

TRANS

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FORMATION

LANXESS AG Balance Sheet

	Note	Dec. 31, 2005	Dec. 31, 2006
€ '000			
ASSETS			
Non-current assets	[8]		
Intangible assets			
Acquired concessions, industrial property rights, similar rights and assets, and licenses thereunder		29	17
Property, plant and equipment			
Furniture, fixtures and other equipment		17	10
Financial assets			
Investments in subsidiaries	[9]	738,839	738,839
Other loans		42	10
		738,927	738,876
Current assets			
Receivables and other assets			
Receivables from subsidiaries	[10]	1,193,153	1,070,906
Other assets	[11]	25,115	54,234
		1,218,268	1,125,140
Securities		0	29,996
Liquid assets		60,259	124,572
		1,278,527	1,279,708
Prepaid expenses		917	25,516
Total assets		2,018,371	2,044,100
STOCKHOLDERS' EQUITY AND LIABILITIES			
Stockholders' equity	[12]		
Capital stock		84,621	84,621
Capital reserves		804,777	804,777
Other retained earnings		0	81,897
Balance sheet profit		0	81,897
		889,398	1,053,192
Provisions			
Provisions for pensions and other post-employment benefits	[13]	6,713	9,069
Tax provisions		0	15,471
Other provisions	[14]	10,931	14,839
		17,644	39,379
Liabilities			
Liabilities to banks	[15]	155,817	46,783
Trade payables	[16]	2,470	1,654
Payables to subsidiaries	[17]	946,167	891,232
Other liabilities	[18]	6,875	11,860
		1,111,329	951,529
Total stockholders' equity and liabilities		2,018,371	2,044,100
Contingent liabilities from guarantees	[19]	535,370	527,609

LANXESS AG Income Statement

	Note	2005	2006
€ '000			
Sales	[1]	33,589	15,470
Cost of sales	[2]	(33,589)	(15,470)
Gross profit		0	0
General administration expenses		(6,232)	(20,205)
Other operating income		1,855	482
Other operating expenses		(1,916)	(198)
Operating result		(6,293)	(19,921)
Income (loss) from investments in affiliated companies – net		(118,365)	218,420
Interest income (expense) – net	[3]	2,379	14,941
Other financial income and expenses – net	[4]	(33,760)	(16,035)
Financial result		(149,746)	217,326
Income (loss) before income taxes		(156,039)	197,405
Income taxes		0	(33,034)
Other taxes		0	(577)
Net income (loss)		(156,039)	163,794
Allocation to retained earnings		0	(81,897)
Loss carried forward from previous year		(1,738)	0
Withdrawal from capital reserves		157,777	0
Balance sheet profit		0	81,897

Notes to the Annual Financial Statements of LANXESS AG, Leverkusen, for Fiscal 2006

General LANXESS AG was formed by being spun off from Bayer AG. (The spin-off was entered in the commercial register on January 28, 2005). Since then, LANXESS AG has gradually taken over from LANXESS Deutschland GmbH the function of management holding company for the LANXESS Group. Accordingly, the income statements of LANXESS AG for 2006 and 2005 are not directly comparable.

The Board of Management and Supervisory Board have issued a Declaration of Compliance with the German Corporate Governance Code pursuant to Article 161 of the German Stock Corporation Act (AktG). This declaration has been made available to the stockholders and the English version is permanently posted at www.lanxess.com, Investor Relations, Corporate Governance.

Accounting Policies The financial statements of LANXESS AG are prepared in accordance with the provisions of the German Commercial Code (HGB) and the Stock Corporation Act (AktG) applicable to large stock corporations.

To enhance clarity, certain items in the income statement and balance sheet are combined, as explained in the Notes.

The income statement is drawn up by the cost-of-sales method.

Financial income and expenses whose disclosure is not covered by a mandatory item are reflected in other financial income or expenses.

LANXESS AG has prepared consolidated financial statements for the LANXESS Group as of December 31, 2006. The recognition and valuation principles used in those statements are at variance with German GAAP in the following material respects:

- Goodwill is not amortized. Instead it is tested for impairment at least once a year if it relates to a business combination effected on or after March 31, 2004.
- Financial instruments are measured at fair value.
- Foreign currency receivables and payables are translated at the respective closing rates on the reporting date, the resulting differences being recognized in income.
- Pension provisions are computed by the projected unit credit method, taking into account future increases in remuneration and pensions.
- Provisions are only recorded for liabilities to third parties.
- Other provisions are not recorded if the probability of utilization is less than 50%.

- Deferred taxes are recognized using the balance sheet liability method, including recognition of deferred taxes on loss carryforwards where utilization of the loss carryforwards is sufficiently probable.

Recognition and Valuation Principles Intangible assets that have been acquired are recognized at cost and amortized on a straight-line basis over their estimated useful lives.

Property, plant and equipment is carried at the cost of acquisition. Assets subject to depletion are depreciated. Write-downs are made for any declines in value that go beyond the depletion reflected in depreciation and are expected to be permanent. Low-value assets are fully depreciated in the year of acquisition. Where permitted under the tax laws, depreciation is made by the declining-balance method at the highest rates possible, switching to the straight-line method as soon as this leads to higher depreciation.

Useful lives of intangible assets, property, plant and equipment:

Software licenses	3 to 4 years
Computer equipment	3 to 4 years
Furniture and fixtures	4 to 10 years

Investments in affiliated companies are recognized at cost of acquisition.

