GROUP MANAGEMENT REPORT

Preliminary remarks about preparation of the LANXESS Combined Financial Statements The following presentation and analysis of the asset situation, financial position and profitability should be read in connection with the IFRS Combined Financial Statements of the LANXESS Group, including the explanatory notes to them that are printed elsewhere in this document. At its meeting on 22 April 2005, the Supervisory Board of LANXESS AG was in possession of the Combined Financial Statements of the LANXESS Group as per 31 December 2004 that were based on the Group financial statements of Bayer AG as well as the unqualified audit opinion issued on these Combined Financial Statements by the auditor of the Group financial statements of Bayer AG. The documents were explained by the Management Board of LANXESS AG. The Supervisory Board took notice of the Combined Financial Statements as per 31 December 2004. Technical preparation of the Combined Financial Statements on the basis of the assumptions made in the context of the spin-off process was carried out for the LANXESS Group by the Bayer AG corporate center.

The financial data that are referred to below were determined for 2003 and 2004 in the framework of the Combined Financial Statements. The assets and liabilities to be transferred to the LANXESS Group were recognized and valued in the Combined Financial Statements in accordance with the standards issued by the International Accounting Standards Board ("IASB"), London, in effect as of the closing date of the financial statements.

The Combined Financial Statements basically present LANXESS as if the Group had already existed independently within the Bayer Group in the past in its structure as specified for the spin-off. It was assumed in preparing the financial data that LANXESS AG had already acted as parent company of the Group and the legal structure below this company after the spin-off of the LANXESS Group took effect had already been in existence on 1. January 2002. The IFRS do not include any rules about the allocation of assets and liabilities in the context of the Combined Financial Statements. The relevant provisions of the agreements concluded to form the LANXESS Group are the basis for the allocation of the business operations to the LANXESS Group. The presentation of the legal entities to be transferred ("share deals") in the Combined Financial Statements is therefore based on their legal structure. The reporting structures of the Bayer Group specified for Group control purposes were the basis for the allocation of business operations ("asset deals"), taking into account the contractual arrangements between LANXESS and the Bayer Group.

The business to be transferred was specified accordingly on the basis of the structures of Bayer Group reporting and thus on the reporting units in this system. Differing allocations of individual products below the level of the reporting units are not taken into account as a result. The product allocations that differ from treatment in the Combined Financial Statements relate in particular to the Engineering Plastics segment.

For the preparation of the Combined Financial Statements, additional assumptions and estimates had to be made that had an impact on the assets and liabilities included in the balance sheets, on the income and expenditure and on the contingent liabilities. The actual figures may differ from the estimates. The Combined Financial Statements described in this presentation do not therefore necessarily reflect the asset situation, financial position and profitability that would have been the case if the LANXESS Group had already existed in the past as an independent group and the transactions between LANXESS and Bayer companies on which they were based had therefore been carried out between independent companies. To the extent that they are of material significance, the main allocation procedures in this context and the restrictions on their information value are explained in detail in the section of the notes to the Combined Financial Statements included elsewhere in this document entitled "Basis for financial statement reporting".

The Combined Financial Statements presented here are based on the consolidated reporting of the Bayer Group and differ from the discontinuing operations information included for the LANXESS Group in the Bayer Group financial statements in accordance with IAS 35 in that they have a different objective. The objective of discontinuing operations reporting is to present the business that is being discontinued as an integrated element of the Group, i.e. after consolidation of internal Group transactions, whereas the Combined Financial Statements shown here are supposed to present the relevant business in such a way that it corresponds to independent Group reporting. The point of this approach is to communicate information about the historical asset situation, financial position and profitability of the LANXESS business on the assumption that the structure of the future LANXESS Group had already existed in the past.

The fact that the LANXESS Group did not exist as an independent entity in the past limits the information value of the Combined Financial Statements for the above-mentioned reasons, however. The Combined Financial Statements do not therefore enable a reliable forecast to be made about the future development of the business operations organized in the LANXESS Group.

Forward-looking statements This presentation also includes forward-looking statements, statements which are based on plans, assumptions and estimates rather than on historical facts. The forward-looking statements in this presentation do not therefore represent any guarantee about the future development of the LANXESS Group and only apply in each case to the time when they were made. These statements involve both risks and uncertainties. A number of factors may lead to the actual financial data of the LANXESS Group deviating considerably from the statements made here. Many of these factors are associated with the economy in general or are outside the area that the Management Board of LANXESS AG can influence in other ways. Some of these factors are described in the "Risk factors" section.

Definition of EBIT and EBITDA In the following presentation, EBIT are defined as the operating result generated in the form of net result before deduction of minority interests, taxes and the financial result. EBITDA pre exceptionals is one of the other indicators that is used. EBITDA (consisting of the operating result plus depreciation of intangible assets and property, plant and equipment) pre exceptionals is an indicator that is not defined by IFRS and should not on its own be considered to be an alternative to net result, the operating result or another IFRS performance indicator. It must be taken into account that EBITDA pre exceptionals is not an indicator that is used consistently or is standardized, that calculation of it can vary considerably from company to company and that it on its own does not represent a basis for comparisons with indicators given similar names by other companies. EBITDA pre exceptionals is one of the indicators used by the LANXESS management to run its businesses and to assess the success of the business operations carried out by the LANXESS Group and its individual segments.

LANXESS business operations The LANXESS Group is a chemical company with international operations. Its portfolio includes basic, special and fine chemicals as well as polymers. The LANXESS portfolio consists to a large extent of products that have reached a relatively advanced level of market maturity. The trend towards smaller margins requires the establishment of lean structures of low complexity and the systematic optimization of plants and processes.

General conditions

Economic environment The world economy recorded growth of about 4% in 2004, which was higher than in the previous year. This encouraging performance was driven primarily by the positive developments in the USA and China. The increase in the oil price weakened global economic trends in the course of the year.

The economy in Europe developed comparatively slowly, growing by 2.2%. The economic situation has strengthened, however. The development was attributable in particular to the positive impact of demand from countries outside Europe. Economic growth in Germany was somewhat lower at 2.0%. The only stimulus came from higher exports. Domestic demand continued to be poor, on the other hand.

The economy in the USA reached growth of 4.3% in spite of the high oil price. Consumer expenditure and commercial investments boosted the economy and compensated for the lack of any support at the fiscal policy level.

An international comparison shows that Asia was the region that achieved the highest growth rates. The economy in Asia reported growth of about 5%. Administrative measures to slow down the economy and higher oil prices had practically no effect on curbing growth in China. The economic recovery in Japan continued, although the upswing flattened out somewhat.

The euro increased about 7% in value against the US dollar in 2004. It remained stable against the British pound and the Japanese yen, however.

Chemical industry Worldwide production in the chemical industry increased by 4.4% in 2004 (source: VCI). This development was driven by the growth in industrial production, primarily in the USA and Asia.

Chemical production in Western Europe only rose to a disproportionately small extent (1.5%). The increase in the value of the euro and the poor level of domestic demand had an adverse effect. The chemical industry in the USA benefitted from the economic upswing and achieved growth of about 4% for the year as a whole. Chemical production in Asia increased fast, in line with the development of the economy in general. The countries in Asia developed very differently, however: while Japan posted growth of 2%, China reported double-digit growth.

