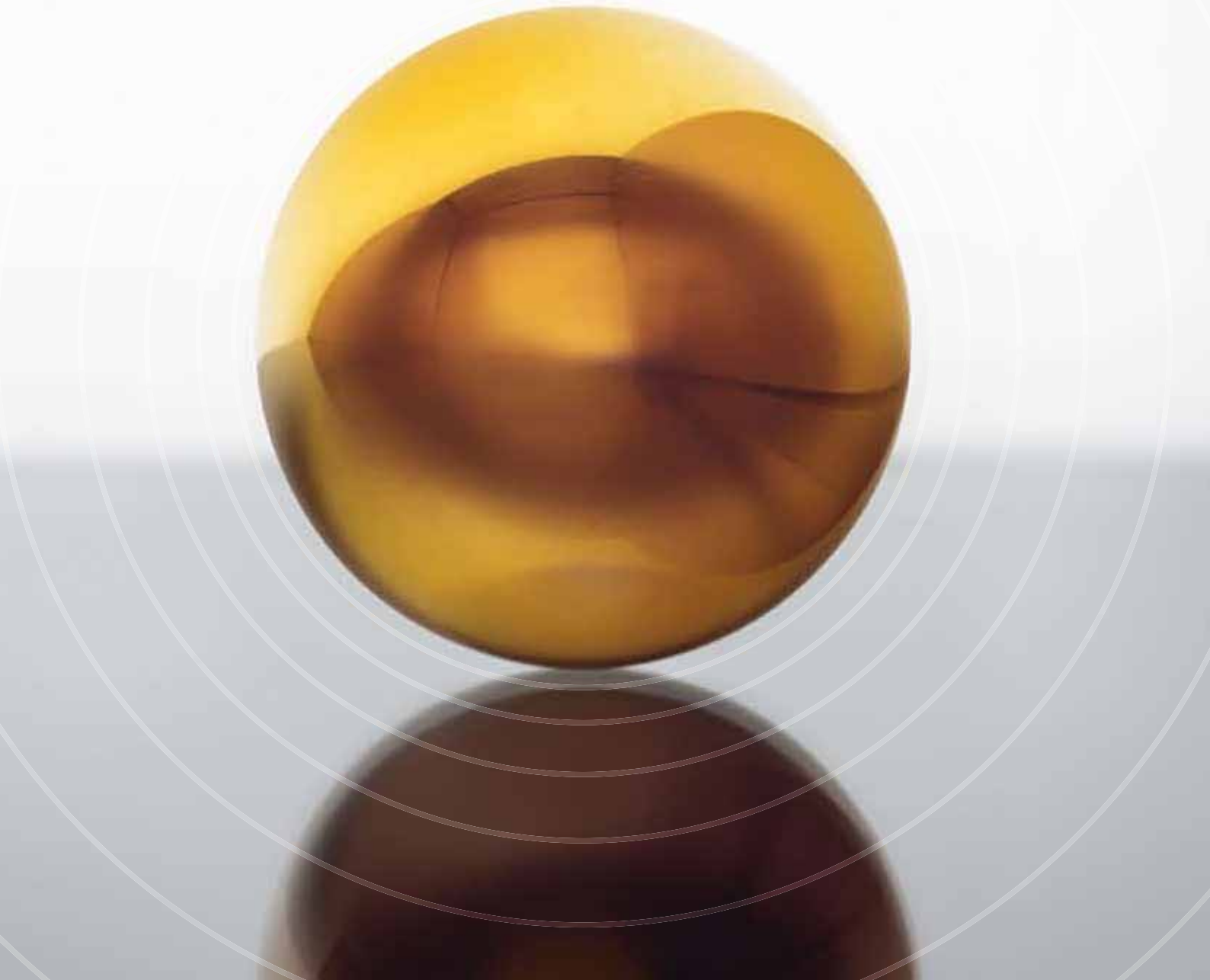
Heraeus

Annual Report 06

Sound Values – Steady Growth



At our company, sound values and sustainability go hand in hand. By upholding our responsibility to our employees, to society, and to the environment, we create the foundation for stable growth.

Our Corporate Responsibility brochure outlines our commitment and describes the areas that we consider most important. Through excellence in these areas, we foster the long-term success and continuity of our company, and promote a sustainable society.

Key Financial Indicators for the Group

	2006	2005	Change in %
Financial performance in € million			
Revenue	12,080	9,311	+29.7
Product revenue	2,690	2,111	+27.4
Precious metal trading revenue	9,390	7,200	+30.4
Earnings before interest and taxes (EBIT)	291	178	+62.9
Net income	173	105	+65.1
Financial position in € million			
Total assets	2,428	2,429	+/–0.0
Shareholders' equity	1,287	1,159	+11.0
Equity-to-assets ratio in %	53%	48%	–
Cash flow in € million			
Gross cash flow from operating activities	318	204	+55.6
Capital expenditure	84	67	+24.5
Depreciation	69	66	+4.5
Working capital [1]	1,057	950	+11.3
Employees			
Employees at year-end	11,275	10,625	+6.1
In Germany	4,381	4,399	–0.4
Outside of Germany	6,894	6,226	+10.7
Personnel expenses	503	496	+1.5

[1] Inventories plus trade receivables less trade payables.

The Company

W. C. Heraeus

A world leader in industrial precious metals and special metals. Our largest business segment processes the precious metals gold, silver, platinum, and other platinum group metals, primarily to produce industrial products for the automotive, semiconductor, electronics, and medical industries. A global network of more than 30 companies includes production facilities for all phases of precious metal production and refining. In addition, W. C. Heraeus holds a leading international position in industrial precious metal trading.

Heraeus Electro-Nite

The world market leader in sensors for the steel industry. The expert for measurements in molten iron, steel, and aluminum operates 24 market-oriented companies on all continents for the production and distribution of high-quality sensors. Heraeus Sensor Technology rounds out the product program with platinum thin film elements for temperature sensors in household appliances and for the semiconductor, electronics, and automotive industries.

Heraeus Kulzer

A globally positioned company in the fields of dentistry and dental technology products. The specialist for dental alloys and single-source provider of systems for the conservation and restoration of natural teeth has an extensive product program for dental laboratories and dentists and also produces bone cements and biomaterials for orthopedics and surgery. Heraeus Kulzer maintains a total of 20 companies in Europe, Asia, the Americas, and Australia to supply its customers around the world with innovative branded products.

Heraeus Quarzglas

The technology leader in high-purity quartz glass. With comprehensive know-how and more than 13 production facilities in Europe, Asia, and North America, this business segment produces and processes high-purity fused silica for the optical, chemical, and semiconductor industries. The product portfolio also includes synthetic silica glass for the manufacture of microchips and for optical fibers for the telecommunications industry.

Heraeus Noblelight

The technology leader in specialty lighting sources. The company develops, manufactures, and markets infrared heaters and ultraviolet lamps for applications in manufacturing, industrial process technology, environmental protection, medicine and cosmetics, research, development, and analytics.

We are a globally active precious metal and technology Group with firm roots in Germany. The company has been family-owned for more than 155 years. Our business encompasses the production and trading of high-quality materials as well as the research and application of complex materials technologies. Precious metal, sensors, dental materials, quartz glass, and specialty lighting sources are the focus of our activities. In 2006, we generated more than € 12 billion in revenues with more than 11,000 employees in over 100 subsidiaries.

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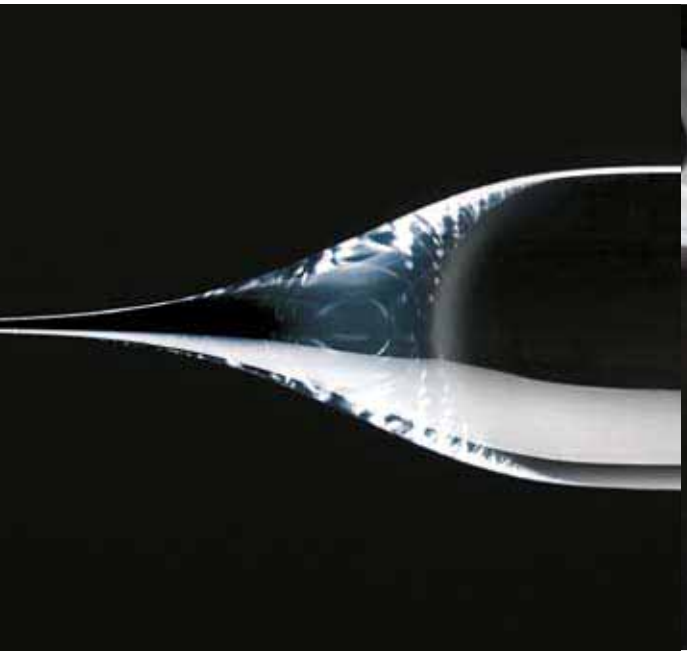


The Group

Business Segments

Consolidated Financial Statements

Ladies and Gentlemen,

2006 was an exceptional year for Heraeus. In a generally positive economic environment, we exceeded our goals. Product revenue rose by 27 % to € 2.7 billion, trading revenue by 30 % to € 9.4 billion, and the Group's total revenues by 30 % to € 12.1 billion. Earnings before interest and taxes (EBIT) increased by 63 % during 2006, reaching € 291 million. Net income improved by 65 % to € 173 million. Return on capital employed (ROCE) – the most important indicator for our value-oriented management boards – rose from 16 % to 20 %, right on the mark for our ambitious target.

