13.6
CFROI	9.1	8.1
net debt / equity plus net debt	0.13	0.06*
equity / total assets	0.55	0.53*
EBITDA / net finance costs	18.7	19.1
cash flow from operational activities / net sales	8.5	11.8
workforce:		
year-average workforce	22,839	24,503
workforce at 31 December	21,820	24,204

* Excluding the impact of the temporary reclassification of cumulative preference shares A in 2004.

Message from the Chairman

Peter Elverding



Managing Board of Directors (from left to right): Henk van Dalen, Feike Sijbesma, Jan Zuidam (deputy chairman), Peter Elverding (chairman) and Chris Goppelsroeder.

DSM is financially sound, technology-rich and has embarked on a new strategic course with new opportunities and challenges.

A very good year

2005 was an important milestone in our company's history. We achieved strong progress on virtually all fronts, and thus laid a solid foundation for further value-creating growth. New opportunities will be captured with great vigor in the context of our ambitious strategy for the next five years: *Vision 2010 – Building on Strengths*.

The financial results for 2005 were significantly better than those for 2004. Net sales growth amounted to almost 5%, and our operating profit of € 808 million was the highest DSM has ever achieved. In 2005 we created substantial value, as the Cash Flow Return on Investment (CFROI) of 9.1% clearly exceeded the weighted average cost of capital (WACC).

The company benefited from balanced market conditions, an economy that was in better shape (although there were marked differences per region), on average stable currency rates and a variety of self-generated activities, ranging from operational excellence programs to the successful market introduction of new products and applications. I find it particularly gratifying to note that almost all our business groups and units were able to improve their sales and operating profit.

Vision 2005 completed – new strategy already in full swing

We have successfully completed our strategy *Vision 2005: Focus and Value*. Major events in the context of the portfolio transformation during 2005 included the acquisition of resins specialist NeoResins from Avecia and the divestment of our bakery ingredients activities. The successful completion of *Vision 2005* has provided us with a solid platform from which we can take the next step, embodied in our new strategy *Vision 2010 – Building on Strengths*. This new strategy focuses on accelerated growth and expansion of the specialty content of our portfolio, accelerated innovation, expansion in emerging economies, and continued operational excellence. The first steps have already been taken. An extensive evaluation of *Vision 2005* and the rationale and objectives of *Vision 2010* are provided on pages 20-23.

2005: a very good year



+44%

Operating profit up € 246 million to € 808 million

+14%

Dividend rise to € 1.00 per share

9.1%

CFROI, clearly exceeding WACC

#1

DSM maintains #1 position in chemicals sector of Dow Jones Sustainability World Index

49%

Total Shareholder Return

-16%

Frequency index of all recordable incidents improves to 0.74 (2004: 0.88)

In terms of Safety, Health and Environment (SHE) important progress was achieved in 2005. At year-end 2005 we had met ten of our fourteen environmental targets for 2006. The frequency index for all recordable accidents decreased further. In 2005, we maintained our number one position in the chemicals sector of the Dow Jones Sustainability World Index. Moreover, sustainability targets have been included in our new strategy. An extensive description of our activities and ambitions in this respect is presented in our Triple P report for 2005.

Where we go from here

All in all, I would qualify 2005 as a very good year for DSM, despite some adverse developments such as the high and volatile cost of raw materials. 2005 was a year of historically strong results, a good performance with regard to sustainability, and significant progress in our efforts to further exploit value-creating growth opportunities based on the accomplishments of 2005 and the preceding years. Our employees deserve tremendous appreciation for their commitment and perseverance in making DSM the better and stronger specialty chemicals company it is today. It has never been easy, but all the hard work has clearly paid off. I would also like to thank our customers and shareholders for their enduring support during the execution of our transformation strategy.

We regret that Henk van Dalen, who has been a Managing Board member for six years, has decided to take up a career opportunity outside DSM with effect from 1 April 2006. The company is grateful to Henk van Dalen for his 29 years of commitment and leadership. He played a key role in the *Vision 2005* transformation process and in the establishment of the company's new strategic direction. We also regret that our Managing Board member Chris Goppelsroeder has decided for personal reasons to relinquish his position with effect from 1 April 2006. Chris Goppelsroeder has, among other things, been instrumental in the establishment of DSM's new *Vision 2010* strategy program. Prior to his appointment as member of the Managing Board, he was vital to the integration and transformation of DSM Nutritional Products. Both colleagues deserve great appreciation for their work.

DSM is financially sound, technology-rich and has embarked on a new strategic course with new opportunities and challenges. The successful completion of *Vision 2005* has paved the way for the next logical step, *Vision 2010 – Building on Strengths*. In fact, we have already started. And more will follow as we further leverage the capabilities and performance of our company in order to successfully execute this strategy.



Peter Elverding
Chairman of the Managing Board of Directors
 peter.elverding@dsm.com

DSM Dyneema produces Dyneema®, a lightweight, super strong high performance polyethylene fiber. Dyneema® is an important component in ropes, cables and nets in the fishing, shipping and offshore industries.

DSM Fibre Intermediates produces caprolactam as a raw material for Nylon-6, which is used in textiles, and acrylonitrile, which is a raw material for acrylic fibers.

DSM Coating Resins produces synthetic coating resins for use in the marine industry.

DSM Engineering Plastics produces insulator materials for LV switchgear and ITE components, lighting fittings and armatures, motors, wire and cable, enclosure housings and electrical equipment.

PeptoPro®, a sports recovery ingredient, a product of **DSM Food Specialties**, differs from other sports and energy drinks in that it enables faster replenishment of muscle energy stores.

DSM Melamine produces melamine, which is mainly applied in adhesives and impregnating resins for wood-based panels used in the construction industry.

DSM Fine Chemicals' products are used in coatings, resins, dyes, pigments, polymers and plastics all around the world, both as base products and as additives that give the end products special qualities, such as strength, UV resistance and elasticity.

DSM everywhere... an innovative company

DSM Nutritional Products produces vitamins and UV filters for use in the personal care industry.



DSM Nutritional Products produces vitamins, carotenoids, enzymes, amino acids and other ingredients for use in the animal feed and pet food industries.



DSM Composite Resins produces unsaturated polyester resins, gel coats, sizings and binders and polymeric plasticizers for use in glass reinforced plastics applications in the marine industry.



DSM NeoResins produces extremely durable resins specially designed for the marine industry.





Beyond bright ideas

Innovation is not just about great ideas, state-of-the-art technology and high-tech laboratories. It also involves spotting market trends and opportunities and using technological capabilities to improve the quality of people's lives in a way that is commercially attractive for our customers and for us.

With our accelerated transformation into a true specialty player, the importance of innovation has become ever greater. We will make great strides in the coming period, as innovation is one of the building blocks of our *Vision 2010 – Building on Strengths* strategy. Our focus will be specifically on the two growth areas performance materials and nutritional ingredients.

We are demonstrating our intensified commitment to innovation by e.g. allocating significant additional funds and by hiring new innovative talents. We are also exploring important emerging domains such as personalized nutrition, biomedical materials, specialty packaging and industrial or 'white' biotechnology.



Navigating for value

DSM has developed technology for structuring materials and surfaces on a nanometer scale. Control of surface and bulk properties and surface chemistries on this scale has led to interesting, valuable functional properties. We first used this technology to develop anti-reflective coatings for the flat-panel-display industry and more recently for other applications such as picture display glass. These anti-reflective coating systems have excellent optical and mechanical properties.

Their nanostructured nature means that these properties can be achieved in a single layer, whereas competitive technologies rely on at least two, and sometimes as many as six optical layers.

In the coming years DSM plans to target applications such as transparent UV-blocking coatings and anti-fogging coatings. Also under development are anti-fouling functionalities, i.e. coatings capable of resisting the adhesion of biological materials such as proteins or microorganisms.

Brewers Clarex™ – a clear solution

Any beer has a tendency to become turbid after some time. How can beer be stabilized without affecting its taste and color? Brewers are dedicated to their own traditional recipes. They do however make use of adsorbents which remove essential components such as protein and polyphenol. These are crucial for flavor and mouth feel. After a period of intense research, we found a clear solution to this problem: Brewers Clarex™. Brewers Clarex™ is a totally new concept, based on enzyme technology, that provides

brewers with an innovative method for preventing turbidity in beer. It does not remove the polyphenols and proteins from the beer, and it saves costs. Brewers Clarex™ was launched at the European Brewing Conference in Prague, Czech Republic, in the summer of 2005.



Open Innovation at DSM

Increasing technological complexity and market developments evolving at high speed make cooperation indispensable. For DSM, innovation is open, multi-site and multidisciplinary.

Building knowledge and expertise in partnership with others can create leverage for everyone involved. Where desirable, DSM works together with external partners. For example, we have scientific and technological collaborations in place with some 2,000 university departments. We participate in renowned research organizations and networks,

such as Gene Alliance (Germany), the Biocatalysis & Bioprocessing of Macromolecules Consortium (USA), the Wageningen Center for Food Sciences and the Dutch Polymer Institute, both in The Netherlands.

DSM also invests in company start-ups. This enables us to exploit trends more quickly and meet social needs such as weight control, health products and health advice.



DSM everywhere...
an international company





What boundaries?

Some 40 years ago, DSM took the last step in the transition from mining to chemicals. Since then, the company has gradually evolved from a national to a European organization. Our strategies of the past ten years speeded up the company's internationalization towards a global player. Important drivers in this development were significant portfolio changes, technological progress, new cooperative patterns and increasing efforts to exploit the opportunities of the emerging economies.

DSM's internationalization is a multi-faceted process, clearly visible in terms of staff, distribution of sales and assets, and our increasing presence in emerging economies. Internationalization is also reflected in our research and development activities. In 2005 we established the new DSM R&D Center China in Shanghai, and opened the doors of a new joint lab with the prestigious Shanghai Fudan University.



Distribution of sales

One aspect of our further internationalization concerns the spread of sales. In 2000 around 70% of our sales were destined for West European markets. Today, sales are more evenly spread across the world, in an almost 50:50 balance between Western Europe and the rest of the world. An important factor is that DSM has in recent years won new customers especially in Asia and the USA.

In 2005, sales outside North America and Europe increased by some € 200 million, while sales in China increased from \$ 500 million to over \$ 580 million. Further internationalization of sales will continue in the coming years, partly because our investment and acquisition decisions will, more than in the past, take account of the need for a presence in the emerging economies.

Staff around the globe

DSM's profile as a mainly European company is changing in terms of the composition of our staff. At year-end 2005 about one out of every three DSM employees was based outside Europe. The internationalization of our staff received an extra boost with the acquisition of DSM Nutritional Products, which also led to substantial expansion in China. Of DSM's total staff, approximately one out of every six employees – all joint ventures included – is now active in China.

Since greater diversity and further internationalization of our staff are spearheads of our new *Vision 2010 – Building on Strengths* strategy, the internationalization trend of the past few years is set to continue.



Stronger presence in the emerging economies

Over the past few years, economic growth and market demand have clearly shifted from Europe to countries in the Asian region, notably China and India. DSM of course took this development into account while crafting its *Vision 2010* strategy. Increasing DSM's presence in the emerging economies is one of the strategy's focal points. Investment and acquisition decisions will be geared to reinforcing the company's positions in these parts of the world. DSM has been present in the US and China for several

decades, but in 2000 the internationalization of business began to receive considerable impetus. Since then, business has grown, both organically and via acquisitions, in countries such as the US, Japan, China and India. DSM will further improve the specialty profile of its portfolio and expand its presence in today's fastest-growing emerging economies.



DSM everywhere... **Operational Excellence**





Better sourcing, production and selling

In 1999, DSM started its Operational Excellence program to optimize the flow of the company's business processes of sourcing, production and selling. Operational Excellence spans a wide range of projects aimed at realizing cost reductions, increasing the efficiency of plants and organizations, improving product quality, strengthening the purchasing organization and enhancing the value pricing of our products and services. Operational Excellence started with a focus on streamlining and standardizing processes at DSM in order to arrive at a better performance at lower costs. Purchasing and value pricing are two important more recent areas of attention.

Operational Excellence has yielded significant results over the past years and it is included as an essential building block in our *Vision 2010 – Building on Strengths* strategy.



Excellence in sourcing

In 2005 DSM established a new, globally active sourcing organization with the aim of improving the company's purchasing practices across the board and thus contributing to DSM's bottom line. Many initiatives have been launched in this context, ranging from the introduction of best purchasing practices to the implementation of new performance management models. The purchasing objectives outlined in 2004 were already to a large extent achieved in 2005.

Excellence in production

Manufacturing Excellence is a program designed to enhance the effectiveness and professionalism of all production, maintenance and project work in the area of manufacturing. Plant output may be boosted without significant investments, efficiency improvements may be realized and costs saved. The results of this program so far are quite worthwhile. Significant yield, quality and reliability improvements and cost reductions have

been realized. Manufacturing Excellence has been implemented mainly within DSM Nutritional Products and the Industrial Chemicals cluster. Implementation in the other parts of DSM is underway.



Excellence in selling

DSM's *Excellerate* program focuses on creating an optimum balance between the value of supplied products and services and the required investments. Value pricing is becoming more and more important for DSM now that the company is marketing ever more specialties. Selling prices should reflect the perceived value that DSM creates for its customers and end-users.

That's why DSM started this program, covering elements such as the upgrading of pricing skills, the introduction of new systems, training and the hiring of new professionals and a change in the mindset of marketing and sales professionals.

Report by the Managing Board

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		Supplies	
	2005	2004	2005	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

operating profit plus depreciation and amortization (EBITDA)

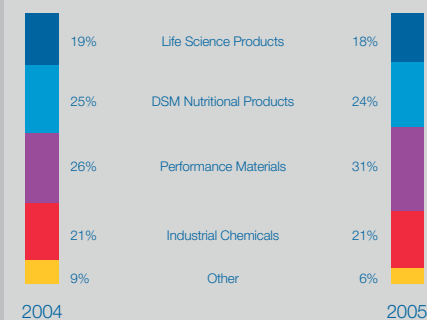
x € million	2005	2004
Life Science Products	266	226
DSM Nutritional Products	376	330
Performance Materials	410	249
Industrial Chemicals	246	207
Other activities	-3	24
Total, continuing operations	1,295	1,036
Discontinued operations	16	31
Total DSM	1,311	1,067

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

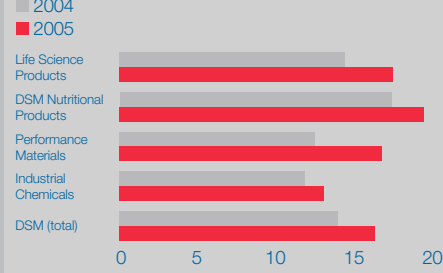
Sales by core activity

excl. discontinued activities



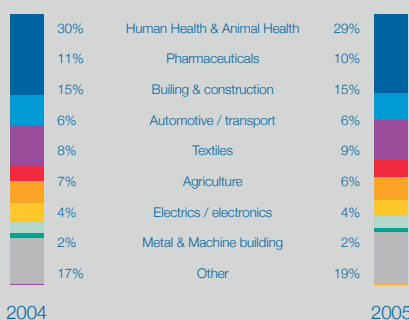
EBITDA / supplies 2004 and 2005

excl. discontinued activities



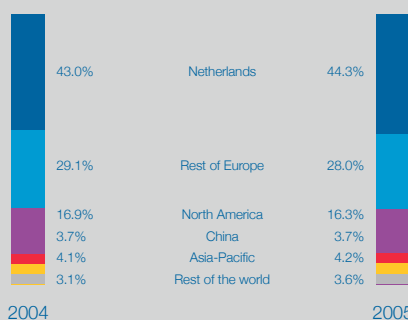
Markets

End-use markets



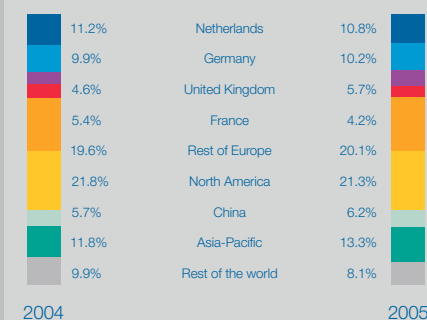
Sales by origin

excl. discontinued activities



Sales by destination

excl. discontinued activities



Developments in 2005

Strategy – looking back and ahead
 Corporate governance
 Safety, Health, Environment
 Human Resources
 Research and Development
 Intellectual Property
 ICT and e-Business
 Purchasing
 Macro-economic review
 Financial results

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.

Report by the Managing Board

Strategy – looking back and ahead

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 2001-2003¹, 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.

Developments in 2005

Strategy – looking back and ahead

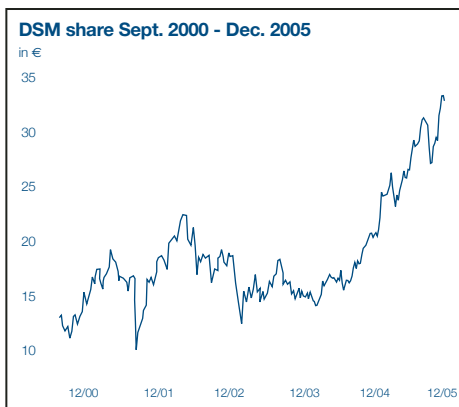
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- Sales around € 10 billion by 2005

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.

**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*.

Report by the Managing Board

Strategy - looking back and ahead – Corporate Governance

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.

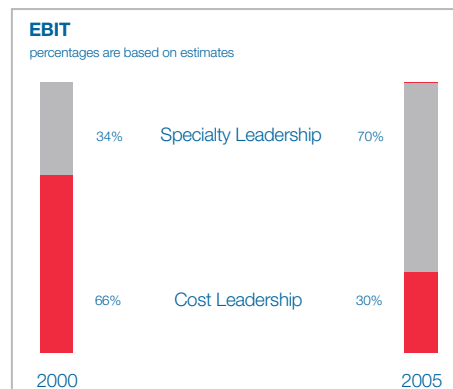
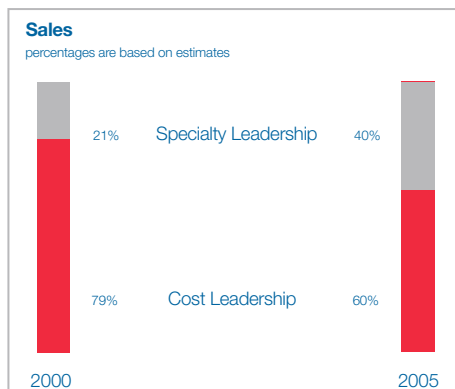
By 2010 DSM aims to have grown its specialties portfolio to 50-60% of sales, coming from 40% under the new specialty leadership definition. Profitable growth via specialty leadership business, innovation and geographic growth should lead to an underlying sales growth rate of 3-5% per year (including 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



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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.

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 group².

Report by the Managing Board

Corporate Governance – Safety, Health, Environment – Human Resources

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.

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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.

Report by the Managing Board

Human Resources – Research and Development



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

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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. Fabules[®], 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. Fabules[®] 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.

Report by the Managing Board

Research and Development



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



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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.

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.

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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, e-logistics, 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 e-logistics 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 e-logistics for road and rail transport in the USA. The company is already using e-logistics 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.

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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.

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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.

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

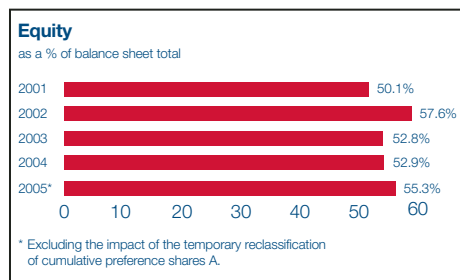
* Excluding the impact of the temporary reclassification of cumulative preference shares A at year-end 2004.

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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.



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 operations³ 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.

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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

EBITDA/net sales

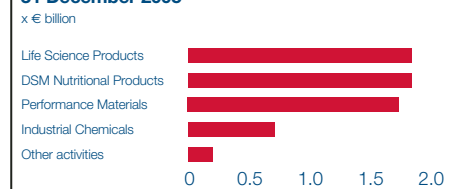
as %	2005	2004
Life Science Products	18.0	15.2
DSM Nutritional Products	19.6	17.4
Performance Materials	16.8	12.4
Industrial Chemicals	14.6	13.2

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

Capital employed by core activity at 31 December 2005

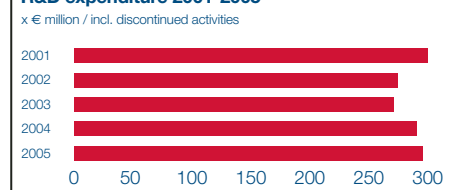


Operating profit by core activity at 31 December 2005



* Excl. discontinued activities

R&D expenditure 2001-2005



Review of business

Life Science Products

The Life Science Products cluster comprises business groups that supply to the pharmaceutical, food and agro-chemical industries. The cluster's share in DSM's overall net sales is 18%.



x € million	2005	2004
net sales*:		
- DSM Fine Chemicals	303	374
- DSM Pharmaceutical Products	482	463
- DSM Anti-Infectives	330	386
- DSM Food Specialties	416	359
total	1,531	1,582
operating profit	126	79
operating profit plus amortization and depreciation	266	226
capital expenditure	97	124
capital employed at 31 December	1,753	1,704
operating profit as % of average capital employed	7.3	4.2
research and development	93	98
workforce at 31 December	6,239	6,836

* Before elimination of intra-group supplies to other clusters.

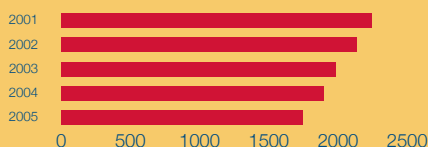
The Life Science Products cluster comprises the following business groups: DSM Fine Chemicals, DSM Pharmaceutical Products, DSM Anti-Infectives, DSM Food Specialties and DSM Bakery Ingredients. DSM Bakery Ingredients was divested in June 2005 and its bakery enzymes activities were transferred to DSM Food Specialties. Our main customers in life science products are the pharmaceutical, food and agrochemical industries. The main drivers of growth are a growing world population, increasing purchasing power, the aging of the population, the increasing importance attached to a healthy lifestyle and the growing emphasis placed on personal care.

The activities in this cluster are to a large extent based on DSM's in-depth knowledge of biotechnology (including fermentation, genomics and biocatalysis) and organic chemistry. DSM is one of the world's leading independent suppliers to the pharmaceutical industry, and we also hold leading positions in the markets for ingredients for human and animal nutrition. The business groups in this cluster work closely together with each other and with DSM Nutritional Products in the field of R&D, for example in biotechnology, and in some cases they share distribution channels as well as production facilities.



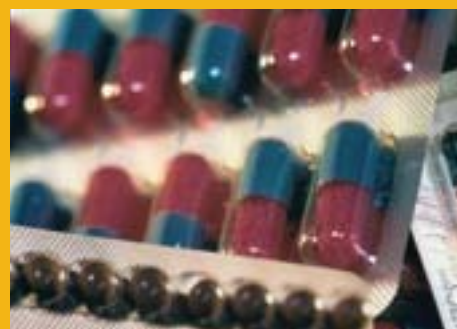
Supplies of Life Science Products

x € million / incl. discontinued activities



Operating profit of Life Science Products

x € million / incl. discontinued activities



Life Science Products

DSM Nutritional Products

Performance Materials

Industrial Chemicals

Other Activities

DSM Fine Chemicals**Working on improved profitability**

DSM Fine Chemicals produces chemical intermediates mainly for the agrochemical and food industries. DSM Fine Chemicals comprised four business units. *DSM Fine Chemicals Intermediates* develops, produces and sells maleic anhydride, glyoxylic acid and fumaric acid and fine chemicals based on these raw materials, applying a broad technology toolbox. The business unit has production facilities in Linz (Austria). *DSM Special Products* develops, produces and sells benzoic acid, sodium benzoate, benzaldehyde, benzyl alcohol and products derived from these for a range of end-use markets in the life science industry. DSM Special Products is the market leader in these products. The business unit has production facilities in Rotterdam, the Netherlands. *DSM Minera* operates an iodine mine in Chile and sells iodine and iodine derivatives to the life science and performance chemicals industries.

Holland Sweetener Company is a joint venture with Tosoh (Japan). It produces and sells aspartame, an intense, low-calorie sweetener. It has a production plant in Geleen (the Netherlands).

Strategy

As a consequence of the organizational re-adjustments in the context of DSM's *Vision 2010* strategy program, the activities of DSM Fine Chemicals will be repositioned in 2006. Until then, the business group's strategy is to maintain its position as a supplier of high-quality specialty chemicals and to aim for improved profitability. The main pillars of the business group's strategy are continuous process improvements, lowest cost production processes and targeted growth in attractive market segments with existing and new intermediates.

Business review

The trend in DSM Fine Chemicals markets in 2005 was in line with the overall trend in 2005. Business was affected mainly by the sharp rises in the prices of various key raw materials, such as toluene and n-butane. These cost increases were in general successfully passed on to customers. The results of the DSM Minera business further improved as a consequence of continuous strong demand for iodine and its derivatives. The restructuring measures we took in relation to our aspartame business showed positive effects. DSM Fine Chemicals profits for 2005 improved compared to the 2004 figures.

Projects

The exclusive synthesis activities were integrated within the activities of DSM Pharmaceutical Products to capture synergies. Restructuring studies for the activities in Linz were started in the second half of 2005 and were already showing results. The full effects will materialize in 2006 and 2007.

The concentration of DSM Special Products' production activities in Rotterdam was completed in 2005 with the integration of benzyl alcohol and benzaldehyde production on this location.

DSM Minera was sold in January 2006 to Sociedad Química y Minera de Chile.

**DSM Pharmaceutical Products****Improved revenues and profit**

DSM Pharmaceutical Products is a leading provider of high-quality global custom manufacturing services to the pharmaceutical industry. Customers – served from five manufacturing sites in North America and Europe – include seventeen of the top twenty pharmaceutical companies, mid-sized and smaller (even virtual) pharma companies as well as a large number of agro-chemical companies across the globe.

The group comprises four business areas. *DSM Pharma Chemicals* is a provider of custom chemical manufacturing services for complex intermediates and active ingredients for pharmaceuticals. *DSM Biologics* provides process development, scale-up and cGMP manufacturing services for clinical and commercial biopharmaceutical products. DSM Biologics' focus, under an exclusive license with Dutch biotech firm Crucell, is to establish the PER.C6® human cell line as a production platform for biopharmaceutical proteins and monoclonal antibodies. *DSM Pharmaceuticals, Inc.* is a leading provider of finished dose manufacturing services to the pharmaceutical and biotech industries. Operating from a state-of-the-art facility in Greenville, North Carolina (US), the company manufactures sterile injectables (liquid & freeze-dried), solid dose (tablets, capsules), semi-solid (creams, ointments) and liquid products. *DSM Exclusive Synthesis* was transferred from DSM Fine Chemicals to DSM Pharmaceutical Products during the year under review. Exclusive Synthesis develops, produces and sells products made by synthesis on an exclusive basis, primarily for use in agrochemical industries.

Review of business

Life Science Products

Strategy

DSM Pharmaceutical Products' strategy is to focus on exclusive high-end solutions to the complex development and manufacturing needs of the pharmaceutical industry. Aiming at being closer to its main customers, the business group headquarters was relocated from The Netherlands to Parsippany, New Jersey in the USA during the first quarter of 2005. New Jersey is an important region in the worldwide pharma industry.

Business Review

Sales in 2005 exceeded the 2004 level due to increased revenues of DSM Pharmaceuticals, Inc. and the addition of the Exclusive Synthesis business with effect from 1 July 2005. A continued focus on cost and the addition of new strategic customers is ongoing in an effort to further improve performance. DSM Pharmaceuticals, Inc. showed a strong increase in revenue and profit versus 2004 due to increases in both solid-dose and sterile manufacturing services. Demand for existing solid-dose products increased as a number of customer products launched in 2004 began to take hold in the marketplace. Sterile manufacturing growth was the result of continued demand for existing biologic products and the addition of significant new projects, including commitments for newly added freeze-drying capacity. Seventeen new products were launched from the Greenville facility during 2005, including major launches into Europe and Japan. New business inquiries exceeded the already high level attained in 2004.

The sterile manufacturing service offerings will be further expanded with the construction of two additional sterile manufacturing suites – one for the manufacture of clinical trial materials (CTM) and another for the manufacture of cytotoxic products. The CTM suite will be operational in late 2006; the cytotoxic area will be ready in 2007. These additions, combined with the completion of additional freeze-drying capacity, will result in further revenue growth capitalizing on the expected demand for sterile manufacturing services resulting from the large number of biologic products in the development pipeline.

DSM Biologics' activities during 2005 were centered on delivering Phase II/III clinical trial materials and commercial supply for customers out of the Groningen (Netherlands) facility and furthering the development of the PER.C6® human cell line. In July 2005, DSM acquired the 40% share interest in DSM Biologics Holding from its joint venture partner Société générale de financement du Québec (SGF). DSM now holds 100% of DSM Biologics. At the end of 2005 the strategic repositioning of DSM Biologics resulted in the decision to mothball the DSM Biologics facilities in Montreal at the beginning of 2006.

Furthermore, stronger emphasis was placed on the accelerated development of PER.C6®, through increased development efforts in a joint effort with Crucell. DSM Biologics and Crucell will intensify their efforts in the development of the promising PER.C6® platform and create an integrated solution for the production of biopharmaceutical proteins and monoclonal antibodies on PER.C6® in order to increase licensing and royalty income and accelerate the development and roll-out of the PER.C6® technology platform in the market. The partnership's Research and Development to create this new platform will be based around a new joint R&D center, located in the Netherlands and the US East Coast. DSM Biologics in Groningen (Netherlands) will focus on providing full support to licensees of the PER.C6® technology, besides its services as a contract manufacturer for the biopharmaceutical market.

Despite a continued tough business environment, DSM Pharma Chemicals performed significantly better, due to faster realization of cost reductions and an ongoing upgrade of its product portfolio. The necessary further reduction of the asset base took shape in the announced closure of the South Haven (Michigan, USA) site, which will take effect in the second quarter of 2007. DSM will increase the focus of its pharmaceutical chemical operations on

higher added-value products (such as active pharmaceutical ingredients and advanced and registered intermediates), capitalizing on its toolbox in chemical and biochemical processing and its track record in regulatory compliance.

Projects

DSM Pharma Chemicals had a good year with respect to project intake. The business unit's product portfolio now contains several high-profile compounds that are close to launch or were launched in 2005. RESCOM, the unit within DSM Pharma Chemicals focusing on early clinical phases, had a record year, and the business group will continue to expand the facility. DSM Exclusive Synthesis had a difficult year, but made good progress in the development of a major restructuring plan for the Linz site. The implementation of this plan will bring exclusive synthesis back on track.

In the course of 2005 the Manufacturing Excellence project Heureka in Linz, Austria entered its implementation phase. The project affects the pharmaceutical, exclusive synthesis and intermediates businesses on the Linz site and aims to deliver an overall performance improvement of € 35 million, to be realized by 2007.

DSM Pharmaceutical Products posted a clearly higher operating profit compared with 2004.

DSM Anti-Infectives

A year of restructuring

DSM Anti-Infectives holds global leadership positions in penicillin G, penicillin intermediates (6-APA and 7-ADCA), side chains, semi-synthetic penicillins, semi-synthetic cephalosporins and other active ingredients such as potassium clavulanate and nystatin. These products are used for combating bacterial or fungal infections. DSM Anti-Infectives has production sites distributed over the Netherlands, Spain, Sweden, Mexico, India, China and Egypt.

Life Science Products

DSM Nutritional Products

Performance Materials

Industrial Chemicals

Other Activities

Strategy

DSM Anti-Infectives strives to actively maintain its positions via technological innovation, customer intimacy and operational excellence.

Business review

Global market demand in penicillin equivalents grew about 4% in 2005. Although worldwide production capacity decreased by 4% in 2005, there is still a situation of oversupply. This oversupply forced several producers to step out in 2005, while many others are still suffering severe financial difficulties. During 2005, the weak dollar kept pressure on top-line results, while rising energy prices could not be passed on in the value chain.

At the end of 2004, DSM Anti-Infectives announced drastic measures to reduce its European cost base, to maximize its technology value extraction and to reduce its bottom-line exposure to the euro-dollar exchange rate. The implementation of these measures progressed well in 2005, leading to a substantially better result compared to 2004. Still, with 2005 being a transition year, major additional improvement and restructuring steps will have to be made in 2006.

The clavulanic acid business had a good year. Substantial cost price improvements were realized in the Sweden plant. The side chains activities of DSM Deretil improved due to the reorganizational measures taken. DSM Deretil took an important step by increasing its presence in China with the initiation of the Shangyu Deretil Yuntao Joint Venture. Considerable

variable-cost reductions were achieved in the 7-ADCA plant in Delft in the Netherlands, while its capacity was increased according to plan. Margins of nystatin were stable in an increasingly competitive market.

The operating profit in 2005 was still negative, but showed a considerable improvement compared to the previous year.

Projects

DSM reaffirmed its plan for a strategic co-operation with North China Pharmaceutical Group Corporation (NCPC) via investments in NCPC and the establishment of a joint venture in anti-infective products. DSM will invest in expanding the production of penicillin-related intermediates and active pharmaceutical ingredients at the Toansa facility in India. This expansion – implying a doubling of production capacity – will take place in 2006. The focus of R&D activities is on variable-cost reduction of core products and on extracting value from DSM technology. R&D activities also contributed to identifying and developing new growth options.

DSM Food Specialties**Operating profit higher**

DSM Food Specialties is a global supplier of advanced ingredients for the food industry, manufactured with the aid of fermentation and enzyme technology, among other technologies. The group comprises five business units. *DSM Dairy Ingredients* supplies enzymes (e.g. rennets), starter cultures and preservation systems for cheese and yogurt, and tests for the detection of residues of antibiotics. DSM is one of the biggest suppliers of dairy ingredients in the world. *DSM Savoury Ingredients* is a major supplier of ingredients for flavorings and flavor enhancers (such as yeast extracts) used in products such as soups, instant meals, sauces and savory snacks. *DSM Enzymes* produces a large range of food enzymes for applications such as baking, fruit processing, brewing and other alcoholic beverages. *DSM Functional Food Ingredients* produces



Review of business

Life Science Products

ingredients for baby food, food supplements and functional foods such as arachidonic acid, probiotics and peptides. *DSM Ingredients Development* develops and pre-launches innovative ingredients for the food industry.

The main production sites are in Seclin (France, enzyme production), Capua (Italy, arachidonic acid), Delft (Netherlands, yeast extracts, natamycin and tests), Belvidere (USA, arachidonic acid) and Moorebank (Australia, cultures). The main R&D center is in Delft (Netherlands).

Strategy

DSM Food Specialties targets market segments characterized by rapid growth and seeks to respond to the major trends in the food industry toward health, convenience and natural products. The business group supplies its customer base with innovative, high-added-value ingredients that enable them to satisfy consumer demands in terms of quality, nutritional value and taste. Under the supervision of a Monitoring Trustee

appointed by the EU Commission and the FTC, DSM Food Specialties has continued to produce and supply feed enzymes to BASF as part of the dissolution arrangement for the former alliance with BASF. Due to the arrangements made, production will fade out in the course of 2006.

Business review

The global food ingredients market grew by about 4% in 2005. DSM Food Specialties saw its sales grow by around 13%. DSM Dairy Ingredients' sales were up on 2004. Sales volumes of starter cultures showed strong growth. Sales volumes of rennets produced by means of fermentation were also higher than in 2004. Sales volumes of antibiotic tests were stable, while sales volumes of preservation systems and coatings increased. Prices were somewhat under pressure in the latter segment.