Loans receivable that are interest-free or bear low rates of interest are carried at present value; other loans receivable are carried at nominal value.

Receivables and other assets are stated at nominal value, less any necessary write-downs.

Provisions for pensions and other post-employment benefits are computed by the actuarial method set out in Article 6a of the German Income Tax Act (EStG) using the mortality tables according to K. Heubeck 2005 G and a discount rate of 6%.

Other provisions are established to cover all foreseeable risks and uncertain liabilities, based on reasonable estimates of such commitments as of the closing date.

Liabilities are stated at nominal value.

Income and expenses are accrued in the fiscal year.

Foreign currency receivables and payables are translated at the rates at which they were initially recorded or at the current year's closing rates, whichever yields the lower amounts for receivables or the higher amounts for payables. Foreign currency receivables and payables that are hedged are translated at the rates applicable on the recording dates or at the hedged rates.

Contingent liabilities arising from sureties and debt guarantees are shown at the amounts equivalent to the loans or commitments actually outstanding on the reporting date.

Notes to the Income Statement

(1) Sales Sales revenues total €15,470,000 (2005: €33,589,000) and relate entirely to services provided to LANXESS Deutschland GmbH in Germany. Effective July 1, 2006 the service agreement between LANXESS AG and LANXESS Deutschland GmbH originating from the time of the spin-off (under which essentially all indirect administration expenses were charged to LANXESS Deutschland GmbH) was altered to a system of charges based on use. This resulted in lower sales revenues.

(2) Cost of sales The cost of sales totaling €15,470,000 (2005: €33,589,000) comprises expenses related to the services provided, mainly personnel and general administration expenses.

(3) Interest income (expense) – net

Interest income (expense) – net	2005	2006
€ '000		
Other interest and similar income		
from third parties	1,136	8,710
from subsidiaries	36,617	41,233
	37,753	49,943
Interest and similar expenses		
to third parties	19,931	3,433
to subsidiaries	15,443	31,569
	35,374	35,002
Interest income (expense) – net	2,379	14,941

(4) Other financial income (expenses) – net

Other financial income (expenses) – net	2005	2006
€ '000		
Other financial expenses		
Expenses for commodity swaps	16,295	29,303
Exchange losses	152,591	157,462
Miscellaneous financial expenses	38,666	8,870
	207,552	195,635
Other financial income		
Income from commodity swaps	16,295	25,873
Exchange gains	157,175	153,234
Miscellaneous financial income	322	493
	173,792	179,600
	(33,760)	(16,035)

Miscellaneous financial expenses principally comprise the costs for a securities lending transaction and guarantee commission payments to subsidiaries. Miscellaneous financial income consists mainly of guarantee commission payments received from subsidiaries.

(5) Personnel expenses

Personnel expenses	2005	2006
€ '000		
Wages and salaries	17,012	17,531
Social expenses for pensions and other benefits	3,626	3,154
of which for pensions	[2,568]	[2,602]
	20,638	20,685

(6) Number of employees

Number of employees	Closing date	Closing date	Average
	Dec. 31, 2005	Dec. 31, 2006	
General administration	106	101	103

(7) Audit fees The following fees for the services of the auditors, PricewaterhouseCoopers Aktiengesellschaft Wirtschaftsprüfungsgesellschaft, were recorded as expenses in fiscal 2006:

Audit fees	2006
€ '000	
Financial statements auditing	333
Audit-related services and other audit work	604
	937

Notes to the Balance Sheet

(8) Non-current assets A breakdown of non-current assets and the changes in them during the year is shown in the statement of changes in non-current assets.

(9) Overview of shareholdings pursuant to Article 285 paragraph 11 German Commercial Code

Overview of shareholdings pursuant to Article 285 paragraph 11 German Commercial Code

Company Name and Place of Business	Interest %	Equity as of Dec. 31, 2006 € '000	Net income 2006 € '000
LANXESS Deutschland GmbH, Leverkusen	100.0	1,299,423	45,561*

* There is a profit and loss transfer agreement with LANXESS Deutschland GmbH, Leverkusen. The loss carryforward of €45,561,000 relating to the period before the companies were treated as a single entity for tax purposes (prior to December 31, 2004) was offset by net income in fiscal 2006.

An overview of the interests held by the LANXESS Group in other companies has been submitted to the electronic Federal Gazette. It can also be obtained directly from LANXESS AG on request.

(10) Receivables from subsidiaries

Receivables from Group companies totaling €1,070,906,000 (2005: €1,193,153,000) comprise short-term loans receivable, including accrued interest, and receivables from financial transactions.

All receivables are due within one year.

(11) Other assets Other assets of €54,234,000 (2005: €25,115,000) mainly comprise the purchase of a promissory note with a nominal value of €25,000,000, claims to value-added tax refunds for December 2006 totaling €17,600,000 (2005: €16,019,000) and option premiums paid totaling €11,142,000 (2005: €6,012,000). €6,406,000 (2005: €2,368,000) of the amount relating to option premiums relates to options with remaining terms of more than one year.

(12) Equity

Equity changed as follows in 2006:

Equity € '000	Dec. 31, 2005	Allocations to other retained earnings	Balance sheet profit	Dec. 31, 2006
Capital stock	84,621	0	0	84,621
Capital reserves	804,777	0	0	804,777
Other retained earnings	0	81,897	0	81,897
Balance sheet profit	0	0	81,897	81,897
	889,398	81,897	81,897	1,053,192

The capital stock of LANXESS AG is divided into 84,620,670 no-par bearer shares of a single class.