These positive developments demonstrate that our corporate strategy of consistent focus on long-term profitable growth is keeping our company on the right track. Our core competence – specializing in highly profitable products for up-and-coming markets – once again boosted sales and earnings in many business segments. Our "climate protection catalyst" for the chemical fertilizer production industry – which reduces the emission of nitrous oxide, a greenhouse gas, by 90 % – brought excellent yields in fiscal year 2006. The same is true of our highly active pharmaceutical ingredients for cancer treatment, as well as the popular UV lamps used to disinfect (drinking) water. With these products, we also make an important contribution to society by helping to protect the environment and improving health. New products and processes – such as quartz glass materials for the latest generation of immersion lithography, the RIC technology developed by Heraeus for optical fiber production, and materials for the photovoltaics market – boost our customers' productivity and contribute to their success. Strong market demands and high order booking from our key customers, along with high prices for precious metals, all contributed to making 2006 a new peak year in company history.

The Heraeus workforce rose from 10,625 to 11,275, with a gain of 668 employees outside Germany and a small decrease (18 employees) domestically, for an overall increase of 6 %. In Germany, our traditionally high training ratio of 6 % enabled us to meet our own needs and once again demonstrated our commitment to fostering education for young people.

Dr. Dieter Truxius, Dr. Helmut Eschwey and Dr. Frank Heinricht (from left to right)

To strengthen our global competitiveness, we continued to pursue international growth. We built new manufacturing facilities for sensor production in Poland. We expanded our global position by acquiring the sputtering target business of Singapore-based Electronic Materials Technologies Pte. Ltd., as well as the platinum activities of the French Fremapi Group. Last but not least, we built a precious metals refining facility in South Africa, thereby supporting the fabrication of added-value products in that country. All of these projects heightened our global profile. On another front, we strengthened our marketing and service organizations; for example, we switched to direct marketing of bone cements throughout Europe, which enhances our developmental partnership with medical sector customers, namely physicians and hospitals. At the same time, we reinforced our commitment to Germany in general, where we increased our investments by about 33 % to € 42 million. In the current year, we will raise these by another 46 %.

Innovation is the key driver of our success. Accordingly, this year we continued to develop and launch new products. We kept our innovation rate in the target range of more than 20 %, increasing the number of new patents registered from 3,900 to 4,300. The Heraeus Innovation Prize, presented to in-house development teams for the fourth time, again recognized forward-thinking product design and improvements that contributed to our customers' success in the marketplace. The teams that developed the Smart Sensor (a new electromagnetic measurement system for the steel industry), a universal composite for



perfect dental fillings, and a new sputtering material that increases tenfold the capacity of magnetic data storage media introduced new products for tomorrow's markets while demonstrating the company's innovative strength.

With the decision to consolidate Heraeus Quarzglas and Heraeus Tenevo, we combined our quartz glass expertise in a single entity – a move that will enhance new product development and new technologies and be especially beneficial to our customers.

The success in 2006 means to us both commitment and incentive. To continue our growth, we must persistently work to improve structures and processes, consistently foster our company's culture of innovation in all segments, and constantly scan the horizon for growth potentials so that we can identify them early on and faster than our competitors.

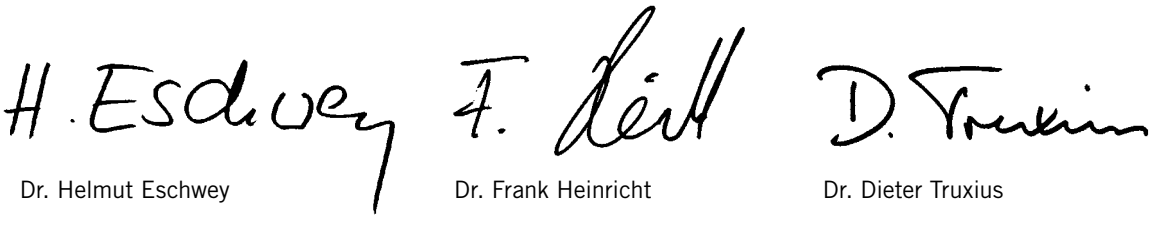
At Heraeus, sound values and sustainable growth go hand in hand. As a globally active, family-owned company with a long tradition of civic engagement and social responsibility, we have now finally defined our corporate responsibility profile – which takes its bearings from the current corporate mission statement and our core values – and set forth the key areas for exercising our social responsibility. We did this to underscore to our shareholders, our business partners, our employees, and society at large our commitment to responsible corporate behavior. By implementing a Code of Conduct to be followed by all Heraeus Group employees and divisions worldwide, we invigorate responsible behavior in our daily business activities at all levels, which in turn secures our long-term corporate success. We are convinced of the quality of our products and the performance of our

employees. These two factors alone ensure our success. We take very seriously any infringement of the Code of Conduct or improper business practices that would jeopardize our reputation. Therefore, we place great importance on open and honest communication with employees and managers about responsible behavior at Heraeus.

We are well equipped for the challenges of 2007, and ready for its opportunities – ready to consolidate the high level already achieved, ready to work for the further growth of our company. The strategic goal remains the same: long-term growth with a concentration in profitable markets, so that the name Heraeus will continue to stand for high-quality and innovative products.

Success is also a reflection of confidence. First and foremost, therefore, we wish to thank our customers for their confidence in our products and services. We also extend special thanks to our shareholders for their support of the company's goals, the Supervisory Board for its critical guidance, the employee representatives for their constructive cooperation, and all of our employees for their dedicated commitment.

The Board of Management of Heraeus Holding GmbH



Dr. Helmut Eschwey
Chairman

Dr. Frank Heinricht

Dr. Dieter Truxius

Ladies and Gentlemen, Dear Shareholders,

In 2006, the Supervisory Board performed all duties incumbent upon it by law and the articles of association, and closely monitored the performance of the Board of Management of the Company. We held two regular meetings in the reporting period, during which the Board of Management informed us of developments in individual business segments and in the Group as a whole. In addition to discussing general corporate policy with the Board of Management at these meetings, we conducted in-depth reviews of all business transactions requiring our approval to comply with statutory regulations and company bylaws. In addition, we made two decisions in February and September 2006 via written communication, at which times we approved two acquisitions in the W. C. Heraeus business segment. At our meeting on December 8, 2006, we approved the 2007 Group finance plan. On June 10, 2006, we met after the shareholders meeting to name new and reelected members of the Supervisory Board. There were no personnel changes in the Board of Management of Heraeus Holding GmbH or the managing companies. In addition to the meetings mentioned above, the Chairman of the Supervisory Board maintained regular contact with the Board of Management. He was regularly and comprehensively informed of significant business transactions and current events of importance for assessing the situation and development of the company, and he advised management in its strategic decisions. During the reporting period, the Supervisory Board steadfastly fulfilled its duty to monitor the Board of Management consistently.

Annual financial statements

The annual financial statements and management report of Heraeus Holding GmbH and the consolidated financial statements and management report of the Heraeus Group for fiscal year 2006 were audited by PricewaterhouseCoopers Aktiengesellschaft, Wirtschaftsprüfungsgesellschaft, Frankfurt am Main, and endorsed with an unqualified auditor's report. The Supervisory Board authorized these audits in its meeting on May 3, 2006. The Board of Management of Heraeus Holding GmbH and the Chairman of the Supervisory

Board discussed relevant accounting matters with the auditor before the annual financial statements were prepared.

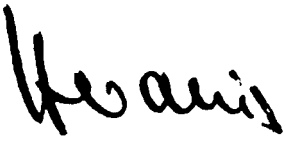
The annual financial statements and the management report of Heraeus Holding GmbH and the Heraeus Group, along with the reports of the auditor, were provided to all members of the Supervisory Board in advance of the meeting on May 4, 2007. The auditors who signed the auditor's report participated in the Supervisory Board's discussion of the documents to be audited. They reported on the most important findings of their audit and were available during the meeting to answer questions. The Supervisory Board approved the findings of the audit with no objections. The Supervisory Board reviewed the financial statements and the management report of Heraeus Holding GmbH as well as the consolidated financial statements and management report of the Heraeus Group prepared for financial year 2006, and there were no objections. Accordingly, the Supervisory Board approved the annual financial statements and management report along with the consolidated financial statements and management report.

Composition of the Supervisory Board

At the shareholders meeting on June 10, 2006, Franz Haniel was elected to succeed retiring member Dr. Martin Kohlhaussen. Dr. Claus Weyrich was reelected to the Supervisory Board. On April 24–25, 2006, employees elected Jutta Jakob and Andreas Wolf as employee representatives to replace Karl-Heinz Ehrhardt and Rainer Scherer. The remaining employee representatives on the Supervisory Board were reelected. At an extraordinary meeting of the Supervisory Board on June 10, 2006, Hans Ostermeier was reelected as Vice Chairman of the Supervisory Board and a member of the Presiding Committee. In accordance with Sections 27(3) and 31(3) of the German Co-Determination Act, Andreas Wolf replaced employee representative Rainer Scherer on the Committee.

