METRO AG

ANNUAL REPORT 1997

Metro Wholesale [1]	METRO	makro	C+C Schaper
Department Stores	GALERIA KAUFHOF	Horten	KAUFHALLE
Hypermarkets	real,-		
Food Stores	extra		
Discount Stores	TIP		
Consumer Electronics Centers	Media Markt	SATURN	
Home Improvement Centers	Praktiker	WIRICHS	
Computer Centers	VOBIS MICROCOMPUTER	MAXDATA	PEACOCK
Fashion Centers	Adler		
Footwear Centers	SCHUHCENTRUM		
Restaurant and Catering	DINEA		
Real Estate	MGV	BSV	CMG
Others	Hungis Express	JACQUES' WEIN-DEPOT	Weinkellerei Wein- und Sekt Kontor

[1] includes Makro since January 1,1998

Highlights

METRO AG Group: Key figures

	1997 DM million	1996 DM million
Gross sales (including VAT)	**64,131**	62,024
Income from ordinary operations	**930**	1,062
Net income	**623**	717
Net income excluding third-party P/L shares	**554**	610
DVFA/SG earnings	**777**	712
Return on equity after taxes	**12.6%**	14.9%
Capital expenditure [1]	**1,891**	1,639
DVFA/SG cash flow	**1,981**	1,898
Total assets	**25,414**	20,777
Equity	**4,962**	4,826
Capital stock	**1,218**	501
Per DM 5 share [2]	**DM**	DM
DVFA/SG earnings	**3.19**	2.96
Cash dividend [3]		
• Common stock	**2.00**	1.67
• Preferred stock I [4]	**2.11**	1.77
• Preferred stock II [4]		1.77
Dividend including tax credit [3] [5]		
• Common stock	**2.03**	1.70
• Preferred stock I [4]	**2.14**	1.80
• Preferred stock II [4]		1.80
DVFA/SG cash flow	**7.85**	7.44

1) Additions to tangible and intangible assets, excluding goodwill

2) 1996 figures adjusted to take account of the capital increase via the 5:7 scrip issue of July 23, 1997

3) 1996 dividend includes a pro rata bonus payment of DM 0.83 per share (common and preferred stock)

4) The two types of preferred stock have been combined to form a single type of preferred stock without voting rights in line with the resolution passed at the stockholders' meeting of July 9, 1997

5) For stockholders resident in Germany

METRO AG Group: Divisional results 1997

	1997 DM million	1996 DM million
Metro Wholesale [1]	**385.9**	427.7
Department Stores [2]	**142.8**	203.6
Hypermarkets	**128.1**	99.7
Food Stores [1]	**73.7**	80.4
Discount Stores	**(74.4)**	(26.8)
Consumer Electronics Centers	**347.0**	240.4
Home Improvement Centers	**81.3**	186.9
Computer Centers	**37.5**	46.0
Fashion Centers	**92.2**	28.2
Footwear Centers	**(30.3)**	24.9
Restaurant and Catering	**17.6**	21.1
Real Estate	**134.9**	179.4
Others [2] [3]	**68.5**	(36.3)
Income from ordinary operations of the divisions before amortization of goodwill	**1,404.8**	1,475.2
– less holding company's result	**(235.1)**	(219.3)
– less goodwill amortized	**(239.5)**	(193.9)
Income from ordinary operations	**930.2**	1,062.0
Extraordinary income	**0.2**	–
– less income taxes	**(250.9)**	(274.5)
– less other taxes	**(56.7)**	(70.3)
Net income of the Group	**622.8**	717.2

1) C&C Schaper has been transferred from Food Stores to Metro Wholesale

2) Michel Farah has been transferred from Department Stores to Others

3) The 1996 results for the furniture and mail order divisions, from which Metro has withdrawn, are included under Others

Contents

METRO AG

Dear Stockholders,

Nearly two years after the flotation of our company, we would like to take stock of two key trends: How far have we come towards meeting our medium-term goals and what activities are we focusing on in 1998?

What have we achieved so far?

- We have made good progress in the streamlining of our portfolio by withdrawing from non-core operations and activities that could not meet long-term profitability targets.

- The acquisition of the European C&C operations of SHV Makro NV will place the METRO AG Group among the leading international players in 1998. Through its divisions METRO AG operates at over 750 locations in 19 countries. Its foreign operations are expected to generate sales of over DM 34 billion in 1998. Foreign sales will thus be well ahead of the 30 percent target at the time of the merger.

- The acquisition of the Allkauf Group, one of Germany's best-known hypermarket chains, has greatly strengthened the Hypermarkets division. Providing this acquisition is approved by the Federal Cartel Office, it will add 86 stores with about 483,000 m² of sales space to the division's portfolio.

- The restructuring of the hypermarkets and city-center department stores is proceeding on schedule and has so far met our expectations. Profitability has improved as expected at the 47 department stores converted to the Galeria Kaufhof format. In southern Germany, the last region to be tackled by the Hypermarkets division, all but a few stores have now been converted to the Real concept.

- All chains that are of significance for international expansion, with the exception of Praktiker, performed exceptionally well in Germany: Real, Media-Saturn and Adler all posted strong profit rises and the C&C operations again provided clear evidence of their high earnings power.

- Merger-related synergies totaled DM 240 million, well above our original target of DM 131 million. However, as a result of tougher competition, most of these gains will have to be invested in expanding our market position, especially on our home market.

What is still to be done?

To improve our overall performance, this year we need to focus on the following activities:

- Integrating the outlets acquired from SHV Makro NV into the Wholesale division has top priority. We expect Makro to boost this division's sales and earnings considerably this year.

- Another key focus is the integration of the Allkauf outlets. This acquisition has given us extremely well-positioned hypermarkets with net sales of around DM 4 billion and thus greatly strengthened our Hypermarkets division.

- International expansion will gain momentum in 1998, with Metro/Makro, Media-Saturn, Real, Praktiker and Adler planning to open a total of 52 new stores.

- METRO AG will continue its systematic benchmarking and restructuring operations and its drive to improve cost structures. Other areas of focus will be optimizing the flow of goods from suppliers to customers and improvements to administrative and logistics processes (optimization of the process chain).

- The sale of the operating business of Kaufhalle AG to Kaufhof Warenhaus AG has laid the foundations for complete restructuring of Kaufhalle, which has posted a disappointing performance to date. It will probably take us three years to stabilize these operations and restructuring will reduce earnings by about DM 150 million over this period.

- The downturn in the German home improvement sector has had serious repercussions on Praktiker. The downswing, which was partly due to major structural changes, has now bottomed out and we expect store space to expand far more slowly in 1998. The underlying trend in gross profits improved in the first few months of this year.

- We expect expansion of our Tip store format to generate further losses. High start-up losses for new stores and the establishment of the necessary infrastructure in Germany and Poland will depress earnings considerably for another two years. However, there is no alternative to rapid expansion of our store network if we wish this discounter concept to become established. We are therefore planning to open about 75 stores in Poland alone in 1998, followed by another 100 in 1999.

- Reno will be repositioned this year. This will include full acquisition and integration of the Mayer Schuh footwear chain. We are anticipating a strong improvement in this division's performance this year.

Result from ordinary operations

The result from ordinary operations totaled DM 930 million (DM 1,062 million in 1996). Although allowance had already been made for substantial restructuring expenses, start-up losses of over DM 100 million as a result of faster international expansion and expenses for expansion/protection of our market shares, the absolute result for the full year was below our expectations.

Earnings and cash flow per share up on the previous year

DVFA/SG earnings came to DM 777 million or DM 3.19 per share, a rise of 9.2 percent / 7.8 percent on the adjusted 1996 figure. DVFA/SG cash flow rose 4.4 percent to DM 1.98 billion, chiefly as a result of a DM 143 million rise in depreciation/write-downs of fixed assets and amortization of goodwill.

Strong rise in dividend payout

For fiscal 1997, the Supervisory Board and Executive Board are proposing a dividend of DM 2.00 for common stock and DM 2.11 for preferred stock. This would lift the absolute payout substantially to DM 489.7 million (1996: DM 403.4 million). DM 220.3 million have been transferred to the reserves retained from earnings.

Outlook

Although business conditions remain difficult in the German retail sector this situation is also a catalyst for change: it is speeding up the shake-out of the market and creating scope for the necessary cost reductions.

With net sales of around DM 95 billion, we will expand our position as the Number Two in the retail/wholesale sector and retain our policy of selective and above all profitable growth in foreign markets.

In 1997 we were again able to rely on the commitment of our employees. We wish to thank them for successfully completing a wide range of challenging assignments in a very short time.

We would also like to thank our shareholders, customers and business associates for their trust and support over the past year.

Sincerely:

Wiegandt

Kaske

Dr. Körber

Dr. Loose

de Raad

Suhr

725750 725753

Organizational structure of the Group

In the first full fiscal year following its establishment, METRO AG optimized its organizational structure as the management holding company at the head of an international trading and services group.

As the Group management, METRO AG establishes strategies and targets in conjunction with the divisions. Within its field of responsibility, it decides on the allocation of resources, globalization and how to generate synergies. It coordinates the divisions and outlet chains and is responsible for the selection and career development of qualified executives within the Group.

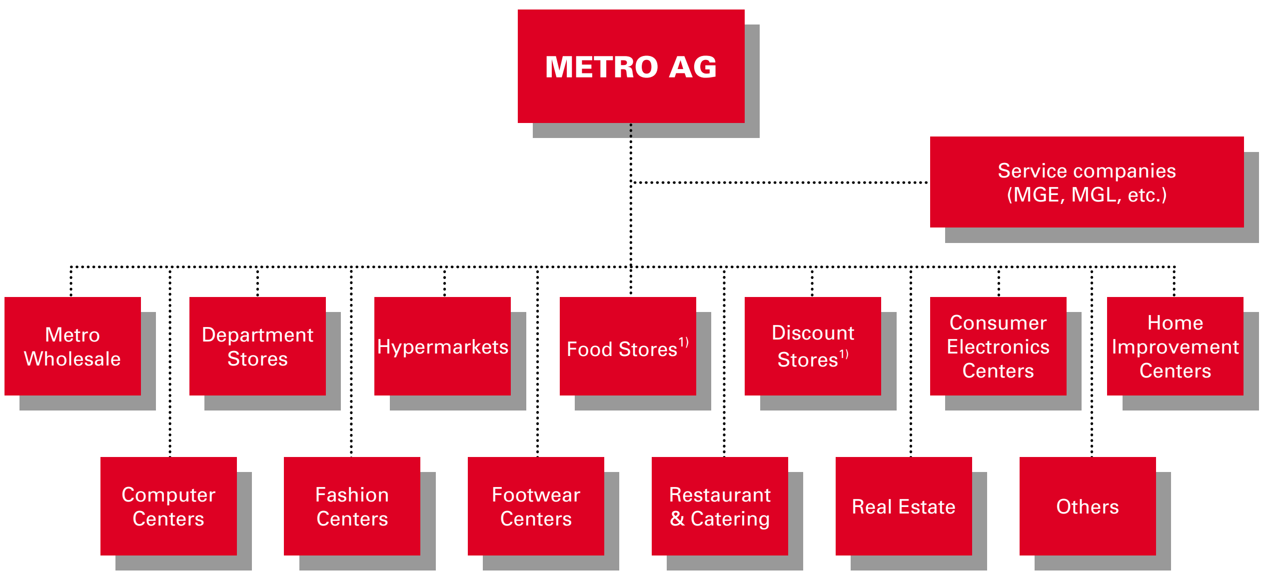
The Group comprises 13 (1996: 14) divisions, some of which are subdivided into outlet chains. In addition, service companies operating as independent legal entities provide central services for the divisions.

The Group's portfolio comprises the following divisions: Metro Wholesale, Department Stores, Hypermarkets, Food Stores, Discount Stores, Consumer Electronics Centers, Home Improvement Centers, Computer Centers, Fashion Centers, Footwear Centers, Restaurant & Catering, Real Estate and Others. These divisions are independent operating units with full earnings responsibility.

The service companies provide know-how for the entire Group and are under the direct control of METRO AG. They include Metro MGE Einkauf (purchasing), Metro MGL Logistik (logistics), Metro MGI Informatik (information technology) and Metro MWG Werbung (advertising).

In 1997, priority was given to developing the Group's core competencies, stepping up expansion into international markets, coordinating the divisions' business operations, providing well-qualified executives, streamlining Group structures and optimizing decision-making processes.

A simplified overview of the Group structure is shown below:



[1] Combined in the Food Stores & Discounters division in the previous fiscal year

Group sales

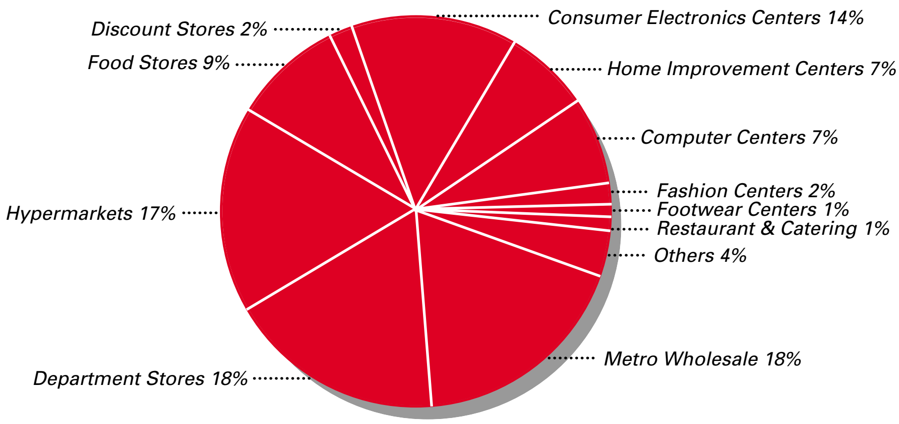
In 1997, the METRO AG Group generated gross sales of DM 64.1 billion (+3.4 percent). This includes the following acquisitions: Peacock (Computer Centers division) as at June 1, 1997 (pro rata sales: DM 787 million), Wirichs (Home Improvement Centers) as at October 1, 1997 (pro rata sales: DM 204 million) and Büffeteria (Restaurant & Catering) as at February 1, 1997 (sales: DM 42 million).

For comparison, sales must be adjusted to account for disposals from the Food Stores division (Bolle, Schätzlein) with effect from February 1/May 1, 1996, respectively, which generated proportionate sales of DM 257 million, Metro Wholesale (BLV) which posted sales of DM 364 million in the year to December 31, 1996, Fashion Centers (Mac Fash), which accounted for sales of DM 134 million up to December 31, 1996, and Furniture Centers (Unger/Massa), which generated sales of DM 629 million to June 30, 1997, and DM 1,506 million in 1996.

After adjustment for these acquisitions/disposals, Group sales rose by DM 2.7 billion (+4.5 percent).

Expansion into foreign markets was stepped up significantly, as planned. Five chains (Real, Media-Markt, Praktiker, Adler and Vobis) launched operations in further European countries. The METRO AG Group raised foreign sales 50.1 percent to DM 4.5 billion. Foreign sales accounted for 7.1 percent of total sales.

Breakdown of sales of METRO AG Group



Divisional breakdown of sales and earnings

METRO AG Group: Sales trends (gross)

	1997 DM million	1996 DM million	Year-on-year change (in %)
Metro Wholesale[1]	**11,376**	11,632	(2.2)
Department Stores[2]	**11,368**	11,520	(1.3)
Hypermarkets	**10,787**	10,722	0.6
Food Stores[1]	**6,050**	5,914	2.3
Discount Stores	**1,563**	1,346	16.1
Consumer Electronics Centers	**8,686**	7,632	13.8
Home Improvement Centers	**4,656**	4,304	8.2
Computer Centers	**4,514**	3,135	44.0
Fashion Centers	**1,357**	1,417	(4.2)
Footwear Centers	**815**	816	(0.1)
Restaurant & Catering	**493**	474	4.0
Others[2] [3]	**2,466**	3,112	(20.8)
METRO AG Group	**64,131**	62,024	3.4
thereof foreign operations	**4,525**	3,015	50.1

1) C&C Schaper has been transferred from Food Stores to Metro Wholesale

2) Michel Farah has been transferred from Department Stores to Others

3) Primarily Möbel Unger/Massa furniture stores, Free Com Die Telekommunikationsgesellschaft, Oppermann, Rungis-Express Group, Hawesko, Jacques' Weindepot. Sales generated in 1996 by the Furniture Centers and Mail Order divisions, from which the Group has now withdrawn, are included under Others in this breakdown

In 1997, the METRO AG Group achieved a result from ordinary operations of DM 930.2 million (–12.4 percent compared with 1996).

Breakdown of the result from ordinary operations in the METRO AG Group

	1997 DM million	1996 DM million	Year-on-year change (in DM million)
Metro Wholesale[1]	**385.9**	427.7	(41.8)
Department Stores[2]	**142.8**	203.6	(60.8)
Hypermarkets	**128.1**	99.7	28.4
Food Stores[1]	**73.7**	80.4	(6.7)
Discount Stores	**(74.4)**	(26.8)	(47.6)
Consumer Electronics Centers	**347.0**	240.4	106.6
Home Improvement Centers	**81.3**	186.9	(105.6)
Computer Centers	**37.5**	46.0	(8.5)
Fashion Centers	**92.2**	28.2	64.0
Footwear Centers	**(30.3)**	24.9	(55.2)
Restaurant & Catering	**17.6**	21.1	(3.5)
Real Estate	**134.9**	179.4	(44.5)
Others[2] [3]	**68.5**	(36.3)	104.8
Result from ordinary operations of the divisions before amortization of goodwill	**1,404.8**	1,475.2	(70.4)
less holding company's result	**(235.1)**	(219.3)	(15.8)
less goodwill amortized	**(239.5)**	(193.9)	(45.6)
Result from ordinary operations	**930.2**	1,062.0	(131.8)
Extraordinary result	**0.2**	–	0.2
less income taxes	**(250.9)**	(274.5)	23.6
less other taxes	**(56.7)**	(70.3)	13.6
Net income of the Group	**622.8**	717.2	(94.4)

1) C&C Schaper has been transferred from Food Stores to Metro Wholesale

2) Michel Farah has been transferred from Department Stores to Others

3) The 1996 results for the Furniture Centers and Mail Order divisions, from which Metro has withdrawn, are included under Others in this breakdown

Notes on the divisional sales and earnings trends

Metro Wholesale booked sales of DM 11.4 billion (–2.2 percent) in 1997. This includes for the first time sales of DM 625.5 million (+4.4 percent) generated by the Schaper C&C business, which was transferred to this division with effect from January 1, 1997. These operations have been eliminated from the Food Stores division and stated under Metro Wholesale for both years shown in the comparative overview. Excluding BLV-Grossverbraucherservice, which was divested as of December 31, 1996, sales rose 1.0 percent. Expansion continued, with the division opening two C&C stores in China and one in Romania, as well as two Sigma office supplies centers and a C&C Schaper outlet. Cost management and selective advertising enabled Metro Wholesale to maintain its position as the dominant earnings generator in the Group, posting earnings of DM 385.9 million, even though this was DM 41.8 million below the previous year's result, mainly because of start-up losses resulting from international expansion.

The *Department Stores* division suffered from weak consumer spending, which depressed sales by 1.3 percent to DM 11.4 billion. The Kaufhof Warenhaus Group reported a 0.4 percent drop in sales to DM 9.3 billion while sales slipped 5.3 percent year-on-year to DM 2.1 billion at Kaufhalle AG. The Kaufhof-Warenhaus Group boosted earnings to DM 194.9 million, whereas the Kaufhalle Group reported a loss of DM 52.1 million.

As part of the restructuring of the *Hypermarkets* division, 10 stores with total sales of DM 250 million were transferred to the Food Stores division in 1997. More former Meister supermarkets were converted to the Real format, Real opened five hypermarkets in Germany and four in Poland, and three stores were closed. In a market characterized by aggressive price competition, this division registered sales of DM 10.8 billion (+0.6 percent) and raised earnings by DM 28.4 million to DM 128.1 million despite start-up losses resulting from international expansion.

Following the transfer of C&C Schaper to Metro Wholesale, the *Food Stores* division registered 2.3 percent sales growth to DM 6.1 billion. Excluding the stores transferred from Real, this division opened 31 stores and closed 11 smaller outlets in 1997. Earnings were DM 6.7 million lower than the previous year at DM 73.7 million.

The *Discount Stores* division posted a 16.1 percent rise in sales to DM 1.6 billion following the opening of 109 stores in Germany and 20 in Poland. Partly because of these new stores, the division's loss increased by DM 47.6 million to DM 74.4 million.

The *Consumer Electronics Centers* division again provided evidence of the success of its concept, reporting 13.8 percent growth in sales to DM 8.7 billion. Even earnings rose over-proportionately by DM 106.6 million to DM 347.0 million, despite expansion costs. This division opened 23 new stores in 1997, including 7 outside Germany. By expanding its range of hard and software, multimedia and telecommunications products, the Consumer Electronics Centers division is in a position to participate in the strong growth in these segments.

The *Home Improvement Centers* division posted sales of DM 4.7 billion (+8.2 percent). This figure includes pro rata sales of DM 204 million for the 59 stores in the Wirichs Group, which was acquired with effect from October 1, 1997. Adjusted for this acquisition, sales rose 3.4 percent. The division opened seventeen new stores in Germany and three in other countries. It also prepared for market entry in Hungary, Italy and Turkey. A sharp drop in sales on a like-for-like basis and the drive to expand into foreign markets were the main reasons for the DM 105.6 million decline in earnings to DM 81.3 million.

The *Computer Centers* division boosted sales 44.0 percent to DM 4.5 billion. Excluding the acquisition of Peacock as of June 1, 1997 (sales: DM 787 million), sales growth was 18.9 percent. The chief factors in this were the performance of the wholesale segment (Maxdata) and expansion into foreign markets, especially Belgium, Spain, Italy, the Netherlands, Switzerland and Poland. Overall, 22 stores were opened, while 36 smaller outlets were closed or converted to franchises. As a result of aggressive competition and declining volume sales, especially in Germany, earnings were DM 8.5 million down on the previous year at DM 37.5 million.

As a result of the disposal of the Mac Fash stores, which generated sales of DM 134 million in 1996, the *Fashion Centers* division registered a 4.2 percent drop in sales to DM 1.4 billion. However, after making allowance for this divestment, the division booked sales growth of 5.7 percent. Eight stores were added in 1997 and two were closed. Despite expenses for the opening of new stores in Germany and Poland, earnings advanced DM 64.0 million to DM 92.2 million. It should, however, be noted that the 1996 figure includes exceptional expenses of DM 42 million for relocation of the logistics center.

The *Footwear Centers* division only narrowly failed to match the previous year's performance, booking sales of DM 815 million (–0.1 percent). Reno continued its expansion drive, opening 82 new stores in 1997. This division made a loss for the first time (DM 30.3 million), chiefly as a result of accruals for the forthcoming restructuring of its investment in Mayer Schuh GmbH. The division's earnings were depressed significantly by an approx. DM 53 million charge relating to its stake in Mayer Schuh GmbH.

The *Restaurant & Catering* division raised sales 4.0 percent to DM 493 million. Adjustment for sales of DM 42 million from Büffeteria, which was acquired with effect from February 1, 1997, gives a decline in sales of 4.9 percent. This, together with non-recurring factors, pushed earnings down DM 3.5 million to DM 17.6 million.

The *Real Estate* division reported earnings of DM 134.9 million in 1997. The year-on-year decline of DM 44.5 million was predominantly attributable to lower book gains on the sale of real estate and investment for the expansion of operations in Germany and abroad.

Revenues generated by Metro's service companies through synergy projects have been apportioned to the divisions on a pro rata basis.