Raw material prices went up considerably in 2004. On average over the year, the Brent oil price climbed 33% to about USD 38.20 dollars per barrel.

Development of the industries supplied The car industry developed positively overall, reaching a production growth rate of 4%. The markets in North America, Western Europe and Japan registered slow growth, due in particular to the higher raw material prices. Faster growth was recorded in Asia and Eastern Europe, on the other hand. The tire industry benefitted from this too.

Production in the electrical engineering industry increased substantially. The main growth drivers here were the Asian countries. Particularly the electronics industry and information technology benefitted from the upswing to a large extent.

Business in the building industry stagnated in Western Europe and declined in Germany. Building investments in Eastern Europe, the USA and Asia increased, however.

LANXESS Group

- Sales increased by 7.3%
- EBITDA pre exceptionals up substantially by € 136 million to € 447 million
- High raw material and energy costs slowed the encouraging earnings development
- Restructuring and cost-cutting measures are producing initial success
- Spin-off from the Bayer Group successfully completed

Summary Operating result before depreciation and amortization (EBITDA) and exceptional items increased substantially by € 136 million or 43.7% to € 447 million in 2004. This was attributable not only to the favorable overall economic conditions – primarily in Asia and America – but also and in particular to better capacity utilization as well as to our efforts to cut costs and raise efficiency. The increase in earnings is especially encouraging, because rising raw material and energy costs were recovered to some extent but only after a time lag. There was in addition considerable competitive pressure in various areas of our operations due to the overcapacities that continue to exist worldwide. Smaller exceptional expenses after the extensive write-downs in the previous year and a better financial result led to a considerable improvement in net result.

Key financial data	2003	2004	Change
€ million			%
Sales	6,315	6,773	7.3
Gross profit	1,104	1,424	29.0
As a percentage of sales (%)	17.5	21.0	–
Operating result before depreciation and amortization (EBITDA) and exceptional items	311	447	43.7
As a percentage of sales (%)	4,9	6,6	–
Operating result before depreciation and amortization (EBITDA)	180	387	115.0
Operating result (EBIT) before exceptional items	–119	158	–
Operating result (EBIT)	–1,297	59	–
Financial result	–111	–79	28.8
Earnings before taxes	–1,408	–20	*
Net result	–997	–12	*
Earnings per share	–13.65	–0.16	*

* Change of more than 200%.

Sales Sales in the 2004 fiscal year increased by 7.3%, from € 6,315 million in the previous year to € 6,773 million. Growth of € 630 million or 10.0% for price and volume reasons was offset by negative currency translation effects of € 172 million or 2.7%, due mainly to changes in the US dollar exchange rate. Price increases in some areas compensated for the substantially higher raw material and energy costs to some extent.

A considerable increase in sales due primarily to volume growth was achieved in the Engineering Plastics segment. Higher sales were recorded in the Performance Rubber and Chemical Intermediates segments too, while the Performance Chemicals segment reported a small decrease in sales. In constant currency, all the segments increased their sales. The Engineering Plastics segment increased its share of consolidated LANXESS sales from 22.2% in the previous year to 25.4%. The proportion of total sales accounted for by the Performance Rubber segment decreased, on the other hand, from 21.8% in the previous year to 21.1%, while the contribution made by the Chemical Intermediates segment dropped from 22.3% to 22.0% and the share contributed by the Performance Chemicals segment went down from 30.5% to 28.2%. The miscellaneous business operations accounted for 3.3% of consolidated sales in the 2004 fiscal year after 3.2% in the previous year.

Gross profit The gross profit improved by 29.0%, from € 1,104 million in the previous year to € 1,424 million. The gross profit margin was therefore 3.5% points higher at 21.0%.

The costs of goods sold and services provided increased by 2.6%, from € 5,211 million in the previous year to € 5,349 million. The increase in the costs of goods sold and services provided due to higher volume and, in particular, higher raw material prices was compensated for to some extent by lower depreciation in connection with the impairments made at the end of 2003 and the reductions in the costs of goods sold due to exchange rate changes.

Operating result (EBIT) Selling expenses were 8.0% lower than in the previous year at € 860 million. This reduction is attributable essentially to the effects of currency translation and to the elimination of exceptional items. The selling expenses include expenses incurred in the storage, transport and sale of our products as well as for advertising, miscellaneous marketing activities, the provision of advice to customers and market research.

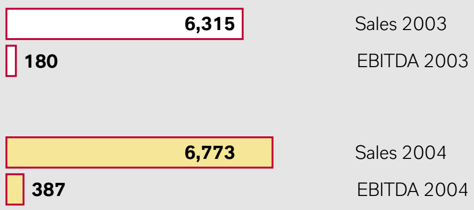
Research and development expenses were 26.8% lower than in the previous year at € 123 million. This was due, among other things, to the reductions in the research operations that had already begun at the end of 2003 – mainly at the Leverkusen location – and to the transfer of staff to other functional areas.

The increase of 10.5% in general administration expenses to € 284 million was attributable primarily to cost increases due to changes in allocation for organizational reasons, to the transfer of staff from other functional areas and to the establishment of the Group functions in the newly created LANXESS Group. The effects of currency translation made up for this to some extent.

The other operating expenses less the other operating income were € 943 million lower than in the previous year (€ 1,041 million) at € 98 million. This reduction is mainly attributable to the absence of the impairment charges of € 988 million that were included in this item in the previous year.

Sales and EBITDA

€ million



Exceptional expenses of € 99 million were incurred in 2004, all of which are included in the other operating expenses. These exceptional expenses consisted in particular of the formation of provisions for environmental protection measures (€ 40 million) and for legal disputes (€ 20 million). Goodwill impairment of € 20 million and net impairment charges of € 19 million also depressed earnings. Apart from the impairments of € 988 million, the exceptional expenses of € 1,178 million in the previous year essentially included software depreciation charges, expenses in connection with the early retirement programme implemented throughout the Group as well as site closure and other restructuring expenses.

Operating results before depreciation and amortization (EBITDA) and exceptional items improved considerably by € 136 million from € 311 million to € 447 million as a result of the higher sales, a disproportionately small increase in the costs of goods sold and services provided and a reduction in the other function costs.

Financial result The financial result improved by 28.8% from € –111 million to € –79 million, essentially because of an increase in the results from investments, a considerably better exchange rate balance and lower interest expenses. With respect to the determination of the interest expenses in the Combined Financial Statements, reference is made to the information provided in the "Basis for financial statement reporting – capital structure" section of the notes to the Combined Financial Statements as per 31 December 2004.

Result before income tax The result before taxes on income improved from a loss of € –1,408 million in the previous year to a loss of € –20 million in 2004.

Income tax Tax income in the 2004 fiscal year amounted to € 13 million, compared with tax income of € 412 million in 2003. € 56 million of the reduction in the tax income were due to taxes paid or owed, while € 343 million were accounted for by deferred taxes. The decrease in the deferred tax income was associated with the substantially better earnings, as a result of which smaller future tax reimbursement claims attributable to losses carried forward were created than in the previous year. The actual tax rate for the LANXESS Group amounted to 65.0% compared with 29.3% in the previous year. LANXESS' actual tax balance in future depends on the legal structure and tax strategies of the LANXESS Group as an independent company. Further details about income tax can be found in the explanations given in section (9) Income tax in the notes to the Combined Financial Statements for the 2004 fiscal year.

