Group Management Report

The LANXESS Group

Business and strategy The LANXESS Group is a globally operating chemicals enterprise with a portfolio ranging from basic, specialty and fine chemicals to polymers. The partly low margin level has made it essential to evolve lean, uncomplicated structures, and to systematically optimize plants and processes.

To raise profitability to the level typical of other companies in the industry, LANXESS has adopted a strategic package with four phases: performance improvements, targeted restructuring, portfolio adjustments and acquisitions. In the past fiscal year, we implemented measures in all four phases and acquired a company for the first time in our history as an independent enterprise. An additional aim is selective organic growth in profitable markets.

The segments in brief Organizationally, the LANXESS Group is divided into four segments: Performance Rubber, Engineering Plastics, Chemical Intermediates and Performance Chemicals.

The **Performance Rubber** segment combines all the Group's activities in synthetic rubber production. Here LANXESS offers a broad portfolio of innovative products, many of which are international leaders. The segment comprises the Butyl Rubber, Polybutadiene Rubber and Technical Rubber Products business units, and has production sites in Dormagen, Leverkusen and Marl, Germany; Zwijndrecht, Belgium; La Wantzenau and Port Jérôme, France; Sarnia, Ontario, Canada; and Orange, Texas, United States. Its products have applications in areas ranging from tires and other automotive components to construction materials, leisure equipment, machinery and chewing gum.

LANXESS's **Engineering Plastics** segment makes it one of the world's most important suppliers of polymers. This segment's business units are Lustran Polymers (formerly Styrenic Resins) and Semi-Crystalline Products, and its production sites are located in Dormagen, Hamm-Uentrop and Krefeld-Uerdingen, Germany; Antwerp, Belgium; Tarragona, Spain; Addyston, Ohio, and Bushy Park, South Carolina, in the United States; Katol, Moxi and Nandesari, India; Map Ta Phut, Thailand; and Wuxi, China. The plastics that LANXESS produces are particularly used in household appliances, the automotive industry, electrical engineering, electronics, and medical equipment.

The operations that LANXESS combines in its **Chemical Intermediates** segment make it one of the world's leading suppliers of basic and fine chemicals and inorganic pigments. The business units in this segment are Basic Chemicals, Saltigo (formerly Fine Chemicals) and Inorganic Pigments, and its production sites are in Brunsbüttel, Dormagen, Leverkusen and Krefeld-Uerdingen, Germany; Branston, Staffordshire, United Kingdom; Vilassar de Mar, Spain; Baytown, Texas, and Burgettstown, Pennsylvania, in the United States; Porto Feliz, Brazil; Shanghai, China; and Sydney, Australia. These products are used in such diverse sectors as agrochemicals, construction, dyes and pharmaceuticals.

The **Performance Chemicals** segment embraces the Group's application-oriented specialty chemicals operations. The business units in this segment are Material Protection Products, Functional Chemicals, Leather, RheinChemie, Rubber Chemicals and Ion Exchange Resins. It has numerous production sites: in Mannheim, Leverkusen, Krefeld-Uerdingen, Dormagen, Brunsbüttel and Bitterfeld, Germany; Antwerp, Belgium; Filago, Italy; Merebank, Newcastle, Isithebe and Rustenburg, South Africa; Birmingham, New Jersey, Bushy Park, South Carolina, and Chardon, Ohio in the United States; Lerma, Mexico; Zarate, Argentina; Wuxi, Weifang, Tongling and Qingdao, China; Thane and Madurai, India; and Toyohashi, Japan. Its varied products are used in disinfectants, dyes, wood preservatives, the food and beverage industry, water treatment, the leather industry, and more.

Organization LANXESS AG functions largely as a management holding company. Each business unit has global responsibility for its own operations. They are complemented by group functions with international responsibility for providing services.

LANXESS GmbH is a wholly owned subsidiary of LANXESS AG, and in turn controls the other subsidiaries and affiliates both in Germany and elsewhere.

The following are the principal companies wholly owned by LANXESS directly or indirectly:

- LANXESS Deutschland GmbH, Leverkusen, Germany: production and sales, all segments
- LANXESS Corporation, Pittsburgh, Pennsylvania: production and sales, all segments
- LANXESS Elastomères S.A.S., Lillebonne, France: production and sales, Performance Rubber
- LANXESS Holding Hispania, S.L., Barcelona, Spain: holding company, all segments
- LANXESS Inc., Sarnia, Ontario, Canada: production and sales, Performance Rubber
- LANXESS International SA, Fribourg, Switzerland: sales, all segments
- Lanxess N.V., Antwerp, Belgium: production and sales, Engineering Plastics and Performance Chemicals
- LANXESS Rubber N.V., Zwijndrecht, Belgium: production and sales, Performance Rubber
- Rhein Chemie Rheinau GmbH, Mannheim, Germany: production and sales, Performance Chemicals
- SALTIGO GmbH, Leverkusen, Germany; production and sales, Chemical Intermediates

We initiated or carried out the following major changes in the segments during 2006:

In the Leather business unit, we completed the first acquisition in our history as an independent enterprise, acquiring the 50% interest in Chrome International South Africa Ltd. (CISA) in Newcastle, South Africa, held by the Dow Chemical Group. We are now the sole owner of the world's most modern sodium dichromate and chromic acid plant. The transaction took legal and economic effect on February 1, 2007.

Effective February 28, 2006, we divested the Fibers business unit of the Engineering Plastics segment. Two other divestments related to the Performance Chemicals segment. We sold the Paper business unit of this segment effective March 31, 2006, while the Textile Processing Chemicals business unit was divested at the end of fiscal 2006.

The Fine Chemicals business unit of the Chemical Intermediates segment has been operating independently since April 2006 as SALTIGO GmbH, a wholly owned subsidiary of LANXESS Deutschland GmbH.

Value management and control system To achieve its strategic goals, the LANXESS Group needs concrete controlling parameters against which it can measure the success of its efforts. Such assessments are founded on a reliable, readily understandable financial and controlling information system. LANXESS is constantly working to improve the information provided by the Accounting and Controlling group functions, through consistent reporting of projected, expected and actual data.

The key controlling parameter for the LANXESS Group and the individual segments at present is EBITDA (earnings before interest, taxes, depreciation and amortization) pre exceptionals. It is calculated from EBIT by adding back depreciation and amortization relating to operations, leaving out any exceptional items. Each operating decision or achievement is measured in both the short and the long term by how it affects EBITDA. We aim to improve our profitability, measured as the EBITDA margin (pre exceptionals), to the level of our competitors by 2009. In 2006, this was between 12% and 14%. We also set profitability targets for our business operations. All LANXESS business units are expected to achieve an EBITDA margin pre exceptionals of at least 5% in 2009.

To monitor working capital, we use two key performance indicators: DSI (days of sales in inventories) and DSO (days of sales outstanding). These represent inventories and receivables, respectively, in relation to sales after adjustment for portfolio effects. Another important performance indicator is business free cash flow, which indicates the business units' direct contributions toward generating cash. It is calculated for the operating units by a simplified cash flow method.

As previously announced, we introduced two additional controlling parameters – return on capital employed (ROCE) and the net debt ratio – in the reporting year. ROCE is a profitability ratio that indicates how effectively we utilize our employed and tied-up capital, and is calculated as the ratio of EBIT pre exceptionals to capital employed. Capital employed can be derived from balance sheet data; it is defined as total assets less deferred tax assets and interest-free liabilities. Interest-free liabilities comprise provisions (not including provisions for pensions), tax liabilities, trade payables, and material items included under "other liabilities." The net debt ratio is defined as the total of current and non-current financial liabilities, less liquid assets, divided by EBITDA pre exceptionals. Both controlling parameters are used exclusively at Group level.

Value Management and Control System		2005	2006
EBITDA pre exceptionals	€ million	581	675
EBITDA margin pre exceptionals	%	8.1	9.7
Capital employed	€ million	2,578	2,640
ROCE	%	12.9	15.9
Days of sales in inventories (DSI)	Days	53.8	56.1
Days of sales outstanding (DSO)	Days	53.6	49.5
Net financial liabilities	€ million	680	511
Net debt ratio		1.2x	0.8x
Investment ratio	%	3.5	3.8

Thanks to a disproportionate increase in EBIT pre exceptionals and an only slight increase in capital employed, our ROCE improved from 12.9% in 2005 to 15.9% in 2006. Our net debt ratio also improved due to a significant reduction in net debt and to the growth in business during the year measured as EBITDA pre exceptionals.

Expenditures for property, plant and equipment are subject to rigorous capital discipline, and focus systematically on those product areas with the greatest potential for success. We have defined 4% of sales as a sustainable and appropriate investment ratio for the Group. Capital expenditures last year were just below this level but will be slightly higher in 2007, at or slightly above €300 million.

Business Conditions

The economic environment 2006 was characterized by sustained strong expansion of the global economy, which grew by 3.8% and therefore somewhat more than our forecast of 3.5%.

As expected, this robust growth rate was supported above all by the Asia-Pacific region and here especially by China, India and other East Asian countries. In addition to the significant rise in consumer demand, investments in this booming region were also increased strongly again. Especially in the first quarter, the United States remained a major driver of the global upswing, but has noticeably lost impetus since the spring due to weaker economic performance. Two factors in particular were responsible for this development: the end of the real estate boom and the restrictive monetary policy of the U.S. Federal Reserve from the spring onward. The economic upturn in Japan also slowed perceptibly due to flatter production growth and a decline in public-sector investment. By contrast, the economies of the European markets that are of importance to German industry continued to consolidate their gains. The main impetus came from trade with European countries, and deliveries to the euro zone and the new E.U. member states expanded considerably.

During the course of the year, the U.S. dollar dropped sharply in value against the euro. This development was accompanied by a strong increase in volatility. At the end of 2006, the euro was worth around $1.32, up 11.9% from a year earlier. The main reasons for this decrease were inflation expectations and uncertainty about the further course of U.S. monetary policy. The average value of the euro for the year was around $1.26, which was what we had anticipated.

Prices of raw materials climbed strongly again during 2006 on account of the dynamic global economy. The price of oil reached a new high of around US$74.00 per barrel in September due to the political tensions in the Middle East. The fact that there were no major hurricanes and that both the Middle East situation and the confrontation with Iran cooled led in December to a drop in the price of oil to around US$58 per barrel. The expected fluctuations on the commodities markets were also reflected in consumer prices.

GDP and Chemical Production in 2006		
Change vs. prior year in % (projected)	Gross domestic product	Chemical production
Americas	3.5	3.1
NAFTA	3.3	2.9
Latin America	4.8	4.2
EMEA	3.2	4.5
Germany	2.7	3.7
Western Europe	2.6	4.2
Central/Eastern Europe	5.4	12.7
Asia-Pacific	4.9	6.3
Japan	2.0	(0.9)
Greater China	9.2	12.7
India	8.5	7.3
World	**3.8**	**4.7**

The chemical industry The upswing in the chemical industry that began in 2003 continued in 2006. Global production increased by around 4.7% in 2006 and, like general economic growth, slightly exceeded our forecast of 4%. The Asian markets accounted for a disproportionate share of this growth, underscoring the ongoing trend toward local production.

As anticipated, the chemical industry in the NAFTA region bounced back from its noticeable slump in 2005 to post more dynamic growth of 3%. At 4.5%, growth in chemical production in Europe was much higher than we had anticipated a year earlier. The new E.U. member states in central and eastern Europe saw the highest production growth, although they started from a low base. As in 2005, exports were the main driver for the European chemical industry's growth.

Evolution of major user industries The automotive industry performed robustly in 2006, as expected, with global production growing 4.1%. The main growth drivers here were the Asia-Pacific region with China and India, which posted impressive growth rates of 22.3% and 17.2% respectively. Central and eastern Europe also contributed substantially to this positive trend with growth of 6.7%. As in 2005, growth was less vigorous in the industry's main markets in North America and western Europe. The reasons for this were still high fuel prices and the resulting decline in purchasing power, as well as consumers' continued reluctance to spend.

The performance of the construction industry was positive overall with growth at 5%, up two percentage points from the previous year. By far the largest gains were posted in India, China and Latin America. The momentum for the construction industry's growth in Asia-Pacific and Latin America derived from the dynamic economic expansion in both of these regions. Growth in the European construction industry was driven above all by the new markets in central and eastern Europe.

With growth of 8%, the electrical and electronics industries posted by far the strongest expansion in 2006, which in fact slightly exceeded our positive forecast of 7%. This robust growth was global, bypassing only Latin America and, to a certain degree, Japan.

In the tire industry, the trend of shifting production to emerging nations continued in 2006. The downturn in the NAFTA region accelerated at a surprising rate and was only marginally offset by a slight increase in production in Latin America. The decline continued in Germany and elsewhere in western Europe as well. Expansion of 6% in the Asia-Pacific region was driven primarily by China with growth of 14%.

The apparel industry performed unexpectedly well in 2006, with world production growing by 3.5%. As in the previous year, performance was uneven across the various regions. The industry posted very high growth rates in the Asia-Pacific region, again principally in India and China. This underscores the importance of expanding markets in Asia and the increase in production capacities in emerging nations. Additional impetus came from Latin America, and central and eastern Europe. However, the EMEA (Europe, Middle East, Africa) region experienced a downturn overall, mainly due to a decline in production in Germany and elsewhere in western Europe. The textile industry in North America also reported negative growth rates, although the pace of this downward trend was much slower than in 2005.

Evolution of Major User Industries in 2006

Change vs. prior year in % (projected)	Automotive	Construction	Electrical	Tires	Textiles, Apparel, Leather
Americas	(1.2)	6.0	9.0	(4.3)	0.0
NAFTA	(2.6)	5.0	9.0	(5.9)	(1.0)
Latin America	6.3	12.0	3.0	1.6	3.0
EMEA	3.0	3.5	8.0	0.2	(2.0)
Germany	1.0	4.0	8.5	(2.5)	(5.0)
Western Europe	(1.3)	3.5	7.5	(1.7)	(3.0)
Central/Eastern Europe	6.7	8.5	7.0	1.4	(1.0)
Asia-Pacific	9.2	6.0	8.0	6.0	9.0
World	**4.1**	**5.0**	**8.0**	**1.5**	**3.5**

The Legislative Environment On December 13 and 18, 2006, the Regulation concerning the Registration, Evaluation, Authorisation and Restriction of Chemicals (REACH) was adopted by the European Parliament and the European Council of Environment Ministers respectively. This concluded the process lasting several years of reforming European chemicals legislation. The regulation enters into force on June 1, 2007.