Group net income and DVFA/SG earnings

In 1997, Group net income was 13.2 percent below the previous year's level at DM 622.8 million. After deduction of profits allocated to third parties, the net income attributable to METRO AG's stockholders comes to DM 553.9 million. That represents a year-on-year decline of 9.3 percent. Adjustment for non-recurring effects gives DVFA/SG earnings per share of DM 3.19. After adjustment for the capital increase, which raised the number of shares in circulation from 100,242,419 as of December 31, 1996 to 240,581,806, DVFA/SG earnings were 7.8 percent higher.

Annual accounts of METRO AG

The annual accounts of METRO AG, the parent company of the METRO AG Group, as of December 31, 1997 show a sound asset, financial and earnings position. Total assets came to DM 11.8 billion, mainly comprising financial assets and receivables from Group companies, giving an equity ratio of 36.5 percent. Net debt rose by DM 1,942.5 million from December 31, 1996 to DM 2,049.5 million on December 31, 1997, mainly as a result of increased financing of acquisitions and expansion at subsidiaries. Net income of METRO AG, which chiefly comprises income from investments in subsidiaries, was DM 710.0 million. After transfer of DM 220.3 million to the reserves retained from earnings, METRO AG had net earnings amounting to DM 489.7 million.

Following the resolution made at the Annual Stockholders' Meeting of July 9, 1997 and the entry in the Commercial Register of July 11, 1997, the capital stock of METRO AG was raised by DM 701.7 million to DM 1,202.9 million by a 7:5 scrip issue. The capital increase involved the issue of 126,922,649 common shares, 11,149,432 preferred shares I and 2,268,000 preferred shares II. At the Annual Stockholders' Meeting held on July 9, 1997 and the separate meeting of holders of preferred stock I and II held on the same day, it was resolved to combine the non-voting preferred stock types I and II to form new non-voting preferred stock with a uniform cumulative dividend of 6.4 percent and a uniform non-cumulative bonus of 2.2 percent. The corresponding amendments to the Articles of Association were entered in the Commercial Register on August 4, 1997.

The share exchange ratios set at the time of the merger of Asko Deutsche Kaufhaus AG, Deutsche SB-Kauf AG and Kaufhof Holding AG with METRO AG in 1996 are to be reviewed by the District Courts in Saarbrücken, Frankfurt am Main and Cologne following an appeal lodged by former stockholders of these three companies. The applicants claim that they were disadvantaged because the exchange ratio was too low. The status of these cases and the arguments put forward by the applicants do not give any grounds to doubt the correctness of the exchange ratios set in the merger agreements.

The complete accounts of METRO AG, which have been given an unqualified opinion by the auditors, Fasselt-Mette & Partner Wirtschaftsprüfungsgesellschaft, will be published in the Federal Gazette ("Bundesanzeiger") and filed with Cologne Local Court under HRB 26888. Copies are available from METRO AG.

METRO AG
Balance sheet as of December 31, 1997

Assets

In DM million	**Balance at Dec. 31,1997**	Balance at Dec. 31,1996
Fixed assets		
Intangible assets	**0.164**	0.326
Tangible assets	**5.154**	4.654
Financial assets	**6,271.448**	5,971.300
	6,276.766	5,976.280
Current assets		
Receivables and sundry assets	**4,778.474**	2,707.489
Short-term securities and note loans	**36.657**	305.628
Cash on hand and in bank	**690.119**	768.218
	5,505.250	3,781.335
Prepaid expenses and deferred charges	**13.578**	6.869
	11,795.594	9,764.484

Stockholders' equity and liabilities

In DM million	**Balance at Dec. 31,1997**	Balance at Dec. 31,1996
Stockholders' equity		
Capital stock	**1,217.952**	501.212
Reserve from capital surplus	**2,161.063**	2,729.608
Reserves retained from earnings	**431.319**	211.070
Unappropriated retained earnings	**489.711**	403.366
	4,300.045	3,845.256
Untaxed/special reserves	**170.608**	217.856
Accruals	**764.783**	879.669
Liabilities	**6,557.668**	4,820.611
Deferred income	**2.490**	1.092
	11,795.594	9,764.484

METRO AG
Income statement
for the year ended December 31, 1997

In DM million	1997	1996
Income from investments	**1,109.494**	1,012.437
Net financial result	**(28.387)**	(43.921)
Other operating income	**311.403**	394.407
	1,392.510	1,362.923
Personnel expenses	**(109.246)**	(93.966)
Amortization of intangible assets and depreciation of tangible assets	**(2.787)**	(4.232)
Other operating expenses	**(427.748)**	(526.575)
	(539.781)	(624.773)
Result from ordinary operations	**852.729**	738.150
Extraordinary result	**(121.486)**	–
Income taxes	**(24.018)**	(110.280)
Other taxes	**2.735**	(13.434)
Net income	**709.960**	614.436
Transfer to reserves retained from earnings	**(220.249)**	(211.070)
Net earnings	**489.711**	403.366

Profit appropriation

The Supervisory and Executive Boards of METRO AG will propose to the Annual Stockholders' Meeting on July 7, 1998 that the profit of DM 489.7 million remaining after transfer to the reserves retained from earnings should be appropriated as follows:

- to pay a cash dividend of DM 2.00 per share of common stock of DM 5 par value,

- to pay a cash dividend of DM 2.11 per share of preferred stock of DM 5 par value.

Attached to the dividend payment is a tax credit of 3/7 of DM 0.062 per share of common stock and 3/7 of DM 0.065 per share of preferred stock. Stockholders resident in Germany may offset this credit against their personal or corporate income taxes, together with the capital yields tax and solidarity surcharge.

Group cash flow and capital expenditure

METRO AG generated a cash flow of DM 2,074 million. This was 9.7 percent above capital spending on tangible and intangible assets (excluding the acquisition of companies), which totaled DM 1,891 million. Cash flow was 6.5 percent higher than in the previous year.

METRO AG Group: Cash flow

In DM million	1997	1996
Net income of the Group	**623**	717
Amortization/depreciation/ write-downs of fixed assets	**1,361**	1,218
Change in long-term accruals	**(22)**	7
Transfer to untaxed/ special reserves	**17**	17
All other items	**95**	(11)
	2,074	1,948

The Real Estate division invested DM 536.7 million, primarily to secure the acquisition of land in Germany and abroad and to erect buildings.

The Department Stores division invested DM 394.1 million. The focus here was on the continued switch to the Galeria Kaufhof merchandising concept.

Integration of new sites into the Real store concept resulted in capital expenditure of DM 236.5 million in the Hypermarkets division.

Metro Wholesale invested DM 188.0 million, mainly for expansion in China and Romania.

Consumer Electronics Centers spent DM 163.7 million on expansion of its network of stores in Germany and abroad.

Expansion into foreign markets and the opening of new stores in Germany generated capital expenditure of DM 79.5 million in the Home Improvement Centers division.

Capital structure and assets of the Group

The balance sheet for the METRO AG Group shows equity capital of DM 4,962 million at year-end 1997, which covers 37.7 percent of fixed assets. Total assets of DM 25,414 million give an equity ratio of 19.5 percent. Net financial accounting indebtedness after offsetting interest-bearing assets and liabilities is around DM 5,308 million, that is 20.9 percent of total liabilities.

In the future, property management will play a more significant role in the Group's strategy. METRO AG has majority stakes in a large number of real estate companies. For historical reasons, most of these are operated autonomously by leasing companies. As part of this new strategy, voting rights in 167 real estate companies have been adjusted to reflect the stakes held. As a result, these companies were included in the Group accounts as of December 31, 1997 for the first time. Consolidation of these companies raised fixed assets by DM 2,777 million, long-term liabilities by DM 2,195 million and short-term liabilities by DM 256 million.

Structure of the Group balance sheet

In DM million	**1997**	1996
Assets		
Fixed assets	**13,174**	9,673
Current assets	**12,240**	11,104
	25,414	20,777
Equity and liabilities		
Equity	**4,962**	4,826
Long-term debt	**5,111**	3,061
Short-term debt	**15,341**	12,890
	25,414	20,777

Material events occurring after the end of the fiscal year

Acquisition of the European cash-and-carry operations of the Makro Group

METRO AG acquired the European operations of the Makro Group from SHV Makro NV, Utrecht, with effect from January 1, 1998. Makro had stakes of up to 60 percent in 86 C&C stores in the UK, the Netherlands, Belgium, Spain, Portugal, Greece, Poland, the Czech Republic and Morocco. The remaining shares are still held by Metro Holding AG, Baar, Switzerland. At the same time, METRO AG acquired the 40 percent stake held by Makro in the operations of Metro Holding AG in Denmark, Austria, France, Italy, Hungary and Turkey. In these countries, Metro International Management GmbH, a 100 percent subsidiary of METRO AG, was already responsible for the C&C operations under a business management agreement.

Part of the acquisition took the form of a capital increase against contribution in kind. SHV Makro NV transferred its entire European C&C business (including the operations in Morocco) to Mebrö Beteiligungs AG, Frankfurt am Main (now Metro Cash & Carry AG) in return for shares worth around DM 1.8 billion and the establishment of a claim of around DM 3 billion on Mebrö Beteiligungs AG. METRO AG then used the authorized capital II approved at the Stockholders' Meeting on September 11, 1997 to grant SHV Makro NV a total of 21,760,000 bearer shares in return for the transfer of all shares in Mebrö Beteiligungs AG. The resultant capital increase of DM 108.8 million was entered in METRO AG's Commercial Register at Cologne Local Court on January 6, 1998. Taking into account the liabilities acquired in Mebrö Beteiligungs AG, the total price of the transaction was around DM 4.8 billion.

In connection with the acquisition of the stakes in SHV Makro NV and a number of subsidiaries, in December 1997 METRO AG and Metro Holding AG signed an option agreement on their mutual investments in the Makro and Metro wholesale operations in the countries listed above. Under this agreement, METRO AG has the right to require Metro Holding AG to transfer all direct and indirect stakes held by this company in Makro's foreign operations. This right can be exercised at six months notice as of December 31 in the period 1998 to 2001 or as of June 30, 2002.

In return, Metro Holding AG has the right to sell all direct and indirect stakes in the Makro companies to METRO AG. This right can be exercised for the first time with effect from June 30, 2002. In this case, METRO AG has the right, either to sell its stake in Metro's foreign operations to Metro Holding AG, or to require Metro Holding AG to transfer to it its stakes in Metro's foreign operations. If METRO AG does not utilize the above rights, Metro Holding AG has the right to require METRO AG to transfer its stakes in Metro's foreign operations to Metro Holding AG.

The aim of the option agreement is to bring together the entire foreign operations of Makro and Metro in the hands of METRO AG.

The purchase prices to be paid upon exercise of these options will be calculated on the basis of the formula used when the Makro subsidiaries were acquired from SHV Makro NV.

Acquisition of the Allkauf Group

Pending approval by the anti-trust authorities, in February 1998 METRO AG acquired all shares in Viehof GmbH, Mönchengladbach, the umbrella company of the Allkauf-SB-Warenhaus Group, retroactively with effect from January 1, 1998. In 1997, Allkauf generated sales of around DM 4.7 billion at 86 hypermarkets with total selling space of around 483,000 m^2 (excluding the Otten franchise operator). In addition, the Allkauf Group has granted franchises for 91 photographic stores, 152 travel agencies and 9 "allkauf" hypermarkets operated on a franchise basis by Otten. The Allkauf Group is an ideal strategic addition to the Hypermarkets division because of its strong bias towards North-Rhine Westphalia.

Share purchase offer to Kaufhalle stockholders and sale of Kaufhalle's operating business to Kaufhof Warenhaus AG

In February 1998, METRO AG made a voluntary public offer for the free float of Kaufhalle AG, Cologne, a 90.5 percent subsidiary of METRO AG, at a price of DM 200 per share of DM 50 par value. The bid, which is conditional upon a minimum take-up rate of 126,700 shares, is part of the sale of the operating business of Kaufhalle AG to Kaufhof Warenhaus AG. By the deadline set, 141,968 Kaufhalle shares had been offered to METRO AG, giving it 95.6 percent of the capital of Kaufhalle AG.

At the Annual Stockholders' Meeting of Kaufhalle AG on April 1, 1998, a 99.15 percent majority of the stockholders voted to sell the operating business to Kaufhof Warenhaus AG for DM 88.2 million. Some stockholders have announced that they will be appealing against the resolution.

Outlook

METRO AG is continuing to pursue its medium-term business objectives, namely

- a Group return on sales of 3 percent before taxes, based on the average for the divisions,

- a return on equity of 15 percent after taxes.

METRO AG has extended its market position by acquiring Allkauf and the European C&C operations of SHV Makro NV. The Group expects to report net sales of DM 95 billion in 1998. Foreign sales will rise to around 38 percent of the total, chiefly as a result of the acquisition of Makro.

METRO AG will continue to strengthen and expand its market position in 1998 and seize all market opportunities for its core businesses. To this end, the integration of Makro and Allkauf will have top priority.

The METRO AG Group will continue its drive for selective and above-all profitable growth in foreign markets.

Dependency report

Pursuant to Art. 20 para. 4 of the German Stock Corporation Act, in a letter dated January 4, 1996, Metro Vermögensverwaltung GmbH & Co KG, Düsseldorf, informed METRO AG that it holds a majority stake in METRO AG. Similarly, under the terms of Art. 20 para. 4 in conjunction with Art. 16 para. 4 of the German Stock Corporation Act Metro Holding AG, Baar, Switzerland, informed METRO AG that it owns a majority stake in METRO AG indirectly through Metro Vermögensverwaltung GmbH & Co KG, which is controlled by Metro Holding AG under the terms of Art. 17 para. 1 of the German Stock Corporation Act. Accordingly, in compliance with Art. 312 of the Stock Corporation Act, the Executive Board of METRO AG prepared a report on Group affiliation.

The dependency report for fiscal 1997, which has been given an unqualified opinion by the auditors, Fasselt-Mette & Partner Wirtschaftsprüfungsgesellschaft, Duisburg, was submitted to the Supervisory Board. The Executive Board ends its report with the following declaration:

"The Executive Board of METRO AG states and represents that, under the circumstances which were known to the Executive Board at the time legal transactions were entered into, the Company has in all cases received an equitable consideration. Other reportable actions were neither taken nor omitted."

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Economic background

Germany

Economic growth picked up slightly in Germany in 1997, with real GDP rising 2.2 percent, compared with 1.4 percent in 1996. However, there were clear differences in both regional and sector trends. In western Germany, real GDP grew 2.2 percent, compared with 1.3 percent in 1996 but in eastern Germany growth was just 1.6 percent, compared with 1.9 percent the year before. Consequently, the economic growth rate in eastern Germany dropped below the western German level for the first time.

The economic upswing was mainly export-led. Boosted by a clear improvement in international competitiveness, exports rose 10.7 percent in real terms. By contrast, domestic demand remained weak, booking a real rise of just 1.2 percent. Despite real growth of 3.9 percent in capital spending, real construction spending declined 2.2 percent. State spending did not inject any impetus into the domestic economy either as fiscal policy was primarily geared to meeting the Maastricht criteria for monetary union. Public-sector consumption declined 0.4 percent in real terms.

Private consumption was even weaker than in previous years (+0.2 percent in real terms). A decline in real wages, coupled with mounting employment problems, was the main reason for persistently low consumer confidence. The unemployment rate (based on the civilian labor force) rose to an annual average of 11.4 percent, with eastern Germany registering a far stronger rise (from 15.7 percent to 18.1 percent) than the west of the country (up from 9.1 percent to 9.8 percent). On average, there were nearly 4.4 million jobless in Germany in 1997. That was about 9.6 percent more than in 1996.

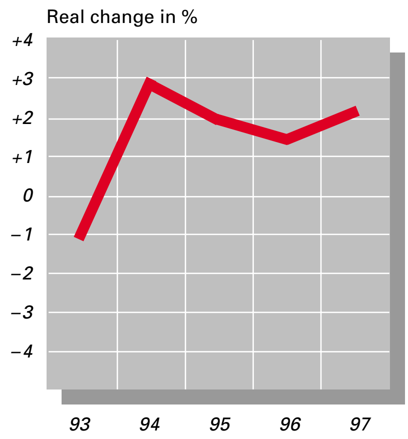
Retail and wholesale trade

The German retail trade generated sales of DM 952.3 billion in 1997. This was in line with the previous year's level (±0.0 percent) but represented a decline of 0.5 percent in real terms.

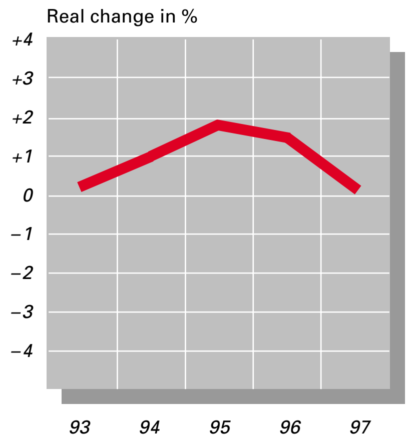
The proportion of private consumption being channeled into the retail sector has been declining for years. This contraction continued in 1997 even though private consumption as a whole was virtually unchanged. Since real incomes are not growing and the savings rate has reached a historic low, private households are scaling back spending on consumer goods to compensate for higher spending on services, rents, holidays, etc.

The Federal Statistics Office reported the following nominal declines in sales in retail segments: textiles –6.6 percent, electrical appliances, radios and televisions –4.3 percent, and footwear –2.6 percent. Retailers specializing in the sports sector (–0.8 percent) and food, drink and tobacco (+0.2 percent) maintained sales at roughly the previous year's level. A slight rise in sales was registered by filling stations (+1.7 percent) and car dealers (+2.8 percent). Retail sales of cosmetics and body-care products rose 5.1 percent.

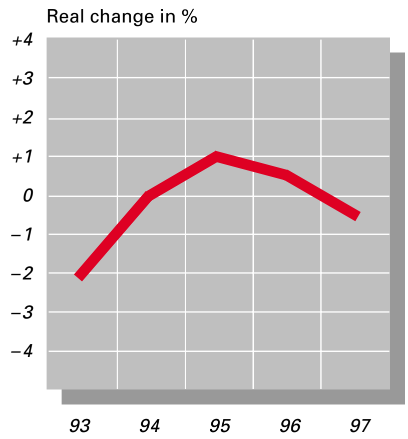
Gross domestic product



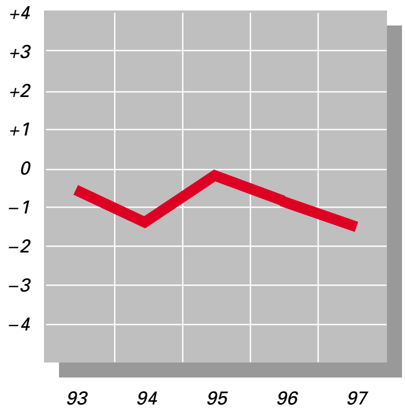
Private consumption



Retail sales

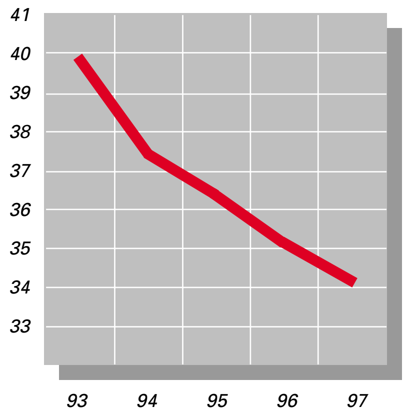


Retail trade (narrower definition)[1)]



[1)] excluding motor vehicles, fuels, lubricants and pharmacy sales

Retail sales (narrower definition[1)]) as a proportion of private consumption (in %)



[1)] excluding motor vehicles, fuels, lubricants and pharmacy sales

Taking the narrower definition of retail sales (excluding motor vehicles, fuels, lubricants and pharmacy sales), sales slipped 0.8 percent to DM 715.0 billion. That equates to a real decline of 1.5 percent. Real sales defined in this way thus declined for the fifth year in succession. Retail prices remained fairly stable in 1997: the retail price index only rose by 0.7 percent.

German wholesalers booked a nominal rise in sales (excluding motor vehicles) of 3.2 percent and a real rise of 1.3 percent. Wholesale prices rose 1.9 percent. Wholesale sales of food, drink and tobacco was roughly in line with 1996 (–0.1 percent) but because of price rises real sales of food declined by 4.5 percent. Wholesaling of consumer products improved slightly (+1.4 percent in nominal terms and +1.5 percent in real terms).

Western industrialized countries

Economic trends in the industrialized countries remained positive in 1997, with real GDP growing by an average of 2.7 percent compared with 2.6 percent in 1996. However, trends varied greatly from one country to another.

Real GDP and consumer prices in industrialized countries in 1997/1996
Year-on-year change in %

	Weighting in %	GDP 1997	GDP 1996	Consumer prices 1997	Consumer prices 1996
Germany	10.8	2.2	1.4	1.8	1.5
France	7.0	2.4	1.5	1.2	2.0
Italy	5.6	1.5	0.7	1.8	4.0
UK	5.3	3.4	2.3	3.1	2.4
Spain	2.7	3.3	2.3	2.0	3.6
Netherlands	1.8	3.3	3.3	2.1	2.1
Belgium	1.2	2.5	1.5	1.5	2.1
Sweden	1.1	2.0	1.1	0.9	0.8
Austria	1.0	2.0	1.6	1.5	1.9
Denmark	0.8	3.0	3.4	2.0	2.1
Finland	0.6	4.5	3.3	1.5	0.6
Greece	0.6	2.5	2.6	5.5	8.2
Portugal	0.5	3.5	3.0	2.1	3.1
Ireland	0.3	7.5	7.9	1.4	1.7
Luxembourg	0.1	3.5	3.0	1.4	1.4
European Union	**39.4**	**2.5**	**1.7**	**1.9**	**2.4**
Switzerland	1.3	0.5	(0.2)	0.6	0.8
Norway	0.7	4.0	5.3	2.5	1.3
Western Europe	**41.4**	**2.5**	**1.7**	**1.9**	**2.3**
USA	34.9	3.8	2.8	2.3	3.0
Japan	21.0	0.9	3.9	1.8	0.1
Canada	2.7	3.8	1.5	1.6	1.6
Total [1]	**100.0**	**2.7**	**2.6**	**2.0**	**2.1**

[1] Total for the countries listed. Weighted on the basis of GDP for 1996
Sources: OECD and Institut für Weltwirtschaft, Kiel

In the USA, economic momentum increased further and GDP grew by 3.8 percent in 1997. By contrast, the Japanese economy went into a decline: Real GDP growth slipped from 3.9 percent in 1996 to 0.9 percent. Despite the currency and financial crisis in South-East Asia, Japan reported a rise of around 10 percent in exports in 1997. The economic downturn was caused by a slump in domestic demand as a result of the government's restrictive fiscal policy.

The economic recovery gained ground in western Europe, with real GDP expanding by 2.5 percent in 1997, following 1.7 percent growth in 1996. Here, too, trends varied greatly from country to country. While some countries such as the UK, the Netherlands and Norway reported a strong rise in employment, accompanied by a decline in jobless figures, in other countries – most notably Germany and France – the employment situation remained difficult. This was mainly due to differences in domestic demand. In Germany and France private consumption was very weak and capital spending remained low. This contrasted with the first group of countries, where the economy received a strong boost from private consumption and capital expenditures.

In virtually all western European countries fiscal policy was dominated by efforts to meet the budget deficit criteria set by the Maastricht Treaty (3 percent of GDP). Most countries appear to have met this target. However, due to budget consolidation in all countries, public-sector consumption depressed cyclical trends.

Boosted by positive economic trends in the industrialized world and the sustained strength of the US dollar, western European countries registered a strong rise in exports in 1997.

Although monetary policy was expansionary in most western European countries, on the whole inflationary pressure remained moderate. Average consumer price inflation was just 1.9 percent in 1997 compared with 2.3 percent in 1996. However, the decline in inflation bottomed out in a number of countries in the course of the year.