DSM Savoury Ingredients recorded strong sales volume growth, in particular in the segment of specialty yeast extracts including the newly launched product with

a high nucleotide content under the brand name Maxarome® Select. Early in 2005 the hydrolyzed vegetable protein business (HVP) and the manufacturing site in Zaandam (Netherlands) were sold to the Dutch company Oterap Holding B.V., in line with the strategy to further focus on high added-value savory ingredients. Yeast extracts are produced in Delft (Netherlands). Investments are being made to build a dedicated factory for processed flavors in Shanghai (China).

DSM Food Enzymes' sales were up on 2005 with volume growth in fruit-processing enzymes and a good performance in a newly introduced pectinase enzyme under the brand name Rapidase® Smart. Sales volumes of brewing enzymes and baking enzymes grew, whilst a new enzyme was successfully introduced on the market under the brand name Brewers Clarex®. This enzyme provides brewers with a method to prevent turbidity in beers. A new enzyme for improved emulsification properties in mayonnaise, sauces and bakery products was launched under the



Life Science Products

DSM Nutritional Products

Performance Materials

Industrial Chemicals

Other Activities

brand name Maxapal®. On 1 January 2005, a new Enzyme Unit was formed, which includes the baking enzymes activities from the DSM Bakery Ingredients business group.

DSM Functional Food Ingredients saw its sales increase very sharply as more and more baby food manufacturers in the USA are launching new product lines for infant formula enriched with arachidonic acid (ARA). DSM Food Specialties is the exclusive supplier of ARA to Martek, the company that markets ARA/DHA oil. Production capacity for ARA was expanded in 2005 in Belvidere (USA). A new natural ingredient in the weight-management category marketed under the trade name Fabuless® was successfully launched on the market for fermented milk products. It contains a special emulsion of natural palm and oat oil, which are already part of the normal diet, and uses the body's natural appetite control mechanism to reduce calorie intake. The product has been developed by Swedish-based Lipid Technologies Provider AB, and DSM has the exclusive, worldwide marketing rights in this most promising application area of dairy products.

DSM Ingredients Development was successful in the development of radically new ingredients for the (functional) food industry. The number of new product launches from the radical innovation program increased from two in 2004 to four in 2005, and the business unit expects to launch up to eight new products in 2006. In 2005, Maxarome® Select (Savory Ingredients), Brewers Clarex® (Enzymes), Maxapal® (Enzymes) and Fabuless® (Functional Foods) were introduced on the market by a combined effort of the Ingredients Development unit and the marketing and sales organizations. Sales of the patented peptide PeptoPro® started in Europe, Japan and the USA and are gradually picking up. Various producers of sport and energy drinks have now included PeptoPro® in their new product lines targeted at fast recovery after exercise or endurance during exercise. A promising development program concerns a product concept which enables beverage manufacturers to include the nutritional value of milk into a beverage without the limitations of the specific color and taste of milk.

Thanks to higher sales coupled with lower costs as a result of streamlining the organization, DSM Food Specialties' operating profit was clearly higher than in 2004.

Projects

Various efforts were made to facilitate strong sales growth and to increase operational efficiency. The restructuring project at our enzyme production facility in Seclin (France) was completed, and a new chromatography unit was opened which will secure the highest level of purity of our dairy enzymes in particular. In the course of the year all production facilities for yeast and yeast extracts in Delft (Netherlands) were audited by the American Institute of Baking and rated as "excellent". Various projects were completed to further improve our ability to serve our customers in an optimal way, focusing on Demand and Supply Chain Management. The USA organization was streamlined and aligned with the needs of the market. The organization of DSM Food Specialties in China was strengthened in a significant way in order to capture the growing demand for food ingredients and to investigate possibilities for local production and formulation of ingredients.



Review of business

DSM Nutritional Products

The activities of DSM Nutritional Products are focused on three sectors: food and feed ingredients and supplements and personal care. Net sales of DSM Nutritional Products amount to 24% of DSM's overall net sales.

x € million	2005	2004
net sales *	1,946	1,910
operating profit	252	202
operating profit plus amortization and depreciation	376	330
capital expenditure	97	55
capital employed at 31 December	1,830	1,694
operating profit as % of average capital employed	14.3	11.5
research and development	80	75
workforce at 31 December	6,119	6,607

* Before elimination of intra-group supplies to other clusters.

Strong performance in challenging markets

DSM Nutritional Products is the world's largest supplier of vitamins, carotenoids (pigments and anti-oxidants) and other biochemicals and fine chemicals used in products for human and animal nutrition and health and in personal care products. It has eleven large production sites in seven countries: Switzerland (Sisseln and Lalden), France (Village-Neuf), Belgium (Tienen), Germany (Grenzach), the UK (Dalry), the USA (Freeport and Belvidere) and China (two plants in Shanghai and one in Wuxi). At these sites DSM Nutritional Products produces its main straight products as well as formulations. Specific formulation plants are located in Belvidere, Sisseln and Village-Neuf. The unit also owns 35 premix plants for animal nutrition and health and 10 premix plants for human nutrition and health, where products are made in response to specific customer needs. R&D work is concentrated in the region of Basel, Switzerland, strongly integrated in an innovation network with the other DSM R&D campuses in Delft and Geleen (Netherlands). DSM Nutritional Products has some 40 sales offices that are active in over 100 countries.



Supplies of DSM Nutritional Products

x € million



Operating profit of DSM Nutritional Products

x € million



The VITAL project

The VITAL project was continued, as planned, by defining the strategy and new organizational outline of DSM Nutritional Products. In 2004, the focus had been on improving profits by reducing costs and on unbundling DSM Nutritional Products from its former parent company, the Roche Group, and integrating its systems, people and culture into DSM. In 2005, the project on Profitable Growth focused on improving the quality of profits and creating new options for growth and developing innovation management, while the running improvement programs and the unbundling/integration efforts were continued. To capture the full innovation potential, DSM's R&D model was introduced in research & development. In the second half of 2005, the *Innovation Engine* was started. The aim of the Innovation Engine is to bring high added-value, innovative products to market faster. It speeds up the selection, funding, development and testing process for new products and formulations.

Most of the outcomes of the three-stage VITAL project have been handed over to the line organization of DSM Nutritional Products to ensure that the achievements can be sustained. During the third stage of the VITAL project the organization focused on certain strategic issues, among other things on the concentration of vitamin C production in Dalry (United Kingdom), and it was announced that as a consequence vitamin C production in Belvidere (USA) would be discontinued.

DSM Nutritional Products is now an integral part of DSM's core business and has contributed to the company's operating profit from day one. The VITAL project will contribute approximately € 200 million in total by the end of 2006, thus exceeding the original target of € 150 million. The contribution mainly results from reduced staff levels, global efficiency improvements, lower cost of purchased goods and gains in the aforementioned program focused on profitable growth. The planned closure of the Belvidere bulk vitamin C plant in 2006 and the newly formed alliance with North China Pharmaceutical Group Corporation represent steps in the strategic repositioning.

From 2006 onwards, the integration of DSM Nutritional Products and DSM Food Specialties in a new Nutrition cluster and intensified cooperation with external organizations will allow for new opportunities for innovative products. In 2005 DSM Nutritional Products defined its Dual Track strategy to improve and strengthen existing products and at the same time fully boost innovation and new business development. The new strategy offers business partners continuity as well as new opportunities to develop and exploit additional applications, while drawing on DSM Nutritional Products' strengths in R&D, manufacturing and marketing & sales. To further support the implementation of the new strategy, the organizational structure has also been aligned. It is centered around two operational units allowing for a sharper focus on the two key industries – Human Nutrition & Health and Animal Nutrition & Health – and a new unit, New Business Development, fostering a broader and more intense approach to innovation.

Business Review

DSM Nutritional Products strengthened its position as the leading player in the market for nutritional ingredients, recording sales of € 1.9 billion and an operating profit of more than € 250 million. Despite the increase in new product growth, overall sales were generally stable due to the price pressure on some carotenoids and mature vitamins, such as vitamins E and C. Volume growth compensated for the price erosion at net sales level. DSM Nutritional Products' approach of focusing on differentiation in customer products started to have effects. Recently launched products performed well and accounted for some 10% of aggregate sales, with recently launched forms contributing about 20%.



Human Nutrition & Health

The global food market was stable and saw a continued trend towards functional foods and dietary supplements. Functional food concepts are proving increasingly popular in the nutritional products sector, a trend that ties in well with DSM Nutritional Products' strategy. Due to seasonal effects in Europe and local trends in the US, sales in the pharma segment were not as strong as in 2004. In Human Nutrition & Health, DSM Nutritional Products strongly increased sales of new products such as Lafti[®], Optisharp and Teavigo[®]. Lafti[®] is a probiotic addressing gut health and well-being. Lafti[®] strains can strengthen the natural defense in athletes and reduce the overall severity of gastro-intestinal disturbances while showing excellent survival in the human gastro-intestinal tract. The range of Lafti[®] probiotic strains forms a complete package, offering targeted health benefits for functional foods or dietary supplements. Globally, probiotics is a rapid growth segment in the supplement market, and the range of different Lafti[®] strains offers excellent opportunities for growth. Teavigo[®], now globally launched, showed significant growth. Many new beverages, food and dietary supplement products containing Teavigo[®] are being launched world-wide. In the second half of 2005, DSM launched Bonistein[®], a high-purity genistein produced by a patented process. Genistein is a major health-beneficial component of soy. Bonistein[®] is a nature-identical health ingredient that helps prevent weakening of the bones.

DSM Nutritional Products launched a new program focusing on markets such as Africa, India and China: the Nutrition Improvement Program (NIP). The Program will mainly serve the developing markets as a sustainable business for the future of DSM and will work in close partnership with governmental and non-governmental organizations.

Review of business

DSM Nutritional Products

Animal Nutrition & Health

Significant above-average volume growth and further price decreases affected the Animal Nutrition & Health business. The swine business had a good year globally in 2005, experiencing normal market growth. By contrast, the poultry business, after recovering in early 2005, was confronted in the second half of 2005 with the reappearance of avian flu, which may have an impact on consumer confidence in poultry meat, although this has not yet affected our sales.

In the aquaculture market, the Norwegian salmon industry was impacted in the first half of the year by European import tariffs, affecting salmon farmers' sales. Salmon prices remained strong in the second half of 2005, partly due to a tightening of salmon supplies. The Chilean situation was similar, with forecast supplies not meeting actual supplies, mostly due to disease problems in the freshwater phase resulting in fewer salmon entering the sea for production. Although salmon production was flat for 2005 compared to 2004, DSM Nutritional Products maintained its leadership position in supplying key products to the aquaculture industry.

DSM Nutritional Products continued to see substantial sales growth in new products for Animal Nutrition and Health. Hy-D[®], used by poultry farmers to improve bone health and animal performance, was distributed on a global scale. Feed enzyme products sold under the brands of Ronozyme[®] and Roxazyme[®] continued their excellent performance despite increased competition in various markets. In particular activities focusing on eubiotics, products that improve animal performance by gut flora modulation, enjoyed further growth. This growth was mainly fueled by the ban on antibiotic growth promoters, to be implemented early 2006. DSM Nutritional Products' eubiotics portfolio includes VevoVital[®], Cyclatin and MicroSource, which all achieved substantial growth. VevoVital[®] is an organic acid that is used as a replacement of antibiotic growth promoters in the European, Latin American and Asian markets. It is a very successful product offering new ways for pig farmers to reduce ammonia emissions and improve performance of pigs. In Europe it is currently registered for use in growing and fattening pigs.

Personal Care

This segment saw strong volume growth, with leading cosmetics manufacturers on the lookout for active ingredients for skin, hair and oral care. Parsol[®]SLX, a new generation of UV-B filters, was well received by leading sun care manufacturers. In 2005, DSM Nutritional Products expanded its portfolio by introducing three new products, the two UV-filters Parsol[®] EHS and HMS and the skin care active Allantoin. Stay-C[®] 50, a stable form of vitamin C, made further progress in the skin care market, particularly in Asia where it showed exceptional growth.

Projects

In 2005, DSM took various steps to build a successful future for its Nutritional Products business and to underline its position as the world's leading producer of vitamins for the food, pharmaceutical and personal care industries. New product forms were successfully launched, such as Rovimix[®] A-1000 for the animal nutrition market. For the food and dietary supplements market lutein CWS/S-TG was launched to expand DSM's animal-free ingredients portfolio. This portfolio already includes animal-free product forms of beta-carotene, vitamin A, vitamin E, vitamin D3, ALL-Q[®] (Coenzyme Q10) and Optisharp[®] (zeaxanthin). With this launch DSM is meeting the growing market needs and consumer requirements for animal-free ingredients.

In Dalry (Scotland, UK), DSM Nutritional Products will implement an extensive package of measures to optimize its vitamin C production, leading to considerable cost reductions and improved supply chain flexibility. Dalry is one of the last larger Western plants producing high-quality vitamin C, which fits in with the increasing demand for high-quality, traceable product grades. DSM also reconfirmed its ambition to secure its leadership position in the field of vitamin C by a strategic partnership with



the (low-cost) North China Pharmaceutical Group Corporation Ltd. In Belvidere, USA, DSM Nutritional Products will invest in an arachidonic acid production-related facility and in Grenzach, Germany in an upgrade and the integration of the last step of vitamin D3 production. In China, DSM Nutritional Products opened a new joint laboratory with the renowned Fudan University in Shanghai in 2005 to develop new production processes. Also in China, DSM Nutritional Products will open a new state-of-the-art feed premix plant and start a new project at its citric acid production site in Wuxi.

VITAL project in 2006

In 2006 DSM Nutritional Products will focus on the completion of the defined improvement programs. The main topics for 2006 are the last steps in the implementation of performance improvement plans at the Sisseln, Belvidere and Dalry sites, the further enhancement of the plans focused on profitable growth, the implementation of strategic measures and the roll out of the new organization. Several initiatives will be anchored in the already improved marketing and sales organization, with redefined work processes and systems. The integration of the Activity-Based Costing tool and the hand-over to line management of the last remaining measures will be done in parallel with the implementation of the new organization. The business aspirations and related R&D targets for the coming years have been set. The new organizational model for DSM Nutritional Products has been defined and a start has been made on its implementation. Tracking and tracing of the detailed programs by the VITAL project office will be continued throughout 2006. DSM aims to finalize the VITAL project by the end of 2006.

Directors of DSM Nutritional Products

Chairman	Feike Sijbesma (1959). He combines this position with his membership of the DSM Managing Board
Animal Nutrition & Health	Jos Schneiders (1951)
Human Nutrition & Health	Mauricio Adade (1963)
Finance & ICT	Geert Mooren (1951)
Research & Development	Manfred Eggersdorfer (1951)
Human Resource Management	Alexander Schmid-Lossberg (1959)
New Business Development	Krijn Rietveld (1956)
Strategy / VITAL project	Bruno Müller (1956)
Strategic projects	Bob Hartmayer (1952)



Review of business

Performance Materials

The Performance Materials business groups specialize in technologically sophisticated, high-quality products such as the superstrong Dyneema® fiber and the advanced plastic Stanyl®. Net sales of the cluster amount to 30% of DSM's overall net sales.



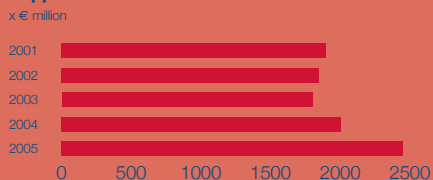
x € million	2005	2004
net sales*:		
- DSM Elastomers (including DSM Dyneema)	646	583
- DSM Engineering Plastics	705	624
- DSM Coating Resins	698	440
- DSM Composite Resins	410	366
total	2,459	2,013
operating profit	305	165
operating profit plus amortization and depreciation	410	249
capital expenditure	667	64
capital employed at 31 December	1,737	988
operating profit as % of average capital employed	19.1	16.0
research and development	94	78
workforce at 31 December	4,441	3,735

* Before elimination of intra-group supplies to other clusters.

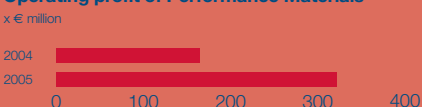
The Performance Materials cluster comprises the business groups DSM Elastomers, DSM Engineering Plastics, DSM Coating Resins and DSM Composite Resins and the DSM Dyneema business unit. All of these specialize in the manufacture of technologically sophisticated, high-quality products that are tailored to meet customers' performance criteria. The products are used in a wide variety of end-use markets, each of which comes with its own particular dynamics. These include the automotive industry, the aviation industry, the electrics & electronics industry, the sports and leisure industries, the coatings industry and the construction industry. We are constantly developing new applications, such as new materials for electronic components and glass-fiber cables, plastic components to replace steel, eco-friendly coatings and new products for enhancing personal safety.



Supplies of Performance Materials



Operating profit of Performance Materials



DSM Elastomers

Profits restored

DSM Elastomers manufactures synthetic rubbers (EPDM) and thermoplastic elastomers (TPVs) for use in cars, white goods, various industrial products and construction materials, and as motor-oil additives. The group is the global market leader in EPDM rubber with a production capacity of 200,000 tpa and a market share of around 20%, and the world's second supplier of thermoplastic rubber. DSM Elastomers has production plants in Geleen (Netherlands), Genk (Belgium), Leominster (USA) and Triunfo (Brazil).

Strategy

DSM Elastomers works to maintain its position as the global leader in the EPDM market by constantly renewing its product range and cutting costs. Both the closure of its EPDM sites in Addis (USA) and Chiba (Japan) in 2004 and improvements in its plants in Geleen and Triunfo made significant contributions to the attainment of this goal. With respect to TPVs the business group is expanding its production in the field of consumer products.

Business review

Global EPDM supply and demand were well balanced in 2005. Demand was strong in Asia and North America, but relatively weak in Europe. In line with oil price developments raw material prices soared for the second consecutive year. DSM Elastomers was able to pass on these raw material price rises to its customers and slightly improve its margins. Another important driver for restoring operating profit was the decrease in fixed costs resulting from the restructuring programs the business group had started in 2003 and 2004.

DSM Elastomers substantially expanded the market targeted by Sarlink® thermoplastic rubber and its derivatives, which are used in sealing profiles for cars and in a range of consumer products.

The investigation into possible restrictive and/or concerted practices involving a number of EPDM producers, including DSM, launched by the European Commission and the US Department of Justice at the end of 2002, is still ongoing. DSM is cooperating fully in this investigation and will continue to do so for as long as necessary.

The operating profit of the business group improved very strongly compared with 2004.

Projects

There is a growing interest in the development of artificial grass pitches. These provide all-season constant playing characteristics and allow multiple use forms of stadiums, for instance for professional soccer as well as for rock concerts. DSM has been pioneering developments in this new application field, which has led to the development of the materials for the first professional artificial soccer pitches. For the Petroleum Additives market a new product line has been developed with excellent soot dispersion properties.

DSM Elastomers has an interest in the development of so-called smart materials. With the recent commercialization of amorphous ethylene-propylene copolymers, grafted with reactive groups to a high degree, a firm basis has been created for further product differentiation. These grafted groups offer myriad diversification opportunities that can give rise to significant changes in materials behavior. DSM will continue to actively explore such opportunities. The development of Keltan® EPDM rubbers based on new catalyst systems is well under way.

DSM Dyneema

A very good year

Dyneema®, DSM's high modulus polyethylene fiber – the strongest fiber in the world on a weight-for-weight basis – was invented and developed by DSM and is used in protective products for the military, the police, the aircraft industry and ropes, nets, cut-resistant gloves and garments, sports goods and medical sutures. DSM Dyneema has production facilities in Heerlen (Netherlands), Greenville, North Carolina (USA) and, in a joint venture with Toyobo, in Katata and Tsuruga (Japan). The Dyneema® business is growing strongly



through application development as well as product innovation. New applications are being developed in rapid succession, and the production lines are constantly being refined and expanded. Over the past few years, sales of Dyneema® have on average grown 10% faster than the market for high-performance fibers. DSM, its customers and end-users provide a constant supply of suggestions for new applications. Demand for light but strong, convenient to use material continues to show steady rapid growth, driven by a range of social and economic factors such as the general increase in safety awareness, the increasing level of violence on the streets, the growing demand for readily manageable materials in the marine industry and the increase in leisure time and prosperity.

Strategy

DSM Dyneema is expanding around the world in selected, high-margin markets offering high profitability. The unit will continue to focus on the further development of ultra-strong polyethylene fiber and UD technology, in order to further increase its lead over rival materials and suppliers.

Business review

2005 was a very successful year. All the markets for Dyneema® products showed growth, and the business unit succeeded in raising its sales in all geographic regions. Sales growth was particularly strong in North America, where high military demand continues to be a main driver. DSM Dyneema's operating profit was strongly up on 2004. The coming year should see continued growth in all relevant market segments.

Review of business

Performance Materials



Projects

Some setbacks were experienced in the building of the new Dyneema® Purity production line in Heerlen, but product availability and business growth were not negatively affected. At the beginning of 2005 DSM Dyneema announced that production capacity in the US would be expanded in response to continued high demand. Construction of two new production lines for Dyneema® fiber and one for bullet-resistant material started in the course of 2005. At the end of 2005, DSM announced that it would make another investment in a new production line for Dyneema® fiber in Greenville, North Carolina (USA). The investment will be substantial, amounting to several tens of millions of US dollars, and will bring the total number of fiber lines for the company to nine, with four production lines being located at the Greenville facility. All projects are running according to schedule. The first expansion is expected to come on stream in the first quarter of 2006; the other expansions will become operational in the second half of 2006 and in 2007.

DSM Engineering Plastics

Clearly higher operating profits

DSM Engineering Plastics is a global player in polyamides (polyamide 6, polyamide 66 and polyamide 46), polyesters (PBT, PET and TPE-E), polycarbonate (PC and PC blends), Ultra-High Molecular Weight Polyethylene (UHMWPE) and extrudable adhesive resins. These materials are used mainly in technical components for the electrical and electronics, automotive, engineering and extrusion industries. The latter industry also includes the market for flexible packaging materials. With a market share of about 5%, DSM is one of the world leaders. DSM is the global market leader in high-heat polyamide. DSM Engineering Plastics has production sites in Emmen and

Geleen (Netherlands), Genk (Belgium), Evansville (USA), Jiangyin (China) and Pune (India). The small facility in Stoney Creek (Canada) was divested at the end of 2005.

Strategy

DSM Engineering Plastics wants to further strengthen its leadership position with a strong focus on performance materials and specialties. All activities are centered on creating value for the business group's customers and for DSM. Thanks to its outstanding knowledge of products and applications, combined with excellent service levels, the business group is increasingly able to position itself as a valuable, solutions-oriented business partner.

Business review

Market growth for engineering plastics strengthened during the year. Sales increased in all regions for all major product lines and in all relevant markets. Asia showed the strongest growth while the automotive markets in Europe and USA demonstrated slow growth. The successful start-up of the new Akulon® polyamide 6 line in Emmen contributed immediately after start-up and supported strong growth in the flexible packaging market.

DSM Engineering Plastics successfully implemented price increases to cope with the continuing increase in raw material prices. For the part of the business that is based on products manufactured in Europe for the world market, the adverse impact from currency exchange rates eased a little with the relative strengthening of the US dollar against the euro. The business group was able to maintain the favorable cost position built up in previous years. Successful price increases, volume growth through innovative new applications and continued cost control were the main reasons for the improved operating profit.

Projects

The business group started the construction of a new compounding site in Jiangyin (China) that will increase capacity significantly and will replace the existing site; the site will start operations early 2006. DSM Engineering Plastics also started the engineering for a new Akulon® polyamide 6 plant in China.

The new Stanyl® Superflow polyamide 46 and Arnite® XL PBT products introduced last year were successful in the market. The de-bottlenecking of the existing Stanyl plant led to a much higher than projected throughput.

Together with leading customers DSM Engineering Plastics developed a variety of new applications. Some examples are Arnitel® TPE-E based crash buffers that make a strong contribution to the safety of rail transport of chemical and dangerous goods, and electronic throttle control gears with Stanyl® polyamide 46. The market for airbag canisters developed very favorably thanks to the increasing numbers of airbags in automobiles; Akulon® polyamide 6 is the leading product for this application. Akulon® XP, a new polyamide 6 product delivering higher productivity for the flexible packaging industry, is being received very well.

The American and European organizations were certified to ISO/TS 16949 during the year under review. DSM Engineering Plastics further re-aligned its North American business and sold the PP-compound business and associated assets in Canada.

DSM Coating Resins

Operating profit increased

The DSM Coating Resins business group consists of three business units: Coating Resins, Desotech and NeoResins.

DSM Coating Resins

The DSM Coating Resins business unit specializes in the development, manufacture and marketing of resins for coating systems. The unit is one of the global leaders in powder coating resins, with a market share of about 25%. These resins are used in industrial applications for the coating of for example washing machines, radiators, façades, car parts and bicycles. In Europe DSM Coating Resins is a leading supplier of liquid coating resins. These products are mainly used in decorative and industrial coatings. The unit focuses on the development and production of environmentally friendly coating resins systems that show interesting growth in Europe. DSM Coating Resins has plants in the Netherlands, Spain, the USA, Germany, Sweden, China and Taiwan.

Strategy

DSM Coating Resins aims to strengthen its position as one of the market leaders with a focus on environmentally friendly coating resins systems and a continued Operational Excellence drive. Its aim is to reduce costs in the value chain by maximizing collaboration with customers and suppliers.

Business review

The DSM Coating Resins business unit's powder coatings market showed highly different growth rates between the regions. The North American market recovered from the decline in previous years and showed moderate growth. The overall European market showed growth rates at GDP levels, with double-digit rates for Eastern Europe and the Middle East. The Far Eastern market featured a decline of the Chinese market in the first half of 2005, with good recovery during the second half of the year and a moderate growth rate in the rest of Asia. Market dynamics were determined by the global overcapacity situation, reflected by severe price pressure and soaring feedstock prices. Price increases and, to a lesser extent, volume growth partially compensated for the steep increase in raw material cost increases.

A reduction in volume in can and coil coating resins was recorded as a correction to the unexpectedly high growth rate in the year before. Similar to the powder resins business, price increases partially compensated for the steep increase in raw material costs.

In 2005 the results for liquid coating resins were below expectation. Especially in Europe the market was slow. The increasing raw material costs throughout the year could be partially passed on to the market.

In October 2005 DSM Coating Resins acquired the Chinese resins producer Syntech. This is an important step that will help reinforce DSM's resins portfolio and speed up the expansion of DSM's activities in China. The DSM Coating Resins business unit's overall operating profit showed a strong increase compared with 2004.



DSM NeoResins

The DSM NeoResins business unit, which has been part of DSM since 1 February 2005, is a leading global supplier of innovative waterborne resins, uniquely suited to the needs of the coatings, adhesives and graphic arts industries. By far the greater part of sales is in the area of coating applications, with the remaining portion in graphic arts and, to a lesser extent, adhesives. These waterborne and other environmentally-friendly technologies comprise acrylics, urethanes, urethane-acrylics, vinyl acrylics and other copolymers. DSM NeoResins focuses on strong customer relations to develop new products and technologies with specific performance goals. The broad portfolio of waterborne, solvent-borne and solid resins is supported by the company's ongoing commitment to quality, service, technical innovation and operational excellence. DSM NeoResins markets its products globally and has manufacturing sites in Waalwijk (Netherlands), Parets del Valles (Spain), Wilmington (Massachusetts, USA) and Frankfort (Indiana, USA).

Strategy

DSM NeoResins' market approach is to detect high growth and high margins in niche applications. DSM NeoResins' waterborne platform enables it to supply special product characteristics in a market that is moving towards environmentally friendly systems. The main focus for the business will be on innovation and capturing growth opportunities in waterborne systems and geographic growth in North America and Asia. In order to provide capacity for the growing market, capacity expansion is planned in Europe.

Business review

Most of DSM NeoResins' sales are generated in Europe (70%) and the USA (20%). The remainder is mainly realized in Asia. While the decorative segments in the USA and Europe were strong, given the strength of the US housing market and the upcoming VOC legislation in Europe, the industrial segments and graphic arts showed some signs of weakness.

Review of business Performance Materials

worldwide. For the longer term, continued growth of construction and industrial production will be driving the growth of this business, along with the migration to eco-friendly technologies. The upcoming VOC legislation in 2007 and 2010 will positively impact on developments in the next few years.

DSM Desotech

The DSM Desotech business unit is a leading producer of specialty UV-curable coatings and resins. These are materials that cure very rapidly in an environmentally friendly fashion when exposed to ultraviolet light. DSM Desotech is the market leader in the supply of coatings for optical fibers and inks and matrix resins that are used in fiber optic cables. The business unit is a co-market leader in the supply of stereolithographic resins that are cured by laser technology for the production of rapid prototypes for a wide variety of industries. It is also active in the supply of antireflective coatings used in the area of LCD and plasma flat panel displays. DSM Desotech markets its products globally with main sales being in the USA, Europe, China, Japan and Korea. Its headquarters are in Elgin, Illinois, USA. The plants are located in Stanley (North Carolina, USA), Hoek van Holland (Netherlands), and in Shanghai (China). DSM Desotech also has a 50/50 joint venture with JSR in Japan, which supplies the Japanese market. Research and Development is critical to Desotech's growth, with main centers being in Elgin (USA), Geleen (Netherlands) and Tsukuba (Japan).

Strategy

DSM Desotech's strategy is to maintain its leading market share in fiber optics, which is expected to be a fairly stable business from a profit point of view. Beyond that, Desotech will grow its overall revenue and profit by using its technology base in stereolithography, flat panel displays and UV chemistry.

Business Review

The DSM Desotech business unit saw the fiber optic market grow by 10-15% in 2005 on a global basis. However, price pressures throughout the chain led to minimal value increases in the overall business. The bulk of the growth was in the USA. Activities in Japan shrank due to a reduction in NTT's (Nippon Telegraph and Telephone Corporation) Fiber to the Home project. Activities in China also slowed down due to economic measures instituted by the

Chinese government. The business unit expects moderate growth in fiber optics over the next few years.

DSM Desotech's Somos business, which supplies stereolithographic resins used for rapid prototyping, saw its sales grow by more than 15% in 2005. The business focuses on new materials that can be used in extending the application of stereolithography and will eventually move towards rapid manufacturing of small volume part runs. 3D Systems, the market leader in equipment supply, has become a distributor of Somos' resins.

DSM Coating Resins' overall operating profit increased very strongly, partly because of the consolidation of DSM NeoResins.



Projects

The acquisitions in 2004 (HAL) and in 2005 (NeoResins and Syntech) leveraged DSM Coating Resins' worldwide presence as well as its ability to pursue different pockets of innovation. The product portfolio, route to market and innovation capabilities have been substantially strengthened by these acquisitions.

To integrate the DSM NeoResins business into the DSM Coating Resins business, an integration project called *Inspire* was started immediately after closing. *Inspire* aims to ensure that the benefits of joining forces are maximized in terms of cost/purchase savings and to create a joint platform for profitable growth for the future. Purchasing savings have already been captured and the analysis of innovation areas that leverage the bundling of DSM and NeoResins expertise and competences has been finalized.

Good progress was made with the development and market introduction of an improved generation of waterborne alkyd resins. To an increasing degree the decorative and industrial markets require waterborne paint with the same qualities as systems based on organic solvents.

In 2005 the liquid coating resins site in Hoek van Holland (Netherlands) went through a major restructuring program. The objectives of this project – improving cost effectiveness as well as ensuring full compliance with the DSM requirements – were met.

For the DSM Desotech business unit the main projects are focused on cost reductions, strengthening the company's positions in Asia and developing innovative growth businesses. The Somos business has been consolidated to the Elgin headquarters, which brings cost and synergy advantages.

DSM Composite Resins

Strong improvement

DSM Composite Resins is a globally leading solutions provider for the composite resins industry. The business group develops, produces and markets unsaturated polyester resins (including vinyl esters and additives), which are used for the production of fiber-reinforced plastics or non-reinforced filled products in end-use applications such as marine, leisure, building & construction, automotive and wind turbine blades. The business group is the European market leader in unsaturated polyesters (UPE) and has its own pan-European distributor (Euroresins). DSM Composite Resins is the global market leader in sizings and binders, which are vital functional components that facilitate the production of glass fiber reinforcements and enhance their performance. China is the fastest growing market for sizings and binders and the business group is investing in local production in this country. The business group has had a presence in China for a long time via JDR, a 75% owned joint venture in Nanjing that is active in unsaturated polyesters and is growing rapidly.

With headquarters in Switzerland, DSM Composite Resins has production sites in France, Italy, the Netherlands, Spain, the UK and China. In addition, Customer Competence Centers are located in France, Germany, Italy, the Netherlands, Scandinavia, Spain and the UK. Besides its Western European base, DSM Composite Resins holds positions in Poland, China and the USA.

Strategy

DSM Composite Resins wants to lead the industry through dedication and innovation. The business group aims to effectuate and strengthen its European leadership by playing a frontrunner role in the composite resins industry to compete with aluminium and steel composites. The group focuses on cost efficiency and innovation and at the same time is expanding globally, especially in China, targeting high-added-value segments. The Sizings and Binders business unit is the global expert and portfolio player in this segment, dedicated to the glass fiber industry.



Business review

Market developments were mixed in 2005, leading to different pictures due to the local-for-local character of the UPE market. The building and construction market in the United Kingdom showed some signs of recession and the automotive market continued to have difficulties passing on the increased raw material prices. Marine continued its strong growth. As in the previous year, raw material prices remained high and volatile, but increases were relatively moderate. Margins consequently returned to sustainable levels, resulting in an improvement in profitability. Sizings and Binders continued to grow strongly, especially in China, but the unit also faced higher raw material costs. Growth in the UPE market in China was somewhat slower, but DSM strengthened its position in the specialty segments thanks to a focus on quality and innovation.

The business group's operating profit for 2005 showed a strong improvement compared with 2004.

Projects

In 2005 substantial investments were made in the business group's European production sites to proactively meet the stricter regulations in the fields of safety and the environment. DSM Composite Resins wants to further reinforce its leadership by investing in sustainability. In 2006 this will be continued, also in China. For Sizings and Binders the new production site in China will start towards the end of 2006, entailing proximity to DSM Composite Resins' biggest and fastest growing customers. The business group will further invest in innovation and in expanding its presence in Eastern Europe.

Review of business

Industrial Chemicals

Industrial Chemicals comprises the business groups that produce industrial chemicals such as fiber intermediates, melamine and fertilizers. The cluster's share in DSM's net sales is 20%.



x € million	2005	2004
net sales*:		
- DSM Fibre Intermediates (including DSM Acrylonitrile)	1,243	1,127
- DSM Melamine	212	209
- DSM Agro	370	351
- DSM Energy	74	60
total	1,899	1,747
operating profit	165	120
operating profit plus amortization and depreciation	246	207
capital expenditure	85	75
capital employed at 31 December	728	673
operating profit as % of average capital employed	23.5	17.5
research and development	14	16
workforce at 31 December	2,234	2,566

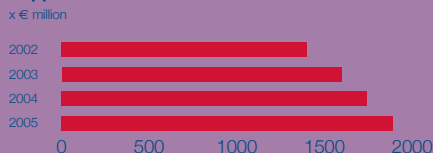
* Before elimination of intra-group supplies to other clusters.

The Industrial Chemicals cluster consists of DSM Fibre Intermediates, DSM Melamine and DSM Agro. These business groups produce materials and chemicals in large-scale, capital-intensive production facilities. Essential features of these businesses, which operate plants in the Netherlands, Asia and the USA and are thus global in scope, are strong customer relations (often geared to the long term), keen cost awareness and careful planning of any capacity expansions. DSM Energy is also part of this cluster.