In contrast to previous European chemicals law, REACH is based on the principle of individual responsibility. Any person (manufacturer or importer) placing chemicals on the market is responsible for those chemicals and must himself procure the data necessary for evaluating their safety. Based on these data, instructions must be provided for the safe handling of these substances along the entire value chain. REACH covers all chemicals produced in quantities of one or more tons per year. The scope of the data required for registration depends on the quantity of the chemical produced.

Since the technical guidelines for implementing this regulation are still being compiled, the precise consequences for LANXESS cannot yet be determined at this time. Please see the Risk Report for further information.

Business Performance of the LANXESS Group

- Sales adjusted for portfolio effects up slightly from previous year
- LANXESS achieves earnings target: EBITDA pre exceptionals climbs €94 million, to €675 million
- EBITDA margin pre exceptionals up from 8.1% in 2005 to 9.7%
- Exceptional items for portfolio adjustments and restructuring measures pull down operating result
- First-time net income of €197 million
- LANXESS pays first dividend

Summary of the fiscal year In 2006, the LANXESS Group improved its operating result before depreciation and amortization (EBITDA) pre exceptionals by €94 million, or 16.2%, to €675 million. A favorable market environment, particularly in Germany and the Asia-Pacific region, improvements in efficiency, and our restructuring successes contributed substantially to this result. Higher costs for raw materials and energy were again passed on to customers through price increases wherever possible. The EBITDA margin rose by 1.6 percentage points to 9.7%. We therefore achieved our objective of significantly increasing our EBITDA margin pre exceptionals to between 9% and 10% as announced in fall 2004. This is also a successful step toward attainment of our new Group objectives, which are explained in greater detail in the Outlook section. Pressure was put on our operating result (EBIT) by exceptional charges for the portfolio adjustments and further restructuring measures undertaken during the fiscal year. As a result of the systematic optimization of our financing structure, our financial result improved by 38.6%. The net income for the Group amounted to €197 million compared with last year's loss of €63 million. It is planned that our stockholders benefit from the company's greatly improved earnings situation in the form of a dividend. The Management Board and Supervisory Board will propose distribution of a dividend of €0.25 per LANXESS share for the first time at the Annual Stockholders' Meeting to be held on May 31, 2007.

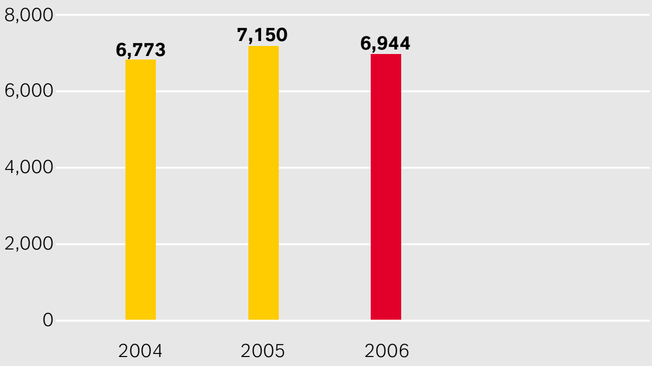
Key Financial Data	2005	2006	Change
€ million			in %
Sales	7,150	6,944	(2.9)
Gross profit	1,613	1,540	(4.5)
EBITDA pre exceptionals	581	675	16.2
EBITDA margin pre exceptionals	8.1%	9.7%	–
EBITDA	341	638	87.1
Operating result (EBIT) pre exceptionals	332	421	26.8
Operating result (EBIT)	28	376	*
Financial result	(145)	(89)	38.6
Income (loss) before income taxes	(117)	287	*
Net income (loss)	(63)	197	*
Earnings per share (€)	(0.75)	2.33	*

* change of more than 100%

Sales and earnings

Sales Sales by the LANXESS Group met expectations in fiscal 2006, amounting to €6,944 million. In the previous year, we announced we would systematically pursue our "price before volume" strategy coupled with only moderate growth in sales in our continuing operations. The decline in sales by 2.9% compared to the previous year was exclusively due to portfolio adjustments and unfavorable currency effects, particularly in the case of the U.S. dollar. Adjusted for the sale of the Fibers and Paper business units and the RheinChemie subsidiary iSL-Chemie GmbH and the unfavorable currency effects, the LANXESS Group saw a slight increase in sales of 1.2%. The positive price effects of €289 million, or 4.0%, more than compensated for the decrease in volume of €197 million, or 2.8%. As far as selling markets were concerned, Germany and the Asia-Pacific region posted very pleasing growth in a favorable economic environment. In the EMEA region (Europe, Middle East, Africa), excluding Germany,

Group Sales
€ million



sales growth was less dynamic than in the previous year, whereas sales in the Americas adjusted for portfolio and currency effects remained at last year's level.

Effects on Sales	2006
Approximate data	in %
Price	4.0
Volume	(2.8)
Currency	(0.4)
Portfolio	(3.7)
	(2.9)

This development reflected our strategy of selective sales growth. Another influencing factor were the higher prices imposed in some areas of the business to pass on increased raw material costs.

Sales by Segment	2005	2006	Change	Contribution to Group sales in %
€ million			in %	in %
Performance Rubber	1,678	1,776	5.8	25.6
Engineering Plastics	1,737	1,708	(1.7)	24.6
Chemical Intermediates	1,535	1,533	(0.1)	22.1
Performance Chemicals	1,977	1,812	(8.3)	26.0
Other/Consolidation	223	115	(48.4)	1.7
	7,150	**6,944**	**(2.9)**	**100.0**

The Performance Rubber segment posted a price-driven rise in sales. The decline in sales in the Engineering Plastics and Performance Chemicals segments resulted from portfolio adjustments. The Chemical Intermediates segment was able to maintain the same high level of sales as in 2005.

Gross profit Compared to the previous year, the cost of sales decreased by 2.4% to €5,404 million, due both to portfolio measures and increases in efficiency. Against these were higher prices for raw materials and energy. Gross profit declined by 4.5% to €1,540 million. Our gross profit margin was 22.2%, nearly matching the prior-year figure of 22.6%. To varying degrees, the continued strong increases in raw material and energy prices were passed on to the market by the segments. Especially in those areas in which stiff competition was an obstacle to implementing the necessary price increases in full, the earnings situation was stabilized by the productivity improvements achieved. The sale of the loss-making Fibers business unit and the low-margin Paper business unit as well as the success of our extensive restructuring measures in fiscal 2005 and 2006 had a positive effect on gross profit.

EBITDA and operating result (EBIT) Despite only a slight decline in business volume, selling costs and general administrative expenses decreased by 11.2% and 10.9% respectively in 2006 due to portfolio effects and the systematic reduction in fixed costs in sales and administration.

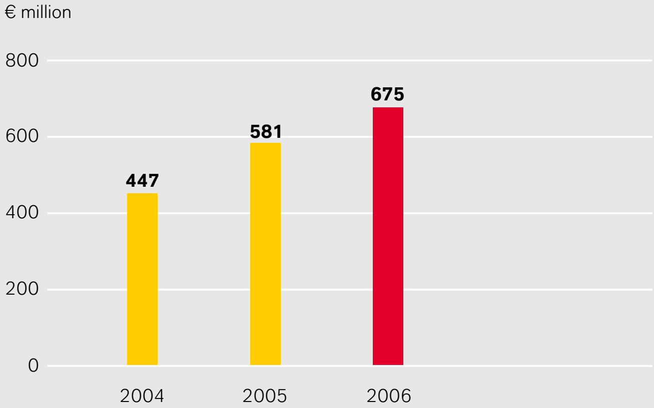
Research and development costs were down 13.9%, to €87 million. Thus R&D costs represented 1.3% of sales, which is around the prior-year level.

Other operating expenses less other operating income dropped substantially from €336 million to €57 million. In the prior year, this item included significant exceptional charges of €304 million relating in particular to restructuring and portfolio measures, and expenses for settlements relating to antitrust investigations. In fiscal 2006, exceptional charges amounted to €45 million, most of which was attributable to restructuring and portfolio measures.

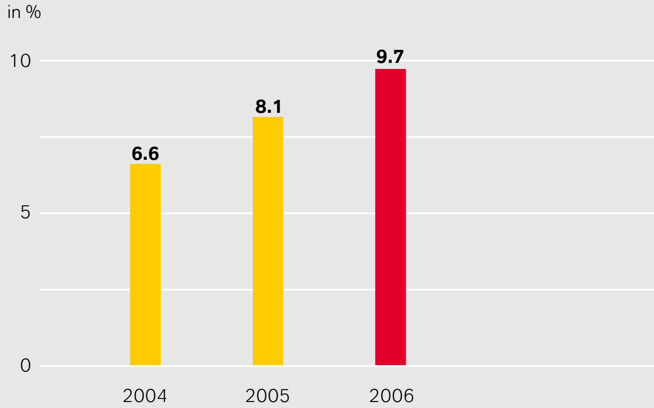
EBITDA Pre Exceptionals by Segment	2005	2006	Change
€ million			in %
Performance Rubber	214	248	15.9
Engineering Plastics	66	103	56.1
Chemical Intermediates	211	245	16.1
Performance Chemicals	212	220	3.8
Other/Consolidation	(122)	(141)	(15.6)
	581	**675**	**16.2**

Since the LANXESS Group began doing business independently, all operating segments have turned in a consistently positive performance. In fiscal 2006, the segments again increased their EBITDA pre exceptionals. The Performance Rubber and Chemical Intermediates segments leveraged their strong market positions

EBITDA Pre Exceptionals



EBITDA Margin Pre Exceptionals



and generated double-digit percentage increases in earnings. The favorable chemical industry environment contributed to this result, as did the successful implementation of efficiency-enhancing programs. The latter were key factors in the jump in earnings of more than 50% in the Engineering Plastics segment, and the sale of the loss-making Fibers business unit also had a positive effect. Earnings performance of the Performance Chemicals operations varied, but the segment posted overall growth of 3.8%.

The operating result amounted to €376 million and was therefore €348 million higher than the prior-year figure of €28 million, which was significantly impacted by exceptionals.

The 2006 operating result (EBIT), which was substantially higher than a year earlier, nevertheless contains exceptionals totaling €45 million, all of which are included in the other operating result. €42 million of this charge related particularly to the additional package of measures to enhance the LANXESS Group's competitiveness, and were mostly the result of global, cross-segment restructuring programs and portfolio adjustments. Additional exceptional charges of €3 million went for settlements related to antitrust investigations.

The total exceptional charges of €304 million for 2005 mainly included expenses for restructuring measures and portfolio adjustments, expenses for settlements related to antitrust investigations and impairments of non-current assets.

Reconciliation of EBIT to Net Income (Loss)	2005	2006	Change
€ million			in %
Operating result (EBIT)	**28**	**376**	*
Loss from investments in affiliated companies	(35)	(16)	54.3
Net interest expense	(41)	(23)	43.9
Other financial income and expenses – net	(69)	(50)	27.5
Financial result	**(145)**	**(89)**	**38.6**
Income (loss) before income taxes	**(117)**	**287**	*
Income taxes	63	(85)	*
Income (loss) after taxes	**(54)**	**202**	*
of which:			
Minority interests	9	5	*
Net income (loss)	(63)	197	*

* change of more than 100%

Financial result The financial result came in at minus €89 million in 2006, compared to minus €145 million for the prior year. The success of our efforts to optimize the capital and financing structure of the LANXESS Group is evident in the significant improvement in net interest expense. The loss from the at-equity valuation of the company's interest in Bayer Industry Services GmbH & Co. OHG (BIS) amounted to €16 million. In addition, there was a slight deterioration in the balance of exchange gains and losses compared to 2005. The expenses for the repurchase and resale of the mandatory convertible bond issued in September 2004 also impacted the other financial result in the prior year.

Income before income taxes Income before income taxes increased by €404 million to €287 million as the result of the higher operating result and improved financial result.

Income taxes The pre-tax income resulted in tax expenses of €85 million, compared to the previous year's tax credit of €63 million. The tax rate was 29.6%.

Net income/Earnings per share After deductions of €5 million for minority interests, the LANXESS Group recorded net income of €197 million in 2006. The net loss of €63 million in 2005 was due largely to exceptional charges. Minority interests amounted to €9 million in 2005. Earnings per share were €2.33 in 2006, compared to minus €0.75 the year before.

Proposal on the utilization of profit In 2006, LANXESS AG's balance sheet profit amounted to €82 million. The Management Board and Supervisory Board will therefore propose to the Annual Stockholders' Meeting on May 31, 2007, that €21 million of this be allocated to retained earnings and that a dividend of €0.25 per share be paid. If this distribution proposal is approved by the stockholders, the total dividend payout will amount to €21 million. A proposal will be made to carry the remaining amount forward to new account.

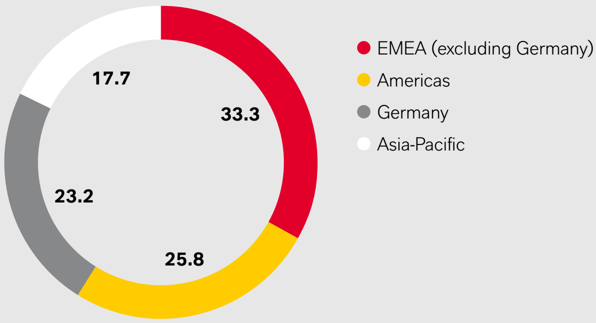
Performance by Region

Sales by Market	2005		2006		Change
€ million	€ million	in % of sales	€ million	in % of sales	in %
EMEA (excluding Germany)	2,494	34.9	2,312	33.3	(7.3)
Germany	1,538	21.5	1,614	23.2	4.9
Americas	1,928	27.0	1,788	25.8	(7.3)
Asia-Pacific	1,190	16.6	1,230	17.7	3.4
	7,150	**100.0**	**6,944**	**100.0**	**(2.9)**

In the **EMEA** region (Europe, Middle East, Africa), excluding Germany, sales were down 7.3% from the previous year, to €2,312 million. Adjusted for portfolio and currency effects, this figure was 3.7% lower. The slight decrease in sales resulted mainly from the conscious decision to forego low-margin business. Sales in the Performance Rubber and Performance Chemicals segments grew, while the other segments saw sales drop. Markets in eastern Europe developed well, while business in Africa and the Middle East remained stable. Sales in France and Belgium in part significantly exceeded prior-year levels, whereas business in the U.K. and Italy did not perform as well as in 2005. The EMEA region (Europe, Middle East, Africa), excluding Germany, accounted for 33.3% of Group sales, compared to 34.9% in 2005.

