

**LANXESS AG** FINANCIAL STATEMENTS 2007

VALUE CREATION

**LANXESS**  
ergizim • C • mistry

# CONTENTS

## FINANCIAL STATEMENTS 2007, LANXESS AG

- 1 Balance Sheet**
- 2 Income Statement**
  
- 3 Notes**
  - 3 General
  - 3 Accounting Policies
  - 3 Recognition and Valuation Principles
  - 4 Notes to the Income Statement
  - 5 Notes to the Balance Sheet
  - 7 Other Mandatory Disclosures
  
- 12 Changes in Non-Current Assets**
  
- 13 Management Report**
  - 13 General
  - 13 Sales and Earnings Performance
  - 13 Asset and Capital Structure
  - 14 Employees
  - 14 Compensation Report
  - 16 Report Pursuant to Section 289 Paragraph 4 of the German Commercial Code
  - 18 Risk Report
  - 21 Outlook
  - 21 Events After the Balance Sheet Date
  
- 22 Responsibility Statement**
- 23 Auditor's Report**
- 24 Contact, Masthead**

# BALANCE SHEET

## LANXESS AG

€ '000	Note	Dec. 31, 2006	Dec. 31, 2007
<b>ASSETS</b>			
<b>Non-current assets</b>	[10]		
<b>Intangible assets</b>			
Acquired concessions, industrial property rights, similar rights and assets, and licenses thereunder		17	5
<b>Property, plant and equipment</b>			
Furniture, fixtures and other equipment		10	4
<b>Financial assets</b>			
Investments in subsidiaries	[11]	738,839	738,864
Other loans		10	8
		<b>738,876</b>	<b>738,881</b>
<b>Current assets</b>			
<b>Receivables and other assets</b>			
Receivables from subsidiaries	[12]	1,070,906	1,154,419
Other assets	[13]	54,234	99,676
		<b>1,125,140</b>	<b>1,254,095</b>
<b>Securities</b>		<b>29,996</b>	<b>0</b>
<b>Liquid assets</b>		<b>124,572</b>	<b>188,495</b>
		<b>1,279,708</b>	<b>1,442,590</b>
<b>Prepaid expenses</b>		<b>25,516</b>	<b>24,649</b>
<b>Total assets</b>		<b>2,044,100</b>	<b>2,206,120</b>
<b>EQUITY AND LIABILITIES</b>			
<b>Equity</b>	[14]		
Capital stock (contingent capital €42,310,000)		84,621	83,203
Capital reserves		804,777	806,195
Other retained earnings		81,897	52,755
Balance sheet profit		81,897	91,469
		<b>1,053,192</b>	<b>1,033,622</b>
<b>Provisions</b>			
Provisions for pensions and other post-employment benefits	[15]	9,069	12,530
Tax provisions		15,471	3,483
Other provisions	[16]	14,839	17,242
		<b>39,379</b>	<b>33,255</b>
<b>Liabilities</b>			
Liabilities to banks	[17]	46,783	2,223
Trade payables	[18]	1,654	1,393
Payables to subsidiaries	[19]	891,232	1,126,726
Other liabilities	[20]	11,860	8,901
		<b>951,529</b>	<b>1,139,243</b>
<b>Total equity and liabilities</b>		<b>2,044,100</b>	<b>2,206,120</b>



# NOTES TO THE FINANCIAL STATEMENTS OF LANXESS AKTIEN- GESELLSCHAFT, LEVERKUSEN

FOR FISCAL 2007

## **GENERAL**

The Board of Management and Supervisory Board have issued a Declaration of Compliance with the German Corporate Governance Code pursuant to Section 161 of the German Stock Corporation Act (AktG). This declaration has been made available to the stockholders

Foreign currency receivables and payables are translated at the rates at which they were initially recorded or at the rates applic-