Net result After deduction of the € 5 million minority interests, LANXESS' net result in 2004 was € –12 million. The net result in the previous year amounted to a loss of € 996 million after deduction of € 1 million minority interests.

Regional development

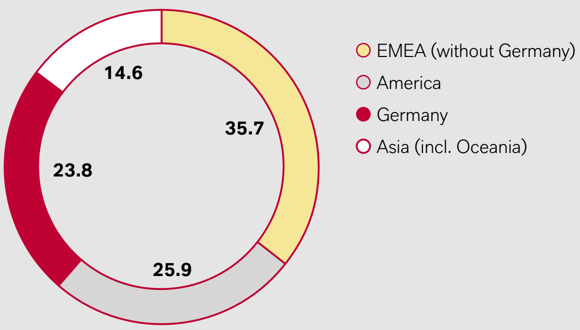
Regional sales	2003	2004	Change
€ million			%
EMEA* (without Germany)	2,149	2,419	12.6
Germany	1,697	1,610	–5.1
America	1,617	1,757	8.7
Asia (including Oceania)	852	987	15.8
	6,315	**6,773**	**7.3**

* EMEA is the abbreviation for Europe, Middle East and Africa.

LANXESS is represented on all the major chemical and polymer markets worldwide via its foreign companies and produces at 50 locations in 18 different countries, particularly Germany, Belgium, the USA, Canada and China, which to a large extent have critical mass as well as leading processes and technologies. LANXESS already has ten sales and application engineering centers in addition to eight production locations in the Asian market, which is growing particularly dynamically at the present time. All in all, almost 50% of LANXESS staff are deployed outside Germany. 76% of LANXESS sales are generated outside Germany too.

Sales by region

in %



Sales in the EMEA region were increased by 12.6% over the previous year to € 2,419 million, following the start of a recovery in the chemical economy attributable to the global economic recovery. The sales growth in Spain and the Netherlands was encouraging. Engineering Plastics was the segment that recorded the biggest sales increase in this region.

Sales in Germany were 5.1% lower than in the previous year at € 1,610 million, a development that fell substantially short of the situation in all other regions. This was attributable to some extent to the slower economic growth than in other markets. The higher sales in the Performance Rubber segment (above all in the Technical Rubber Products Business Unit) and the Performance Chemicals segment (particularly the RheinChemie Business Unit) did not make up for the lower sales in the other segments.

Sales in the American region were increased by 8.7% to € 1,757 million, in spite of the negative development of the exchange rate. In local currency terms, double-digit sales growth was achieved, with business expanding very positively in the USA, Mexico and Brazil in particular. The Engineering Plastics, Chemical Intermediates and – in Central and South America – Performance Rubber segments raised their sales significantly.

A considerable increase in sales of 15.8% to € 987 million was achieved in the Asian region, where the economic environment continued to be dynamic. This is particularly encouraging, since unfavorable exchange rate developments were experienced here too. The businesses in China, India, Korea and Singapore developed particularly positively. Performance Rubber and Engineering Plastics were the main segments that succeeded in making substantial increases in their sales on the Asian markets where LANXESS has a particularly promising future. The proportion of our total sales accounted for by Asia went up from 13.5% to 14.6%.

Financial statements of LANXESS AG Bayer AG transferred all the shares in LANXESS Deutschland GmbH and other parts of its assets to LANXESS AG in their entirety on the basis of the spin-off and takeover contract concluded on 22 September 2004 that took effect on 28 January 2005. The chemical and major proportions of the polymer operations of Bayer AG had been combined beforehand in LANXESS Deutschland GmbH directly and via subsidiaries. The transfer took economic effect on 1 July 2004. After this, the business transactions that related to those assets of Bayer AG that were being spun off were carried out as if they were for the account of LANXESS AG. In accordance with the economic approach that follows the principles of commercial law for the allocation of assets, the spun-off assets were included in the financial statements of LANXESS AG for the year that ended on 31 December 2004 which were prepared on the basis of German commercial law. Until 30 June 2004, LANXESS AG (previously: SIFRI Beteiligungs AG) was a company with no business operations of its own.

In LANXESS AG's individual financial statements prepared on the basis of commercial law, there was a net loss of € 2 million, essentially because of a negative financial result.

The asset situation at LANXESS AG with a balance sheet total of € 1,038 million is characterized by the interest in LANXESS Deutschland GmbH with a value of € 739 million that was transferred with effect from 1 July 2004 as well as by receivables from affiliated companies. On the equity and liabilities side of the balance sheet, there are essentially equity of € 835 million and the liabilities of € 200 million relating to the convertible bond that was issued in September 2004.

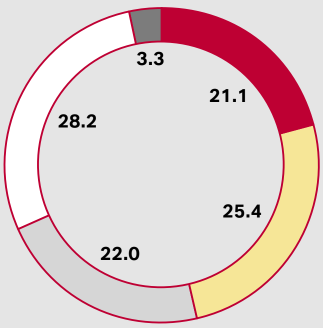
LANXESS AG is included in the Group financial statements of Bayer AG, Leverkusen, as per 31 December 2004. These Group financial statements were prepared under the provisions of § 292a of the German Commercial Code (HGB) and in accordance with the standards issued by the International Accounting Standards Board (IASB), London, in effect as of the closing date of the financial statements, and were entered in the commercial register in Cologne. From the 2005 fiscal year onwards, LANXESS AG will be preparing Group financial statements in accordance with the IASB directives.

The following information relates to the LANXESS Group.

Segment data

Sales by segments

in %



Performance Rubber	2003	2004	Change
€ million			%
Sales	1,375	1,431	4.1
Operating result before depreciation and amortization (EBITDA) and exceptional items	36	117	*
As a percentage of sales (%)	2.6	8.2	–
Operating result before depreciation and amortization (EBITDA)	4	105	*
Operating result (EBIT) before exceptional items	–55	56	–
Operating result (EBIT)	–246	44	–

* Change of more than 200%.

Sales in the Performance Rubber segment in 2004 were 4.1% higher than the sales of € 1,375 million in the previous year at € 1,431 million. Price increases because of the substantial rises in raw material and energy prices as well as volume growth because of a general recovery in demand for rubber products more than made up for negative currency translation effects. The considerable increase in sales by the Technical Rubber Products Business Unit was attributable to higher sales of the core products. Sales in the Polybutadiene Rubber and Butyl Rubber Business Units were up slightly, even though exchange rate developments were unfavorable.

Operating result before depreciation and amortization (EBITDA) and exceptional items in the Performance Rubber segment went up very substantially from € 36 million to € 117 million. The main reason for this increase apart from the better sales performance was the successful implementation of our strategy of concentration on higher-margin business operations.

The formation of provisions in connection with investigations about compliance with cartel law in the Technical Rubber Products Business Unit depressed the operating result by a total of € 12 million. In the 2003 fiscal year, the operating result included impairment charges of € 133 million and unscheduled depreciation charges (mainly for software) of € 26 million. Earnings were also depressed by expenses for legal disputes of € 9 million, restructuring expenses of € 16 million (mainly at the production site in Marl) and expenses of € 7 million for early retirement programmes.