Sales by Region

in %



In **Germany**, LANXESS sales grew 4.9% from the previous year, to €1,614 million. Adjusted for portfolio measures, sales increased by 8.1%. All segments improved sales substantially due to robust development of the German economy. The Performance Rubber and Engineering Plastics segments posted double-digit percentage growth in sales. Germany's share of total sales was 23.2%, compared to 21.5% in 2005.

LANXESS sales in the **Americas** region remained at around last year's level, adjusted for portfolio and currency effects. After portfolio and currency effects, sales shrank by 7.3% to €1,788 million. The Performance Rubber and Performance Chemicals segments achieved a slight improvement in sales, whereas the Engineering Plastics and Chemical Intermediates segments failed to match prior-year performance. In the United States, adjusted sales remained constant despite slightly weaker economic growth, whereas in Canada, sales were down marginally. Latin America saw sales growth of 3.9%, with Brazil and Mexico contributing particularly to this positive development. The Americas region accounted for 25.8% of total sales, down from 27.0% in 2005.

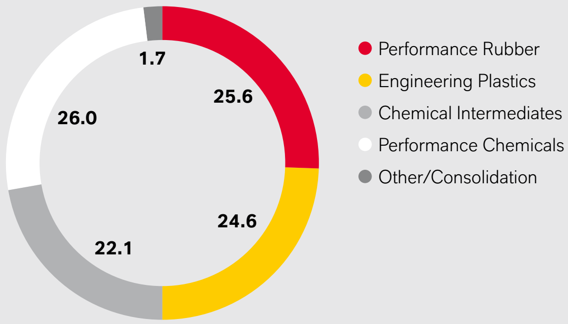
Sales in the **Asia-Pacific** region amounted to €1,230 million in fiscal 2006, up 3.4% from the previous year. Adjusted for currency effects and the business units divested, the increase in sales was 6.3%. All segments performed well, with the Performance Rubber and Engineering Plastics segments reporting above-average growth rates. The drivers of this growth were the Chinese and Indian markets, where substantial double-digit increases in sales were recorded. Business was also especially strong in Hong Kong, Thailand and the Philippines. The withdrawal from agency business in the Chinese market reduced sales there. The Asia-Pacific region's share of total sales rose from 16.6% to 17.7%.

Segment Data

- Performance Rubber: Strong market position underscored
- Engineering Plastics: Broad-based improvements
- Chemical Intermediates: Earnings stable at a high level
- Performance Chemicals: Portfolio effects take hold

Sales by Segment

in %



Performance Rubber	2005		2006		Change
	€ million	in % of sales	€ million	in % of sales	in %
Sales	1,678		1,776		5.8
EBITDA pre exceptionals	214	12.8	248	14.0	15.9
EBITDA	171	10.2	246	13.9	43.9
Operating result (EBIT) pre exceptionals	151	9.0	180	10.1	19.2
Operating result (EBIT)	108	6.4	178	10.0	64.8
Capital expenditures*	75		89		18.7
Depreciation and amortization	63		68		7.9
Number of employees (December 31)	3,119		2,967		(4.9)

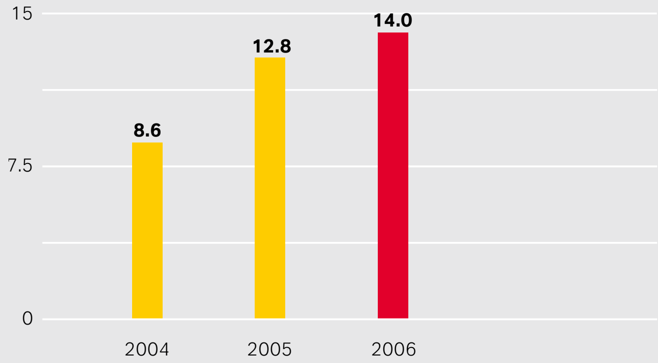
* intangible assets and property, plant and equipment

In 2006, the **Performance Rubber** segment increased sales again over the previous year's high level by 5.8% to €1,776 million. Substantial price increases of 10.2% more than offset the 3.8% decline in volumes and the marginal negative currency effect of 0.6%. Price increases in all of the segment's business units served to pass on the in part considerably higher costs of raw materials to the market. In the Butyl Rubber business unit, the large inventories held by our customers and a strike at a major customer prevented further volume growth. However, the business unit maintained its market position. As expected, the Polybutadiene Rubber business unit reported a decline in volumes in the Americas region. With the start of a market consolidation process, we adjusted production capacities at the U.S. site in Orange, Texas, in early 2006. However, the business unit was unable to match the sales of the previous year due to the difficult market environment in the United States. Volumes in the Technical Rubber Products business unit remained at the previous year's level.

The segment's EBITDA pre exceptionals jumped by 15.9%, to €248 million, with cost containment and efficiency enhancements also helping to improve earnings throughout the segment. In the Butyl Rubber business unit, plant consolidation and process optimization measures were initiated at the site in Zwijndrecht, Belgium, while at the facility in Sarnia, Ontario, Canada, we completed certain capacity expansion activities. In addition to the above-mentioned capacity adjustments in the United States, the Polybutadiene Rubber business unit also modified the production units at Port Jérôme, France, to manufacture the product grades required by the market. Nonetheless, this business unit's earnings remained below the prior-year level due to the adverse demand situation. The restructuring and cost-cutting measures that were initiated in the Technical Rubber Products business unit during 2005 became fully effective in 2006, helping compensate for the rise in energy prices and contributing to a significant improvement in earnings. The EBITDA margin pre exceptionals for the segment as a whole improved 1.2 percentage points, to a pleasing 14.0%.

EBITDA Margin of Performance Rubber

in %



Exceptionals in this segment, at €2 million, related to expenditures for the aforementioned settlements in the context of antitrust investigations involving the Technical Rubber Products business unit. Provisions for such settlements gave rise to exceptional charges of €43 million in the previous year.

Engineering Plastics	2005		2006		Change
	€ million	in % of sales	€ million	in % of sales	in %
Sales	1,737		1,708		(1.7)
EBITDA pre exceptionals	66	3.8	103	6.0	56.1
EBITDA	66	3.8	103	6.0	56.1
Operating result (EBIT) pre exceptionals	33	1.9	70	4.1	**
Operating result (EBIT)	10	0.6	70	4.1	**
Capital expenditures*	45		63		40.0
Depreciation and amortization	56		33		(41.1)
Number of employees (December 31)	3,479		2,814		(19.1)

* intangible assets and property, plant and equipment
** change of more than 100%

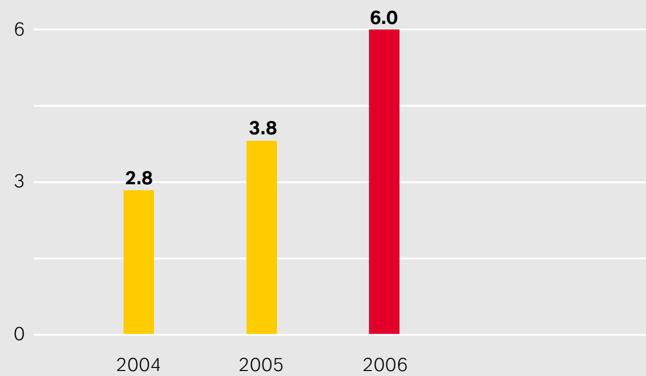
In the **Engineering Plastics** segment, portfolio adjustments led to a decline in sales of 1.7%, to €1,708 million. Adjusted for the sales of the Fibers business unit that was divested in the first quarter, the segment's sales were up slightly from the previous year. Price increases of 4.4% compensated for adverse volume effects of minus 1.6% and negative exchange rate effects of 0.4%.

In the Lustran Polymers (formerly Styrenic Resins) business unit, we continued to pursue our value-oriented growth strategy and consciously forego unprofitable sales, which depressed volumes. However, the price increases implemented were enough to compensate for this reduction in volumes. In the high-growth Indian and Chinese markets, the business unit saw a satisfactory increase in business volume, particularly in the case of ABS plastics. This development was fostered by the commissioning of additional production capacities in India. The markets served by the Semi-Crystalline Products business unit were characterized by high levels of demand, especially in Europe and the Asia-Pacific region. Further positive impetus was provided by the commissioning of a new compounding plant for the manufacture of Durethan® and Pocan® in Wuxi, China. The business unit's volumes exceeded the high levels of the previous year. Higher raw material costs were passed on to the market through higher prices.

Earnings in the Engineering Plastics segment jumped 56.1% to €103 million based on EBITDA pre exceptionals. In both business units of this segment, raising prices to pass on increases in raw material and energy prices had a positive effect. The Lustran Polymers business unit benefited from the successes achieved by changing strategy and initiating restructuring measures. The focus on higher-margin business improved earnings here. The consolidation of European production facilities for ABS specialties in Tarragona, Spain, also improved cost structures, as did the plant consolidations in Dormagen, Germany, and Brazil, which are proceeding according to schedule. To further strengthen our focus on the European ABS specialties business, we sold our Lustran SAN plastics product line in Europe and South America to BASF AG, Ludwigshafen, Germany, in May 2006. The production capacities freed up by this sale are now being used exclusively to produce ABS specialties. The temporary production stoppage in Tarragona due to fire damage had no sustained negative impact on earnings. Production facilities in the Semi-Crystalline Products business unit enjoyed very high levels of utilization all year, while the additional capacities in China made further contributions to earnings. The sale of the loss-making Fibers business to Asahi Kasei Fibers effective February 28, 2006 led to a further improvement in this segment's earnings. The EBITDA margin pre exceptionals jumped to 6.0% from 3.8% in 2005.

EBITDA Margin of Engineering Plastics

in %



This segment did not report any exceptional items in 2006. In the previous year, the segment's operating result was diminished by impairment losses of €14 million in the Lustran Polymers business unit and €9 million in the Fibers business unit.

Chemical Intermediates	2005		2006		Change
	€ million	in % of sales	€ million	in % of sales	in %
Sales	1,535		1,533		(0.1)
EBITDA pre exceptionals	211	13.7	245	16.0	16.1
EBITDA	211	13.7	245	16.0	16.1
Operating result (EBIT) pre exceptionals	143	9.3	181	11.8	26.6
Operating result (EBIT)	129	8.4	181	11.8	40.3
Capital expenditures*	59		45		(23.7)
Depreciation and amortization	82		64		(22.0)
Number of employees (December 31)	3,353		3,658		9.1

* intangible assets and property, plant and equipment

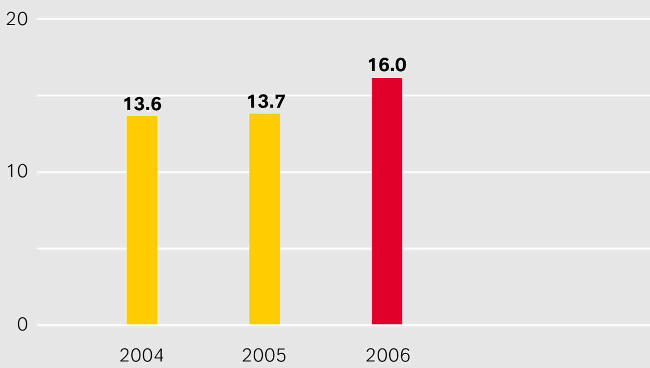
In 2006, sales by the **Chemical Intermediates** segment were nearly unchanged from the prior year at €1,533 million. Price increases of 1.0% compensated for an equally large decline in volumes. Negative currency effects of 0.1% were insignificant in this regard.

The Basic Chemicals and Inorganic Pigments business units implemented price increases to pass on rises in the cost of raw materials and energy. In the Saltigo (formerly Fine Chemicals) business unit, prices and volumes declined due to weaker demand for agrochemicals and specialty chemicals activities. The diminished demand from the agrochemicals market is explained by the dry weather during the year and the resulting reduced need for fungicides. Improvements in pharmaceutical intermediates and active ingredients, due in part to promising projects with new customers, could not fully offset this development. In the Inorganic Pigments business unit volumes increased thanks to buoyant demand for construction, coating and plastics applications.

EBITDA pre exceptionals in this segment improved by 16.1%, to €245 million, primarily because of much higher earnings in the Saltigo and Inorganic Pigments business units. The earnings generated by the Basic Chemicals business unit also remained high. Implementation of the restructuring measures initiated in 2005 enabled the Saltigo business unit to reduce fixed costs in all areas of operation. These measures included the closure of unprofitable facilities and, most importantly, a clearer positioning of this unit in the market for exclusive custom syntheses. The reductions in fixed costs helped compensate for higher raw material prices and improved earnings. On account of the strong project-oriented nature of this business, sales and earnings in the Saltigo business unit are always subject to a certain degree of volatility. Earnings in the Inorganic Pigments business unit were boosted by a positive demand situation and correspondingly high capacity utilization, coupled with the consolidation of production facilities. As part of our restructuring program, we closed our U.S. site at New Martinsville, West Virginia, in 2006. Customers are now supplied from Burgettstown, Pennsylvania, or directly from Krefeld-Uerdingen, Germany, and Porto Feliz, Brazil.

EBITDA Margin of Chemical Intermediates

in %



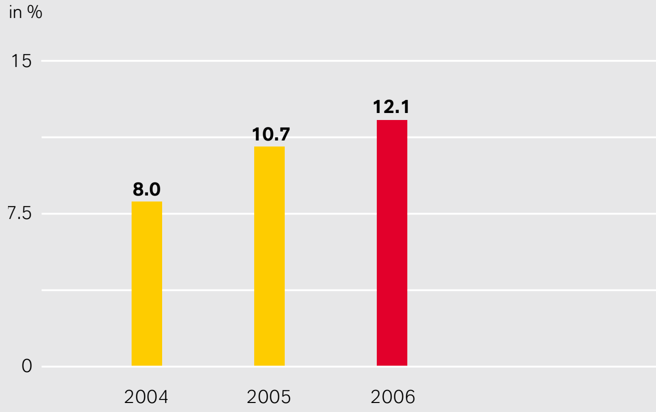
The EBITDA margin pre exceptionals for the segment as a whole improved 2.3 percentage points, to 16.0%.