The Supervisory Board would like to take this opportunity to thank our outgoing members for their years of steadfast service on the Board. We would also like to thank everyone in management and on the works councils for their extraordinary dedication in the past year. And it goes without saying that we offer our heartfelt thanks to each and every employee whose hard work and positive contribution helped make fiscal year 2006 a success.

Hanau, May 4, 2007
The Supervisory Board



Dr. Jürgen Heraeus
Chairman

Corporate Boards of the Heraeus Group

Supervisory Board Heraeus Holding GmbH

Chairman
Dr. Jürgen Heraeus

Hans Ostermeier (Vice Chairman)
Dieter Ammer
Clemens Blaumeiser
Dr. Hans-Tjabert Conring
Karl-Heinz Ehrhardt (until June 10, 2006)
Franz Haniel (as of June 10, 2006)
Jörg Menno Harms
Jutta Jakob (as of June 10, 2006)
Dr. Martin Kohlhaussen (until June 10, 2006)
Michael Pilz
Rainer Scherer (until June 10, 2006)
Hans Schweinsberg
Prof. Dr. Claus Weyrich
Andreas Wolf (as of June 10, 2006)

Board of Management Heraeus Holding GmbH

Chairman
Dr. Helmut Eschwey

Dr. Frank Heinricht
Dr. Dieter Truxius

Board of Management / Executive Board Managing Companies

W.C. Heraeus
Dr. Roland Gerner
Dr. Peter Köhler

Heraeus Electro-Nite
Taco Gerbranda

Heraeus Kulzer
Dr. Roland Richter
Jan Rinnert

Heraeus Quarzglas/Tenevo
Heinz Fabian
Dr. Walter Körmer

Heraeus Noblelight
Rainer Küchler

(As of December 31, 2006)

We Do It Ourselves

The 2006 year was good! The global economy continued to grow. Europe, and especially Germany, managed to make some headway; they no longer lag so far behind the growth regions. Germany shone with particular brilliance in the year of the FIFA World Cup. A soccer coach proved that he could shape a diverse group of players into a team that stood behind him one hundred percent, and almost made it to the finals. The team showed that you do not necessarily have to come out on top to draw sellout crowds and win the hearts of fans everywhere. For four weeks, Germany stood tall in the public eye. Many people who otherwise think of Germans as petulant and discontented suddenly had a different image of us. But it also turned out that the coach – Jürgen Klinsmann – came perilously close to losing his job, because the entrenched institutional culture of the soccer authorities, the coaches, and many former national players stubbornly resisted his new ideas. It seemed that many preferred to ridicule the German team's coach, to undermine his efforts, hoping to be rid of him and continue in the old ways.

Businesses are not soccer teams, of course. But they, too, compete with other companies in the international arena – and not just every four years, but every day. Some rise in the standings, some fall, and some disappear from the ranks altogether.

How do businesses thrive in global competition? Often, it seems, companies believe that size is the key to survival. Acquisitions and mergers, unrestrained growth, and workforces that can number more than half a million seem to mark the path to the top. But we know from soccer that buying a roster of talented players does not necessarily make the best team. Likewise, a company that acquires too many other companies can find it difficult to integrate them and struggle to build a cohesive culture. Implementing policies and monitoring adherence to them seems doomed to failure, as one of Germany's largest corporations learned from bitter experience during the past year.

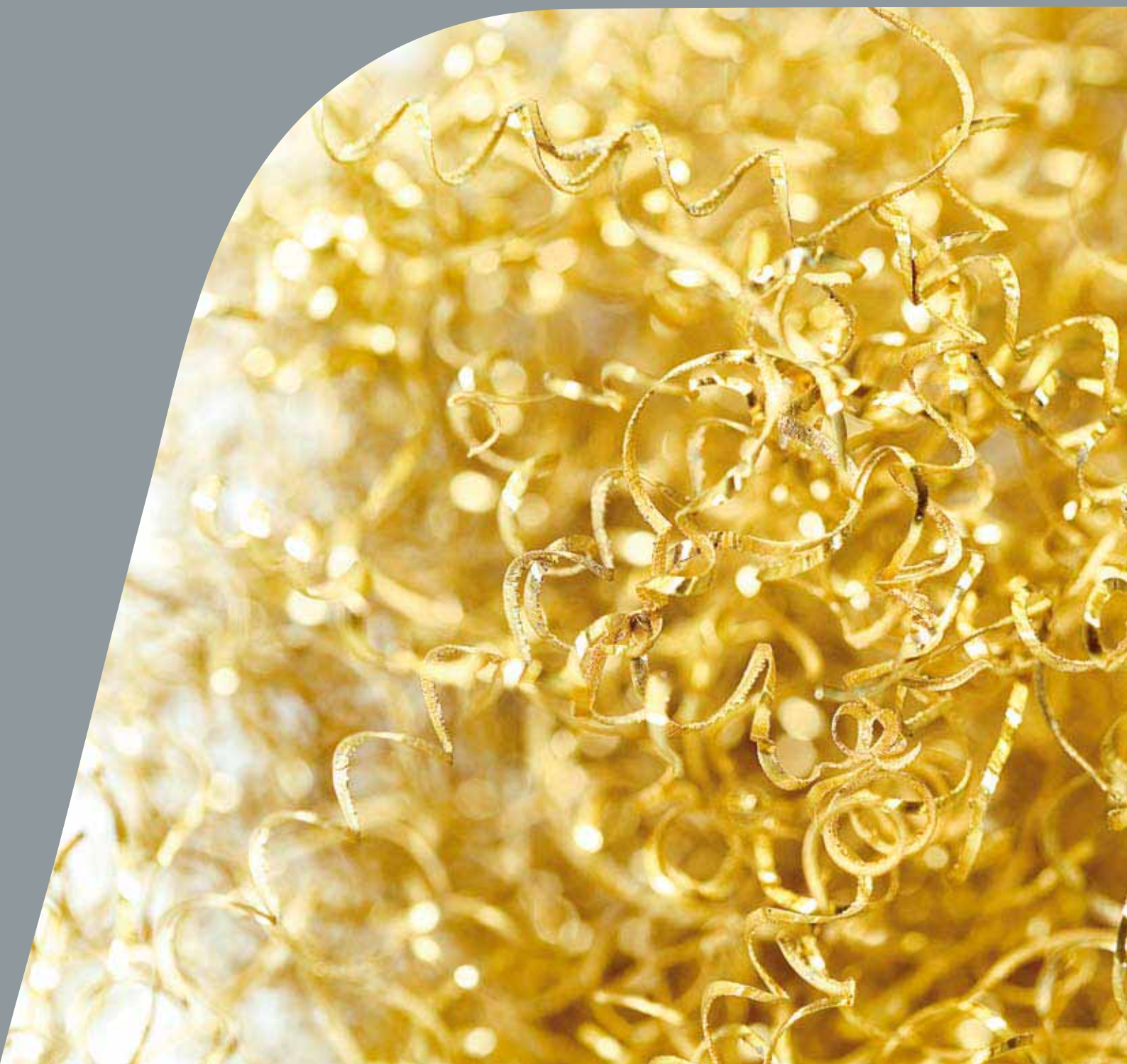
How does the Heraeus team function in this arena? Our company does not strive to reach the top through absolute size, but through substance and brilliance in limited business sectors where we truly

want to excel – and often already hold the lead. We rely on building our own workforce, with our tradition-rich and yet modern training of young employees as well as a strong emphasis on lifelong learning. We work with our employees to prepare them for change and to sustain – or, if need be, to develop – their job satisfaction. We know that it will become more difficult to find skilled workers, especially in engineering and the natural sciences. Therefore, Heraeus must remain an attractive place to work, offering an environment that encourages young scientists and specialists and promotes innovation among employees. That is how we secure our company's future. The results of the fourth Heraeus Innovation Prize competition give us every reason for optimism about our prospects in the years ahead.

At the same time, we cannot wait for the government, political leaders, the employers' associations or the unions to improve the playing field for businesses. We must do it ourselves. In our company in Germany, this will include the introduction of longer work hours. Most of our employees completely understand the need for this measure – unlike the unions, which view a shorter workday as their last bastion of defense. But it will also include the issue of performance-based pay. To return to the soccer analogy: Some clubs pay their players far too much – so much that the players themselves evidently lose their motivation to go all out. Why should they play hard? They already rake in more money than they could possibly spend. A similar trend has emerged recently in corporate pay practices, particularly in the United States, but also in Germany. We will not get caught up in this competition for excessive compensation; we believe we can attract and motivate good employees with interesting jobs and opportunities for entrepreneurial freedom. We value employees who work with passion and enthusiasm for our company´s – their company's – future, employees who are every bit as proud of this winning team as its owners, the Heraeus family.