High unemployment remains the most serious economic and social problem in a number of European countries, for example, Germany, France, Italy and Spain.

Other countries

The currency and financial crisis that hit South-East Asia in fall 1997 has put an end to the dynamic growth rates in the "Tiger States" and produced enormous challenges for the global currency and financial systems. Although Germany and other western European states have relatively few direct economic links with South-East Asia, there is growing concern that the crisis could have adverse repercussions on western industrialized countries via the financial markets and competition on international markets.

Countries in central and southern America made good headway in the fight against inflation. Most of these countries posted higher exports. However, since imports rose even faster, their trade balances deteriorated and foreign debt rose. In view of the Asian crisis, the risks inherent in the scale and development of foreign debt in central and south American countries should not be ignored.

The economic situation in central and eastern Europe improved slightly in 1997. The prolonged economic downturn in Russia came to a halt and in Bulgaria and the Ukraine the downward trend slowed.

Overall, further progress was made with the process of transformation in central and eastern Europe, although as Albania and Romania proved in 1997, setbacks cannot be ruled out entirely. Poland and Hungary again registered good growth rates in 1997.

Country overview

Country	Population 1996[1]		Gross domestic product (GDP)		Private consumption	Consumer goods trade	
	total in 1,000	per km²	per capita GDP in US$ based on 1994 purchasing power parities[2]	total GDP in US$ billion 1997[3]	in US$ billion total 1997[3]	in US$ billion total 1997[4]	in % of Germany
Austria	8,013	96	20,348	203	111	57	10
Belgium	10,114	332	19,765	243	151	71	12
Bulgaria	8,726	79	5,470	12	8	6	1
China	1,212,985	127	3,002	937	415	290	50
Czech Republic	10,302	131	8,536	55	26	17	3
Denmark	5,188	120	21,204	161	85	44	7
France	58,211	107	21,784	1,397	835	356	61
Germany	**81,817**	**229**	**19,395**	**2,100**	**1,206**	**583**	**100**
Greece	10,483	79	8,618	118	88	57	10
Hungary	10,073	108	6,098	45	29	19	3
Italy	57,218	190	18,109	1,149	711	286	49
Luxembourg	410	159	30,950	[5]	[5]	[5]	[5]
Mexico	95,470	49	7,753	423	283	212	36
Netherlands	15,603	382	20,264	362	216	110	19
Poland	38,448	119	6,208	125	81	53	9
Portugal	9,818	107	10,817	97	65	42	7
Romania	22,770	96	3,522	37	24	17	3
Spain	39,676	78	13,888	532	329	145	25
Switzerland	7,269	176	24,230	252	151	113	19
Turkey	63,120	81	5,235	198	132	92	16
UK	58,424	239	18,592	1,291	832	434	74

[1] Source: Federal Statistics Office

[2] Source: ifo-Schnelldienst 19/07 (ifo-Institut, Munich)

[3] Source: FERI

[4] End-user consumer goods trade
(Sources: EUROSTAT, Deutsche Bundesbank, M+M EURODATA, joint diagnosis, EU Commission, our own calculations and estimates)

[5] No data available

Reports on the divisions

METRO AG provides concise reports on the performance of all its divisions over the past fiscal year. In addition, specific divisions/outlet chains are outlined in more detail to give the reader a better insight into business policy and corporate strategy.

The following divisions have been singled out for in-depth reports in this Annual Report: Consumer Electronics Centers, Home Improvement Centers and Fashion Centers. The Annual Report for 1996 looked in more detail at the Metro Wholesale division, the Kaufhof Warenhaus outlet chain and the Hypermarkets division. Further profiles are scheduled for the future.

Divisional breakdown of the METRO AG Group

	Gross sales	Result from ordinary operations	Capital expenditure[1]	Employees (full-time jobs)	Outlets	Selling space
	DM million	DM million	DM million	Number	Number	1,000 m²
Metro Wholesale	11,376	386	188	16,711	90	800
Department Stores	11,368	143	394	33,423	303	1,740
Hypermarkets	10,787	128	236	21,588	158	1,149
Food Stores	6,050	74	84	12,697	515	789
Discount Stores	1,563	(75)	40	2,182	496	247
Consumer Electronics Centers	8,686	347	164	10,394	179	450
Home Improvement Centers	4,656	81	80	12,934	297	1,509
Computer Centers	4,514	38	46	3,512	266	65
Fashion Centers	1,357	92	22	5,027	94	223
Footwear Centers	815	(30)	19	1,664	542	307
Restaurant & Catering	493	18	15	4,214	298	110
Real Estate	–	135	537	432	–	–
Others	2,466	68	49	9,008	162	142
METRO AG	–	(475)[2]	17	233	–	–
METRO AG Group	**64,131**	**930**	**1,891**	**134,019**	**3,400**	**7,529**

[1] Additions to tangible and intangible assets (excluding goodwill)

[2] Including DM 240 million amortization of goodwill

Metro Wholesale

Metro Wholesale bucks weak demand

The companies in this division, which is headed by Metro International Management GmbH (MIM), maintained their position in fiscal 1997, despite the extremely weak economic environment.

This division operates 50 Metro C&C stores, two Metro Eco stores, 24 C&C Schaper stores and 9 Sigma Bürowelt office supplies stores in Germany, plus three C&C stores in China and two in Romania. In 1997 the Metro Wholesale division generated sales of DM 11.38 billion, 2.2 percent below adjusted sales for 1996. It should be noted that C&C Schaper (sales of DM 625 million in 1997 and DM 599 million in 1996) was transferred to the Metro Wholesale division with effect from January 1, 1997. The division divested its stake in BLV-Grossverbraucherservice (sales: DM 364 million) in 1996. After adjustment for these changes, sales grew by 1.0 percent. On a like-for-like basis, the division booked a year-on-year decline in sales of 1.2 percent.

Sigma Bürowelt opened two new stores in Germany – one in Hagen and one in Ulm. It also continued its international expansion, opening stores in Wuxi and Minhang in China and a second store in Bucharest, Romania. The division's selling space increased by 46,400 m² to 799,600 m².

Result from ordinary operations

The result from ordinary operations declined by DM 41.8 million (9.8 percent) to DM 385.9 million in 1997. After adjustment for the disposal of BLV and the transfer of C&C Schaper, the decline was 3.1 percent. This downturn was primarily attributable to start-up losses in China and Romania, and at two new Sigma stores and the Metro Eco outlets.

Sharp rise in employees compared with the past year

The division's average workforce was 16,711, including 1,864 employees outside Germany. The headcount rose 1,097 over the year from 15,614 in 1996 (based on equivalent full-time jobs and including C&C Schaper) primarily due to expansion and the introduction of overnight shelf-stocking in the C&C outlets.

Capital expenditure

The Wholesale division invested a total of DM 188.0 million in 1997 (capitalization of tangible and intangible assets). Of this, DM 73.3 million was invested in China and DM 29.5 million in Romania. The bulk of the DM 85.2 million capital expenditure in Germany went on the maintenance and modernization of C&C stores.

Outlook

The economic outlook for the Wholesale division's target customers will not improve in 1998. In the coming years, internationalization will center on further expansion in China and Romania and preparations to enter the Bulgarian market. In Germany, work will continue to focus on repositioning the non-food segments and increased customer focus.

Department Stores

Rapid changeover to the Galeria store concept

The strategic focus of the Kaufhof Warenhaus Group centered on converting further suitable stores to the successful "Galeria" concept in 1997. Following completion of 14 stores (12 new ones and 2 converted ones), at year-end 1997 the Group had a total of 47 Galeria Kaufhof outlets. So far 49 percent of Kaufhof Warenhaus AG's sales space has been converted and the stores operating on the new model generate 53 percent of sales. The future-oriented Galeria model is constantly being improved and refined to meet customer requirements. In 1997, measures thus included heightening the distinction between different display areas and the introduction of multi-media services (interactive window-shopping, Fashion-Surf CD-ROM). In the apparel sector, the proportion of top-performing private labels such as "Miss H" and "Fabiani" was increased.

Logistics project completed

Phase 2 of the "New Logistics Project" (NL2) introduced in spring 1995 was completed earlier than anticipated at the end of 1997. The aim was to optimize logistics and merchandise management by combining and simplifying the logistics capacities of Kaufhof Warenhaus and Horten, which previously operated in parallel, thus eliminating duplication of work. Following completion of this project, the Kaufhof Warenhaus Group now has a highly efficient network comprising four central warehouses where goods can be called off, four regional distribution centers and ten regional service points, with combined warehousing space of approx. 470,000 m².
The "NL2" project has made a major contribution to bringing about a sustained improvement in the earnings power of the Kaufhof Warenhaus Group. The new logistics concept also ensures more effective product management and enhances service through timely – and transparent – supply of goods to meet current demand, especially in the textile sector.

Sales trends satisfactory overall despite difficult market conditions

METRO AG's Department Stores division comprises the Kaufhof Warenhaus Group and Kaufhalle AG. In 1997 this division booked sales of DM 11.37 billion (–1.3 percent); after adjustment for changes in selling space, sales declined 3.1 percent. As a result of the modernization and conversion of stores, selling space increased to 1,740,400 m² (+3.0 percent) and the number of outlets dropped from 306 to 303.

Sales trends at Galeria stores above the sector-average

The 144 Kaufhof stores posted sales of DM 9.26 billion (–0.4 percent). On a comparable basis, sales were 2.6 percent below the previous year's level. The Galeria stores performed well, raising sales by 2.4 percent (+0.6 percent on a like-for-like basis).

Kaufhalle AG posted sales of DM 2.11 billion (–5.3 percent). Its performance was primarily hampered by the temporary closure of 16 outlets for conversion to the multi-store concept. Calculated on a same-store basis, the decline in sales was 4.0 percent.

Kaufhof Warenhaus Group posted renewed earnings growth

The Kaufhof Warenhaus Group reported pleasing earnings trends. The result from ordinary operations rose 5.8 percent to DM 194.9 million. In 1997 expenses for the conversion of outlets to the Galeria concept were more than offset by extremely good earnings trends at the stores converted in 1995 and 1996.
The main contribution to this uptrend came from the improved product mix, particularly in the textile segment.

Earnings trends proved disappointing at Kaufhalle AG. The result from ordinary operations slipped to –DM 52.1 million (1996: DM 19.3 million). The unsatisfactory performance in 1997 was partly attributable to weak sales trends, which reduced gross profits, and partly due to restructuring charges, which trimmed the operating result.

Investing in new concepts

Capital spending in this division came to DM 394.1 million. DM 316.3 million of this went to the Kaufhof Warenhaus Group and DM 77.8 million to Kaufhalle AG. At Kaufhof, capital spending focused on converting 12 stores to the Galeria concept while Kaufhalle invested DM 51.8 million to convert 16 branches to its new multi-store concept.

Higher productivity

The average headcount at the Kaufhof Warenhaus Group was 27,147 (translated into full-time jobs). Personnel adjustments (for instance, as part of the "NL2" logistics project) generated a strong rise in productivity.

Kaufhalle AG employed an average of 6,276 people (converted into full-timers), a decline of 7.3 percent. The unsatisfactory sales trends and the resultant shortfall in earnings made it necessary to adjust staff numbers again across the board.

In the medium term, integrating Kaufhalle AG's operating business into Kaufhof Warenhaus AG will reduce costs considerably. However, restructuring expenses of DM 150 million are expected in 1998 – 2000.

Hypermarkets

Four Real hypermarkets opened in Poland

Real embarked on internationalization of its established hypermarket concept by setting up a regional management team in Poland and opening four stores – in Szczecin, Czestochowa, Lubin and Czeladz. At the same time, it set up a management team in Turkey as a basis for expansion into another major strategic market. The first Real hypermarket in this country will be opened in Ankara in 1998.

Continued restructuring

In Germany, Real optimized its store network by opening five new outlets and closing three unprofitable branches. It continued its restructuring program as scheduled by converting another nine former Meister hypermarkets in southern Germany. Ten smaller outlets with average selling space of 3,300 m² were transferred to the Food Stores division.

The conversion/restructuring phase, which has been going on for some years, is scheduled for completion by late 1998/early 1999. Real will be expanding and strengthening its market leadership in the hypermarket segment through its uniform nationwide store format and by opening new outlets. The basic prerequisite for this is its ability to maintain its cost leadership in the hypermarket segment. To simplify the division's organizational structure, seven independent legal entities were merged into Real SB-Warenhaus GmbH in 1997. As well as improving the speed and efficiency of decision-making and administrative processes, this will cut personnel and material costs.

Following optimization of logistics and stock management systems, automatic call-off of goods from warehouses has been introduced at all stores. Inspection of incoming goods has now been concentrated at the central warehouses and is no longer performed by the hypermarkets themselves. In future, Metro-MGL-Logistik will be handling transport logistics for suppliers in order to pool resources.

Hypermarkets division is expanding its market leadership

The Hypermarkets division generated sales of DM 10.79 billion (+0.6 percent) in fiscal 1997. That was a decline of 0.1 percent on a same-store basis. As in 1996, adjusted sales were held back by continued conversion work in the southern region. Nevertheless, Real outperformed its competitors, who booked a year-on-year decline in sales of nearly 4 percent. As a result of expansion and optimization of its portfolio of outlets, the division's selling space increased 0.3 percent to 1,148,553 m². The number of outlets declined from 162 to 158.

Hypermarkets division posted a strong earnings advance in Germany

Despite tougher competition, Real posted a 64 percent rise in the result from ordinary operations to DM 164 million. This was primarily due to strong earnings advances at the stores converted to the Real format between 1994 and 1996. Operations in Poland and Turkey generated expenses of DM 36 million.

Capital expenditure

Capital expenditure totaled DM 236.5 million. DM 98.7 million of this was spent on the modernization and conversion of stores and DM 72.2 million on expansion.

Further rise in productivity

Real had an average of 21,588 employees (translated into full-time employees). That was 8.5 percent more than in the previous year. This rise was entirely due to expansion in Germany and abroad. On the administrative side, the division shed 162 staff by amalgamating administrative functions.

Food Stores

Further structural improvements

The restructuring of the distribution network and organization of the Extra chain, which commenced in 1996, continued in 1997. To improve its competitive position, 11 unprofitable outlets were closed and selling space was increased in 18 supermarkets. Extra took over 10 stores from the Hypermarket division. Most of these are in southern Germany and they have an average sales space of 3,300 m². 31 new stores were opened, increasing the density of the store network and improving the chain's market position. The organizational structure was simplified further by merging five previously independent legal entities.

Expansion generates sales growth

Food Stores generated sales of DM 6.05 billion (+2.3 percent) but declined by 0.4 percent on a like-for-like basis. However, after adjustment for the disposal of the Bolle/Schätzlein supermarkets, sales were 7.0 percent higher. The number of supermarkets rose from 485 to 515 and selling space increased to 788,800 m² (a year-on-year rise of 74,800 m²).

Earnings growth

The Extra stores held their earnings position despite weak consumer spending and the rapid pace of expansion. The result from ordinary operations came to DM 73.7 million (–DM 6.7 million on 1996).

Capital expenditure

Extra invested a total of DM 83.7 million. About DM 30.2 million of this went on expansion of its store network.

Employees

The supermarkets had an average of 12,697 employees (translated into full-time jobs). That was 7 percent more than the year before, mainly due to expansion.

Branch/logistics structure

Extra intends to improve the structure of its branch network by focusing on high-quality expansion. Small and/or unprofitable stores are to be closed. The IGL (Interbuy Grosshandel und Logistik) service company has now opened its warehouse in Reichenbach, so Extra will be able to optimize its logistics structure from mid-1998.

Discount Stores

Rapid expansion

In 1997 this division's strategic focus comprised extending the Tip chain of discount stores in Germany and Poland. 109 new Tip stores were opened across Germany and 14 outlets that did not fit in with the strategic concept were removed from the portfolio. In response to customer demand for better standards of service, especially in the fresh-food segment, Tip expanded its product range. In addition, some outlets added OTC (over-the-counter) pharmaceuticals to their range.

Tip entered the Polish market with 16 discount stores in 1996. This concept, which focuses on proximity to customers, ease of access and exceptionally good value for money, was well-accepted by Polish consumers, providing a basis for further expansion in the country. Accordingly, another 20 stores were opened in Poland in 1997.

Sales growth due to expansion

Discount Stores generated sales of DM 1.56 billion (+16.1 percent) but on a same-space basis, sales declined 6.5 percent. Tip's highly competitive discount stores were hit by a drop in shopping frequency and the resultant decline in productivity per unit of sales space. This was a result of longer store opening hours in Germany, as many customers took advantage of the change to shop in attractive full-range out-of-town hypermarkets.

The Tip chain comprises 496 discount stores with total selling space of 246,900 m^2 (net change: +115 stores with total selling space of 55,400 m^2).

Substantial earnings decline at Discount Stores

The increased pace of expansion in Germany and abroad, coupled with a weak rise in sales on a same-store basis, resulted in another steep earnings decline at Tip. The loss increased from DM 26.8 million in fiscal 1996 to DM 74.4 million in 1997. Expansion in Poland resulted in expenses of around DM 20 million.

Capital expenditure

The discount stores invested DM 40.2 million, DM 27.1 million of which went on expansion.

Employees

Tip increased the average number of employees by 44.8 percent to 2,182 (converted to full-timers).

Strengthening and expanding market leadership in Poland

Tip will continue to expand in Poland by opening another 75 stores. In Germany, it plans to add another 77 stores to its network. Tip plans to set up its own logistics platform to ensure a sustained reduction in logistics costs.

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A successful track record going back to the eighties

In 1979, three businessmen pioneered Media-Markt, a new type of self-service consumer electronics megastore. Since the response was very positive, the first Media-Markt store in Munich was soon followed by steady expansion of the concept, initially in southern Germany.

The inclusion of Kaufhof Holding AG in the group of stakeholders in 1988 and the subsequent integration of the Saturn electrical goods retail group, which was originally established in Cologne in 1961, paved the way for nationwide implementation of this merchandising concept. Saturn's positioning, which was primarily geared to city-center customers, was systematically refocused to match the quality-oriented growth strategy of the Media-Saturn Group.

Media-Markt and Saturn specialize in consumer electronics, household appliances, new media, hi-fi and telecommunications equipment, computer hard and software, photographic equipment and accessories.

The clear shift in retail structures in Germany's city centers is generating new opportunities for the Saturn format, which is to be expanded rapidly. Expansion of the chain of Media-Markt outlets is scheduled for completion in the next three years and a stronger market presence is expected to generate a further improvement in earnings.

Originally designed for out-of-town stores, Media-Markt now also has a presence in attractive shopping malls, where it positions itself as a specialist consumer electronics retailer with an average store size of 2,500 – 3,000 m². By contrast, Saturn stores are designed for city-center locations. This chain operates both on a stand-alone basis and in shopping centers, with selling space of 2,000 – 6,000 m², as well as in selected city-center Kaufhof and Horten department stores, where a whole floor is given over to it.

Strategic focus and value for money

Despite differences in their positioning, Media-Markt and Saturn share a common corporate philosophy and staff image, focusing on the creativity, initiative, responsibility and team spirit of their employees. Responsibility for purchasing, selling and advertising is systematically delegated to individual stores. Like self-employed retailers, all store managers hold a stake in their store and are thus directly affected by its performance. This structure allows rapid adjustment to market demands and opportunities.

Key features of this store concept include competent advice by specially trained sales staff and extensive customer service. Customers are able to obtain a full overview of the products available without having to do without advice. Delivery, assembly and repair services are available at all times.

Another key feature of the consumer electronics centers is their focus on value for money. Instead of short-term special offers, they concentrate on permanently low prices, which customers appreciate. Last but not least, Media-Markt and Saturn draw attention to themselves with original, award-winning advertising.

Efforts to achieve cost-leadership are backed up by lean administrative structures. Business processes are constantly reviewed in the wake of expansion. As well as giving the companies an edge over direct competitors, the business-oriented management structure is one of the keys to the rapid expansion of the Media-Saturn Group. In this way, both sales and the number of stores have tripled over the past five years. In eastern Germany and Berlin alone, 23 stores have been opened since reunification, making the Group the market leader in eastern Germany, too. Sites are selected on the basis of sales and earnings potential. This policy has ensured an above-average rise in market penetration and earnings power.

Rising demand for office communications technology and new media

The German consumer electronics sector is currently undergoing a structural shift. Pricing is aggressive and there are signs of market saturation, particularly in the radio/stereo/TV segment. The market contracted for the fifth year in succession. Moreover, consumers are becoming more discriminating and the scale of innovation varies enormously from one segment to another. Demand for consumer electronics and electrical appliances is declining, while office communications technology and new media are registering double-digit growth rates. Media-Markt and Saturn are investing in these future-oriented markets. The focus here is on quality and promotion of goods, resulting in strong growth in the new media segment.

International expansion

Market analyses in major European countries indicate that the low-cost all-round Media-Markt format has the best chance of success on international markets. The Media-Saturn Group has been operating on foreign markets since 1989. Since then, 15 stores have been opened in Austria, where the Group is now the clear market leader. Efforts to gain a foothold in the French market, which started at the same time, proved problematic at first, partly due to incorrect assessment of the market. Following a complete refocus, the Group is now ready to expand its presence beyond the eleven stores currently operating in France. In Switzerland, the number of Media-Markt stores has risen to six since 1993 and the aim is to at least double the number over the next three years.

A pilot store was opened in Hungary in 1997 and the Group is now planning to expand its presence in Budapest. Expansion into eastern Europe is continuing in Poland, where synergies with the Metro operations are expected. At the same time, a presence is to be established in the dynamic but fiercely competitive Spanish market.

Consumer Electronics Centers continue their profitable growth trend

This division booked sales of DM 8.69 billion (+13.8 percent) in 1997. Sales rose 3.6 percent on a same-space basis, enabling the Consumer Electronics Centers to increase their market leadership in Germany. Media-Saturn also increased productivity per m² at its foreign operations.

Media-Saturn Group posts record results

The strong rise in sales on a same-store basis, with high double-digit growth rates, particularly in the last two weeks of December, produced a steep hike in earnings in 1997. The result from ordinary operations rose 44.3 percent to DM 347.0 million (1996: DM 240.4 million).

High earnings power on the home market is the essential prerequisite for expansion abroad. The Group's market shares in Germany and Austria provide a sound basis for extending the fundamentally more risky foreign operations. Expansion in Hungary led to start-up losses of DM 2.5 million.

Denser network of sales outlets

At year-end 1997, the division had 179 stores with 450,210 m² selling space (1996: 156 stores with 395,686 m² selling space). 23 stores were opened in Germany and abroad in 1997.

Capital expenditure of DM 163.7 million included DM 45.2 million for expansion in Germany. DM 3.9 million was invested in transferring the successful Media-Saturn concept to Hungary.

Expansion raises headcount

Expansion in Germany and abroad raised the average number of employees (translated into full-time staff) by 16.1 percent to 10,394.

Home Improvement Centers

METRO AG's Home Improvement Centers division comprises the Praktiker chain, which generates higher sales than any other company of its type in Germany. The majority stake held by Asko Deutsche Kaufhaus AG became part of the METRO AG Group through the merger in 1996. The first Praktiker store was opened in Luxembourg in 1978 and by year-end 1997 the company had 297 stores in Germany, Luxembourg, Greece, Austria and Poland. Expansion is based on a blend of internal and external growth.

Praktiker's strategy

Praktiker's strength lies in its combination of two basic strategies: a strict customer focus accompanied by utilization of every opportunity to enhance operating efficiency. In this way, the company has gained a reputation with cost-conscious customers and reinforced its leading position on the DIY market.

Praktiker's price leadership is based on its edge on the cost side: extremely good purchasing conditions enable it to offer permanent discount prices in line with its image as "the low-cost home improvement center". Its lean distribution and administrative structures also help to minimize expenses by combining high efficiency with low cost structures.