In 2006, this segment did not report any exceptional items. The exceptionals included in the segment's operating result in the previous year comprised impairment losses of €14 million for the Saltigo business unit.

Performance Chemicals	2005		2006		Change
	€ million	in % of sales	€ million	in % of sales	in %
Sales	1,977		1,812		(8.3)
EBITDA pre exceptionals	212	10.7	220	12.1	3.8
EBITDA	184	9.3	219	12.1	19.0
Operating result (EBIT) pre exceptionals	146	7.4	156	8.6	6.8
Operating result (EBIT)	118	6.0	155	8.6	31.4
Capital expenditures*	61		55		(9.8)
Depreciation and amortization	66		64		(3.0)
Number of employees (December 31)	4,743		3,891		(18.0)

* intangible assets and property, plant and equipment

EBITDA Margin of Performance Chemicals



Sales in the **Performance Chemicals** segment dropped 8.3% from the prior year, to €1,812 million, due to portfolio effects. Adjusted for the divestment of the Paper business unit and RheinChemie subsidiary iSL-Chemie GmbH, sales were up slightly by 1.7%. This was due to positive price and volume effects of 1.6% and 0.6% respectively, with a small negative currency effect of minus 0.5%. All business units except Rubber Chemicals raised prices or maintained them at last year's levels. The price increases allowed the business units to pass on the higher costs of raw materials and energy. The Material Protection Products and Leather business units posted pleasing sales growth. The former likewise increased volumes, also of its cold sterilization agent Velcorin®. The Leather business unit benefited especially from its strong market position in the Asia-Pacific region where price increases were implemented successfully. The two production facilities in Wuxi, China, that were completed in 2005, also contributed to this development. In the Rubber Chemicals business unit, sales dipped because of stronger competition and the closure of production facilities by customers, coupled with the associated drop in demand.

EBITDA pre exceptionals improved 3.8%, to €220 million, due mainly to the strong performance of the Material Protection Products, Leather and Ion Exchange Resins business units. The sale of the Paper business unit to Finland's Kemira Group in 2006 had a positive impact on the segment's performance. In the Rubber Chemicals business unit, earnings were diminished by the expenses involved in the launch of the new production joint venture, Anhui Tong Feng Shengda Chemical Co. Ltd. This company, based in Tongling, China, will enable us to further expand LANXESS's strong position in the Chinese rubber chemicals market. The Textile Processing Chemicals business unit was sold at the end of 2006. The segment's EBITDA margin pre exceptionals increased by 1.4 percentage points to 12.1%.

The segment's operating result was hampered by €1 million in the context of antitrust investigations already referred to above in the Rubber Chemicals business unit. In the previous year, such settlements led to exceptional charges of €28 million.

The exceptional items of €42 million reported by the **Other/ Consolidation** segment related mainly to restructuring measures and portfolio adjustments initiated in fiscal 2006, as did the previous year's exceptional items of €196 million. The expenses for restructuring measures and portfolio adjustments mainly comprise costs for headcount reductions, impairment charges, closures or partial closures of facilities, and the preparation of corporate transactions. Included in these expenses are impairment losses of €8 million, compared to €27 million in 2005. As in the prior year, restructuring and portfolio expenses are included in the Other/Consolidation segment because they relate to a Group-wide, cross-segment program of asset consolidations, process improvements and portfolio adjustments initiated by the Board of Management, and it is therefore not possible to allocate them properly among the operating segments.

Financial Condition

Balance sheet structure

- Net financial debt significantly reduced
- Equity ratio improved further
- Total assets down from previous year due to portfolio adjustments

Balance Sheet Structure	Dec. 31, 2005		Dec. 31, 2006		Change
	€ million	in %	€ million	in %	in %
Assets					
Non-current assets	1,835	42.3	1,730	41.1	(5.7)
Current assets	2,506	57.7	2,475	58.9	(1.2)
Total assets	**4,341**	**100.0**	**4,205**	**100.0**	**(3.1)**
Equity and liabilities					
Equity (including minority interest)	1,256	28.9	1,428	34.0	13.7
Non-current liabilities	1,576	36.3	1,554	37.0	(1.4)
Current liabilities	1,509	34.8	1,223	29.0	(19.0)
Total equity and liabilities	**4,341**	**100.0**	**4,205**	**100.0**	**(3.1)**

Total assets were down €136 million, or 3.1%, from the previous year, primarily because of portfolio adjustments in fiscal 2006. Please see the Notes to the Consolidated Financial Statements for more detailed information about assets and liabilities disposed of during the divestments. A decline in non-current assets on the assets side of the balance sheet stands against a decrease in current liabilities on the equity and liabilities side. The equity ratio improved 5.1 percentage points, to 34.0%.

Adjusted for portfolio measures, intangible assets and property, plant and equipment remained almost unchanged from the prior year. Deferred tax assets declined, as did the value of the interest in Bayer Industry Services GmbH & Co. OHG, which is included at equity, due to the loss posted by this company.

Non-current assets accounted for 41.1% of total assets, compared to 42.3% in 2005.

Current assets remained at around the prior-year level with a minimal slip of 1.2%. Inventories shrank by €21 million, or 2.0%. After adjustment for currency and portfolio effects, higher raw material prices yielded a slight increase in inventories. The low level of the previous year was also influenced by problems in obtaining deliveries from a raw material supplier. As a result, days of sales in inventories (DSI) rose marginally in fiscal 2006. Trade receivables were down by €141 million, or 13.2%, from the previous year. However, they remained virtually unchanged when adjusted for portfolio and currency effects. The days of sales outstanding (DSO) improved again against the previous year.

On the equity and liabilities side, equity, including minority interest, increased €172 million, or 13.7%, from the year before, due mainly to the net income recorded. The equity ratio came in at 34.0%, compared to 28.9% for the prior year. Further details of changes in equity are provided in the Statement of Changes in Equity and the Notes to the Consolidated Financial Statements.

Non-current liabilities remained close to last year's level with a slight drop of 1.4%, accounting for 37.0% of total equity and liabilities. They include the €500 million Euro Benchmark Bond issued in fiscal 2005, which strengthened Group financing for the long term. Provisions for pensions and other post-employment benefits were up €23 million, or 4.6%, from the year before.

Current liabilities decreased €286 million, or 19.0%, to €1,223 million, largely because of utilization of the restructuring provisions set up in the previous year, reduced trade payables and the repayment of short-term liabilities to banks.

Net financial debt, defined as financial liabilities less cash and cash equivalents, came to €511 million as of December 31, 2006. This represents a substantial €169 million, or 24.9%, decrease from the previous year. The reduction is primarily the consequence of strict capital discipline, stable operating cash flow and net income.

The Group's key balance sheet ratios are as follows:

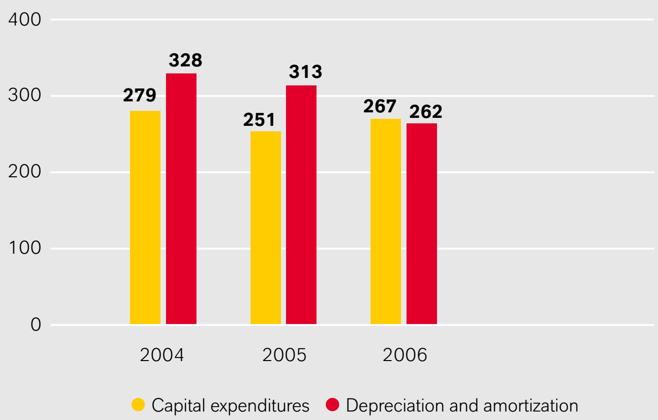
Ratios		2005	2006
in %			
Equity ratio	Equity* / Total assets	28.9	34.0
Non-current asset ratio	Non-current assets / Total assets	42.3	41.1
Asset coverage I	Equity* / Non-current assets	68.4	82.5
Asset coverage II	Equity* and non-current liabilities / Non-current assets	154.3	172.4
Funding structure	Current liabilities / Total liabilities	48.9	44.0

* including minority interest

Capital expenditures LANXESS makes selective capital expenditures to increase its international competitiveness, focusing on profitable businesses with attractive growth opportunities. Funds are allocated to individual segments in keeping with strategic targets. As a rule, capital expenditures are financed out of the cash flow from operating activities, or if these funds are insufficient, from other cash and credit lines available. Additionally, capital expenditure projects are also pursued as part of production and other joint ventures with international partners.

Capital Expenditures vs. Depreciation and Amortization

€ million



In 2006, capital expenditures for property, plant and equipment and for intangible assets came to €267 million, compared to €251 million the year before. Thus capital expenditures were level with depreciation and amortization, which came to €262 million. Depreciation and amortization included €8 million in impairments, which were reported as exceptionals. The prior year's depreciation and amortization was €313 million, including impairments of €67 million, €64 million of which were classified as exceptionals.

Capital expenditures focused primarily on measures to replace or maintain facilities or to enhance plant availability, and projects to improve equipment safety, improve quality or comply with environmental protection requirements. About 60% of the capital expenditures in 2006 were to preserve existing facilities, while the rest were for expansion or efficiency improvement measures.

In regional terms, about 39% of 2006 capital expenditures for property, plant and equipment in 2006 were made in Germany, about 20% in the EMEA region outside Germany, about 32% in the Americas, and about 9% in Asia. The figure for the Americas nearly doubled compared to the previous year. This is attributable to capital expenditures for expanding our butyl rubber production facilities in Canada.

Capital expenditures in the Performance Rubber segment, at €89 million (2005: €75 million), exceeded depreciation and amortization of €68 million. As in the previous year, expenditures served to expanding the capacity of the Butyl Rubber business unit's facilities in Sarnia, Ontario, Canada. Moreover, the Technical Rubber Products business unit invested significantly in chloroprene rubber (CR) production at the Dormagen site with the goal of expanding capacities and further improving process reliability.

In the Engineering Plastics segment capital expenditures came to €63 million, an increase of 40% over the previous year's spending of €45 million. This was significantly higher than the level of depreciation and amortization, which amounted to €33 million. In Tarragona, Spain, targeted capital expenditures were made in ABS production in support of the clear strategy of making Tarragona the hub of LANXESS's ABS operations for Europe and Latin America. In the Semi-Crystalline Products business unit, expenditures related to expanding polyamide 6 production at the Krefeld-Uerdingen site in Germany.

The Chemical Intermediates segment made capital expenditures of €45 million (2005: €59 million). These were less than depreciation and amortization, which amounted to €64 million. In Leverkusen, Germany, the Saltigo business unit initiated expansion of an existing complex compliant with cGMP (current Good Manufacturing Practice) to manufacture products for the pharmaceutical industry.

Capital expenditures in the Performance Chemicals segment, at €55 million (2005: €61 million), were slightly below depreciation and amortization of €64 million. Major expenditures related to the relocation of the hydrazine hydrate production plant from the Baytown, Texas, site in the United States to Weifang, China, which was completed in 2006. The RheinChemie business unit completed work on a service and technology center at its headquarters in Mannheim.

Among the major individual projects for 2006 were:

Segment	Description
Performance Rubber (BU: Butyl Rubber)	Expansion of butyl rubber production in Sarnia, Canada
Performance Rubber (BU: Technical Rubber Products)	Expansion of chloroprene rubber (CR) capacities in Dormagen, Germany
Engineering Plastics (BU: Lustran Polymers)	Expansion of ABS production in Tarragona, Spain
Engineering Plastics (BU: Semi-Crystalline Products)	Expansion of polyamide 6 production in Krefeld-Uerdingen, Germany
Chemical Intermediates (BU: Saltigo)	Expansion of an existing facility that complies with cGMP (current Good Manufacturing Practice) for the pharmaceuticals industry in Leverkusen, Germany
Performance Chemicals (BU: Functional Chemicals)	Joint venture for hydrazine hydrate in Weifang, China

Liquidity and capital resources

Financial condition

- Operating cash flow burdened by one-time payments
- Capital expenditures for property, plant and equipment financed out of operating cash flow
- Sound basis established for growth and restructuring cash-outs in 2007
- Term of syndicated credit line successfully extended

The cash flow statement shows cash inflows and outflows by type of business operation.

Cash Flow Statement	2005	2006	Change
€ million			
Income (loss) before income taxes	(117)	287	404
Depreciation and amortization	313	262	(51)
Other items	322	(22)	(344)
Net cash provided by operating activities before change in working capital	**518**	**527**	**9**
Change in working capital	106	(118)	(224)
Net cash provided by operating activities	**624**	**409**	**(215)**
Net cash used in investing activities	**(246)**	**(207)**	**39**
Net cash used in financing activities	**(319)**	**(164)**	**155**
Change in cash and cash equivalents from business activities	59	38	(21)
Cash and cash equivalents as of December 31	136	171	35

Cash provided by operating activities before changes in working capital improved slightly in 2006 compared to the year before. While income before taxes increased substantially and depreciation and amortization was €51 million below the previous year's figure, operating cash flow was impacted by significant one-time payments resulting from the utilization of provisions established in 2005 for restructuring, antitrust cases and higher bonus payments. In the prior year, the increase in other items included the corresponding allocations to provisions. They did not therefore result in cash outflows, and thus did not affect operating cash flow in 2005.

The change in working capital compared to December 31, 2005 resulted in a cash outflow of €118 million. Taking into account portfolio and currency effects, the increase in trade receivables and especially in inventories resulted from higher raw material prices and growth in business volume. In addition, the previous year's inventories were unusually low due to the problems in obtaining deliveries from a raw material supplier and production bottlenecks associated with Hurricane Rita. Moreover, an extension of payment terms with BIS was settled. Adjusted for these effects, working capital approximately matched the level of the previous year.

Cash used in investing activities in 2006 was less than in the previous year, at €207 million. Expenditures for property, plant and equipment and for intangible assets were up €16 million, or 6.4%, to €267 million and thus at the upper end of the range budgeted for 2006. Sales of property, plant and equipment brought in cash of €13 million, compared to €8 million the year before. The LANXESS Group received cash inflows of €104 million from the sale of companies and business units in 2006. The compensation paid for the prior-year loss of BIS and investments in securities led to expenditure on financial assets of €78 million.