**NOTES TO THE BALANCE SHEET**

● Non-current assets

A breakdown of non-current assets and the changes in them dur-

### Contingent Capital I and II

On May 31, 2007, the Annual Stockholders' Meeting of LANXESS AG twice authorized the Board of Management to issue, on one or more occasions through May 31, 2012, convertible bonds and/or warrant bonds, profit-participation rights, and/or income bonds, made out to the bearer or registered, with or without limited maturity, up to a total par value of €500,000,000 in either case, and to grant the bearers or creditors of such bonds conversion or option rights to no-par bearer shares of the company up to a total value of €21,155,167 of the capital stock. As stated in Section 4 Paragraphs 4 and 5 of the articles of association of LANXESS AG, the capital stock of LANXESS AG has been increased conditionally up to the sum of €21,155,167 in each case in connection with these authorizations (Contingent Capital I and II). Each contingent capital increase serves the purpose of granting no-par bearer shares to the holders or creditors of convertible and/or warrant bonds, profit-participation rights, and/or income bonds (or any combination of these instruments). The only difference between the two authorizations to issue convertible and/or warrant bonds, profit-participation rights, and/or income bonds (or any combination of these instruments) in connection with the creation of contingent capital is the amount of the conversion or option price. Otherwise they are identical in content. The Board of Management will utilize just one of the two authorizations. When issuing the convertible and/or warrant bonds, profit-participation rights, and/or income bonds (or any combination of these instruments), the Board of Management is authorized, subject to the approval of the Supervisory Board, to exclude the subscription right of stockholders in the following cases:

- for residual amounts resulting from the subscription ratio;
- if the issue price for the new shares is not significantly lower than the market price of the already listed shares at the time the issue price is finalized. If convertible and/or warrant bonds or mandatory convertible bonds are issued by application of Section 186 Paragraph 3 Sentence 4 of the German Stock Corporation Act, the



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



In addition to the compensation payable for fiscal 2007, claims to compensation exist as follows:

The 2006 Annual Stockholders' Meeting amended Section 12 of the Articles of Association to introduce a long-term incentive based on the standard term of an individual's membership of the Supervisory Board (five years). Unlike the fixed compensation component, this variable compensation component is not paid every year, 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 prorated.

Payment of the variable compensation depends on how LANXESS's stock performs relative to the Dow Jones STOXX 600 Chemicals<sup>SM</sup> index during a member's five-year term. The percentage changes in the stock price and the index over this period are calculated as follows: The average price of LANXESS stock and the average level of the index during the 90 trading days prior to the Annual Stockholders' Meeting at which the Supervisory Board members were elected are each compared to the respective average for the 90 trading days prior to the Annual Stockholders' Meeting at the conclusion of which the members' terms end. The variable compensation is only payable if the stock price has outperformed the index over the five-year period, and the amount of variable compensation is then based on the degree of outperformance. If LANXESS stock has outperformed the Dow Jones STOXX 600 Chemicals<sup>SM</sup> by up to 10 percentage points, the variable compensation amounts to €50,000, if it has outperformed the index by between 10 and 20 percentage points, €100,000 is paid, and if the degree of outperformance is greater than this, the variable compensation is €150,000.

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

As of December 31, 2007, the total entitlement to variable compensation (current nominal value €100,000) was valued at €1,466,000 (2006: €2,120,000; nominal value €150,000) and a provision in this amount was recorded.

Details of the compensation system for members of the Supervisory Board and the remuneration of individual members of the Supervisory Board can be found in the corporate governance section of the Annual Report of the LANXESS Group.