Price, product range and location are the keys to customer satisfaction, although other requirements are starting to become more important. These mainly relate to the quality of products and advice and the availability of special services and complete construction and conversion packages. These changing market requirements are integrated into future business strategies.

Praktiker's performance in 1997

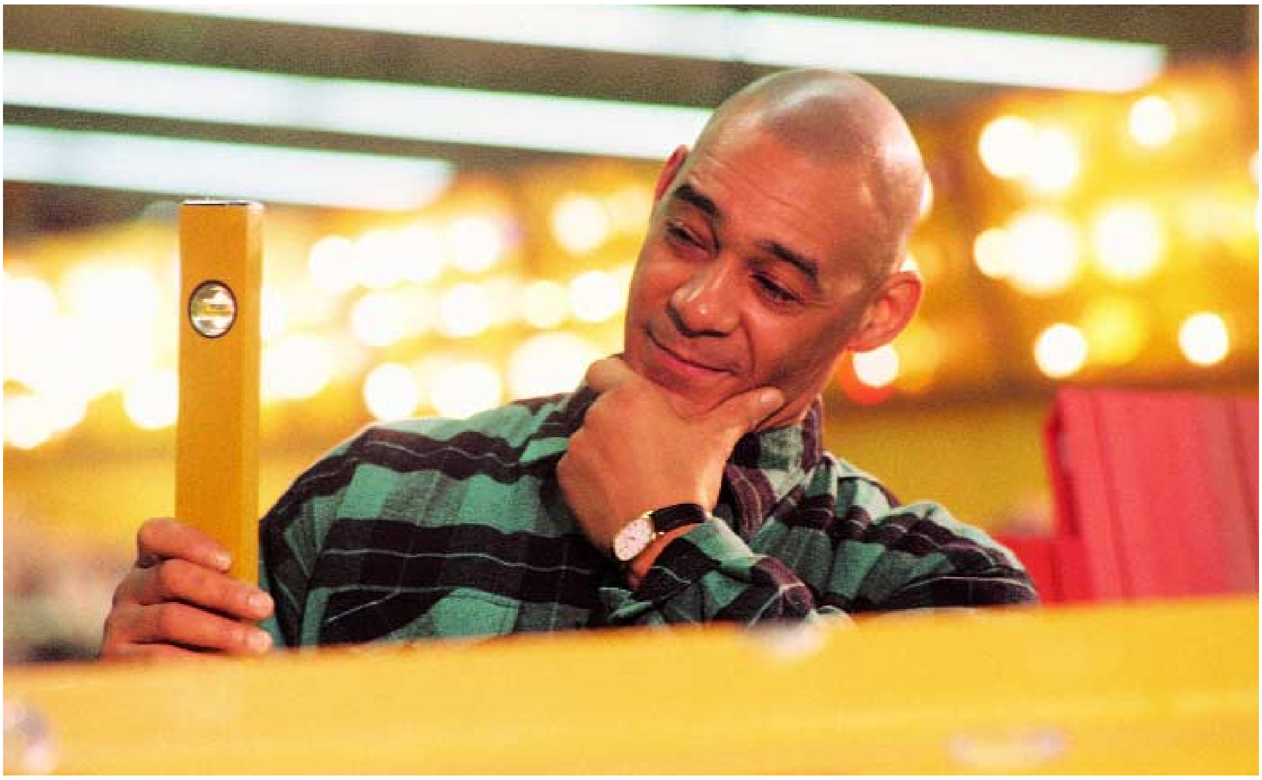
The German DIY sector suffered badly from the general economic environment. Sales growth slipped from 5.2 percent in 1996 to 3.5 percent while selling space expanded far faster, by 9.1 percent (1996: 9.2 percent).

1997 was a year of stark contrasts at Praktiker: earnings were well below expectations but expansion of its market position in Germany and above all international expansion proved very successful.

Adjusted sales remain weak

The Praktiker Group posted an 8.2 percent rise in sales to DM 4.66 billion in 1997, with the acquisition of Wirichs contributing DM 204 million of this. The stores in Luxembourg, Austria, Greece and Poland registered a strong improvement in sales to DM 392 million – a rise of 28.9 percent. However, for the second year in succession sales on a same-store basis remained well below expectations in Germany, declining by 4.8 percent. By contrast, at foreign outlets like-for-like sales rose 8.2 percent.

At year-end 1997, Praktiker had 297 stores in Germany and abroad, compared with 222 at year-end 1996. The acquisition of Wirichs added 59 stores in the last quarter of 1997. Selling space rose sharply to 1,509,335 m² (1996: 1,091,375 m²).



Capital expenditure

Capital expenditure of the Home Improvement Centers division totaled DM 79.5 million, with DM 63.3 million going to Germany and DM 16.2 million to foreign operations.

Earnings

Earnings slumped at the Praktiker Group in 1997: the result from ordinary operations dropped from DM 186.9 million in 1996 to DM 81.3 million. The main reasons are outlined below.

- Sales slipped 4.8 percent on a same-store basis in Germany due to a 9.1 percent year-on-year rise in selling space in the DIY sector and low consumer spending.

- At the same time, tougher competition pared back the trading margin.

- The third factor was strong expansion in other European markets, which reached a temporary peak in 1997. Praktiker now has 14 stores outside Germany – in Greece, Luxembourg, Austria and Poland. Moreover, in 1997 the company was preparing to enter the Italian, Turkish and Hungarian markets in 1998.

These measures, which are of enormous significance for the future of Praktiker, generated start-up and store opening expenses of around DM 22 million outside Germany. That was roughly DM 17 million more than in 1996.

- Finally, in line with sales trends, Praktiker made higher write-downs on inventories.

Earnings were thus depressed by a culmination of market and in-house factors in fiscal 1996/97 and the fourth quarter of 1997. Praktiker has grounds to assume that this combination of factors, all of which weakened earnings, is unlikely to recur. As already noted, expansion of selling space in Germany has passed its peak. At the same time, this trend, together with stagnation of the overall market volume in the DIY sector, opens up opportunities for Praktiker to increase its leading market position.

Acquisition of Wirichs

The Praktiker Group acquired all shares in Wirichs GmbH & Co, Krefeld, with effect from October 1, 1997. In fiscal 1996/97 this family-owned company reported sales of DM 858 million at its originally 60 stores (including 22 in eastern Germany). Following consolidation of Wirichs, Praktiker heads the German home improvement sector in terms of sales. The acquisition increased the balance-sheet caption "goodwill" by DM 326 million.

The geographical structure of Wirichs' outlets is an ideal complement to Praktiker. Most Wirichs stores in North-Rhine Westphalia and eastern Germany are in areas where Praktiker's presence was patchy. Moreover, there are very few overlaps.

Wirichs has positioned itself successfully within the sector and with customers as a service-oriented medium-price chain. Its outlets are regarded as attractive shopping centers for the whole family, mainly because of its garden centers (at 47 stores). Its well-established concept will be retained, with the stores operating under the motto ”Good, close, cheap – Wirichs, the friendly DIY center”.

Wirichs home improvement centers will be positioned as local suppliers in areas serving an average of 50,000 to 100,000 inhabitants. Well-positioned stores and an extremely good employee structure provide significant scope for growth. Expansion of these complementary store formats will enable the Praktiker Group to improve its market penetration quickly and systematically.

International expansion

Alongside systematic exploitation of the German market by means of varied concepts, expansion into high-growth foreign markets is extremely important for the division.

When it was founded in 1978, the Praktiker Group's only non-German sites were in Luxembourg. Having embarked on a program of international expansion it has had a presence in Greece since 1991, Austria since 1996 and Poland since 1997. By 1997 there were 14 Praktiker stores outside Germany: six in Greece, four in Austria, three in Luxembourg and one in Poland. Praktiker's decision to move into these markets has proved correct as their key performance indicators are far higher than at its German stores.

Acquisition of Wirichs and expansion have raised headcount

As a result of rapid expansion in Germany and abroad and the acquisition of Wirichs, the average number of full-time employees rose by 26.6 percent to 12,934. On a like-for-like basis, though, the division's workforce contracted by 87, in line with the decline in sales.

Strategic focus: internationalization and integration of Wirichs

Praktiker is planning wide-ranging expansion into foreign markets in 1998, in addition to further growth in Germany. In 1997, it secured over 20 new sites. Central administrative functions were set up in Austria and Poland at the end of 1996 and management teams were set up in Italy and Turkey during 1997. The Austrian team is responsible for expansion into the Hungarian market. In 1998 the Group will be entering the Italian and Turkish markets and continuing its systematic expansion in Austria and Poland. In Germany, the main focus will be on integrating the Wirichs Group.

The Home Improvement Centers division aims to achieve market leadership or at least a position among the top 3 in all countries in which it operates. Praktiker intends to raise the number of foreign stores to over 70 by the year 2000, giving it a total of 400 home improvement centers.

A strong position in its home market is the foundation for success abroad because an established basis on home territory is the key to accessing new markets. This must be reflected in improved earnings and Praktiker anticipates that it will be able to meet this goal in the current fiscal year.

Computer Centers

Integration of Peacock successfully completed

The acquisition of Peacock AG with effect from June 1, 1997 has greatly strengthened the division's presence in the wholesale/distribution segment. Following restructuring and repositioning of Peacock, the company is now back on an expansionary course. Procurement of components and monitors for all Group companies (Vobis, Maxdata and Peacock) was pooled at year-end 1997. This has greatly improved purchasing power on the international market.

Refocusing of Vobis

Vobis analyzed and refocused its market position in 1997. Volume sales of entry-level computers through alternative sales outlets, especially in the German food sector, increased in 1997. Vobis therefore decided to improve its positioning as the low-price market leader by highlighting its focus on product quality and selected services. Operating under the slogan "Vobis – the low-cost PC expert", its communication strategy in Germany was completely revamped: its advertising was redesigned and the media mix altered. 65 Vobis outlets were restructured and steps were taken to optimize the product range, e.g. in the notebook and telecommunications segments.

In October 1997 Vobis set up a joint venture with the Sonae Group in Portugal to build up retail operations in this country. This will also provide a basis for strategic cooperation with Vobis, Spain.

Maxdata on course for success

Maxdata is continuing its successful course and has expanded its market share in the monitor segment in Germany and Europe.

Sales growth generated by Peacock and Maxdata

The Computer Centers division posted a 44.0 percent rise in sales to DM 4.51 billion in 1997. The main factors behind this were Maxdata and the acquisition of Peacock. Declining sales at Vobis due to difficult conditions on the German market were more than offset by growth outside Germany. The number of outlets dropped from 279 to 266 but selling space rose to 64,500 m^2 (+1.5 percent) due to extension of larger stores. Another 558 outlets were operated on a franchise basis.

Strong earnings rise at Maxdata, turnaround at Peacock

This division's result from ordinary operations slipped DM 8.5 million from the previous year's level to DM 37.5 million. Despite a strong earnings improvement at Maxdata and a slightly positive contribution from Peacock, the decline in earnings at Vobis could not be offset in full. Vobis booked expenses of around DM 2 million for expansion of its foreign operations.

Investment to optimize locations and business processes

The division's capital spending totaled DM 45.9 million. This covered modernization of outlets and expansion of IT and warehousing capacity.

Headcount boosted by acquisition of Peacock

The division employed an average of 3,512 people (based on equivalent full-time jobs). That was 20.2 percent more than in the previous year due to the acquisition of Peacock and strong expansion of business volume at Maxdata.

Stronger customer focus at Vobis

Vobis will be stepping up its service drive this year: customer service and constant improvements in the quality of own-brand products make a major contribution to long-term customer loyalty. This includes expansion of the Superstore concept which provides a wide range of hard and software products at excellent value for money in a larger sales space.

Maxdata intends to expand its leading market position in Germany in 1998. It aims to grow faster than direct competitors through its "Belinea" brand monitors. It will also be expanding its presence in Europe.

Fashion Centers

Adler in the past, present and future

Adler started life in 1960 as a family-owned manufacturer of ladies' coats. In 1967 its headquarters were relocated from Engen on Lake Constance to Haibach, near Aschaffenburg. The advent of factory outlet shopping in 1971 led to the first Adler fashion center. The company was acquired by Asko Deutsche Kaufhaus AG in 1982 and became part of the METRO AG Group following the merger in 1996.

Adler no longer has any manufacturing operations. It now operates entirely as a retail outlet, marketing a wide range of clothing for the whole family, i.e. ladies' outerwear, menswear, children's clothing and accessories. With its large and systematically designed and managed stores on the edge of medium to large towns and urban areas, Adler has successfully countered the downward trend in the fashion sector and is booming.

Adler currently has 77 fashion stores in Germany, mainly in out-of-town locations. Most of these are located alongside other outlets in specialty shopping centers. There are also 13 Adler outlets in Austria, two in Luxembourg, and – since 1997 – two in Poland. Eight more outlets are scheduled in Germany and Adler is planning rapid expansion in Poland. It will be entering the Turkish market in 1999.

In view of the proven and sustained success of this store format, the basic principles will be retained and adapted to local requirements wherever necessary. This is based on the consistently good sales performance at Adler, which has gained market share for four years in a row.

The Adler concept

There are a number of factors behind Adler's success:

- *Systematic focus on 30 to 50 year-olds*

  The vast majority of fashion stores in Germany target extremely fashion-conscious young customers with high brand awareness. By contrast, Adler focuses on middle-aged customers who are looking for value for money, quality and wearable clothing. It sees this as a future-oriented approach as the 30 to 50 year-old target group is set to grow considerably in the foreseeable future.

- *Early focus on out-of-town locations*

  Adler opted for out-of-town stores in the eighties in response to changing consumer spending patterns. Parking problems in city centers and the convenience of stowing goods, especially heavy items, in a car parked close by favored stores with free parking. Moreover, Adler's policy of selling clothes in large, ground-floor stores – currently with average selling space of 2,400 m^2 – where it can offer good value for money can only be realized effectively in out-of-town locations where rents and utility charges are low.

- *Integration into specialty store centers*

  Wherever possible, Adler stores are integrated into specialty store centers alongside other Metro companies. This raises the overall attractiveness of the shopping center and greatly increases customer frequency.

- *Use of joint purchasing power*

  By pooling their purchasing power and concentrating on competitive suppliers, the advantages of major purchase orders and experience of high-quality procurement can be shared within the Group.

- *Comprehensive inventory management system*

  Adler has been using a comprehensive inventory management system since 1978. Every item, down to details like size and color, can be tracked at all stages in the chain from receipt of the goods to sale. The system supports demand-based reordering and distribution. All fashion centers have an online link to head office. This constellation allows the company to respond to market demand, enabling all decisions to be made as fast as possible.

- *Adler customer chargecard*

  Adler introduced a customer loyalty card giving a 3 percent discount back in 1974. Today, it has 6 million customers on its list, about 2.5 million of whom are regular clients. Combining the information provided by the inventory management and customer databanks, allowing ongoing optimization of advertising and personalized direct mail campaigns, thus reducing non-selective advertising losses. This strategy enhances customer ties and counteracts the general decline in customer loyalty in this segment.

Adler's logistics concept

Adler's subsidiary Motex provides distribution services for Adler and other companies in the Metro Group. Goods are delivered to the distribution center in Grossostheim, which is responsible for inspection, quality control, pre-sales processing and distribution. It works on the principle of immediate distribution of the latest goods to stores, rather than storage followed by call-off.

The Grossostheim distribution center was built in 1984 to handle a maximum of 25 million items per year. Rental of additional warehouse space and the introduction of a second shift enables it to handle a maximum of 40 million items today. To provide scope for further growth, a new distribution center capable of handling 70 million items p.a. will be opened near Gotha, Thuringia, in 1998. Total capital spending for this will be DM 140 million.

This site has been selected because it is a central transport hub in Germany and thus optimizes costs. New conveyor and handling technology, computer-assisted systems and cost-effective processes will greatly reduce costs. The new distribution technology will enable the center to meet rising demands from stores. Investment in this distribution center will

- cut handling costs,
- reduce transport costs by combining purchasing and distribution logistics with the optimum location of the site,
- ensure rapid availability of goods,
- reduce tied capital,
- meet demands for quality improvements.

Adler is still gaining market share

The Fashion Centers generated sales of DM 1.36 billion (–4.2 percent). However, after adjustment for the divestment of Mac Fash Textilhandels GmbH with effect from January 1, 1997 (sales contribution 1996: DM 134 million), the division's sales rose 5.7 percent. Adler maintained sales on a same-store basis, enabling it to outperform its competitors once again. In Austria, selective optimization of the product range generated a double-digit rise in sales on a same-store basis. As part of its strategy of expanding into international markets, Adler opened two fashion centers in Poland, one in Czestochowa on August 18, 1997 and one in Czeladz on December 6, 1997. At year-end Adler had 94 fashion centers (1996: 88) in Germany, Austria, Luxembourg and Poland with total sales space of 222,860 m^2 (1996: 208,768 m^2).

Strong rise in result from ordinary operations

Adler raised its result from ordinary operations to DM 92.2 million (1996: DM 27.4 million, excluding Mac Fash). In addition to the fact that non-recurring expenses of DM 42 million relating to the relocation of the distribution warehouse to Thuringia dropped out of the comparison, this unexpectedly strong rise was due to a higher trading margin generated by an improved product mix. Expansion into Poland resulted in start-up costs of DM 3.2 million.

Capital expenditure

Adler invested a total of DM 22.5 million, including DM 10.1 million on expansion in Germany and Poland.

Employees

As a result of the disposal of Mac Fash and Inter Fashion (production site in Sri Lanka) and expansion of Adler, the division's headcount changed to 5,027 (average number of employees, converted into full-time jobs).

Footwear Centers

Continued expansion at Reno

This division's sales slipped slightly year-on-year to DM 815 million (–0.1 percent) but sales on a same-store basis dropped 5.5 percent. Reno opened 82 new stores in 1997 (64 in Germany and 18 in other countries). It also closed 9 outlets, bringing the total at year-end to 542. Selling space rose to 306,900 m^2 (1996: 287,000 m^2).

Earnings depressed by Mayer Schuh

Write-downs on accounts receivable and additions to accruals for its 30 percent stake in Mayer Schuh GmbH came to DM 53.2 million and thus reduced divisional earnings significantly. The result from ordinary operations deteriorated to a loss of DM 30.3 million (1996: +DM 24.9 million).

Capital expenditure

Reno invested DM 18.5 million, primarily in the expansion of its network of sales outlets.

Employees

The Reno Group had an average of 1,664 employees, converted into full-time jobs (–14.0 percent). The reduction in the headcount was due to the introduction of the agency concept at 110 stores.

Restaurant & Catering

The Restaurant & Catering division posted sales of DM 493 million (+4.0 percent), with DM 18.4 million of the rise coming from the acquisition of "Büffeteria" and the opening of new outlets. The change in store opening hours in Germany caused a decline in sales on breakfast business but overall Dinea did better than its competitors. This division had 298 outlets at year-end 1997. Selling space rose to 110,000 m^2 (1996: 97,000 m^2) as a result of the acquisition of Büffeteria.

Earnings

The result from ordinary operations declined to DM 17.6 million (1996: DM 21.1 million).

Capital expenditure

Dinea invested DM 15.3 million, most of which went on the modernization of 13 catering outlets. It also opened four new restaurants.

Headcount boosted by acquisition

The acquisition of Büffeteria increased the average number of employees (based on equivalent full-time jobs) by 8.7 percent to 4,214.

Real Estate

Strategy

Good sites are one of the keys to success in the stationary retail sector and thus a major component of the company's intrinsic value. The long-term availability of such sites, together with maximum flexibility in site design and development, are the main demands made by the operating divisions in the METRO AG Group. The ideal way of ensuring this is through ownership of real estate.

It is therefore METRO AG's declared aim to acquire properties at the Group's retail locations. The restrictions inherent in this policy are countered by using all available alternatives for acquisition and financing.

There are a number of possibilities apart from Group ownership of real estate. These include joint ownership concepts, option properties, legal constellations equivalent to ownership and permanent third-party investment concepts.

Structure

Metro Immobilien Holding GmbH (MIH) is the umbrella company in Metro's Real Estate division.

In addition to managing the real estate companies, it operates in the following fields, reflecting the value-added chain in the real estate sector:

- property development,
- construction management,
- facility management and center management,
- administration of real estate.

MIH undertakes all central functions of the Real Estate division, including cross-divisional real estate projects for Group companies.

For international expansion projects, the division develops and implements real estate strategies, taking into account national market conditions.

Employees

The Real Estate division had an average of 432 employees (based on equivalent full-time jobs) over the year.

Capital expenditure

To support the international expansion drive by METRO AG's successful chains, over the past fiscal year the Real Estate division has invested in properties in Poland (DM 210 million), Turkey (DM 118 million) and Italy (DM 17 million).

In Poland, the Group's first specialty store center was opened in Czeladz and two hypermarkets were set up in Lubin and Czestochowa. Three more specialty store centers, four hypermarkets and two home improvement centers are scheduled to open in 1998.

In Turkey, premises for a hypermarket in the Bilkent Center in Ankara were acquired. Real opened its first store here in 1998. The hypermarket and the home improvement center in the Gaziantep Center are scheduled for completion in 1998.

In Germany, the division erected a hypermarket in Germersheim and a home improvement center in Kulmbach and acquired the hypermarket in Schleswig. The Rüsselsheim and Duisburg specialty store centers were converted, and the Schaper C&C store in Braunschweig, the home improvement center in Frankenthal, the hypermarket in Castrop-Rauxel and the Roller store in Finowfurt were extended.

The division invested a total of DM 536.7 million in tangible and intangible assets in 1997 (excluding goodwill).

Option properties

Under current real estate leasing agreements, the METRO AG Group has numerous option rights on sites used by the Group.

The book value of these options as at December 31, 1997 was DM 2,721 million (1996: DM 4,681 million) and the underlying residual liability was DM 3,035 million (DM 4,896 million). Repayments made in 1997 totaled DM 53 million.

The year-on-year decline in book values and residual liabilities was attributable to the full consolidation of 167 real estate companies for the first time as of December 31, 1997. These companies were stated under option properties in 1996.

Earnings

The result from ordinary operations in the Real Estate division totaled DM 134.9 million. The decline of DM 44.5 million compared with the previous year was essentially due to lower book gains on the sale of properties and prepayments for expansion projects in Germany and abroad.

About 81 percent of rental income came from companies in the METRO AG Group.

Real estate owned and option properties (as of December 31, 1997)

	Group real estate		Option properties		Total real estate	
Type of property	No. of properties	Area m²	No. of properties	Area m²	No. of properties	Area m²
Shopping centers/ combined sites	34	785,480	17	500,857	51	1,286,337
Hypermarkets	24	240,893	8	60,163	32	301,056
Department stores	166	2,276,752	22	218,784	188	2,495,536
Food and discount stores	75	135,608	4	7,245	79	142,853
Home improvement centers	53	331,452	12	70,248	65	401,700
Furniture centers	8	75,781	1	10,353	9	86,134
Fashion centers	13	91,276	–	–	13	91,276
C&C centers	9	70,795	1	3,800	10	74,595
Warehouses	30	679,410	6	433,580	36	1,112,990
Empty land	84	–	–	–	84	–
Other		272,599		15,024		287,623
	496	4,960,046	71	1,320,054	567	6,280,100

Others

This division essentially covers the remaining furniture store and mail order operations, the Group's other wholesale operations, service companies and sundry investments. The Möbel Unger Group (furniture centers), the Oppermann Group (mail order) and the Rungis Group (supplying up-market restaurants) have now been divested.

The Group's service companies provide central services for the divisions and outlet chains, specifically:

- strategic purchasing and private-label management,
- purchasing and distribution logistics,
- joint purchasing of advertising production, agency services and media purchasing,
- IT services and standardization/harmonization of information structures.