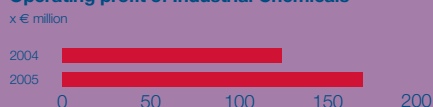
Our caprolactam and melamine businesses are among the global leaders in terms of sales and technology. DSM Agro, our fertilizer company, is active in Northwestern Europe. DSM Energy has small but profitable stakes in various oil and gas fields in the Dutch part of the Continental Shelf.



Supplies of Industrial Chemicals



Operating profit of Industrial Chemicals



DSM Fibre Intermediates

Further profit improvement

DSM Fibre Intermediates produces caprolactam and acrylonitrile, which are raw materials for synthetic fibers and plastics. Caprolactam is the raw material for nylon 6 (also called polyamide 6). Nylon 6 is a versatile material, which in the form of fibers is used in sports and leisure clothes, military equipment, and also in tires and carpets. It is increasingly used as a high-performance construction material in, for example, the electronics and automotive industries, in packaging materials and in medical applications. Nylon 6 has reached the mature phase of its life cycle, where market demand and selling prices are strongly influenced by economic cycles.

DSM Fibre Intermediates has caprolactam plants in the Netherlands, the USA and China, with a total capacity of more than 500,000 tons per year. This makes it the largest merchant producer in the world, with a market share of 15%. In addition, the business group produces about one million tons of fertilizer (ammonium sulfate) per year as a co-product.

Acrylonitrile is a raw material used in textile fibers, ABS plastics, latex rubber and water purification products. The business group's acrylonitrile production capacity is 235,000 tons per year. With a market share of 25%, DSM is a major player in the merchant acrylonitrile market in Europe.

DSM Fibre Intermediates also produces about 25,000 tons per year of sodium cyanide, which is used in detergents, in water purification products and in the synthesis of vitamins and antibiotics.

Strategy

DSM Fibre Intermediates' distinguishing characteristics are its process technology, reliability and service. The business group aims to exploit its global cost and technology leadership position in caprolactam while growing its position in China parallel to a further strengthening in Europe and North America. For acrylonitrile, DSM Fibre Intermediates aims to strengthen its manufacturing base to maintain its solid position in Europe.

Business review

Global demand for caprolactam grew in 2005 compared with 2004. Prices were on average higher than in 2004 as demand was strong even in the face of high raw material prices. Energy-related raw material prices (e.g. ammonia prices) remained volatile and high relative to historical norms but declined slightly compared to 2004. Natural gas prices in the USA skyrocketed in the second half of 2005. Margins were on average higher than in 2004, helped by sustained high selling prices and the effects of cost control measures.

Demand for acrylonitrile was comparable to 2004. The steady rise in raw material prices, especially for propylene, could be recouped with higher selling prices.

DSM Fibre Intermediates closed the year 2005 with a higher profit than in the previous year thanks to higher margins.

Projects

The capacity of DSM Fibre Intermediates' caprolactam plant in Nanjing (China) was expanded to 140,000 tons per year on the basis of DSM's HPO^{Plus}® technology, during a shutdown of the plant from May until September. The plant will reach its new capacity level in 2006. The expansion will make the business group the leading supplier in the rapidly growing Chinese market. DSM Fibre Intermediates is planning an additional expansion to support this market growth. It is studying the feasibility of expanding the capacity of its acrylonitrile plant in Geleen (Netherlands) by 40,000 tons per year.



DSM Melamine

Difficult year for successful business

Melamine is a product used in impregnating resins and adhesive resins for the wood-processing industry. It boosts the scratch, moisture and heat resistance of wood-based products. Melamine can be combined with softwood from rapidly growing trees to obtain high-quality panels that can replace hardwood. One of its main applications is in laminated flooring, which is a market that has been expanding rapidly for several years, particularly in Europe and China. Melamine is also used in many other products, such as car paints, durable plastic tableware, euro bank notes and flame retardants.

With a market share of about 25%, DSM Melamine is the global leader in melamine. The business group is well established, with production plants on three continents and a sophisticated technical support system in place for its customers. It earns more than half its sales from long-term contracts. DSM Melamine's aggregate production capacity is 240,000 tons per year. The new plant in Geleen (Netherlands), which is based on advanced SLP technology, is not yet producing at capacity, but is expected to reach its capacity level in 2006.



Strategy

DSM Melamine's objective is to further strengthen its leading position in a market that is growing at an average rate of 6-7% per annum. From a demand point of view, the long-term outlook is reasonably good due to the growing scarcity of hardwood. Due to the high price of natural gas, the prices of raw materials and auxiliary materials for the production of melamine are at a structurally higher level than in the past. There is an ongoing need to increase the scale of operations still further and to gain access to low-cost raw materials, in order to achieve the necessary further reduction in costs. Major customers expect their suppliers to provide them with products and support services all over the world. The melamine industry is therefore likely to see a restructuring.

Business review

Demand for melamine grew by 2% in 2005. Following the exceptional growth in 2004, in the first half of 2005 the business group saw customers depleting their stocks. China was once again the center of growth in 2005. DSM has developed formulations for low-formaldehyde-emission resins. Together with customers it has successfully devised new applications, for example in OSB (Oriented Strand Board) panels and flame retardants. Furthermore, formulations have been developed that give resins a longer shelf life and thus increase the geographical reach of a resins plant. In 2005 the prices of natural gas and ammonia in the USA reached record highs, due in part to the hurricanes. In line with this, the AMEL plant, a 50/50 production joint venture with Cytec, saw its production costs increase significantly. Given the price of melamine on the world market, DSM's production operations in the USA were loss-making.

In Europe and Asia, too, the costs of raw materials and auxiliaries increased very strongly. Melamine prices did not increase until the fourth quarter. As a result, margins were considerably lower than in previous years. The 2005 operating result was slightly positive.

Projects

Mid-2005 DSM announced to Cytec that it would pull out of the AMEL joint venture with effect from August 2007 at the latest. DSM will take timely measures to ensure continuity of supply to its American customers.

DSM intends to implement major capacity expansions in response to market growth in Asia and the need for a low-cost supply of the markets in the USA. Negotiations on a new 120,000 metric tons/year plant, based on DSM's proprietary gas phase know-how, are progressing well. The plant is expected to come on stream at the end of 2008.

DSM Agro

Once again a better performance

DSM Agro is a producer of ammonia and high nitrogen fertilizers for grasslands and agricultural crops, which it supplies mainly to agricultural wholesalers in Western Europe. DSM Agro is the market leader in the Netherlands and ranks among the market leaders in Germany, France and Belgium. It is the number 2 supplier of calcium ammonium nitrate (CAN) and ammonium sulfate (AS) in Western Europe. Its fertilizer production facilities are located in Geleen and IJmuiden (Netherlands). DSM Agro operates world-scale ammonia plants in Geleen.

Strategy

DSM Agro's strategy is to maintain a profitable position in Western Europe. On top of this, DSM Agro makes an additional contribution to DSM's cash flow by providing DSM's production facilities at the Geleen site with a sustainable and secure supply of raw materials and auxiliaries at the lowest possible cost. DSM Agro also supplies these raw materials (such as ammonia, nitric acid and carbon dioxide) to third parties in Europe.

Business review

The year 2004 had been characterized by a balanced market with good returns, but in 2005 the fertilizer market was relatively tight. Following a hesitant start in the first quarter, the situation developed favorably in the course of the year. Bad farming conditions led to weak demand in Western Europe, but this turned around in the second quarter as weather conditions improved. Backed by globally high urea and ammonia prices – resulting from high gas prices and a healthy ammonia balance – at the end of the first half of 2005 healthy fertilizer prices were recorded. This situation continued in the second half of the year with the fertilizer balance becoming very tight and customers rushing for materials, leading to record price increases towards the end of the year. These developments helped DSM Agro achieve an even better performance than in the already strong 2004.

Projects

DSM Agro is well underway with on-line-ordering via webshop and business-to-business connectivity in 2005. These activities were expanded further in 2005; almost 50% of fertilizer turnover is now e-enabled. The facilities in IJmuiden have been upgraded to ensure a larger volume and broader portfolio of fertilizer specialties. The Copernicus project in Geleen and Operational Excellence programs in IJmuiden led to substantial cost reductions at both sites in 2005, and will also further improve DSM Agro's competitive position in 2006.

DSM Energy

Very strong profit increase

DSM Energy participates in the exploration and production of oil and gas on the Dutch Continental Shelf. The business group is also involved in the transportation of oil and gas through its ownership of pipelines on the Shelf. DSM usually participates as non-operator with a stake of up to 25% in the oil and gas joint ventures. At year-end, the business group had a share in nineteen producing oil and gas fields and participated in four gas field developments. All fields are located in fifteen production licenses.

Strategy

DSM Energy's strategic mission is to maximize cash flow by minimizing cost and maximizing production in the existing licenses.

Business review

In 2005 a gas discovery was made in offshore block G14. The fast-track development decision for this field was taken at the end of the year. The development of two other new fields in the same block was completed and production started up in November 2005. The production license for the A/B blocks, containing six shallow gas accumulations, was granted. The development of three of these reservoirs started in 2005. Total production of the group decreased from 2.3 million bbls of oil equivalent in 2004 to 2.0 million bbls in 2005.

The production decline is due to the fact that most fields in the portfolio are mature and their production capacity is decreasing due to pressure decline and increasing water-cut. The new Q1-b field, started up in 2004, contributed nearly 50% to the group's overall production.

The remaining reserves at the end of the year in the producing fields were about nine million bbls of oil equivalent, the same as the year before. The discovery of the new G14 gas fields compensated for the reduction in reserves resulting from the production of two million bbls in 2005.

In spite of the production decline the business group's operating profit increased very strongly compared to 2004. This was due to the increased oil price. The average Brent price in 2005 was \$ 54 per barrel, compared to \$ 38 per barrel in 2004.

DSM Venturing & Business Development

DSM Venturing & Business Development participates in external start-up companies (Venturing) and initiates small businesses that gradually develop into grown-up businesses (Business Development).

Strategy

DSM Venturing & Business Development is on a constant quest for innovative businesses or technologies in the fields of life science products (nutritional products, pharmaceuticals) and performance materials.

Venturing

DSM Venturing explores new markets and technologies to strengthen DSM's activities and product portfolio. DSM Venturing plays an important part in DSM's open innovation policy and invests in activities that are of immediate or potential relevance to DSM's business groups and their current or future markets. In 2005 DSM Venturing added Oryxe Energy (fuel additives) to its portfolio, which comprises ten direct investments. Speedel (drug development), in which DSM Venturing invested in 2003, listed its shares on the Swiss Stock Exchange. DSM's participation in Sciona (genetic tests for personalized health and wellness advice with applications in nutrition, sports and skin care), which took place in 2004, signaled DSM's first steps in the field of personalized nutrition. This is one of the areas DSM will focus its innovation efforts on in the coming years. DSM Venturing is also involved in a number of venture capital funds.

Business development

Activities in which DSM Venturing & Business Development was involved in 2005 included the development of a liquid for a new generation of computer-chip-manufacturing equipment and PictoClear™, an anti-reflective coating system based on a nano-structured surface. In addition, DSM Medical Coatings was launched. This entity develops and markets innovative photo-curable polymer coatings for medical devices. DSM Venturing & Business Development also initiated a specialty packaging project and developed a number of bio-process business opportunities. Most of these activities will be further developed in the newly created *Emerging Business Areas*, as part of DSM's *Vision 2010* strategy.

Start-ups

The business group's portfolio comprises the following start-ups: Micabs® (laser marking), Hybrane® (highly branched polyester amides, used in for example oil field chemicals and cosmetics) and Premi®Test (for rapid detection of antibiotic residues in meat, fish, eggs, urine and blood). These businesses made significant progress and established stronger market positions.

Grown-ups

DSM Venturing & Business Development also manages a number of grown-ups: DSM Solutech (producer of ultra-thin but very strong Solupor® film which is used in for example fuel cells and drug delivery systems) and SBR (Styrene Butadiene Rubber). The latter was sold in 2005 because it no longer fitted in DSM's portfolio.

Noordgastransport

Noordgastransport (NGT) transports gas produced offshore through a system of pipelines from gas fields in the North Sea to a processing plant in Uithuizen in the north of the Netherlands. Here, the gas is treated so that it matches customers' specifications, before being delivered to these customers.

DSM Industrial Services

DSM Industrial Services consists of various units. Some services are provided for the Geleen site (Netherlands), others are targeted at DSM organizations all over the world. These services include technological consultancy, expertise in energy and auxiliary materials, the supply of utilities, human resources and the management of the Chemelot site in Geleen. The Copernicus project, aimed at re-organizing this activity, was completed in 2005. Manufacturing-related services have been regrouped into the new DSM Manufacturing Center (DMC). The savings objective of Copernicus, € 50 million on an annual basis, is expected to be achieved in 2006.

Stamicarbon

Stamicarbon had a successful and challenging year. It continued to be the world's leading urea licensor with a market share of approximately 70%. In 2005 Stamicarbon granted a license for a grass-roots urea plant in Egypt and for a large revamp project in China. Furthermore, it started broadening its scope as the DSM Licensing Center. Stamicarbon uses its long-standing experience to professionalize DSM's licensing-out and licensing-in activities and to create more value from intellectual property. These activities are instrumental to boosting DSM's innovation process.

EdeA

EdeA VoF owns, operates and maintains most of the production and distribution facilities for utilities (i.e. steam, power and water) at the Chemelot site in Geleen (Netherlands). EdeA VoF is a joint venture with Essent, an energy production and distribution company in which DSM's stake is 50%.

Heerlen, 8 February 2006

The Managing Board

Peter Elverding, chairman
Jan Zuidam, deputy chairman
Henk van Dalen
Feike Sijbesma
Chris Goppelsroeder

Report by the Supervisory Board of Directors to the shareholders

There were several changes in the composition of the Supervisory Board during the year under review. Mr Sosa resigned from the Supervisory Board on 6 April 2005 at his own initiative because the intercontinental travels related to his Board membership were increasingly becoming a burden to him. The Supervisory Board is grateful to Mr Sosa for his commitment to the company during his five-year membership and his constructive and valuable contribution to the Board's work. According to the rotation scheme it was Mr Müller's turn to resign. He was reappointed by the Annual General Meeting on 6 April 2005 on the understanding that – in compliance with the Dutch Corporate Governance Code – he will step down at the Annual General Meeting in 2007, as he will by then have served the maximum term of twelve years on the Supervisory Board. Mr Sonder and Mr Hochuli were appointed as Supervisory Board members by the Annual General Meeting on 6 April 2005.

On 1 April 2005 Mr Dopfer stepped down as a member of the Managing Board. The Supervisory Board would like to express its sincere appreciation for all that Mr Dopfer did for the company during the many years he worked for DSM, of which almost six were served on the Managing Board. The resulting vacancy on the Managing Board was filled by the appointment by the Annual General Meeting on 6 April 2005 of Mr Goppelsroeder with effect from the same date. In his previous position Mr Goppelsroeder had been responsible for DSM Nutritional Products' North American business and, as Project Director of the VITAL project, had supervised the integration of the acquired Roche Vitamins & Fine Chemicals business into DSM. For personal reasons, Mr Goppelsroeder has decided to relinquish his position with effect from 1 April 2006. The Supervisory Board wishes to express its appreciation for the contribution he made to the successful integration of the former Roche business within DSM and for his commitment to DSM during his period of Managing Board membership.

After having worked for DSM 29 years, of which six were served on the Managing Board, Mr Van Dalen has decided to pursue his career as Chief Financial Officer of the Dutch express, logistics and postal services group TNT with effect from 1 April 2006. The Supervisory Board would like to express its sincere appreciation for all that Mr Van Dalen has done for the company, especially for his key role in the transformation process of DSM, both during the execution of *Vision 2005* over the past five years and in the establishment of DSM's new strategic direction as outlined in the *Vision 2010 – Building on Strengths* program.

The Supervisory Board held six meetings in the presence of the Managing Board during the year under review. Each of these meetings was preceded by a private Supervisory Board meeting. The Supervisory Board also devoted a separate meeting to its profile, composition and functioning. The composition and performance of the Managing Board were also discussed at the same meeting. The meeting concluded that all members of the Supervisory Board were independent, as defined by the Dutch Corporate Governance Code, and that the competences of its individual members were in aggregate in line with the Board's profile. Virtually all Supervisory Board meetings in 2005 were attended by all its members. One of the meetings was held in China; on this occasion the Supervisory Board visited several DSM sites (in Beijing, Nanjing, Wuxi and Shanghai) and had sessions on the Chinese economic, financial, political and business environment.

The composition of the Audit Committee changed in 2005. Mr Van Woudenberg stepped down as member of the Audit Committee and was succeeded by Mr Herkströter. The Audit Committee, thus consisting of Messrs Bodt (chairman), Müller and Herkströter, met three times in 2005. The external auditor was in attendance at these meetings, and at most meetings the internal – operational – auditor was present as well.

The main topics of discussion during the Audit Committee meeting held in February were the adoption of the group's financial statements, the external auditors' comments and their assessment of DSM's annual accounts and internal control systems. In addition, various aspects relating to the conversion to IFRS were discussed. The meeting concluded that the external auditors were independent of DSM. The main topics discussed during the meeting held in June were the work of the Corporate Operational Audit department, some IFRS technicalities, Directors' & Officers' liability and the status of the *True Blue* project concerning the further upgrading of the internal control and risk management system. The possibility of a stock split was also discussed. The main agenda items during the Committee's December meeting were the provisions and impairments for 2005, an interim report by the external auditor and the Corporate Operational Audit plan for 2006. Furthermore the committee was informed about DSM's risk management system.

The composition of the Nomination and Remuneration Committee also changed. Mr Kist was appointed as member of this Committee. He succeeded Mr Bodt. The Committee, thus consisting of Messrs Herkströter (chairman), Van Woudenberg and Kist, met five times in 2005. The Committee's activities regarding remuneration are described in detail on page 64 (in the chapter on remuneration policy). The Committee made suggestions for dealing with future changes in the composition of the Supervisory Board. The Committee made a recommendation concerning the remuneration of members of the Managing Board. This recommendation was adopted by the Supervisory Board. Information on the group's remuneration policy is to be found on page 62 of this annual report.

The Supervisory Board and the Managing Board discussed company matters on a regular basis during the year under review. The Supervisory Board discussed and approved the Capital Expenditure and Financing Plan for 2005. Approval was given for the refinancing of the existing bond maturing at year-end 2005. The financial results recorded by the various company units and developments at these units were discussed at every meeting. Special attention was paid to those units that were not performing well or whose future prospects were less bright. Various meetings included a discussion of the progress made in implementing the corporate strategy adopted in 2000, as set out in *Vision 2005: Focus and Value*. Furthermore the Supervisory Board held in-depth discussions with the Managing Board on the new strategy program for the next five years. The Board approved the new strategy program, which has been named *Vision 2010 – Building on Strengths*, focusing on accelerating profitable and innovative growth of DSM's specialties portfolio. The Board supports the ambitious targets set and will see to the implementation of this strategy.

The Supervisory Board monitored the progress of the transformation and integration process at DSM Nutritional Products (formerly Roche's Vitamins & Fine Chemicals Division, which DSM acquired in 2003) and a similar program for the integration of the NeoResins business that was acquired in early 2005. The Supervisory Board supported the continuation of the collaboration with North China Pharmaceutical Group Corporation (NCPC) in Shijiazhuang, China, on the formation of a strategic alliance and the possibility of forming joint ventures for the production of vitamins and antibiotics. The Supervisory Board approved the sale of DSM Bakery Ingredients (excluding Baking Enzymes) and the share in the South African joint venture Rymco. The Board also approved the divestment of the styrene-butadiene-rubber business and the divestment of the Chilean DSM Minera iodine business.

The Supervisory Board approved the acquisition of coating resins producer Syntech, located in the Guangdong area (China). The Board also approved two major investment projects in Greenville (North Carolina, USA) for building additional capacity for the production of Dyneema® fibers.

The Supervisory Board gave its approval for the Heureka project regarding major restructuring measures at the Linz (Austria) site. The Board agreed with the asset streamlining within the DSM Pharmaceutical Products business group, leading to the closure of the South Haven (USA) site in 2007 and the mothballing of the Montreal (Canada) site.

The Supervisory Board approved the replacement of two existing stand-by credit facilities by one new facility.

The Supervisory Board agreed with a proposal that was to be presented to an extra General Meeting of Shareholders for amending the articles of association in connection with a two-for-one share split.

The Supervisory Board discussed the dividend policy in relation to the implementation of IFRS and approved the continuation of the existing policy. The Supervisory Board approved the interim dividend to be paid for 2005 and the proposal to be made to the Annual General Meeting regarding the final dividend to be paid out for 2005.

As in previous years, the Supervisory Board invited managers from a number of DSM business groups and corporate staff departments to its meetings, to present relevant developments in their units in person.

Discussions were held with the external auditor, Ernst & Young Accountants, about the financial statements and the financial reports for 2005. The Report by the Managing Board and the financial statements for 2005 were submitted to the Supervisory Board by the Managing Board, in accordance with the provisions of Article 30 of the Articles of Association, and subsequently approved by the Supervisory Board in its meeting on 8 February 2006.

The financial statements were audited by Ernst & Young Accountants, who issued an unqualified opinion (see page 133 of this report).

We submit the financial statements to the Annual General Meeting of Shareholders, and propose that the shareholders adopt them and discharge the Managing Board from all liability in respect of its managerial activities and the Supervisory Board from all liability in respect of its supervision of the Managing Board. The profit appropriation as approved by the Supervisory Board is presented on page 134 of this report.

In 2005 DSM achieved an operating profit which considerably surpassed the result of the previous years, and also succeeded in improving its safety, environmental and health performance. DSM has achieved almost all of the strategic goals set out in *Vision 2005: Focus and Value* and has successfully concluded the Group's transformation into a specialty company, realizing more stable and higher earnings. This strong foundation will enable the company to embark on the *Vision 2010 – Building on Strengths* program with confidence. The Supervisory Board wishes to express its sincere appreciation for the company's performance and would like to thank the Managing Board and all employees for all the good work done.

Heerlen, 8 February 2006

The Supervisory Board
Cor Herkströter, chairman
Henk Bodt, deputy chairman
Pierre Hochuli
Ewald Kist
Okko Müller
Claudio Sonder
Cees van Woudenberg

Supervisory Board

Cor A. Herkströter (1937, m), Chairman

First appointed: 2000. End of current term: 2008.

Position: retired; last position held: President of Koninklijke Nederlandsche Petroleum Maatschappij N.V. and Chairman of the Committee of Managing Directors of Royal Dutch/Shell Group.

Nationality: Dutch.

Supervisory directorships and other positions held: chairman of the Supervisory Board of the ING Group, chairman of the Advisory Committee on the Listing and Issuing Rules of Euronext Amsterdam N.V., trustee of the International Accounting Standards Committee Foundation (IASCF), professor of International Management at the University of Amsterdam, chairman of the Social Advisory Council of the Tinbergen Institute, member of the Advisory Council of Robert Bosch.

Henk Bodt (1938, m), Deputy Chairman

First appointed: 1996. End of current term: 2008.

Position: retired; last position held: Executive Vice President of Philips Electronics N.V.

Nationality: Dutch.

Supervisory directorships and other positions held: member of the Supervisory Boards of ASM Lithography N.V., Neopost SA and Delft Instruments N.V.

Pierre Hochuli (1947, m)

First appointed: 2005. End of current term: 2009

Position: Chairman of the Board of Directors of Devgen N.V., chairman of the Executive Committee and member of the Board of Directors of Unibioscreen S.A. and member of the Board of Directors of Oncomethylome S.A.

Nationality: Swiss.

Supervisory directorships and other positions held: Venture Partner of Polytechnos Venture-Partners GmbH.

Ewald Kist (1944, m)

First appointed: 2004. End of current term: 2008.

Position: retired; last position held: Chairman of the Managing Board of the ING Group.

Nationality: Dutch.

Supervisory directorships and other positions held: member of the Supervisory Boards of De Nederlandsche Bank N.V., Philips Electronics N.V. and Moody's Investor Services, member of the Board of Governors of the Peace Palace in The Hague (Netherlands).

Okko Müller (1936, m)

First appointed: 1994. End of current term: 2007.

Position: retired; last position held: member of the Managing Boards of Unilever N.V. and Unilever PLC.

Nationality: German.

Supervisory directorships and other positions held: Chairman of the Supervisory Board of Unilever Deutschland Holding GmbH (till 9 December 2005).

Claudio Sonder (1942, m)

First appointed: 2005. End of current term: 2009.

Position: retired; last position held: Chairman of the Managing Board of Celanese

Nationality: Brazilian and German.

Supervisory directorships and other positions held: member of the Supervisory Boards of Companhia Suzano de Papel e Celulose S.A. (Brazil), Suzano Petroquímica S.A. (Brazil), RBS-Media Group (Brazil), Cyrela Brazil Realty S.A. (Brazil), Hospital Albert Einstein (Brazil) and member of the Board of the Ibero-America Association, Hamburg (Germany).

Cees Van Woudenberg (1948, m)

First appointed: 1998. End of current term: 2006.

Position: member of the Executive Committee of Air France.

Nationality: Dutch.

Supervisory directorships and other positions held: member of the Supervisory Boards of Transavia CV, Mercurius Group Wormerveer B.V. and Coöperatieve Vereniging Verenigde Bloemenvelling Aalsmeer B.A., member of the management committee of the Confederation of Netherlands Industry and Employers (VNO-NCW); chairman of the Dutch employers' association AWWN.

Managing Board

Peter A. Elverding (1948, m), Chairman

Position: chairman of DSM's Managing Board since July 1999; member of the Managing Board since October 1995.

Nationality: Dutch.

Supervisory directorships and other positions held: president of the European Chemical Industry Council (CEFIC), member of the Board of the American Chemical Council (ACC), member of the Supervisory Board of N.V. Nederlandse Gasunie and chairman of the Committee of Delegate Members of the Supervisory Board of N.V. Nederlandse Gasunie till 1 January 2006, vice-chairman of the Supervisory Board of De Nederlandsche Bank N.V., member of the Supervisory Board of VNU N.V., member of the General Council of the Confederation of Netherlands Industry and Employers (VNO-NCW), chairman of the management committee of Stichting Management Studies till January 2006; member of the Supervisory Board of the University of Maastricht and the Transnational University of Limburg.
e-mail: peter.elverding@dsm.com

Jan Zuidam (1948, m), Deputy Chairman

Position: deputy chairman of DSM's Managing Board since January 2001; member of the Managing Board since January 1998.

Nationality: Dutch.

Supervisory directorships and other positions held: member of the Supervisory Board and the Committee of Delegate Members of the Supervisory Board of N.V. Nederlandse Gasunie (till 1 January 2006), member of the Supervisory Board of Gamma Holding N.V., vice-chairman of the Dutch Chemical Industry Association (VNCI), chairman of the Supervisory Board of the ORBIS medicare group, chairman of the Netherlands Forum for Technology and Science; member of the Supervisory Board of the Bonnefanten Museum in Maastricht (Netherlands), chairman of the Technology Committee of the Confederation of Netherlands Industry and Employers (VNO-NCW).
e-mail: jan.zuidam@dsm.com

Henk Van Dalen (1952, m)

Position: member of DSM's Managing Board since January 2000.

Nationality: Dutch.

Supervisory directorships and other positions held: member of the Supervisory Board of Macintosh Retail Group N.V. and NIB Capital Group, member of the Supervisory Board of Stichting Verpakking en Milieu Pact (SVM) (on behalf of the Dutch polymer sector), board member of the Foundation for Responsible Entrepreneurship (SVA), member of the Board of Advisors of AIESEC Nederland, member of 'Ambassadeursnetwerk', a council set up by the Dutch government to promote women's participation in governance and leadership, member of the Advisory Council of ADL Benelux.
e-mail: henk.dalen-van@dsm.com

Feike Sijbesma (1959, m)

Position: member of DSM's Managing Board since July 2000.

Nationality: Dutch.

Supervisory directorships and other positions held: board member of EuropaBio (European Association for Biotech Industries), board member of BIO (Biotechnology Industry Organization, USA), board member of the Dutch Top Institute for Food Sciences WCFS (Wageningen Centre for Food Sciences – WCFS), member of the Supervisory Board of Utrecht University and member of the Supervisory Board of the Dutch Genomics Initiative, board member of DuVo (Dutch Food Chain Sustainability Foundation) and board member of SGCI (Swiss Society of Chemical Industry), member of the Advisory Board of RSM Erasmus University and member of the Advisory Board of ECP.NL.
e-mail: feike.sijbesma@dsm.com

Chris Goppelsroeder (1959, m)

Position: member of DSM's Managing Board since April 2005.

Nationality: Swiss.

Supervisory directorships and other positions held: None.
e-mail: christoph.goppelsroeder@dsm.com

**Other corporate officers
(as at 31 December 2005)**

Corporate Secretary
Paul Fuchs (1946)

Directors of business groups

DSM Fine Chemicals
Henk Numan (1949)

DSM Pharmaceutical Products
Leendert Staal (1953)

DSM Anti-Infectives
Nico Gerardu (1951)

DSM Food Specialties
Rob van Leen (1957)

DSM Elastomers
Ben van Kooten (1951)

DSM Engineering Plastics
Jos Goessens (1951)

DSM Coating Resins
Don Verstegen (1944)

DSM Composite Resins
Jan Paul de Vries (1958)

DSM Fibre Intermediates
Bill Price (1944)

DSM Melamine
Hans Dijkman (1948)

DSM Agro
Renso Zwiers (1955)

DSM Energy
Frank Choufoer (1951)

DSM Venturing & Business Development
Henk Numan (1949)

**Directors of corporate departments
and services**

Finance & Economics
Arnold Gratama van Andel (1946)

Human Resources
Ben van Dijk (1951)

Planning & Development
Hein Schreuder (1951)

Chief Innovation Officer (as of 01/01/2006)
Rob van Leen (1957)

Safety, Health, Environment & Manufacturing
John Prooi (1946)

DSM Nederland B.V. / DSM Industrial Services
Just Fransen van de Putte (1943)

Chief Information Officer
Jo van den Hanenberg (1947)

Communications
Bernard van Schaik (1951)

President DSM China
Stefan Sommer (1959)

Chief Purchasing Officer
Ton Trommelen (1950)

Legal Affairs
Pieter de Haan (1954)

Operational Audit
Roelof Mulder (1946)

Strategic Projects
Hans van Suijdam (1950)

Strategic Projects
Frans Pistorius (1948)

Remuneration Policy regarding the Managing Board and the Supervisory Board

Remuneration Policy as from 2005

This chapter comprises two parts. The first part outlines the remuneration policy for 2005 and subsequent years as approved by the Annual General Meeting on 6 April 2005. The second part contains details of the remuneration received in 2005.

Remuneration policy as from 2005

Objectives of remuneration policy for 2005 and onwards

The objective of DSM's remuneration policy is to attract, motivate and retain the qualified and expert individuals that the company needs in order to achieve its strategic and operational objectives.

Below, the following elements of the remuneration policy will be addressed:

- DSM strives for high performance in the field of sustainability/Triple P, finding a balance between economic gain, respect for people and concern for the environment. The remuneration policy should reflect a balance between the interests of DSM's main stakeholders as well as a balance between the Company's short-term and long-term strategy. In the light of the remuneration policy, the structure of the remuneration package for the Managing Board is designed to balance short-term operational performance with the long-term objective of creating sustainable value within the company, while taking account of the interests of all stakeholders.
- To ensure that highly skilled and qualified managers can be attracted and retained, DSM aims for a total remuneration level that is comparable to levels provided by other Dutch multinational companies that are similar to DSM in terms of size and complexity. For that purpose, external reference data are used. See below for an outline of the labor market reference group.
- The remuneration policy for the members of the Managing Board is aligned with the remuneration of other senior executives of DSM.
- In designing and setting the levels of remuneration for the Managing Board, the Supervisory Board also takes into account the relevant provisions of statutory requirements, corporate governance guidelines and other best practices applicable to DSM.

Labor Market Peer Group

In order to be able to recruit the right caliber of people for the Managing Board and to secure long-term retention of the current Board members, DSM has taken external reference data into account in determining adequate salary levels. For that purpose, a specific labor market peer group has been defined which consists of Dutch companies that are headquartered in the Netherlands and are more or less comparable to DSM in terms of size, international scope and complexity of industrial operations.

The labor market peer group consists of the following ten companies:

- Aegon
- Akzo Nobel
- Getronics
- Heineken
- KPN
- Numico
- Nutreco
- Océ
- TNT
- Wolters Kluwer

Professional independent remuneration experts have modified the raw data of the peer-group companies using a statistical empirical model, so as to make them comparable with a company the size of DSM, with the associated scope and responsibilities of the Managing Board. Peer-group data will be updated on an annual basis.

DSM operates in a competitive international industry. Therefore, DSM will also closely monitor industry-specific international developments with respect to remuneration, notably at the following companies: CIBA, Clariant, Degussa, Lonza and Solvay.

The European industry peer group is influenced by factors such as the type of organization and the organizational superstructure of these companies. Therefore in assessing DSM pay levels, the peer data are used with caution, as they do not reflect the specific organizational structure of DSM.

Below, the various remuneration components are addressed separately.

Base Salary

On joining the Board, the Managing Board members receive a base salary that is comparable with the median of the labor market peer group. Every year base salary levels are reviewed. Adjustment of the base salary is at the discretion of the Supervisory Board, which takes into account external and internal developments.

Bonus

Managing Board members can earn a bonus amounting to 50% of their annual base salary for on-target performance. Under the bonus plan, the part of the bonus that is related to financial targets accounts for 35% of base salary, which can increase to 52.5% in the case of an exceptionally good financial performance.

The part of the bonus that is not related to financial targets accounts for 15% of the base salary and cannot increase beyond that.

Bonus part linked to financial targets

The part of the bonus that is linked to financial targets includes elements related to operational performance, being operating profit and free cash, reflecting short-term financial results, in addition to CFROI. The balance of the financial elements of the bonus is CFROI 17.5%, operating profit 10% and free cash 7.5% of annual base salary for on-target performance.

	On-target pay-out (% of base)	Maximum pay-out (% of base)
Financial targets:		
- CFROI	17.50	26.25
- Operating Profit	10.00	15.00
- Free Cash	7.50	11.25
Non-financial targets	15.00	15.00
total	50.00	67.50

CFROI

The definition of CFROI has been established in such a way that the realization of the CFROI target can be derived from the financial information in the annual report and is as follows⁴:

$$\frac{\text{recurring EBITDA} - \text{related annual tax} - \text{economic depreciation (1\%)}}{\text{gross asset base (incl. working capital)}}$$

CFROI focuses on value realization and creation compared with the Weighted Average Cost of Capital (WACC) established for DSM.

⁴ Recurring EBITDA is defined as: EBIT excluding exceptional items plus depreciation and amortization as reported in the profit and loss account. Related annual tax is defined as taxes paid minus the effect of exceptional items as reported in the statement of income. Economic depreciation is defined as a 1% charge on the historic value of intangible assets and property, plant and equipment as reported in the balance sheet (see notes 9 and 10 to the consolidated financial statements). Working capital is defined as inventories plus receivables minus other current liabilities as reported in the balance sheet. The 1% charge represents the fund to be formed to replace the average asset mix after economic lifetime ends. Gross asset base is defined as the historic value of property, plant and equipment and intangible assets plus average annualized working capital.

Operational performance

There are two financial-target-related bonus elements that allow for a focus on short-term operational targets: operating profit and cash. These can be derived from the financial statements and are defined as follows:

- Operating profit: EBIT excluding exceptional items.
- Free cash, defined as cash from operating activities minus capital expenditure (as shown in the cash flow statement) and minus the average dividend paid in the previous three years.