Cash used in financing activities for 2006 came to €164 million, compared to €319 million in 2005. Most of this outflow resulted from a net loan repayment of €124 million. Interest expenses and other financial disbursements resulted in cash outflows of €39 million. The prior-year figure of €76 million included items such as payments associated with the June 2005 repurchase and resale of the convertible bond.

Cash and cash equivalents came to €171 million on the reporting date, €35 million, or 25.7%, above the prior-year figure of €136 million.

Financing of the LANXESS Group On the reporting date, the LANXESS Group had unutilized liquidity reserves amounting to approximately €1.6 billion comprising cash, committed credit lines and an asset-backed securities program. This significant liquidity reserve ensures the Group's solvency at all times and is evidence of LANXESS's good overall financial flexibility.

At the core of this liquidity reserve is a credit line of €1.25 billion agreed with an international syndicate of banks. This credit line was extended for a further year during 2006, so that the agreement now expires in October 2011. All of the banks in the syndicate consented to the extension, representing the successful exercise of the first of two extension options. The next date for further extension of the credit line is October 2007.

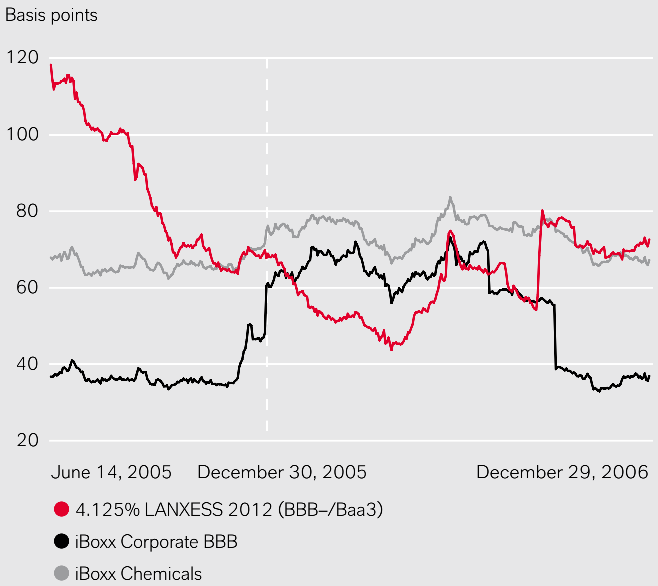
LANXESS's excellent liquidity enabled it to reduce the asset-backed securities program with an initial volume of €200 million implemented by LANXESS Deutschland GmbH in 2004. During 2006, the program was utilized to a maximum of €50 million. As a rule, the sale of receivables to raise liquidity is recognized in the consolidated balance sheet, which is why this transaction is considered to be on-balance sheet financing. LANXESS had not utilized this program by the reporting date.

No additional financing-related transactions were entered into during 2006.

In 2005, we issued a bond with a volume that qualified it as a benchmark bond for inclusion in the major European bond indices. It was issued with a seven-year maturity and a 4.125% annual interest coupon by LANXESS Finance B.V., an indirectly wholly owned subsidiary of LANXESS AG. The bond is guaranteed by LANXESS AG and received investment-grade ratings of BBB– from Standard & Poor's and Baa3 from Moody's Investor Services. The bonds are traded on the Luxembourg Stock Exchange under the securities identification code A0E6C9.

Bond performance – evolution of credit spread An important indicator for corporate bonds, apart from the absolute change in price, is the relative valuation of the risk specific to the issuer in comparison to a reference interest rate. This valuation is expressed in what is known as the "credit spread". The chart below shows the evolution of the credit spread of the LANXESS bond in comparison to the interest-rate swap curve. Following outstanding prior-year performance, the spread at times developed in significant variance to the market in comparison to both to LANXESS's own BBB rating class and to other chemical companies. The announcement by the Board of Management that LANXESS is also considering options for external growth led the bond markets to price in the event risk, which resulted in an increase in the credit spread. At the end of 2006, the LANXESS credit spread traded at the same level as the iBoxx Index for BBB-rated corporate bonds.

Bond Performance – Evolution of Credit Spread



Ensuring a healthy balance sheet and financing structure is an expression of the forward-looking and prudent financial strategy pursued by LANXESS. In the same context is the strategic corporate objective formulated by the Supervisory Board and the Board of Management of maintaining an investment-grade rating in the BBB range. Among other things, this ensures flexible access to capital markets. In 2006, signals from the rating agencies were mostly positive. For example, Fitch included LANXESS in its rating universe in May 2006, issuing an initial BBB flat rating with stable outlook. This was one level higher than the existing ratings from Standard & Poor's and Moody's. In June 2006, Moody's confirmed its Baa3 rating, at the same time upgrading the outlook from stable to positive. Standard & Poor's also confirmed its BBB– rating in May 2006, but its upgrade to a positive outlook was subsequently downgraded again to stable in September 2006. Standard & Poor's justified this move with the assumption that LANXESS in the future would use the financial scope provided by the BBB– rating for external growth.

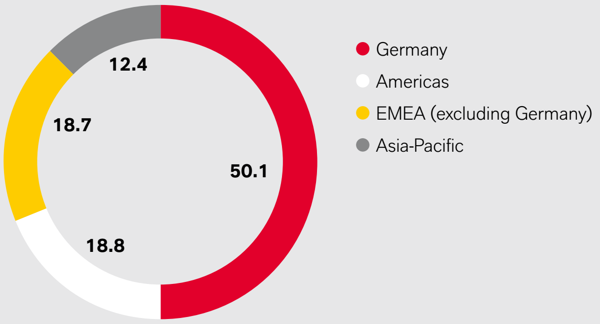
Employees As of December 31, 2006, the LANXESS Group had a total of 16,481 employees. This was 1,801 fewer than a year earlier, due primarily to the restructuring measures and the divestment of the Fibers, Paper and Textile Processing Chemicals business units. The employees of these business units were no longer included as of the reporting date.

As of December 31, 2006, the LANXESS Group employed 3,083 individuals in the EMEA region (not including Germany), compared to 3,290 the year before. The number of employees in Germany declined from 9,410 to 8,263, which most clearly reflects the effects of the abovementioned changes. Staff in the Americas region was down from 3,694 in the previous year to 3,094. The increase in the number of employees in the Asia-Pacific region from 1,888 to 2,041 reflects our expanding activities in the high-growth Asian markets.

Personnel expenses totaled roughly €1,136 million, or 16.4% of sales, down 14.8% from the previous year. Wages and salaries, at €877 million, accounted for most of this figure. Social security contributions were €177 million, while pension plan expenses totaled €78 million, and social assistance benefits came to €4 million.

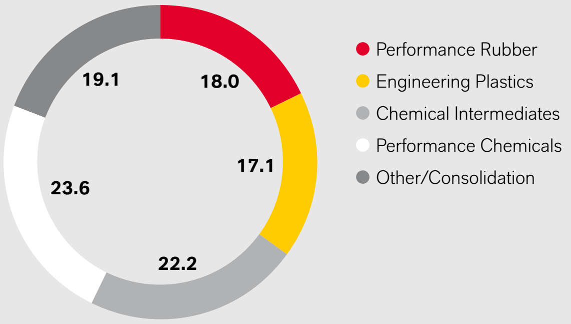
Employees by Region

in %



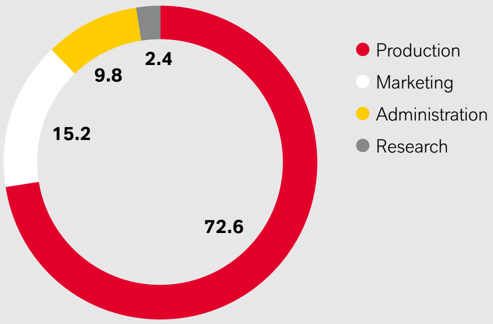
Employees by Segment

in %



Employees by Functional Area

in %



Compensation Report The structure of the compensation system for the members of the Management Board is determined and regularly reviewed by the Supervisory Board in line with proposals from its Human Resources Committee. This Committee is responsible for determining appropriate compensation for individual Management Board members on the basis of criteria that include, in particular, the duties of the individual Management Board member, his personal performance, and the LANXESS Group's economic situation, performance, and future outlook.

In addition to a market-oriented annual base salary that is broadly in line with that paid by comparable companies, their compensation contains two variable components based on LANXESS's short-term and long-term performance.

The fixed compensation comprises the annual base salary and remuneration in kind, consisting mainly of the tax value of perquisites such as the use of a company car. The aggregate amount of these components came to €2.047 million in 2006.

The short-term, performance-based component is called the Short Term Incentive (STI), which is based on the Group's attainment of defined EBITDA targets and is equivalent to the annual base salary in the event of 100% target attainment. The maximum amount payable is 150% of the annual base salary. The aggregate amount of the performance-based STI payments amounted to €2.333 million in 2006.

The long-term, performance-based component of the compensation system is the Long Term Incentive Program (LTIP), which is divided into three tranches for the years 2005 to 2007. The LTIP comprises the Stock Performance Plan (SP) and the Economic Value Plan (EVP). The first award from the LTIP is made after three years, provided defined conditions are satisfied.

The SP is linked to the performance of LANXESS stock against a reference index, the Dow Jones STOXX 600 Chemicals^{SM}. The EVP is an incentive oriented toward an increase in the economic value of LANXESS. The reference for all three tranches is the business plan for 2005 through 2007. The requirement for participation in the LTIP is a prior personal investment in LANXESS shares, which are subject to a five-year lock-up period.

For more information, particularly regarding the valuation parameters applied, please see Note (21) to the Financial Statements.

The number of stock-based compensation rights issued in 2006 and their corresponding fair values at the time of issue are as follows:

Stock Performance Plan	Number of option rights	Fair values
		in €
Dr. Axel C. Heitmann	360,000	406,800
Dr. Ulrich Koemm	281,400	317,982
Dr. Martin Wienkenhöver	240,000	271,200
Matthias Zachert	240,000	271,200
	1,121,400	**1,267,182**

On termination of their employment contracts, the members of the Management Board receive benefits under the company pension plan. These benefits are paid when the beneficiary reaches age 60 or if the beneficiary is permanently unable to work. They are paid to surviving dependents in the event of the beneficiary's death.

The new pension plan set up in 2006 for Dr. Axel C. Heitmann, Dr. Martin Wienkenhöver and Matthias Zachert is a cash balance plan stipulating a basic benefit of 25% of their respective annual base salary. Moreover, Management Board members must themselves pay an amount from deferred compensation amounting to 12.5% of the STI, which is matched by LANXESS. From the date of entitlement, 70% of the accumulated capital is paid out in a lump sum. The remaining 30% is converted to a pension benefit. Claims arising from provisions in place before the new pension plan was established are granted as vested rights. If the employment relationship ends before the beneficiary reaches age 60, the company shall pay certain additional benefits up to a defined ceiling.

LANXESS has set up provisions for the future claims of Management Board members. The service costs recognized in the 2006 annual financial statements for this purpose totaled €4.841 million. Most of this amount is attributable to the modification of the pension plan.

The following table shows details of the compensation paid to individual Management Board members:

Compensation of the Management Board	Short-term compensation			Long-term compensation	Pensions		
in € '000	Base salary	Variable component	Total	Stock Performance Plan and Economic Value Plan	Service costs	Annual pension benefits from date of entitlement	Capital from interest
Dr. Axel C. Heitmann	670	749	1,419	523	1,757	192	390
Dr. Ulrich Koemm	502	586	1,088	408	664	202	0
Dr. Martin Wienkenhöver	437	499	936	348	1,221	144	260
Matthias Zachert	438	499	937	348	1,199	68	260
	2,047	**2,333**	**4,380**	**1,627**	**4,841**	**606**	**910**

The members of the Management Board receive indemnification should their employment contracts be terminated by the company for defined reasons such that they would leave the company before reaching age 60. In such cases, the contractually agreed annual base salary and the STI continue to be paid for the remaining duration of the employment contract or, following its expiration, for 12 months, assuming 100% target attainment. In addition, a new placement budget is made available and a monthly transition benefit amounting to 50% of the Management Board member's monthly base salary is paid for a period not to exceed 48 months and only until the Management Board member has reached age 60. Any non-compete payments and, under certain defined conditions, income from other employment are offset against the settlement payments.

In the event of a material change of control over the company, the Management Board members have the right to claim benefits if their employment contracts are terminated mutually or expire within 12 months after the event causing the change of control, or if the Management Board member himself ends the employment relationship because of a material change in his position. This can, for example, include a change in the strategy of the company or a change in the responsibilities of the Management Board member. Benefits in the event of a change of control correspond to the aforementioned benefits in connection with contract termination initiated by the company, with the exception that the monthly transition benefit is paid for 60 months and only until age 60.

As part of the new five-year Management Board contracts signed with Dr. Axel C. Heitmann and Matthias Zachert effective July 1, 2007, the severance indemnity agreement and change-of-control provisions were extended. The terms depend on the respective circumstances and, in addition to contractual compensation for the remaining term of the employment contract or transition benefits, also include settlement payments amounting to up to two times the annual base salary plus the STI. The severance indemnity agreement and change of control provisions described for Dr. Heitmann and Mr. Zachert are also applicable for Dr. Rainier van Roessel, who was appointed to the Management Board on January 1, 2007.

In the event of a Management Board member's death during his active service period, compensation will continue to be paid to his surviving dependents in the month of death and for an additional six months. This payment is based on the contractually agreed base compensation component.

No additional benefits have been pledged to any Management Board member in the event of termination of their employment. In 2006, no member of the Management Board received benefits or corresponding commitments from third parties in respect of their duties as Management Board members.

In 2006, no loans were granted to members of the Management Board.

Reporting Pursuant to Article 315 Paragraph 4 of the German Commercial Code Pursuant to Article 315 Paragraph 4 Nos. 1 to 9 of the German Commercial Code, we hereby make the following declarations:

1. As in the previous year, the capital stock of the Group parent company LANXESS AG amounted to €84,620,670 as of December 31, 2006, and is composed of 84,620,670 no-par bearer shares. The rights and obligations arising from the shares are governed by the German Stock Corporation Act.
2. We are not aware of any restrictions affecting voting rights or the transfer of shares. However, participants in employee stock plans are subject to a lock-up period on disposal of their shares.
3. No direct or indirect equity investments in the capital of LANXESS AG exceeding 10% of total voting rights were reported to LANXESS AG.
4. No shares carry special rights granting control authority.