The synergies and earnings generated by these cross-division service companies are allocated to the individual outlet chains on a pro rata basis.

Financial services are provided, among others, by Assevermag Versicherungsvermittlung, Metro Leasing and Metro Finance BV.

Sales generated by Others slipped 20.8 percent to DM 2.47 billion as a result of the disposal of a number of companies in 1997. After adjustment for the sale of Möbel Unger and the closure of the remaining Massa furniture centers, sales were up 14.4 percent. The result from ordinary operations was DM 68.5 million.

Capital expenditures totaled DM 49.0 million.

The average number of employees, calculated on the basis of full-time jobs, was 9,008. This figure includes pro rata employment at the companies divested.

Globalization

Selective internationalization is a central element in the corporate strategy of METRO AG and was a key focus in 1997.

For the Group as a whole the picture is as follows:

METRO AG Group: International operations 1997 (as of December 31) [1)]

METRO AG
15 countries
474 outlets

Denmark	
C&C	4

Luxembourg	
Vobis	2
Praktiker	3
Adler	2
Roller	1

France	
C&C	70
Vobis	2
Media	11
Reno	15

Switzerland	
Media	6
Vobis	11
Reno	22

China	
C&C	3

Netherlands	
Vobis	30

Poland	
Real	4
Praktiker	1
Adler	2
Vobis	18
Tip	36

Belgium	
Vobis	12

Hungary	
C&C	8
Reno	17
Media	1

Austria	
C&C	11
Media	15
Vobis	13
Reno	44
Adler	13
Praktiker	4
Dinea	3

Romania	
C&C	2

Spain	
Vobis	10

Italy	
C&C	28
Vobis	38

Greece	
Praktiker	6

Turkey	
C&C	6

Total foreign sales 1997: DM 17.0 billion

1) Outlets per chain and country, including C&C business management; Vobis excluding franchises

METRO AG Group: 1997 non-German sales by countries [1]

DM million	C&C	Real	Tip	Media	Praktiker	Vobis/ Maxdata	Adler	Reno	Dinea	Others[2]	Metro divi- sions	C&C business manage- ment	Total non- German sales
Austria				1,077	64	181	147	63	4	31	1,567	1,657	3,224
Belgium						59					59		59
China	216										216		216
Denmark												551	551
France				364		42		14		21	441	4,842	5,283
Greece					223						223		223
Hungary				35				21			56	1,420	1,476
Italy						250					250	3,183	3,433
Luxembourg					77	11	34			18	140		140
Netherlands						298					298		298
Poland		146	123		28	58	5				360		360
Romania	225										225		225
Spain						61					61		61
Switzerland				366		193		37			596		596
Turkey												809	809
UK[3]						33					33		33
	441	**146**	**123**	**1,842**	**392**	**1,186**	**186**	**135**	**4**	**70**	**4,525**	**12,462**	**16,987**

1) Including C&C business management

2) Rungis Express Gesellschaft für Frischimporte; Free Com Die Telekommunikationsgesellschaft, Roller

3) Wholesale/no outlets

METRO AG Group
International expansion of cash & carry operations in 1998 [1]

METRO AG C&C

Germany (50)
Romania (4)
China (4)

Metro Holding AG C&C

France (70)
Italy (31)
Austria (11)
Turkey (6)
Denmark (4)
Hungary (8)

Makro C&C

Netherlands (12)
Belgium (6)
UK (27)
Greece (5)
Spain (20)
Portugal (7)
Czech Republic (5)
Poland (17)
Morocco (4)

Potential additions

(in Europe)
Bulgaria
Slovenia/Croatia
Ukraine
Russia

1) C&C outlets per country

Group synergies

Towards the end of the first quarter of 1996, the Group's majority shareholder, Metro Vermögensverwaltung GmbH & Co KG essentially contributed to METRO AG its majority stakes in Asko Deutsche Kaufhaus AG, including Deutsche SB-Kauf AG, and Kaufhof Holding AG and its shares in its wholly-owned C&C business, together with the shares in a number of cross-division service companies geared to achieving synergies in the Group. At the start of the second half of 1996, Asko Deutsche Kaufhaus AG, Deutsche SB-Kauf AG and Kaufhof Holding AG were merged into METRO AG.

One reason for pooling resources through this process of contributions and the subsequent merger was to place METRO AG on a sound competitive footing. The aim was to achieve synergies through strategic allocation of resources and systematic utilization of the benefits generated by enhancing operating efficiency, thus improving the earnings power of METRO AG and the strength of the decentralized outlet chains.

Synergies budgeted for 1997

The anticipated benefits of the merger were originally put at over DM 400 million (from 1999). Since it takes several years to generate synergies, the following schedule was set out for the cumulative benefits:

- 1996 DM 0 million
  (but DM 50 million initial expenses)
- 1997 DM 131 million
- 1998 DM 265 million
- 1999 DM 405 million

These synergies were to be generated in three main areas identified prior to the merger:

- amalgamation of holding functions,
- procurement and private-label management,
- services.

Synergies generated in 1997

The synergies generated in these areas in 1997 can be broken down as follows:

- *Amalgamation of holding functions*

  The focus here is on the savings generated by amalgamating the holding companies to form the new METRO AG.

  Synergies of DM 34.4 million were generated in 1997. This compares with DM 35 million anticipated in the original merger report.

- *Procurement and private-label management*

  Pooling sourcing for Group companies in the hands of the purchasing subsidiary Metro MGE Einkauf has led to the establishment of efficient supplier management structures. A reduction in the number of suppliers and the resultant optimization of product lines has greatly improved procurement terms and savings.

  Cost advantages were also generated in the management of private labels, which many of METRO AG's outlets use as entry-level products and to round out their product range. Group-wide private-label controlling and coordination of all promotional activities to strengthen Group brands will increase the benefits in the coming years.

  Synergies totaling DM 50 million were budgeted in these two areas. The synergies generated in 1997 were well above this level at DM 154 million.

- *Services*

  In this sector, synergies center on IT, logistics, advertising and financing. The relevant cross-division service companies at METRO AG pool demand from individual divisions and the expertise available in the Group.

  Significant cost reductions have been achieved on the IT side through joint use of resources and the establishment of competence centers at the initiative of the information technology subsidiary, Metro MGI Informatik.

  Optimization of logistics functions, which were organized separately by each company before the merger, has allowed coordination of the flow of goods. Combining these services under the auspices of the logistics subsidiary, Metro MGL Logistik, has enabled the Group to exploit efficiency reserves and thus generate significant cost savings.

  Advertising requirements for Group companies are drawn together by Metro MWG Werbung, an advertising services subsidiary. Joint purchasing of production and advertising services has cut costs. Further cost savings have come from accompanying measures such as the establishment of a joint picture bank and harmonization of pre-advertising processes.

  Substantial savings were generated in fiscal 1997 by enhancing the standing of the Group on the capital markets and utilizing financing concepts for the entire Group.

  Synergies totaling DM 46.1 million were budgeted for the services sector in 1997. The actual savings generated came to DM 51.4 million.

Overall, synergies totaled DM 239.8 million, putting them 83 percent above the DM 131 million budgeted.

The cross-division service companies allocated these savings to the outlet chains on a pro rata basis (after deduction of expenses), thus enhancing their financial performance.

Human resources

Structure of the workforce

The Group had an annual average of 177,470 employees (excluding apprentices), compared with 166,161 in 1996. Converted into full-time jobs, this equated to 134,019 (130,725) employees, 68.0 percent (69.6 percent) of whom were female. The average length of service was 7.4 (8.1) years and the average age of the workforce was 37.6 (36.6) years.

The strong rise in headcount was attributable to changes in the composition of the Group's portfolio and further expansion in Germany and abroad in most divisions.

At the same time, there was a substantial increase in the proportion of part-time employees, from 45.2 percent to 49.9 percent of the workforce. This reflects the Group's successful endeavors to increase flexibility in the deployment of staff, enabling it to respond to customer demands for longer store opening hours in Germany. In many instances, the increase in the proportion of part-time staff has also eased the adjustment of personnel structures to sales trends.

Personnel development

Rising demands on the expertise, performance and flexibility of managerial staff have increased the challenges facing human resources staff at METRO AG. The prime aims are to select suitably qualified staff for management positions within the Group (including increasing recruitment from within the Group), to train future managers and create cross-divisional career development opportunities. Additional tasks include shaping the transfer of know-how within the Group through networks and selective transfer of staff.

At the apex of these personnel development programs is the Metro Academy, which opened its doors to twenty top executives in 1997. Through its strong practical bias and links with other Group companies, this program trains executives for general management assignments. Topics include corporate management, innovation and change management, as well as future operating conditions and the challenges facing the retail/wholesale trade. A special management development program for middle-managers takes an inter-divisional approach through projects of practical relevance to the Group. The results are presented to the Executive Board of METRO AG and divisional management and integrated into the ongoing improvement process actively promoted throughout the Group.

About 100 employees took part in 10 junior career development schemes in 1997. These cross-divisional courses gave participants an opportunity to exchange experience with colleagues from other fields while improving their skills. Strengthening the transfer of know-how within the Group is also the aim of the management network run in conjunction with USW (University Seminar for Trade and Industry, Schloss Gracht). This project involves 27 managers from eleven divisions working on issues such as change management and innovation management.

Over 350 employees made use of METRO AG's broadly based continuing education program. Courses cover topics such as leadership, international training, knowledge management and bring together colleagues from all over the Group.

In response to the dynamic international growth of the Group, the Executive Board of METRO AG has decided to introduce English as a second working language. More than 430 managers are currently taking tuition on a group or individual basis to improve their language skills.

To support its international expansion, at year-end 1997 the METRO AG Group also established an international management development group to train suitably qualified staff with international experience. Candidates are selected both within the Group and through selective external recruitment. On the basis of individual career development plans, they are given practical training at two outlet chains and METRO AG. METRO AG intends to step up its international management development projects to ensure that it is able to meet the rising demands resulting from expansion into foreign markets.

Vocational training

Vocational training is a sign of confidence in the future and the rising generation. In view of the increasing number of school-leavers, METRO AG has responded to demands to increase the number of training places it offers.

Despite the difficult conditions in the retail sector, the Group took on 2,948 apprentices in 1997, a rise of 15 percent compared with 1996. In eastern Germany, where there is still a serious shortage of training places, the Group undertook a special drive to create an additional 250 training places last summer. In total, the Group had 7,461 apprentices in 1997. That was equivalent to about 5.6 percent of its workforce (based on full-time jobs).

Vocational training enjoys high priority at METRO AG. The Group provides a wide range of career opportunities and gives school-leavers from all educational backgrounds a chance to enter the world of work. Increasing priority is being given to the development of personal skills such as initiative, communication skills, decision-making ability, team spirit and life-long learning.

Pay policy

As in other sectors of the economy, pay talks in the German retail sector focused on suitable pay rises, the dispute about sick pay and appropriate compensation arrangements.

For the first time ever, pay rises below the inflation rate and a reduction in holiday pay were agreed. In Brandenburg and Thuringia the pay agreement made in 1995, under which wage levels were to be raised gradually to West Berlin levels by January 1, 1998 has been extended for six months. By year-end, only three areas in eastern Germany had failed to reach agreement on rulings reflecting the difficult conditions in the sector.

A number of Group companies have negotiated in-house agreements reflecting their individual needs and structures and allowing a high degree of flexibility. The in-house agreements made for Praktiker and Adler were systematically extended in line with the companies' requirements.

In-house job center

This is an inter-divisional personnel recruitment unit set up to find jobs within the Group for staff affected by structural changes. This greatly reduces expenses for staff reductions and recruitment.

Restructuring of the pension system

Several years ago, company-financed retirement pension schemes were closed to new employees, the latest being the pension schemes operated at the former Kaufhof Holding AG and Kaufhof Warenhaus AG.

In view of the rising importance of personal pension provision, two pension plans based on employee contributions were developed in 1997. The Company's involvement in these pension plans gives employees significant advantages that they could not otherwise utilize. From 1998, all Group companies are free to offer these personal pension plans to their employees. The last Company-financed pension scheme was closed at the end of 1997.

Corporate vision

Clear goals for management and employees are essential for systematic, value-oriented management of a company. These cannot be imposed unilaterally by the Executive Board; they must be developed through dialog with employees. METRO AG's corporate vision is the result of this type of dialog. It is designed as a basis for developing the Metro culture and is intended as both a guideline and a benchmark.

Working in cross-divisional groups, over a period of several months representatives of the workforce drafted a mission statement which was then developed further and approved by the Executive Board. This broadly-based and well-accepted process has made a major contribution to drawing together the METRO AG Group.

The vision expresses the Group's corporate philosophy and outlines the principles and objectives of METRO AG. It provides an identity for all the divisions and serves as a guide for our employees on how to do their job.

According to the Executive Board of METRO AG, "We all have to put these values into practice if we wish to position ourselves as international market leaders."

Versatility is our strength

We, METRO AG, are an international retail group with a wide range of different store formats and locations.

Our divisions complement one another. We analyze new trends and developments to help in the continuous development of our business. A strong position in our domestic market is the basis for international expansion.

Our aim is systematic globalization.

Our expansion drive focuses on mass distribution outlets aimed at price-conscious consumers and – in Germany – on modern concepts for city center shopping areas.

We focus on customer requirements

Success means knowing and responding to our customers' needs.

Wherever we operate, we have to focus on our customers' expectations.

We live out this philosophy within our organization.

Our employees help shape Metro

Our response is fast, efficient and service-oriented. We see change as an opportunity, not a threat.

Our relationship with one another is characterized by openness, trust and respect for personal values. We use differences of opinion to help achieve a consensus.

We expect our employees to meet high standards of professional and personal conduct and encourage them to work independently.

Our employees are the key to our success. We expect them to keep abreast of developments so that we can be better and faster than our competitors. To this end we provide ongoing learning opportunities.

We offer successful employees a wide variety of national and international career opportunities within the Metro Group.

Working together enhances our performance

Our divisions aim to be the market leaders or rank among the top three in their market segment. They are responsible for their own performance and develop their own image and strategy. Ongoing learning is the key to future success. We therefore make systematic use of opportunities to transfer knowledge within the Group.

Expertise, pooling of resources and idea management enable our service companies to generate competitive advantages for our divisions.

The METRO AG management holding company regards itself as part of a Group-wide network of companies, each of which has full operational responsibility. It shapes corporate strategy, decides on the allocation of resources and provides Group-wide management development. Its task is to add value to the Group and individual chains.

Partnership

Our relationship with our business associates is a partnership geared to enhancing performance.

Our role in society goes beyond our role in corporate management. We actively contribute to prosperity and well-being in the countries where we operate.

Integrity and fairness are our key business principles.

The Euro project

On the basis of the convergence data for 1997, by the start of May 1998 the European Council of Heads of Government and Heads of State will have decided which countries will be participating in European Monetary Union. It is already fairly clear that EMU will comprise most EU member states and will be introduced on schedule on January 1, 1999.

Through its divisions, METRO AG has operations in virtually all EU member states. As a multinational company it welcomes the single currency, the Euro. Given its strategic focus, METRO AG anticipates that in the medium to long term the Euro will bring a number of advantages, for example:

- completion of the single European market,
- access to new retail and procurement markets,
- elimination of currency risks and hedging operations,
- reduction in transaction costs,
- increased competition as a result of more transparent pricing,
- creation of a European capital market.

The creation of European Monetary Union will bring extensive changes to economic life in the member states. Virtually every area of the companies will be affected by the introduction of the single currency, from financial management through accounting, IT processes, procurement and marketing to personnel administration.

METRO AG has set up a special project group to identify the action required. The project group will be producing a practical manual outlining all relevant points for the individual outlet chains. Employees from a variety of divisions and staff positions are contributing their specific requirements on the following aspects of the project group's work:

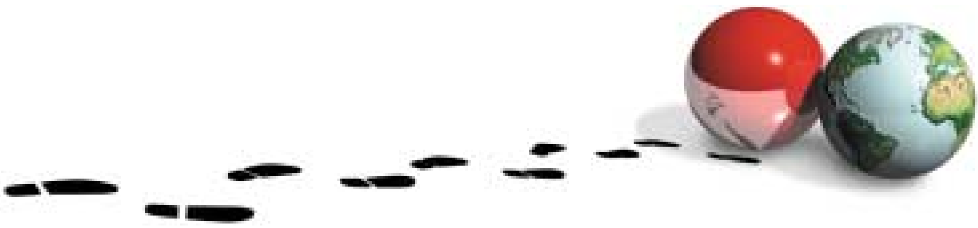
- conversion of stock,
- procurement/logistics,
- organization of business processes,
- accounting,
- payments transactions,
- financial management,
- controlling/reporting,
- contracts,
- personnel administration.

The aim of the Euro project, which is extremely important for the METRO AG Group, is to ensure that the adjustments required within the Group can be made with a minimum of time and expense.

It is generally recognized that the forthcoming introduction of the single currency will have a far broader impact on the wholesale/retail trade than on almost any other sector. Above all, the cost of the changeover would be inflated enormously by a period of coexistence of the old and new currencies and a transition period with dual pricing. If the German government decided to introduce the single currency as a "big bang", this would keep the cost of the changeover to a reasonable level for the German wholesale/retail sector as a whole and thus for METRO AG.

From the start of EMU, stock traded on German stock exchanges will be quoted in Euros. Like most other major listed companies, METRO AG intends to introduce no-par stocks from January 1, 1999 if possible. Planned legislation will make it possible to trade no-par stocks in Germany. These represent a proportional share in the Company and are thus an elegant way of switching to the new currency without having to raise or lower the Company's capital stock as would otherwise be necessary.

The Annual Stockholders' Meeting on July 7, 1998 will be asked to approve the introduction of no-par stock at METRO AG, if possible from January 1, 1999.



METRO AG goes Internet

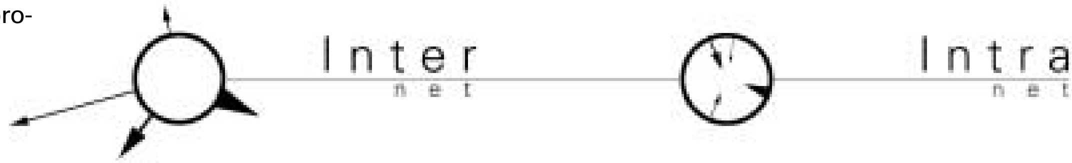
A professional Internet presentation is an integral part of contemporary information management. METRO AG has had a global Internet site since mid-1997 and since fall 1997 this has been complemented by an Intranet for in-house use.

The presentation currently covers corporate communications, investor relations, globalization, careers, personnel administration and public affairs. Journalists, financial analysts, shareholders, job-seekers and others interested in the Group can thus access information on Europe's biggest wholesale/retail group via the Internet. The presentation also provides an overview of the main Group companies, many pictures of outlets, a sketch map showing how to reach the Group's headquarters in Cologne and direct links to Internet presentations provided by subsidiaries. The main pages are also available in English. Anyone requiring further information can contact METRO AG by e-mail or – in somewhat more antiquated fashion – by phone or fax.

Every day more than 3,000 people visit the Group's Internet site under http://www.metro.de. The most popular Internet pages are the job vacancies, online share prices and up-to-date news about the Group. The average visit lasts eleven minutes. Three-quarters of users are from Germany; most of the remainder log on in the USA, Switzerland and the UK.

Intranet

The Intranet is still being developed but an increasing number of staff departments at headquarters are already making use of this future-oriented method of digital communication. Around 20,000 users have access to the Intranet at present. The Group's headquarters in Cologne and most Group companies have access to the Intranet. Even foreign subsidiaries have online links: companies in Poland, Romania and Turkey have direct links to headquarters in Cologne and in the other countries where Metro operates companies have indirect links. A special code allows users to dial into the Intranet server run by Metro MGI Informatik via computer and modem 24 hours a day. Data security is ensured for the Intranet and Internet presentations and firewalls separate the two networks from the Group's internal computer network. Metro employees can access the Internet via the Intranet but external users cannot gain access to the Intranet.



Their information requirements are covered by the Internet site.

Both sites are updated regularly. A visit to the METRO AG homepage shows the date of the latest update.

Environmental protection

Protecting the environment means accepting responsibility, even when times are hard. Since ecological problems are often caused by business practices, METRO AG takes a proactive approach, focusing on the search for solutions. It is currently building up a Group-wide environmental management system. The unit responsible for this works out strategies and targets with the outlet chains, within its sphere of responsibility decides on the allocation of resources and looks for potential synergies. Individual chains are responsible for defining and implementing the actual targets but in some areas it makes sense to coordinate activities. This is the task of service companies, which undertake specific assignments and can utilize potential for optimization within the Group.

METRO AG thus recognizes its responsibility towards its customers and environment. After all, the wholesale/retail sector has to make it its business to respond to the higher environmental awareness of consumers and pass on demands for environmentally friendly production processes to manufacturers. That requires expert knowledge of the properties of products and their environmental relevance. METRO AG's environmental guidelines contain a commitment to optimize ecological and economic aspects of product policy.

Instead of aiming for short-term success, METRO AG focuses on a long-term strategy. This takes account of changing social requirements, as well as environmental standards. The complex structure of the Group makes it difficult to implement a uniform environmental concept but the size of the Company provides scope to identify and utilize synergies.

Environmental protection is essentially a learning process. A sustained reduction in environmental problems can only be achieved by continuous implementation of a large number of – often unspectacular – measures. METRO AG's divisions have made progress along this road through a whole range of projects. The Group has now published its first environmental report. Rather than listing the Group's achievements, this report focuses on the ongoing process: it shows where improvements have been made, what action is currently being taken and how much still needs to be done in the following areas:

- ecological focusing of product policy,
- quality assurance,
- waste disposal,
- cleaning,
- energy management,
- responsible utilization of resources,
- avoidance of harmful substances,
- logistics,
- returnable packaging systems,
- packaging,
- advertising materials,
- paper-free offices,
- social compatibility.

Specific measures designed to raise environmental awareness include Group-wide communication via the Intranet, environmentally compatible waste disposal and cleaning processes, environmentally focused product ranges, environmental performance indicators, supporting initiatives to put Local Agenda 21 into practice and, last but not least, training and motivating employees to protect the environment.

Agenda 21 is the document produced at the end of the Earth Summit in Rio de Janeiro in 1992, which was signed by over 170 countries. It is essential that all citizens should be actively involved. Agenda 21 focuses on local authority initiatives to support the process. In Germany nearly 30 towns and cities have passed corresponding resolutions. Implementation of Local Agenda 21 requires close cooperation between public institutions, political parties and the corporate sector and is regarded as the driving force behind future developments. METRO AG and its divisions support selected projects.

Interest rate and currency management

METRO AG uses financial derivatives to hedge interest rate and currency risks. This increases the volatility of the financial result because, unlike conventional financial instruments, profits and losses are often realized in the short term.

METRO AG undertakes interest and currency management for all Group companies. Its policy is geared to minimizing the underlying risks. Trading and settlement are strictly segregated. To minimize risks, the Company only accepts top-rated banks as its counterparties and sets maximum limits for each of them.

Translated into 10-year maturities, the basis of the long-term financial plans established in 1997, over the year 29 percent of total long-term interest risks were hedged through fixed-interest bonds and fixed-rated loans (86 percent) or interest-rate derivatives (14 percent). The corresponding level of hedging at year-end was 37 percent.

Currency management comprises hedging of receivables and liabilities in currencies other than the local currencies of the Group companies. These may result from operating business, real estate holdings or financial transactions (e.g. foreign-currency financing). All elements are combined and hedged on the basis of the overall risk situation.

On an annual average and related to all companies, micro hedges cover some 20 percent of yearly requirements from individual operational risks, according to the particular circumstances at the various business areas.