Engineering Plastics	2003	2004	Change
€ million			%
Sales	1,401	1,722	22.9
Operating result before depreciation and amortization (EBITDA) and exceptional items	22	44	100.0
As a percentage of sales (%)	1.6	2.6	–
Operating result before depreciation and amortization (EBITDA)	–14	44	–
Operating result (EBIT) before exceptional items	–80	4	–
Operating result (EBIT)	–488	7	–

Sales in the Engineering Plastics segment were increased substantially by 22.9% to € 1,722 million. Both Styrenic Resins and Semi-Crystalline Products contributed to this improvement by expanding volume considerably and making selective price increases. Sales by the Fibers business decreased, on the other hand, in a market characterized by global excess capacities and price pressure associated with this.

Operating result before depreciation and amortization (EBITDA) and exceptional items in the Engineering Plastics segment increased from € 22 million to € 44 million in 2004, in spite of the raw material cost increases. The main reasons for this were the considerable increase in sales and the improvement in the cost structures in some areas following the restructuring measures that had been carried out. The earnings situation in the segment continues to be unsatisfactory, however, due to an extremely difficult market environment. Even after the restructuring measures carried out last year, EBITDA before exceptional items still amount to only 2.6% of sales.

The operating result was improved by the write-up of € 24 million relating to assets in the Styrenic Resins Business Unit, offset to some extent by additional impairment charges of € 21 million. Impairment charges of € 355 million in the Styrenic Resins and Fibers Business Units and unscheduled software depreciation charges of € 16 million depressed the operating result in the previous year. Costs of € 12 million for the closure of the production site in Goch, other restructuring expenses of € 18 million that related mainly to the site in Antwerp and expenses of € 7 million for early retirement programmes were also incurred in 2003.

Chemical Intermediates	2003	2004	Change
€ million			%
Sales	1,411	1,487	5.4
Operating result before depreciation and amortization (EBITDA) and exceptional items	153	178	16.3
As a percentage of sales (%)	10.8	12.0	–
Operating result before depreciation and amortization (EBITDA)	119	178	49.6
Operating result (EBIT) before exceptional items	22	87	*
Operating result (EBIT)	–344	65	–

* Change of more than 200%.

The Chemical Intermediates segment generated sales of € 1,487 million in 2004. This represented an increase of 5.4% or € 76 million over the previous year. The main reason for this was the sales growth in the Basic Chemicals Business Unit, which resulted from volume increases and price rises because of higher raw material and energy costs. Sales of Fine Chemicals were down on the previous year in spite of an improvement in the situation with agrochemicals, essentially because of the market environment with photo chemicals, which continued to be difficult.

Operating result before depreciation and amortization (EBITDA) and exceptional items in the segment increased to € 178 million in 2004 from € 153 million in 2003 because of better capacity utilization in some areas. In addition to this, the Fine Chemicals Business Unit benefitted from improved cost structures following the impairments at the end of the 2003 fiscal year.

The operating result was depressed by impairment charges of € 27 million in the Fine Chemicals Business Unit, which were reduced by write-ups of € 5 million. A review of asset values led in the previous year to impairment charges of € 332 million in the Chemical Intermediates segment, primarily in the Fine Chemicals Business Unit. Expenses of € 34 million in connection with the Group-wide early retirement programme were incurred in the previous year too.

Performance Chemicals	2003	2004	Change
€ million			%
Sales	1,925	1,910	–0.8
Operating result before depreciation and amortization (EBITDA) and exceptional items	125	123	–1.6
As a percentage of sales (%)	6.5	6.4	–
Operating result before depreciation and amortization (EBITDA)	96	75	–21.9
Operating result (EBIT) before exceptional items	24	48	100.0
Operating result (EBIT)	–176	–20	–88.6

The sales of € 1,910 million in the Performance Chemicals segment were at almost exactly the same level as in the previous year. Higher sales were generated if the currency translation effects are eliminated. Sales in the RheinChemie, Leather, Ion Exchange Resins and Material Protection Products Business Units were increased. This made up almost completely for the lower sales in the other business units.

Operating result before depreciation and amortization (EBITDA) and exceptional items in the segment of € 123 million was at the same level as in the previous year.

The operating result in 2004 was depressed by the formation of provisions for environmental protection measures of € 40 million in the Leather Business Unit at the location of the production plant for chrome tanning agents in Merebank, South Africa, the goodwill impairment in the RheinChemie Business Unit amounting to € 20 million and the formation of provisions of € 8 million in connection with investigations about compliance with cartel law in the Rubber Chemicals Business Unit. The operating result in the previous year was depressed essentially by impairment charges of € 168 million in the Paper, Rubber Chemicals and Textile Processing Chemicals Business Units. Unscheduled software depreciation charges of € 4 million, expenses of € 18 million for early retirement programmes, expenses of € 6 million for legal disputes in the Rubber Chemicals Business Unit and other restructuring expenses of € 4 million – mainly at the site in Antwerp – were incurred in the Rubber Chemicals Business Unit in the previous year too.

Asset situation and financial position

Balance sheet structure

- Balance sheet total and equity practically unchanged; equity ratio of 29.1%
- Net financial debt on 31 December 2004 at the level of € 1.1 billion planned for the spin-off date
- Increase in current assets due to expansion of the business volume

Balance sheet structure	31.12.2003		31.12.2004	
	€ million	%	€ million	%
Assets				
Fixed assets	1,690	37.3	1,671	36.5
Current assets	2,653	58.6	2,723	59.5
Deferred taxes and prepaid expenses	188	4.1	183	4.0
Equity and liabilities				
Equity (including minority interest)	1,401	30.9	1,365	29.8
Non-current liabilities	870	19.2	788	17.2
Current liabilities	2,147	47.4	2,328	50.9
Deferred taxes and deferred income	113	2.5	96	2.1
Balance sheet total	**4,531**	**100.0**	**4,577**	**100.0**

The balance sheet total was almost exactly the same as in the previous year, with an increase of € 46 million or 1.0%. An increase in cash and cash equivalents and in assets committed for the short term in current assets was offset by a small reduction in fixed assets.

The fixed assets decreased essentially because of the goodwill impairment in the RheinChemie Business Unit and the lower investments than depreciation in the intangible assets and property, plant and equipment. The financial assets were higher, on the other hand, mainly because of the addition of the interest of 40% in Bayer Industry Services GmbH & Co. OHG. Fixed assets accounted for 36.5% of the balance sheet total after 37.3% in the previous year.

Current assets were € 70 million or 2.6% higher than in the previous year. This increase was due to the higher business volume and the raw material price rises that continued throughout almost the whole of the fiscal year. Inventories accounted for 25.1% of the balance sheet total on 31 December 2004. Trade receivables, which amounted to 24.1% of the balance sheet total, were 14.8% or € 147 million higher. The loan receivables from the Bayer Group of € 256 million included in the current assets in the previous year were, on the other hand, paid back completely. Working capital, which is the balance of inventories and trade receivables less trade payables, decreased by 2.9% from € 1,512 million to € 1,468 million. An extension of the payment periods for selected products and services from the Bayer Group to the LANXESS Group with a volume of up to € 130 million that was arranged at the end of the 2004 fiscal year on a rolling basis until the third quarter of the 2006 fiscal year contributed to this.