5. Employees hold a direct interest in the capital of LANXESS AG through employee stock programs. There are no restrictions on directly exercising the control rights arising from these shares.
6. Article 84 of the German Stock Corporation Act and Article 31 of the German Codetermination Act apply to the appointment and dismissal of Management Board members. Articles 179 et seq. of the German Stock Corporation Act apply to amendment to the articles of association. The articles of association of LANXESS AG do not contain any provisions deviating from these regulations.
7. On May 31, 2006, the Annual Stockholders' Meeting of LANXESS AG authorized the Management Board to purchase a total of 10% of the company's capital stock for any legal purpose through November 30, 2007. The Management Board can decide whether to acquire shares on the stock exchange or via a public purchase offer. Moreover, pursuant to Article 4 Paragraph 2 of LANXESS AG's articles of association, the Management Board is authorized to increase the company's capital stock with the approval of the Supervisory Board once or several times through August 30, 2009, by way of the issue of new no-par shares against cash or non-cash contributions up to a total amount of €36,517,096.
8. The employment contracts between the company and the members of the Management Board of LANXESS AG contain agreements subject to the condition of a change of control. These are outlined in detail in the Compensation Report in this Management Report. In addition, the terms of the €500 million Euro Benchmark Bond issued by LANXESS Finance B.V. in 2005 contain a change-of-control clause which gives bondholders the right to redeem the bond should certain events occur that affect its rating. The bond was guaranteed by LANXESS AG.
9. The employment contracts between the company and the members of the Management Board of LANXESS AG contain compensation agreements applicable in the event of a takeover bid. These are also outlined in detail in the Compensation Report in this Management Report.

Procurement and Production

Procurement LANXESS uses a centrally managed global procurement organization to ensure a reliable supply of materials and services. Global procurement teams coordinate with the business units to pool requirements. A global procurement network enables them to leverage purchasing synergies, so that LANXESS can move efficiently in the market and exploit price advantages. LANXESS systematically applies best practice processes. These include e-procurement tools, such as e-catalogs and electronic marketplaces, many of which are integrated into the company's internal IT systems. About 30% of all items ordered are now handled through e-procurement.

Procuring petrochemical raw materials is a significant priority at LANXESS. The biggest suppliers here in 2006 included BP, Chevron Phillips, Dow, Exxon Mobil, Huntsman, Ineos, Lyondell, Nova Chemicals, Repsol, Siam Styrene, Shell Chemicals and Total. Other important suppliers of basic inorganic and organic chemicals are BASF, Bayer, Degussa, European Oxo, Ineos and Polimeri.

Among the most important petrochemical raw materials by far for our production operations are 1,3-butadiene, styrene, cyclohexane, acrylonitrile, C4 raffinate 1, toluene, isobutylene and benzene. The basic chemicals ammonia, aniline, chlorine, caustic soda, and sulfur are also important, as are ferrous raw materials. In all, petrochemical raw materials accounted for a purchasing volume of about €1.6 billion in fiscal 2006 (previous year €1.5 billion), or around 50% of total raw materials expenses for the LANXESS Group.

Production LANXESS is one of Europe's major producers of chemical and polymer products. Our production facilities can make anywhere from very small batches of custom-synthesized products to basic, specialty and fine chemicals and polymers in quantities of several thousand tons.

Each of the Group's production facilities is organizationally assigned to an individual business unit. The most important production sites are at Leverkusen, Dormagen and Krefeld-Uerdingen, Germany; Antwerp, Belgium; Bushy Park, South Carolina, and Addyston, Ohio, United States; Sarnia, Ontario, Canada; and Wuxi, China. LANXESS also has other production sites in Argentina, Australia, Belgium, Brazil, Canada, China, France, Germany, India, Italy, Japan, Mexico, South Africa, Spain, Thailand, the United Kingdom and the United States.

In the past fiscal year, we invested €267 million, primarily in maintaining and expanding our production capacities, especially in Sarnia, Ontario, Canada; and Dormagen, Leverkusen and Krefeld-Uerdingen, Germany. New production facilities were opened in Tongling and Wuxi, China, and in Madurai, India. In other cases, we relocated production capacities to other sites. For example, we moved a hydrazine hydrate plant from the United States to China and ABS plastics production units from Dormagen, Germany, to Tarragona, Spain.

We experienced two temporary production outages at two sites last year. In early January, we were forced to cut back butyl rubber production in Sarnia due to supply problems. In mid-March, we were able to lift our force majeure declaration. Then in August, ABS plastics production in Tarragona was brought to a partial halt after a fire. However, the affected plants were quickly repaired.

As part of our restructuring measures, the plants at Trenton, New Jersey, and New Martinsville, West Virginia, in the United States and the facility in Camaçari, Brazil, were closed.

Sales Organization and Customers

Sales organization LANXESS sells its products all over the world, to several thousand customers in more than 140 countries across all continents. LANXESS's long-standing customer base includes leaders in each of its user industries. Our well-established customer relationships are especially extensive in Europe and North and South America. To meet our customers' needs, we have set up very flexible marketing and sales structures. Sales are managed through 39 legal entities owned by LANXESS itself, 31 Bayer sales agencies, and independent sales partners throughout the world. Additionally, orders worth some €1.5 billion, or 21.6% of total sales, were processed via e-business in 2006. This capability is provided by the LanxessONE Internet tool and the ELEMICA Web portal for chemical products. Compared to the previous year, the share of total sales accounted for by e-business rose by 3.4 percentage points.

To keep as close as possible to customers and ensure they receive individual support, the LANXESS business units each manage their own sales organizations. Another competitive advantage for LANXESS is provided by our 47 production sites in 17 countries. Wherever possible, customers are supplied from production sites in the same region, saving both time and money.

Selling costs for fiscal 2006 came to 11.0% of LANXESS Group sales, compared to 12.1% for the previous year.

Customers Because of its many products and lines of business, LANXESS has business relationships with a vast range of customers all over the world. They need an individualized, well-focused approach, which we are able to provide because our sales organizations are managed through the business units. Individual marketing strategies are reviewed on the basis of customer satisfaction surveys.

LANXESS serves the following industries: tires, automotive supply, chemicals, plastics, electronics, agrochemicals, pharmaceuticals, food, textiles, water treatment, and furniture.

Shares of Sales by Industry Sector	2006
in %	
Chemicals	> 15
Automotive, construction, electrical/electronics, life science, tires	5 – 15
Leather/shoes, textiles, apparel	< 5
Others	~ 15

The LANXESS Group's top five customers accounted for about 11% of total sales in fiscal 2006. The decline of this share by approximately three percentage points compared with 2005 underscores that we have broadened our customer base and further reduced our dependence on individual key accounts. 14 (2005: 18) customers accounted for sales of between €20 million and €50 million. About 24,000 (2005: 15,000) customers contributed sales of up to €100,000.

The number of customers in each segment varied widely, as in the past year. The Performance Rubber segment again had some 2,000 customers in 2006, while Engineering Plastics had about 4,000. Chemical Intermediates significantly expanded its customer base to 8,000, adding 1,000 to the 2005 figure. The number of customers served by Performance Chemicals increased by 3,000 on the prior year, to 17,000. Each segment includes all customer groups and sales volumes. However, one customer may do business with more than one segment.

The comparatively low sales per customer in the Performance Chemicals segment, as well as its broad customer base, reflect the way in which its business often involves custom-tailored solutions in specialty chemistry. The substantially lower number of customers in the Performance Rubber segment, which generates relatively high sales, is likewise typical of the synthetic rubber products business. This extensive customer base means that no segment can be considered dependent on just a few customers.

Research and Development Our research and development activities continue to focus on optimizing and further developing our existing operations and technologies. New products are developed only in selected business areas offering a good chance for success. Thus, innovations can be specifically developed for our markets and applications and offered to customers within a short time.

LANXESS research and development units worldwide had about 400 employees as of December 31, 2006 (compared with about 600 the previous year). We have research and development units worldwide at our sites in Leverkusen, Dormagen and Krefeld-Uerdingen, Germany; Sarnia, Ontario, Canada; Wuxi, China; and Moxi, India.

In 2006, we conducted approximately 120 research and development projects, around 90 of which aimed to develop new products or improve existing ones. Thirty projects were concerned with optimizing chemical processes to reduce costs, improve yields or increase capacities. Roughly 85% of the research and development projects started in 2006 are scheduled to reach the market or technical implementation stages by the end of 2007.

The results of our research and development work are protected by patents, where this is expedient. In the course of 2006, we submitted 103 priority applications worldwide. As of December 31, 2006, the full patent portfolio includes 1,400 patent families covering approximately 8,300 property rights.

LANXESS does not conduct fundamental research. Instead, nearly all business units enter project-specific R&D partnerships with external partners to leverage expertise not available in-house for innovative product development. In 2006, a total of 33 major R&D partnerships were established, 13 of which were with universities, 13 with suppliers or customers, and 7 with research institutes.

An example of a successful research and development project involving universities is the development of Therban® AT, a new product line by the Technical Rubber Products business unit. The University of Waterloo (Toronto, Ontario, Canada), the University of Zurich (Switzerland) and the Munich University of Technology participated in the development of this product. In August 2006, Therban® AT received the DKG (German Rubber Society) award for outstanding innovations in the rubber industry. The new manufacturing process underlying this product is based on the principle of metathesis, the discovery of which received the Nobel Prize in Chemistry in 2005. Due to its modified chemical structure, Therban® AT has special rheological properties that provide our customers with significant processing advantages, at the same time substantially broadening the range of applications for this type of high-performance elastomer.

Most of the LANXESS Group's research and development expenditures are in the Saltigo, Semi-Crystalline Products, Butyl Rubber and Technical Rubber Products business units. In 2006, these accounted for 51% of the Group's total research and development spending (compared with 46% in 2005).

Organizationally, the LANXESS Group's research and development units are assigned to the individual business units. This approach is intended to ensure that development activities are always closely allied to the business units' own strategies, markets and customers. For example, business units with a large proportion of commodities (products in very mature markets), such as Basic Chemicals, concentrate on constantly improving their production facilities and processes (process optimization). Other business units, such as Material Protection Products, Semi-Crystalline Products and Leather, focus their R&D activities more on optimizing products and product quality, and developing new products to meet market requirements and customers' special needs. There is also a Board initiative to coordinate research and development work across business unit boundaries, thereby promoting especially innovative products from an overall LANXESS perspective and coordinating the exchange of R&D expertise and staff among business units.

Research and development in the **Performance Rubber** segment is conducted mainly by the Butyl Rubber and Technical Rubber Products business units. Butyl Rubber develops products such as novel types of butyl rubber with a broader spectrum of applications and improved mechanical properties. As outlined above, Therban® AT is an important and successful result of the Technical Rubber Products business unit's research and development activities. However, the main focus of research is still on optimizing existing products and further improving processes in terms of both costs and ecology.

Research and development activities in the **Engineering Plastics** segment concentrate on identifying and developing new areas of application for existing products, as well as further updating these products for this purpose. A current focus of the Semi-Crystalline Products business unit is the development of flame-retardant, halogen- and antimony-free polyamides and polyesters that comply with the stricter statutory regulations recently introduced. These innovative products can be used in all areas of the electronics industry, as well as in household appliances. In developing this new generation of flame-retardant products, particular emphasis was placed on excellent mechanical and rheological performance, as well as outstanding flame-resistant properties.

The market launch of this new product line is already successfully underway and is expected to be expanded steadily through the advanced product and application development activities.

In the **Chemical Intermediates** segment, R&D work is concentrated mainly in Saltigo's custom manufacturing sector, which develops processes for customers' specific intermediates as a service and manufactures the resulting products. Development services are an integral part of Saltigo's portfolio. The customers for these services are primarily pharmaceutical companies, manufacturers of agrochemicals, and companies that market chemical specialties such as electronic chemicals, fragrances and flavorings. The Basic Chemicals business unit's development work focuses mainly on further optimizing existing production processes. Product development is limited to a few promising growth segments, such as the biofuels market. This business unit has developed the Baynox® product line of stabilizers for biodiesel, which it brought to market in December 2006. Inexpensive vegetable oils in particular oxidize very rapidly on exposure to air. Baynox® is a highly effective stabilizer which prolongs the storage stability of biodiesel based on such oils. We anticipate a successful market launch for Baynox®, particularly in the leading soybean-growing countries such as the United States and Brazil.

In the **Performance Chemicals** segment, the emphasis is on applications development to optimize products. One current goal of the Ion Exchange Resins business unit is the development of anion exchangers with excellent thermal stability for use in fuel cells. With a view to accessing this attractive growth market, the business unit is experimenting with variations of existing products.

LANXESS's total research and development expenditures in 2006 amounted to €87 million, or 1.3% of sales, compared with €101 million, or 1.4% of sales, in 2005. This decline is attributable in part to portfolio measures implemented in fiscal 2006.

Corporate Responsibility

Corporate values LANXESS's guiding principles are characterized to a great extent by ethical values. The company's objective is sustainable, forward-looking development, which sensibly combines the demands of economy, ecology and society through responsible care – in short: sustainable development. This issue is therefore firmly anchored in our organization, requiring all employees to act responsibly in respect of people, the environment and capital. In practice, this means that we always apply our high sustainable business standards in making entrepreneurial decisions.

Our Corporate Compliance Guideline is a code of legal compliance and responsible conduct that is binding on all LANXESS employees and expresses a commitment to act in accordance with the law, apply the principles of responsible care and demonstrate ethical conduct. It contains guidance on issues such as competition; occupational, product and plant safety; environmental protection and interactions with other people.

The great importance we assign to protecting nature and the environment is manifested in our company's voluntary commitment to the principles of sustainable development and in our global implementation of a standardized environmental management system in accordance with ISO 14001. Furthermore, LANXESS is one of the signatories to the international Responsible Care® Charter that was adopted by the International Council of Chemical Associations as a significant step toward sustainable development.

Our activities have already resulted in several awards. Moreover, LANXESS features in the FTSE4Good sustainability index. This index lists companies which have performed particularly well in the areas of environmental protection, human rights and social standards.