DVFA/SG earnings per share

As a yardstick of the Company's profitability, earnings per share are calculated using the guidelines drawn up by Deutsche Vereinigung für Finanzanalyse und Anlageberatung e.V. (DVFA) and Schmalenbach Gesellschaft Deutsche Gesellschaft für Betriebswirtschaft (SG). After eliminating specific income and expense items to be adjusted and deducting third-party shares in net income, the METRO AG Group reported DVFA/SG earnings of DM 777.1 million in 1997. Divided by the average number of shares (243.6 million), this results in DVFA/SG earnings per DM 5 share of DM 3.19.

METRO AG Group: Calculation of DVFA/SG earnings per share for fiscal 1997

In DM million	Items to be adjusted in 1997	Effect on the DVFA/SG calculation
Net income		**622.8**
Income items		
Gains on the disposal of fixed assets	(65.3)	(22.6)
Income from the release of accruals	(216.8)	(5.7)
Income from the disposal of shares in Hapag-Lloyd AG	(241.7)	(241.7)
Income from final consolidation	(89.3)	(43.7)
Total income items	**(613.1)**	**(313.7)**
Expense items		
Amortization of goodwill	239.5	215.9
Transfer to untaxed/special reserves	17.2	16.9
Expenses in connection with the disposal of Möbel Unger GmbH	304.1	304.1
Total expense items	**560.8**	**536.9**
DVFA/SG earnings		**846.0**
Third-party share in net income		(68.9)
DVFA/SG earnings excluding third-party share in net income		**777.1**
Average number of shares ranking for dividend in fiscal year (million)		243.6
DVFA/SG earnings per share (in DM)		**3.19**

Method used to calculate DVFA/SG earnings

In fiscal 1997 the METRO AG Group generated net income of DM 622.8 million (excluding third-party share in net income). In line with the recommendations issued by the DVFA/SG committee, DM 223.2 million was added back to calculate DVFA/SG earnings. All adjustments only account for the Group's share and are stated on a gross-for-net basis (i.e. excluding imputed taxation) since most adjustments refer to Group companies that do not generate taxable income and/or have profit and loss transfer agreements with METRO AG, which, in turn, is able to carry forward tax-deductible losses.

The purpose of business of both METRO AG and the METRO AG Group includes the acquisition, disposal and management of land and buildings. Consequently, no adjustment is made for book gains and losses from the divestment of such assets, insofar as they form part of the Group's normal business operations and are not exceptionally high. Book gains arising from the sale of land and buildings that have been leased back under sale-and-lease-back agreements were deducted from net income when calculating DVFA/SG earnings. Similarly, book gains realized on the sale of real estate in connection with the operations of Möbel Unger GmbH were stripped out of net income.

A multitude of specific circumstances caused numerous Group companies to release accruals to income. None of the accruals released exceeded DM 9 million. Most of these accruals were charged against the operating result of the companies concerned and therefore reduced DVFA/SG earnings in the past. Where accruals did not reduce DVFA/SG earnings when they were set up, revenues from the release of such accruals were eliminated.

In addition, all income and expenses shown in the extraordinary result were eliminated. These comprise book gains from the divestment of shares in Hapag-Lloyd AG, revenues from the final consolidation of the operations of the Oppermann and the Rungis Groups, which the METRO AG Group has divested, and losses arising from the disposal of Möbel Unger GmbH.

DVFA/SG cash flow

The cash flow of the METRO AG Group calculated on the basis of the DVFA/SG recommendations amounted to DM 1,981 million (+4.4 percent). DVFA/SG cash flow per DM 5 share after elimination of third-party share in net income amounted to DM 7.85.

Cash flow of the METRO AG Group

In DM million	**1997**	1996
Net income of the Group	**623**	717
Amortization/depreciation/write-down of fixed assets	**1,361**	1,218
Straight cash flow	**1,984**	1,935
Change in long-term accruals	**(22)**	7
Transfer to untaxed/special reserves	**17**	17
All other items	**95**	(11)
Annual cash flow	**2,074**	1,948
Adjustment for significant cash income	**(93)**	(50)
DVFA/SG cash flow	**1,981**	1,898

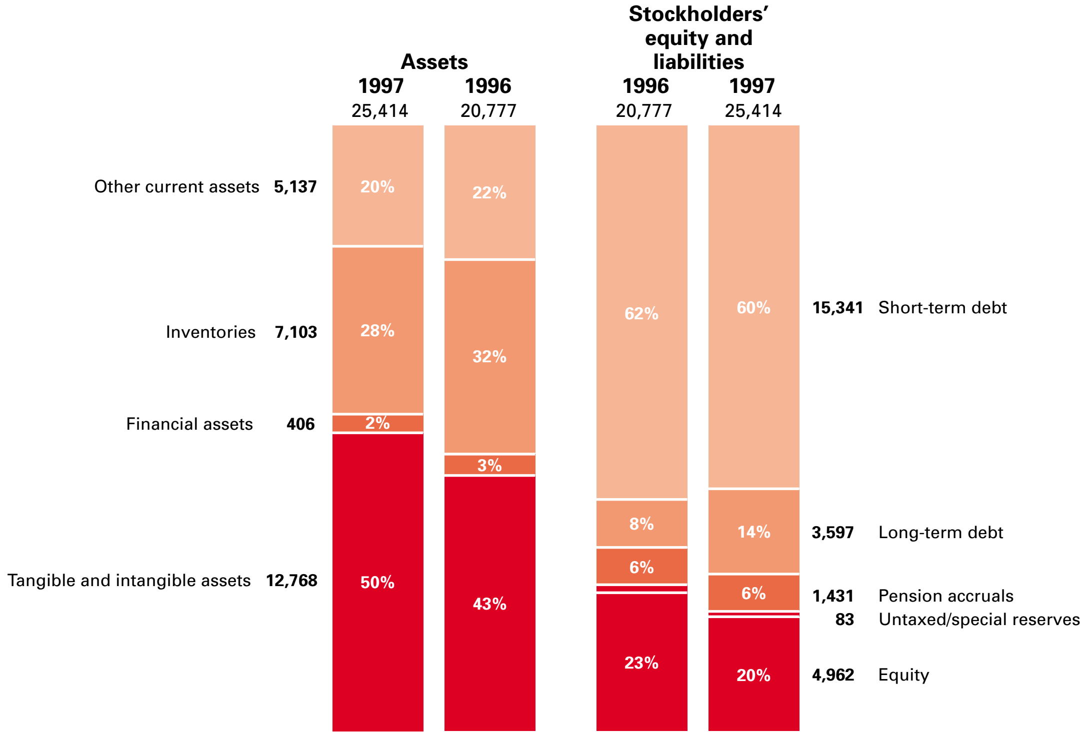
Cash flow statement of the METRO AG Group

In DM million	1997	1996
Cash flows from		
sales	**56,840.2**	55,104.2
materials [1]	**(40,280.3)**	(38,348.9)
personnel	**(7,887.8)**	(7,860.7)
other operating cash inflows	**2,579.4**	2,275.8
other operating cash outflows	**(7,842.6)**	(7,767.1)
Gross cash flow	**3,408.9**	3,403.3
Other cash flows from		
financial activities	**(107.7)**	(74.4)
income from investments	**5.8**	8.5
taxes	**(381.2)**	(330.8)
Net cash provided by operating activities	**2,925.8**	3,006.6
Disposal of fixed assets	**(102.6)**	622.8
Cash used for investment in fixed assets	**(3,232.8)**	(2,137.3)
Net cash used in investing activities	**(3,335.4)**	(1,514.5)
Decrease in third-party shares in equity	**(126.0)**	(140.1)
Distribution to shareholders	**(499.5)**	(104.9)
Exercise of options	**148.2**	4.4
Other changes in equity	**14.0**	19.3
Increase/decrease in financial debts	**663.6**	(114.6)
Net cash used in / provided by financing activities	**200.3**	(335.9)
Change in cash and cash equivalents	**(209.3)**	1,156.2
Cash and cash equivalents at January 1	**1,718.0**	561.8
Cash and cash equivalents at December 31	**1,508.7**	1,718.0

[1] Includes DM 1,063.2 million DM (1996: DM 760.1 million) increase in notes payable

The cash flow statement was prepared in accordance with Statement HFA 1/1995. Net cash provided by / used in financing activities includes liquid assets and note loans (previous year). The statement of net cash provided by operating activities uses the direct cash flow structure preferred by HFA 1/1995 and international practice. The previous year's figures have been restated accordingly. The difference between net cash provided by operating activities and DVFA/SG cash flow is primarily due to negative working capital in inventory management. Cash provided by / used in financing activities primarily reflects the flow of payments from interest rate and currency management. The impact of changes in the group of consolidated companies from the aquisition/disposal of companies has been eliminated and included as investment/ divestment in the net cash used in investing activities. The increase in cash used in investing activities chiefly refers to investments included for the first time as a result of consolidation of the ”real estate investment companies” and the acquisition of Peacock AG and of the Wirichs Group. The disposal of Möbel Unger generated a negative cash flow of DM 102.6 million.

METRO AG Group: Balance sheet structure
In DM million



Metro stock

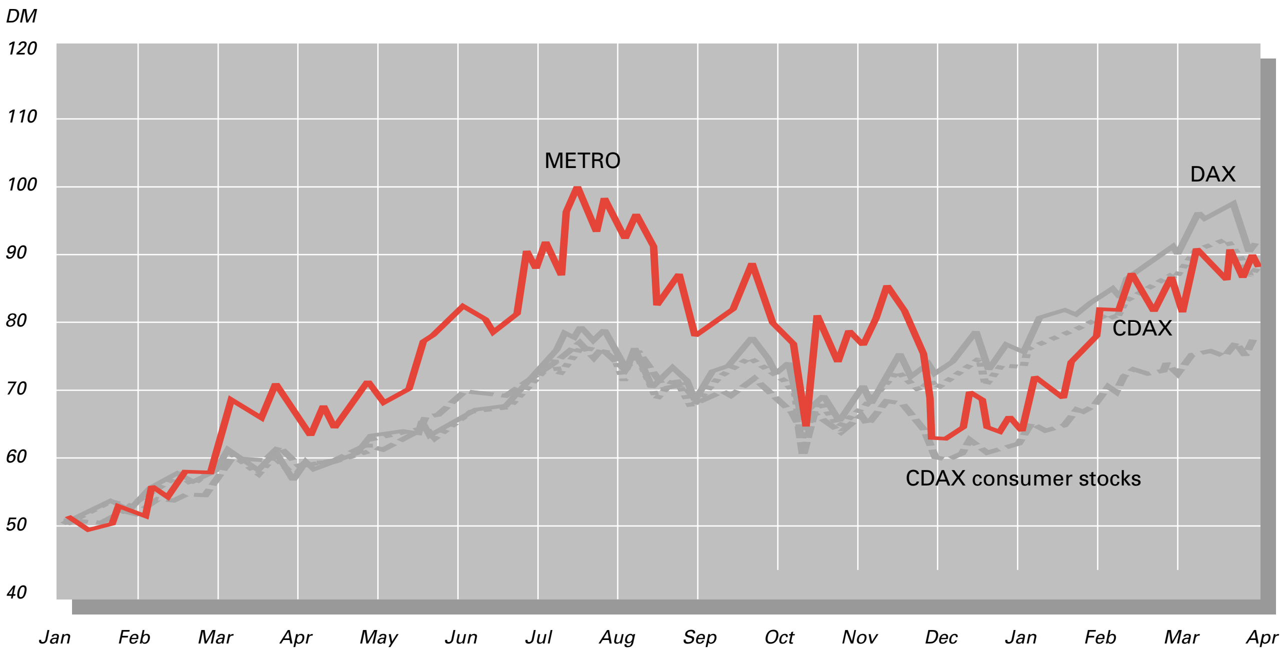
Uptrend in 1997

Metro stock performed far better than the DAX between January and December 1997. Since pre-Christmas trade was sluggish in November and the first-half of December, on December 18, 1997 METRO AG announced that the result from ordinary operations would be about 25 percent down on the previous year. As a result, the share price dropped considerably in the last two weeks of December. Nevertheless, the common stock ended the year up 24.8 percent at DM 64.50 on December 30, 1997. The non-voting preferred stock created by combining preferred stock I and II rose 38.5 percent to DM 50.20.

The German stock index (DAX) rose 46.2 percent to 4,224.30 points in 1997. The CDAX index, which comprised 354 listed German companies at year-end 1997, also advanced strongly, ending the year up 40.8 percent at 371.02 points. By contrast, the CDAX consumer stocks index, which contains listed German retail and consumer goods companies, posted a below-average rise of 18.1 percent to 169.16 points.

Metro common stock rose strongly between January 1998 and the end of April from DM 64.50 at year-end 1997 to DM 88.60 on April 30, 1998.

Performance of Metro common stock [1)]



[1)] February 2, 1997 to April 30, 1998. Absolute performance of Metro common stock; DAX, CDAX, CDAX consumer stocks indexed to Metro common stock

Source: Datastream

Market capitalization rose 27 percent to DM 15.38 billion at year-end 1997

The market capitalization of METRO AG rose 27 percent from DM 12.07 billion at year-end 1996 to DM 15.38 billion on December 30, 1997. In terms of market capitalization, METRO AG ranked 21st among the DAX-30 companies. Turnover of Metro stock (including Xetra/Ibis trades) totaled DM 40.46 billion in 1997. Metro shares are among the most liquid standard German stocks, ranking 23rd among the DAX-30 shares. METRO AG is thus Germany's biggest public retail/wholesale company.

Introduction of no-par stock from January 1, 1999 and changeover to the Euro

German legislation permitting the introduction of no-par stock (spring 1998) will allow division of the capital stock into shares with no par value, representing a proportion of the capital stock. A resolution on the introduction of no-par stock is to be put to the Annual Stockholders' Meeting on July 7, 1998. The stock will be quoted in Euros from January 4, 1999. The Supervisory and Executive Boards therefore feel that the amount of capital stock and conditional and authorized capital should be set as early as is permitted under the legislation on the introduction of the Euro. This legislation will probably come into force on January 1, 1999. However, the final conversion rate has not yet been set. A proposal will therefore be put to the Annual Stockholders' Meeting on July 7, 1998 that conversion to the single currency shall take place on January 1, 1999, provided that the relevant statutory regulations have come into force and the irrevocable conversion rate has been fixed.

METRO AG is one of the Top 50 European stocks in the Euro zone

The composition of the new Euro index, the "Dow Jones Euro Stoxx 50" was announced on February 12, 1998. This will track the performance of the 50 leading companies in the Euro zone. METRO AG is among the eleven German stocks included in this index and the only German wholesale/retail company on the index, where it has a weighting of 0.67 percent.

Authorized capital increase/simplified capital structure approved

Nearly 100 percent of the capital represented at the Annual Stockholders' Meeting of July 9, 1997 voted to raise the capital stock from DM 501.2 million to DM 1,202.9 million by converting capital reserves into capital stock. The first quote for Metro stock after the resultant 7:5 scrip issue was made on July 23, 1997 in the Ibis (now Xetra) trading system. The new stock is entitled to the full dividend as from January 1, 1997. The scrip issue has substantially enhanced the liquidity of Metro stock.

Further, through the resolutions passed at the Ordinary Annual Stockholders' Meeting and the separate meetings of holders of preferred stock I and II on July 9, 1997, almost 100 percent of the capital represented voted to simplify the capital structure by combining the non-voting preferred stock types I and II to form non-voting preferred stock with a uniform preferred dividend of 6.4 percent, plus a uniform bonus of 2.2 percent. This has improved the transparency of preferred stock for investors and increased its liquidity.

The Extraordinary Stockholders' Meeting of September 11, 1997 approved the creation of authorized capital II. The meeting voted in favor of this important strategic step with a majority of 97.9 percent, enabling METRO AG to raise its capital stock on or before September 11, 2002 through one or several ex rights issues of common stock against contributions in kind by an aggregate total of up to DM 350,000,000 at par. METRO AG made partial use of this option at the start of 1998 in connection with the acquisition of Makro. 21.76 million common bearer shares at a par value of DM 5, with a total par value of DM 108.8 million and full dividend entitlement from January 1, 1998 were issued in return for contributions in kind.

Metro stock – key figures 1997

Data per share		**1997**	1996
Year-end price [1]			
Common stock	DM	**64.50**	51.67
Preferred stock	DM	**50.20**	36.25
High for the year [1]			
Common stock	DM	**99.60**	59.58
Preferred stock	DM	**74.00**	43.21
Low for the year [1]			
Common stock	DM	**50.00**	50.21
Preferred stock	DM	**35.00**	36.04
No. of shares [1]	number	**243,590,388**	240,581,806
Common stock	number	**220,589,076**	217,580,494
Preferred stock	number	**23,001,312**	23,001,312
Option rights outstanding	number	**4,140,000**	7,148,582
Dividend payout [1]		**1997**	1996
Per DM 5 common share			
Cash dividend [2]	DM	**2.00**	1.67
Tax credit [3]	DM	**0.03**	0.03
Total payout	DM	**2.03**	1.70
Dividend yield [4]	%	**3.1**	3.3
Per DM 5 preferred share			
Cash dividend [2]	DM	**2.11**	1.77
Tax credit [3]	DM	**0.03**	0.03
Total payout	DM	**2.14**	1.80
Dividend yield [4]	%	**4.3**	5.0
Per share data (par value DM 5) [1]		**1997**	1996
DVFA/SG earnings per share (net)	DM	**3.19**	2.96
DVFA/SG cash flow	DM	**7.85**	7.44
Price/book value		**3.1**	2.5
Market capitalization	DM bill.	**15.38**	12.07

Note: The data for preferred stock in 1996 refer to preferred stock I

[1] Data for 1996 adjusted to take account of the 7:5 scrip issue of July 23, 1997

[2] 1996 dividend including adjusted bonus of DM 0.83 per share (common and preferred stock)

[3] For stockholders resident in Germany

[4] Based on year-end closing price

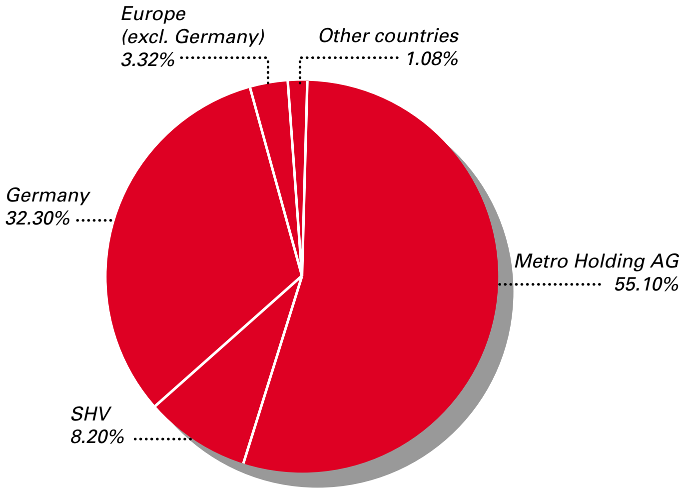
METRO AG stepping up dialog with the capital market

METRO AG stepped up its investor relations activities in fiscal 1997. Between February and July 1997, 132 representatives of 107 financial institutions attended investors'/analysts' meetings and visited premises operated by the METRO AG Group. Interest was clearly focused on the C&C operations. In addition, METRO AG organized two presentations for financial analysts (on May 27 and December 18, 1997). The second of these related specifically to the acquisition of the European C&C operations of Makro/Metro Holding. METRO AG also ran a roadshow from March 9–13, 1998 to enhance dialogue with the capital market. This comprised 5 presentations and 17 meetings with 95 people from 75 companies in Frankfurt, London, New York and Boston.

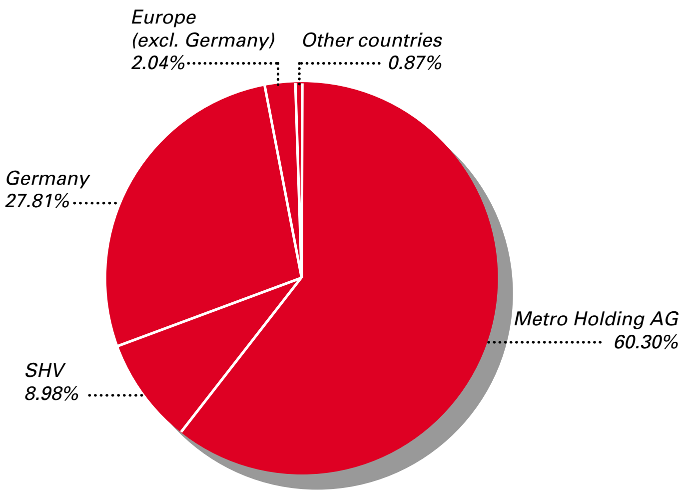
To provide a basis for efficient and targeted communication with the capital market, at the start of 1998 METRO AG carried out a survey to identify the ownership structure of its free float. This survey, which was conducted on February 12 showed that about 28 percent of the voting capital is held by German investors. As a result of the acquisition of Makro, METRO AG obtained a new major stockholder, the Dutch company SHV Makro NV, which holds 8.20 percent of the capital stock and 8.98 percent of the voting capital.

From fiscal 1998, METRO AG will be switching its financial reporting to net sales. This will ensure better comparability with other international wholesale/retail companies and thus corresponds to the international accounting practices used by its main competitors.

METRO AG: Stockholder structure Total capital



METRO AG: Stockholder structure Common stock



Source: Technimetrics

Additional information

Reuters' codes:	
Common stock	MEOG.F
Preferred stock	MEOG_p.F
Option warrant (86/98)	DE781905.F
Bloomberg codes:	
Common stock	MEO GR
Preferred stock	MEO3 GR
Option warrant (86/98)	KFHC GR
Securities identification numbers:	
Common stock	725 750
Preferred stock	725 753
Option warrant (86/98)	781 905
Trading in Metro stock:	Düsseldorf*, Frankfurt*, Geneva, Vienna, Xetra* (* official listing)

Investor Relations calendar 1998/99:

Financial press conference/analysts' meeting	May 26, 1998
Annual Stockholders' Meeting	July 7, 1998
Interim report 1998	late August 1998
Sales figures for 3rd quarter of 1998	late October 1998
Quiet period	December 1998–January 1999
Provisional sales figures for 1998	early February 1998
Sales figures for first quarter of 1999	late April 1999

Annual accounts 1997 of the METRO AG Group

1. Legal basis

METRO AG's consolidated accounts have been prepared in accordance with the provisions of the German Commercial Code ("HGB") and the German Stock Corporation Act ("AktG").

The accounts of the companies included in the Group financial statements are drawn up using uniform accounting and valuation principles. At most of these companies, the fiscal year is the same as at METRO AG. Where the fiscal year of consolidated companies does not end on the same date as the fiscal year of METRO AG and thus the closing date for the Group accounts, interim statements were prepared for consolidation purposes.

2. Group of consolidated companies and associated affiliates

In addition to the parent company METRO AG, the Group accounts cover 577 domestic subsidiaries (1996: 443) and 175 foreign companies (1996: 110) in which METRO AG directly or indirectly holds the majority of the voting rights.

Pursuant to Art. 271 para. 2 of the German Commercial Code, in addition to the subsidiaries of METRO AG, Group companies include the subsidiaries of Metro Vermögensverwaltung GmbH & Co KG, Düsseldorf, and of Metro Holding AG, Baar, which directly or indirectly hold a majority stake in METRO AG. Relations to these companies (which are not included in METRO AG's Group accounts) are disclosed separately under "Non-consolidated Group companies".

Under the terms of Art. 296 of the German Commercial Code, 31 (1996: 28) subsidiaries of minor significance are not consolidated. Twenty-two of these (1996: 13) are not or no longer engaged in operational activities.