At the Extraordinary Stockholders' Meeting of LANXESS AG on September 15, 2004, the Management Board was authorized until August 30, 2009 to increase the company's capital stock, with the approval of the Supervisory Board, by a total of €36,517,096 in one or more installments by issuing new no-par shares against cash or non-cash contributions (authorized capital). This resolution on authorized capital was entered in the Commercial Register on February 25, 2005. Stockholders normally have to be granted subscription rights to any authorized capital issued. However, with the approval of the Supervisory Board, the Management Board is authorized to exclude subscription rights for stockholders in certain circumstances.

In accordance with Article 270 II of the German Commercial Code, 50 percent of net income for the fiscal year (= €81,897,000) was allocated to other retained earnings, leaving a balance sheet profit of €81,897,000.

(13) Provisions for pensions and other post-employment

benefits Pension provisions relate to pension obligations for present employees and commitments under early retirement programs.

(14) Other provisions The other provisions are established for vacation and overtime credits, the part-time working program for older employees, long-service anniversaries, bonuses, stock option plans (LTIP) for employees and other uncertain liabilities.

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 ChemicalsSM. The fair value of the commitments under this plan was calculated using a Monte Carlo simulation. This simulates the future returns on the stock and the reference index and determines the value of the option rights on the basis of the expected payment. A two-dimensional standard distribution of returns is assumed. The expected volatility is based on the historical volatility of LANXESS stock and the Dow Jones STOXX 600 ChemicalsSM index.

The EVP is an incentive oriented toward an increase in the economic value of LANXESS. The reference base for all three tranches is the business plan for 2005 through 2007.

Participation in the LTIP is contingent upon a personal investment in shares of LANXESS AG, which must be held for a total of five years.

(15) Liabilities to banks Liabilities to banks total €46,783,000 (2005: €155,817,000) and include €16,317,000 in short-term borrowings and €30,190,000 pertaining to a promissory note; both amounts include accrued interest.

Of these liabilities, an amount of €16,783,000 is due in 2007 and an amount of €30,000,000 is due in 2012.

(16) Trade payables All trade payables are due to third parties and mature within one year.

(17) Payables to subsidiaries Payables to subsidiaries amounting to €891,232,000 (2005: €946,167,000) mainly comprise short-term loans, including accrued interest, and receivables relating to financial transactions.

All payables are due within one year.

(18) Other liabilities

Other liabilities	Dec. 31, 2005	Dec. 31, 2006
€ '000		
Option premiums received	6,012	11,142
Tax liabilities	308	292
Liabilities for social expenses	442	415
Miscellaneous liabilities	113	11
	6,875	11,860
Amount due within one year	4,507	5,454
Residual terms of more than one but less than five years (option premiums)	2,368	6,406

(19) Contingent liabilities Under Article 133 paragraphs 1 and 3 of the German Transformation Act (UmwG), LANXESS AG is jointly and severally liable for obligations of Bayer AG incurred prior to the spin-off on January 28, 2005 if they are due within five years from the announcement of the entry of the spin-off in the Commercial Register for Bayer AG and the resulting claims against LANXESS are lodged in the correct legal form. The Spin-Off and Acquisition Agreement of September 22, 2004 specifies that LANXESS AG and Bayer AG shall each release the other party from all legally determined liability for obligations that the respective other party assumed as principal debtor under that Agreement. Further, in a master agreement concluded on the same date, LANXESS AG and Bayer AG agreed upon further arrangements on the general allocation of liability and on the allocation of specific liability of either party vis-à-vis the other party for environmental contamination, antitrust violations and product liability in the relationship between them. LANXESS AG has given the following guarantees on behalf of its subsidiaries:

Contingent liabilities	2005	2006
€ '000		
to banks	25,114	14,914
to suppliers	10,256	12,695
to holders of the bond issued by LANXESS Finance B.V.	500,000	500,000
	535,370	527,609

(20) Other financial commitments Bayer AG offered stock incentive programs to all employees in the years 2000 to 2004. These comprised different offers for different employee groups. Participants in these programs have the opportunity to receive free Bayer AG shares over a period of up to ten years if they made an initial personal investment in the stock. The allocation of free shares to senior executives depends not only on certain retention periods, but also on internal and external performance criteria which, if achieved, would trigger corresponding financial commitments. Under the Spin-Off and Acquisition Agreement, such commitments relating to employees transferred to LANXESS AG in accordance with Article 613a paragraph 1 of the German Civil Code (BGB) were assigned to LANXESS AG.

Other Information

(21) Derivative financial instruments The notional value of financial derivatives contracts concluded with external counterparties was €2,258 million as of December 31, 2006 (2005: €1,467 million). Opposite derivatives contracts with a notional value of €1,374 million (2005: €942 million) were concluded with Group companies. The notional value of derivative financial instruments totaled €3,632 million (2005: €2,409 million) on the closing date and comprised the following:

Derivative financial instruments	Dec. 31, 2005			Dec. 31, 2006		
	Notional value*	Fair value	Carrying amount	Notional value*	Fair value	Carrying amount
€ '000						
Forward exchange contracts						
positive fair values	792,191	20,622	0	1,595,443	42,908	0
negative fair values	1,148,382	29,313	1,682	1,426,563	36,445	0
	1,940,573	(8,691)	(1,682)	3,022,006	6,463	0
Currency option contracts						
positive fair values	145,278	5,245	6,012	179,249	7,308	11,142
negative fair values	145,278	5,245	6,012	179,249	7,308	11,142
	290,556	0	0	358,498	0	0
Commodity contracts						
positive fair values	89,099	19,827	0	125,654	18,419	0
negative fair values	89,099	19,827	0	125,654	18,419	0
	178,198	0	0	251,308	0	0
	2,409,327	(8,691)	(1,682)	3,631,812	6,463	0

* The presentation of the notional values in the financial statements of LANXESS AG has been aligned to the presentation in the consolidated financial statements.