In 2006, the LANXESS Group for the first time honored outstanding achievements in three categories: environmental protection; occupational, plant, process and product safety; and communication. The Global HSE Award, with prizes of €10,000, €5,000 and €2,500, went to teams from Belgium (1st place), Germany (2nd place) and Thailand (3rd place).

Committees The Management Board established the Compliance Committee to implement the Corporate Compliance Guideline. This Committee handles all referrals concerning compliance violations, with the goal of correcting any illegal conduct by LANXESS employees that may occur. The Compliance Committee includes the heads of the Law and Intellectual Property, Human Resources, Technical Services and Procurement group functions and the head of Internal Auditing as the LANXESS Compliance Officer.

The HSEQ Committee steers all management processes required to ensure and further improve environmental and health protection, safety, product stewardship and quality. The committee includes all heads of business units and group functions and is headed by a Management Board member. It initiates all necessary HSEQ directives and programs for LANXESS, defines HSEQ objectives for the medium and long terms, and continually reviews the effectiveness of the management system and reporting on Responsible Care and sustainable development. The programs initiated are implemented worldwide with support from global and regional HSEQ units and are regularly tracked by means of internal audits.

HSEQ management system In fiscal 2005, we initiated a comprehensive global process of aligning and controlling the HSEQ management system in order to ensure that the same environmental and safety standards are applied at all LANXESS locations throughout the world. These standards are regularly reviewed in compliance checks. We completed this process at the end of fiscal 2006. Our quality and environmental policies were revised, and global responsibilities were assigned in LANXESS directives that are binding at all our sites. Moreover, we established a global reporting system for HSEQ indicators, introduced a worldwide information network and internationalized the performance review process.

A further priority is the comprehensive certification of our facilities. At the end of fiscal 2006, around 81% of our key sites had been certified at least according to ISO 9001 or ISO 14001. We plan to have completed certification of all our major sites by the end of 2007.

Occupational safety Occupational safety is a key issue at LANXESS. The Safety Master Plan systematically identifies and corrects weak points in every organizational unit. Even after concluding the Thousand-Day Program to improve occupational safety in October 2005, we continue to track the key performance indicators. The accident rate per million work hours was 2.9 for 2006, a reduction of 63% compared to the baseline figure at the starting date.

Environmental protection As LANXESS sees it, conserving natural resources – for example, through the most efficient possible use of raw materials and energies – and identifying further potential for reducing emissions and waste is an ongoing mission, an inherent part of our ecological obligations to which we must apply our expertise. The continuous improvement of environmental performance is a key corporate goal.

We are concerned that our products in all segments must be environmentally compatible. As early as the development stage, we consider ways that a product can be disposed of safely. LANXESS views product stewardship as our responsibility to continually improve product safety for the sake of both people and the environment. For this reason, we expressly support the protection goals of E.U. chemicals policy, implementation of the REACH regulation, and the international Responsible Care® Charter. A healthy balance must be achieved between safe production and use of chemicals and the competitiveness of the chemical industry in Europe.

It is not yet possible to separately report consolidated environmental protection spending for all LANXESS subsidiaries and affiliates worldwide. However, in the future we will report transparently about the progress of our environmental protection activities. For LANXESS Deutschland GmbH, expenditures for waste disposal, water protection, noise abatement, clean air and other environmental protection measures came to 5.1% of total operating costs in 2006, compared with 4.9% the previous year.

Idea management When LANXESS employees have good ideas for improving work processes, safety and environmental protection, or preventing mistakes, those ideas pay off. An idea management system encourages suggestions for improvements to ensure that LANXESS will constantly be provided with new ways to improve cost-effectiveness, occupational safety and environmental protection. During 2006, employees submitted 2,256 suggestions, around 440 of which related to occupational safety and environmental protection. Total savings of €3.3 million were achieved as a result. In the future, our idea management activities will continue to contribute substantially to LANXESS's success thanks to a simplified, IT-based processing system and an attractive, performance-based bonus system.

Risk Report

Risk management Risk management is important for LANXESS because business activity necessarily entails risks as well as opportunities. The LANXESS Group's success is significantly dependent on identifying both opportunities and risks and actively managing them. Effective risk management is therefore a core element in safeguarding the company's existence for the long term and ensuring its successful future development.

LANXESS's risk management approach is based on clearly defined business processes, the precise assignment of responsibilities throughout the Group, and reporting systems that ensure the timely provision of the information required for decision-making to the Management Board or other management levels. LANXESS views risk management as an integral part of corporate controlling. Risk management is incorporated into business processes primarily through the company's organizational structure, its planning, reporting and communication systems, and a body of detailed management regulations and technical standards. Various committees and other bodies discuss and monitor opportunities and risks.

At LANXESS, the business units each conduct their own operations, for which they have global profit responsibility. Group functions support the business units by providing financial, legal, technical and other centralized services. Complementing this global alignment of the business units and group functions, the country organizations ensure the required proximity to markets and the necessary organizational infrastructure.

In line with this division of duties, LANXESS has assigned responsibility, i.e. defined the risk owners, for the following:

- risk identification and analysis,
- risk prevention (measures taken to avoid, minimize or diversify risk),
- risk monitoring and
- risk mitigation (measures to minimize damage upon occurrence of a risk event).

Risk transfer transactions (hedging transactions or insurance) are entered into and managed centrally at LANXESS via the Treasury group function.

In connection with the decentralized organization of its risk management, LANXESS has established a central risk database to which the risk owners contribute structured data about identified risks. To this end, standardized risk categories have been defined for the Group along with parameters for probabilities of occurrence and damage levels. The central risk database therefore provides an overview of LANXESS's risk landscape as typical for the industry. The Management Board receives a regular report on any material changes to this risk database from the head of the Internal Auditing group function. There is also provision for immediate internal reporting on specific risk issues such as significant corporate compliance violations. In 2006 there was no cause for immediate reporting of this kind on significant risks at LANXESS. In addition to the standard risk reporting system required by the German Law on Corporate Control and Transparency, LANXESS has a hierarchical reporting system for appraising potential opportunities and risks and making them known to the Management Board.

To supplement the central risk database, corporate planning is another core element of opportunity and risk management at LANXESS. During the planning process, information about developments expected in the future is collected and mapped across the Group. Forecasts are prepared and those risks and opportunities considered relatively likely to materialize are presented as worst-case/best-case scenarios. Certain Management Board meetings are dedicated to discussing corporate planning and the associated opportunities and risks. Each fiscal year, the annual plan is adjusted and monitored by regularly recording current expectations. Significant and strategic opportunities and risks are systematically analyzed and evaluated by the Corporate Development group function with the goal of ensuring that the Group is pursuing the correct long-term strategy.

LANXESS's risk management principles are laid down in a Group directive. Risk management also includes preventing illegal conduct by our employees. To this end, we obtain extensive legal advice concerning business transactions and obligate employees by means of our compliance code to observe the law and to act responsibly. A Compliance Committee promotes and monitors adherence to these compliance guidelines. Its work is supported by compliance officers who have been appointed for each country in which LANXESS has a subsidiary. The Compliance Committee reports directly and regularly to the Management Board.

Monitoring of risk management and of LANXESS's internal control system (ICS) by means of process-independent testing is part of the risk management system. Within the Group, the Internal Auditing group function is tasked with overseeing both the functionality of the internal control and monitoring system and compliance with organizational safeguards. Planning of audits (selection of audit subjects) and audit methods applied by this group function are correspondingly aligned with risks. In addition, the risk management system is evaluated by the auditor as part of the audit of the annual financial statements. In the course of exercising its duties under the articles of association, the Supervisory Board also exercises control functions, including regular monitoring of the functioning of the risk management system by its Audit Committee.

LANXESS considers the motivation of its employees to be a key factor in exploiting opportunities. For this reason, we highly value a corporate culture which fosters the search for and implementation of new possibilities. One component of this effort is providing a financial bonus for ideas submitted via the company's idea management system.

LANXESS has acknowledged that managing the company necessarily involves managing risk. Steps have been taken to ensure that potential risks or opportunities relevant to the attainment of corporate goals are fully identified and quantified at an early stage. Preventive measures and safeguards minimize the probability that risks will materialize and limit their potentially adverse effects. The management of opportunities and risks is one of LANXESS's goals and therefore constitutes an integral part of decision-making processes.

Risks of future development

Market risks LANXESS is exposed to the general economic and political opportunities and risks of the countries and regions in which its companies operate. As a chemicals enterprise, LANXESS is subject to economic risks and the risks typical of this industry sector. The volatility and cyclicality of the global chemical and polymer markets and their dependence on developments in customer industries harbor opportunities and risks with respect to LANXESS's business volume. LANXESS anticipates future growth to come from a continuing increase in demand on Asian markets, particularly in China and India. If the general business environment in this region should deteriorate due to economic or other factors, one of LANXESS's key growth drivers could be weakened or eliminated.

LANXESS's risk profile is influenced by structural changes in markets, such as the entry of new suppliers, particularly those based in emerging economies; the migration of customers to countries with lower costs; and product substitution or market consolidation trends of the kind already occurring in some sectors, particularly rubber. LANXESS counters such trends by restructuring operations to achieve a sharper focus and arrive at a product portfolio with which it can operate successfully for the long term. At the same time, LANXESS systematically manages costs.

On the procurement side, the principal risk lies in the volatility of raw material and energy prices. LANXESS mitigates this type of procurement risk by entering into long-term supply contracts for most raw materials and agreeing price escalation clauses with customers. LANXESS also hedges this risk in some cases via derivatives transactions where liquid futures markets are available for raw materials and energy. To guard against possible supply bottlenecks due to factors such as the failure of an upstream operation at a networked site, LANXESS pursues an appropriate inventory strategy and lines up alternative sources of supply.

Corporate strategy risks LANXESS plans to continue with its restructuring and its realignment toward strategic core businesses, as well as participating in industry consolidation through active portfolio management, including partnerships, divestments and acquisitions, as well as possible changes in the investment, facility and product portfolios. The success of these decisions is naturally subject to forecasting risk, associated on the one hand with predicting future market developments and on the other hand with making assumptions about the feasibility of planned measures. For example, the entry into or exit from a business segment could be based on profitability or growth expectations that prove to be unrealistic over time. LANXESS mitigates this risk by carefully and systematically processing decision-making information. During this process, the business units affected and the Management Board receive support from the Corporate Development group function and, if necessary, also from the Mergers and Acquisitions group function and possibly from external consultants. The preparatory work for investments that exceed a specified significance threshold is the responsibility of the relevant business units. After review by an Investment Committee set up for this purpose, this information is presented to the Management Board for a decision. This procedure ensures that investments are in line with our corporate strategy and satisfy our profitability and security requirements.

Financial risks Changes in the euro exchange rate, particularly against the U.S. dollar, can affect LANXESS's results. At LANXESS, payment flows in various currencies are documented, monitored and managed centrally for the entire Group. This enables LANXESS to offset the various foreign exchange effects of procurement and sales activities, and the foreign currency balances of the individual LANXESS companies, against one another. The goal is to hedge the residual amounts with derivative financial instruments. LANXESS only hedges foreign currency items that have arisen from the company's core businesses or are considered highly likely to arise. Long-term changes in currency parities can negatively or positively affect competitiveness in relation to suppliers outside the euro zone.

The risk of interest rate changes is centrally managed by the Treasury group function for the entire LANXESS Group. The majority of the company's debt was raised at fixed terms. Possible interest rate shifts in the coming years will therefore only have a limited effect on LANXESS. The Treasury group function also verifies customers' creditworthiness in close cooperation with our sales departments to minimize the default risk.

Due to our existing liquidity reserves, including a largely undrawn five-year credit line of €1.25 billion, and our financial structure, which has improved significantly since LANXESS's founding, we have not identified any liquidity risks (see "Financial Condition"). This assessment is supported by the investment-grade ratings assigned to LANXESS by external rating agencies. In the event of possible acquisitions in the future, LANXESS is willing to accept only a temporary rating downgrade to slightly below investment grade (BB+ or BB), if financing these acquisitions necessitates this. Even with such a rating, we anticipate being able to ensure sufficient liquidity.

Legal risks Companies in the LANXESS Group are parties to various litigations. The outcome of individual proceedings cannot be predicted with assurance due to the uncertainties always associated with legal disputes. To the extent necessary in light of the known circumstances in each case, LANXESS has set up risk provisions for the event of an unfavorable outcome of such proceedings.

Taking into account existing provisions and insurance, as well as agreements reached with third parties in respect of liability risks arising from legal disputes, the company currently estimates that none of these proceedings will materially affect the future earnings of the LANXESS Group.

In our reporting in previous years, we referred to heightened risks relating to certain antitrust proceedings brought against Bayer AG by regulatory authorities or civil courts in the United States, Canada and Europe with respect to businesses that were transferred to LANXESS AG or its subsidiaries. LANXESS AG and Bayer AG agreed on specific rules with regard to proceedings associated with the spin-off of LANXESS AG from the Bayer

Group. These provided that LANXESS AG had to bear such liabilities vis-à-vis Bayer AG, limited to a maximum of €100 million. This amount has now been exhausted. Still open are possible additional liabilities of LANXESS AG in respect of defense costs and proportionate reimbursement of additional taxes that may be payable if the tax deductibility of expenses is restricted.

Production and environmental risks Although LANXESS applies high technical and safety standards to the construction, operation and maintenance of production facilities, interruptions in operations, including those due to external factors, such as natural disasters or terrorism, cannot be ruled out. These can lead to explosions, the release of materials hazardous to health, or accidents in which people, property or the environment are harmed. In addition to systematically monitoring compliance with quality standards aimed at avoiding such stoppages or accidents, LANXESS is also insured against the resulting damage to the extent usual in the industry.

Possible tightening of safety, quality and environmental regulations or standards can lead to additional costs and liability that are beyond the control of LANXESS. Particularly noteworthy in this regard is the implementation of the E.U. Regulation concerning the Registration, Evaluation, Authorisation and Restriction of Chemicals (REACH). In addition to direct costs that could arise due to additional measures necessary to comply with these standards, market structures could change to LANXESS's disadvantage as a result of a shift by suppliers and customers to regions outside Europe.