Since December 31, 1996, the group of consolidated companies has changed as follows:

Number at December 31, 1996	**554**
Changes in fiscal 1997:	
due to mergers into other Group companies	**– 39**
due to the disposal of shares	**– 18**
due to changes in voting rights	**+168**
due to the establishment of new companies	**+ 33**
due to the acquisition of shares	**+ 48**
due to non-application of Art. 296 I 2 HGB	**+ 7**
Number at December 31, 1997	**753**

167 real estate companies and one equipment leasing company had to be fully consolidated for the first time at year-end 1997 following changes in voting rights. In 1996, these companies were included in investments (hereinafter referred to as "real estate investment companies"). Further major additions to the group of consolidated companies comprise the Wirichs Group (24 companies) and Peacock AG.

Shares divested in fiscal 1997 in order to streamline the Group portfolio mainly included shares in Möbel Unger GmbH (June 30, 1997), the Oppermann Group (December 31, 1997) and the Rungis Group (December 31, 1997). As a result, the Furniture Centers and Mail Order divisions were closed.

Under Art. 311 et seq. of the German Commercial Code, investments in 10 (1996: 10) associated affiliates are included at equity. Twenty-one (1996: 26) associated affiliates of minor significance are stated at book value pursuant to Art. 311 para. 2 of the German Commercial Code.

A complete list of Group companies and associated affiliates will be deposited with the Commercial Register of Cologne Local Court under HRB 26888.

The complete list of Group companies can also be obtained directly from METRO AG.

3. Consolidation principles

For consolidation, the so-called book value method of accounting is generally adopted: In a single step, the cost of subsidiaries is offset against the Group's share in the subsidiaries' equity as of the date of first-time consolidation or acquisition. In accordance with legislative provisions, any resultant net equity under cost is allocated to the reserves hidden in the consolidated subsidiaries' assets. Any residual net equity under cost, as far as there is no impairment of value, is disclosed as goodwill.

Goodwill acquired by the Group for valuable consideration is also capitalized to the extent that such goodwill is allocable to third-party stockholders. Amortization of third-party shares in goodwill is charged to the Group's income and disclosed as third-party P&L shares.

Investees included at equity are capitalized according to the book value method at their prorated equity. Any net equity under cost from the inclusion at equity of investments in associated affiliates as of December 31, 1997, is shown under goodwill.

The minority shares of outside stockholders in the capital of consolidated subsidiaries are disclosed separately pursuant to Art. 307(1) HGB. The same applies to third-party shares in goodwill to the extent that these outside stockholders have acquired such goodwill jointly with the Company.

Under the terms of Art. 308 par. 3(1) HGB, the untaxed/special reserves set aside in the individual financial statements are principally carried over to the consolidated accounts. Untaxed/special reserves existing at initial consolidation date are allocated to deferred taxation or to the reserves retained from earnings in accordance with their third-party capital shares or their equity shares, respectively, thus being duly reflected in capital consolidation.

Intercompany P&L, intra-Group transfers, expenses and income, as well as receivables and payables are eliminated. The option of third-party debt consolidation is utilized.

If based on timing differences substantially after 3 years, deferred taxes are provided for income tax effects from consolidation transactions recognized in net income. The reason for this approach is that tax loss carryovers exist within the METRO AG Group which, according to current income forecasts, will have been fully applied after 2 or 3 years.

4. Currency translation

All balance sheet captions, including net income and all lines upstream of net earnings, denominated in non-DM currencies are translated at the mean current rate. For expenses and income, the annual average rate is used. Currency translation differences are thus produced in the income statement which are posted to other operating expenses or other operating income, as applicable. Consolidation-related differences from currency translation are offset against the reserves retained from earnings and not recognized in net income.

5. Accounting and valuation principles

Intangible assets are stated at acquisition cost, tangible assets at purchase or production cost, both less accumulated systematic amortization or depreciation, less write-down and less tax-deductible accelerated depreciation charges as applicable or required. Additions to movable tangibles are generally depreciated by using the tax convenience of charging the full or half the rate for additions in the first or the second six-month period, respectively. Systematic depreciation is charged to buildings and self-contained building appurtenances or elements on a straight-line basis, while for movable tangible assets, the declining-balance method is as a rule used wherever permitted by tax regulations. From the year in which straight-line depreciation exceeds declining-balance charges, the former method is adopted thenceforth. Assets are written down whenever any impairment in value is of a long-term nature. So-called low-value assets (i.e., at net cost of DM 800 or less) are fully written off in the year of their addition. Systematic amortization and depreciation are based on the following useful lives (AAR/ADRs) throughout the Group:

Goodwill:	generally 15 years
Buildings:	25–50 years
Leasehold improvements:	lease term or 10 years, whichever is shorter
Store improvements:	7 years (first use prior to Jan. 1, 1994: 8 years)
Factory and office equipment:	3–10 years

Where holdings of minor significance are involved, investments in associated affiliates and shares in non-consolidated Group companies are capitalized at cost. Investments other than insignificant in associated affiliates are then stated at the prorated net accounting equity. For first-time consolidation purposes, the cost of such associated affiliates is offset against their prorated equity, any adjustment to Groupwide uniform valuation methods being waived in these cases. The cost of investments stated according to the equity method of accounting varies as a function of the annual change in equity capital.

Long-term loans are capitalized at par, non- or low-interest loans being discounted to their present values.

Inventories are priced at the lower of cost or market.

Purchase cost of inventories is partly determined on a cost price basis according to the merchandise information system (MIS), or else by applying the inverse method to the selling value. Where the inverse method is used to determine purchase cost, the markdown rates derived from pricing margins of stocks on hand are deducted from stocked goods valued at selling prices.

Risks from changing fads and similar exposures are adequately allowed for at standard industry rates. Pricing is based on net realizable values.

Production cost also includes reasonable portions of overhead expenses besides direct costs.

Receivables and sundry assets are principally stated at par or face value. Specific allowances provide for the risks inherent in doubtful receivables; non-interest receivables are discounted. Standard allowances for doubtful accounts provide for part of the general collection risk.

Short-term securities and note loans are valued at cost, market or current value, whichever is lower.

Accruals provide for foreseeable or apprehensible risks, uncertain commitments and impending losses, as deemed appropriate in accordance with sound business practice and judgment. The actuarial present value is used to provide for pension accruals, on the basis of an imputed yearly interest rate of 6 percent, all pursuant to Art. 6a German Income Tax Act ("EStG"). Same-amount accruals provide for the deficient cover resulting from non-consolidated employee benevolent funds. Long-term accruals, such as for deficient rental cover or employment anniversary allowance commitments, are disclosed at par, i.e. not discounted.

Liabilities are generally stated at the amount repayable.

Financial derivatives of interest rate and currency management are used to minimize risks from the companies' operational activities, their valuation being itemwise and predicated on the imparity principle (which requires unrealized losses to be accrued and prohibits recognition of unrealized profits).

Nonlisted financial instruments are valued either as marked to market, by using generally accepted option pricing models or, for non-option-type derivatives, according to the present-value method.

Currency-related financial transactions are principally valued at the current mean spot price. Exchange transactions maturing later are valued at the forward rates for the respective remaining terms.

For interest rate futures and options thereon, net compensation payments made due to a reduction in value are charged to expenses.

Specific accruals provide in principle for impending losses from derivative financial instruments at the notional losses from evening up such positions (marked to market). In accordance with the true-and-fair-view standards of Art. 264 par. 2(1) HGB and in line with international practice, transactions constituting economic units and whose collateralization is objectively interrelated and documented accordingly are valued on an offset basis, i.e., within a position valued as a unit, losses from unsettled contracts are offset against, and up to the amount of, unrealized profits. The formation of separate valuation units is premised on currency identity, financial-standing identity (prime debtors exclusively), and substantially matching maturities.

Comments on the consolidated balance sheet

Following the closure of the Furniture Centers and Mail Order divisions, the Group comprised 13 divisions as of December 31, 1997. Insofar as amounts with respect to these divisions were included in individual items on the balance sheet in 1996, they have been restated under the division "Others" for 1996. The separation of the Food Stores & Discounters division into a Food Stores division and a Discount Stores division in 1997 and the transfer of companies to different divisions (e.g. the transfer of C&C Schaper GmbH from Food Stores to Metro Wholesale) led to corresponding restatement of the previous year's figures.

6. Fixed assets

in DM million	Balance at Jan. 1, 1997	Currency adjustment	Change in the group of consolidated companies
Intangible assets			
Franchises, concessions, industrial-property and similar rights and assets, and licenses thereto	379.403	0.553	26.140 (15.647)
Goodwill	2,778.557	–	– –
Prepayments on intangible assets	1.486	–	0.234 (0.666)
	3,159.446	0.553	26.374 (16.313)
Tangible assets			
Land, equivalent titles, and buildings (including buildings on leased land and leasehold improvements)	7,050.326	(6.367)	3,099.283 (168.105)
Production plant and machinery	117.270	0.734	14.864 (5.154)
Other plant, factory and office equipment	3,557.076	0.671	228.083 (158.446)
Prepayments on tangible assets, construction in progress	153.280	(6.780)	133.034 (0.429)
	10,877.952	(11.742)	3,475.264 (332.134)
Financial assets			
Shares in non-consolidated Group companies	74.271	–	4.990 (23.028)
Loans to non-consolidated Group companies	0.500	–	28.796 –
Other investments	442.589	–	0.294 (192.730)
Investments in associated affiliates	89.103	–	– (0.362)
Loans under investor/investee relations	71.722	4.104	– (0.740)
Other long-term securities	4.046	–	0.104 (0.069)
Other long-term loans	123.021	–	0.832 (7.302)
	805.252	4.104	35.016 (224.231)
Total	14,842.650	(7.085)	3,536.654 (572.678)

[1] Including pro rata net income of DM 13.090 million (= additions), pro rata net losses of DM 56.622 million and profit distributions of DM 14.564 million (= disposals)

	At cost					
	Additions	Book transfers	Disposals	Charges (accumulated)	**Balance at Dec. 31, 1997**	Charged in fiscal year
	44.935	(0.173)	77.213	224.030	**133.968**	76.904
	491.517	–	9.042	561.108	**2,699.924**	239.579
	15.524	(1.939)	0.063	–	**14.576**	–
	551.976	(2.112)	86.318	785.138	**2,848.468**	316.483
	554.862	341.778	272.082	2,759.327	**7,840.368**	346.319
	13.083	(3.133)	12.877	87.755	**37.032**	10.703
	784.724	26.431	514.178	2,427.345	**1,497.016**	684.946
	477.735	(159.981)	50.571	1.001	**545.287**	–
	1,830.404	205.095	849.708	5,275.428	**9,919.703**	1,041.968
	0.037	(0.010)	0.781	14.393	**41.086**	–
	0.926	57.617	0.121	81.583	**6.135**	0.269
	0.288	(202.973)	1.342	28.657	**17.469**	–
	67.093[1)]	–	68.958[1)]	1.793	**85.083**	–
	17.316	(57.617)	8.819	–	**25.966**	–
	0.318	–	0.092	0.005	**4.302**	–
	140.341	–	21.735	9.169	**225.988**	1.341
	226.319[1)]	(202.983)	101.848[1)]	135.600	**406.029**	1.610
	2,608.699	–	1,037.874	6,196.166	**13,174.200**	1,360.061

Divisional breakdown of additions to fixed assets in the fiscal year (excluding goodwill and financial assets):

in DM million	**Dec. 31, 1997**	Dec. 31, 1996
Metro Wholesale	**188.043**	138.357
Department Stores	**394.127**	290.461
Hypermarkets	**236.496**	197.530
Food Stores	**83.648**	82.499
Discount Stores	**40.242**	33.490
Consumer Electronics Centers	**163.654**	111.953
Home Improvement Centers	**79.525**	86.360
Computer Centers	**45.867**	53.389
Fashion Centers	**22.485**	27.805
Footwear Centers	**18.528**	10.138
Restaurant & Catering	**15.345**	17.566
Real Estate	**536.683**	424.565
Others	**66.220**	165.144
	1,890.863	1,639.257

Additions of DM 3,536.654 million resulting from changes in the group of consolidated companies, especially additions to land, equivalent titles and buildings (including buildings on leased land and leasehold improvements) totaling DM 3,099.283 million, are essentially due to the first-time consolidation of "real estate investment companies".

7. Intangible assets

Breakdown of goodwill totaling DM 2,699.924 million as of December 31, 1997:

DM 2,500.603 million	differences arising from capital consolidation,
DM 95.338 million	differences arising from consolidation at equity,
DM 103.983 million	goodwill carried over from financial statements of individual companies.

The additions to goodwill chiefly relate to the complete acquisition of the Wirichs Group and Peacock AG and the purchase of further shares in Maxdata GmbH.

In addition to goodwill, intangible assets primarily comprise software acquired.

Goodwill is amortized over its useful life, generally 15 years.

8. Tangible assets

Land and buildings reflects the first-time consolidation of the "real estate investment companies." Conservatively-valued hidden reserves in land and buildings were disclosed as part of the initial consolidation of investments in "real estate investment companies."

Depreciation of tangible assets in the fiscal year include write-downs of DM 14.239 million and tax-deductible accelerated depreciation of DM 0.399 million (1996: DM 0 million) in compliance with Art. 6b of the German Income Tax Act (EStG).

9. Financial assets

Additions to investments in associated affiliates include pro rata net income of DM 13.090 million. Disposals include profit distribution of DM 14.564 million and pro rata net losses of DM 56.622 million. In particular, the book value as of December 31, 1997 includes the investment in Roller GmbH & Co KG.

Disposals and transfers of investments mainly relate to the "real estate investment companies", which were fully consolidated for the first time as of December 31, 1997.

Additions to other loans comprise loans totaling DM 115.029 million maturing on or before June 30, 2002.

10. Inventories

in DM million	Dec. 31, 1997	Dec. 31, 1996
Raw materials and supplies	**175.141**	145.005
Work in process	**6.310**	12.526
Finished products, merchandise	**6,858.807**	6,338.461
Prepayments made	**63.200**	48.723
	7,103.458	6,544.715

The rise in inventories is mainly due to expansion of selling space.

Divisional breakdown of inventories as of December 31, 1997:

in DM million	Dec. 31, 1997	Dec. 31, 1996
Metro Wholesale	**804.678**	763.746
Department Stores	**1,727.104**	1,683.223
Hypermarkets	**974.638**	871.056
Food Stores	**598.133**	487.241
Discount Stores	**93.135**	73.477
Consumer Electronics Centers	**923.805**	810.635
Home Improvement Centers	**1,012.582**	803.768
Computer Centers	**463.470**	279.864
Fashion Centers	**155.878**	168.318
Footwear Centers	**154.424**	143.595
Restaurant & Catering	**8.118**	5.290
Others	**187.493**	454.502
	7,103.458	6,544.715

11. Receivables and sundry assets

in DM million	Dec. 31, 1997	Dec. 31, 1996
Trade receivables	**805.189**	656.911
thereof with a remaining term of more than 1 year	**[1.644]**	[0.822]
Receivables due from non-consolidated Group companies	**79.937**	46.634
thereof with a remaining term of more than 1 year	**[0.560]**	[–]
thereof from trading	**[46.861]**	[26.127]
Receivables due under investor/investee relations	**44.260**	118.942
thereof with a remaining term of more than 1 year	**[–]**	[–]
thereof from trading	**[0.006]**	[0.641]
Sundry assets	**2,511.361**	1,689.013
thereof with a remaining term of more than 1 year	**[141.944]**	[88.912]
	3,440.747	2,511.500

The rise in trade receivables is mainly due to the first-time consolidation of Peacock AG. The first-time consolidation of the "real estate investment companies" explains the decline in receivables due under investor/investee relations.

Sundry assets mainly relate to the short-term receivables typically shown at balance sheet date (creditors with a debit balance, rebates from merchandise management, purchase price claims from the disposal of shares and land, and the reimbursement of taxes). The rise is primarily due to purchase price claims in connection with the sale of the shares in Hapag-Lloyd AG, the Oppermann Group, the Rungis Group and of Unger's operations.

12. Short-term securities and note loans

in DM million	**Dec. 31, 1997**	Dec. 31, 1996
Shares in non-consolidated Group companies	**1.359**	0.471
Other short-term securities	**42.903**	231.634
Note loans	**–**	114.690
	44.262	346.795

The shares in Hapag-Lloyd AG included in other short-term securities in the previous year were sold in 1997. Note loans used to finance sites used by the METRO AG Group, which were included in 1996, were redeemed in 1997.

13. Cash on hand and in bank

in DM million	**Dec. 31, 1997**	Dec. 31, 1996
Checks	**9.987**	85.391
Cash	**117.498**	132.456
Cash in bank	**1,381.251**	1,385.489
	1,508.736	1,603.336

14. Deferred taxes

This item contains (net) deferred taxes of DM 25.562 million resulting from consolidation.

15. Prepaid expenses and deferred charges

Prepaid expenses and deferred charges mainly comprise prepaid rents. Discounts on loans of DM 1.208 million (1996: DM 0.808 million) are amortized over the term of the underlying liabilities.

16. Equity

The equity of the METRO AG Group since January 1, 1997 changed as follows:

in DM million	METRO AG's capital stock	METRO AG's reserve from capital surplus	Reserves retained from earnings	Unappro-priated retained earnings, Group	Third-party equity shares	Total
Balance as of January 1, 1997	501.212	2,729.608	215.483	403.366	976.686	4,826.355
Scrip issue	701.700	(701.700)				–
Exercise of option rights	15.040	133.155				148.195
Unappropriated retained earnings				489.711	68.886	558.597
Transfer from net income to reserves retained from earnings			64.210			64.210
Currency translation/Sundry			1.256			1.256
Net equity from the acquisition of shares					(96.480)	(96.480)
Distribution of unappropriated retained earnings				(403.366)	(123.937)	(527.303)
Payments to third parties from 1997 earnings					(12.871)	(12.871)
Balance as of December 31, 1997	**1,217.952**	**2,161.063**	**280.949**	**489.711**	**812.284**	**4,961.959**

17. Capital stock

The capital stock of METRO AG corresponds to the par value of the stock issued. In 1997, the capital stock increased by DM 701.700 million by a 7:5 scrip issue. The exercise of option rights increased the capital stock by a further DM 15.040 million to a total of DM 1,217.952 million as of December 31, 1997. The table shows the breakdown of the capital stock:

Class	Number	Par value per share	Total par value DM million
Common stock	220,589,076	DM 5	1,102.945
Preferred stock	23,001,312	DM 5	115.007
Capital stock (total)	243,590,388	DM 5	1,217.952

As of December 31, conditional capital I of DM 20.700 million exists to enable the Company to grant shares of METRO AG common stock upon the exercise of option rights attached to Metro Finance BV's 2% DM warrant bond issue of 1986/1998. In addition, conditional capital II of DM 100.000 million exists relating to the Executive Board's authority to issue warrant and/or convertible bonds to a total value of up to DM 2,000.000 million by July 9, 2002 and to grant option and/or conversion rights for new METRO AG common and/or preferred stock with a par value totaling not more than DM 100.000 million.

The Executive Board is also authorized, with the approval of the Supervisory Board, to increase the capital stock by up to DM 250.000 million on one or more occasions by July 9, 2002, by issuing new common or preferred stock (authorized capital I) against contribution in cash.

Further, with the approval of the Supervisory Board, the Executive Board is authorized to increase the capital stock of the Company by issuing new common bearer stock on one or more occasions by up to an aggregate maximum of DM 350.000 million by September 11, 2002 (authorized capital II) in return for contribution in kind. The Executive Board made partial use of this authorization through its resolutions of December 8 and 16, 1997 (approved by the Supervisory Board on December 17, 1997) and increased the capital stock by DM 108.800 million to DM 1,326.752 million in return for contribution in kind under exclusion of stockholders' subscription rights. The contribution in kind comprises the transfer by SHV Makro NV of all shares in Mebrö Beteiligungs AG, now renamed Metro Cash & Carry AG, which in turn holds all European C&C operations of the Makro Group (including its operations in Morocco). The contribution in kind and the entry of the implemented capital increase in the Commercial Register took place on January 6, 1998 on the basis of the audit report on the contribution in kind prepared by Wollert-Elmendorff Deutsche Industrie-Treuhand GmbH dated January 2, 1998. In compliance with Art. 189 of the German Stock Corporation Act (AktG), the capital stock was deemed increased only when the entry in the Commercial Register and the implementation of the capital increase actually took place. Consequently, this action had no impact on the capital stock as of December 31, 1997. Following this transaction, authorized capital II of DM 241.200 million remains.

18. Reserves from capital surplus

This item includes the stock premium reserve generated by the capital increase based on contribution in kind, mergers and the exercise of option rights.

In 1997, the exercise of option rights increased the reserve by DM 133.155 million. The scrip issue reduced the reserve by DM 701.700 million but increased the capital stock.

19. Reserves retained from earnings

These reserves show the 1997 profits of the companies included in the Group accounts, where such profits were not distributed.

20. Third-party equity shares

The shares of outside stockholders in the capital, including reserves, amount to DM 756.269 million (1996: DM 882.247 million). Following the distributions already made, equity includes DM 56.015 million (1996: DM 94.439 million) attributable to third-party shares in net income.

21. Accruals

in DM million	**Dec. 31, 1997**	Dec. 31, 1996
Pension accruals	**1,431.477**	1,266.165
Tax accruals	**376.548**	417.197
Other accruals	**2,154.684**	2,375.113
	3,962.709	4,058.475

Pension accruals provide for company-specific direct pension commitments, as well as for obligations under various pension schemes handled by independent pension and similar funds.

Pension accruals are based on actuarial calculations. Since these include calculations for the volume of pension commitments at two pension funds for the first time, the pension accruals set up at the time of first-time consolidation as per January 1, 1996 had to be adjusted in view of the 1999 pension fund legislation.

Tax accruals mainly provide for municipal trade tax and contain reasonable amounts to cover risks arising from tax audits.

Other accruals chiefly provide the following:

in DM million	Dec. 31, 1997	Dec. 31, 1996
Rental obligations	**466.851**	522.173
Personnel-related commitments	**440.537**	439.264
Commitments arising from trading	**208.567**	191.678
Outstanding invoices for capital expenditures and costs	**207.447**	182.669
Close-downs and restructuring	**159.038**	401.767
Impending losses from investments	**112.355**	63.755
Guaranty obligations	**52.968**	48.340
Deferred maintenance	**47.243**	64.331
Litigation fees and risks	**46.430**	50.791
Warranties and sureties	**28.381**	54.334
Other	**384.867**	356.011
	2,154.684	2,375.113

Long-term accruals, e.g. for deficient rental cover and employment anniversary allowance commitments are stated at nominal value, i.e. they are not discounted.

The reduction in accruals for close-downs and restructuring is mainly due to the disposal of Möbel Unger GmbH.

Accruals for impending losses from investments essentially contain risks relating to the Group's stake in Mayer Schuh GmbH and diverse risks relating to foreign subsidiaries.

22. Liabilities

in DM million	Dec. 31, 1997	Dec. 31, 1996
Bonds	**1,856.582**	542.495
Due to banks [1]	**2,597.310**	643.556
Prepayments received on orders	**224.825**	114.760
Trade payables	**7,309.064**	7,335.366
Notes payable	**2,363.230**	1,300.039
Due to non-consolidated Group companies [2]	**403.552**	343.862
Payables under investor/ investee relations [3]	**3.742**	30.948
Sundry liabilities	**1,229.701**	1,127.654
thereof for taxes	**[455.978]**	[501.269]
thereof for social security	**[227.314]**	[218.711]
	15,988.006	11,438.680

[1] including DM 2,095.685 million (1996: DM 246.838 million) to finance real estate

[2] including trade payables of DM 22.495 million (1996: DM 75.313 million)

[3] including trade payables of DM 0.255 million (1996: DM 0.847 million)

The bonds were issued by Metro Finance BV and guaranteed by METRO AG. The rise in bonds and liabilities to banks is due to the first-time consolidation of "real estate investment companies" in the Group accounts of METRO AG.

The sundry liabilities chiefly comprise personnel-related obligations, tax liabilities and loans from employee benevolent funds.