The notional value of forward exchange contracts totaling €1,096 million includes instruments with fair values of €31.5 million passed through to other Group companies (matching negative fair values at other Group companies).

The currency option and forward commodity contracts concluded with external counterparties were passed through to other Group companies as of December 31, 2006 via back-to-back transactions.

The fair values of forward contracts are derived from their trading or listed prices using the "forward method." Currency options are valued using an asset pricing model based on that of Black & Scholes. The fair values of commodity swaps are also derived from their trading or listed prices by the "forward method". If no market price is available, the value is determined using capital market pricing models.

Wherever possible, derivative financial instruments are valued in closed positions with the corresponding underlyings, so no valuation results had to be recognized. Option premiums paid and received totaled €11.1 million (2005: €6.0 million) and are recognized in other assets and miscellaneous liabilities, respectively, as accounting units at cost of acquisition. There were no derivatives with negative fair values on the reporting date (2005: €1.7 million; recognized in other provisions).

Total remuneration of the Board of Management and the Supervisory Board, advances and loans

In fiscal 2006 the members of the Management Board received remuneration totaling €6,007,000. In addition, expenses of €1,526,000 were incurred for retirement pensions for members of the Management Board.

Information in accordance with Article 285 No. 9a Sentence 4 German Commercial Code:

Stock Performance Plan		
€ '000	No. 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
Total	1,121,400	1,267,182

For further details of the remuneration of Management Board members please see the Compensation Report in the Management Report.

Compensation of the Supervisory Board in fiscal 2006				
€ '000	Fixed remuneration	Remuneration for committee membership	Attendance at meetings	Total
Total	555	128	81	764

In addition to the compensation payable for fiscal 2006, claims to compensation exist as follows:

The Annual Stockholders' Meeting in 2006 resolved to amend Article 12 of the articles of association in order to introduce a long-term incentive based on the company's performance during the standard (five-year) term of an individual's membership of the Supervisory Board. The variable compensation component is not paid every year like the fixed component, but only once at the end of the standard five-year term of office. If a Supervisory Board member serves a shorter term, the amount is pro-rated.

Whether the variable compensation is paid or not depends on the how LANXESS's stock performs in the market compared to the Dow Jones STOXX 600 ChemicalsSM benchmark index during a member's five-year term. The comparison is between the average of the stock price and the index on the 90 stock exchange trading days before the Annual Stockholders' Meeting at which the Supervisory Board members were appointed, and the average of the stock price and the index on the 90 stock exchange trading days before the Annual Stockholders' Meeting whose end marks the

end of the Supervisory Board members' terms. The variable compensation is only payable if the stock has outperformed the benchmark index. The exact amount of the variable compensation depends on the extent to which the stock price outperformed the benchmark index in the preceding five years. In the event of a difference of up to 10 percentage points, the compensation amounts to €50,000. If the difference is between 10 and 20 percentage points, €100,000 will be paid; if the difference is greater, the compensation will total €150,000.

The variable compensation is paid at the end of the regular term of the respective Supervisory Board member.

As of December 31, 2006, the total entitlement to variable compensation was valued at €2,120,000 and a provision in this amount was recorded.

There were no loans or advances to members of the Board of Management or the Supervisory Board on December 31, 2006 nor had any other financial commitments been entered into for these individuals.

Corporate Officers

Supervisory Board Members of the Supervisory Board hold or held offices as members of the supervisory board or a comparable supervising body of the corporations listed in addition to the offices held on supervisory or similar boards of subsidiaries of companies in which they hold corporate office (as of February 28, 2007):

The following gentlemen represent the company's stockholders on the Supervisory Board:

Dr. Rolf Stomberg Chairman of the Board of Directors of Management Consulting Group plc, London

Further offices:

- Member of the Supervisory Board of LANXESS Deutschland GmbH
- Member of the Supervisory Board of Deutsche BP AG, Hamburg
- Member of the Supervisory Board of Biesterfeld AG, Hamburg
- Member of the Board of Directors of Reed Elsevier plc, London, U.K.
- Member of the Supervisory Board of Reed Elsevier NV, Amsterdam, Netherlands
- Member of the Board of Directors of Smith & Nephew plc, London, U.K.
- Member of the Supervisory Board of TNT Post Group NV, Amsterdam, Netherlands
- Chairman of the Supervisory Board of Francotyp-Postalia Holding AG, Birkenwerder
- Chairman of the Board of Directors of Management Consulting Group plc, London, U.K.
- Member of the Board of Directors of JSC Severstal, Russia

Dr. Friedrich Janssen Member of the Executive Board of E.ON Ruhrgas AG, Essen

Further offices:

- Member of the Supervisory Board of LANXESS Deutschland GmbH
- Member of the Supervisory Board of Gerling Versicherungs-Beteiligungs AG, Cologne
- Member of the Supervisory Board of HDI Rechtsschutz Versicherung AG, Hanover
- Member of the Supervisory Board of STEAG AG, Essen (term ended December 31, 2006)
- Member of the Supervisory Boards of various subsidiaries of E.ON Ruhrgas AG, Essen
- Member of the Advisory Board of HDI Haftpflichtverband des Deutschen Industrie Versicherungsverein auf Gegenseitigkeit, Hanover
- Member of the Supervisory Board of National-Bank AG, Essen

Rainer Laufs Self-employed consultant

Further offices:

- Member of the Supervisory Board of LANXESS Deutschland GmbH
- Chairman of the Supervisory Board of WCM Beteiligungs- und Grundbesitz AG, Frankfurt am Main
- Chairman of the Supervisory Board of Klöckner Werke AG, Duisburg
- Member of the Supervisory Board of KHS Maschinen- und Anlagenbau AG, Dortmund
- Vice Chairman of the Supervisory Board of Petrotec AG, Duesseldorf

Dr. Jürgen F. Kammer Former chairman of the Supervisory Board of Süd-Chemie AG, Munich

Further offices:

- Member of the Supervisory Board of LANXESS Deutschland GmbH
- Member of the Supervisory Board of Villeroy & Boch AG, Mettlach
- Member of the Supervisory Board of Augustinum Gemeinnützige GmbH, Munich
- Member of the Administrative Board of Wittelsbacher Ausgleichsfonds, Munich

Robert J. Koehler Chairman of the Management Board of SGL Carbon AG, Wiesbaden

Further offices:

- Member of the Supervisory Board of LANXESS Deutschland GmbH
- Chairman of the Supervisory Board of Benteler AG, Paderborn
- Member of the Supervisory Board of Pfeiderer AG, Neumarkt
- Member of the Supervisory Board of AXA Versicherung AG, Cologne
- Member of the Supervisory Board of Heidelberger Druckmaschinen AG, Heidelberg
- Member of the Supervisory Board of Demag Cranes AG, Wetter/Ruhr

Lutz Lingnau Business administrator

Further offices:

- Member of the Supervisory Board of LANXESS Deutschland GmbH
- Member of the Board of Directors of Sirna Therapeutics Inc., San Francisco, U.S.A. (term ended December 31, 2006)

Dr. Ulrich Middelmann Vice Chairman of the Executive Board of ThyssenKrupp AG, Duisburg and Essen

Further offices:

- Member of the Supervisory Board of LANXESS Deutschland GmbH
- Member of the Supervisory Board of RAG AG, Essen
- Member of the Supervisory Board of RAG Beteiligungs-AG, Essen
- Member of the Supervisory Board of Commerzbank AG, Frankfurt am Main
- Chairman of the Advisory Board of Hoberg & Driesch GmbH, Duesseldorf
- Member of the Supervisory Board of E.ON Ruhrgas AG, Essen
- Further offices at subsidiaries of ThyssenKrupp AG, Duisburg and Essen

Dr. Sieghardt Rometsch Chairman of the Supervisory Board of HSBC Trinkaus & Burkhardt KGaA, Duesseldorf

Further offices:

- Member of the Supervisory Board of LANXESS Deutschland GmbH
- Chairman of the Supervisory Board of HSBC Trinkaus & Burkhardt AG, Duesseldorf
- Vice Chairman of the Supervisory Board of APCOA Parking AG, Stuttgart
- Member of the Supervisory Board of Duesseldorf University Hospital
- Member of the Board of HSBC Private Banking Holdings (Suisse) SA, Geneva, Switzerland
- Member of the Supervisory Board of HSBC Bank Polska S.A., Warsaw, Poland
- Chairman of the Advisory Board of Management Partner GmbH, Stuttgart

The following representatives of the company's employees are members of the Supervisory Board:

Ralf Deitz Vice Chairman of the Supervisory Board

Chemical production technician

Further offices:

- Member of the Supervisory Board of LANXESS Deutschland GmbH
- Member of the Supervisory Board of SALTIGO GmbH

Gisela Seidel Chemical laboratory assistant

Further offices:

- Member of the Supervisory Board of LANXESS Deutschland GmbH, Leverkusen

Wolfgang Blossey District Secretary of the German Mine, Chemical and Power Workers' Union, Cologne

Further offices:

- Member of the Supervisory Board of LANXESS Deutschland GmbH
- Member of the Supervisory Board of M-real Deutsche Holding GmbH, Bergisch-Gladbach
- Member of the Supervisory Board of INEOS Manufacturing Deutschland GmbH, Cologne
- Member of the Supervisory Board of INEOS Köln GmbH, Cologne

Werner Czaplík Chairman of the LANXESS Central Works

Council, Vice Chairman of the LANXESS Group Works

Council and Vice Chairman of the LANXESS Works Council in Leverkusen

Further offices:

- Member of the Supervisory Board of LANXESS Deutschland GmbH

Dr. Rudolf Fauss Head of the Human Resources Central

Functions; Chairman of the LANXESS Group Managerial

Employees' Committee and Chairman of the LANXESS

Managerial Employees' Committee

Further offices:

- Member of the Supervisory Board of LANXESS Deutschland GmbH, Leverkusen

Ulrich Freese Vice Chairman of the German Mine, Chemical and Power Workers' Union, Hanover

Further offices:

- Member of the Supervisory Board of LANXESS Deutschland GmbH
- Vice Chairman of the Supervisory Board of Vattenfall Europe Mining AG, Cottbus
- Vice Chairman of the Supervisory Board of Vattenfall Europe Generation AG, Cottbus
- Member of the Supervisory Board of Vattenfall Europa AG, Berlin
- Vice Chairman of the Supervisory Board of RAG Immobilien AG, Essen (term ended December 31, 2006)
- Vice Chairman of the Supervisory Board of Deutsche Montan Technologie, Essen
- Vice Chairman of the Supervisory Board of GSB – Gesellschaft zur Sicherung von Bergmannswohnungen mbH, Essen
- Vice Chairman of the Supervisory Board of GSG Wohnungsbau Braunkohle GmbH, Cologne
- Vice Chairman of the Supervisory Board of Wohnbau Westfalen GmbH, Dortmund

Rainer Hippler Chairman of the LANXESS Group Works Council and of the Works Council of Rhein Chemie Rheinau GmbH

Further offices:

- Member of the Supervisory Board of LANXESS Deutschland GmbH, Leverkusen
- Member of the Supervisory Board of Rhein Chemie Rheinau GmbH, Mannheim

Hans-Jürgen Schicker Chairman of the LANXESS Works Council in Uerdingen

Further offices:

- Member of the Supervisory Board of LANXESS Deutschland GmbH, Leverkusen

Board of Management The members of the Management Board are:

Dr. Axel C. Heitmann Chairman of the Management Board

External offices:

- Member of the Presidium of the German Chemical Industry Association (VCI)

Offices within the LANXESS Group:

- Member of the Executive Board of LANXESS Deutschland GmbH, Leverkusen
- Chairman of the Board of Directors of LANXESS Chemical (Shanghai) Co. Ltd., China

Dr. Ulrich Koemm Management Board member

External offices:

- Member of the Supervisory Board of Bayer Industry Services Geschäftsführungs-GmbH
- Member of the Advisory Board of ITT Richter Chemie-Technik GmbH
- Member of the Advisory Board of Richter Chemie-Technik GmbH
- President of the Board of the Association of the Mineral Pigments Industry (VDMI)
- Member of the Board of Cefic
- Member of the Curatorium of the Chemical Industry Fund of the Association of the German Chemical Industry (VCI)

Offices within the LANXESS Group:

- Member of the Executive Board of LANXESS Deutschland GmbH, Leverkusen
- Member of the Supervisory Board of SALTIGO GmbH, Leverkusen
- Chairman of the Board of Directors of LANXESS K.K., Japan
- Chairman of the Board of Directors of LANXESS S.A. de C.V., Mexico
- Member of the Board of Directors of LANXESS Industria de Produtos Quimicos e Plasticos Ltda., Brazil
- Chairman of the Board of Directors of LANXESS International S.A., Switzerland

Dr. Rainier van Roessel Management Board member

External offices:

None

Offices within the LANXESS Group:

- Member of the Board of Administration of LANXESS N.V., Belgium

Dr. Martin Wienkenhöver

Member of the Board of Management and Industrial Relations Director

External offices:

- Chairman of the VCI Technology and Environment Committee
- Chairman of the German Responsible Care Board in the VCI
- Member of the Board of the VCI Regional Association for North Rhine-Westphalia
- Member of the VCI Trade Policy Committee
- Member of the Business Advisory Board of the Sparkasse Leverkusen
- Member of the Advisory Board of NTS Energie and Transport GmbH

Offices within the LANXESS Group:

- Member of the Executive Board of LANXESS Deutschland GmbH, Leverkusen
- Chairman of the Supervisory Board of Rhein Chemie Rheinau GmbH, Mannheim
- Chairman of the Board of Directors of LANXESS Hong Kong Ltd., China
- Member of the Board of Directors of Chrome International South Africa (Pty.) Ltd., South Africa
- Member of the Board of Directors of Sybron Chemical Industries Nederland B.V., Netherlands
- Member of the Board of Directors of Sybron Chemicals Holdings B.V., Netherlands
- Chairman of the Board of Directors of LANXESS Holding Hispania S.L., Spain
- Chairman of the Board of Directors of LANXESS Chemicals S.L., Spain
- Chairman of the Board of Directors of LANXESS Corp., U.S.A.
- Chairman of the Board of Directors of LANXESS Pte. Ltd., Singapore
- Chairman of the Governing Board of LANXESS S.r.l., Italy
- Member of the Board of Directors of LANXESS Chemical (Shanghai) Ltd., China
- Chairman of the Board of Directors of LANXESS India Private Ltd., India
- Chairman of the Board of Directors of LANXESS Yaxing Chemical (Weifang) Co. Ltd., China

Matthias Zachert

Member of the Board of Management, Chief Financial Officer

External offices:

None

Offices within the LANXESS Group:

- Member of the Executive Board of LANXESS Deutschland GmbH, Leverkusen
- Member of the Board of Directors of LANXESS Corp., U.S.A.
- Member of the Board of Administration of LANXESS N.V., Belgium
- Chairman of the Supervisory Board of LANXESS SAS, France