LANXESS is responsible for numerous sites and landfills in which chemicals have been produced or stored for periods that in some cases exceed 140 years. The possibility cannot be ruled out that pollution occurred during this time that has not been discovered to date. LANXESS is committed to the Responsible Care initiative and actively pursues environmental management. This includes constant monitoring and testing of the soil, groundwater and air. Sufficient provisions have been set up within the scope permitted by law for necessary containment or remediation measures in areas with identified contamination.

LANXESS's product portfolio includes substances that are classified as hazardous to health. In order to prevent possible harm to health, LANXESS systematically tests the properties of its products and draws its customers' attention to the risks associated with their use. We have also arranged for adequate product liability insurance.

Other risks In the course of the spin-off from Bayer, LANXESS acquired structures and circumstances that will in the future be subject to assessment by the tax authorities. Even if LANXESS believes that all circumstances have been reported correctly and in compliance with the law, the possibility cannot be ruled out that the tax authorities may come to a different conclusion in individual cases.

The provision of correct information at the correct time to the correct addressee is one of LANXESS's success factors. LANXESS is dependent on its integrated IT systems to manage this information. In order to ensure constant availability of its data, LANXESS maintains data back-up systems, mirrored databases, anti-virus and access restriction systems, along with other state-of-the-art security and monitoring tools.

LANXESS's activities depend on its employees. With regard to human resources risks, industrial actions in some countries resulting from disputes about the implementation of restructuring measures or in connection with negotiations concerning future collective pay agreements cannot be ruled out. We counter this risk by fostering open communication with our employees and their representatives.

In Germany, key units of the LANXESS Group are subject to an employment pact that precludes dismissals for operational reasons before December 31, 2007, and expires at the end of 2007.

Overall risk Based on an overall evaluation of risk management information, we have not identified any sufficiently likely risks or risk combinations that would jeopardize the continued existence of LANXESS.

Subsequent Events The acquisition of the 50% interest in Chrome International South Africa Ltd. (CISA) in South Africa from former joint venture partner the Dow Chemical Group took legal and economic effect on February 1, 2007. This transaction gives us sole ownership of the sodium dichromate production facility at the Newcastle site, South Africa.

Also in February 2007, the hydrazine hydrate production facility in Weifang, China, had to be shut down after operating problems. The stoppage is expected to last several months. As a result, we have declared force majeure to our customers in the Asia-Pacific region. We currently estimate that this situation will diminish EBITDA pre exceptionals by a medium single-digit million figure.

Outlook

Expected changes in business conditions

Future economic environment In 2007, we expect the global economy to continue growing well, although at a slightly slower pace than in the previous year. As in 2006, global economic growth will be driven mainly by Asia's emerging economies, particularly India and China, and by central and eastern Europe. We also anticipate that Latin America will contribute substantially to ongoing growth of the global economy. Germany's robust economic performance in 2006 led us to make a slight upward adjustment to our forecasts. Nonetheless, growth in Germany is expected to again be well below the international average.

Expected Growth in GDP	2007	2008	2009–2012
Change vs. prior year in % (projected)	Gross domestic product		
Americas	2.6	3.3	3.2
NAFTA	2.3	3.2	3.0
Latin America	4.7	4.3	4.1
EMEA	2.7	2.6	2.5
Germany	1.8	1.7	1.7
Western Europe	1.9	1.9	1.9
Central/Eastern Europe	5.2	5.1	4.6
Asia-Pacific	4.6	4.6	4.3
Japan	1.9	2.1	1.6
Greater China	8.2	7.6	7.2
India	7.7	7.6	7.1
World	**3.2**	**3.5**	**3.3**

While we believe that the prices of raw materials will remain at the prior-year level in the first quarter of 2007, a slight decrease is likely to begin in the second or third quarter. However, prices are expected to remain highly volatile, in part as a consequence of market participants' continued uncertainty about the reliability of future supplies. In the case of energy prices, we forecast an increase in the cost of steam and natural gas in Germany and North America.

LANXESS's business projections assume an average exchange rate of about US$1.30 to the euro. Significant short-term fluctuations from this projected figure will be hedged.

Future performance of the chemical industry In view of the ongoing upswing in the global economy, we believe that the chemical industry will also continue on its robust growth path in 2007. For this reason, we have not changed our growth forecast of 4% for worldwide chemical production. However, in line with the situation in the global economy, we expect the pace of growth in all regions to slow slightly compared to last year. Asia, and especially China, will still be the market with the greatest growth potential in 2007.

Expected Growth in Chemical Production	2007	2008	2009–2012
Change vs. prior year in % (projected)	Chemical production		
Americas	2.5	2.5	2.5
NAFTA	2.0	2.0	2.5
Latin America	3.5	3.5	3.0
EMEA	3.0	3.0	3.0
Germany	3.0	3.0	2.5
Western Europe	3.0	3.0	3.0
Central/Eastern Europe	5.0	6.0	5.0
Asia-Pacific	6.0	6.0	6.0
Japan	1.0	1.0	1.5
Greater China	11.0	10.0	9.0
India	8.5	8.0	7.5
World	**4.0**	**4.0**	**4.0**

* rounded to 0.5%

Future evolution of selling markets We also expect the key selling markets for LANXESS products to perform in line with the global economy in 2007. Across all industry segments, we anticipate continued growth at a slightly slower pace compared to 2006. Only the tire industry is expected to develop against this trend and post stronger growth than in 2006. We again anticipate that the electrical and electronics industries will provide strong impetus in 2007, which is reflected in the continued positive trend in Asia. In contrast, the automotive industry is expected to be a significantly weaker growth driver than we forecast in 2005, due to a slowdown in the Asian market.

Expected Evolution of Major User Industries

Change vs. prior year in % (projected)	Automotive			Construction			Electrical			Tires			Textiles, Apparel, Leather		
	2007	2008	2009 –2012	2007	2008	2009 –2012	2007	2008	2009 –2012	2007	2008	2009 –2012	2007	2008	2009 –2012
Americas	0.5	1.5	2.0	0.0	2.5	3.0	5.0	4.0	5.0	(3.0)	0.0	0.0	0.0	0.0	0.0
NAFTA	0.0	1.0	2.0	(1.0)	2.0	2.0	5.0	4.0	5.0	(5.0)	2.0	(1.0)	(1.0)	0.0	0.0
Latin America	5.5	3.5	2.5	6.0	5.5	4.5	4.5	5.0	4.5	5.0	6.5	3.5	2.0	2.0	2.0
EMEA	0.5	3.5	3.5	2.5	2.5	2.5	5.5	4.5	4.0	2.0	3.0	3.0	(1.0)	(1.0)	(1.0)
Germany	(2.0)	0.0	2.5	1.5	1.5	1.5	5.5	4.5	3.5	(1.0)	(1.0)	(1.0)	(3.0)	(3.0)	(3.0)
Western Europe	(3.0)	0.0	2.0	2.0	2.0	1.5	5.0	4.0	3.5	0.0	0.0	0.0	(2.0)	(2.0)	(2.0)
Central/Eastern Europe	11.5	10.5	3.0	7.5	5.5	4.5	6.0	7.0	7.0	3.5	4.0	3.0	0.0	1.0	2.0
Asia-Pacific	3.0	6.0	4.5	4.5	4.0	3.0	7.0	6.5	6.0	5.5	5.0	5.0	7.5	7.5	7.0
World	**1.5**	**4.0**	**3.5**	**2.5**	**3.0**	**3.0**	**6.0**	**5.0**	**5.0**	**2.5**	**3.0**	**3.5**	**3.5**	**4.0**	**4.0**

* rounded to 0.5%

Future focus of the LANXESS Group Future opportunities for the LANXESS Group derive from the economic environment and company-specific factors described below.

In the current fiscal year, global economic growth is expected to remain robust, with impetus again coming particularly from Asia (especially China and India). LANXESS is well positioned worldwide, and in recent years, we have also systematically expanded our market position in the key growth market of Asia. Our presence in the relevant markets enables us to benefit from advantageous and dynamic economic environments in the individual regions. Nevertheless, the continued growth of the Asian market means this region will remain significant to LANXESS's future business focus.

The successful transformation of the Group in recent years has enabled us to react more quickly to global market changes today and to sharpen our focus our business on market and industry trends. We are thus able to further reinforce and expand our activities and positions in various markets. We will continue to drive forward the transformation of the Group in order to further boost efficiency, expand our portfolio of leadership businesses, and improve our ability to respond more quickly to changing markets.

For that reason, we will hold steady to our course, based on our four-phase strategy (short-term measures to improve performance, targeted restructuring, portfolio management, acquisitions). Following the successful implementation of the first three phases of the strategy, we entered into the fourth phase in fall 2006 and from now on will consider focused acquisitions in the chemical industry. It is conceivable that LANXESS might acquire individual small or medium-sized chemical operations, as well as chemical companies or divisions of chemical companies that have thus far been unable to optimally develop their potential. We consider such acquisitions to be an opportunity to reinforce or supplement our portfolio and to use our expertise in transformation processes for the good of the company and its stockholders.

LANXESS will actively participate in the consolidation of the chemical industry, create additional value and further improve the long-term perspectives of the company.

Product portfolio LANXESS's presence in all key customer industries is ensured by its broad portfolio of leading, high-demand products for important growth sectors. These include halobutyl rubber for high-performance tires and Durethan® for hybrid components used to achieve weight reductions in automotive engineering. We aim to leverage the opportunities provided by the consistent optimization of our product portfolio and access new future-oriented segments with innovative developments. For example, LANXESS produces antioxidants as additives to improve the storage stability and usability of biodiesel.

The broad diversification of its product portfolio makes LANXESS independent from any one product or process. In that regard, no product or process innovations are expected in 2007 that would individually have a significant influence on the LANXESS Group's performance. Instead, opportunities in procurement, production and sales will derive from the continuous improvement of a large number of products, processes and structures. LANXESS will systematically pursue this optimization process with an eye to market requirements.

Research and development LANXESS's application-oriented research and development activities focus on improving product characteristics and maximizing customer benefits. Examples include improving the thermal stability and flow properties of plastics, developing alternatives to heavy metals in material protection products, and enhancing the biodegradability of ingredients. Product formulations will also be optimized, and new customer-oriented formulations will be developed. Another important aspect is the ongoing review of production methods to reveal any still unused potential for enhancing efficiency and cutting costs.

Roughly 85% of the research and development projects started in 2006 are scheduled to reach the market or technical implementation stages by the end of 2007.

As a contribution to our organic growth initiative, we will launch further growth-oriented research and development projects in the medium term. Additional resources will be needed for this purpose so we plan to increase research and development expenditures by approximately 10% to 15% in 2007.

Expected financial condition We keep the capital and financing structures of the Group under constant review. At present, no additional measures are planned in the aftermath of the refinancing transactions of 2006, which also safeguard the Group's liquidity for the long term. We intend to finance planned capital expenditures out of current cash flow and have sufficient lines of credit available to cover any additional need for financial resources.

We have defined 4% of sales as a sustainable and appropriate investment ratio for the Group. Capital expenditures last year were just below this level but will be slightly higher in 2007, at or just above €300 million. The Performance Rubber segment will be one focus of our spending, with additional production capacity increases planned in the Butyl Rubber business unit in 2007.

Moreover, in the Saltigo business unit of the Chemical Intermediates segment, we plan to establish a state-of-the-art multifunctional plant complex for cGMP-compliant (current Good Manufacturing Practice) production, processing and purification of APIs (active pharmaceutical ingredients) and intermediates. Capital expenditures of around €10 million will enable us to significantly increase cGMP capacities by mid-2007.

In the Engineering Plastics segment, we will invest in the Durethan® product line of the Semi-Crystalline Products business unit, mainly in Krefeld-Uerdingen, Germany, and Wuxi, China.

Expected results of operations In fall 2006, LANXESS announced new earnings targets. We aim to increase our profitability, measured by our EBITDA margin pre exceptionals, to the level of our competitors in 2009. In 2006, this was between 12% and 14%. In order to reach this goal, we also intend to improve our EBITDA pre exceptionals compared to 2006 and bring our EBITDA margin closer to the level of our competitors in 2007. To this end, we will continue to pursue our cost-efficiency initiatives and further improve our margins by optimizing pricing. Adjusted for portfolio effects, we anticipate moderate sales growth in 2007.

Between 2004 and 2006, we reduced the proportion of businesses with an EBITDA margin pre exceptionals of below 5% from approximately 40% to around 20%. We will further pursue this strategy, and our target for 2009 is not to have any businesses with an EBITDA margin pre exceptionals of below 5%.

Earnings in the Performance Rubber segment will be supported by savings from restructuring measures and higher butyl and chloroprene rubber sales volumes.

In the Engineering Plastics segment, the consolidation of all activities of the Lustran Polymers business unit at one site in each region will have a positive effect on earnings, as will cost reductions in toll manufacturing and Durethan® and Pocan® production in the Semi-Crystalline Products business unit.

Ongoing productivity enhancements and our move into fast-expanding high-quality segments in growth markets are key factors in the success of the Chemical Intermediates segment. These measures will help LANXESS remain competitive against new Asian rivals in 2007.

In the Performance Chemicals segment, our focus is also on developing our position in the Asian markets by offering high-quality products. The portfolio adjustments already implemented are expected to improve margins in this segment. However, the absolute level of EBITDA pre exceptionals will be held back by the absence of earnings contributions from the divested Textile Processing Chemicals and Paper Chemicals business units. EBITDA pre exceptionals is also likely to be impaired by the declaration of force majeure for the hydrazine hydrate plant in Weifang, China.

Summary of Group's projected performance In 2009, we aim to achieve an EBITDA margin pre exceptionals that is close to average levels for our industry. In 2006, this figure was between 12% and 14%. Against the backdrop of these goals, we expect our EBITDA margin to grow faster than the average of our competitors over the next three years. In addition to this clearly defined profitability goal for the Group as a whole, we also set profitability targets for our business operations. In 2009, all LANXESS business units are expected to achieve an EBITDA margin pre exceptionals of at least 5%.

In 2007, we anticipate the general economic environment to remain favorable for our business development and expect an increase in the Group operating result. Adjusted for portfolio changes, we forecast moderate sales growth in 2007.

We will propose our first dividend payment of €0.25 for 2006 in recognition of our stockholders' loyalty. In the medium term, if we achieve the earnings targets we have set for the current and future fiscal years, we plan to further increase the dividend paid to stockholders. However, we reserve the right to give priority to targeted capital expenditures if internal or external growth opportunities arise.