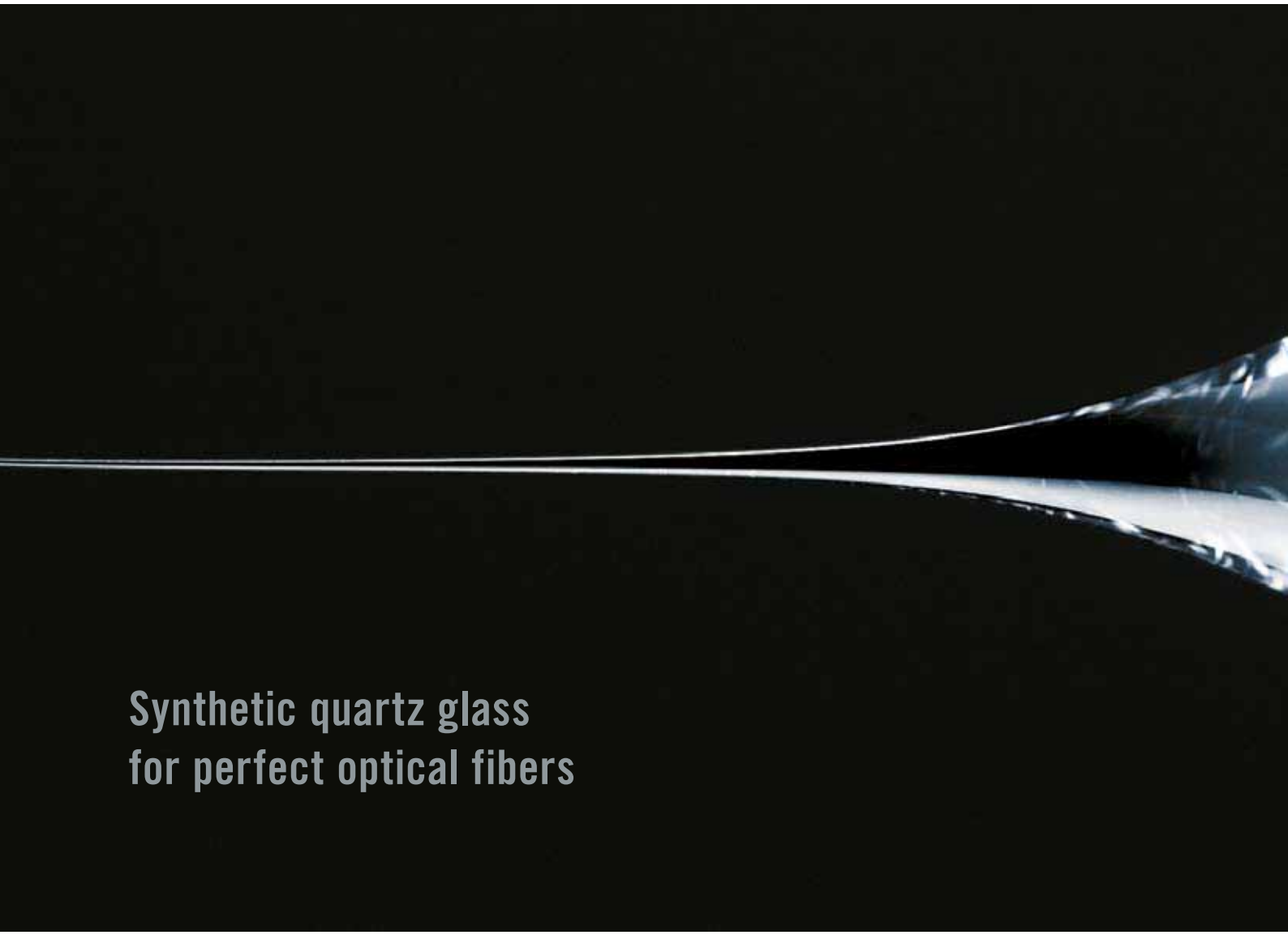
Dr. Jürgen Heraeus

21%



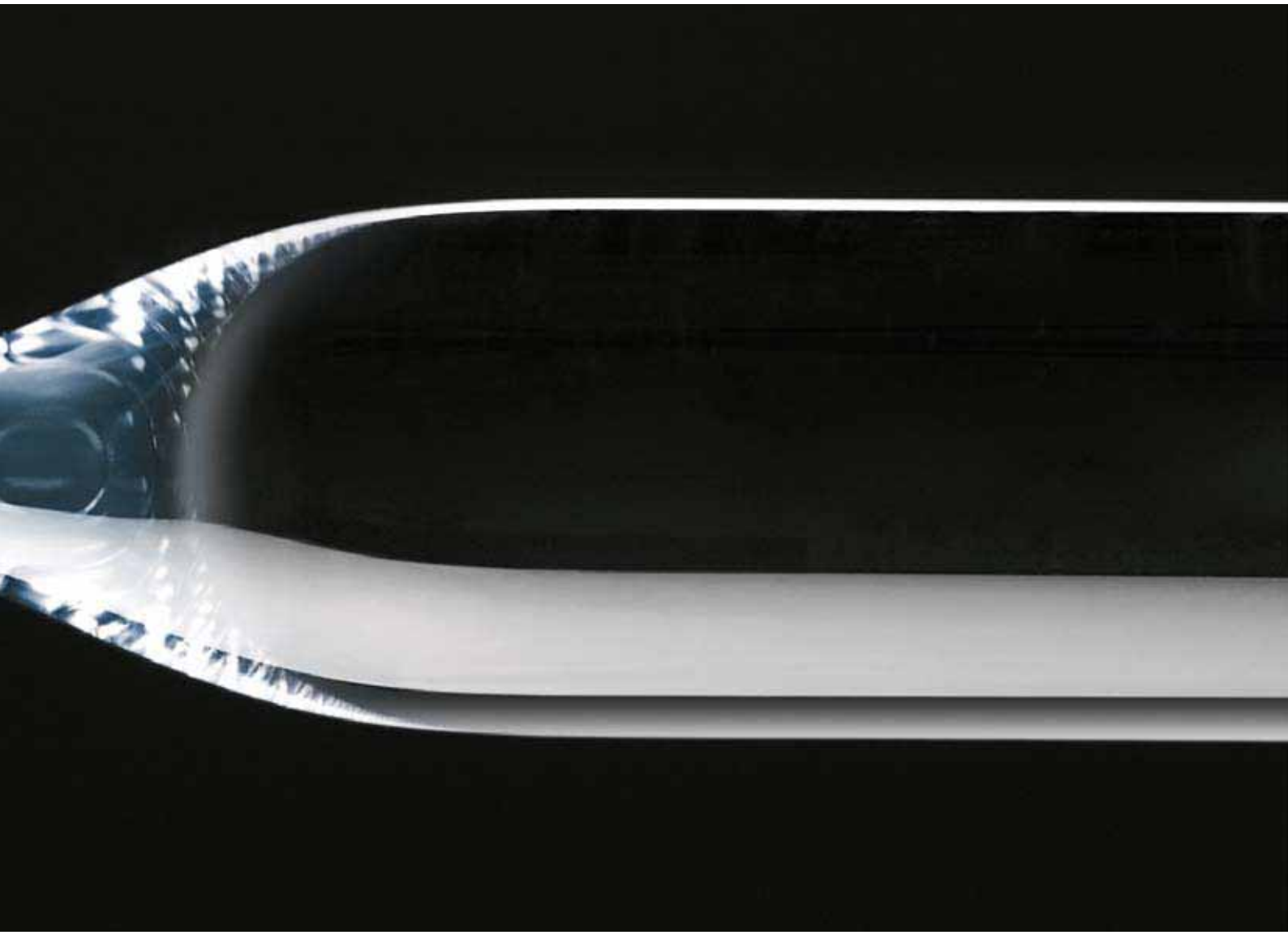
SANTA FE SPRINGS. High prices and new applications for precious metals make recovery of these valuable raw materials ever more important for our customers. By investing in the most up-to-date recycling facilities, consistently pursuing internationalization, and developing existing markets, W. C. Heraeus has further expanded its worldwide leadership in this market. We increased the throughput of platinum group metals by 21 % over the previous year.

DR. STEFFEN VOSS, CHRIS JOHNSON, MIKE COWLES – THE PRODUCTION TEAM OF HERAEUS METAL PROCESSING, INC. (U.S.A.)



Synthetic quartz glass for perfect optical fibers

Increasingly, glass fibers determine our behavior when it comes to information and communication technology. At a rate of more than one terabit – about the capacity of 200 DVDs – per second, data and information can be transmitted rapidly and securely across continents and oceans via inconspicuous optical fibers as fine as a hair.



High-speed Internet, ubiquitous telephones, digital television – today we take rapid communication for granted. And the demand for transmission capacity, such as for downloading music or videos from the Internet, is steadily rising. In many regions of the world, fiber optic cables run right into the end user's home. Bandwidths of up to 100 gigabits per second for private customers are no longer a rarity. Who would ever stop to think that 95 % of a glass fiber consists of fused silica from Heraeus!

Heraeus had a key role in these technological advances right from the start. As early as 1975, Heraeus developed a proprietary deposition method for the fluorine doping of fused silica (Fluosil), which was used to manufacture preforms for optical fibers. In 1978, the German Bundespost in Berlin began using the first experimental fiber optic cable to send messages via its telecommunications network. Heraeus quartz glass fibers were successfully used in a cable to transmit telephone conversations. Today, Heraeus is a global market

To meet the demanding requirements for silica glass in optical fibers, the purity of materials must be carefully controlled (left). Nanoporous silicon dioxide particles are later transformed into transparent silica glass (right).

leader in the production of quartz glass for optical data transmission technology. As an important partner to the telecommunications industry, the company produces and develops fused silica at facilities in Bitterfeld (Germany) and Buford, (U.S.A.). The high-purity silica glass tubes and cylinders produced by Heraeus form the basis for manufacturing high-quality and high-performance glass fibers for optical data transmission. Today, Heraeus supplies about one fourth of the global demand for high-purity silica glass.