The equity ratio was 29.1% after 30.0% in the previous year. The decrease of € 27 million or 2.0% in equity is due to the slightly negative net result and negative currency translation effects.

Net financial debt, which represents the financial liabilities less the cash and cash equivalents, reached € 1,135 million, the volume target set for the time when the spin-off took effect.

Non-current liabilities were € 82 million or 9.4% lower at € 788 million and therefore amounted to 17.2% of the balance sheet total. The provisions for pensions and similar commitments included in this figure only changed slightly, with an increase of € 10 million or 2.5% over the previous year.

Current liabilities increased by € 181 million or 8.4% to € 2,328 million. This item includes the liabilities in connection with the convertible bond issued to Bayer AG in September 2004 with a volume of € 200 million. The other current provisions increased by € 90 million or 58.8%, mainly due to higher provisions for environmental protection measures and legal cases. The increase in trade payables is attributable partly to the higher business volume and partly to larger liabilities to Bayer Industry Services GmbH & Co. OHG.

Indicators		2003	2004
Equity ratio (%)	$\frac{\text{Equity}}{\text{Balance sheet total}}$	30.0	29.1
Fixed asset ratio (%)	$\frac{\text{Fixed assets}}{\text{Balance sheet total}}$	37.3	36.5
Fixed asset cover ratio I (%)	$\frac{\text{Equity}}{\text{Fixed assets}}$	80.4	79.7
Fixed asset cover ratio II (%)	$\frac{\text{Equity and non-current liabilities}}{\text{Fixed assets}}$	131.8	126.8
Funding structure (%)	$\frac{\text{Current liabilities}}{\text{Liabilities}}$	71.2	74.7
Return on sales (%)	$\frac{\text{Operating result}}{\text{Sales}}$	–	0.9
Gross profit margin (%)	$\frac{\text{Gross profit}}{\text{Sales}}$	17.5	21.0
EBITDA margin* (%)	$\frac{\text{Operating result before depreciation and amortization*}}{\text{Sales}}$	4.9	6.6

* Pre exceptionals

Capital expenditures and acquisitions LANXESS bases its investment volume on its current cash budget. The funds are allocated to the segments according to the strategic requirements. The investments are generally financed out of the cash flow from operating activities and, if these funds are not adequate, from other cash and credit lines that are available.

Investments in property, plant and equipment and intangible assets amounted to € 279 million in 2004 following € 312 million in the previous year. This means that the investments were lower than the total depreciation charge of € 328 million. This depreciation charge included € 39 million that were posted as exceptional items. The depreciation charge of € 1,477 million made in the previous year included depreciation of € 1,047 million posted as exceptional items.

The investments focussed on replacements and maintenance, measures to increase equipment availability and projects to increase safety, improve quality and comply with environmental protection regulations. About 60% of the investment expenditure in 2004 involved investments in the maintenance of existing facilities, while the other investments were expansion and rationalization measures.

The regional breakdown shows that about 53% of the investments in 2004 were made in Germany, about 22% in the EMEA region (without Germany), about 21% in the American region and about 4% in the Asian region.

The investments of € 76 million in the Performance Rubber segment (previous year: € 78 million) were higher than the depreciation charge of € 61 million. The investments related in particular to modernization and rationalization measures at our locations in Canada and Belgium. Investments were also made in a thermal reactor for butyl rubber production at the Zwijndrecht location in Belgium as part of an HSEQ project.

Investments of € 45 million were made in the Engineering Plastics segment (previous year: € 85 million). This means that the investments were higher than the depreciation charge of € 37 million. Investments to rationalize ABS plastics production were in particular made at the locations of Tarragona in Spain and Vadodara in India.

The investments in the Chemical Intermediates segment amounted to € 89 million (previous year: € 79 million) and were therefore lower than the depreciation charge of € 113 million. Major investment expenditures related to the modernization and expansion of the preliminary operations for special isocyanate production at the Leverkusen location. As a result of this, considerable improvements can be made to the processes in future, while substantial rationalization potential can be exploited too. The facilities for manufacturing agrochemical intermediate products were also remodelled at our plant in Leverkusen, thanks to which the higher demand for these products can be satisfied. The intermediate products are being incorporated in a new generation of fungicides by one of our major customers.

The investments of € 57 million in the Performance Chemicals segment (previous year: € 63 million) were lower than the depreciation charge of € 95 million. A start was made on expanding the biocide production capacities at the Dormagen location. The project will be completed in 2005 and is to help in the expansion of the business in the fast-growing market for the cold sterilization of drinks.

Major individual projects in 2004 were:

Segment	Description
Performance Rubber	HSEQ project: thermal reactor for butyl rubber production, Zwijndrecht/Belgium
Engineering Plastics	Rationalization measures in ABS plastics production, Tarragona/Spain and Vadodara/India
Chemical Intermediates	Modernization and expansion of the preliminary operations for special isocyanates, Leverkusen/Germany
Chemical Intermediates	Remodelling of the facilities for manufacturing intermediate agrochemical products, Leverkusen/Germany
Performance Chemicals	Expansion of the biocide production capacities, Dormagen/Germany

We invested € 49 million in financial assets. This amount includes the addition of the interest of 40% in Bayer Industry Services GmbH & Co. OHG. The addition was made with economic effect from 1 July 2004 against an injection of € 48 million in cash. Bayer Industry Services GmbH & Co. OHG operates the Bayer chemical estate at the four locations in Leverkusen, Dormagen, Krefeld-Uerdingen and Brunsbüttel. It provides services for the companies at these locations. They include infrastructure services, energy procurement and supply as well as effluent and waste disposal.

Liquidity and sources of capital

Financial position

- Considerable increase in gross cash flow of 40.4% to € 313 million
- Investments lower than depreciation
- Investments in property, plant and equipment financed out of net cash flow
- Convertible bond issued with a volume of € 200 million

The cash flow statements give a breakdown of the inflows and outflows of funds according to the kind of activities involved.

Cash flow statements	2003	2004	Change
€ million			%
Gross cash flow	223	313	40.4
Change in working capital and other net current assets	123	–2	–
Cash inflow from operating activities (net cash flow)	346	311	–10.1
Cash outflow from investing activities	–300	–39	87.0
Cash outflow from financing activities	–46	–214	*
Change in cash and cash equivalents from operating activities	0	58	–
Cash and cash equivalents at the end of the period	**13**	**72**	*****

* Change of more than 200%.

The gross cash flow improved by € 90 million or 40.4% to € 313 million in spite of larger payments of taxes on income and an increase in pension provisions, essentially because of the substantial improvement in the business operations. The net cash flow in 2004 amounted to € 311 million and was therefore € 35 million or 10.1% lower than in the previous year. Working capital only increased slightly, even though business volume was higher than in the previous year and raw material prices went up. An extension of the payment periods for selected products and services from the Bayer Group to the LANXESS Group with a volume of up to € 130 million that was arranged at the end of the 2004 fiscal year on a rolling basis until the third quarter of the 2006 fiscal year contributed to this. The increase in working capital was compensated for to some extent by the reduction in the other net current assets.