The company is of the opinion that the combination of CFROI (value realization and creation), operating profit and free cash adequately reflects the company's financial performance. Targets will be determined each year by the Supervisory Board, based on historical performance, the operational and strategic outlook of the company in the short term and expectations of the company's management and stakeholders, among other things. The targets contribute to the realization of the objective of long-term value creation.

In determining the realization of the operating-profit target, a (partial) adjustment mechanism for sensitivity to the euro/dollar ratio will apply. The company will not disclose the actual targets, as they qualify as commercially sensitive information.

Besides financial targets, 15% of the base salary is related to non-financial targets. These targets will be defined in areas relating to the strategic development of the company and Triple P, among other things.

Stock Incentives

The stock incentive plan has been adjusted with effect from 2005. Non-performance-related options and a part of the performance-related options have been replaced by performance shares, up to an equal balance of stock options and performance shares in terms of economic value (calculated by independent specialists on the basis of the Black-Scholes method and the weighted-probability method). Both stock options and performance shares operate on the basis of the same performance schedule.

The vesting of stock options and performance shares is conditional on the achievement after three years of previously determined target levels of Total Shareholder Return (TSR) compared to the peer group.

The Chairman will receive 10,000 performance shares and 37,500 performance options; the members of the Board will receive 8,000 performance shares and 30,000 performance options.

Exercise/Grant price

The stock options and shares are granted on the first 'ex dividend' day following the Annual General Meeting at which DSM's annual accounts are adopted. The exercise price/grant price of the stock incentives will be equal to the opening price of the share on the date of grant.

TSR as a performance measure
DSM's TSR performance is compared to the average TSR performance of a set of pre-defined peer companies. TSR measures the returns received by shareholders and captures both the change in a company's share price and the value of dividend income. This measure is used as it assesses long-term value creation by the company.

The TSR peer group for 2005 consists of the following companies:

- | | |
|-----------------------|---------------|
| – Akzo Nobel | – EMS Chemie |
| – BASF | – Holding |
| – Bayer | – ICI |
| – CIBA | – Lanxess |
| – Spezialitätenchemie | – Lonza Group |
| – Clariant | – Rhodia |
| – Degussa | – Solvay |

This peer group is not the same as the one used for determining remuneration levels. The latter is chosen to reflect the relevant labor market. Compared with the peer group for 2004, Lanxess has been added to this group after its spin-off from Bayer.

The peer group used for benchmarking TSR performance reflects the relevant market in which the company competes for shareholder preference. It includes sector-specific competitors which the Supervisory Board considers to be suitable benchmarks for DSM. The peer group is verified by the Supervisory Board each year based on market circumstances (mergers, acquisitions) which determine the appropriateness of the composition of the performance peer group.

In view of the evolution of DSM, its portfolio development and industry context, the Supervisory Board has reconsidered the composition of the peer group for 2006. Bayer will be excluded, whilst Danisco/Genencor and Novozymes will be included in the peer group.

Performance with regard to TSR will remain the criterion for the vesting of stock options and performance shares.

Depending on DSM's performance compared to the peer group a certain number of options will become exercisable and a certain number of shares will be unconditionally awarded. The stock options can be kept for a maximum of eight years (including the three-year vesting period) while the shares shall be retained by the members of the Managing Board for a period of at least five years (after the three-year vesting period) or at least until termination of employment if this period is shorter. The final performance of DSM versus its peers will be determined and validated by a bank and audited by the external auditor at the end of the performance period.

Performance incentive zone

The number of options and shares that become unconditional after three years is determined on the basis of DSM's performance relative to the average TSR performance of the peer group. The difference between DSM's performance and the peer group's performance (in percentage points) determines the vesting.

Remuneration Policy regarding the Managing Board and the Supervisory Board

Remuneration 2005

The following table gives an overview of the vesting conditions.

DSM performance minus peer group performance in % points	Percentage of performance-related stock options that become exercisable and shares awarded
≥ 20	100 %
≥ 10 and < 20	75 %
≥ -10 and < 10 (Target)	50 %
≥ -20 and < -10	25 %
< -20	0 %

Pensions

The members of the Managing Board are participants in the Dutch pension fund "Stichting Pensioenfonds DSM Chemie (PDC)". PDC operates similar pension plans for various DSM companies. The pension provision of the Managing Board is equal to the pension provision for the employees of DSM Limburg BV and executives employed in the Limburg area.

Due to changes in legislation with respect to pre-pensions, the pension plans of PDC have been revised with effect from 1 January 2006. Since the Managing Board members are participants in the PDC pension plans, these changes apply to the Managing Board as well.

The non-pension early-retirement scheme and the temporary individual pension scheme will be revised too.

For members of the Managing Board born before 1 January 1950 (Peter Eilverding and Jan Zuidam) continuation of the present pension plans will be possible. Continuation of the present plans will not be possible for other Board members. For Henk van Dalen and Feike Sijbesma a transitional arrangement will be applicable. As a result, retirement before the age of 65 will remain possible. Chris Goppelsroeder only participates in the plan with a retirement age of 65.

Employment Contracts

Term of employment

The employment contracts of the members of the Managing Board appointed before 1 January 2005, have been entered into for an indefinite period of time. Newly appointed members of the Managing Board are also offered an employment contract for an indefinite period of time. The employment contract ends on the date of retirement or by notice of either party.

Term of appointment

Members of the Managing Board appointed before 1 January 2005 are appointed for an indefinite period of time. New members of the Managing Board (after 1 January 2005) will be appointed for a period of four years as Board Member. Newly appointed members are subject to reappointment by the shareholders after a period of four years.

Notice period

Termination of employment by a member of the Managing Board is subject to three months' notice. A notice period of six months will for legal reasons be applicable in the case of termination by the company.

Severance arrangement

There are no specific contractual exit arrangements for the members of the Managing Board appointed before 1 January 2005. Should a situation arise in which a severance payment is appropriate for these Board members, the Nomination and Remuneration Committee will recommend the terms and conditions. The Supervisory Board will decide upon this, taking into account usual practices for these types of situations, as well as applicable laws and corporate governance requirements.

The employment contracts of newly appointed members of the Managing Board (after 1 January 2005) will include an exit arrangement provision which is in accordance with best practice provision II.2.7. of the Dutch Corporate Governance Code (i.e. a sum equivalent to the fixed annual salary, or if this is manifestly unreasonable in the case of dismissal during the first term of office, two times the fixed annual salary).

Remuneration 2005

Nomination & Remuneration Committee

The Nomination & Remuneration Committee (hereinafter referred to as 'the Committee') reviews the remuneration policy on a regular basis and proposes changes to this policy to the Supervisory Board. The Committee consists entirely of Supervisory Board members. Its members are Mr Herkströter (Chairman), Mr Kist and Mr Van Woudenberg. The Corporate Vice President Human Resources acts as the Secretary to the Committee. The Committee met five times in 2005. During these meetings it discussed the remuneration for 2005 for the Managing Board. The Committee also defined targets for the bonus plan and assessed the degree to which the members of the Managing Board had achieved their targets for the previous year. The Committee made recommendations for stock options and performance shares to be granted to the Managing Board. The Committee also discussed proposals to revise the pension scheme for the Managing Board. Finally, the Committee discussed the changes in the Managing Board (Jan Dopper and Chris Goppelsroeder).

Remuneration 2005

The remuneration package for the Managing Board is subject to annual review. The market competitiveness of the remuneration package of the Managing Board for 2005 was reviewed, based on the Dutch labor market peer group. The data below reflect the July 2005 remuneration levels. All values are denominated in euros.

Target bonus and stock option grants are expressed as a percentage of base salary. The remuneration data are regressed to reflect the size and scope of DSM. Stock incentive valuations are based on the Black-Scholes method.

Furthermore, data are presented as median actual levels.

Benchmark against Dutch labor market peer group 2005

	DSM	Peer group median
Managing Board Chairman		
Base salary	612,000	750,000
Bonus at target (%)	50%	65%
Total Cash at target	918,000	1,237,500
Annualized Stock Incentive Value (%)	34%	65%
total Direct Compensation	1,126,080	1,725,000
<hr/>		
Board member		
Base salary	470,000	470,000
Bonus at target (%)	50%	60%
Total Cash at target	705,000	752,000
Annualized Stock Incentive Value (%)	36%	50%
total Direct Compensation	874,200	987,000

Base salary in 2005

The Committee reviewed whether circumstances justified an adjustment of the base salary levels. Based on the 2005 benchmark against the peer group, it was established that the base salary for the chairman was at the lower quartile whilst the members of the Managing Board were around the median level. Although a gradual move toward the median level of the external benchmark is part of the policy, no extra increase was effectuated on 1 January 2005. External and internal circumstances however justified a modest general increase of the base salary with effect from 1 July 2005 to cope with inflation and labor market developments. The base salary was increased by 2% with effect from 1 July 2005.

In order to move closer towards the median level of the benchmark a 5% increase of the base salary of the chairman will be effectuated on 1 January 2006. After this increase, the gap with the median of the market for the chairman remains considerable.

Bonus for 2005

Bonus targets are revised annually so as to ensure that they are stretching but realistic. Considerations regarding the performance targets are influenced by the operational and strategic course taken by the company and are directly linked to the company's ambitions. The targets are determined at the beginning of the year for each Board member.

Target bonus level and pay-out
When they achieve all their targets, Managing Board members receive a bonus of 50% of their annual base salary. Outstanding financial performance can increase the bonus level to 67.5% of the annual base salary.

The 2005 annual report presents the bonuses that have been earned on the basis of results achieved in 2005. These bonuses will be paid out in 2006. The Supervisory Board has established the extent to which the targets for 2005 were achieved. The targets relating to the group's financial performance were all met and partially even exceeded. The other, non-financial targets were also fully realized. The average realization percentage was 62.5%.

See page 68 for tabular overviews on the actual bonus pay-out per individual Board member in 2005.

To move further towards the median level of the benchmark, the at-target bonus percentage for all members of the Managing Board will be increased from 50% to 60% with effect from 1 January 2006. After this increase, there is still a gap for the chairman, whilst the members will be at the median of the 2005 benchmark.

Stock options and (performance) shares in 2005

Stock incentives granted in 2005
In 2005 performance-related stock options and performance shares were granted to the Managing Board. The respective stock incentives were granted on April 8, 2005 against an exercise/grant price (after stock split) of € 29.05. The table below shows the number of stock incentives granted to the individual Board members:

	Number of stock incentives granted*	
	Stock options	Performance shares
Peter Elverding	37,500	10,000
Jan Zuidam	30,000	8,000
Henk van Dalen	30,000	8,000
Feike Sijbesma	30,000	8,000
Chris Goppelsroeder	30,000	8,000

* After stock split.

Vesting of stock incentives in 2005
In 2005, besides the regular vesting of non-performance-related options, all performance-related options granted in 2002 vested on the basis of DSM's performance relative to the aforementioned peer group (≥ 20%).

Outstanding and exercised stock incentives in 2005
The tables below show the stock incentives positions of the individual members of the Managing Board and the rights exercised during 2005.

Remuneration Policy regarding the Managing Board and the Supervisory Board

Remuneration 2005

Overview of Stock options/ Stock Appreciation Rights (SARs) *

Peter Elverding		outstanding at December 31 2004	during 2005				outstanding at December 31 2005	exercise price	average share price at exercise
			granted	exercised	vested	forfeited			
Vested stock options ⁽¹⁾ :	1999	36,000		-36,000		0	13.005	31.445	
	2000	45,000				45,000	18.240		
	2001	75,000				75,000	19.990		
	2002	0			75,000	75,000	23.505		
Unvested stock options:	2002	75,000			-75,000	0	23.505		
	2003	75,000				75,000	18.195		
	2004	75,000				75,000	17.895		
	2005 ⁽²⁾		37,500			37,500	29.050		
	Total	381,000	37,500	-36,000	0	0	382,500		

Jan Zuidam		outstanding at December 31 2004	during 2005				outstanding at December 31 2005	exercise price	average share price at exercise
			granted	exercised	vested	forfeited			
Vested stock options ⁽¹⁾ :	1999	36,000		-36,000		0	13.005	31.445	
	2000	36,000				36,000	18.240		
	2001	60,000				60,000	19.990		
	2002	0			60,000	60,000	23.505		
Unvested stock options:	2002	60,000			-60,000	0	23.505		
	2003	60,000				60,000	18.195		
	2004	60,000				60,000	17.895		
	2005 ⁽²⁾		30,000			30,000	29.050		
	Total	312,000	30,000	-36,000	0	0	306,000		

Henk van Dalen		outstanding at December 31 2004	during 2005				outstanding at December 31 2005	exercise price	average share price at exercise
			granted	exercised	vested	forfeited			
Vested stock options ⁽¹⁾ :	1999	22,500		-22,500		0	13.005	26.595	
	2000	36,000		-36,000		0	18.240	30.672	
	2001	60,000				60,000	19.990		
	2002	0			60,000	60,000	23.505		
Unvested stock options:	2002	60,000			-60,000	0	23.505		
	2003	60,000				60,000	18.195		
	2004	60,000				60,000	17.895		
	2005 ⁽²⁾		30,000			30,000	29.050		
	Total	298,500	30,000	-58,500	0	0	270,000		

Feike Sijbesma		outstanding at December 31 2004	during 2005				outstanding at December 31 2005	exercise price	average share price at exercise
			granted	exercised	vested	forfeited			
Vested stock options ⁽¹⁾ :	1999	15,000		-15,000		0	13.005	31.000	
	2000	22,500		-22,500		0	18.240	31.000	
	2001	60,000				60,000	19.990		
	2002	0			60,000	60,000	23.505		
Unvested stock options:	2002	60,000			-60,000	0	23.505		
	2003	60,000				60,000	18.195		
	2004	60,000				60,000	17.895		
	2005 ⁽²⁾		30,000			30,000	29.050		
	Total	277,500	30,000	-37,500	0	0	270,000		

Chris Goppelsroeder	outstanding at December 31 2004	during 2005				outstanding at December 31 2005	exercise price	average share price at exercise
		granted	exercised	vested	forfeited			
Unvested SARs:	2003	59,000				59,000	19.770	
	2004	59,000				59,000	17.895	
Unvested stock options:	2005 ⁽²⁾		30,000			30,000	29.050	
	Total	118,000	30,000	0	0	0	148,000	

Jan Dopper	outstanding at December 31 2004	during 2005				outstanding at December 31 2005	exercise price	average share price at exercise
		granted	exercised	vested	forfeited			
Vested stock options:	1999	27,000		-27,000		0	13.005	26.750
	2000	36,000				36,000	18.240	
	2001	60,000				60,000	19.990	
	2002	0			40,000	40,000	23.505	
	2003	0			40,000	40,000	18.195	
	2004	0			40,000	40,000	17.895	
Unvested stock options ⁽³⁾ :	2002	60,000		-40,000	-20,000	0	23.505	
	2003	60,000		-40,000	-20,000	0	18.195	
	2004	60,000		-40,000	-20,000	0	17.895	
	Total	303,000	0	-27,000	0	-60,000	216,000	

* After stock split.

(1) All stock incentives (performance related as well as non-performance related) may only vest three years after the granting date.

(2) Vesting of all stock incentives granted since 2005 is performance related.

(3) At retirement date 2/3 of all unvested stock options become exercisable and 1/3 are forfeited.

Restricted Shares

Peter Elverding	outstanding at December 31 2004	during 2005			outstanding at December 31 2005	share price at date of grant
		granted	vested	forfeited		
Unvested ⁽¹⁾ :	2005	0	10,000		10,000	29.050
Total		0	10,000		10,000	

Jan Zuidam	outstanding at December 31 2004	during 2005			outstanding at December 31 2005	share price at date of grant
		granted	vested	forfeited		
Unvested ⁽¹⁾ :	2005	0	8,000		8,000	29.050
total		0	8,000		8,000	

Henk van Dalen	outstanding at December 31 2004	during 2005			outstanding at December 31 2005	share price at date of grant
		granted	vested	forfeited		
Unvested ⁽¹⁾ :	2005	0	8,000		8,000	29.050
total		0	8,000		8,000	

Feike Sijbesma	outstanding at December 31 2004	during 2005			outstanding at December 31 2005	share price at date of grant
		granted	vested	forfeited		
Unvested ⁽¹⁾ :	2005	0	8,000		8,000	29.050
total		0	8,000		8,000	

Chris Goppelsroeder	outstanding at December 31 2004	during 2005			outstanding at December 31 2005	share price at date of grant
		granted	vested	forfeited		
Unvested ⁽¹⁾ :	2005	0	8,000		8,000	29.050
total		0	8,000		8,000	

(1) Vesting of all stock incentives granted since 2005 is performance related.

Remuneration Policy regarding the Managing Board and the Supervisory Board

Remuneration 2005

Shares

At year-end 2005 the members of the Managing Board together held 1,836 shares in Royal DSM N.V.

Pensions in 2005

The members of the Managing Board are participants in the Dutch pension fund "Stichting Pensioenfonds DSM Chemie" (PDC).

The retirement age is 65. PDC operates two different schemes: a pre-pension scheme providing benefits between age 62 and 65 and a basic pension scheme for old-age pension benefits as of age 65. The latter scheme is a defined-benefit final-pay scheme. Old-age pension rights are accrued according to vested years of service. Only base salary, after deduction of an offset, is pensionable. In 2005 this offset was € 20,231.

The accrual of pension rights in the salary range between the offset and € 50,810 amounts to 1.75% per annum, and in the salary range above € 50,810 to 1.55% per annum. The basic pension scheme includes entitlement to a pension and a waiver of pension contributions in the event of disability, as well as a spouse's/dependants' pension on death. Contribution to this basic pension scheme is a flat-rate percentage of pensionable salary. The scheme participants contribute a pension premium of 4% of base salary above € 50,810.

The pre-pension scheme (PPS) is basically a defined contribution scheme, in which benefits are based on the contributions paid by the participants. The scheme guarantees a pre-pension income of 75% of base salary from age 62, provided that the participant has paid the full contribution.

Since July 1999 a (temporary) individual scheme has been applied to members of the Managing Board, aimed at accruing additional pension rights (as of age 65). The company pays a premium of 4.5% of the monthly base salary. This scheme is intended to compensate for the fact that an old-age pension of max. 60% of the pensionable salary will normally be attainable only after 40 years of service. Old-age pension rights are accrued according to vested years of service. In practice most current members of the Managing Board will not reach 40 years of service and therefore their maximum attainable old-age pension will be less than 60% of their base salary and an even lower percentage of their total compensation (including bonuses and stock options).

Early retirement plan

In addition to the pension provisions as set out above, DSM operates a non-pension early-retirement scheme for the members of the Managing Board. Early retirement is possible from the age of 60 if the Supervisory Board decides so. The early-retirement income is 80% of base salary during the first six months of payment and 75% thereafter. The early-retirement benefit stops at age 65. The total attainable early-retirement income is determined taking into account as an offset the benefits from the pre-pension scheme operated by PDC. The early-retirement benefits do not accrue or vest. The early-retirement scheme is non-contributory.

Loans

The Company does not provide any loans to members of the Managing Board. There are therefore no loans outstanding.

Total remuneration

The total remuneration (including pension costs and other commitments) of Managing Board members amounted to € 3.9 million in 2005 (2004: € 3.4 million). The increase of € 0.5 million is mainly due to a higher bonus pay-out in 2005 (results DSM 2004).

Overview of Remuneration 2005 – Managing Board

The tables below show the remuneration paid to the Managing Board in 2005.

Fixed Annual Salary in €	01.07.2004	01.07.2005
Peter Elverding	599,760	612,000
Jan Zuidam	461,040	470,000
Jan Dopper (until 01.04.05)	461,040	n.a.
Henk van Dalen	461,040	470,000
Feike Sijbesma	461,040	470,000
Chris Goppelsroeder (as from 01.04.05)	n.a.	470,000

Bonus in €	2005 ¹	2004 ²
Peter Elverding	378,675	215,914
Jan Zuidam	290,950	165,974
Jan Dopper (until 01.04.05)	31,380 ³	165,974
Henk van Dalen	290,950	165,974
Feike Sijbesma	290,950	165,974
Chris Goppelsroeder (as from 01.04.05)	218,913 ⁴	n.a.

1 Based on results achieved in 2005 and therefore payable in 2006.

2 Bonus paid in 2005 based on results achieved in 2004.

3 Bonus paid in 2005 based on estimated results achieved in Q1-2005.

4 Pro-rated bonus based on results achieved in 2005.

Pension

in €	Pension costs (employer)		Accrued pension as of age 65	
	2005	2004	31-12-2005	31-12-2004
Peter Elverding	111,482	110,289	283,206	274,162
Jan Zuidam	86,148	85,250	225,192	218,298
Jan Dopper (until 01.04.05)	21,401	85,250	n.a.	190,149
Henk van Dalen	86,148	85,250	200,490	193,596
Feike Sijbesma	86,148	85,250	140,745	133,851
Chris Goppelsroeder (as from 01.04.05)	48,304	n.a.	48,830	n.a.

Overview of Remuneration in 2005 – Supervisory Board

The remuneration package of the Supervisory Board comprises an annual fixed fee and an annual committee membership fee. The fixed fee for the Chairman of the Supervisory Board is € 50,000. The members of the Supervisory Board each receive a fixed fee of € 35,000. Committee membership is awarded € 5,000 per member and € 7,500 per committee for the Chairman.

In accordance with good corporate governance, the remuneration of the Supervisory Board is not dependent on the results of the Company. This implies that neither stock options nor shares are granted to Supervisory Board members by way of remuneration.

If any shareholdings in DSM are held by Supervisory Board members, they serve as a long-term investment in the Company. At year-end 2005 the members of the Supervisory Board together held 8,084 shares in Royal DSM N.V.

The Company does not provide any loans to its Supervisory Board members.

Rules have been adopted governing ownership and reporting on transactions in securities (other than securities issued by DSM) by Supervisory Board members.

The table below gives an overview of the remuneration paid to the Supervisory Board in 2005.

Supervisory Board Remuneration 2005

in €	Annual fixed fee	Committee fee	Total
Cor Herkströter, Chairman	50,000	11,250	61,250
Henk Bodt, Deputy Chairman	35,000	8,750	43,750
Okko Müller	35,000	5,000	40,000
Enrique Sosa **	8,750	0	8,750
Cees van Woudenberg	35,000	6,250	41,250
Ewald Kist	35,000	3,750	38,750
Claudio Sonder *	26,250	0	26,250
Pierre Hochuli *	26,250	0	26,250
TOTAL	251,250	35,000	286,250

* Supervisory Board member since 06.04.05.

** Supervisory Board member until 06.04.05.

The table below shows the Committee membership of the Supervisory Board members in 2005. Mr Herkströter chairs the Nomination and Remuneration Committee, whilst Mr Bodt is the chairman of the Audit Committee.

Committee membership

	Audit Committee	Nomination & Remuneration Committee
Cor Herkströter	X*	X
Henk Bodt	X	X**
Okko Müller	X	
Enrique Sosa		
Cees van Woudenberg	X**	X
Ewald Kist		X*
Claudio Sonder		
Pierre Hochuli		

* Since 06.04.05.

** Until 06.04.05.

In the 2004 annual report, an extensive account was given of the way in which DSM conducts its governance, risk management and control. In this section, the main elements are reported, the overall governance framework is described, and the risk management and control system is explained.



Web link

Detailed Corporate governance information can also be found at www.dsm.com : Governance

Organization

Royal DSM N.V. is a public limited company with a Managing Board and an independent Supervisory Board. The Managing Board is responsible for the company's strategy, its portfolio policy, the deployment of human and capital resources and the company's financial performance as based on these factors.

The Supervisory Board supervises the policy pursued by the Managing Board, the Managing Board's performance of its managerial duties and the company's general state, taking account of the interests of all the company's stakeholders. The annual financial statements are approved by the Supervisory Board and then submitted for adoption to the Annual General Meeting of shareholders, accompanied by an explanation by the Supervisory Board of how it carried out its supervisory duties during the year concerned.

Members of the Managing Board and the Supervisory Board are appointed (and, if necessary, dismissed) by the Annual General Meeting of shareholders.

DSM fully informs its stakeholders about its corporate objectives, the way the company is managed and the company's performance. Its aim in doing so is to pursue an open dialog with its shareholders and other stakeholders.

DSM has a decentralized organizational structure built around business groups that are empowered to carry out all business functions. This structure ensures a flexible, efficient and fast response to market changes. DSM Nutritional Products is a separate entity. At the corporate level, DSM has a number of staff departments to support the Managing Board and the business groups. The services of a number of shared service departments and DSM Research and intra-group product supplies are contracted by the business groups at market prices.

Dutch Corporate Governance Code

DSM supports the Dutch Corporate Governance Code (Tabaksblat Code), and applies all but one of the 113 Best Practices. The only exception is Best Practice III.5.11, which stipulates that the remuneration committee shall not be chaired by the chairman of the Supervisory Board. This exception has been discussed in the Annual General Meeting of shareholders, where it met no objections. All documents related to the implementation at DSM of the Dutch Corporate Governance Code, can be found at the corporate website (www.dsm.com).

Governance Framework

The figure below depicts DSM's overall governance framework. It shows how responsibilities are divided over the various levels of the company and lists some of the most important governance elements and regulations at each level.

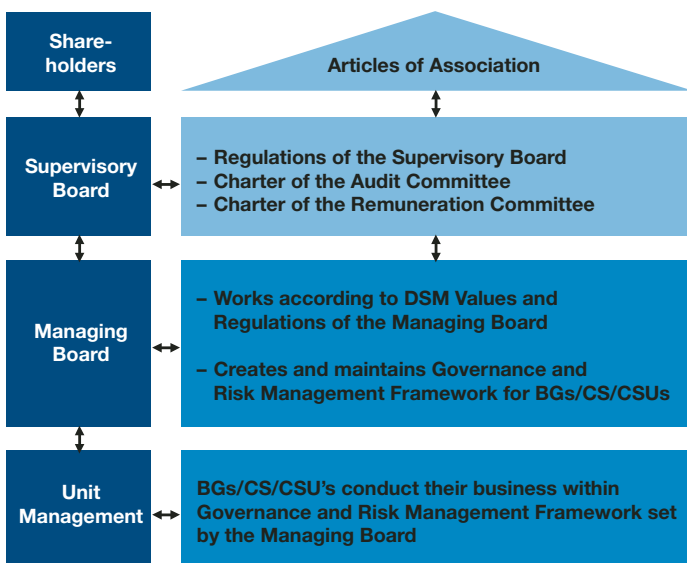
The relationship between the Managing Board and the operational units (business groups, corporate staff departments and central service units) is described by the governance and risk management and control framework that the Managing Board has established and to which the operational units adhere.

The most important governance elements of this framework are:

- The DSM Values to which both the Managing Board and the operational units adhere.
- The governance model, including the charters of several functional Boards, specifying the basic organizational structure and division of responsibilities between Managing Board and operational units.
- The Corporate Strategy Dialog (CSD), specifying the strategic direction and objectives of the corporation and Business Strategy Dialogs (BSD), establishing unit strategy and objectives
- Policies and Multi-Year Plans in several functional areas.
- The Corporate Requirements.

Compliance with the Corporate Requirements and the effectiveness of the risk management and internal control system are discussed regularly between Managing Board and operational units. On average once every three years, the units are also audited by Corporate Operational Audit (COA). The director of the COA department reports to the Chairman of the Managing Board and has the authority to consult with the Chairman of the Audit Committee. Furthermore, the director of COA acts as the compliance officer with regard to inside information and is the chairman of the DSM Alert Committee, which implements the whistle-blower policy.

Within the responsibilities as defined by the governance model and in the context of the strategies and policies of the company, the operational units have the freedom to operate within the limits set by the Corporate Requirements (and of course in compliance with all applicable national or international laws and regulations). These corporate requirements form the basis for systematic risk management and internal control at the operational level. If a special situation calls for it, the Corporate Requirements are extended by so-called Management Directives (e.g. a travel ban for security reasons).



Note: all internal regulations apply in addition to applicable national and international laws and regulations. In cases where internal regulations are incompatible with national or international laws and regulations, the latter prevail.

Corporate Governance, risk management and internal control

Risk Management

Risk Management System

Managing Board Level

DSM's risk management and internal control system is based on the Enterprise Risk Management framework of the Committee of Sponsoring Organisations of the Treadway Commission (COSO ERM), and covers the eight risk management elements identified in that framework.

The COSO ERM risk management elements

- internal environment
- objective setting
- event identification
- risk assessment
- risk response
- control activities
- information & communication
- monitoring

By instituting the governance structures as described above and specifying a risk management and internal control framework for the operational units, the Managing Board has established the internal environment for enterprise risk management. The DSM Values and Requirements as well as policies in the field of finance and economics (page 74), human resources, safety, health and environment (SHE), security and legal affairs define the 'tone at the top' with regard to ethical behavior and doing business.

Strategies are established for every unit and translated into clear objectives, amongst others, with regard to business, markets, innovation, financial results, SHE and social matters. The objectives are reviewed in the

Annual Strategic Review for the corporation as well as at unit level.

Performance and compliance are monitored consistently in discussions between accountable management and the Managing Board.

The Corporate Strategy Dialog, executed every three to five years, includes an elaborate process for the identification and assessment of risks and the definition of responses at the corporate level. These are updated in an annual Corporate Risk Assessment.

Operational Unit Level

The Corporate Requirements form the basis for systematic risk management and internal control at the operational level. They are structured as follows:

The application of the Corporate Requirements leads to systematic risk management and internal control. The Unit Risk Management (URM) Requirements 'govern' the whole system and are the backbone of the internal environment for risk management in the operational units.

They require that:

- a risk management system be put in place.
- risks be identified and assessed and risk responses chosen.
- compliance with applicable law and Corporate Requirements be monitored and deviations corrected.
- reporting of control failures be encouraged and identified material risks be reported immediately.
- the effectiveness of the risk management system be assessed and reported, together with the compliance status, in an annual Letter of Representation.

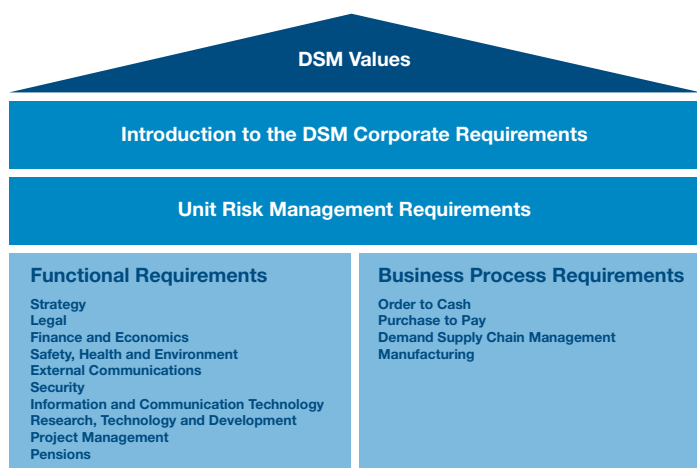
The Corporate Requirements require that Corporate Policies are translated into policies for the operational units. They also stipulate that management should take the lead and give the example, and should keep the employees accountable for compliance. In this way the "tone at the top" is cascaded downward in the organization.

Each operational unit executes a Business Strategy Dialog (BSD) at regular intervals. The outcome of this strategic process is translated into clear objectives for financial as well as other functional and business fields. As part of the BSD, events are identified that could influence the risk profile of the business. It is an important aspect of the DSM risk management and internal control system that it provides for the assessment, control and monitoring of risks in two ways:

- Common Risk and Common Controls
In companies such as DSM, a large part of the identifiable risks are directly linked to the nature of the operations. DSM has chosen to identify and assess these common risks and design common controls for them. These mandatory common controls are part of the Corporate Requirements and cover all functional fields. Especially in the field of the primary flow of goods and products and the related financial control processes, but also in some supportive processes, implementation is supported by standard ICT solutions. In these cases, the controls are built into so-called standard business processes. A special tool (DSM i2i) supports the monitoring of the effectiveness of a number of key controls in these standard business processes.

Through this concept of common risks and common controls, control or mitigation of a large number of risks is achieved in an efficient and effective way.

- Business-specific risks and responses
According to the Unit Risk Management Requirements, operational units are nevertheless required to carry out risk assessments following every BSD. These assessments are aimed at identifying and designing responses to risks that are not covered by the common controls as described above. In these cases specific responses have to be identified and controls have to be implemented and monitored.



A business continuity plan needs to be prepared for an effective response to all risks with a potentially serious impact which, although they have a very low chance of occurring, cannot be excluded altogether.

The corporate Policies and Requirements and their implementation in the operational units are the subject of mandatory training and specific attention is given to communication about risks, also, for example, in job hand-over procedures at senior management levels.

To help the operational units in implementing the risk management and internal control system, the DSM Business System Portal has been developed (see figure below).

The portal is made available to them on the DSM intranet and all relevant Policies, Requirements, practices and standard business processes are to be found under the respective buttons. The operational units have to copy the portal for their own use and can add unit-specific Policies, Requirements and practices and make links to documents archived, such as documents describing standard operating procedures.

Application of the system

Of course, having a suitable risk management system only leads to the desired degree of control if it is effectively applied. Below, the implementation of the system and the way in which the effectiveness of implementation is monitored is described for each COSO ERM category: strategic, operational, reporting and compliance.

Strategic

In the DSM risk management and internal control system, a great deal of attention is given to ensuring that the strategic direction is clear at all times. At the corporate level the strategic choices for the company are made through an elaborate process, the Corporate Strategy Dialog (CSD). The strategy is translated into concrete targets, financial and otherwise, the attainment of which will be checked in annual strategic reviews. A similar process (BSD) takes place in the operational units. In this way DSM attempts to ensure that it understands the extent to which its strategic objectives are being achieved.

Operational

Operational risks are identified through Process Risk Assessments and categorized as either business-specific or common; in the latter case the controls are prescribed in the Corporate Requirements and, if applicable, implemented through a standard business process. Policies and plans are drawn up for each relevant operational field, based on the chosen strategy. Fulfillment of these plans is monitored and reported at least on a quarterly basis and revised forecasts are made. In this way, surprises with regard to the operational results should be avoided.

The business processes themselves, however, should also be reliable. Each step in a process and its related risks must be defined and controls must be put in place. DSM has developed and implemented standard business processes; in these processes the necessary internal control is "designed in"

For units that have not yet implemented the standard business processes, the Corporate Requirements describe which controls need to be implemented as a minimum.

Reporting

To ensure reliable financial reporting there are detailed accounting and reporting requirements and related annexes specifying amongst other things reporting time schedules and formats, the DSM Chart of Accounts, the IFRS-compliant DSM Accounting Rules and the format for a quarterly affidavit, to be signed by the Financial Director of each unit.

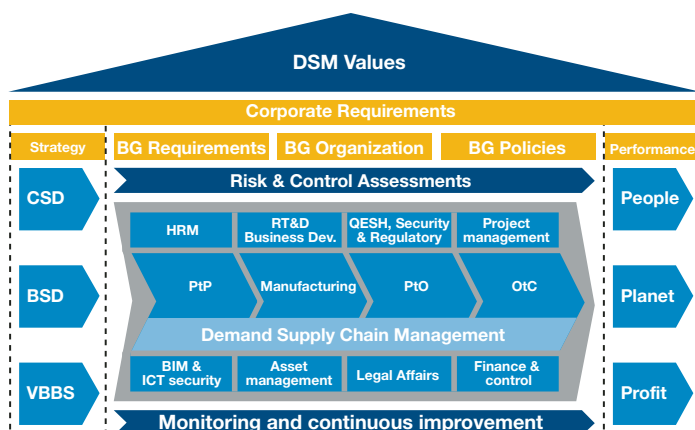
The financial control process has also been translated into a standard business process, with 'built in' internal controls such as authorizations and segregations of duty, mandatory control reports and documented procedures.