Size and purity are critical quality characteristics

An optical fiber consists of a light-transmitting core (high refractive index) and a cladding layer (low refractive index). The light propagates down the fiber core by total internal reflection at the core-cladding boundary – even when the fiber is bent. The core, just nine micrometers in diameter, allows the light to travel at only one propagation speed (a single mode), thus reducing dispersion. Encoded in very short pulses of light, data travels at high speed without distortion to destinations far away. This fiber optic technology makes possible the very high-speed transmission of electronic data over long distances that we take for granted today.

Size, geometric precision, the utmost purity, transparency, and homogeneity are crucial to the quality of the silica glass tubes and decisive for the effectiveness of the resulting optical fibers. To stay at the cutting edge of technology, Heraeus must flank its production activities with comprehensive research and development. Engineers and scientists work to develop new and improved production methods. As a result, Heraeus customers can count on continuous quality improvement and, above all, cost-effectiveness. Two key aspects provide the watchwords that guide our endeavors: evolution of purity and evolution of size.

High-purity fused silica is produced through the oxidation of silicon tetrachloride with oxyhydrogen gas flames at high temperatures, causing nanoparticles of silica glass to precipitate onto a ceramic tube. Over several hours, this results in a high-purity nanoporous silica body more than three meters long and weighing a quarter of a metric ton. This is dried and then vitrified at 1,700 °C to form a transparent glass cylinder. Finally, it is machined to produce a geometrically precise cylinder with its inner diameter bored and outer diameter ground to exact dimensions. To guarantee the high purity of the silica glass materials, most of the production processes take place under clean room conditions.

The introduction of fused silica in place of natural quartz glass made it possible to reduce metallic impurities and hydroxyl groups by several orders of magnitude. "Evolution of purity" carries this farther. The material today measures its purity in the sub-ppb range (parts per billion – about one gram in 1,000 metric tons). The purity of the fused silica ultimately determines the fiber strength as well as the distance the light can travel in the glass fiber without attenuation.

Innovations secure our technology advantage
In addition to their purity, the size of the silica glass preforms from which the glass fibers are drawn has also steadily increased over the years (evolution of size). Through an innovative production process for glass fibers, Heraeus helps its customers achieve significantly lower production costs. The new online RIC technology – RIC stands for "rod in cylinder" – allows the production of the extremely fine optical fibers from large silica glass cylinders in a single processing step. "Online" means that the silica glass cylinders produced by Heraeus can now be fused directly with the customer's silica glass rods while drawing the fiber, eliminating two steps from the processes used in the past.

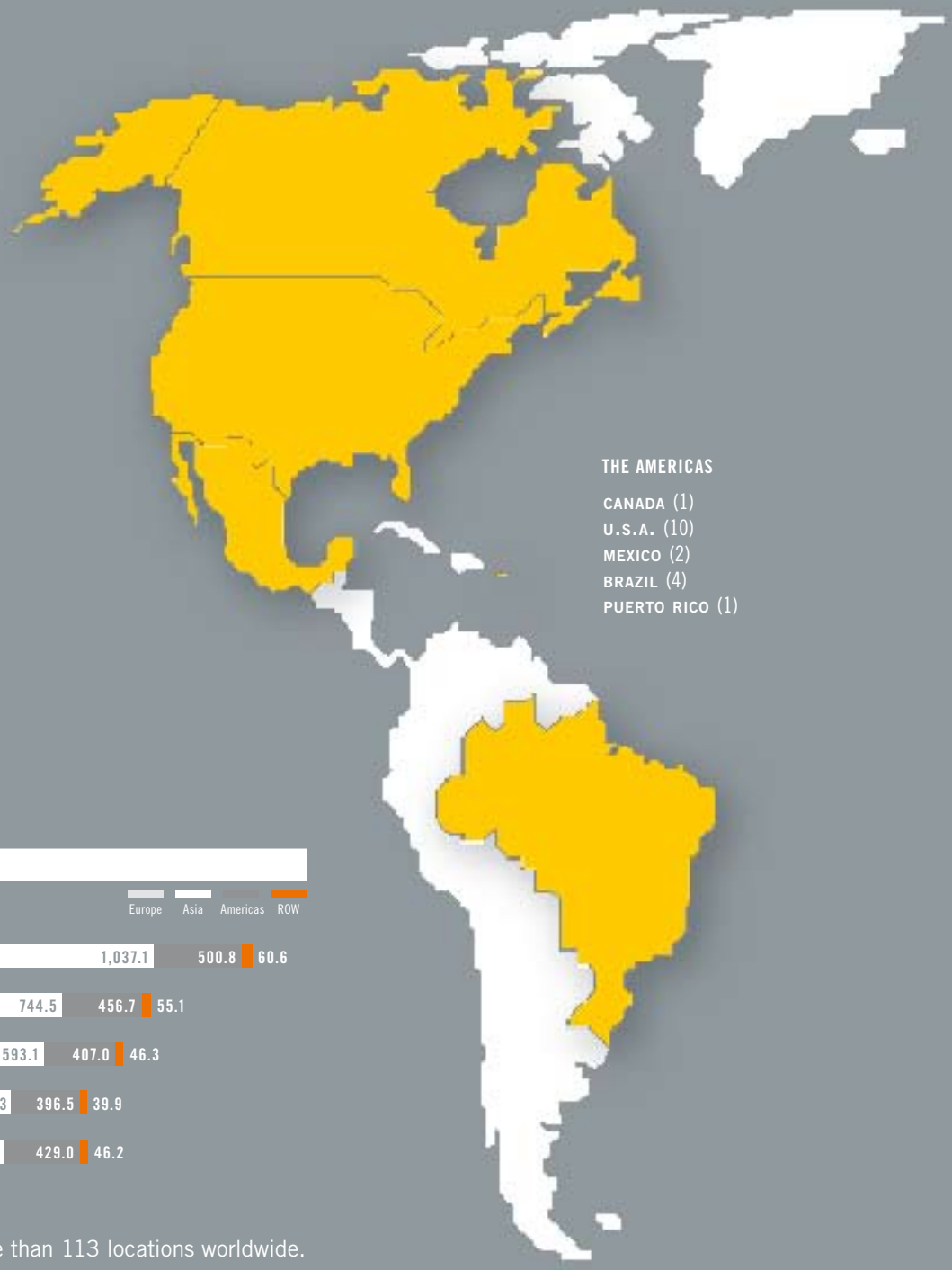
The high-purity fused silica cylinders precision-machined for the new method are also much larger than the earlier ones. While in the standard process one tube is sufficient to draw 400 kilometers of fiber, the new process provides fiber lengths up to 5,000 kilometers. Thus, eight online RIC preforms suffice to draw a glass fiber that would reach around the world. While the earlier preforms were about as thick as a person's arm, Heraeus managed to increase the diameter to as much as 200 millimeters with the new technology. This gives glass fiber manufacturers a clear market advantage over their competition. They can produce glass fibers faster while reducing production costs by up to 30 %.

Precision-machined fused silica cylinder (left), like the ones used in the new RIC method, are produced in state-of-the-art facilities in Bitterfeld (right).

The optical fiber business is coming back to life after a significant slump in demand in recent years. By 2006, some 800 million kilometers of optical fiber had been installed worldwide. According to conservative estimates, the annual total will surpass the 110 million mark by 2010. The new optical fiber installed in 2006 extended almost 90 million kilometers, with the lion's share – more than 50 million kilometers – in the United States and China. The 2008 Olympic Games in Beijing will significantly expand the Middle Kingdom's fiber optics network. In addition, the introduction of UMTS mobile telephones in China and the associated expansion of infrastructure will further boost the demand for optical fiber. Heraeus is the primary supplier for a major Chinese client who holds approximately 5 % of the country's optical fiber market. In the United States, meanwhile, the expansion of fiber-to-the-home (FTTH) is going strong, and Heraeus also supplies a major client there. This has made it possible for Heraeus to further expand its traditionally strong position in that market.

Experts predict continued growth in the optical fiber industry until 2010. Heraeus has the expertise to make the best of this trend. Over the years, with state-of-the-art production facilities and innovations in the production of silica glass preforms, Heraeus has earned a significant technology advantage.

Heraeus is present worldwide with 76 production facilities and 25 development centers.



THE AMERICAS

CANADA (1)
U.S.A. (10)
MEXICO (2)
BRAZIL (4)
PUERTO RICO (1)

Product revenues

in € million

	Europe	Asia	Americas	ROW
2006	1,091.2	1,037.1	500.8	60.6
2005	854.9	744.5	456.7	55.1
2004	905.1	593.1	407.0	46.3
2003	815.2	491.3	396.5	39.9
2002	812.3	459.4	429.0	46.2

Heraeus is present at more than 113 locations worldwide.