The cash outflow from investing activities in 2004 was € 261 million or 87% lower than the outflow of funds in the previous year. This is mainly attributable to the fact that short-term loans of € 256 million granted to the Bayer Group in 2004 in the context of the internal Group financing system were repaid. In addition to this, expenditure on property, plant and equipment was reduced by € 33 million or 10.6% to € 279 million by maintaining strict capital discipline. There were proceeds of € 26 million from the sale of property, plant and equipment after € 65 million in the previous year. € 48 million were spent on the investment in the 40% share in Bayer Industry Services GmbH & Co. OHG.

Financing activities led to an outflow of € 214 million in 2004. This outflow of funds is the result of a net loan repayment of € 166 million as well as interest expenses of € 48 million. The net loan repayment includes the inflow of funds in connection with the convertible bond of € 200 million issued to Bayer AG in September 2004.

This means on balance that cash and cash equivalents were increased substantially by € 59 million to € 72 million on the qualifying date for the financial statements.

Presentation of funding in the combined financial statements A funding structure was calculated for the previous years on the basis of the net debt planned for the LANXESS Group at the time of the spin-off and taking the cash flow expected in 2004 into account. The net debt target was presented on the assumption that additional external loan capital was obtained by the LANXESS Group.

Interest expenses in 2003 and 2004 were based fundamentally on the market interest rates for industrial bonds in the lower investment grade range. The interest rates were computed by averaging the rates charged on a short-term instrument and on a five-year instrument. The proportion of funding required in non-euro currencies was taken into account by including a risk premium. The interest expenses for the first six months of 2004 were determined in accordance with the above-mentioned procedure. In the second six months of 2004 the interest expenses recorded by the individual Group companies in their accounts preparation were included in the Combined Financial Statements.

Funding of the LANXESS Group In the structuring of the LANXESS Group, financial debt was concentrated as far as possible and economically advisable at LANXESS AG and/ or LANXESS Deutschland GmbH. On 10 December 2004, LANXESS AG, LANXESS Deutschland GmbH and LANXESS Corporation, Pittsburgh/Pennsylvania, USA, arranged a credit line of € 1.5 billion with an international bank syndicate led by Bank of America, Citigroup Global Markets Ltd., Commerzbank Aktiengesellschaft and Deutsche Bank AG. Planned uses of these funds included the repayment of the financial liabilities to the companies in the Bayer Group transferred in the course of the establishment of the LANXESS Group after the spin-off took effect. The credit line includes a tranche of € 0.5 billion designed to be a revolving credit line with a term of 364 days that can be extended by a period of 364 days in each case on multiple occasions with the approval of the banks. The credit line also consists of two more revolving tranches with a term up to December 2009, totalling € 1.0 billion.

An asset-backed commercial paper programme with a funding range of up to € 200 million was also arranged. Financial leasing contracts relating to the LANXESS Group in existence at the time of the spin-off were transferred to the LANXESS Group companies directly or indirectly via sub-leasing contracts.

Another element of the funding of the LANXESS Group is a mandatory convertible bond payable to the bearer with a nominal value of € 200 million and a term until 15 September 2007 that was issued to Bayer AG by LANXESS AG on 15 September 2004. The conversion right exists from 20 July 2005 to 20 July 2007 with a conversion obligation at the end of the term. The convertible bond is provided with an interest deferral right and is subordinated to more senior, not subordinated receivables held by other creditors of LANXESS AG. LANXESS AG has in the meantime exercised the interest deferral right.

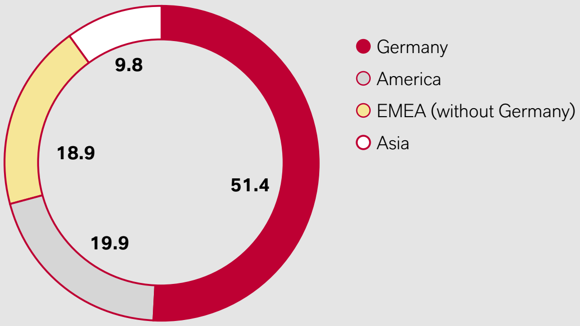
It is not out of the question that the LANXESS Group will take advantage of the favorable market conditions at the present time to issue a corporate bond with a standard market volume and a medium to long term in 2005. The inflowing funds would be used to repay bank loans and thus to lead to a further diversification of the maturity structure of the financial debt.

The net debt in the form of financial debts to the Bayer Group (including the convertible bond), bank liabilities, financial leasing less cash and cash equivalents and excluding pension provisions of the LANXESS Group amounted to € 1,135 million on 31 December 2004. In October 2004, the rating agency Standard & Poor's gave LANXESS AG a BBB– (investment grade) rating with a stable outlook.

Employees The LANXESS Group had a total of 19,659 employees on 31 December 2004. This was 764 fewer than at the end of 2003. The reduction is attributable essentially to restructuring measures.

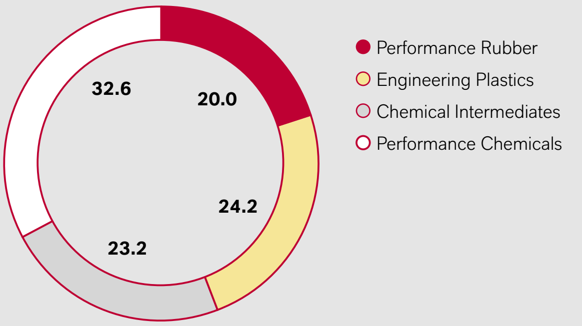
Employees by region

in %



Employees by segment

in %



Personnel expenses decreased by € 160 million to € 1,117 million in 2004. This represents 16.5% of sales.

Procurement and production

Procurement LANXESS makes sure it is supplied with all the materials and services it needs via a centrally controlled, global procurement organization. Global procurement teams liaise with the business units to combine the requirements. A global procurement network makes it possible to take effective advantage of purchasing synergies, so that LANXESS is able to operate on the market as efficiently as possible and exploit price benefits. LANXESS applies best practice processes systematically. They include the use of e-procurement tools, such as e-catalogues or electronic marketplaces (Elemica, CC-Chemplorer), which are integrated in the internal EDP systems to a large extent. About 30% of the goods and services bought in the 2004 fiscal year were procured via the Internet.

The procurement of petrochemical raw materials is of crucial importance to LANXESS. The biggest suppliers in this segment in 2004 included Shell Chemicals, Chevron Phillips, Huntsman, Exxon Mobil, Nova Chemicals and SABIC. Further major suppliers of basic inorganic and organic chemicals are BASF and Bayer. About 14% of the raw materials required by the LANXESS Group in 2004 were bought from the Bayer Group.

By far the most important petrochemical raw materials for the production operations of the LANXESS Group include 1,3 butadiene, styrene, acrylonitrile, benzene, C4 raffinate 1, cyclohexane, isobutylene and toluene. The basic chemicals ammonia, aniline, chlorine and caustic soda also play a prominent role. The ten most important raw materials accounted for a total purchasing volume of about € 1.2 billion in the 2004 fiscal year. This corresponds to about 50% of the total raw material expenses of the LANXESS Group.

The total procurement volume amounted to about € 2.6 billion in 2004.

Production LANXESS is one of the major manufacturers of chemical and polymer products in Europe. Not only very small amounts of product based on tailor-made customer syntheses but also basic, special and fine chemicals and polymers in quantities of several thousand tons can be manufactured at its production facilities.