Compliance

In its Corporate Requirements, DSM puts much emphasis on compliance with internal rules as well as applicable external laws and regulations. The text under the heading 'Management Leadership' in the Human Resources section of the Requirements reads:

"Management is visibly committed to and, wherever applicable, leads by example in, achieving full compliance with the DSM Values and Requirements and (local) legislation. Management ensures that systems, specific information and expertise are available for its employees to ensure compliance. It keeps its employees accountable for compliant behavior. To support this, it has a policy in place with regard to the consequences".

Compliance with the internal requirements and external laws is monitored consistently. A special program on the assessment and reporting of SHE compliance is in place. In the field of compliance with Competition Law an awareness program is run and relevant people have to sign for compliance.



Corporate Governance, risk management and internal control

Financial Policy – Risks

Financial Policy

As a basis for and contribution to effective risk management and to ensure that the company will be able to pursue its strategies even during periods of economic downturn, DSM retains a solid financial policy.

One of the key targets of *Vision 2010* is to achieve a cash flow return on investment (CFROI, see definition on page 62) which is at least 50 base points higher than the weighted average cost of capital (WACC). DSM further aims for a net debt which is between 30 and 40% of equity plus net debt and an operating profit before amortization and depreciation (EBITDA) which is at least 8.5 times the balance of financial income and expense. This underlines the company's aim of maintaining its single A long-term credit rating.

An important element of DSM's financial strategy is the allocation of cash flow. DSM primarily allocates cash flow to investments aimed at strengthening its business positions and to dividend payments to its shareholders. The cash flow is further used for strengthening the Nutrition and Performance Materials businesses by means of selective acquisitions. As the occasion arises, the company may choose to buy back shares, if excess cash is available in the context of a medium-term analysis of primary cash flow allocation requirements and a sustained solid single A rating.

DSM's dividend policy is outlined on page 34 of this report. In order to avoid dilution of earnings per share as a result of the exercise of management and employee options, DSM buys back shares insofar as this is desirable and feasible at a reasonable price.

An important acquisition criterion is that the business concerned should be compatible with DSM in terms of technological and/or market competencies. Capitalized goodwill paid in the case of acquisitions is subject to an annual impairment test. Acquired companies are in principle required to contribute to DSM's cash EPS from the very beginning and to meet the company's profitability requirements. In some cases, for instance in the case of small innovative growth acquisitions, this requirement cannot be used.

DSM's policy in the various sub-disciplines of the finance function is strongly oriented towards solidity, reliability and optimum protection of cash flows. The finance function also plays an important role in business steering.

The accounting and control function is responsible for the administrative processing of business processes, financial reporting and making assessments and providing advice regarding business processes geared to the company's financial targets. The main policy aim in this function is to obtain and make available reliable financial information that meets statutory and other governance requirements and is adequate for business steering purposes.

The treasury function's tasks include financing the group and its units, managing the cash held by the company and managing currency risks and interest risks. To ensure that its policy in these fields is properly implemented and produces the best possible results, DSM has a set of stringent internal regulations, procedures, organizational measures and market-related benchmarks in place. DSM's treasury policy is mainly geared to optimizing the financial risks to which the group and its units are exposed and to optimizing the balance of financial income and expense.

The tax function is responsible for optimizing the company's position with regard to taxes and import, export and excise duties. As part of this task, it handles the various tax returns and reviews acquisitions, disposals and liquidations of business components and/or joint ventures, as well as restructuring programs and reorganizations. It also examines the tax consequences of cross-border activities between business components such as transfer pricing, cross-border activities that lead to some permanent form of foreign establishment, and changes in the shareholdings in legal entities.

DSM's tax policy is aimed at realizing an optimal position in the field of taxes and import, export and excise duties, and at maintaining such a position for the long term.

The investor relations function's primary task is to maintain contacts with current and potential shareholders of DSM and with analysts who advise shareholders. The policy of this function is to provide quality information to investors and analysts about developments at DSM, ensuring that relevant information is equally and simultaneously provided and accessible to all interested parties.

The insurance function has the task of achieving a proper balance between self-financing hazardous risks or having these risks transferred to external insurers, based on the relative costs involved. The underlying premise is the company's risk management philosophy, which is that group-wide risk awareness must ultimately lead to gaining a proper insight into the risks that a company such as DSM may be confronted with, and to controlling, preventing and limiting such risks. An insurance policy is therefore viewed as a last-resort element of this risk management process.

The choice as to whether or not to obtain external insurance coverage also depends on the scope of the risk exposure in relation to the financial parameters that are relevant for a listed corporation. Such parameters determine the amount of risk that the corporation will afford to bear itself.

All DSM units have to report their results periodically and comply with Corporate Requirements in the field of finance & economics. Compliance with the requirements of accounting and reporting is confirmed by means of a quarterly written statement signed by the management. Before the annual report is disclosed it is first discussed by the Managing Board with the Supervisory Board's Audit Committee and the external auditor, and then with the Supervisory Board. Quarterly financial reports are discussed by the Managing Board, with the Chairman of the Audit Committee and the external auditor. The company uses a release calendar for financial results.

Risks

The following section contains a selection of important risks that have been identified and for the management of which strategies, controls and mitigating measures have been put in place as part of our risk management practices. They nevertheless involve uncertainty that may lead to the actual results differing from those projected. There may also be current risks that the company has not yet fully assessed and that are currently qualified as "minor" but that could have a material impact on the company's performance at a later stage. The company's risk management and internal control system has been designed to identify and respond to these developments on time, but 100% assurance can never be achieved, of course.

Generic risks

Macroeconomic trends

Being a global company, DSM is subject to the usual business risks associated with macroeconomic trends and events. The projected results from the *Vision 2010 strategy* are sensitive to deviations from the assumed and defined economic scenario on which the strategy is based.

General market developments

DSM operates in many different business segments with contingent risk profiles reflecting the different business environments, the diverse nature of the businesses and the distinctive competitive positions those businesses target for. DSM's *Vision 2010* strategy aims at further reducing the cyclical element, but a substantial portion of its activities may still experience material fluctuation in sales and results due to changes in general market conditions, supply-driven overcapacity, economic conditions, currency exchange rate fluctuations or other factors.

Low-cost competition

Counteracting the influence of low-cost competitors and seizing opportunities in low-cost areas (especially China) is one of the centerpieces of DSM's new strategy. The risk remains, however, that such low-cost competitors may penetrate in DSM's core markets.

Political risks

DSM has subsidiaries in more than 35 countries. These subsidiaries can be exposed to changes in government regulations and potentially unfavorable political developments that might hamper

the exploitation of certain opportunities or might impair the value of the local business.

Currency risks

All DSM sales that are priced in currencies other than the euro are subject to economic transaction and/or translation risks that may significantly impact on the financial results, as the company's reporting unit is the euro.

DSM's aim is to mitigate its currency exposure by developing sales in certain regions, through product mix improvements, by focusing manufacturing activities and through increased dollar-based purchasing. However, these 'natural hedges' are never fully balanced. The volatility of the US dollar in relation to the euro and the Swiss franc can have a significant impact on the company's results. Although the production base still has its center of gravity in Europe, a large portion of DSM's product sales is in US dollars or is based on US-dollar-denominated world-market prices. Consequently, from a currency perspective there is a mismatch between revenue and costs. In the 2005 business mix a 1% change in the euro-US dollar rate and the US dollar-Swiss franc rate has on aggregate a € 8 - 10 million impact on gross margin level (=sales minus variable costs). Fluctuations in the relative values of other currencies (such as the yen or the pound sterling) have a limited impact on DSM's results.

DSM companies are obliged to hedge their open currency positions via the DSM Inhouse Bank in order to protect the operating result against effects of currency fluctuations. Only under strict conditions are DSM companies allowed to hedge firm commitments in order to protect the cash flow of the contract value against currency fluctuations. Hedging of forecast transactions is only allowed after the approval of the Managing Board.

Risks of derivatives used for hedging purposes

DSM uses derivatives to hedge various currency and interest rate risks. Under IFRS, all derivatives are recognized as either assets or liabilities. In line with IAS 39 derivatives are recognized at fair value. Changes in fair value go to the income statement either contemporaneously or, in case hedge accounting is applied, at the moment that the hedged item impacts on the income statement. These changes normally consist of a currency and an interest rate component. To limit the

volatility deriving from the use of derivatives, hedge accounting is applied in certain cases. Hedge accounting is only allowed under strict conditions, which are different per hedge type.

DSM applies the following hedge accounting models: fair value hedge accounting, cash flow hedge accounting and net investment hedge accounting. The goal of a *fair value hedge* is to fix the value of an asset/liability (hedged item). Changes in fair value of a designated derivative that is highly effective as a fair value hedge, together with the change in fair value of the corresponding asset, liability or firm commitment attributable to the hedged risk, are included directly in earnings. So both fair value changes are offset in the income statement. The goal of a cash flow hedge is to limit the variability of highly probable future cash flows due to foreign currency or interest rate movements. Changes in fair value of a designated derivative that is highly effective as a *cash flow hedge* are included in equity and reclassified into income in the same period during which the hedged forecast cash flow affects income. This means there is no volatility in the income statement. The goal of a *net investment hedge* is to fix the value of an investment in a foreign entity. Changes in fair value of a designated derivative that is highly effective as a net investment hedge are included in equity. So volatility of the hedged part of the net investment is offset in equity.

Under IFRS hedge accounting through combined derivatives is not allowed. For this reason DSM has chosen to hedge the interest and foreign currency risk with separate derivatives and not to use combined derivatives to hedge both risks.

Any ineffectiveness of hedges is reflected directly in income. DSM aims to mitigate these risks by closely monitoring the effectiveness of the hedges through effectiveness testing. Ineffectiveness only occurs when fair value changes of the hedging instrument compared to fair value changes of the underlying risk are outside a 80 – 125 % bandwidth. All hedges in 2005 have proven to be effective.

Corporate Governance, risk management and internal control

Risks

Strategic risks

Acquisitions, divestments and joint ventures

The success of DSM's strategy is partly dependent on the results obtained in spotting and implementing acquisition and divestment opportunities and joint ventures. Risks in this field are connected to the company not identifying relevant acquisitions or alliances, or not doing so in time, or not being successful in bid processes or in the integration of acquired businesses needed to safeguard its path of growth. DSM uses joint ventures and other strategic alliances whenever it is beneficial to do so (for example to combine strengths and to share investments and inherent risks). Although joint ventures and strategic alliances are always intended to add value, situations can arise that result in a conflict of interests that could potentially damage the business.

New markets, products and technologies

In its *Vision 2010* strategy, DSM increases its focus on innovation in order to develop new technologies and products and explore new markets. Market intelligence will be strengthened and market and customer orientation enhanced. Nevertheless, the actual developments in the targeted markets, the speed with which new products and technologies are accepted and the emergence of new competition will always constitute risks to the success of the chosen strategy.

Innovation Risks

Within DSM's new strategy there is an extra focus on innovation. A multitude of actions are being taken to ensure success in the R&D and market development processes. There is a risk that goals nevertheless will not be achieved and that the company will have to abandon a project on which it has already spent substantial sums of money. The company may reach a point where its overall sales volume does not, on a longer-term basis, justify the company's related R&D expenditure.

A certain portion of the company's financial results is based on legally protected intellectual property. When these protection mechanisms expire and the company is unable to follow up these situations appropriately, e.g. through new valuable patents, there is a risk that the financial results might deteriorate.

Human resource risks

DSM's ability to retain highly specialized and committed technical staff as well as talented staff working in sales, R&D, manufacturing, finance, general management and human resources is critical to the future success of the company. Within the company's new strategic direction, huge and ongoing efforts are directed to managing the required processes. The company may have to adjust the timing of its growth path, due to constraints or opportunities in this field.

Specific risks

Corporate reputation risks

Any failure by any of its business units to meet production safety, social, environmental and/or ethical standards could harm DSM's corporate reputation and thereby impact on its business and results. DSM values such as good corporate citizenship, open communication and transparency should reasonably assure appropriate employee conduct. Moreover, the company mitigates its reputation risk by making substantial efforts to reduce the probability that any of its units might fail to comply with internal requirements and/or external laws and regulations (see the general section on risk management).

In 2005 DSM was ranked No. 1 worldwide in the chemical industry sector of the Dow Jones Sustainability Index for the second year running, reflecting among other things the enormous efforts the company continues to make in the area of production processes and their potential impact on the environment and on the safety and well-being of its employees.

Customer risks

The company makes considerable efforts to delight its customers. Compliance with customer agreements and commitments is measured regularly. Appropriate process and product quality checks and balances are in place to mitigate the risk of non-compliance with customers' and DSM's sales conditions.

No DSM customer represents more than 3% of DSM's total sales.

Production process risks

DSM tries to mitigate production process risks by spreading production where possible, but concentration is necessary in order to achieve economies of scale. The design of any new facilities and/or production processes is required to include state-of-the-art safety and security facilities. Plants are regularly and systematically inspected against predefined risk and engineering standards. Nevertheless, certain risks and the degree to which SHE elements are managed may not be sufficiently well known.

Legal risks

DSM's current strategic position and direction has considerably changed the product portfolio. The life science business is rather different from the other businesses from a product-liability point of view. For instance some pharma product liabilities cannot be insured against, or only at prohibitively high costs. This typically holds true for the pharma business in the USA. On the basis of highly demanding process and product quality requirements, the company tries to mitigate such product liability risks as far as is reasonably possible.

The company is putting in a great deal of effort on an ongoing basis into ensuring that all its units comply with internal and external requirements (e.g. FDA compliance). The risk of non-compliance has been further reduced by the recent revision and tightening-up of the Corporate Requirements.

ICT risks

In order to control potential ICT risks DSM employs a policy of using the latest proven hardware and software solutions. Group-wide DSM works with integrated and standardized ICT infrastructures, backup, encoding and encryption systems, replicated databases, virus and access protection and a fully compatible global network and intranet. Regular local ICT security assessments should assure adequate local applications. External ICT service providers have been contracted in and are required to report regularly on the measures they are taking to reasonably assure that DSM's ICT processes are not disrupted.

Although DSM has applied strict measures with regard to the security and reliability of its IT systems, incidents regarding for example back-up recovery, hot failover systems, virus attacks and international network connections may still occur, and this can have a material impact on business operations.

Project risks

The company is currently undertaking some major projects whose success is important to the overall business results and exposure. In general these fall into three categories: pricing reinforcement projects, reorganization projects and ICT projects. *Apollo* is a project that assures uniform application of standard business processes designed in SAP-R3 throughout DSM worldwide. The *True Blue* project is intended to reduce the risk of internal and external non-compliance and to further strengthen controls.

DSM has extensive experience in project management. It second its best people to projects that are considered critical. Moreover, direct Board involvement and monitoring are in place to mitigate the risk of project failure.

Financial risks

Additional financial risks include commodity risk, credit risk, interest rate risk, tax risk, pension risk and country risk. The major credit rating institutions may change their assessments of DSM's creditworthiness, thereby affecting the company's borrowing capacity and/or the conditions under which it can borrow money and causing

fluctuations in the cost of finance. The company aims to keep its single-A credit rating. The risk of fluctuating interest rates is addressed in the financial statements, see page 113 of this report.

The low effective rate of corporation tax may come under pressure under the new harmonized European and Dutch tax legislation. In addition, the outcomes of ongoing disputes with tax authorities could impact on the company's tax position with retroactive effect. Although tax assets have been recognized at fair value, future profits may not suffice to realize all tax-loss carry-forwards.

Insurable risks

Global insurance policies are in place to reduce the risk of damage to property, business-interruption loss and general liability. Uninsured losses in 2006 for any one incident will not exceed about € 30 million per occurrence with an annual aggregate maximum of € 45 million.

Control failures

In DSM's Triple P Report some of the control failures are mentioned that occurred in spite of the risk management efforts. They can be found in the section 'What still went wrong'. All failures are extensively analyzed and lessons learnt are implemented.

Information about the DSM share

Shares and listings

Ordinary shares in Royal DSM N.V. are listed on the Euronext stock exchange in Amsterdam, the Netherlands (Stock code 00981, ISIN code NL0000009819). On 31 December 2005 DSM de-listed from the electronic exchange in Switzerland (SWX).

Options on ordinary DSM shares are traded on the European Option Exchange in Amsterdam, the Netherlands (Euronext.liffe).

In the USA a sponsored unlisted American Depositary Receipts (ADR) program is offered by Citibank NA (Cusip 23332H202), with four ADRs representing the value of one ordinary DSM share.

On 5 September 2005 the ordinary DSM shares and the ADRs were split two for one (two new shares/ADRs for one old share/ADR). With this stock split DSM aimed to promote the tradeability of its shares, which threatened to be hampered by the favorable development of the share price. As the share price had risen to over € 60 per share (a doubling of the share price since the

inception of DSM's *Vision 2005* strategy in September 2000), DSM had become one of the highest-priced shares in the AEX group of companies at the Amsterdam Euronext stock exchange.

Besides the ordinary shares, 44.04 million cumulative preference shares A are in issue, which are not listed on the stock exchange; these are placed with institutional investors in the Netherlands. The cumprefs A have the same voting rights as ordinary shares, as their nominal value of € 1.50 per share is equal to the nominal value of the ordinary shares. The dividend on cumprefs A amounted to 6.8% of the issue price of € 5.295 per share until the contractual dividend reset date (1 January 2006). As of this date the dividend has been reset to 4.348%.

The total number of ordinary DSM shares in issue decreased by 1,033,931 in 2005. On 31 December it stood at 190,922,965.

Distribution of shares

Under the Dutch Major Holdings Disclosure Act, shareholdings of 5% or more in any Dutch company must be disclosed to that company. On 31 December 2005 the following shareholders had disclosed that they owned between 5 and 10% of DSM's total share capital:

- ABN AMRO Holding N.V.
- Delta Lloyd Levensverzekering N.V.
- ING Investment Management B.V.
- Rabobank Nederland Participatiemaatschappij B.V.

Development of the number of ordinary DSM shares*

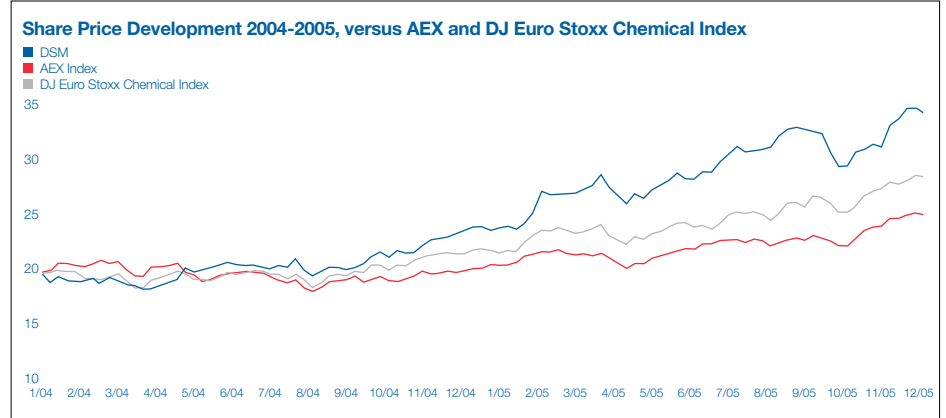
	placed	repurchased	in issue
balance at 31 December 2004	201,953,008	-/- 9,996,112	191,956,896
changes:			
- issue of shares to service option rights		5,108,069	5,108,069
- repurchased		-/- 6,142,000	-/- 6,142,000
balance at 31 December 2005	201,953,008	-/- 11,030,043	190,922,965

average number of shares outstanding	190,783,006
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DSM share prices

- highest price	€ 35.22
- lowest price	€ 23.07
- at 31 December	€ 34.50

* Where applicable, the effects of the share split have been recognized retroactively in the figures in this table.



Geographical spread of DSM shares

	2005	2004
Netherlands	35%	32%
North America	14%	14%
Belgium / Luxembourg	16%	16%
United Kingdom	24%	19%
Germany	2%	5%
Switzerland	3%	5%
Other countries	6%	9%

Royal DSM N.V. Financial statements 2005

Share split

On 5 September 2005 DSM effected a share split on a two-for-one basis (two shares for one old share) in order to increase the liquidity of the DSM share. This split is applicable to the ordinary shares as well as to the class A and class B preference shares. In the financial statements the split is considered to be effective as of January 1, 2004. Unless otherwise noted, all relevant per-share data in the financial statements are presented in accordance with the number of shares outstanding after the share split.

Royal DSM N.V. Financial statements 2005

Consolidated financial statements

Summary of significant accounting policies

Basis of preparation

DSM's consolidated financial statements have been prepared in accordance with International Financial Reporting Standards (IFRS) as adopted by the European Union. DSM applied accounting policies that comply with IFRS effective at December 2005, the so-called IASB stable platform for 2005. Details about the first-time adoption of IFRS by DSM can be found in note 35.

Consolidation

The consolidated financial statements comprise the financial statements of the parent entity, Royal DSM N.V., and its subsidiaries as well as the proportion of DSM's ownership of joint ventures (together 'DSM' or 'Group'). A subsidiary is an entity over which DSM has control. Control is the power to govern the financial and operating policies of the entity so as to obtain benefits from its activities. The financial data of subsidiaries are fully consolidated. Minority interests in the Group's equity and income are stated separately. A joint venture is an entity in which DSM holds an interest and which is jointly controlled by DSM and one or more other venturers under a contractual arrangement. The financial data of joint ventures are included in the consolidated financial statements according to the method of proportionate consolidation.

Subsidiaries and joint ventures are consolidated from the acquisition date and de-consolidated from the date on which DSM ceases to have control or joint control, respectively. On consolidation all intra-group balances and transactions and unrealized gains and losses from intra-group transactions are eliminated. Unrealized losses are not eliminated if these losses indicate an impairment of the asset transferred. In such cases a value adjustment for impairment of the asset is made.

Segmentation

Segment information is presented in respect of the Group's business and geographical segments. The primary format, business segments, reflects the Group's management structure. Prices for transactions between segments are determined on an arm's length basis. Segment results, assets and liabilities include items directly attributable to a segment as well as those that can be allocated on a reasonable basis.

Foreign currency translation

The presentation currency of the Group is the euro.

Each entity of the Group records transactions and balance sheet items in its functional currency. Commercial transactions denominated in another currency than the functional currency are recorded at the spot exchange rates prevailing at the date of the transactions. Monetary assets and liabilities denominated in a currency other than the functional currency of the entity are translated at the closing rates at the balance sheet date. Exchange differences resulting from the settlement of these transactions and from the translation of monetary items are recognized in income.

On consolidation, the balance sheets of subsidiaries and joint ventures whose functional currency is not the euro are translated into euro at the closing rate. The income statements of these entities are translated into euro at the average rates for the relevant period. Goodwill paid on acquisition is recorded in the functional currency of the acquired entity. Exchange differences arising from the translation of the net investment in entities with a functional currency other than the euro are recorded in equity (Translation reserve). The same applies to exchange differences arising from borrowings and other financial instruments in so far as they hedge the currency exchange risk related to the net investment. On disposal of an entity with a functional currency other than the euro the cumulative exchange difference relating to the translation of net investment is recognized in income. DSM has made use of the exemption in IFRS 1, according to which the cumulative translation differences at the date of transition to IFRS (1 January 2004) are deemed to be zero.

Distinction between current and non-current

An asset (liability) is classified as current when it is expected to be realized (settled) within 12 months after the balance sheet date.

Emission rights

DSM is subject to legislation encouraging reductions in greenhouse gas emission and has been awarded emission rights in a number of jurisdictions, principally to cover emission of CO₂. Emission rights are reserved for meeting delivery obligations and are not recognized. Revenue is recognized when surplus emission rights are sold to third parties. When actual emissions exceed the emission rights available to DSM a provision is recognized for the expenditure required to obtain the additional rights.

Intangible assets

Goodwill represents the excess of the cost of an acquisition over DSM's share in the net fair value of the identifiable assets, liabilities and contingent liabilities of an acquired subsidiary, joint venture or associate. Goodwill paid on acquisition of subsidiaries and joint ventures is included in intangible assets. Goodwill paid on acquisition of associates is included in the carrying amount of these associates. Goodwill is tested for impairment annually and when there are indications that the carrying value may not be recoverable. Any impairment is recognized in income. Gains and losses on the disposal of an entity include the carrying amount of goodwill relating to the entity sold.

It was DSM's policy up to and including 1999 to charge goodwill paid immediately against equity. In accordance with IFRS 1 this goodwill is not recognized in the opening balance sheet but remains a deduction from equity. From 2000 up to and including 2003, goodwill was capitalized and amortized over its estimated useful life. DSM has made use of the exemption of IFRS 1 that permits entities to elect not to apply IFRS 3, Business Combinations, retrospectively. The carrying amount of the goodwill on 31 December 2003 according to 'NL GAAP' is used as the deemed cost of the goodwill as at the date of transition to IFRS (1 January 2004).

Consolidated financial statements

Financial statements of Royal DSM N.V.

Other information

DSM figures: five-year summary

Explanation of some financial concepts and ratios

Acquired licenses, patents and application software are carried at cost less straight-line depreciation and less any impairment losses. The expected useful lives vary from 4 to 10 years. Costs of software maintenance and new releases are expensed when incurred. Capital expenditure that is directly related to the development of application software is recognized as intangible asset and amortized over its estimated useful life (5-8 years).

Research costs are expensed when incurred. Where the recognition criteria are met, development expenditure is capitalized and amortized over its useful life from the moment the product is launched commercially. The carrying amount of an intangible asset from development is reviewed for impairment at each balance sheet date or earlier upon indication of impairment. Any impairment losses are recorded in income.

Property, plant and equipment

Property, plant and equipment is carried at cost less depreciation calculated on a straight-line basis and less any impairment losses. Interest during construction is capitalized. Expenditures relating to major scheduled turnarounds are capitalized and depreciated over the period up to the next turnaround.

The items of property, plant and equipment are systematically depreciated over their estimated useful lives. Reviews are made annually of the estimated remaining lives of the most important individual productive assets, taking account of commercial and technological obsolescence as well as normal wear and tear. The initially assumed expected useful lives are in principle: for buildings 10-50 years; for plant and machinery 5-15 years; for other equipment 4-10 years. Land is not depreciated.

An item of property, plant and equipment is derecognized upon disposal or when no future economic benefits are expected to arise from continued use or the sale of the asset. Any gain or loss arising on derecognition of the asset is included in income.

Associates and financial assets

An associate is an entity over which DSM has significant influence but no control, usually supported by a shareholding that entitles DSM to between 20% and 50% of the voting rights. Investments in associates are accounted for by the equity method of accounting, which involves recognition in income of DSM's share of the associate's profit or loss for the year. DSM's interest in an associate is carried in the balance sheet at its share in the net assets of the associate together with goodwill paid on acquisition, less any impairment loss.

When DSM's share in the loss of an associate exceeds the carrying amount of the associate, including any other receivables, the carrying amount is reduced to nil. No further losses are recognized, unless DSM incurs obligations of the associate which it has guaranteed or is otherwise committed to.

Unrealized profits and losses from transactions with associates are eliminated according to DSM's percentage ownership of these entities.

Securities comprise interests in entities in which DSM has no significant influence that are accounted for as available-for-sale securities. These securities are measured against fair value with changes in fair value being recognized in equity (Fair value reserve). If a reliable fair value cannot be established the securities are held at cost. Available-for sale securities are tested for impairment with other than temporary declines in value being charged to income. On disposal the cumulative fair value adjustments of the related securities are released from equity and included in income. Proceeds from other securities held at cost are recognized in income on disposal (Net finance costs).

Loans and long-term receivables are measured at amortized cost, if necessary with deduction of a value adjustment for bad debts. The proceeds are recognized in income (Net finance costs).

Impairment losses

When there are indications that the carrying amount of a non-current asset (an item of intangible assets, property, plant and equipment, or financial assets) may exceed the estimated recoverable amount (the higher of its value in use and fair value less costs to sell), the possible existence of an impairment loss is investigated. If an asset does not generate largely independent cash inflows, the recoverable amount is determined for the cash-generating unit to which the asset belongs. In assessing the value in use, the estimated future cash flows are discounted to their present value using a pre-tax discount rate that reflects current market assessments of the time value of money and the risks specific to the asset. When the recoverable amount of an asset is less than its carrying amount, the carrying amount is impaired to its recoverable amount. An impairment loss is reversed when there has been a change in estimate that is relevant for the determination of the asset's recoverable amount since the last impairment loss was recognized. Impairment losses for goodwill will never be reversed.

Inventories

Inventories are stated at the lower of cost and net realizable value. The first-in, first-out (FIFO) method of valuation is used. The cost of finished goods and intermediates includes directly attributable costs and related production overhead expenses. Net realizable value is determined as the estimated selling price in the ordinary course of business, less the estimated costs of completion and the estimated costs necessary to make the sale. Products whose manufacturing cost cannot be calculated because of joint cost components are stated at net realizable price after deduction of a margin.

Current receivables

Current receivables are stated at face value less an allowance for bad debts.

Current investments

Deposits held at call with banks with a remaining maturity of more than 3 months and less than 12 months are classified as current investments. They are measured at amortized cost. Proceeds from these deposits are recognized in income (Net finance costs).

Cash and cash equivalents

Cash and cash equivalents comprise cash at bank and in hand and deposits held at call with banks with a remaining maturity of less than 3 months. Bank overdrafts are included in current liabilities. Cash and cash equivalents are stated at nominal value.

Assets held for sale

Non-current assets or assets and liabilities related to a disposal group are separately disclosed as assets and/or liabilities held for sale when such assets are available for immediate sale and when the sale is highly probable. These conditions are usually met as from the date a first draft of an agreement to sell is ready for discussion. Assets and liabilities classified as held for sale are measured at the lower of carrying amount and fair value less costs to sell. For non-current assets classified as held for sale depreciation is terminated.

Shareholders' equity

DSM's ordinary shares and cumulative preference shares are classified as equity. The consideration paid for repurchased DSM shares (treasury shares) is deducted from Shareholders' equity until the shares are withdrawn or reissued. Dividend to be distributed to holders cumulative preference shares is recognized as a liability in the period in which the Supervisory Board of Directors approves the proposal for profit distribution. Dividend to be distributed to holders of ordinary shares is recognized as a liability in the period in which the Annual General Meeting of Shareholders approves the proposal for dividend.

Borrowings

Borrowings are initially recognized at cost, being the fair value of the proceeds received, net of transaction costs. Subsequently, borrowings are stated at amortized cost using the effective interest method. Amortized cost is calculated by taking into account any discount or premium. Interest expenses are accrued for and recorded in income for each period.

Where the interest rate risk relating to a long-term borrowing is hedged, and the hedge is regarded as effective, the carrying amount of the long-term loan is adjusted for changes in fair value of the interest component of the loan.

Provisions

Provisions are recognized when all of the following conditions are met: 1) there is a present legal or constructive obligation as a result of past events; and 2) it is probable that a transfer of economic benefits will settle the obligation; and 3) a reliable estimate can be made of the amount of the obligation.

If the effect of the time value of money is material, provisions are determined by discounting the expected cash flows at a pre-tax rate. Where discounting is used, the increase in the provision due to the passage of time is recognized as borrowing cost. However, the interest costs relating to pension obligations are included in pension costs.

Any provision for costs that will arise from future site restoration is made when the investment project concerned is taken into operation. These are included in Property, plant and equipment, along with the historic cost of the relating asset, and depreciated over the useful life of the asset.

Income tax expense

Income tax is accounted for using the balance sheet liability method. Income tax expense is recognized in the income statement except to the extent it relates to an item recognized directly within shareholders' equity.

Current tax is the expected tax payable on the taxable income for the year, using tax rates enacted at the balance sheet date, and any adjustment to tax payable in respect to previous years. Deferred tax assets and liabilities are recognized for the expected tax consequences of temporary differences between the bases of assets and liabilities and their reported amounts. Deferred tax assets and liabilities are measured at the tax rates and under the tax laws that have been enacted or substantially enacted at the balance sheet date and are expected to apply when the related deferred tax assets are realized or the deferred tax liabilities are settled. Deferred tax assets are recognized to the extent that it is probable that future taxable profits will be available against which the deductible temporary differences and unused tax losses can be utilized. If necessary a value adjustment is deducted. Deferred tax assets and liabilities are stated at face value.

Deferred tax liabilities relating to withholding taxes are included only if and to the extent that DSM intends to distribute the profits made by subsidiaries in the form of dividend in the near future.

Pensions and other post-employment benefits

The Group operates a number of defined benefit plans and defined contribution plans throughout the world, the assets of which are generally held in separately administered funds. The pension plans are generally funded by payments from employees and by the relevant Group companies. The Group also provides certain additional post-employment healthcare benefits to retired employees in the United States. These benefits are unfunded.

For defined benefit plans, pension costs are determined using the projected unit credit method. Actuarial gains and losses are recognized in income, spread over the average remaining service lives of employees, using the corridor approach. Prepaid pension costs relating to defined benefit plans are capitalized only if they lead to refunds to the employer or to reductions in future contributions to the plan by the employer. Payments to defined contribution plans are charged as an expense as they fall due.

Share-based compensation

The costs of option plans are measured by reference to the fair value of the options at the date at which the options are granted. The fair value is determined using the Black-Scholes option pricing model, taking into account market conditions linked to the price of the DSM share. The costs of these options are recognized in income (Employee benefits), together with a corresponding increase in equity (Reserve for share-based compensation) during the vesting period in the case of share-settled options. In the case of cash-settled options (share appreciation rights) the contra-account is Other liabilities. No expense is recognized for options that do not ultimately vest, except for options where vesting is conditional upon a market condition, which are treated as vesting irrespective of whether or not the market condition is satisfied, provided that all other performance conditions are satisfied.

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Leases

Finance leases, which transfer to the Group substantially all the risks and benefits incidental to ownership of the leased item, are capitalized at the inception of the lease at the fair value of the leased property or, if lower, at the present value of the minimum lease payments. All other leases are operating leases. Lease payments for finance leases are apportioned to finance charges and reduction of the lease liability so as to achieve a constant rate of interest on the remaining balance of the liability. Finance charges are charged directly against income. Capitalized leased assets are depreciated over the shorter of the estimated useful life of the asset or the lease term. Operating lease payments are recognized as an expense on a straight-line basis over the lease term.

Revenue

Revenue from the sale of goods is recognized when the significant risks and rewards of ownership are transferred to the buyer. Net sales represent the invoice value less estimated rebates and cash discounts, and excluding value-added taxes.

Royalty income is recognized (Other operating revenue) on an accruals basis in accordance with the substance of the relevant agreements. Interest income is recognized on a time-proportion basis using the effective interest method. Dividend income is recognized when the right to receive payment is established.

Government grants

Government grants are recognized at their fair value where there is reasonable assurance that the grant will be received and all related conditions will be complied with. If the grant relates to an expense item, it is recognized as income over the periods necessary to match the grant on a systematic basis to the costs that it is intended to compensate. Where the grant relates to an asset, the fair value is initially recognized as deferred income (Other non-current liabilities) and then released to income over the expected useful life of the relevant asset by equal annual amounts.

Research and development

Research expenditure is charged to income in the period in which it is incurred. Internal development expenditure is charged to income in the period in which it is incurred unless it meets the recognition criteria for intangible assets.