EUROPE

GERMANY (19)
FRANCE (3)
ITALY (3)
SPAIN (2)
SWITZERLAND (4)
AUSTRIA (3)
UNITED KINGDOM (7)
IRELAND (1)
SWEDEN (3)
THE NETHERLANDS (2)
BELGIUM (1)
POLAND (2)
RUSSIA (3)
UKRAINE (1)
TURKEY (2)
GREECE (1)
CZECH REPUBLIC (1)

ASIA

INDIA (2)
CHINA (14)
HONG KONG (1)
SINGAPORE (2)
INDONESIA (1)
PHILIPPINES (1)
TAIWAN (3)
KOREA (3)
JAPAN (4)

SOUTH AFRICA (4)

AUSTRALIA (2)

100%

HANAU. Nowadays aesthetics are the key success factor for attractive, top-quality dentures. An entirely natural-looking aesthetic outcome in terms of shade and optical dynamics is achieved with Heraeus veneering ceramics, which rank among the fastest-growing products in their segment in Germany.

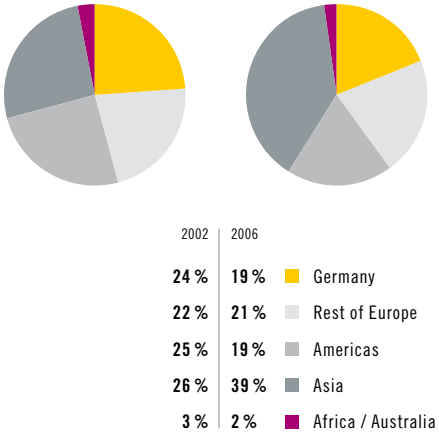
ANNETTE MILDNER – MARKETING MANAGER DIVISION FIXED PROSTHETICS OF HERAEUS KULZER GMBH (GERMANY)

Group Management Report 2006

Business development
Against the backdrop of strong overall economic growth, business has developed exceptionally well for the Heraeus Group over the course of the last fiscal year. Particular momentum came from the electronics and semiconductor, steel, and chemical industries. Heraeus was able to secure a significant share of positive economic developments in these industries, thanks to its broadly based international positioning.

In addition, strong price increases for precious metals in the first half of 2006 contributed to increased revenues, in particular in the Group's trading operations. The Heraeus Group is therefore closing fiscal year 2006 with new highs for revenues and earnings.

Product revenues by region



Group revenues
At € 12.1 billion, overall group revenues are nearly 30 % higher than in the previous year. Of this, € 9.4 billion came from precious metal trading, which likewise increased by about 30 %. Approximately two-thirds of the increase in trading revenue is derived from expanded gold trading, which last year opened up numerous market opportunities at a high price level.

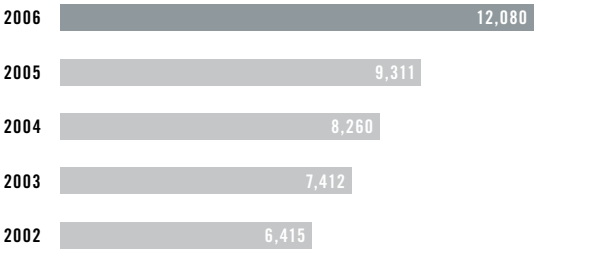
Product revenues in 2006 climbed to nearly € 2.7 billion, thereby exceeding the previous year's figure by about 27 %. Along with higher precious metal prices, revenue growth in the product business is based on clear business expansion in all of the Group's major product areas with the exception of precious-metal dental alloys, which declined as expected.

The average annual exchange rate for the currencies essential to Heraeus changed only slightly from 2005 to 2006. Therefore, currency conversion effects had little influence on revenue development.

The precious metal business segment (W.C. Heraeus) succeeded in nominally increasing its product revenues by 40.3 %. Adjusted for price effects related to

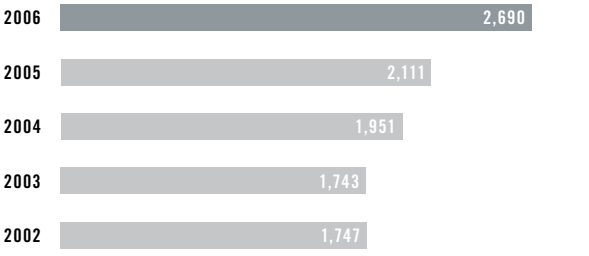
Group revenues

in € million



Product revenues

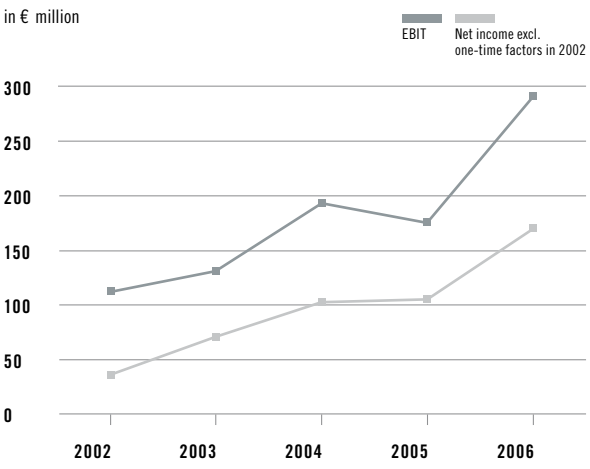
in € million



precious metals, the revenue increase was 17.8 % in real terms. For many years the Chemicals Division has provided the greatest contribution to the growth of W. C. Heraeus. In reporting year 2006, it grew by 51.7 % including precious metal, and 11.7 % excluding it. The newly created Contact Materials Division, which was formed by merging the Bonding Wire and Surface Mount Divisions, also played an essential role in the revenue growth, to which all other divisions of W. C. Heraeus likewise contributed. However, the Thin Film Materials Division did not live up to high expectations for its magnetic data storage products.

The sensors business segment (Heraeus Electro-Nite) added to its track record of success with an upsurge in revenue of 12.8 %. Against the backdrop of persistently good steel business, Heraeus Electro-Nite further developed its business in the growth regions of Asia and Eastern Europe, in particular, and has integrated companies acquired during the previous year in Russia and Japan into the global organization.

Group earnings



The market environment for the dental and medical business segment (Heraeus Kulzer) continued to undergo major changes in 2006. All together, Heraeus Kulzer's revenues fell by 2.5 %, in part because of the continued negative market development for precious-metal dental alloys. Heraeus Kulzer revenues for this product line weakened analogously to the market trend, sinking 12.3 %, but they remained within expectations. The remaining dental laboratory business and the sales of dentistry products developed at the same level as the previous year, while the medical products business increased by 18.5 % on the heels of a successful conversion to direct distribution in Europe.

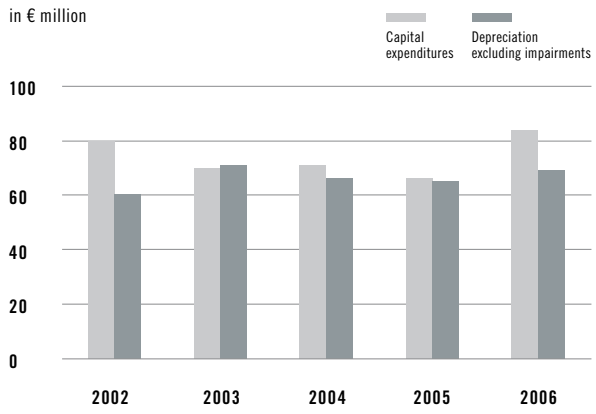
The Quarzglas business segment's jump of 30.8 % was especially gratifying. Both Heraeus Quarzglas subdivisions contributed to it about equally, with the Semiconductor Division climbing by 30.1 %, and the Fiber Optics Division (Heraeus Tenevo) improving by 32.5 %.

The Specialty Lighting Sources business segment (Heraeus Noblelight) also achieved a double-digit growth rate, at +10.5 %, and in so doing benefited principally from a strong demand for infrared lamps for industrial process technology as well as for UV lamps for water disinfection and for the printing industry.

Financial performance

In a significant jump in gross earnings, the strong revenue growth was seen as the difference between overall performance and material usage. This gross profitability topped one billion for the first time and at € 1,104.9 million, it was € 174.1 million (18.7 %) more than the previous year.

Capital expenditure and depreciation and amortization



Human resources costs, the second-largest cost pool after spending on materials, saw a disproportionately small increase of € 7.5 million, or 1.5 %, to € 503.5 million. Here further internationalization with an increase in the workforce at lower-cost locations had a positive effect. Moderate wage agreements in high-wage locations contributed to maintaining the competitiveness of our production areas there. In addition, it was not necessary to add to pension reserves during the reporting year because of changes to the discount rate. In the two previous years, these adjustments to capital market development, which our conservative accounting practices always take into consideration to the full extent of their effect on profit, led to cost burdens of € 21.6 million in 2005 and € 20.5 million in 2004. The human resources cost increase, adjusted for these and other actuarial special items from 2005 to 2006, amounts to 4.8 %, putting it slightly under the increased headcount.

The remaining operating cost categories have increased by € 57.8 million, primarily on account of the higher business volume, but also due to higher depreciations as well as intensified maintenance activities. The affiliated companies' contribution to earnings improved by € 3.5 million. Thus, the group's earnings before interest and taxes (EBIT) of € 290.7 million exceeded the figure for 2005 by € 112.2 million, or 62.9 %. All business segments were able to improve their EBIT considerably, and the Quarzglas segment is clearly in the black again.