The production operations of the Group are assigned to individual business units at the organizational level. The most important production locations are in Leverkusen, Dormagen and Uerdingen in Germany, Antwerp in Belgium, Bushy Park and Addyston in the USA, Sarnia in Canada and Wuxi in China. LANXESS also has other production locations in Argentina, Australia, Belgium, Brazil, Canada, China, France, Germany, Great Britain, India, Italy, Japan, Mexico, the Netherlands, South Africa, Spain, Thailand and the USA.

As part of the restructuring exercise that began in 2004, the polybutadiene rubber plant in Marl and the yarn finishing facility in Goch were shut down and the rubber sales location in Akron/USA was closed. The company expects shutdowns caused by this to lead to total expenses of about € 15 to 20 million. A start has also been made on transferring a facility for the production of hydracine hydrate from Baytown/Texas, USA, to China.

Research and development The aims of the research and development activities of the LANXESS Group are to continue development of the existing product range, to open up new application areas for products and to increase the quality of the products by optimizing production processes while cutting their production costs.

LANXESS had about 700 employees at its research and development units around the world on 31 December 2004 (previous year: about 900 employees).

Most of the research and development expenditure of the LANXESS Group is incurred by the Fine Chemicals, Semi-Crystalline Products and Technical Rubber Products Business Units. They accounted for 43.1% of the total research and development expenditure of the Group in 2004. The proportion in 2003 was 37.5%.

The lower research and development expenditure in the 2004 fiscal year is attributable to some extent to the restructuring of the research and development activities that started in the previous year. The central research operations were relocated and the relevant resources were allocated to the individual businesses in this context in the 2003 fiscal year.

At the organizational level, the research and development units of the LANXESS Group are assigned to the individual business units. The purpose of this is to guarantee that the development activities are based strictly on the requirements of the business units and the needs of their markets and customers. Business units with a large proportion of commodities (products in highly mature markets), such as Basic Chemicals, for example, focus on the steady improvement of their production equipment and processes (process optimization). Other business units, such as Material Protection Products, Semi-Crystalline Products or Leather, are concentrating their research and development activities to an increasing extent on the optimization of their products and the quality of them as well as on the development of new products designed to satisfy the requirements of the markets and the special demands of the customers. LANXESS plans to make its research and development activities efficient while keeping total R&D expenditure low, by means of strict concentration on the requirements of the individual business units, critical selection of projects and systematic exploitation of existing development synergies (e.g. by using application technologies that have already been developed for substances with a similar structure).

LANXESS has research and development units at several locations around the world, with focal points in Leverkusen, Dormagen, Krefeld-Uerdingen and Sarnia (Canada). Further R&D centers are in Madurai (India), Woodbridge (USA) and Ede (Netherlands).

The emphasis in the research and development activities in the Performance Rubber segment is on the Technical Rubber Products Business Unit. The research and development activities of this business unit concentrate on optimization of existing products and processes as well as on environmentally sound production processes. New products and product lines are also developed and supported until they are ready to be launched on the market. LANXESS co-operates with institutes from different universities on this. The new product line Therban® AT is the latest result of the development activities by Technical Rubber Products and was presented at the “K 2004” trade fair in October 2004.

The research and development activities of the Engineering Plastics segment focus on the identification and development of new application areas for existing products. This is particularly true of the thermoplastics Durethan® and Pocan® and the plastic-metal hybrid technology developed for these products. The research and development units also support the day-to-day business in the area of compound products in particular – e.g. by improving the processability of the products – and work on quality and efficiency optimization projects.

The R&D activities in the Chemical Intermediates segment concentrate in particular on the custom manufacturing sector of the Fine Chemicals Business Unit. As a service here, individual manufacturing processes for customer-specific intermediate products are developed and the relevant products are also manufactured. The aim of custom manufacturing is to enable the customer to focus on his own core skills and to save development time. In contrast to all the other R&D activities of the LANXESS Group, development services here therefore form an integrated part of the package sold. The main customers are pharmaceutical companies, manufacturers of pesticides and companies that market such chemical specialties as electronic chemicals, odorants or flavorings. The development activities in the custom manufacturing field are currently pooled in Leverkusen, where about 180 employees work. New technologies are also licensed from such external partners as the Massachusetts Institute of Technology, USA, or the Max Planck Institute for Coal Research in Mülheim, or are developed with external co-operation partners, such as – again – the Max Planck Institute for Coal Research, Ludwig Maximilian University in Munich and the Swiss Technical University in Zurich.

The priority in the Performance Chemicals segment is product optimization at the application engineering level. In many markets, such as textiles or leather, product life cycles are short and products are subject to rapid change – in some cases due to fashion trends. In order to be able to respond to such market changes quickly, continuous and flexible development work is necessary. For this reason, the development units in the Performance Chemicals segment operate very close to the market, sometimes in joint projects with customers.

Environment

Importance of environmental protection to LANXESS As is specified in the LANXESS HSEQ policy, our goals in all our operations are quality, environmental protection and safety. We promote awareness of the importance of environmental protection by pursuing clear objectives that we communicate to all employees and we emphasize the key role of environmental protection as a major success factor in the achievement of corporate goals. The high priority that protection of nature and the environment is given at LANXESS is demonstrated, for example, by our voluntary commitment to the principles of sustainable development and responsible care as well as by the global implementation of a standardized environmental management system that complies with the requirements of DIN EN ISO 14001.

We consider it to be a continuous assignment and a constant challenge to our environmental commitment and capabilities to minimize the input of natural resources, e.g. by making the most efficient possible use of raw materials and energy, and to identify further potential for reducing emissions and waste.

All in all, we make further improvements in environmental performance on an ongoing basis one of our central corporate goals.

Expenditure on environmental protection It is not yet possible to show the consolidated environmental expenditure of all the LANXESS companies and equity interests around the world at the present time. Our expenditure on waste disposal, water protection, noise abatement, clean air and other environmental protection measures at the LANXESS Deutschland GmbH locations amounted to 5.2% of total operating costs.

Risk report LANXESS AG is exposed to the general economic and political risks in the countries and regions in which it and its subsidiaries operate. As a company involved in the chemical industry, LANXESS is exposed to the typical risks of this industry. The spin-off from Bayer and the strategic realignment of LANXESS are sources of further risks.

On the sales side, the volatile and cyclical nature of the global chemical and polymer markets and their dependence on developments in the industries supplied represent price and volume risks for LANXESS. LANXESS expects growth in future thanks to continuing increases in demand on the Asian markets and in China particularly. If the economic situation in this region deteriorates for whatever reason, a major driver of LANXESS' growth may weaken or be eliminated completely.

Structural market changes, such as the entry of new suppliers, particularly from newly industrialized countries, the migration of customers to countries with a low cost level, product substitution or consolidation trends on sales markets of the kind that are already apparent in the rubber field in particular, have an impact on LANXESS' risk profile. LANXESS responds to these developments by restructuring, i.e. primarily by focussing and optimizing a product portfolio with which LANXESS can operate successfully in the long term as well as by applying strict cost management.