Derivative financial instruments

The Group uses derivative financial instruments ('derivatives') such as foreign currency contracts and interest rate swaps to hedge risks associated with foreign currency and interest rate fluctuations. Financial derivatives are initially recognized in the balance sheet at cost and subsequently measured at their fair value on each balance sheet date. The method of recognizing the resulting gains or losses is dependent on the nature of the item being hedged.

When derivative contracts are entered into, the Group designates them as either hedges of the fair value of recognized assets or liabilities, hedges of firm commitments or forecast transactions or hedges of net investments in entities with a functional currency other than the euro.

Changes in the fair value of derivatives designated and qualifying as fair value hedges are immediately recognized in income, together with any changes in the fair value of the hedged assets or liabilities attributable to the hedged risk.

Changes in the fair value of derivatives designated and qualifying as cash flow hedges are recognized in equity (Hedging reserve). Upon recognition of the related asset or liability the cumulative gain or loss is transferred from the Hedging reserve and included in the carrying amount or in income.

Changes in the fair value of derivatives designated and qualifying as net investment hedges are recognized in equity (Translation reserve). Gains and losses accumulated in the Translation reserve are included in income when the net investment is disposed of.

Gains or losses relating to the ineffective portion of fair value hedges, cash flow hedges and net investment hedges are immediately recognized in income.

Exceptional items

Exceptional items relate to material non-recurring items of income and expense arising from circumstances such as:

- write-downs of inventories to net realizable value or of property, plant and equipment to recoverable amount, as well as reversals of such write-downs;
- restructurings of the activities of an entity and reversals of any provisions for the cost of restructurings;
- disposals of property, plant and equipment;
- disposals of investments;
- discontinued operations;
- litigation settlements;
- other reversals of provisions.

Exceptional items are reported separately to give a better understanding of the underlying results of the period.

Effect of new accounting standards

DSM did not opt for early adoption of the following new standards, amendments to standards, and new IFRIC interpretations, which are mandatory for annual periods beginning on or after 1 January 2006 or later years:

- IFRS 6 Exploration for and Evaluation of Mineral Resources
- IFRS 7 Financial Instruments: Disclosures
- Amendment to IAS 1: Capital Disclosures
- Amendment to IAS 19: Actuarial Gains and Losses, Group Plans and Disclosures
- Amendment to IAS 21: Net Investment in a Foreign Operation
- Amendment to IAS 39: Cash Flow Hedge Accounting of Forecast Intragroup Transactions
- Amendment to IAS 39: The Fair Value Option
- Amendment to IAS 39 and IFRS 4: Financial Guarantee Contracts
- IFRIC 4 Determining whether an Arrangement contains a Lease
- IFRIC 5 Rights to Interests arising from Decommissioning, Restoration and Environmental Rehabilitation Funds
- IFRIC 6 Liabilities arising from Participating in a Specific Market – Waste Electrical and Electronic Equipment
- IFRIC 7 Applying the Restatement Approach under IAS 29 Financial Reporting in Hyperinflationary Economies

DSM expects that the adoption of these new standards, amendments to standards and new IFRIC interpretations in future periods will have no material impact on DSM's financial statements.

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Consolidated income statement

x € million	2005			2004		
	result before exceptional items	exceptional items (8)	total	result before exceptional items	exceptional items (8)	total
net sales, continuing operations	8,012	-	8,012	7,434	-	7,434
<i>net sales, discontinued operations</i>	183	-	183	398	-	398
total net sales	8,195	-	8,195	7,832	-	7,832
other operating income (4)	223	59	282	197	19	216
	8,418	59	8,477	8,029	19	8,048
own work capitalized	47	-	47	38	-	38
change in inventories of intermediates and finished goods	251	-	251	-126	-	-126
raw materials and consumables used	-4,338	-	-4,338	-3,574	-	-3,574
work subcontracted and other external costs	-1,501	-	-1,501	-1,503	-	-1,503
employee benefits costs (5)	-1,352	-	-1,352	-1,342	-	-1,342
depreciation and amortization (5)	-496	-64	-560	-490	-108	-598
other operating costs (5)	-46	-31	-77	-83	-110	-193
<i>costs, discontinued operations</i>	-175	-	-175	-387	-	-387
operating profit (including discontinued operations)	808	-36	772	562	-199	363
<i>less operating profit from discontinued operations</i>	-9	-	-9	-16	-	-16
operating profit from continuing operations	799	-36	763	546	-199	347
net finance costs (6)	-70	-8	-78	-56	-	-56
share of the profit of associates	-2	-15	-17	9	-	9
profit before income tax expense	727	-59	668	499	-199	300
income tax expense (25)	-173	23	-150	-95	57	-38
net profit from continuing operations	554	-36	518	404	-142	262
<i>net profit from discontinued operations</i>	2	-	2	8	-	8
profit for the year	556	-36	520	412	-142	270
profit attributable to minority interests	7	-	7	11	12	23
net profit attributable to equity holders of Royal DSM N.V.	563	-36	527	423	-130	293
earnings per share in euro (7)						
- shares outstanding	2.87		2.68	2.09		1.41
- diluted	2.85		2.66	2.09		1.41

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Consolidated balance sheet

assets	31 December	31 December	31 December
x € million	2005	2004*	2004**
non-current assets			
intangible assets (9)	1,003	453	453
property, plant and equipment (10)	3,750	3,811	3,811
deferred tax assets (11)	517	432	427
associates (12)	43	78	78
prepaid pension costs (13)	405	355	355
other financial assets (14)	189	82	82
	5,907	5,211	5,206
current assets			
inventories (15)	1,535	1,348	1,348
receivables (16)	1,597	1,556	1,566
financial derivatives (26)	36	244	-
current investments	5	6	6
cash and cash equivalents	902	1,261	1,274
	4,075	4,415	4,194
assets classified as held for sale (17)	43	-	-
	4,118	4,415	4,194
total	10,025	9,626	9,400

equity and liabilities

x € million

equity (18)

shareholders' equity	5,474	4,835	5,053
minority interests	67	22	22
	5,541	4,857	5,075

non-current liabilities

deferred tax liabilities (11)	198	147	142
employee benefits liabilities (19)	363	345	345
provisions (20)	145	266	266
borrowings (21)	1,381	1,497	1,118
other non-current liabilities (22)	53	60	60
	2,140	2,315	1,931

current liabilities

employee benefits liabilities (19)	25	40	40
provisions (20)	218	218	218
borrowings (21)	329	527	524
financial derivatives (26)	65	59	-
other current liabilities (23)	1,699	1,610	1,612
	2,336	2,454	2,394
liabilities classified as held for sale (17)	8	-	-
	2,344	2,454	2,394

total	10,025	9,626	9,400
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* Pro forma: after application of IAS 32 and IAS 39.

** Before application of IAS 32 and IAS 39.

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Consolidated statement of changes in equity

x € million	share capital	share premium	treasury shares	other reserves (18)	retained earnings	total shareholders' equity	minority interests	total equity
balance at 1 January 2004	370	548	-179	1	4,380	5,120	44	5,164
translation differences	-	-	-	-46	-10	-56	-4	-60
income tax expense	-	-	-	-6	-	-6	-	-6
total income and expense for the year directly recognized in equity	-	-	-	-52	-10	-62	-4	-66
profit for the year	-	-	-	-	293	293	-23	270
total income and expense for the period	-	-	-	-52	283	231	-27	204
dividends	-	-	-	-	-194	-194	-1	-195
management options	-	-	-	4	-	4	-	4
share buy-backs	-	-	-119	-	-	-119	-	-119
proceeds from re-issued shares	-	-	10	-	1	11	-	11
capital payments	-	-	-	-	-	-	6	6
	370	548	-288	-47	4,470	5,053	22	5,075
adoption of IAS 32 and IAS 39	-66	-167	-	-1	16	-218	-	-218
balance at 31 December 2004, after adoption of IAS 32 and 39	304	381	-288	-48	4,486	4,835	22	4,857
translation differences	-	-	-	121	-	121	7	128
income tax expense	-	-	-	7	-	7	-	7
capital duty	-	-3	-	-	-	-3	-	-3
change in 'hedging' reserve	-	-	-	-2	-	-2	-	-2
total income and expense for the year directly recognized in equity	-	-3	-	126	-	123	7	130
profit for the year	-	-	-	-	527	527	-7	520
total income and expense for the period	-	-3	-	126	527	650	-	650
reclassification cumulative preference shares A	66	167	-	-	-	233	-	233
dividends	-	-	-	-	-183	-183	-3	-186
management options	-	-	-	7	-	7	-	7
share buy-backs	-	-	-170	-	-	-170	-	-170
proceeds from re-issued shares	-	-	82	-	20	102	-	102
change in share of subsidiaries	-	-	-	-	-	-	48	48
balance at 31 December 2005	370	545	-376	85	4,850	5,474	67	5,541

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Consolidated cash flow statement (29)

x € million	2005	2004
<i>operating activities</i>		
net profit	527	293
adjustment for:		
- depreciation, amortization and impairments	567	613
- gain from divestments	-20	-18
- result of associates	23	-9
- dividends received from associates	3	7
- change in provisions	-131	-57
- interest:		
. received	24	30
. paid	-95	-96
. charged to income	78	56
	7	-10
- income taxes:		
. paid	-133	-77
. charged to income	150	38
	17	-39
- post-employment benefits:		
. paid	-104	-120
. charged to income	33	24
	-71	-96
- other changes	-28	5
operating cash flow before changes in working capital	894	689
change in working capital:		
- inventories	-140	69
- receivables	-59	-53
- other current liabilities	-2	193
	-201	209
net cash provided by operating activities	693	898
<i>investing activities</i>		
investments in:		
- intangible assets	-23	-12
- property, plant and equipment	-370	-337
proceeds from sale of property, plant and equipment	28	28
acquisition of subsidiaries	-564	-
proceeds from sale of subsidiaries and businesses	192	-
financial assets:		
- capital payments	-3	-12
- change in loans granted	-107	10
- sale proceeds	2	-
net cash used in investing activities	-845	-323
<i>financing activities</i>		
sale of derivatives	133	-
loans taken up	348	64
redemption of loans	-487	-197
change in debt to credit institutions	42	-103
dividend paid	-183	-194
buy-back of own shares	-170	-119
proceeds from re-issued shares	102	11
change in minority interests	-2	5
capital duty	-3	-
net cash used in financing activities	-220	-533
net change in cash and cash equivalents	-372	42
change IAS 32/39	-	17
cash and cash equivalents at beginning of year	1,261	1,209
exchange differences of cash held and changes in consolidation	13	-7
cash and cash equivalents at end of year	902	1,261

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(1) General information

Unless stated otherwise, all amounts are in € million.

To enhance transparency and readability of the notes to the financial statements, balance sheet items at December 31, 2004 are presented after application of IAS 32 and 39. These standards have been implemented with effect from January 1, 2005 and were applicable during the full year. Therefore, this presentation enhances the comparability of individual balance sheet items and provide a better understanding of changes during the year.

In conformity with article 402, Book 2 of the Dutch Civil Code, a condensed statement of income is included in the Royal DSM N.V. accounts.

A list of DSM participations is published at the Chamber of Commerce for Zuid-Limburg in Maastricht (The Netherlands) and available from the company upon request. The list is also available on the company's website www.dsm.com.

On 5 September 2005 DSM effected a share split on a two-for-one basis (two shares for one old share) in order to increase the liquidity of the DSM share. This split is applicable to the ordinary shares as well as the class A and class B preference shares. In the financial statements the split is considered to be effective as of January 1, 2004. Unless otherwise noted, all relevant per-share data in the financial statements are presented in accordance with the number of shares outstanding after the share split.

The preparation of financial statements requires estimates and judgments that affect the reported amounts of assets and liabilities, revenues and expenses, and related disclosure of contingent assets and liabilities at the date of the financial statements. The policies that management considers both to be most important to the presentation of financial condition and results of operations and to make the most significant demands on management's judgments and estimates about matters that are inherently uncertain are discussed in the notes that are impacted by such estimates and judgements. Management cautions that future events often vary from forecasts and that estimates routinely require adjustment.

Currency exchange rates

The currency exchange rates that were used in drawing up the consolidated statements are listed below for the most important currencies.

1 euro =	exchange rate at balance sheet date		average exchange rate	
	2005	2004	2005	2004
US dollar	1.18	1.36	1.25	1.24
Swiss franc	1.56	1.54	1.55	1.54
Pound sterling	0.69	0.71	0.68	0.68
100 Japanese yen	1.39	1.41	1.37	1.34

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(2) Scope of consolidation**Acquisitions**

On February 2, 2005 DSM acquired 100% of NeoResins (now DSM NeoResins), the coating resins business of Avecia. As of the date of acquisition net sales of NeoResins were € 238 million. The impact of this acquisition on the consolidated balance sheet of DSM, at the date of acquisition, is summarized below:

assets

intangible assets	151
property, plant and equipment	82
deferred tax assets	16
inventories	25
receivables	49
cash and cash equivalents	6
total assets	329

liabilities

provisions	36
deferred tax liabilities	48
other liabilities	80
total liabilities	164
fair value of net assets	165
acquisition price (in cash)	516
acquisition costs	7
goodwill	358

The goodwill relates to items, other than property, plant and equipment, which do not meet the recognition criteria for intangible assets because they do not meet the identifiability criterion (for example customer contacts) or cannot be controlled by the company (for example workforce).

On May 30, 2005 DSM increased its share in Roche Vitamins (Shanghai) Ltd. (now renamed DSM Vitamins (Shanghai) Ltd.) from 64% to 100% and on July 13, 2005 DSM increased its share in DSM Biologics Holding, Inc. from 60% to 100%. On October 16, 2005 DSM acquired the Chinese resins company Syntech.

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Divestments

Discontinued operations

The activities of DSM Bakery Ingredients excluding the joint venture Rymco Pty. Ltd. in South Africa were sold to Gilde Investment Management on June 30, 2005. Rymco was sold to the joint venture partner Daniel Mills & Sons on September 30, 2005. The impact of the deconsolidation of these activities on the consolidated balance sheet of DSM is as follows:

<i>assets</i>	
intangible assets	-4
property, plant and equipment	-96
deferred tax assets	-7
other financial assets	-7
inventories	-27
receivables	-93
cash and cash equivalents	-32
total assets	-266
<i>liabilities</i>	
provisions	-22
borrowings	-2
other liabilities	-56
total liabilities	-80
net asset value	-186
sales price, net of selling costs	200
gain (before income tax expense)	14

The impact of the disposal of DSM Bakery ingredients on the cash flow statement is disclosed in the table below.

	2005	2004
net cash provided by operating activities	10	36
net cash used in investing activities	-1	-3
net cash used in financing activities	0	0
net change in cash and cash equivalents	9	33

Other divestments

On October 31, 2005 DSM sold the Styrene-Butadiene-Rubber (SBR) business to Lion Chemical Capital LLC in the form of an asset deal.

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(3) Segment information

Business segments 2005

	continuing operations						eliminations	total, continuing operations	discontinued operations	total
	Life Science Products	DSM Nutritional Products	Performance Materials	Industrial Chemicals	Other activities**					
<i>financial performance</i>										
net sales	1,479	1,914	2,447	1,687	485	-	8,012	183	8,195	
deliveries to other clusters	52	32	12	212	13	-321	-	-	-	
supplies	1,531	1,946	2,459	1,899	498	-321	8,012	183	8,195	
operating profit (excluding exceptional items)	126	252	305	165	-49	-	799	9	808	
exceptional items	-91	9	4	-	42	-	-36	-	-36	
operating profit	35	261	309	165	-7	-	763	9	772	
depreciation and amortization	-140	-124	-105	-81	-46	-	-496	-7	-503	
additions to provisions	-42	-20	-1	-2	-24	-	-89	-	-89	
share in result of associates	-	1	-	-1	-2	-	-2	-	-2	
R&D costs	-93	-80	-94	-14	-8	-	-289	-1	-290	
labor costs***	-329	-379	-258	-103	-236	-	-1,305	-32	-1,337	
<i>financial position</i>										
total assets	2,330	3,246	2,504	1,403	10,166	-9,624	10,025	-	10,025	
total liabilities	2,082	1,492	1,418	889	3,465	-4,862	4,484	-	4,484	
capital employed at year-end	1,753	1,830	1,737	728	173	-	6,221	-	6,221	
capital expenditure	97	97	667	85	26	-	972	2	974	
share in equity of associates	2	7	-	27	7	-	43	-	43	
<i>financial ratios in %</i>										
EBITDA / net sales	18.0	19.6	16.8	14.6						
R&D costs / net sales	6.3	4.2	3.8	0.8	1.6	-	3.6	0.5	3.5	
<i>workforce*</i>										
average	6,403	6,285	4,302	2,312	2,758	-	22,060	779	22,839	
year-end	6,239	6,119	4,441	2,234	2,787	-	21,820	-	21,820	

* The workforce of joint ventures has been included on a proportionate basis.

** Other activities also include costs for defined benefit pension plans, corporate overhead and share-based compensation. A reliable allocation of the costs for defined benefit pension plans to the individual clusters is not available, because these costs relate to both active and inactive employees.

*** Wages, salaries and social security costs.

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Business segments 2004

	continuing operations						discontinued operations	total	
	Life Science Products	DSM Nutritional Products	Performance Materials	Industrial Chemicals	Other activities**	eliminations	total, continuing operations		
<i>financial performance</i>									
net sales	1,484	1,899	2,007	1,570	474	-	7,434	398	7,832
deliveries to other clusters	98	11	6	177	11	-303	-	-	-
supplies	1,582	1,910	2,013	1,747	485	-303	7,434	398	7,832
<i>operating profit</i>									
(excluding exceptional items)	79	202	165	120	-20	-	546	16	562
exceptional items	-168	-	19	-	-50	-	-199	-	-199
operating profit	-89	202	184	120	-70	-	347	16	363
<i>depreciation and amortization</i>									
	-147	-128	-84	-87	-44	-	-490	-15	-505
additions to provisions	-62	-56	-11	-4	-50	-	-183	-	-183
share in result of associates	0	1	-2	2	8	-	9	0	9
R&D costs	-98	-75	-78	-16	-11	-	-278	-8	-286
labor costs***	-365	-403	-218	-113	-215	-	-1,314	-68	-1,382
<i>financial position</i>									
total assets	2,421	2,907	1,701	1,224	9,199	-8,083	9,369	257	9,626
total liabilities	1,992	1,324	1,195	776	4,155	-4,826	4,616	153	4,769
capital employed at year-end	1,704	1,694	988	673	331	-	5,390	168	5,558
capital expenditure	124	55	64	75	26	-	344	4	348
share in equity of associates	2	3	1	34	29	-	69	7	76
<i>financial ratios in %</i>									
EBITDA / net sales	15.2	17.4	12.4	13.2					
R&D costs / net sales	6.6	3.9	3.9	1.0	2.3	-	3.7	2.0	3.7
<i>workforce*</i>									
average	6,950	6,868	3,687	2,581	2,891	-	22,977	1,526	24,503
year-end	6,836	6,607	3,735	2,566	2,953	-	22,697	1,507	24,204

* The workforce of joint ventures has been included on a proportionate basis.

** Other activities also include costs for defined benefit pension plans, corporate overhead and share-based compensation. A reliable allocation of the costs for defined benefit pension plans to the individual clusters is not available, because these costs relate to both active and inactive employees.

*** Wages, salaries and social security costs.

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Geographical areas

2005	the Netherlands	rest of Europe	North America	China	rest of Asia-Pacific	rest of the world	eliminations	total
net sales* by origin								
in € million	3,549	2,240	1,304	300	333	286	-	8,012
in %	44	28	16	4	4	4	-	100
net sales* by destination								
in € million	867	3,220	1,707	498	1,068	652	-	8,012
in %	11	40	21	6	14	8	-	100
total assets	8,967	3,580	1,708	585	373	455	-5,643	10,025
capital expenditure on property, plant and equipment	119	82	105	62	4	6	-	378
carrying amount of property, plant and equipment	1,405	1,377	523	332	59	54	-	3,750
workforce** at year-end	7,258	6,948	2,764	2,581	1,156	1,113	-	21,820
2004								
net sales* by origin								
in € million	3,200	2,162	1,258	275	305	234	-	7,434
in %	43	29	17	4	4	3	-	100
net sales* by destination								
in € million	836	2,941	1,619	427	876	735	-	7,434
in %	11	39	22	6	12	10	-	100
total assets	8,516	3,617	1,427	430	323	444	-5,131	9,626
capital expenditure on property, plant and equipment	118	74	72	34	2	4	-	304
carrying amount of property, plant and equipment	1,436	1,517	474	233	68	83	-	3,811
workforce** at year-end	7,553	8,126	3,291	2,439	1,121	1,674	-	24,204

* Continuing operations only.

** The workforce of joint ventures has been included on a proportionate basis.

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(4) Other operating income

	2005	2004
continuing operations		
release of provisions	41	35
settlements	25	-
government grants	18	13
gain on assets and emission rights sold	20	22
insurance claims	6	16
proceeds from the sale of scrap, waste materials, etc.	10	13
sundry	101	96
total other operating income, before exceptional items	221	195
exceptional items (see note 8)	59	19
total, continuing operations	280	214
total, discontinued operations	2	2
total	282	216

The government grants include an amount of € 6 million (2004: € 5 million) for investment grants.

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(5) Specification of Employee benefits costs, Depreciation and amortization and Other operating costs

	2005	2004
<i>employee benefits costs:</i>		
in continuing operations		
- wages and salaries	1,119	1,117
- social security costs	186	197
- post-employment benefits (see also note 27)	47	28
total, continuing operations	1,352	1,342
total, discontinued operations	33	69
total	1,385	1,411
<i>depreciation and amortization:</i>		
in continuing operations		
- amortization of intangible assets	34	21
- depreciation of property, plant and equipment	440	455
- impairments	22	14
total depreciation and amortization, before exceptional items	496	490
- exceptional items (see note 8)	64	108
total, continuing operations	560	598
total, discontinued operations	7	15
total	567	613
<i>other operating costs:</i>		
in continuing operations		
- additions to provisions	31	60
- exchange differences	3	23
- sundry	12	0
total other operating costs, before exceptional items	46	83
- exceptional items (see note 8)	31	110
total, continuing operations	77	193
total, discontinued operations	-	-7
total	77	186

(6) Net finance costs

	2005	2004
interest income	19	22
interest expense	-92	-88
capitalized interest during construction	6	6
net interest costs	-67	-60
exchange differences	-7	-
income from other securities	1	3
interest charge on discounted provisions	-2	-
sundry	5	1
total, net finance costs, before exceptional items	-70	-56
interest expense on exceptional items (see note 8)	-8	-
total, continuing operations	-78	-56

In 2005 the interest rate applied in the capitalization of interest during construction was 5% (2004: 5%).

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(7) Earnings per ordinary share

	continuing operations before ex- ceptional items	discon- tinued opera- tions	result before ex- ceptional items	excep- tional items	total
2005					
net profit attributable to equity holders of Royal DSM N.V.	561	2	563	-36	527
dividend on cumulative preference shares	-16	-	-16	-	-16
net profit used for calculating earnings per share	545	2	547	-36	511
average number of ordinary shares outstanding (x 1,000)	190,783	-	190,783	-	190,783
effect of dilution:					
- share options	1,066	-	1,066	-	1,066
adjusted weighted average number of ordinary shares	191,849	-	191,849	-	191,849
earnings per share in euro:					
- shares outstanding	2.86	0.01	2.87	-0.19	2.68
- diluted	2.84	0.01	2.85	-0.19	2.66
dividend paid in 2005 per share in euro	0.875	-	0.875	-	0.875

2004

net profit attributable to equity holders of Royal DSM N.V.	415	8	423	-130	293
dividend on cumulative preference shares	-22	-	-22	-	-22
net profit used for calculating earnings per share	393	8	401	-130	271
average number of ordinary shares outstanding (x 1,000)	191,617	-	191,617	-	191,617
effect of dilution:					
- share options	375	-	375	-	375
- convertible debenture loan	14	-	14	-	14
adjusted weighted average number of ordinary shares	192,006	-	192,006	-	192,006
earnings per share in euro:					
- shares outstanding	2.05	0.04	2.09	-0.68	1.41
- diluted	2.05	0.04	2.09	-0.68	1.41
dividend paid in 2004 per share in euro	0.875	-	0.875	-	0.875

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(8) Exceptional items

	2005	2004
exceptional income:		
- gain from the sale of activities	23	19
- release of provision for environmental costs	36	-
total exceptional income	59	19
exceptional expense:		
- loss from the sale of activities	-3	-
- additions to provisions for reorganization costs and severance payments	-28	-94
- additions to other provisions	-	-15
- impairment of intangible assets and property, plant and equipment	-64	-108
- impairment of other assets	-	-1
total exceptional expense	-95	-218
	-36	-199
net finance costs	-8	-
share of the profit of associates (net)	-15	-
total, exceptional items (before income tax expense)	-59	-199
income tax expense	23	57
total, exceptional items after income tax expense	-36	-142
minority interests	-	12
net result from exceptional items	-36	-130

2005

The gain from the sale of activities relates to book profits on the sale of DSM Bakery Ingredients and on the sale of land (DSM Nutritional Products). Jurisprudence showed that a provision for environmental costs could be released. The loss from the sale of activities is related to the sale of the SBR business. The addition to provisions for reorganization and severance costs is mainly the balance of restructuring and reorganization costs at the Linz site in Austria (€ 15 million) and expenses due to the closing of the South Haven site (USA) of DSM Pharmaceutical Products (€ 11 million). The impairment of intangible assets and property, plant and equipment relates to impairment of property, plant and equipment at the Linz site (€ 6 million), the South Haven site (€ 27 million) and the Montreal site in Canada (€ 31 million). The net finance costs are related to interest payments in connection with a final tax assessment in the Netherlands for the years 1997 and 1998. The share of profit of associates (net) concerns an impairment of DSM's share in Methanor. The income tax expense on exceptional items also includes the recognition of withholding tax credits over previous years and the settlement of tax returns in the Netherlands over previous years.

2004

The exceptional income in 2004 related to book profits on the sale of land (Performance Materials). The addition to provisions for reorganization and severance costs is the balance of restructuring and reorganization costs at DSM Anti-Infectives (€ 44 million) and in the production organization at the Geleen site in the Netherlands (€ 50 million, Other activities). The addition to the other provisions relates to an onerous purchasing contract in the field of anti-infectives. The impairment of assets relates entirely to the restructuring measures and reorganizations in the Life Science Products cluster.

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(9) Intangible assets

	total	goodwill	licences and patents	other
balance at 31 December 2003				
cost	515	355	72	88
amortization	64	-	38	26
carrying amount	451	355	34	62
changes in carrying amount:				
- capital expenditure	44	-	17	27
- acquisitions	-	-	-	-
- disposals	-	-	-	-
- amortization	-22	-	-10	-12
- impairments	-1	-	-1	-
- exchange differences	-32	-29	-2	-1
- reclassifications	14	-	13	1
- other	-1	-	-1	0
	2	-29	16	15
balance at 31 December 2004				
cost	545	326	102	117
amortization	92	-	52	40
carrying amount	453	326	50	77
changes in carrying amount:				
- capital expenditure	24	-	19	5
- acquisitions	526	368	7	151
- disposals	-4	-	-	-4
- amortization	-35	-	-7	-28
- exchange differences	54	48	5	1
- classified as held for sale	-13	-	-13	-
- reclassifications	-2	0	0	-2
- other	0	-	-6	6
	550	416	5	129
balance at 31 December 2005				
cost	1,110	742	93	275
amortization	107	-	38	69
carrying amount	1,003	742	55	206

DSM acquired several entities in business combinations that have been accounted for by the purchase method, resulting in recognition of goodwill and other intangible assets. The amounts assigned to the acquired assets and liabilities are based on assumptions and estimates about their fair values. In making these estimates, management consults independent, qualified appraisers if appropriate. A change in assumptions and estimates could change the values allocated to certain assets and estimated economic lives, which could affect the amount or timing of charges to the income statement, such as amortization of intangible assets.

The carrying amount of goodwill as at 31 December 2005 includes an amount of € 366 million relating to the acquisition of Catalytica in 2001 and an amount of € 358 million relating to the acquisition of NeoResins in 2005. The goodwill of Catalytica is allocated to DSM Pharmaceuticals Inc. (DPI) as cash generating unit and tested annually for impairment on the basis of the Annual Strategic Review (ASR) for the business. The goodwill of NeoResins is tested at the level of the DSM Coating Resins and DSM Composite Resins business groups (which are in the process of being merged into the new DSM Resins). In all cases the carrying amount is tested against the fair value of the business. Fair value is based on parameters, which are common for the industry in acquisitions of similar businesses. This includes a 10-year cash flow and a terminal value without growth. Discount rates applied are between 6 and 8%.

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The other intangible assets include:

	cost	amorti- zation	carrying amount	of which acquisition related
application software	100	44	56	8
marketing-related	11	3	8	7
customer-related	3	2	1	-
technology-based	154	19	135	126
other	7	1	6	-
total	275	69	206	141

(10) Property, plant and equipment

	total	land and buildings	plant and machinery	other equip- ment	under construc- tion	not used for operating activities
balance at 31 December 2003						
cost	8,843	1,629	6,284	306	611	13
depreciation	4,644	595	3,794	246	6	3
carrying amount	4,199	1,034	2,490	60	605	10
changes in carrying amount:						
- capital expenditure	304	19	86	5	194	-
- put into operation	-	34	393	14	-441	-
- disposals	-10	-3	-5	-1	-	-1
- depreciation	-469	-55	-392	-22	-	-
- impairments	-147	-14	-93	-	-40	-
- exchange differences	-56	-12	-35	-1	-8	-
- reclassifications	-14	-13	-1	-	-	-
- other	4	8	-4	-	-3	3
	-388	-36	-51	-5	-298	2
balance at 31 December 2004						
cost	8,838	1,635	6,566	299	323	15
depreciation	5,027	637	4,127	244	16	3
carrying amount	3,811	998	2,439	55	307	12
changes in carrying amount:						
- capital expenditure	378	16	94	4	264	-
- put into operation	-	39	218	7	-264	-
- acquisitions	88	48	30	1	9	-
- disposals	-126	-44	-63	-15	-4	-
- depreciation	-446	-57	-372	-17	-	-
- impairments	-86	-26	-33	-1	-26	-
- exchange differences	140	34	85	1	20	-
- classified as held for sale	-6	-1	-5	-	-	-
- other	-3	8	-8	-3	-	-
	-61	17	-54	-23	-1	-
balance at 31 December 2005						
cost	8,804	1,664	6,483	284	343	30
depreciation	5,054	649	4,098	252	37	18
carrying amount	3,750	1,015	2,385	32	306	12

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Property, plant and equipment includes assets acquired under finance lease agreements with a carrying amount of € 34 million (31 December 2004: € 49 million). The related commitments are included under Borrowings and amount to € 22 million (31 December 2004: € 40 million). The total of the minimum lease payments at the balance sheet date amount to € 25 million and their present values to € 24 million.

Overview of minimum lease payments in time:

	lease
2006	14
2007 - 2010	6
after 2010	5
total	25

(11) Deferred taxes

	2005	2004
deferred tax assets	517	432
deferred tax liabilities	198	147
net deferred tax assets	319	285

On balance net deferred tax assets increased by € 34 million owing to the following changes:

balance at 31 December 2004	285
deferred tax expense	-14
income tax expense recognized in equity	7
acquisitions and disposals	-37
exchange rate differences	21
other	57
balance at 31 December 2005	319

The changes under the heading "other" consist for the greater part of reclassifications.

(12) Associates

	2005	2004
balance at beginning of year	78	76
changes:		
- share of profit	-2	9
- dividends	-3	-7
- capital payments	2	6
- acquisitions	2	-
- disposals	-9	-
- other value changes	-21	-
- transfers	-2	-
- other	-2	-6
balance at end of year	43	78
of which loans issued	-	2

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(13) Prepaid pension costs

	2005	2004
balance at beginning of year	355	286
changes:		
- charged to income	13	10
- employer contributions	35	59
- reclassifications	2	-
balance at end of year	405	355

For more details see also note 27.

(14) Other financial assets

	total	other securities	other receivables	other deferred items
balance at 31 December 2003	92	41	15	36
changes:				
- charged to income	-3	-	-	-3
- capital payments	6	6	-	-
- loans issued	1	-	1	-
- redemptions	-5	-	-5	-
- exchange differences	1	-	1	-
- transfers to current assets	-6	-	-	-6
- other	-4	-1	-1	-2
balance at 31 December 2004	82	46	11	25
changes:				
- charged to income	-3	-	-	-3
- capital payments	4	4	-	-
- disposals	-3	-2	-1	-
- advances	3	-	3	-
- loans issued	111	-	111	-
- redemptions	-5	-	-5	-
- exchange differences	4	-	3	1
- transfers to current assets	-4	1	1	-6
balance at 31 December 2005	189	49	123	17

Other securities relate to equity instruments in companies with activities that support DSM's business, such as venture funds. In Other securities an amount of € 45 million is included that relates to unquoted equity instruments for which the fair value cannot be measured reliably because there is no quoted price in the active market for these equity instruments. These securities are therefore held at cost.

The increase in loans issued relates for the major part to a loan to the Gist-brocades pension fund.

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(15) Inventories

	2005	2004
raw materials and consumables, at cost	442	540
intermediates and finished goods, at cost	1,120	850
	1,562	1,390
adjustments to lower net realizable value	-27	-42
total	1,535	1,348

The carrying amount of inventories adjusted to net realizable value is € 78 million, the value adjustments of inventories charged to the income statement was € 4 million.

(16) Receivables

	2005	2004
trade accounts receivable	1,350	1,261
receivable from associates	13	25
income taxes receivable	58	68
other taxes and social security contributions	92	89
government grants	3	7
other receivables	59	63
deferred items	48	66
	1,623	1,579
adjustments for bad debts	-26	-23
total	1,597	1,556

In government grants an amount of € 2 million (2004: € 3 million) for investment grants and an amount of € 1 million (2004: € 4 million) for cost grants is included.

(17) Assets and liabilities classified as held for sale

Assets and liabilities classified as held for sale are related to the expected disposal of the DSM Minera business unit and comprise the following:

assets

intangible assets	13	
property, plant and equipment	6	
inventories	13	
receivables	11	
total assets		43

liabilities

other current liabilities	8	
total liabilities		8

The sale of Minera was signed and closed on January 19, 2006, with an effective date of January 1, 2006.

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(18) Equity

	2005	2004
balance at beginning of year	4,857	5,164
net profit for 2005	520	270
reclassification cumulative preference shares A	233	-233
exchange differences, net of income tax expense	135	-66
dividends paid	-186	-195
buy-back of ordinary shares	-170	-119
proceeds from re-issue of ordinary shares	102	11
other changes	50	25
balance at end of year	5,541	4,857

On January 1, 2005, the date of first-time application of IAS 32/39, it was not unequivocally clear that the cumulative preference shares A met all the requirements for an equity instrument as set out in IAS 32 paragraph 16. This was clarified in the course of the first quarter, by adaptation of the contract with the holders of these shares. For this reason the cumulative preference shares were recognized in the opening balance sheet of 2005 (which includes application of IAS 32/39) as debt, which was reversed in the course of the first quarter.

Details of the impact of IFRS on shareholders' equity is explained in note 35: first-time adoption of IFRS by DSM.

After the balance sheet date the following dividends were established by the Managing Board:

	2005	2004
€ 0.36 per cumulative preference share A (2004: € 0.36)	16	16
€ -.- per cumulative preference share C (2004: € 0.16)	-	-
€ 1.00 per ordinary share (2004: € 0.875)	191	168
total	207	190

The proposed dividend on ordinary shares is subject to approval by shareholders at the Annual General Meeting and has not been deducted from equity.