Financial results were down by € 8.7 million to € 23.5 million. Although further reduction of the interest-bearing liabilities (see below) led to a decrease in long-term interests as of the third quarter, this positive effect was offset by a temporary increase in the use of short-term credit instruments for precious metal trading, which grew vigorously. The interest portion of the allocations for provisions for pensions, which barely changed compared with the previous year, was shown as another expense item in the non-operating earnings.

EBIT and non-operating results together form the group's earnings before taxes, which at € 256.8 million is about € 104.0 million or 68.1 % higher than in 2005 and represents a new high for the Heraeus Group. The previous record was € 218.0 million in 2000.

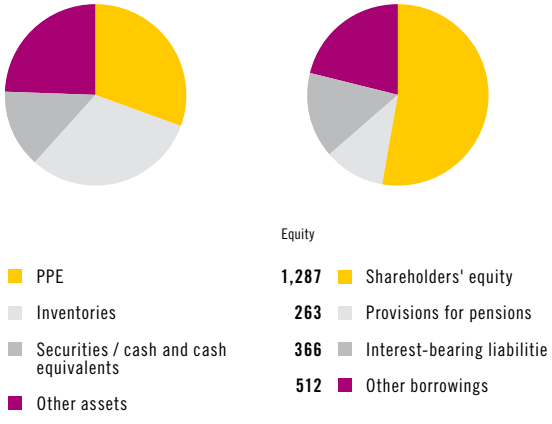
In the area of taxes, we specified one-time special earnings of € 17.3 million. It is the necessary result of a recent change in German law, which led to a fixed claim on future payments of old corporation tax credit regardless of the financial position. The paid income taxes have otherwise developed essentially analogously to the course of the operating results. Within the deferred taxes, we have taken into consideration for the purposes of a conservative statement of income only those tax loss carryforwards whose realization is practically certain. The tax burden for the Group was 32.5 % (31.3 % in 2005).

Group net income was thus € 173.3 million, an improvement of € 68.3 million over the previous year or 65.1 %.

Financial position and cash flow

At the end of 2006, the Heraeus Group's total assets of € 2,428.4 million remained almost unchanged from the previous year (– € 0.1 million).

Financial position as of Dec. 31, 2006 in € million



The good financial position allowed consistent continuation of the debt-reduction program initiated in 2004. In the reporting year the interest-bearing liabilities were further diminished by € 135.6 million; their share of the total assets could then be reduced at year-end to 15.1 %. Property, plant and equipment and current assets rose at a disproportionately low rate compared to business expansion, and the provision volume in particular remained under the 2005 level on account of the positive outcome for Heraeus of some legal cases. On balance the net share of shareholders' equity in the total assets could be increased from 47.7 % to 53.0 %. This healthy balance-sheet structure fulfills an

important fiscal condition for the Group's goal of further growth. The improved operational results in the reporting year had an equally positive effect on the group's cash flow. Gross cash flow from operating activities rose by 55.6 % to € 318.0 million; after taking into consideration the increase due to business in funds tied up in financing in the current assets, the cash flow from current business activity still amounted to € 202.3 million – € 189.1 million more than the previous year. The intensified investment activity and the debt reduction according to plan led to a decrease of € 68.6 million in the Group's liquidity reserves to € 335.3 million at the end of 2006.

Capital expenditure

Capital expenditures in 2006 grew to € 84.0 million; this corresponds to growth of 24.5 % over the previous year. Investments in property, plant and equipment were thus 22.4 % above depreciations in the reporting year. A good half of all investment expenditures went to the precious metal segment, with an emphasis on expansion and modernization projects in Germany, the United States, and China. In 2006, Heraeus Electro-Nite started up a new production plant in China. Heraeus Group investments in Germany in 2006 totaled € 42.2 million, an increase of 32.7 % over the previous year.

A total of € 31.7 million was spent on acquisitions in the reporting year. In particular, this concerned the acquisition of EMAT in Singapore, a manufacturer of targets for coating flat-screen displays, and the platinum business of France's Fremapi Group (Platecxis) by W. C. Heraeus, as well as the acquisition of all shares in the Chinese subsidiary of Heraeus Kulzer.

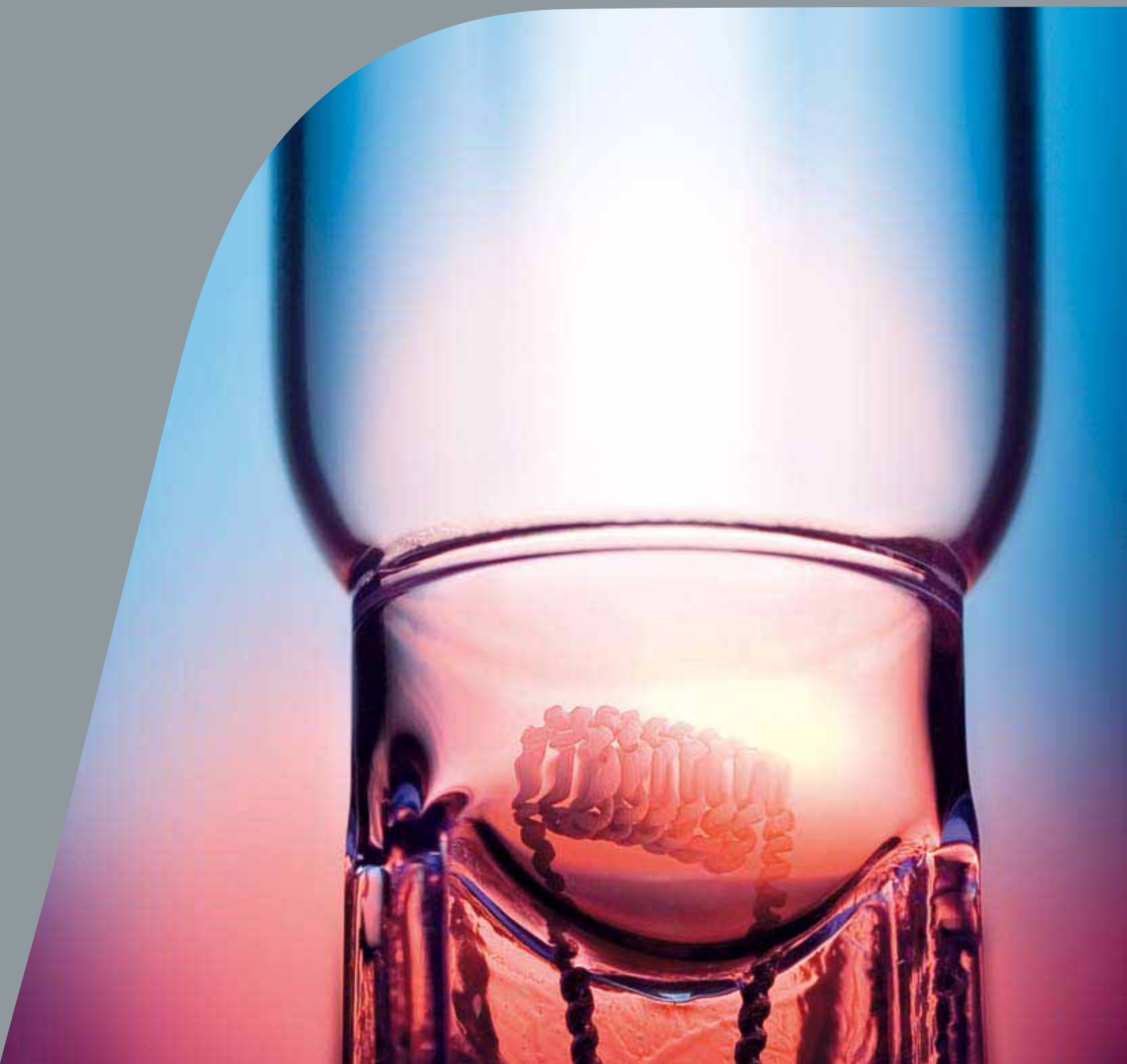
Outlook

Last year's economic tail wind is continuing to blow. However, we must expect a slightly falling sales trend for Heraeus Quarzglas, which is a result of the weakened market forecasts for the semiconductor industry.

All of the business segments' order books are currently well filled, and the revenue figures for the first months of 2007 likewise reveal no perceptible declines. Therefore, for fiscal year 2007 we are anticipating that the current good course of business will continue overall. And at present we are also expecting to be able to maintain the course of profitable growth under our own power for 2008.

Of the Heraeus Group's total dividends of € 30.5 million, about € 4.8 million went to foundations, both directly and indirectly. Thus a significant portion of our dividends again benefited the general public through non-profit channels.

600 watts



HANAU. We are the first manufacturer to present a functioning high-power amalgam lamp at the Aquatech Amsterdam (Netherlands) trade fair. Our long-life lamps save both money and energy in the treatment of drinking water and sewage, thereby helping to protect the environment.