The table below shows liabilities as of December 31, 1997.

	Dec. 31, 1997	Remaining term of		Thereof collateralized by	
in DM million	**Total**	1 year or less	more than 5 years	charges on realty	other rights
Bonds	**1,856.582**	1,258.791	387.586		
Due to banks	**2,597.310**	188.637	1,934.262	2,095.685	4.322
Prepayments received on orders	**224.825**	216.473			
Trade payables	**7,309.064**	7,309.064			
Notes payable	**2,363.230**	2,363.230			
Due to non-consolidated Group companies	**403.552**	327.410			
Payable under investor/investee relations	**3.742**	3.742			
Sundry liabilities	**1,229.701**	1,143.458	53.523	9.047	4.941
	15,988.006	12,810.805	2,375.371	2,104.732	9.263

23. Deferred income

This item mainly refers to forfaiting operations in the leasing sector.

24. Contingent liabilities

in DM million	Dec. 31, 1997	Dec. 31, 1996
Sureties	**739.563**	450.683
Notes endorsed and discounted	**–**	0.082
Guarantee commitments	**3,799.508**	535.726
Endorsement of collateral for third-party liabilities	**0.400**	–
	4,539.471	986.491

The increase in liabilities arising from guarantee commitments relates primarily to the acquisition of the Makro Group in January 1998. In December 1997, METRO AG gave a guarantee to SHV Makro NV (the seller) that it would honor all payment obligations entered into by Mebrö Beteiligungs AG, which it acquired as from January 2, 1998. This transaction has now been completed.

25. Other financial obligations

in DM million	Dec. 31, 1997	Dec. 31, 1996
Obligations from leases, rental and leasing contracts (per annum)	**2,430.228**	2,586.936
Commitments from share tender rights	**2,909.355**	922.187
thereof to non-consolidated Group companies	**[1,986.452]**	[–]
Purchasing commitments	**169.789**	132.860
Liability as general partner	**4.463**	11.354
Obligations to provide credit	**140.000**	–
All other	**191.071**	47.634
thereof commitments to non-consolidated Group companies	**[4.830]**	[3.901]
	5,844.906	3,700.971

The rise in commitments under share tender rights mainly relates to the option agreement concluded with Metro Holding AG, Baar, in December 1997. This contains a right to tender for its shares (generally 40 percent) of the European and Moroccan C&C activities of the Makro Group. The amount stated here is the gross amount, i.e. without offsetting METRO AG's tender rights with regard to Metro Holding AG.

26. Derivative financial instruments

On December 31, 1997, the following financial derivatives were being used to minimize risks:

in DM million	Notional amount (net positions)	Market value (net positions)
Interest rate transactions		
Listed products:		
3 months	144.000	(0.366)
5 years	169.000	(1.349)
10 years	844.750	(9.396)
10 year call option	250.000	(0.500)
10 year put option	500.000	(1.465)
	1,907.750	(13.076)
OTC products:		
Interest rate swaps	455.566	0.572
Caps and collars	400.000	0.189
	855.566	0.761
Currency transactions		
OTC products:		
Futures	3,720.274	4.785
Interest rate/currency swaps	(22.555)	(12.138)
	3,697.719	(7.353)
	6,461.035	(19.668)

The notional amounts are calculated from the net positions based on the underlying purchase/selling prices. The market value is the balance of unrealized gains and losses generated by the mark-to-market method. Where negative market values are not offset against unrealized gains within the same valuation unit, accruals are made for negative market values. For details of the accounting and valuation procedures used for financial derivatives, see Note 5. All currency futures/forward rate transactions mature within one year.

Comments on the Group's income statement

27. Sales

Breakdown of gross sales:

in DM million	1997	1996
Metro Wholesale [1]	**11,376.077**	11,632.366
Department Stores [2]	**11,368.019**	11,520.265
Hypermarkets	**10,786.632**	10,721.634
Food Stores [1]	**6,050.035**	5,913.234
Discount Stores	**1,562.642**	1,346.462
Consumer Electronics Centers	**8,686.289**	7,631.684
Home Improvement Centers	**4,655.802**	4,303.958
Computer Centers	**4,514.416**	3,134.852
Fashion Centers	**1,357.077**	1,417.201
Footwear Centers	**815.260**	816.440
Restaurant & Catering	**492.534**	474.106
Others [2] [3]	**2,466.039**	3,111.862
	64,130.822	62,024.064

[1] C&C Schaper has been transferred from Food Stores to Metro Wholesale

[2] Michel Farah has been transferred from Department Stores to Others

[3] Primarily Möbel Unger/Massa furniture stores, Free Com Die Telekommunikationsgesellschaft, Oppermann, the Rungis Express Group, Hawesko, Jacques' Weindepot. 1996 sales of the Furniture Centers and Mail Order divisions, from which the Group has now withdrawn, are restated under Others

Gross sales totaling DM 4,524.927 million (1996: DM 3,014.567 million) were generated by Group companies based outside Germany.

28. Other operating income

in DM million	1997	1996
Rentals	**738.782**	703.068
Advertising income	**494.078**	306.631
Building/construction work	**303.477**	360.139
Release of accruals	**216.805**	192.526
General services	**212.022**	175.096
Central A/P clearing for divisions	**154.374**	151.415
Gains from the disposal of fixed assets	**46.360**	108.932
Commissions	**40.553**	25.268
Sundry	**499.550**	410.120
	2,706.001	2,433.195

The rise in income from advertising services was due to higher advertising allowances from suppliers for specific advertising campaigns.

Income from building/construction work was roughly equivalent to the corresponding expense item.

Income from the release of accruals contains a large number of individual items at various companies, particularly for deficient rental cover, close-downs and restructuring, outstanding invoices for capital expenditure and costs, litigation risks and employment anniversary allowance commitments.

The income from central A/P clearing for divisions relates to the settlement of trade accounts payable via a central clearing office.

29. Cost of materials

in DM million	1997	1996
Raw materials, supplies, merchandise purchased	**41,266.318**	39,819.431
Services purchased	**65.690**	41.272
	41,332.008	39,860.703

30. Personnel expenses

in DM million	1997	1996
Wages and salaries	**6,567.948**	6,435.341
Social security contributions, expenses for pensions and related benefits	**1,446.337**	1,328.441
thereof pension expenses	**[142.828]**	[101.299]
	8,014.285	7,763.782

In 1997, expenses of DM 106.806 million (1996: DM 102.168 million) were incurred for social plans under restructuring programs.

31. Amortization of intangible and depreciation of tangible assets

in DM million	1997	1996
Amortization of goodwill from capital consolidation	**189.423**	154.502
Amortization of goodwill from consolidation at equity	**26.932**	8.733
Amortization of goodwill from individual company accounts	**23.224**	30.634
Amortization of other intangible assets	**76.904**	79.413
Depreciation of tangible assets	**1,042.588**	944.699
	1,359.071	1,217.981

Amortization of goodwill carried over from individual accounts to the Group accounts includes write-downs of DM 20.423 million (1996: DM 8.884 million). Depreciation of tangible assets includes write-downs of DM 14.638 million (1996: DM 27.232 million).

The application of different currency translation rates in the balance sheet and income statement leads to a difference of DM 0.620 million in the depreciation charges shown in the breakdown of fixed assets.

32. Other operating expenses

in DM million	1997	1996
Rents	**2,468.016**	2,486.822
Advertising and promotion	**1,569.331**	1,399.879
Maintenance	**491.140**	506.630
Energy	**455.578**	450.962
Personnel-related expenses	**304.798**	292.859
Building/construction work	**285.226**	330.157
Transportation of goods	**278.477**	294.517
Cleaning/waste disposal	**264.267**	230.732
Consumption of materials	**182.824**	185.854
Postal charges and related expenses	**142.169**	138.117
Legal, audit and similar fees	**125.296**	128.342
Write-downs/losses on current assets	**99.104**	74.542
Security expenses	**89.677**	76.980
Insurance policies	**75.022**	77.544
Close-down and restructuring expenses	**48.246**	109.107
Sundry	**913.619**	790.761
	7,792.790	7,573.805

Sundry other operating expenses chiefly comprise administrative and IT expenses and expenses for payment transactions.

33. Result from investments

in DM million	1997	1996
Net loss/profit from associated affiliates	**(41.638)**	16.991
Income from other investments	**5.813**	2.408
	(35.825)	19.399

Net loss/profit from associated affiliates mainly reflects the DM 53.208 million loss made by Mayer Schuh GmbH.

34. Net financial result

in DM million	1997	1996
Other interest and similar income	**192.067**	182.932
thereof from non-consolidated Group companies	**[1.707]**	[2.017]
Other financial income	**142.109**	103.826
Income from other long-term securities and loans	**4.300**	7.503
Write-downs of financial assets and short-term securities	**(1.673)**	(1.056)
Interest and similar expenses	**(268.297)**	(261.294)
thereof paid to non-consolidated companies	**[(12.866)]**	[(18.974)]
Other financial expenses	**(163.606)**	(103.906)
	(95.100)	(71.995)

35. Extraordinary result

in DM million	1997	1996
Extraordinary income		
Book gain from the disposal of shares in Hapag-Lloyd AG	**241.700**	–
Income from final consolidations	**43.721**	–
Book gain from the disposal of Unger's real estate	**18.946**	–
	304.367	–
Extraordinary expense		
Loss from the disposal of Möbel Unger GmbH	**(304.121)**	–
	(304.121)	–
	0.246	–

Extraordinary income was largely generated by the disposal of investments in Hapag-Lloyd AG and the Unger Group. The book gain from the disposal of the Unger Group's real estate was reduced by DM 48.410 million by allocations to untaxed/special reserves as permitted by Art. 6b of the German Income Tax Act.

Income arising on final consolidations shows income from the disposal of the companies of the Oppermann and the Rungis Groups.

36. Income taxes

in DM million	1997	1996
Corporation income tax	**138.266**	150.153
Municipal trade tax on income	**114.525**	112.310
Non-German income taxes	**(2.183)**	2.420
	250.608	264.883
Deferred taxes	**0.342**	9.603
	250.950	274.486

As of December 31, 1997, the METRO AG Group had tax loss carryforwards totaling DM 3.1 billion (1996: DM 3.8 billion) for corporation income tax purposes and DM 3.0 billion (1996: DM 3.5 billion) as a credit against municipal trade tax on income. These losses can be carried forward for an indefinite period of time.

37. Net income

Net income of METRO AG amounts to DM 709.960 million while net income of the Group totals DM 622.807 million. The difference is mainly due to consolidation effects (including amortization of goodwill) and DM 68.886 million third-party shares in net income.

Tax-deductible accelerated depreciation did not have a material impact on the net income of the Group.

38. Third-party shares in net income

Third-party shares amount to DM 127.912 million (1996: DM 142.488 million) in net income and DM 59.026 million (1996: DM 35.677 million) in net losses.

39. Additional information

Average number of employees	**1997**	1996
Salaried	**134,537**	130,703
Wage earners	**42,933**	35,458
Apprentices/trainees	**7,461**	7,684
	184,931	173,845

The figures include 88,529 (1996: 75,032) part-time employees (headcount).

40. Supervisory and Executive Boards

Emoluments totaling DM 1.828 million were paid to the members of the Supervisory Board of METRO AG.

Emoluments paid to members of the Executive Board totaled DM 16.163 million. This figure includes a severance payment for a former member of the Executive Board.

A total of DM 6.146 million was paid to former members of the Executive Boards and their surviving dependants of those companies merged into METRO AG. Accruals of DM 77.164 million for their pensions have been provided for in the accounts of METRO AG.

Members of the Supervisory Board

Erwin Conradi
Chairman
Baar, Switzerland
Chairman of the Executive Board of
Metro Holding AG

Klaus Bruns
Vice-Chairman
Oberhausen
Kaufhof Warenhaus AG

Hans-Dieter Cleven
Baar, Switzerland
Vice-Chairman of the Executive Board of
Metro Holding AG

Holger Grape
Hamburg
Head of the Wholesale/Retail and
Private Services Employees' Group
at the DAG trade union

Professor Dr. Erich Greipl
Düsseldorf
Member of the Management Board of
Metro Vermögensverwaltung GmbH & Co KG

Hubert Haselhoff
Sarstedt
Chairman of the Central Works Council of
Extra Verbrauchermärkte GmbH

Hanns-Jürgen Hengst
Cologne
Kaufhof Warenhaus AG

Gerhard Herbst
Frankfurt
Regional Chairman of the NGG trade union

Hermann Hesse
Düsseldorf
Kaufhof Warenhaus AG

Ingeborg Janz
Goslar
Real SB-Warenhaus GmbH

Dr. Hermann Krämer
Seevetal
Former member of the Executive Board of
Veba AG

Dr. Klaus Liesen
Essen
Chairman of the Supervisory Board of
Ruhrgas AG

Dr. Karlheinz Marth
Düsseldorf
Secretary to the Central Executive Committee of the
HBV trade union

Gustav-Adolf Munkert
Cologne
Kaufhof Warenhaus AG

Professor Dr. Helmut Schlesinger
Oberursel
Former President of Deutsche Bundesbank

Dr. Manfred Schneider
Leverkusen
Chairman of the Executive Board of
Bayer AG

Hans Peter Schreib
Düsseldorf
Lawyer, Member of the Board of
Deutsche Schutzvereinigung
für Wertpapierbesitz e.V.

Dr. Henning Schulte-Noelle
Munich
Chairman of the Executive Board of
Allianz AG

Peter Seuberling
Kirkel
Praktiker Bau- und Heimwerkermärkte AG

Dr. Joachim Theye
Bremen
Lawyer and notary public

Members of the Executive Board

Klaus Wiegandt
Spokesman

Wolfgang Urban
Spokesman
until January 31, 1998

Siegfried Kaske

Dr. Hans-Joachim Körber

Dr. Wolf-Dietrich Loose

Theo de Raad
as from January 1, 1998

Joachim Suhr

Cologne, March 31, 1998

THE EXECUTIVE BOARD

Wiegandt

Kaske

Dr. Körber

Dr. Loose

de Raad

Suhr

Global structural change is having a major impact on business decisions at METRO AG and its strategic objectives. A presence needs to be established on new markets, customer purchasing habits have become far more flexible and new marketing concepts and a rise in the number of competitors have stepped up pressure for change.

In view of this, the Supervisory Board of METRO AG discussed the positioning of the Group and the outlook for individual divisions in Germany and abroad. At seven meetings held in 1997, the Supervisory Board looked in detail at all processes requiring its approval and at the financial situation of the Group. At its meetings, priority was given to the following issues:

- concentration of METRO AG on the role and functions of a management holding company,
- focus of capital expenditures, especially the acquisition of the European C&C business of SHV Makro NV as of January 1, 1998 and securing locations for strategic expansion in Germany and abroad,
- structural changes in the divisions/outlet chains geared to strengthening earnings power,
- divestment of non-core activities.

The Chairman of the Supervisory Board maintained permanent contact to the Executive Board and was updated regularly on significant business occurrences and decisions.

In particular, the Supervisory Board took an in-depth look at the strategic focus of METRO AG. It discussed forthcoming capital expenditures and divestments and the establishment of joint ventures and alliances, with particular reference to their strategic significance, profitability and social impact.

The Supervisory Board held a special meeting to prepare for the resolution passed by the Extraordinary Stockholders' Meeting of September 11, 1997 on the creation of authorized capital II totaling up to DM 350 million through the issue of new common bearer shares against contributions in kind, combined with the authority to exclude subscription rights. This was made possible by the Federal Constitutional Court, which issued a judgement altering prevailing legal opinion (Decision II ZR 132/93 of June 23, 1997).

Discussions focusing on business performance and the Company's situation were supplemented by detailed examination of investment and financial plans. Following the acquisition of the C&C business of SHV Makro NV, the Supervisory Board also requested a report on the integration of this business unit into the METRO AG Group.

The Supervisory Board has three committees with equal numbers of representatives of the two sides represented on the Board. These are the Central Committee of the Supervisory Board/Personnel Committee, the Committee set up in compliance with Art. 27 para. 3 of the Codetermination Act and the Financial Audit Committee.

The Central Committee met twice and the Financial Audit Committee met once before the plenary meeting of the Supervisory Board held to discuss the financial statements. The Committee established pursuant to Art. 27 para. 3 of the Codetermination Act did not need to meet.

The accounting, financial statements for the fiscal year ended December 31, 1997 and the combined Management Report of METRO AG and the Group have been audited by Fasselt-Mette & Partner Wirtschaftprüfungsgesellschaft, Duisburg, who issued an unqualified opinion. The audit reports were submitted to all members of the Supervisory Board and discussed at the meeting held in the presence of the auditors. The Supervisory Board approved the outcome of the audit, which did not contain any objections.

The Supervisory Board examined and approved the annual accounts as of December 31, 1997 submitted by the Executive Board, together with the combined Management Report of METRO AG and the Group. The annual accounts are thus adopted. The Supervisory Board agrees to the Executive Board's proposal for the appropriation of net earnings.

Further, the Executive Board has submitted to the Supervisory Board the annual accounts and Management Report for the Group, together with the auditors' report. The Supervisory Board approved the Group accounts, including the Management Report for the Group.

In addition, in compliance with Art. 312 of the German Stock Corporation Act (AktG), the Executive Board prepared a report on Group affiliation. The auditors examined this report, provided a written statement and issued the following opinion:

"According to our audit which we performed with due care and to professional standards, it is our opinion that:

1. the facts stated in the report are valid,
2. the consideration paid by the Company for the legal transactions mentioned in the report was not unreasonably high."

Following its own examination, the Supervisory Board did not raise any objections, either to the representations made by the Executive Board in its report pursuant to Art. 312 of the German Stock Corporation Act, or to the auditors' opinion thereon.

At its meeting on December 17, 1997, the Supervisory Board appointed Mr. Theo de Raad to the Executive Board with effect from January 1, 1998. Mr. Wolfgang Urban left the Executive Board on January 31, 1998. Mr. Georg Kulenkampff was appointed to the Executive Board with effect from May 1, 1998 and at the same time appointed Deputy Spokesman for the Executive Board.

The Supervisory Board would like to thank the Executive Board, the executive managers of the divisions and outlet chains, the members of works councils as well as the staff of METRO AG and all Group companies for their hard work and commitment.

Cologne, May 1998

THE SUPERVISORY BOARD

Erwin Conradi
Chairman

Survey of the main Group companies

Name	Registered Office	% held by Group	Equity DM million
METRO AG	Cologne		4,300.045
Metro Wholesale			
Metro International Management GmbH	Düsseldorf	100.00	283.906
Metro Großhandelsgesellschaft mbH	Düsseldorf	100.00	72.333
Department Stores			
Kaufhof Warenhaus AG	Cologne	87.50	330.000
Kaufhalle AG	Cologne	90.48	333.430
Hypermarkets			
Real SB-Warenhaus GmbH	Alzey	100.00	474.041
Massa AG	Alzey	98.38	429.983
Food Stores			
Extra Verbrauchermärkte GmbH	Sarstedt	100.00	63.351
Discount Stores			
Tip Discount Handels GmbH & Co KG	Sarstedt	100.00	22.146
Consumer Electronics Centers			
Media-Saturn-Holding GmbH	Ingolstadt	71.69	409.810
Home Improvement Centers			
Praktiker Bau- und Heimwerkermärkte AG	Kirkel	75.00	788.597
Wirichs Vertriebs GmbH	Krefeld	75.00	33.937
Computer Centers			
Vobis Microcomputer AG	Würselen	90.00	75.047
Maxdata Computer GmbH	Marl	57.60	63.555
Fashion Centers			
Adler Modemärkte GmbH	Haibach	100.00	66.000
Footwear Centers			
Reno Versandhandel GmbH	Thaleischweiler-Fröschen	75.00	5.352
Restaurant & Catering			
Dinea Gastronomie GmbH	Cologne	100.00	16.050
Real Estate			
Metro Immobilien Holding GmbH	Saarbrücken	100.00	378.807
Asset Immobilien GmbH & Co KG	Cologne	100.00	560.099
Horten AG	Düsseldorf	95.07	433.460
Others			
Metro MGE Einkauf GmbH	Düsseldorf	100.00	1.050

A full list of the METRO AG Group's shareholdings will be deposited with the Commercial Register in Cologne (HRB 26888). It is also available directly from METRO AG.

The consolidated accounts, which we have examined in accordance with professional standards, comply with the law. The consolidated accounts have been prepared in accordance with generally accepted accounting principles and give a true and fair view of the net assets, financial position and results of the METRO AG Group. The Management Report for the Group, which is combined with the Management Report for METRO AG, is in conformity with the financial statements for the Group.

Duisburg, April 21, 1998

FASSELT-METTE & PARTNER
WIRTSCHAFTSPRÜFUNGSGESELLSCHAFT

Dr. H. Herrmann
Wirtschaftsprüfer
(Auditor)

Dr. P. Schöneberger
Wirtschaftsprüfer
(Auditor)

METRO AG Group
Balance sheet
as of December 31, 1997
Income statement
for the year ended
December 31, 1997

METRO AG Group
Balance sheet as of December 31, 1997

Assets

In DM million	Note no.	Balance at Dec. 31, 1997	Balance at Dec. 31, 1996
Fixed assets	6		
Intangible assets	7	**2,848.468**	2,611.444
Tangible assets	8	**9,919.703**	6,381.299
Financial assets	9	**406.029**	680.715
		13,174.200	9,673.458
Current assets			
Inventories	10	**7,103.458**	6,544.715
Receivables and sundry assets	11	**3,440.747**	2,511.500
Short-term securities and note loans	12	**44.262**	346.795
Cash on hand and in bank	13	**1,508.736**	1,603.336
		12,097.203	11,006.346
Deferred taxes	14	**25.562**	–
Prepaid expenses and deferred charges	15	**116.817**	97.585
		25,413.782	20,777.389

Stockholders' equity and liabilities

In DM million	Note no.	Balance at Dec. 31, 1997	Balance at Dec. 31, 1996
Equity	16		
Capital stock	17	**1,217.952**	501.212
Reserve from capital surplus	18	**2,161.063**	2,729.608
Reserves retained from earnings	19	**280.949**	215.483
Unappropriated retained earnings, Group		**489.711**	403.366
Third-party equity shares	20	**812.284**	976.686
		4,961.959	4,826.355
Untaxed/special reserves		**83.096**	17.205
Accruals	21	**3,962.709**	4,058.475
Liabilities	22	**15,988.006**	11,438.680
Deferred income	23	**418.012**	436.674
		25,413.782	20,777.389

METRO AG Group
Income statement
for the year ended December 31, 1997

In DM million	Note no.	1997	1996
Gross sales (including VAT)	27	**64,130.822**	62,024.064
Value-added tax		**(7,290.796)**	(6,990.164)
Net sales		**56,840.026**	55,033.900
Change in inventories of finished products and work in process		**7.393**	57.013
Other work and material capitalized		**5.860**	6.793
Other operating income	28	**2,706.001**	2,433.195
Total operating performance		**59,559.280**	57,530.901
Cost of materials	29	**(41,332.008)**	(39,860.703)
Personnel expenses	30	**(8,014.285)**	(7,763.782)
Amortization of intangible and depreciation of tangible assets	31	**(1,359.071)**	(1,217.981)
Other operating expenses	32	**(7,792.790)**	(7,573.805)
Operating result		**1,061.126**	1,114.630
Income from investments	33	**(35.825)**	19.399
Net financial result	34	**(95.100)**	(71.995)
Result from ordinary operations		**930.201**	1,062.034
Extraordinary result	35	**246**	–
Income taxes	36	**(250.950)**	(274.486)
Other taxes		**(56.690)**	(70.334)
Net income	37	**622.807**	717.214
Third-party shares in net income	38	**(68.886)**	(106.811)
Transfer to reserves retained from earnings		**(64.210)**	(207.037)
Net earnings, Group		**489.711**	403.366