Share capital

On 31 December 2005 the authorized share capital amounted to € 1,125 million, distributed over 306,960,000 ordinary shares, 44,040,000 cumulative preference shares A and 375,000,000 cumulative preference shares B with a par value of € 1.50 each, and 1,200,000,000 cumulative preference shares C with a par value of € 0.03 each. The changes in the number of shares in 2005 are shown in the table below.

	ordinary	shares in issue cumprefs A	cumprefs C	treasury shares ordinary	cumprefs C
situation as at 31 December 2004*	201,953,008	44,040,000	37,500,000	9,996,112	37,500,000
re-issue of shares in connection with					
exercise of options	-	-	-	-5,108,069	-
buy-back of own shares	-	-	-	6,142,000	-
situation as at 31 December 2005	201,953,008	44,040,000	37,500,000	11,030,043	37,500,000
number of treasury shares as					
at 31 December 2005	11,030,043	-	37,500,000		
number of shares outstanding as					
at 31 December 2005	190,922,965	44,040,000	-		

* In this overview the split of the DSM shares is considered to be effective as of December 31, 2004.

The average number of ordinary shares outstanding in 2005 was 190,783,006. All shares in issue are fully paid.

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Share premium

Of the total Share premium of € 545 million, an amount of € 139 million can be regarded as entirely free of tax.

Ordinary shares held in treasury

On 31 December 2004 DSM possessed 9,996,112 ordinary shares (nominal value € 15 million, 4.1% of the share capital). In 2005, DSM used 5,108,069 ordinary shares for servicing option rights. The company bought back 6,142,000 ordinary shares.

On 31 December 2005 DSM possessed 11,030,043 ordinary shares (nominal value € 17 million, 4.5% of the share capital). The average purchase price of the ordinary treasury shares was € 23.82. The ordinary treasury shares will be used for servicing management and personnel share option rights.

Other reserves

	translation reserve	'hedging' reserve	fair value reserve	reserve for share-based compensation	total
balance at 31 December 2004	-51	-1	-	4	-48
fair value changes of cash flow hedges	-	-2	0	-	-2
exchange differences, net	128	-	-	-	128
options granted	-	-	-	7	7
balance at 31 December 2005	77	-3	0	11	85

(19) Employee benefits liabilities

	2005	2004
balance at beginning of year	385	425
expenses	46	34
acquisitions	34	-
disposals	-31	-
employer contribution	-69	-61
exchange differences	13	-8
other changes	10	-5
balance at end of year	388	385
of which current	25	40

The Employee benefits liabilities of € 388 million (2004: € 385 million) include € 321 million (2004: € 314 million) related to liabilities from defined benefit and medical care plans, other long-term employee benefits such as jubilee benefits and long-term compensated absences for an amount of € 21 million (2004: € 17 million) and € 46 million (2004: € 54 million) for other plans. The liability for post-employment benefits is explained in detail in note 27.

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(20) Provisions

	2005		2004	
	total	of which current	total	of which current
restructuring costs and termination benefits	207	156	306	175
environmental costs	54	24	91	21
other provisions	102	38	87	22
total	363	218	484	218

Where the effect of the time value of money is material, provisions are measured at the present value of the expenditures expected to be required to settle the obligation. The discount rate used is based on swap rates for various terms, increased with 75 to 100 base points depending on those terms.

The Provision for restructuring costs and termination benefits mainly includes the costs of redundancy schemes relating to the dismissal and transfer of employees, costs of termination of contracts and consulting fees. These provisions have an average life of 1 to 3 years.

The Provision for environmental costs relates to soil clean-up obligations, among other things. These provisions have an average life of more than 10 years.

Several items have been combined under Other provisions, for example obligations ensuing from drilling platform decommissioning and site restoration, expenses relating to claims and onerous contracts. These provisions have an average life of 5 to 10 years.

The total of non-current and current provisions decreased by € 121 million. This is the balance of the following changes:

	balance at 1 January 2005	additions	releases	uses	exchange differences	other changes	balance at 31 December 2005
restructuring costs and termination benefits	306	45	-7	-145	5	3	207
environmental costs	91	11	-36	-12	2	-2	54
other provisions	87	33	-2	-18	1	1	102
total	484	89	-45	-175	8	2	363

The other changes include amounts relating to transfers to and from other balance-sheet items.

The addition to the Provision for restructuring costs and termination benefits mainly relates to the Life Science Products cluster (€ 28 million) and DSM Nutritional Products (€ 15 million). The withdrawal from this provision concerns expenditure related to restructuring operations at DSM Pharmaceutical Products, DSM Food Specialties, DSM Anti-Infectives, DSM Nutritional Products, DSM Elastomers and DSM Industrial Services (Copernicus project).

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(21) Borrowings

	2005		2004	
	total	of which current	total	of which current
debenture loans	1,057	140	1,131	383
private loans	492	37	538	46
finance lease liabilities	22	13	40	16
credit institutions	139	139	82	82
	1,710	329	1,791	527
cumulative preference shares A	-	-	233	-
total	1,710	329	2,024	527

For more information relating to the reclassification of cumulative preference shares A see note 18.

In agreements governing loans with a residual amount at year-end 2005 of € 1,322 million, of which € 147 million of a short-term nature (31 December 2004: € 1,392 million, of which € 400 million short term), clauses have been included which restrict the provision of security. The documentation of the € 300 million bond issued in November 2005 includes a change of control clause. This clause allows the bond investors to request repayment at par if 50% or more of the DSM shares are controlled by a third party and if the company is downgraded below investment grade (< BBB-). For private loans no collateral was furnished (31 December 2004: also zero).

At 31 December 2005, borrowings to a total of € 630 million had a remaining term of more than 5 years. The schedule of repayment of borrowings excluding credit institutions is as follows:

- 2006	190
- 2007	462
- 2008	36
- 2009 and 2010	253
- 2011 through 2015	630
- after 2015	0
total	1,571

A breakdown of the borrowings, excluding debt to credit institutions and cumulative preference shares, by currency is given below:

	2005	2004
EUR	986	1,117
USD	459	407
CNY	124	107
CAD	-	56
ZAR	-	16
other	2	6
total	1,571	1,709

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On balance, total borrowings decreased by € 314 million owing to the following changes:

balance at 31 December 2004	2,024
loans taken up	348
redemptions	-487
changes in fair value	-27
changes in credit institutions	42
exchange differences	100
reclassification of cumulative preference shares A	-233
transfer	-1
other changes	-56
balance at 31 December 2005	1,710

The changes in fair value of external borrowings are offset by the changes in fair value of related financial derivatives (see also note 26).

The other changes related to the increase of DSM's share in DSM Biologics Holdings, Inc.

The average effective interest rate on the portfolio of borrowings, including financial instruments related to these borrowings, outstanding in 2005 amounted to 4.1% in 2005 (2004: 4.2%).

A breakdown of debenture loans is given below:

			2005	2004
4.75%	DEM loan	1998-2005	-	383
6.25%	NLG loan	1996-2006	140	143
6.75%	USD loan	1999-2009	204	182
6.38%	EUR loan	2000-2007	413	423
4.00%	EUR loan	2005-2015	300	-
total			1,057	1,131

All debenture loans have a fixed interest rate. The fixed interest rate of the 6.25% NLG loan 1996-2006, the 6.75% USD loan 1999-2009 and the 6.38% EUR loan 2000-2007 have been swapped to floating rates by means of interest rate swaps (fair value hedges). The 6.38% EUR loan 2000-2007 was swapped into US dollars in 2000 to hedge the currency risk of net investments in US dollar denominated subsidiaries. This net investment hedge was unwound in 2005. In 2005 this EUR loan was swapped into Swiss francs to hedge the currency risk of net investments in Swiss franc denominated subsidiaries.

The 4.00% EUR loan 2005-2015 was pre-hedged (cash flow hedge) in 2005 as a forecast transaction, which led to an effective lower fixed interest rate of 3.66%.

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Private loans breakdown is given below:

			2005	2004
9.22%	NLG loan	1990-2005	-	12
9.3%	NLG loan	1991-2006	7	7
4.34%	NLG loan	1998-2008	11	15
floating (6 months)	NLG loan	2000-2014	69	67
floating	CNY loan	2002-2005	-	20
12.9%	ZAR loan	2002-2006	-	16
floating (indefinite)	CNY loan	2002-2010	123	87
5.51%	USD loan	2003-2013	128	115
5.61%	USD loan	2003-2015	127	110
3.67%	CAD loans		-	46
	other loans		27	43
total			492	538

The fixed interest rate of the 5.51% USD loan 2003-2013 was swapped into a floating rate by means of an interest rate swap (fair value hedge). During 2005 this interest rate swap was unwound. The gain from this will be amortized until the maturity date, leading to an effective fixed US dollar interest rate of 4.29% for the loan.

The currency component of the 5.61% USD loan 2003-2015 was swapped into euros (cash flow hedge). The resulting EUR obligation was swapped into Swiss francs to hedge the currency risk of net investments in Swiss-franc-denominated subsidiaries (net investment hedge).

DSM's policy regarding financial risk management is described in note 26.

(22) Other non-current liabilities

	2005	2004
government grants	37	38
other deferred items	16	22
total	53	60

The government grants include an amount of € 37 million (2004: € 38 million) in investment grants.

(23) Other current liabilities

	2005	2004
received in advance	8	3
trade accounts payable	960	845
notes and checks due	3	6
owing to associates	14	38
income taxes payable	57	29
other taxes and social security contributions	64	65
pensions	4	0
other liabilities	205	210
deferred items	384	414
total	1,699	1,610

In the 'deferred items' an amount of € 1 million (2004: € 1 million) in cost grants is included.

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(24) Contingent assets and contingent liabilities

Contingent liabilities

	2005	2004
operating leases	34	23
guarantee obligations on behalf of associates and third parties	28	19
outstanding orders for projects under construction	8	11
other	17	6
total	87	59

Most of the outstanding orders for projects under construction will be completed in 2006.

The commitments for operating leases are spread as follows:

- 2006	9
- 2007	6
- 2008	4
- 2009 and 2010	5
- after 2010	10
total	34

Litigation

There is an ongoing investigation into possible restrictive and/or concerted practices involving a number of EPDM producers, including DSM, launched by the European Commission and the US Department of Justice at the end of 2002. DSM is cooperating fully in this investigation and will continue to do so for as long as necessary. The investigation has prompted various buyers to institute proceedings for damage against a number of EPDM producers, including DSM. These proceedings include a class action brought before the United States District Court in Connecticut.

There is a process in place to monitor legal claims periodically and systematically.

(25) Income tax expense

As part of the process of preparing consolidated financial statements, DSM is required to estimate income tax expense in each of the jurisdictions in which it conducts business. This process involves estimating actual current tax expense and temporary differences between tax and commercial reporting. Temporary differences result in deferred tax assets and liabilities, which are included in the consolidated balance sheet. The Company has to assess the likelihood that deferred tax assets will be recovered from future taxable income. Deferred tax assets are reduced if, and to the extent that, it is not probable that all or some portion of the deferred tax assets will be realized. In the event that actual results differ from estimates in future periods, and depending on tax strategies that DSM may be able to implement, changes to the valuation of deferred taxes could be required, which could impact on the financial position and net income.

The tax expense on the total result was € 150 million (2004: € 38 million). In 2005 the exceptional items included a tax gain of € 23 million, compared with a gain of € 57 million in 2004.

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The tax expense can be broken down as follows:

	2005	2004
total tax on result from continuing operations, before exceptional items	-173	-95
tax on exceptional items	23	57
total tax expense from continuing operations	-150	-38
of which:		
current tax expense		
- current year	-82	14
- prior year adjustments	-54	38
	-136	52
deferred tax expense		
- originating from and reversal of temporary differences	-93	-163
- prior year adjustments	69	-23
- change in tax rate	-3	30
- benefit of tax losses and tax credits recognized	13	66
	-14	-90
total tax expense	-150	-38

The relationship between the domestic income tax rate and the effective tax rate is as follows:

as a %	2005	2004
domestic income tax rate	31.5	34.5
tax effects of		
- deviating rates	-9.9	-14.5
- tax-exempt income and non-deductible expense	-0.9	-
- other effects	3.0	-0.6
effective tax rate excluding exceptional items	23.7	19.4
effective tax rate including exceptional items	21.9	13.1

The difference in effective tax rate including and excluding exceptional items in 2005 was due to the fact that exceptional items included a separate (positive) tax item. The difference in 2004 was caused by the relatively high tax rate on the exceptional loss.

No deferred tax assets were recognized for losses carried forward amounting to € 115 million (2004: € 121 million).

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The deferred tax assets and liabilities relate to the following balance sheet categories:

	December 31, 2005		December 31, 2004	
	deferred tax asset	deferred tax liability	deferred tax asset	deferred tax liability
intangible assets	25	47	11	1
property, plant and equipment	72	295	55	229
financial assets	35	15	60	74
other non-current assets	2	123	2	122
inventories	52	35	42	35
receivables	3	1	34	3
other current assets	3	0	0	7
equity	0	10	1	12
other non-current liabilities	29	7	27	3
non-current provisions	69	11	133	9
non-current borrowings	9	6	37	12
other current liabilities	57	7	27	28
tax losses carried forward	520	-	391	-
	876	557	820	535
set-off	-359	-359	-388	-388
total	517	198	432	147

(26) Financial instruments

Policies on financial risks

General

DSM is exposed to several financial risks: liquidity risk, currency risk, interest rate risk and credit risk. DSM's financial risk policy is aimed at minimizing the effects of fluctuations in currency exchange and interest rates on its results in the short term and following the market exchange rates and interest rates in the long term. Within DSM financial risk management is centralized. DSM uses financial derivatives to manage financial risks relating to business operations. DSM does not use derivative instruments for trading purposes.

Liquidity risk

At DSM cash management is carried out centrally insofar as this is possible via an "In-house Bank". To this end, in the major countries use is made of cash pools operating mainly via zero-balancing agreements. DSM has two confirmed credit facilities of € 400 million and € 500 million amounting to a total of € 900 million (2004: three credit facilities) and two commercial paper programs, one amounting to € 900 million (2004: € 900 million) and the other amounting to \$ 400 million (2004: \$ 400 million). The company will use the two commercial paper programs to a total of not more than € 900 million (2004: € 900 million).

Currency risk

The currency risk arises from recognized assets and liabilities, firm commitments and forecast transactions, denominated in currencies other than the euro. The currencies giving rise to this risk are primarily the US dollar, the UK pound and the Swiss franc. DSM uses currency forward contracts, spot contracts and – to a limited extent – currency options to hedge the exposure to fluctuations in foreign exchange rates. In general, currency forward contracts and currency options have maturities of less than one year. It is DSM's policy to hedge 100% of the currency risks resulting from sales and purchases at the moment of recognition of the trade receivables and trade payables. In addition, operating companies may opt – under strict conditions – for hedging currency risks from firm commitments. Currency risks arising from forecast transactions denominated in US dollar are in some instances hedged, following a decision to that effect by the Managing Board. This kind of hedge is treated as cash flow hedges.

The currency risk associated with the translation of DSM's net investment in entities denominated in currencies other than the euro is partially hedged. Swiss-franc-denominated net assets have to some extent been hedged by currency swaps (CHF 826 million). US-dollar-denominated net assets have to some extent been hedged through USD loans (USD 400 million). The reason for these hedges is the relatively high level of foreign-currency-denominated net investments.

Interest rate risk

DSM's interest rate risk policy is aimed at minimizing the interest rate risks associated with the financing of the company and thus at the same time optimizing the net finance costs. Interest rate instruments will be applied only on the basis of underlying positions. This policy translates into a certain desired profile of fixed interest and floating interest positions, with the floating interest position in principle not exceeding 60% of net debt. DSM manages interest rate risks by means of interest rate swaps and, to a limited extent, the purchase of interest rate options.

Market values

Financial assets and financial liabilities are initially recognized at cost, being the fair value of the proceeds received, net of transaction costs. Subsequently, the estimated fair value of financial instruments is determined by using available market information and appropriate valuation methods. The fair value of derivatives and borrowings has been calculated by discounting the expected cash flows at prevailing interest rates. For the loans included in the non-current financial assets, trade accounts receivable, cash and cash equivalents, and trade accounts payable, the carrying amount approximates the fair value.

Borrowings are valued at amortized cost, with the exception of the loans related to fair value hedges.

Hedge accounting

DSM applies the following hedge accounting models: fair value hedge accounting, cash flow hedge accounting and net investment hedge accounting, to manage the risks as mentioned above. The goal of a **fair value hedge** is to fix the value of an asset/liability (hedged item). Changes in fair value of a designated derivative that is highly effective as a fair value hedge, together with the change in fair value of the corresponding asset, liability or firm commitment attributable to the hedged risk, are included directly in earnings. So both fair value changes are offset in the income statement. The goal of a **cash flow hedge** is to limit the variability of highly probable future cash flows due to foreign currency or interest rate movements. Changes in fair value of a designated derivative that is highly effective as a cash flow hedge are included in equity and reclassified into income in the same period during which the hedged forecast cash flow affects income. This means there is no volatility in the income statement. The goal of a **net investment hedge** is to fix the value of an investment in a foreign entity. Changes in fair value of a designated derivative that is highly effective as a net investment hedge are included in equity. So volatility of the hedged part of the net investment is offset in equity.

Any ineffectiveness of hedges is reflected directly in income. DSM aims to mitigate these risks by closely monitoring the effectiveness of the hedges through effectiveness testing. Ineffectiveness only occurs when fair value changes of the hedging instrument compared to fair value changes of the underlying risk are outside a 80 – 125 % bandwidth. All hedges in 2005 have proven to be effective.

Credit risk

DSM manages the credit risk to which it is exposed through credit limits per financial institution and by dealing exclusively with financial institutions having a high credit rating. At the balance sheet date there were no significant concentrations of credit risk.

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Financial derivatives

	total	current assets	current liabilities
interest rate swaps	41	43	-2
currency swaps	129	158	-29
total financial derivatives related to external borrowings	170	201	-31
currency forward contracts	29	38	-9
currency options	-14	5	-19
balance at 31 December 2004	185	244	-59
interest rate swaps	14	22	-8
currency swaps	-7	11	-18
total financial derivatives related to external borrowings	7	33	-26
currency forward contracts	-36	3	-39
currency options	-	-	-
balance at 31 December 2005	-29	36	-65

Value changes of external borrowings and related financial derivatives 2005 vs. 2004:

hedges on external borrowings	external borrowings	derivatives	total	equity	P&L	other
fair value hedges (interest rate swaps)	27	-27	-	-	-	-
cash flow hedge (currency swaps)	-17	11	-6	-6	-	-
net investment hedge (currency swaps)	26	-147	-121	-	-2	-119*
total	36	-163	-127	-6	-2	-119

* Positive cash flow impact of unwinding the currency swap from EUR to USD on the 6,38% EUR loan 2000-2007.

Interest rate swaps

Interest rate swaps are used to achieve an appropriate mix of fixed and floating interest rate exposure of external loans. These swaps are accounted for as fair value hedges. The maturities of the swaps match those of the related loans. On 31 December 2005, the notional amount of the interest rate swaps for fair value hedging purposes relating to long-term loans was € 748 million (2004: € 830 million).

Interest rate swaps are from time to time used to hedge the fixed interest rate (excluding the DSM credit spread) of a new external loan as from the future issue date. In this way DSM achieves up-front certainty about the interest costs for a major part of DSM long-term euro debt. Under IFRS such swaps are accounted for as cash flow hedges. DSM pre-hedged the 4.00% EUR loan 2005-2015 (€ 300 million) during 2005 as a highly probable transaction, which led to an effective lower fixed interest rate of 3.66% (including DSM credit spread). A second interest rate swap of € 200 million was concluded in 2005 for the highly probable refinancing of the 6.38% EUR 400 million loan 2000-2007 maturing in 2007. On 31 December 2005, the notional amount of the interest rate swaps for cash flow hedging purposes relating to future long-term loans was € 200 million (2004: zero).

Currency swaps

With currency swaps the currency risk of loans and net investments in subsidiaries denominated in foreign currencies are hedged. These currency swaps are accounted for as net investment hedges. DSM uses currency swaps to hedge part of the net investment in Swiss-franc-based assets (CHF 826 million). On 31 December 2005, the notional amount of the currency swaps relating to net investment hedges was € 538 million (2004: € 538 million).

Currency swaps that hedge the currency risk resulting from recognized assets and liabilities, firm commitments and forecast transactions are accounted for as cash flow hedges. The notional amount of currency swaps relating to long-term-loans denominated as cash flow hedges was € 141 million (2004: € 141 million).

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Currency forward contracts

To hedge intercompany loans and receivables/payables denominated in the non-functional currency of the subsidiaries, DSM uses currency forward contracts. These hedges are based on underlying positions. Hedge accounting is not applied. On 31 December 2005, the notional amount of the currency forward contracts was € 1,567 million (2004: € 1,891 million).

DSM hedged part of its projected net cash flow in USD in 2006 (USD 306 million) by means of currency forwards, more specifically average rate forwards, at an average exchange rate of USD 1.22 per euro for the four quarters. This hedge has fixed part of the DSM net USD exposure at this exchange rate. The effects of these hedges will be included in the operating profit of the clusters involved.

Currency options

Currency options, more specifically average rate options, are used to hedge certain currency risks related to forecast transactions and firm commitments of operating companies. These options provide protection against deterioration of the USD whilst allowing DSM to retain upward USD potential. The premiums for these instruments are paid up-front and impact on the operating result of the subsidiary involved. In 2004 DSM hedged two USD firm commitment contracts for 2005 and 2006 by buying average rate options with a total underlying value of USD 34.6 million (2005) and USD 37.2 million (2006). Additional, average rate options were used to hedge part of the projected net cash flow in USD in the second half of 2005 at an exchange rate of USD 1.20 per euro with an underlying value of USD 160 million. The costs of these options were € 2.3 million.

(27) Post-employment benefits

The charges for post-employment benefits recognized in the income statement (note 5) consist of :

	2005	2004
net costs related to defined benefit plans	22	21
net costs related to medical care plans	5	-2
costs related to other long-term employee benefits	20	9
total, continuing operations	47	28
discontinued operations	1	1
total	48	29

For 2006 net costs related to defined benefit and medical care plans will approximate the costs for 2005.

Pensions

The DSM Group companies have various pension plans, which are geared to the local regulations and practices in the countries in which they operate. As these plans are designed to comply with the statutory framework, tax legislation, local customs and economic situation of the countries concerned, it follows that the nature of the plans varies from country to country.

Defined benefit plans are applicable to the majority of employees in the Netherlands, Germany, the United Kingdom, Switzerland and the United States. The rights that can be derived from these plans are based primarily on length of service and (average) final salary. The majority of these obligations are funded and have been transferred to independent pension funds and life assurance companies. Post-employment benefits relate to obligations that will be settled in the future and require assumptions to project benefit obligations and fair values of plan assets. Post-employment benefit accounting is intended to reflect the recognition of post-employment benefits over the employee's approximate service period, based on the terms of the plans and the investment and funding decisions made. The accounting requires management to make assumptions regarding variables such as discount rate, future salary increases, return on assets, and future medical costs. Management consults with outside actuaries regarding these assumptions at least annually for significant plans. Changes in these key assumptions can have a significant impact on the projected benefit obligations, funding requirements and periodic costs incurred.

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The amounts recognized in the balance sheet for defined benefit plans are as follows:

	2005	2004
<i>present value of benefit obligation</i>		
benefit obligation at 1 January	4,756	4,247
changes:		
- service costs	112	90
- interest costs	210	215
- employee contributions	12	12
- plan changes	4	0
- net actuarial gain (-) or loss (+)	149	407
- exchange differences	20	-10
- acquisitions	81	-
- divestments	-62	-
- curtailments	-5	-
- benefits paid	-233	-230
- other	-	25
benefit obligation at 31 December	5,044	4,756
<i>fair value of plan assets</i>		
plan assets at 1 January	4,616	4,253
changes:		
- actual return on plan assets	734	458
- employer contributions	88	99
- employee contributions	12	12
- exchange differences	14	-7
- benefits paid	-233	-230
- other	0	31
plan assets at 31 December	5,231	4,616
<i>net assets</i>		
present value of benefit obligations	5,044	4,756
fair value of plan assets	5,231	4,616
funded status	187	-140
unrecognized actuarial gains (-) or losses (+)	-49	228
unrecognized past service costs	-	0
effect of asset ceiling	-1	-
net assets in balance sheet	137	88
amounts in the balance sheet:		
- liabilities (provision for post-employment benefits)	268	267
- assets (prepaid pension costs)	405	355
net assets in balance sheet	137	88

The amounts recognized in the income statement are as follows:

	2005	2004
current service costs	112	89
interest costs	210	215
expected return on plan assets	-305	-283
past service costs	4	0
asset ceiling	1	0
net costs related to defined benefit plans	22	21

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The changes in the net asset recognized in the balance sheet are as follows:

	2005	2004
net assets at 1 January	88	7
net expense recognized in the income statement	-22	-21
employer contributions	88	99
exchange differences	-7	3
others	-10	-
net assets at 31 December	137	88

The main actuarial assumptions for the year (expressed as ranges) are:

	2005	2004
discount rate	2.6% - 6.1%	3.3% - 6.1%
price inflation	1.5% - 3.0%	1.5% - 3.0%
salary increase	1.8% - 4.0%	1.8% - 4.0%
pension increase	0% - 2.8%	0% - 2.8%
return on assets	4.5% - 8.5%	4.8% - 8.5%

Post-employment medical care and other costs

In some countries, particularly the United States, group companies provide retired employees and their surviving dependants with post-employment benefits other than pensions, mainly allowances for medical and dental expenses and life insurance premiums. Some of these are unfunded; in these cases, approved expense claims are reimbursed out of the financial resources of the group companies concerned.

The amounts included in the balance sheet are as follows:

	2005	2004
present value of obligations	67	54
fair value of plan assets	13	11
present value of obligations	54	43
unrecognized actuarial gains (-) or losses (+)	-3	0
unrecognized past service costs	2	4
net liability in balance sheet (provision for post-employment benefits)	53	47

The amounts recognized in the income statement are as follows:

	2005	2004
current service cost	2	2
interest costs	4	3
expected return on plan assets	-1	-1
past service costs	-	-6
net costs related to medical care plans	5	-2

The (net) changes in the liability for post-employment medical care and other costs recognized in the balance sheet (Provision for post-employment benefits) can be shown as follows:

	2005	2004
net liability at 1 January	47	61
net expense recognized in the income statement	5	-2
benefits paid	-3	-6
exchange differences on foreign plans	7	-4
other	-3	-2
net liability at 31 December	53	47

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The main actuarial assumptions for post-employment medical care costs for the year are:

	2005	2004
underlying inflation rate	3.0%	3.0%
medical claim inflation rate	7.0%	7.25%
salary increase	6.0%	6.12%
discount rate	4.0%	4.0%

(28) Net debt

	2005	2004
borrowings:		
- non-current borrowings	1,381	1,264
- current borrowings	329	527
total borrowings	1,710	1,791
current investments	-5	-6
cash and cash equivalents	-902	-1,261
net balance of financial derivatives (see also note 26)	29	-185
net debt	832	339

In the calculation of the net debt the temporary reclassification at year-end 2004 to debt of the cumulative preference shares A with an impact of € 233 million has not been taken into consideration.

An amount of € 13 million (2004: € 20 million) in cash and cash equivalents was restricted and mainly relates to cash pledged in connection with the dissolution of the joint venture with BASF in the field of feed enzymes, as a consequence of the takeover in 2003 of Roche's Vitamins & Fine Chemicals division.

(29) Notes to the cash flow statement

The cash flow statement provides an explanation of the changes in cash and cash equivalents. It is prepared on the basis of a comparison of the balance sheets as at 1 January and 31 December. Changes that do not involve cash flows, such as changes in exchange rates, impairments and transfers to other balance-sheet items, are eliminated.

Changes in working capital due to the acquisition or sale of consolidated companies are included under Investing activities.

Most of the changes in the cash flow statement can be traced back to the detailed statements of changes for the balance-sheet items concerned. For those balance-sheet items for which no detailed statement of changes is included, the table below shows the link between the change according to the balance sheet and the change according to the cash flow statement:

	working capital	provisions	borrowings
balance at 1 January 2005	1,294	484	2,024
balance at 31 December 2005	1,433	363	1,710
balance-sheet change	139	-121	-314
adjustments:			
- exchange differences	-103	-8	-100
- changes in consolidation	87	-2	55
- transfers	62	-	29
- reclassifications	16	-	233
adjusted balance-sheet change	201	-131	-97
change in cash flow	-201	-131	-97

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(30) Management share options

Under the current plan performance and non-performance related stock options or stock appreciation rights (SARs) are granted to senior management. Such a grant takes place on the first day on which the DSM share is quoted ex-dividend following the Annual General Meeting. The opening price of the DSM share on that day is the exercise price of the stock options/SARs.

Stock options/SARs have a term of eight years and are subject to a vesting period of three years. After this 3-year period one third of the stock options/SARs (non-performance related) vest and two third of the stock options/SARs which are performance related will become exercisable in whole, in part, or not at all, depending on the Total Shareholder Return (TSR) achieved by DSM in comparison with a peer group. Non-vested stock options/SARs will be forfeited.

The exercise of stock options/SARs is regulated and in any case prohibited if the Plan participant has insider knowledge. A number of senior officers as well as a number of officers involved in processing financial statements are not allowed to exercise their stock options/SARs during predefined black-out periods prior to the publication of quarterly or annual reports. In addition, senior officers must obtain the approval of an officer ranking one level higher in the organization. Senior management that is not included in the aforementioned groups are not subject to any predefined black-out periods and may exercise their stock options at any time, provided they have no insider knowledge. In specific circumstances the Compliance Officer may define special black-out periods for individuals or a group of employees, during which they are not allowed to trade in any DSM securities.

Overview of management option rights

	year	outstanding on 31 Dec. 2004	in 2005			outstanding on 31 Dec. 2005	exercise price (€)	exercise period
			granted	vested (a)	exercised			
stock options:								
- vested	1999	393,500			-393,500	-	13.005	until 14 Jan. 2007
	2000	765,000			-643,500	121,500	18.240	until 31 Mar. 2008
	2001	2,039,250			-1,405,859	633,391	19.990	until 30 Mar. 2009
	2002	479,100		1,779,450	-1,104,300	1,154,250	23.505	until 4 Apr. 2010
	2003	140,000		71,000	-102,500	108,500	18.195	until 4 Apr. 2011
	2003(b)	11,300		14,150	-11,300	14,150	19.770	until 3 Nov. 2011
	2004	6,000		119,150	-43,500	81,650	17.895	until 2 Apr. 2012
	2005	0		65,200	-5,000	60,200	29.050	until 8 Apr. 2013
- unvested	2002	1,801,950		-1,779,450	-22,500	-	23.505	
	2003	2,098,126		-71,000	-98,500	1,928,626	18.195	
	2003(b)	192,050		-14,150	-5,250	172,650	19.770	
	2004	2,634,076		-119,150	-101,250	2,413,676	17.895	
	2005	0	2,580,478	-65,200	-47,600	2,467,678	29.050	
stock appreciation rights								
- vested	1999	72,000			-58,000	14,000	13.005	until 14 Jan. 2007
	2000	72,000			-57,000	15,000	18.240	until 31 Mar. 2008
	2001	31,500			-31,500	-	19.990	until 30 Mar. 2009
	2002	18,000		213,750	-133,750	98,000	23.505	until 4 Apr. 2010
	2003	8,000		8,000	-8,000	8,000	18.195	until 4 Apr. 2011
	2003(b)	1,000		8,450		9,450	19.770	until 3 Nov. 2011
	2004	8,000		16,450	-8,000	16,450	17.895	until 2 Apr. 2012
	2005	0		8,000		8,000	29.050	until 8 Apr. 2013
- unvested	2002	225,750		-213,750	-12,000	-	23.505	
	2003	264,750		-8,000	-16,000	240,750	18.195	
	2003(b)	342,200		-8,450		333,750	19.770	
	2004	633,900		-16,450	-16,000	601,450	17.895	
	2005	0	447,750	-8,000	-4,000	435,750	29.050	
	total	12,237,452	3,028,228	-	-4,005,709	-323,100	10,936,871	
changes in 2004	total		3,341,726	-	-356,150	-482,750		

(a) Stock options / SARs will partly vest and may therefore be exercised immediately upon termination of employment in connection with (early) retirement.

(b) On 3 November 2003 a select group of DSM Nutritional Products employees received stock options / SARs on a one-off basis.

Overview of personnel option rights

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	outstanding on 31 Dec. 2004	granted	in 2005 exercised	expired	outstanding on 31 Dec. 2005	exercise price (€)	exercise period
relating to 1999	289,686	-	-252,348	-480	36,858	19.80	until Feb. 2006
relating to 2000	477,418	-	-413,542	-1,320	62,556	19.99	until Mar. 2006
relating to 2001	410,334	-	-239,310	-6,356	164,668	23.11	until Apr. 2007
relating to 2002	278,262	-	-198,010	-2,370	77,882	18.19	until Apr. 2008
relating to 2003	0	-	-	-	0		
relating to 2004	0	256,100	-11,650	-8,956	235,494	29.05	until Apr. 2010
total	1,455,700	256,100	-1,114,860	-19,482	577,458		
changes in 2004		-	-272,552	-30,088			

Based on the 2004 result, 256,100 personnel option rights were granted in 2005. No personnel option rights were granted in 2004.

Restricted shares

Granting of restricted shares is limited to the Managing Board; a further explanation is available on page 67.

	2005	outstanding on 31 Dec. 2004	granted	during 2005 vested	expired/ forfeited	outstanding on 31 Dec. 2005	share price at date of grant (€)
unvested							
	2005	-	42,000	-	-	42,000	29.050

Before 2005 no restricted shares were granted.

Share-based compensation

The costs of option plans are measured by reference to the fair value of the options at the date at which the options are granted. The fair value is determined using the Black-Scholes option pricing model, taking into account market conditions linked to the price of the DSM share. The costs of these options are recognized in the income statement (Employee benefits). Prior to 2004 share-based compensation was accounted for using the intrinsic value method.

The following assumptions were used in the Black-Scholes option pricing model:

	2005	2004
risk-free interest rate (6 years risk free)	3.15%	3.24%
expected option life management option rights	6 years	6 years
nominal option life management option rights	8 years	8 years
expected option life personnel option rights	2.5 years	2.5 years
nominal option life personnel option rights	5 years	5 years
expected stock price volatility	26%	26%

The costs of wages and salaries include an amount of € 22 million in share-based compensation (2004: € 8 million).

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(31) Interests in joint ventures

DSM holds the following interests in the following most important joint ventures:

company	location	DSM interest	
DEX-Plastomers VoF	Heerlen	NL	50%
Holland Sweetener Company VoF	Geleen	NL	50%
Noordgastransport BV	Zoetermeer	NL	40%
Fersina Gb SA de CV	Ramos Arizpe	MX	50%
Zhang Jia Kou Gist-brocades Pharmaceutical Company Ltd.	Zhang Jia Kou	CN	50%
EdeA VoF	Geleen	NL	50%

The financial data of joint ventures are included in the consolidated financial statements according to the method of proportionate consolidation. DSM interests in the assets and liabilities, revenues and expenses of these joint ventures are:

	2005	2004
non-current assets	187	208
current assets	134	146
non-current liabilities	-116	-127
current liabilities	-66	-68
net assets	139	159
net sales	374	391
expenses	-339	-356
net profit	35	35

(32) Interests in associates

DSM holds the following interests in the following most important associates:

company	location	DSM interest	
American Melamine Industries, Inc.	Fortier	US	50%
Methanor VoF	Amersfoort	NL	30%
Nippon Dyneema Co. Ltd.	Osaka	JP	50%
Nylon Polymer Company, LLC	Augusta	US	25%
Triferto BV	Doetinchem	NL	40%
Xinhui Meida - DSM Nylon Chips Co. Ltd.	Guangzhou	CN	25%

Investments in associates are accounted for by the equity method of accounting. The following table provides summary financial information on associates on a 100% basis.