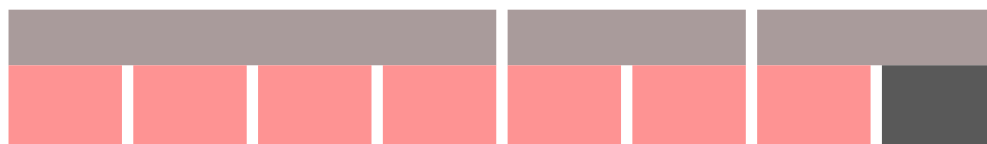


**Board of Management**

The members of the Management Board are:

--	--	--

# CHANGES IN NON-CURRENT ASSETS OF LANXESS AG



# MANAGEMENT REPORT OF LANXESS AG

FOR FISCAL 2007

## **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.

## **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 operational business activities. The earnings of LANXESS Deutschland AG developed positively thanks to the further impact of restructuring undertaken in previous years and a strong chemical economy. Earnings were held back by expenses relating to the sale of the Lustran Polymers business unit to the INEOS Group. LANXESS AG, too, recognized one-time charges in connection with the divestment of this business unit.

The sales revenues of €2,489,000 (2006: €15,470,000) reflected in the income statement relate to services provided to LANXESS Deutschland GmbH. After deducting the cost of sales, which mainly comprises personnel and general administration expenses, the

Equity amounted to €1,033,622,000 and equity coverage of total assets to 46.9%. The change in equity at LANXESS AG comprises a reduction of €21,155,000 for the dividend payment, €49,884,000 for the repurchase of shares in the company, and an increase of €51,469,000 from net income. Equity coverage of non-current assets was 139.9%.

On December 31, 2007 liabilities amounted to €1,172,498,000, which was 53.1% of total equity and liabilities.

Provisions of €33,255,000, amount



The following table provides additional information about the LTIP compensation paid.

**Long-Term Compensation of the Board of Management**



**Authorized Capital I**

Moreover, pursuant to Section 4 Paragraph 2 of LANXESS AG's articles of association, the Board of Management is authorized through August 30, 2009 to increase the company's capital stock with the approval of the Supervisory Board in one or more installments through the issue of new no-par shares against cash or non-cash contributions up to a total amount of €36,517,096. Further details, including the purpose of the authorized capital

## 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 Board of Management or other management levels. The company's risk management system is based on an integration concept, i.e. the early identification of risks is an integral part of the management system and not the object of a separately organized early warning system. The risk management system comprises many different elements that are embedded in the overall structural and process organization. Risk management is viewed as a primary duty of the heads of all business units, as well as of those people in Group companies who hold process and project responsibility. 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 and service companies 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,

-

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 efficiency of the risk management system by its Audit Committee and reviewing reports about the nature and results of the Compliance Committee's work and the work performed by the Internal Auditing group function.

LANXESS considers the motivation of its employee(s) in accordance with the applicable laws and regulations.



- 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.

Another human resources risk we face is the anticipated increase in our personnel expenses because of future wage increases. If the rate of increase is particularly high, we may not be able to raise productivity enough to compensate for the higher costs.

- Overall risk

Over time LANXESS's overall exposure to risk has proven largely stable. Changes with respect to the previous year are chiefly attributable to external factors, most notably the U.S. credit crisis and flagging U.S. economy, rising oil prices, as well as depreciation of the U.S. dollar against the euro.

The world's major rating agencies, Standard & Poor's, Moody's

# RESPONSIBILITY STATEMENT

To the best of our knowledge, and in accordance with the applicable reporting principles for financial reporting, the financial statements give a true and fair view of the assets, liabilities, financial position and profit or loss of LANXESS AG, and the management report includes a fair review of the development and performance of the business and the position of the company, together with a description of the principal opportunities and risks associated with its expected development.



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, 2007. 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.

## **Contact**

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

Contact Corporate Communications

Tel. +49 214 30 47018

Email: [mediarelations@lanxess.com](mailto:mediarelations@lanxess.com)

Contact Investor Relations

Tel. +49 214 30 23851

Email: [ir@lanxess.com](mailto:ir@lanxess.com)

## **Masthead**

LANXESS AG

51369 Leverkusen

PUBLISHER  
LANXESS AG  
51369 LEVERKUSEN  
GERMANY  
[WWW.LANXESS.COM](http://WWW.LANXESS.COM)