Leverkusen, March 5, 2007

LANXESS Aktiengesellschaft, Leverkusen

Dr. Axel C. Heitmann

Dr. Ulrich Koemm

Dr. Rainier van Roessel

Dr. Martin Wienkenhöver

Matthias Zachert

Changes in non-current assets of LANXESS AG

€ '000	Gross carrying amounts				Amortization/depreciation and write-downs		Net carrying amounts	
	Jan. 1, 2006	Acquisitions	Retirements	Dec. 31, 2006	Accumulated Dec. 31, 2006	2006	Dec. 31, 2005	Dec. 31, 2006
Intangible assets								
Software licenses	35	0	0	35	18	12	29	17
	35	0	0	35	18	12	29	17
Property, plant and equipment								
Furniture, fixtures and other equipment	29	1	0	30	20	8	17	10
	29	1	0	30	20	8	17	10
Financial assets								
Investments in subsidiaries	738,839	0	0	738,839	0	0	738,839	738,839
Other loans	42	2	34	10	0	0	42	10
	738,881	2	34	738,849	0	0	738,881	738,849
Total non-current assets	738,945	3	34	738,914	38	20	738,927	738,876

Management Report of LANXESS AG for Fiscal 2006

General LANXESS AG serves primarily as the management holding company for the LANXESS Group. Subordinated to LANXESS AG is LANXESS Deutschland GmbH, a wholly owned subsidiary with which it has a profit-and-loss transfer agreement. LANXESS Deutschland GmbH has subsidiaries in Germany and other countries. The economic performance of LANXESS AG thus depends essentially on that of the operating companies in the LANXESS Group and on the development of the chemical industry.

It was only during the course of 2005 that LANXESS AG assumed its full and active role as the Group's management company. Its income statement for fiscal 2006 is thus not fully comparable with the income statement for the previous year.

Sales and Earnings Performance The earnings of LANXESS AG are chiefly dependent on profit or loss transfers from LANXESS Deutschland GmbH, which holds the shares of direct and indirect subsidiaries and thus bundles all productive business operations. The earnings performance of LANXESS Deutschland GmbH improved in 2006 due to the success of the restructuring undertaken in prior years, the absence of negative exceptional or one-time effects and the generally favorable business climate in the chemical industry. LANXESS AG, too, benefited from the absence of negative exceptional or one-time effects. Its results were also improved by the fact that its operations in 2006 covered the entire fiscal year.

The sales revenues of €15,470,000 reflected in the income statement (2005: €33,589,000) relate to services provided for LANXESS Deutschland GmbH. After deducting the cost of sales, which mainly comprises personnel and general administration expenses, the gross profit was at break-even point. The drop in sales revenues and the corresponding cost of sales is attributable to adjustments made to the service agreement with LANXESS Deutschland GmbH, which dates from the spin-off from Bayer AG, to align it to present conditions.

The remaining general administration expenses of €20,205,000 (2005: €6,232,000) principally comprise personnel and other business expenses not directly related to services provided by the Group. Including other operating income of €482,000 (2005: €1,855,000) and other operating expenses of €198,000 (2005: €1,916,000), the company reported an operating loss of €19,921,000 (2005: operating loss of €6,293,000).

The financial result, which comprises the balances of income and losses from investments in affiliated companies, interest income and expense, and other financial income and expenses, was positive at €217,326,000 (2005: negative at €149,746,000). This positive result was chiefly due to the profit transfer of €218,420,000 from LANXESS Deutschland GmbH (2005: loss assumption of €118,365,000). Moreover, the company recorded net interest income, mainly from intercompany financing, of €14,941,000 (2005: €2,379,000). The balance of financial income and expenses was negative at €16,035,000 (2005: negative at €33,760,000). This was principally caused by negative results of hedging operations (including the cost of hedging items for the Group and the company) amounting to €7,461,000 and other expenses for financial transactions totaling €8,870,000.

LANXESS AG thus reported a pre-tax profit of €197,405,000 (2005: pre-tax loss of €156,039,000). Utilization of tax loss carryforwards reduced income tax expense to €33,034,000, yielding net income of €163,794,000.

In accordance with Article 270 II of the German Commercial Code, 50% of net income for the fiscal year (= €81,897,000) was allocated to other retained earnings, leaving a balance sheet profit of €81,897,000.

Asset and Capital Structure In view of its function as a financial holding company, the balance sheet of LANXESS AG is dominated by financial assets and by receivables and payables to subsidiaries.

Total assets were €2,044,100,000 as of December 31, 2006. This was €25,729,000 (1.3%) higher than at year-end 2005.

Non-current assets amounted to €738,876,000, which was 36.1% of total assets. Financial assets include the interest in LANXESS Deutschland GmbH totaling €738,839,000.

Current assets accounted for €1,279,708,000 (62.6%) of total assets. Receivables from subsidiaries accounted for 52.4% of total assets and related to financial transactions and short-term loans. Liquid assets were 6.1% of total assets. LANXESS AG also has available credit lines of €1,250,000,000 under a multi-currency syndicated revolving credit facility granted by an international bank consortium.

Equity amounted to €1,053,192,000 and equity coverage of total assets to 51.5%. The increase in equity at LANXESS AG results from net income or, more specifically, the other retained earnings and balance sheet profit. Equity coverage of non-current assets was 142.5%.

On December 31, 2006 liabilities amounted to €990,908,000, which was 48.5% of total equity and liabilities. Provisions of €39,379,000, amounting to 1.9% of total equity and liabilities, are mainly for employee pensions and other commitments.

The liabilities totaling €951,529,000 account for 46.6% of total equity and liabilities. Of this amount, 2.3%, or €46,783,000, consists of liabilities to banks, including non-current liabilities of €30,000,000. Payables to subsidiaries are the main source of funding, accounting for 43.6% of total equity and liabilities or €891,232,000.