	2005	2004
non-current assets	126	218
current assets	65	64
non-current liabilities	-17	-48
current liabilities	-62	-147
net assets	112	87
net sales	358	542
net profit	-2	34

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(33) Related parties

Related parties disclosure relates entirely to the key management of DSM.

Remuneration of Members of the Managing Board and the Supervisory Board of Royal DSM N.V.

The remuneration of the members of the Managing Board and the Supervisory Board is included in the employee benefits. In the financial year under review, the remuneration of persons who were on the Managing Board of Royal DSM N.V. in 2005 amounted to € 3.9 million (2004: € 3.4 million). This includes fixed annual salaries € 2.5 million (2004: € 2.4 million), bonuses € 0.9 million (2004: 0.5 million), pension costs € 0.3 million (2004: € 0.3 million) and other costs € 0.2 million (2004: € 0.2 million). In 2005 the average number of Managing Board members employed by Royal DSM N.V. was 5 (2004: 5). The remuneration of former members of the Managing Board amounted to zero (the same as in 2004).

Members of the Supervisory Board received a fixed remuneration (included in 'Other operating costs') totaling € 0.3 million (2004: € 0.2 million).

Further information about the remuneration of Managing Board members and Supervisory Board members and their share option rights is given on page 62 of the Report by the Managing Board.

(34) Service fees paid to external auditors

The service fees paid to Ernst & Young included in 'Work subcontracted and other external costs' in 2005 amounted to € 5.2 million for audit services (2004: € 5.8 million), € 1.6 million for tax services (2004: € 1.6 million) and € 0.4 million for sundry services (2004: € 0.5 million).

(35) First-time adoption of IFRS by DSM**Introduction**

Until 2004 DSM prepared its consolidated financial statements in accordance with accounting principles generally accepted in the Netherlands ('NL GAAP'). From 2005 onwards DSM is required to prepare its consolidated financial statements in accordance with International Financial Reporting Standards (IFRS) as adopted by the European Union.

In the Annual Report 2004 DSM provided an annex that explained the main consequences of the transition from NL GAAP to IFRS. The information in that annex was prepared on the basis of the best of our knowledge. At that moment some issues were still subject to debate with respect to the general interpretation of certain standards (notably with respect to IAS 19, IAS 32 and IAS 39). For this reason, the reconciliations in the Annual Report 2005 deviate from the figures presented in the annex of the Annual Report 2004. As DSM publishes comparative information for one year in its Annual Report, the date for transition to IFRS is 1 January 2004, this being the start of the earliest period for which comparative information is given. The financial information of DSM according to IFRS has been prepared on the basis of IFRS effective at 31 December 2005.

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Overview of the impact of the transition to IFRS

The impact of the transition on shareholders' equity and net profit can be summarized as follows:

SHAREHOLDERS' EQUITY

	1 January 2004	31 December 2004	1 January 2005
according to NL GAAP	4,918	4,812	
changes due to the application of:			
- IFRS 2 Share-based payment	-1	-3	
- IFRS 3 Business combinations	22	20	
- IAS 19 Employee benefits	83	163	
- IAS 28 Investments in associates	7	8	
- IAS 31 Interests in joint ventures	-3	-4	
- IAS 37 Provisions	35	1	
addition of dividend on cumprefs, declared after balance sheet date, but under NL GAAP already deducted from equity	15	11	
reclassifications	44	45	
according to IFRS (excluding IAS 32 and IAS 39)	5,120	5,053	5,053
IAS 32 and IAS 39 Financial instruments			-218
according to IFRS (including IAS 32 and IAS 39)			4,835

NET PROFIT

	2004 result before exceptional items	2004 exceptional items	2004 total
group profit according to NL GAAP	348	-109	239
changes due to the application of:			
- IFRS 2 Share-based payment	-8	-	-8
- IFRS 3 Business combinations			
- reversal of amortization of goodwill	21	-	21
- deferred costs relating to DNP	-29	-	-29
- IAS 19 Employee benefits	86	-	86
- IAS 28 Investments in associates	1	-	1
- IAS 31 Interests in joint ventures	-1	-	-1
- IAS 37 Provisions	-1	-50	-51
income tax expense	-5	17	12
profit for the year	412	-142	270
difference	64	-33	31
of which: operating profit	73	-50	23
net finance costs	-5	-	-5
income tax expense	-5	17	12
share in results of associates	1	-	1

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The impact on net sales and cash flows (both effects resulted from the application of *IAS 31 Interests in Joint Ventures*) and on earnings per share were:

2004	NL GAAP	IFRS	Delta
net sales (€ million)	7,752	7,832	+80
net cash provided by operating activities	911	898	-13
net cash used in investing activities	-308	-323	-15
net cash used in financing activities	-561	-533	+28
	42	42	0
per ordinary share in euro:			
- net profit excluding exceptional items	1.76	2.13	+0.37
- net profit	1.25	1.45	+0.20
- net profit, after dilution	1.25	1.45	+0.20

Transitional arrangements

DSM made use of the following exemptions to retrospective application of IFRSs as permitted by *IFRS 1 First-time Adoption of International Financial Reporting Standards*:

- Business combinations prior to the transition date of 1 January 2004 have not been restated according to the requirements of *IFRS 3 Business Combinations*.
- Cumulative actuarial gains and losses for post-employment benefits have been recognized in equity at the transition date.
- The cumulative translation differences for all foreign operations are deemed to be zero at transition date.
- The provision for site restoration has been recalculated without taking into account changes in such liabilities that occurred before the transition date.
- The comparative information for 2004 about financial instruments is based on existing NL GAAP. *IAS 32 Financial Instruments: Disclosure and Presentation* and *IAS 39 Financial Instruments: Recognition and Measurement* were not applied in 2004, but have been applied as from 1 January 2005.

Most important changes in DSM's accounting policies as at 1 January 2004

On page 82 you find a summary of significant accounting policies used in this annual report. The most important changes in DSM's accounting policies and their impact on result and equity are summarized below.

IFRS 2 Share-based Payment

In accordance with IFRS 2, an expense must be recognized representing the fair value of employee share options and stock appreciation rights granted to employees. The fair value is calculated using the Black-Scholes option pricing model and is charged to the income statement over the relevant vesting periods. The share-based payment charge of € 8 million for 2004 related to:

- employee share options granted since 7 November 2002 (the effective date of IFRS 2), and not yet vested at 1 January 2005 (transitional provisions of IFRS), and
- stock appreciation rights existing at 1 January 2004.

The impact on equity at 1 January 2004 and at 31 December 2004 was not material.

Management options and stock appreciation rights in DSM typically have a vesting period of three years.

Consequently, it will take until 2006 before the full impact of IFRS 2 will be visible.

IFRS 3 Business Combinations

Goodwill is no longer amortized, but tested for impairment at least annually. Goodwill was tested for impairment as at 1 January 2004 and 31 December 2004.

The impact for DSM is as follows:

- amortization of goodwill has been discontinued as of the transition date of 1 January 2004; and
- the carrying amount of the goodwill on 31 December 2003 according to NL GAAP amounting to € 355 million is used as the deemed cost of the goodwill as at the date of transition to IFRS (1 January 2004).

The operating profit impact in 2004 was a reduction of the amortization charge of € 21 million, the most significant element being the removal of amortization relating to the acquisition of Catalytica in 2000. There were no related income tax expense effects because of the tax-exempt nature of this goodwill. Under NL GAAP an amount of € 29 million in negative goodwill was allocated to current liabilities (for deferred costs related to DSM Nutritional Products). Recognition of negative goodwill is not allowed under IFRS 3. The impact for the opening balance under IFRS was an increase in equity of € 22 million and a decrease in deferred tax assets of € 7 million. The impact on net profit 2004 under IFRS was a reduction of € 22 million.

IAS 19 Employee Benefits

With regard to defined benefit plans (pensions and other post-retirement benefits) IAS 19 requires for each plan the recognition of a liability that equals the net amount of:

- the present value of the defined benefit obligation;
- deferred actuarial gains and losses and deferred past service costs; and
- the fair value of any plan assets at balance sheet date.

This calculation may result in an asset. It is DSM's policy to use the corridor approach for the recognition of actuarial gains and losses. The balance sheet impact of the implementation of IAS 19 was the recognition of a pension asset of € 282 million and an additional pension liability of € 160 million in DSM's IFRS opening balance sheet as at 1 January 2004. On balance, the after-tax impact on equity was an increase of € 83 million in the balance sheet as at 1 January 2004 and an increase of € 163 million in the balance sheet as at 31 December 2004. The pension charge under IFRS for the year 2004 was € 28 million, compared with an amount recognized under NL GAAP of € 114 million. Consequently, the operating profit impact of the transition to IFRS in 2004 was an additional gain of € 86 million, with a related tax charge of € 15 million.

IAS 28 Investments in Associates

This Standard applies to investments in which the investor has significant influence. There is a rebuttable presumption of significant influence if the investor holds 20% or more of the voting power of the associate. Associates are accounted for in the consolidated financial statements using the equity method. DSM has reclassified non-consolidated companies as associates or as other securities. Other securities are interests in companies over which DSM has no significant influence. These other securities are measured at fair value, or at cost if a fair value cannot be reliably measured. The application of IFRS resulted in an increase in equity of € 7 million in the balance sheet as at 1 January 2004 and an increase of € 8 million in the balance sheet as at 31 December 2004. The positive impact on net profit 2004 under IFRS was € 1 million.

IAS 31 Interests in Joint Ventures

DSM has opted to consolidate joint ventures according to the proportionate consolidation method. Under NL GAAP DSM restricted this method to joint ventures that were important to DSM in terms of sales to external parties. This restriction is not allowed under IFRS. As a result, one additional joint venture will be proportionally consolidated (EdeA VoF). This had a limited impact on equity (a decrease of € 3 million) and net profit, but had a larger impact on the separate items within the balance sheet and income statement. In the cash flow statement, the cash flow from operating activities increased by € 13 million, the cash flow used in investing activities increased by € 15 million and the cash flow used in financing activities decreased by € 5 million.

IAS 37 Provisions

According to IAS 37 a provision shall be recognized only when a past event has created a legal or constructive obligation, an outflow of resources is probable, and the amount of the obligation can be estimated reliably. Under NL GAAP DSM recognized a provision of € 50 million in 2003 for restructuring and reorganization costs in the manufacturing operations at the Geleen site in the Netherlands (Copernicus project), which under IFRS should have been recognized in 2004. The impact of this change was an increase in equity of € 33 million at 1 January 2004, a decrease in deferred tax assets of € 17 million, and a decrease in net profit in 2004 of € 33 million. Furthermore, DSM has adjusted the existing provisions for site restoration in the area of DSM Energy to the level required by IAS 37. The effect in the opening balance sheet of 1 January 2004 (31 December 2004) was an increase in provisions of € 11 million (increase of € 8 million), an increase in property, plant and equipment of € 14 million (increase of € 11 million), and an increase in equity of € 2 million (increase of € 1 million). The impact on net profit in 2004 was negligible.

Reclassifications

In changing over to IFRS, DSM implemented several changes in the format of the financial statements and the terminology used. The reclassifications in the opening balance sheet at 1 January 2004 relate to the following:

- The reclassification of application software (€ 45 million) from Tangible fixed assets (Property, plant and equipment) to Intangible fixed assets (Intangible assets).
- The introduction of a separate category Deferred tax assets (€ 234 million), which were previously presented under Financial fixed assets.
- The transfer of prepayments (€ 37 million) from Tangible fixed assets (Property, plant and equipment) to Other non-current assets (€ 30 million) and to Receivables (€ 7 million) for the current portion of prepayments made to suppliers.
- Prepaid expenses (€ 10 million) have been transferred from Receivables to Other non-current assets.
- Amounts from Provisions that will be used within 12 months (€ 282 million) months are presented in Provisions under Current liabilities.
- An amount of € 66 million related to deferred items (such as Government grants) and reported under Current liabilities has been transferred to Other non-current liabilities.

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Change in DSM's accounting policies as at 1 January 2005

IAS 32 and IAS 39 Financial Instruments

IAS 32 and IAS 39 address the accounting for and financial reporting of financial instruments. IAS 32 covers disclosure and presentation whilst IAS 39 covers recognition and measurement. The general principle of IAS 39 is that all financial assets and financial liabilities, including all derivatives, shall be recognized on the balance sheet. Borrowings shall be measured at amortized cost, most other financial assets and financial liabilities (including derivatives) at fair value. DSM has opted to apply these standards as from the beginning of the financial year 2005. Changes in this regard relate to:

- The inclusion in the balance sheet of derivative financial instruments that were held off-balance in previous years;
- Measurement of all financial derivatives at their fair value;
- Separate recognition of derivative financial instruments as non-current or current assets and liabilities, instead of netting them with the related hedged items.

Adoption of IAS 32 and IAS 39 resulted on balance in a decrease of € 218 million in equity at 1 January 2005, the main reason being a temporary classification of cumulative preference shares A to debt for an amount of € 233 million. The impact on net profit for 2005 was negligible.

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Balance sheet

assets

x € million	31 December 2005	31 December 2004*	31 December 2004**
non-current assets			
intangible assets (2)	359	-	-
property, plant and equipment (3)	21	20	20
financial fixed assets (4)	7,989	7,459	7,455
	8,369	7,479	7,475
current assets			
receivables (5)	309	228	226
financial derivatives	33	200	-
cash and cash equivalents	1	3	3
	343	431	229
total	8,712	7,910	7,704

shareholders' equity and liabilities

x € million	31 December 2005	31 December 2004*	31 December 2004**
shareholders' equity (6)	5,474	4,835	5,053
non-current liabilities			
deffered tax liabilities	24	13	13
provisions (7)	12	17	17
borrowings (8)	1,175	1,216	819
	1,211	1,246	849
current liabilities			
provisions (7)	14	8	8
borrowings (8)	147	400	400
financial derivatives	25	31	-
other current liabilities (9)	1,841	1,390	1,394
	2,027	1,829	1,802
total	8,712	7,910	7,704

* Pro forma: after application of IAS 32 and IAS 39.

** Before application of IAS 32 and IAS 39.

Income statement

x € million	2005	2004
share in results of subsidiaries, joint ventures and associates (after income tax expense)	471	359
other income and expense	56	-66
net profit attributable to equity holders of Royal DSM N.V.	527	293

Notes to the Royal DSM N.V. balance sheet

(1) General

Unless stated otherwise, all amounts are in € million.

To enhance the transparency and readability of the notes to the financial statements, balance sheet items at December 31, 2004 are presented after application of IAS 32 and 39. These standards were implemented with effect from January 1, 2005 and were applicable during the full year. Therefore, this presentation enhances the comparability of individual balance sheet items and provide a better understanding of changes during the year.

The company financial statements have been prepared in accordance with accounting principles generally accepted in the Netherlands (NL GAAP).

The accounting policies used are substantially the same as those used in the consolidated financial statements in accordance with the provisions of article 362-8 of Book 2 of the Dutch Civil Code, except for investments in subsidiaries, which are accounted for at net asset value in accordance with the equity method. In conformity with article 402, Book 2 of the Dutch Civil Code, a condensed statement of income is included in the Royal DSM N.V. accounts.

A list of DSM participations has been published at the Chamber of Commerce for Zuid-Limburg in Maastricht (The Netherlands) and is available from the company upon request. The list is also available on the company's website www.dsm.com.

(2) Intangible assets

The intangible assets completely comprise out of the goodwill related to the acquisition of NeoResins (now DSM NeoResins) on February 2, 2005.

(3) Property, plant and equipment

This item mainly relates to land and buildings and corporate IT projects. Capital expenditure in 2005 was € 5 million, while the depreciation charge in 2005 was € 3 million. The historic cost of property, plant and equipment as at 31 December 2005 was € 52 million; accumulated depreciation amounted to € 31 million.

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(4) Financial fixed assets

	total	share in equity	subsidiaries loans	other securities	other loans
balance at 31 December 2003	7,022	6,954	63	4	1
changes:					
-share in profit	262	262	-	-	-
- dividends	-505	-505	-	-	-
- capital payments	899	899	-	-	-
- loans granted	318	-	318	-	-
- intra-group transactions	-498	-498	-	-	-
- value adjustments	55	55	-	-	-
- exchange differences	-102	-102	-	-	-
- other	8	-22	33	-2	-1
balance at 31 December 2004	7,459	7,043	414	2	0
changes:					
-share in profit	450	450	-	-	-
- dividends	-422	-422	-	-	-
- capital payments	728	727	-	1	-
- goodwill	-358	-358	-	-	-
- loans granted	108	-	-	-	108
- intra-group transactions	-211	-211	-	-	-
- value adjustments	107	107	-	-	-
- exchange differences	136	136	-	-	-
- other	-8	-11	3	-	-
balance at 31 December 2005	7,989	7,461	417	3	108

(5) Receivables

	2005	2004
receivables from subsidiaries	228	142
other receivables	81	86
total	309	228

(6) Shareholders' equity

	2005	2004
balance at 31 December	4,835	5,120
net profit	527	293
reclassification of cumulative preference shares A	233	-233
net translation differences	128	-62
management options	7	4
dividend	-183	-194
share buy-backs	-68	-108
adoption of IAS 32 and IAS 39 - 15	-	15
other	-5	-
balance at 31 December, after adoption of IAS 32 and IAS 39	5,474	4,835

For details see the consolidated statement of changes in equity on page 88.

Legal reserves

Since the profits retained in Royal DSM N.V.'s consolidated and non-consolidated companies can be distributed, and received in the Netherlands, without restriction, no legal reserve for retained profits is required. In shareholders' equity an amount of € 77 million is included for translation reserve and -€ 3 million for hedging reserve.

(7) Provisions

	2005		2004	
	total	of which current	total	of which current
environmental costs	8	3	12	6
other provisions	18	11	13	2
total	26	14	25	8

The total of non-current and current provisions increased by € 1 million. This is the net effect of the following changes:

	balance at 31 december 2004	additions	uses	balance at 31 december 2005
environmental costs	12	-	-4	8
other provisions	13	12	-7	18
total	25	12	-11	26

(8) Borrowings

	2005		2004	
	total	of which current	total	of which current
debenture loans	1,057	139	1,383	400
private loans	265	8	-	-
	1,322	147	1,383	400
cumulative preference shares A	-	-	233	-
total	1,322	147	1,616	400

Of the total amount of borrowings outstanding at 31 December 2005, € 558 million had a remaining term of more than five years.

The repayment schedule for non-current borrowings is as follows:

- 2006	147
- 2007	413
- 2008	-
- 2009 and 2010	204
- 2011 through 2015	558
	1,322

The repayments scheduled for 2006 relate to redemption of debenture loans and private loans.

In agreements governing loans with a residual amount at year-end 2005 of € 1,175 million, of which € 147 million of a current nature (31 December 2004: € 1,392 million, of which € 400 million current), clauses have been included which restrict the provision of security.

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(9) Other current liabilities

	2005	2004
owing to subsidiaries	1,769	1,343
other liabilities	70	44
deferred items	2	3
total	1,841	1,390

Contingent liabilities

Guarantee obligations on behalf of affiliated companies and third parties amounted to € 300 million (31 December 2004: € 300 million). Other commitments not appearing on the balance sheet amounted to zero (the same as in 2004). Royal DSM N.V. has declared in writing that it accepts several liability for debts arising from acts-in-law of a number of consolidated companies. These debts are included in the consolidated balance sheet.

Employees

The remuneration of the individual members of the Managing Board was as follows: Peter Elverding, annual salary € 612,000 (2004: € 599,760), bonus € 378,675 (2004: € 215,914), pension € 111,482 (2004: € 110,289); Jan Zuidam, Henk van Dalen and Feike Sijbesma, annual salary € 470,000 (2004: € 461,040), bonus € 290,950 (2004: € 165,974), pension € 86,148 (2004: € 85,250) and Chris Goppelsroeder, annual salary € 470,000 (2004: n.a.), bonus € 218,913 (2004: n.a.), pension € 48,304 (2004: n.a.). Further details are provided in the Remuneration 2005 paragraph (pages 64-69).

Heerlen, 6 February 2006

MANAGING BOARD,

Peter Elverding
Jan Zuidam
Henk van Dalen
Feike Sijbesma
Chris Goppelsroeder

Heerlen, 8 February 2006

SUPERVISORY BOARD,

Cor Herkströter
Henk Bodt
Pierre Hochuli
Ewald Kist
Okko Müller
Claudio Sonder
Cees van Woudenberg

Auditors' report

Introduction

We have audited the financial statements of Royal DSM N.V. Heerlen for the year 2005. These financial statements consist of the consolidated financial statements and the company financial statements. These financial statements are the responsibility of the company's management. Our responsibility is to express an opinion on these financial statements based on our audit.

Scope

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

Opinion with respect to the consolidated financial statements

In our opinion, the consolidated financial statements give a true and fair view of the financial position of the company as at 31 December 2005 and of the result and the cash flows for the year then ended in accordance with the International Financial Reporting Standards as adopted by the EU and comply with the financial reporting requirements included in Part 9 of Book 2 of the Netherlands Civil Code as far as applicable.

Furthermore we have established to the extent of our competence that the annual report is consistent with the consolidated financial statements.

Opinion with respect to the company financial statements

In our opinion, the company financial statements give a true and fair view of the financial position of the company as at 31 December 2005 and of the result for the year then ended in accordance with the accounting principles generally accepted in the Netherlands and comply with the financial reporting requirements included in Part 9 of Book 2 of the Netherlands Civil Code.

Furthermore we have established to the extent of our competence that the annual report is consistent with the company financial statements.

Maastricht, 8 February 2006
for Ernst & Young Accountants

W.J. Spijker

Chr. J. Westerman

Profit appropriation

According to Article 32 of the Royal DSM N.V. Articles of Association and with the approval of the Supervisory Board of Directors, every year the Managing Board of Directors determines the portion of the net profit to be appropriated to the reserves. For the year 2005 the net profit is € 527 million and the amount to be appropriated to the reserves has been established at € 320 million. From the subsequent balance of the net profit (€ 207 million), dividend is first distributed on the cumulative preference shares B. At the end of 2005 no cumprefs B were in issue. Subsequently, a 6.78% dividend is distributed on the cumulative preference shares A, based on a share price of € 5.30 per cumulative preference share A. For 2005 this distribution amounts to € 0.36 per share, which is € 16 million in total. An interim dividend of € 0.12 per cumulative preference share A having been paid in August 2005, the final dividend will then amount to € 0.24 per cumulative preference share A. The cumulative preference shares C were repurchased on 28 November 2004; consequently no final dividend was distributed on these shares in 2005.

The profits remaining after distribution of these dividends (€ 191 million) will be put at the disposal of the Annual General Meeting in accordance with the provisions of Article 32, section 6 of the Articles of Association.

In view of the above, the proposed dividend on ordinary shares outstanding for the year 2005 would amount to € 1.00 per share. This dividend corresponds to about 18% of the net profit excluding exceptional items (€ 563 million) plus depreciation and amortization (€ 503 million) minus the dividend paid 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 would then amount to € 0.71 per ordinary share.

If the Annual General Meeting of Shareholders makes a decision in accordance with the proposal, the net profit will be appropriated as follows:

x € million	2005	2004
net profit	527	300
profit appropriation:		
- to be added to / paid from the reserves	320	110
- dividend on cumprefs A and C	16	22
- interim dividend on ordinary shares	55	56
- final dividend payable on ordinary shares	136	112

Special statutory rights

DSM Preference Shares Foundation

The DSM Preference Shares Foundation was established in 1989.

By virtue of DSM's Articles of Association, 375,000,000 preference shares B can be issued. Shares thus issued can be placed with the Foundation in order to provide protection against a hostile takeover bid.

The DSM Preference Shares Foundation and DSM have concluded agreements on the placement of preference shares B and an option on such shares. Under these agreements, the Foundation is obliged to take preference shares B in DSM's capital or has the right to acquire such shares to a maximum corresponding to 100% of the capital issued in any form other than preference shares B, less one. The Foundation acquired no preference shares B in 2005.

On 31 December 2005 the Committee was composed as follows:

Floris Maljers, chairman
Maarten van Veen, vice-chairman
Bas Kortmann

The Foundation Committee

Declaration of independence

The DSM Managing Board and the Foundation Committee hereby declare that, according to their joint assessment, the DSM Preference Shares Foundation meets the independence requirements laid down in Appendix X to the Listing and Issuing Rules of Euronext Amsterdam N.V.

The Managing Board of Royal DSM N.V.
The Foundation Committee

DSM Vision 2005 BV and DSM Vision 2005 Priority Foundation

In 2002, DSM Vision 2005 BV and the DSM Vision 2005 Priority Foundation were established. DSM entrusted the revenues from the sale of DSM's petrochemical activities, as well as the financial resources that became available in 2001 following the sale of DSM's interest in Energie Beheer Nederland BV, to its subsidiary DSM Vision 2005 BV. This company was set up to manage these revenues and their use for the implementation of the *Vision 2005* strategy.

A number of decisions by the company, including decisions on the use of the financial resources that it manages, required the approval of the Priority Foundation. The only criterion to be used by the Priority Foundation in assessing the proposed decisions was whether they were compatible with the *Vision 2005: Focus and Value* strategy.

The financial resources were mainly used for the acquisition of Roche Vitamins and Fine Chemicals (now DSM Nutritional Products) and NeoResins (now DSM NeoResins).

Since DSM Vision 2005 BV had fulfilled its objective, e.g. support the implementation of the *Vision 2005 strategy*, the Priority Foundation was liquidated and dissolved in the course of the year and DSM Vision 2005 BV will in due course transfer its remaining funds (approximately € 30 million) to Royal DSM N.V.

Annual General Meeting of shareholders

The Annual General Meeting is to be held at the DSM head office in Heerlen (the Netherlands) on Wednesday, 29 March 2006 at 14.00 hours.

Important dates

Ex-dividend quotation	Friday, 31 March 2006
Publication of first-quarter results	Friday, 28 April 2006
Publication of second-quarter results	Thursday, 27 July 2006
Publication of third-quarter results	Thursday, 26 October 2006
Annual figures 2006	Thursday, 8 February 2007*
Annual General Meeting	Wednesday, 28 March 2007*

* These are provisional dates.

Royal DSM N.V. Financial statements 2005

DSM figures: five-year summary

Balance sheet

x € million	2005*	2004*	2004	2003	2002	2001
intangible assets	1,003	453	369	405	462	594
property, plant and equipment	3,750	3,811	3,809	4,188	2,885	3,607
deferred tax assets	517	432	-	-	-	-
associates	43	78	491	371	292	241
prepaid pension costs	405	355	-	-	-	-
other financial assets	189	82	-	-	-	-
non-current assets	5,907	5,211	4,669	4,964	3,639	4,442
inventories	1,535	1,348	1,347	1,474	944	1,171
receivables	1,597	1,556	1,669	1,746	1,439	1,814
financial derivatives	36	244	-	-	-	-
current investments	5	6	4	4	2,014	-
cash	902	1,261	1,247	1,212	960	1,148
	4,075	4,415	4,267	4,436	5,357	4,133
assets classified as held for sale	43	-	-	-	-	-
current assets	4,118	4,415	4,267	4,436	5,357	4,133
total assets	10,025	9,626	8,936	9,400	8,996	8,575
shareholders' equity	5,474	4,835	4,812	4,918	5,142	4,239
minority interests	67	22	22	43	44	59
equity	5,541	4,857	4,834	4,961	5,186	4,298
deferred tax liabilities	198	147	-	-	-	-
employee benefits liabilities	363	345	-	-	-	-
provisions	145	266	874	901	682	809
borrowings	1,381	1,497	1,045	1,505	1,337	1,533
other non-current liabilities	53	60	-	-	-	-
non-current liabilities	2,140	2,315	1,919	2,406	2,019	2,342
employee benefits liabilities	25	40	-	-	-	-
provisions	218	218	-	-	-	-
borrowings	329	527	543	382	599	482
financial derivatives	65	59	-	-	-	-
other current liabilities	1,699	1,610	1,640	1,651	1,192	1,453
	2,336	2,454	2,183	2,033	1,791	1,935
liabilities classified as held for sale	8	-	-	-	-	-
current liabilities	2,344	2,454	2,183	2,033	1,791	1,935
total equity and liabilities	10,025	9,626	8,936	9,400	8,996	8,575
capital employed	6,221	5,558	5,554	6,162	4,538	5,763
capital expenditure:						
- intangible assets and property, plant and equipment	401	348	334	433	503	652
- participating interests** and other securities	573	0	0	1,561	33	-
divestments	222	28	28	17	2,037	1,465
depreciation and amortization, continuing operations	496	490	524	429	442	521
net debt****	832	339	337	671	-1,038	867
ratios***:						
net sales / average capital employed	1.34	1.34	1.32	1.21	1.29	1.41
current assets / current liabilities	1.76	1.80	1.95	2.18	2.99	2.14
equity / total assets	0.55	0.53	0.54	0.53	0.58	0.50
net debt / equity plus net debt	0.13	0.06	0.07	0.12	-0.25	0.17

* Figures according to IFRS, including IAS 32 and IAS 39. The figures for previous periods were drawn up according to NLNL GAAP.

** Including goodwill.

*** To enhance comparability the net debt and ratios 2004 do not include the impact of the temporary reclassification of cumulative preference shares A (see also note 8).

Income statement

x € million	2005*	2004*	2004	2003	2002	2001
net sales	8,195	7,832	7,752	6,050	6,665	7,970
change compared with previous year (%)	5	1	28	-9	-16	-1
operating profit plus depreciation and amortization (EBITDA)	1,311	1,067	1,013	723	892	1,042
operating profit (EBIT)	808	562	489	294	450	521
net finance costs	-70	-56	-51	-31	-14	-97
income tax expense	-180	-103	-98	-49	-84	-69
share of the profit of associates	-2	9	8	5	-3	14
net profit excluding exceptional items	556	412	348	219	349	369
net result from exceptional items	-36	-142	-97	-94	840	1,045
profit for the year	520	270	251	125	1,189	1,414
profit attributable to minority interests	7	23	11	14	-1	1
net profit attributable to equity holders of Royal DSM N.V.	527	293	262	139	1,188	1,415
net profit attributable to holders of cumulative preference shares	-16	-22	-22	-22	-22	-22
net profit used for calculating earnings per share	511	271	240	117	1,166	1,393
workforce at 31 December (x 1,000)	22	24	24	26	18	22
employee benefits costs (x € million)	1,385	1,411	1,487	1,215	1,217	1,251
percentage ratios:						
- EBIT / net sales	9.9	7.2	6.3	4.9	6.8	6.5
- CFROI	9.1	8.1	7.6	5.8	7.0	7.7
- net profit / average shareholders' equity available to holders of ordinary shares	10.5	6.2	5.7	2.5	26.8	42.3
EBITDA / net finance costs	18.7	19.1	19.9	23.3	63.7	10.7
dividend (x € million)	207	190	190	188	199	199

* Figures according to IFRS, including discontinued operations. The figures for previous periods were drawn up according to NL GAAP.

Royal DSM N.V. Financial statements 2005

DSM figures: five-year summary – Explanation of some financial concepts and ratios

Information about ordinary DSM shares*

On 5 September 2005 DSM effected a share split on a two-for-one basis (two shares for one old share) in order to increase the liquidity of the DSM share. The data regarding the number of shares and earnings per share in the overview below have been presented as if the ordinary DSM shares had been issued for all periods presented.

per ordinary share in € :	2005**	2004**	2004	2003	2002	2001
net profit excluding exceptional items	2.87	2.09	1.76	1.11	1.69	1.81
net profit	2.68	1.41	1.25	0.62	6.04	7.25
cash flow	5.65	4.52	3.99	2.88	8.34	9.96
shareholders' equity	27.45	25.19	23.86	23.86	24.82	20.24
dividend:	1.00	0.875	0.875	0.875	0.875	0.875
- interim dividend	0.29	0.290	0.290	0.290	0.290	0.290
- final dividend	0.71	0.585	0.585	0.585	0.585	0.585
pay-out as % of net profit before exceptional items	32%	42%	50%	79%	54%	51%
pay-out including dividend on cumulative preference shares as % of net profit before exceptional items	34%	45%	53%	81%	57%	54%
pay-out as % of net profit	37%	62%	70%	143%	15%	13%
dividend yield (based on average price of an ordinary DSM share)	3.4%	4.3%	4.3%	4.5%	3.9%	4.5%
share prices on Euronext Amsterdam:						
- highest price	35.22	23.85	23.85	22.50	25.63	22.58
- lowest price	23.07	17.88	17.88	15.65	18.95	14.40
- at 31 December	34.50	23.81	23.81	19.52	21.69	20.51
x 1,000						
number of ordinary shares outstanding:						
- at 31 December	190,923	191,957	191,957	191,537	193,179	192,293
- average	190,783	191,617	191,617	189,430	192,935	192,180
daily trading volumes on Euronext Amsterdam:						
- average	1,063	1,014	1,014	1,126	1,034	1,086
- lowest	238	26	26	130	140	47
- highest	6,563	6,494	6,494	6,540	3,864	5,538

* The table is based on the annual figures published for the years concerned.

** Figures according to IFRS. The figures for previous periods were drawn up according to NL GAAP.

General

In calculating financial profitability ratios use is made of the average of the opening and closing values of balance-sheet items in the year under review.

The financial indicators per ordinary share are calculated on the basis of the average number of ordinary shares outstanding (average daily number). In calculating shareholders' equity per ordinary share, however, the number of shares outstanding at year-end is used.

In calculating the figures per ordinary share and the 'net profit as a percentage of average shareholders' equity available to holders of ordinary shares', the amounts available to the holders of cumulative preference shares are deducted from the profits and from shareholders' equity.

Definitions

Capital employed

The total of the carrying amount of intangible assets and property, plant and equipment, inventories and receivables, less other current liabilities.

Capital expenditure

This includes all investments in intangible assets and property, plant and equipment as well as the acquisition of participating interests and other securities.

Cash flow

Cash flow is net profit plus depreciation and amortization.

CFROI (Cash Flow Return On Investment)

Cash Flow Return On Investment is the sustainable cash flow (EBITDA minus normative annual tax and minus 1% depreciation on weighted average historic asset base) divided by weighted average asset base plus average working capital.

Divestments

This includes the divestment of intangible assets and property, plant and equipment as well as the sale of participating interests and other securities.

Earnings Before Interest, Tax, Depreciation and Amortization (EBITDA)

EBITDA is the sum total of operating profit plus depreciation and amortization.

Earnings per ordinary share

-Net profit attributable to equity holders of Royal DSM N.V. minus dividend on cumulative preference shares, divided by the average number of ordinary shares outstanding.

-Net profit attributable to equity holders of Royal DSM N.V. excluding exceptional items minus dividend on cumulative preference shares, divided by the average number of ordinary shares outstanding.

Total Shareholder Return (TSR)

Total Shareholder Return is capital gain plus dividends.

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Annual report

Copies of this report (which is also available in the original Dutch version) can be ordered by phone (+31 800 0233480) or e-mail (DSM@servicebureau.nl).

Internet

The information contained in this annual report is also available via DSM's website: www.dsm.com. You can view the annual report online and also download and print parts of it.

Information

Our other publications and sources of information are:

- Internet: www.dsm.com
- Triple P Report 2005
- Brochure: The Unlimited World of DSM

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