There are risks on the procurement side because of the highly volatile nature of raw material and energy prices. We counter such procurement risks by concluding long-term supply contracts for key areas of our raw material requirements and by making price adjustment arrangements with customers. We also carry out hedging via derivatives where there are liquid forward markets for the raw materials and energy sources concerned. We protect ourselves against possible supply bottlenecks, due for example to the shutdown of preliminary operations at a location with linked processes, by adopting an appropriate stocking strategy and preparing alternative sources of supply.

Changes in exchange rates, particularly between the euro and the US dollar, can affect LANXESS' earnings. Such risks are monitored and hedged throughout the LANXESS Group. This makes it possible to offset the different currency translation effects of procurement and sales activities as well as the foreign currency balances of the different individual LANXESS companies. Any remaining peaks are hedged by using derivative financial instruments. The only exposures that are hedged in this context are those relating to basic business transactions or those where the risk is very high. Long-term changes in exchange rates can have a negative or positive impact on the competitive situation by comparison with suppliers from outside Europe. Other financial management risks, such as interest rate change and credit risks, are monitored and processed centrally by our treasury department too. The credit standing of our customers is reviewed there in close liaison with our sales departments as well, in order to minimize the risk of bad debts.

Companies in the LANXESS Group are affected by various legal disputes. In view of the uncertainty that is always associated with legal disputes, the outcome of the individual cases cannot be predicted definitely. To the extent that it has been necessary on the basis of the facts known in each case, provisions have been formed to hedge the risk of an unfavorable end to such cases.

Taking into account existing provisions and insurance cover as well as agreements made with third parties about liability risks in connection with legal disputes, it is the company's view at the present time that none of the cases will have considerable influence on the future profitability of the LANXESS Group. There may, however, be higher risks with respect to certain anti-trust proceedings with authorities and civil courts in the USA, Canada and Europe, in which as far as what is now LANXESS' business is concerned Bayer AG and to some extent what are now subsidiaries of LANXESS AG are involved. In the context of the spin-off, the operations that used to belong to the Bayer AG rubber division were transferred to the LANXESS Group. In connection with various products that are or were part of these business operations, investigations are being or have been made by the cartel authorities and several private joint and individual suits are pending. LANXESS AG and Bayer AG have made special arrangements for these cases. With respect to all the liabilities in connection with proceedings that had at least been initiated before 1 June 2004, LANXESS AG bears 30% of the liabilities and Bayer AG 70% in the internal relationship with Bayer AG. LANXESS AG's reimbursement commitment is limited to a total of € 100 million, to which the reimbursement of tax damage arising from restrictions on tax deductibility and the costs of legal defense may perhaps be added.

Although LANXESS applies high technical and safety standards in the building, operation and maintenance of production facilities, breakdowns – attributable to such external influences as natural catastrophes or terrorism too – cannot be ruled out. They may lead to explosions, the escape of harmful substances or accidents, in which people are injured and property or the environment is damaged. In addition to monitoring quality standards systematically in order to avoid such breakdowns and accidents, LANXESS has insurance cover against the damage that is suffered to the extent that is normal in the industry.

The possible tightening of safety, quality and environmental regulations and standards may lead to additional costs and liability that LANXESS is unable to influence. Particular attention needs to be drawn in this connection to the planned implementation of the EC regulation about the registration, evaluation, authorization and restriction of chemical substances (REACh) as well as to the "Strategy for the Environment and Health" (SCALE) proposed by the European Commission. Apart from direct costs, that might be incurred due to additional measures to meet these standards, market structures may change to the disadvantage of LANXESS due to evasive action taken by suppliers and customers involving relocation to areas outside Europe.

LANXESS is responsible for numerous locations and landfill sites where chemical production has taken place for more than 140 years in some cases. It is not out of the question that contamination has occurred during this period which has not been discovered yet. LANXESS is committed to the concept of responsible care and carries out active environmental management. This includes the constant monitoring and testing of soil, groundwater and air. Provisions have been formed to the legally permissible extent to cover any safety or restoration measures that are necessary.

The LANXESS product portfolio includes substances that must be classified as a hazard to health. In order to prevent possible health problems, LANXESS tests the properties of its products systematically and draws the attention of its customers to the risks associated with use of them. Appropriate product liability insurance cover has been obtained too.

In the context of the spin-off from Bayer, LANXESS took over structures and situations that will be evaluated by tax authorities in future. Although LANXESS is convinced that all these situations have been presented correctly and legally, it is not out of the question that the tax authorities may come to different conclusions in individual cases.

LANXESS is planning to restructure the Group and refocus it on strategic core areas. The expenditure and investments that may under certain circumstances be incurred as a result may affect LANXESS Deutschland GmbH too and lead to reassessments of business operations and assets. Industrial action cannot be ruled out in connection with the restructuring and if negotiations about collective agreements fail.

LANXESS has recognized the importance of risk management for its corporate operations and has taken appropriate measures so that risks which potentially endanger the achievement of its corporate objectives are identified and assessed completely at an early stage. Suitable preventive and precautionary measures reduce the probability of risk materialization or limit the possible damage that may be caused. LANXESS has set itself the goal of controlling risks and has therefore integrated risk control in its decision-making processes.

Events after the end of the fiscal year Events from business activities that led to a major change in the asset situation, financial position and profitability of LANXESS have not occurred since the balance sheet date.

The spin-off of LANXESS AG from Bayer AG became legally effective when it was entered in the commercial register of Bayer AG on 28 January 2005. It was made with backdated economic effect from 1 July 2004.

Since 31 January 2005, the LANXESS AG shares have been traded officially at Frankfurt Stock Exchange in the Prime Standard segment.

Outlook We are expecting the world economy to develop positively in the 2005 fiscal year and therefore anticipate that the global chemical cycle will continue to develop well too. The encouraging market conditions are, however, being marred at present by a strong euro, further high raw material costs (for petrochemical products in particular) and excess capacity in some areas, as a result of which we have to assume that there will be intensive competition.

If the worldwide uptrend in the chemical economy continues, we expect to increase the earnings generated by our business (EBITDA/operating result before depreciation and amortization) before exceptional items in 2005. This EBITDA growth is being supported by measures to improve operating efficiency, by the restructuring of businesses that are generating inadequate profits and by active portfolio management. In our restructuring exercises, we are planning the possible combination, relocation or closure of locations as well as the initiation of measures to reduce personnel costs. The Fine Chemicals and Styrenic Resins Business Units will be the particular emphases in the restructuring activities in the current 2005 fiscal year.

The first few months of 2005 confirm the positive outlook given here, since price increases have been made successfully in different areas of the business, while order intake has continued to develop favorably too.

The Combined Financial Statements of the LANXESS Group included in this Annual Report were prepared with the aim of already providing historical financial data for the Group in the structure defined for the spin-off. A number of assumptions and estimates therefore had to be made in preparation of the Combined Financial Statements, which have an impact on the size and presentation of the assets and liabilities included in the balance sheets, the income and expenditure and the contingent liabilities. The actual figures will differ from the estimates. Differences can in particular be expected in the Group financial statements of LANXESS AG in future in the deferred tax assets following the spin-off in addition to a corresponding change in equity, because only the losses carried forward that are legally transferred to the LANXESS Group have to be included then and further differences will occur between the figures relevant for tax purposes and the figures in the Group financial statements.