Employees During 2006 the number of employees decreased by five to a total of 101 (2005: 106). The company's average headcount in 2006 was 103 (2005: 102). Personnel expenses came to €20,685,000 (2005: €20,638,000).

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 €2,047,000 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 €2,333,000 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 ChemicalsSM. 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.

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. The pension arrangements for Dr. Ulrich Koemm provide for payment of a percentage of his annual base salary, comprised of a basic amount and incremental additions for each year of service. 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 expenses recognized in the 2006 annual financial statements for this purpose totaled €1,526 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		
	Base salary	Variable component	Total	Stock Performance Plan and Economic Value Plan	Pension expense	Annual pension benefits from date of entitlement	Capital from interest
€ '000							
Dr. Axel C. Heitmann	670	749	1,419	523	585	192	390
Dr. Ulrich Koemm	502	586	1,088	408	422	202	0
Dr. Martin Wienkehöver	437	499	936	348	121	144	260
Matthias Zachert	438	499	937	348	398	68	260
	2,047	2,333	4,380	1,627	1,526	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.

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 289 paragraph 4

German Commercial Code Pursuant to Article 289 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 take-over bid. These are also outlined in detail in the Compensation Report in this Management Report.

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 organization and appropriate reporting systems that ensure the timely provision of the information required for decision-making to the Board of Management and 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 migration (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.

Apart from 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 cyclicity 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 restructuring the Group, realign it toward strategic core businesses, and participate in industry consolidation through active portfolio management, including partnerships, divestments and acquisitions, possibly involving 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. In connection with the spin-off of LANXESS AG from the Bayer Group, LANXESS AG and Bayer AG agreed on specific rules with regard to these proceedings. These rules provided that LANXESS AG had to bear part of 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 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.

Outlook In 2007, we anticipate the general economic environment to remain favorable for our business development and expect an increase in the Group operating result.

In fall 2006 we announced new earnings targets. 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%. 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 changes, we forecast moderate sales growth in 2007.

In performing its tasks as a management holding company, LANXESS AG expects to incur about the same level of costs as in 2006. Moreover, the earnings position of LANXESS AG will be dominated by the financial result (interest income/expense, income/loss from investments in affiliated companies and other financial income/expenses). If profitability in the Group continues to improve as expected, higher dividend payments by Group companies should enable LANXESS AG to report a further improvement in pre-tax income for the year.

We are proposing 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.

Subsequent events No events of material significance have occurred since the end of the 2006 fiscal year.

Auditor's Report

We have audited the annual financial statements, comprising the balance sheet, the income statement and the notes to the financial statements, together with the bookkeeping system, and the management report of LANXESS Aktiengesellschaft, Leverkusen, for the business year from January 1 to December 31, 2006. The maintenance of the books and records and the preparation of the annual financial statements and management report in accordance with German commercial law and supplementary provisions in the articles of incorporation are the responsibility of the Company's Board of Managing Directors. Our responsibility is to express an opinion on the annual financial statements, together with the bookkeeping system, and the management report based on our audit.

We conducted our audit of the annual financial statements in accordance with Article 317 HGB ("Handelsgesetzbuch": German Commercial Code) and German generally accepted standards for the audit of financial statements promulgated by the Institut der Wirtschaftsprüfer (Institute of Public Auditors in Germany – IDW). Those standards require that we plan and perform the audit such that misstatements materially affecting the presentation of the net assets, financial position and results of operations in the annual financial statements in accordance with German principles of proper accounting and in the management report are detected with reasonable assurance. Knowledge of the business activities and the economic and legal environment of the Company and expectations as to possible misstatements are taken into account in the determination of audit procedures. The effectiveness of the accounting-related internal control system and the evidence supporting the disclosures in the books and records, the annual financial statements and the

management report are examined primarily on a test basis within the framework of the audit. The audit includes assessing the accounting principles used and significant estimates made by the Company's Board of Managing Directors, as well as evaluating the overall presentation of the annual financial statements and management report. We believe that our audit provides a reasonable basis for our opinion.

Our audit has not led to any reservations.

In our opinion based on the findings of our audit, the annual financial statements comply with the legal requirements and supplementary provisions in the articles of incorporation and give a true and fair view of the net assets, financial position and results of operations of the Company in accordance with German principles of proper accounting. The management report is consistent with the annual financial statements and as a whole provides a suitable view of the Company's position and suitably presents the opportunities and risks of future development.

Cologne, March 6, 2007

PricewaterhouseCoopers
Aktiengesellschaft
Wirtschaftsprüfungsgesellschaft

(P. Albrecht)
German Public Auditor

(J. Sechser)
German Public Auditor

Contact

Please do not hesitate to contact us if you have any questions or comments.

Contact Corporate Communications
Christoph Sieder
Head of Corporate Communications
Tel. +49 – 214 30 33333
E-mail: mediarelations@lanxess.com

Contact Investor Relations
Michael Pontzen
Head of Investor Relations
Tel. +49 – 214 30 33333
E-mail: ir@lanxess.com

Masthead

LANXESS AG
51369 Leverkusen
Germany
Tel. +49 – 214 30 33333
www.lanxess.com

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Kirchhoff Consult AG, Hamburg,
Germany

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Claudia Kempf, Wuppertal,
Germany

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PUBLISHER

LANXESS AG

51369 Leverkusen

Germany

Tel. +49 (0) 214 30 33333

www.lanxess.com



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