DR. SVEN SCHALK, ERIK ROTH, FRANZ-JOSEF SCHILLING –
FOR THE SURFACE AND ENVIRONMENTAL TECHNOLOGY DIVISION OF HERAEUS NOBLELIGHT GMBH (GERMANY)

Risk Report 2006

The Group's operational risks are documented in a risk management system that includes identified single risks, assessment of the maximum extent of damages, probability of occurrence, and effects on financial position, financial performance and cash flow.

In addition, it entails the measures intended, initiated, and implemented for risk management and risk minimization. The risk management system is updated on a semi-annual basis, and reports are submitted to management of Heraeus Holding GmbH at the same time.

The financial risks arising from the operational business are limited through the implementation of derivative financial instruments. The instruments used primarily include swaps, forward rate agreements, caps, floors, and collars as well as foreign exchange forward contracts and currency options. Short positions are excluded in compliance with the corporate guideline for financial management as updated on September 7, 2005. In its medium-term financial planning, Heraeus bases its assumption on an anticipated development of the financial markets that would not lead to any significant increase in interest and currency risks. Currency risks are nearly eliminated through hedging transactions for the medium-term planning period.

The precious metal trading is also governed by the guideline of December 8, 2004 on the internal limit and risk control of all business transactions tracked in an electronic trading system. Hedging instruments commonly used in the market are employed to hedge price risks. These include in particular spot and futures transactions, loans, and cash-and-carry transactions.

Daily control of the adherence to prescribed limits is conducted by employees who are not subject to trading instructions.

Operational default risks are counteracted with active receivables management, which is the responsibility of the individual business segments.

The Group's strong growth faces the general risks of controlling the technical and business processes. These risks are limited through standardization and the implementation of professional IT systems to the inevitable extent for business.

With the installed systems for risk measurement and mitigation, Heraeus is also taking into account demands for early risk detection in dealing with business opportunities and challenges. At the present time, no risks to the Group's ability to continue as a going concern can be identified with respect to the net assets, results of operation, and financial position.

The following sections list the individual business segments' specific risks and the measures taken to confine them:

Precious metal refinement

Long-term supply contracts exist with the leading precious metal producers in all regions. These contracts are regularly updated to reflect the development of the market and demand situation. In addition, customers supply precious metal in substantial volumes, and Heraeus has access to fine metal (pure precious metal) from the recovery of refining batches and from used products that are reintroduced to the precious metal cycle. The somewhat limited deposits of precious metals in conjunction with an increased demand for new technical applications can lead to supply bottlenecks and thus to price increases. This largely reduces procurement risks. The systems to secure the supply of precious metal are integrated in a data and monitoring network that also enables IT-supported tracking of the efficiency of the respective production processes while supplying important pointers for their optimization. Despite these comprehensive measures, risks arising from the physical loss of precious metal cannot be completely ruled out.

Dental materials

The slump in demand due to the healthcare reforms that have been enacted for certain indication areas continued. Precious metal alloys on the global dental market were especially hard hit by these changes. We have to assume that these developments will continue over the long term and that a consolidation of the organizational and strategic alignment will be required to guarantee adequate and lasting protection of earnings. The new implant system that was launched could include some of the risks resulting from this development, which could delay the prospects of success. However, these risks will not have a substantial effect for the business segment.

Materials for endoprosthetics and osteosynthesis

The entry into direct distribution for these products in Europe was associated with a start-up delay. However, the risks from the resulting loss of market share are limited in that the division will continue to leverage its market leadership in bone cements and biomaterials for orthopedics and surgery, and has solidified its market position in the United States through a long-term sales partnership with a leading prosthetics manufacturer.

Sensors

In light of the further global increase in crude steel production, the business with sensors for the steel industry has continued to develop positively. A certain risk potential is associated with the increasing price pressure resulting from consolidation in the steel industry, as well as from the portentous decline in North American steel production, however. Lower price levels could weaken the financial position of the steel industry. This trend would have effects on the business of Heraeus Electro-Nite; however, we do not anticipate that it will introduce any risks to the ability of the business segment to continue as a going concern.

Quartz glass

The dynamic growth in demand for products for the semiconductor industry and optical waveguide market also brings considerable risk of a cyclical market downturn in the future. The business segment undertook further optimization measures in 2006 and successfully limited the possible effects of fluctuations in demand. Additional modifications are needed, however, to prepare for possible changes in the world market. The business segment is ready for this development and in a position to limit existing risks so that no significant effects need be feared. Focusing activities on key accounts has strengthened market position, but has also increased dependency on a limited number of customers. Therefore, strategic minimization of this risk through the expansion and promotion of the product range will continue.

Specialty lighting sources

The business segment was able to expand its leading market position in lamps for optics and analytics, in particular for industrial applications. The product portfolio ensures that the business segment is only minimally dependent on the cyclical fluctuations of individual customer segments. Potential product liability risks for tanning bed lamps and lamps for the UV disinfection of drinking water are countered with extensive quality management programs. In addition, tanning bed lamps are subject to a substitution risk triggered by expected regulatory changes for the European Union. This is being mitigated by systematic development of products that will comply with regulations in the future as well.

Risks from intragroup services

Sufficient provisions have been made for risks arising from responsibilities for the environment and job security, patent and licensing infringement, information technology breakdowns, and the potential risks of all other internal services. The risks in these areas are therefore limited to a minimum so that substantial impacts on the Group can largely be ruled out.

Patents and licenses

Despite a careful examination of the patent situation, violations of industrial and intellectual property rights can occur. Occasionally, this can lead to expensive and protracted lawsuits. It is therefore not possible to rule out for the future that Heraeus may be confronted with allegations or charges of patent rights infringements and will have to deal with them.

Human Resources

The Heraeus Group grew by 650 employees, a gain of 6.1 % over the previous year. The total number of Heraeus employees around the world numbered 11,275 as at the end of 2006 (2005: 10,625). This growth is due largely to personnel expansion at manufacturing facilities outside Germany, primarily in China, and also to the acquisition of a company with 37 employees.

At W. C. Heraeus, the number of employees jumped by 387 compared with December 31, 2005, figures, for a total of 3,916 at the end of 2006. This growth can be ascribed in large part to the expansion of capacity at manufacturing facilities around the world, as well as to the acquisition of new companies. In addition, 110 new jobs were created in Hanau (Germany).

At Heraeus Kulzer, the staff had to be downsized by 115 employees, from 1,653 to 1,538, in accordance with business development. In this process, job cuts in stagnant markets stood in contrast to hiring in growth markets.

Business expansion at Heraeus Electro-Nite led to an overall rise in employment figures worldwide – up 289 employees to a total of 3,163. Most of the expansion was in Eastern Europe and China, but operations in Germany grew as well.

At Heraeus Quarzglas and Heraeus Tenevo, the number of employees around the world grew by 61 to 1,504. We were able to ensure the responsiveness of our German locations through the use of flexible working time models and temporary employees. During peak times, Heraeus Quarzglas in Germany hired 200 temporary workers.

Heraeus Noblelight increased employment slightly, adding seven new employees for a total of 651.

Jobs in Germany maintained

Employment in Germany was maintained at a stable level. Although the number of employees within Germany actually fell by a nominal 18 (–0.4 %) as of December 31, 2006, 188 additional jobs have been created over the last four years.

Increased demand for qualified employees

The demand for qualified employees has grown and will continue to do so. Our attractiveness as a technology Group and family-owned company still allows us to select from the best applicants.

Capacities adjusted flexibly

We were able to handle the overall excellent order volumes – especially for W. C. Heraeus and in the quartz glass business – by making working hours more flexible and by taking on hired labor. Our many years of working with select, qualified temporary employment agencies proved of value here. In addition, we were able to absorb brief but serious order losses in some manufacturing segments without having to let permanent staff go.

Qualification efforts continue

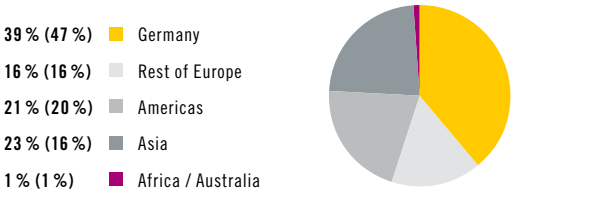
Heraeus has intensified its investment in employee training and education for the purposes of life-long learning to ensure the long-term qualification and employability of its staff. At Heraeus Noblelight, 100 % of employees took part in a program called "Lernen im Prozess der Arbeit" (Education in the Workplace). The Heraeus e-Learning Center, which offers employees numerous Heraeus-specific interactive and multimedia learning opportunities, opened in October 2006 and has been met with active interest. More than 1,000 employees registered by the end of the year. The number of trainees in Germany increased again. 82 young people began their career training in Germany in September 2006. The overall number of trainees rose to 252 in fiscal year 2006. At 6 %, the proportion of trainees is greater at Heraeus than at comparable companies in Germany. Heraeus is known for the high quality of its training. In the reporting year, 10 trainees complemented

their demanding training plans by working abroad at Heraeus affiliates in Europe through the EU Commission's Leonardo Program, thereby strengthening their international experiences and skills.

Organizational changes
Organizational structures are constantly changing to adapt to changes in customer and market requirements. Heraeus is actively shaping this process in order to be prepared for the challenges of the future. For essential structural changes, for example the integration of newly acquired companies, we achieve success by using the syntegration method developed by the St. Gallen Management Center.

Employees by region

2006 (2002)

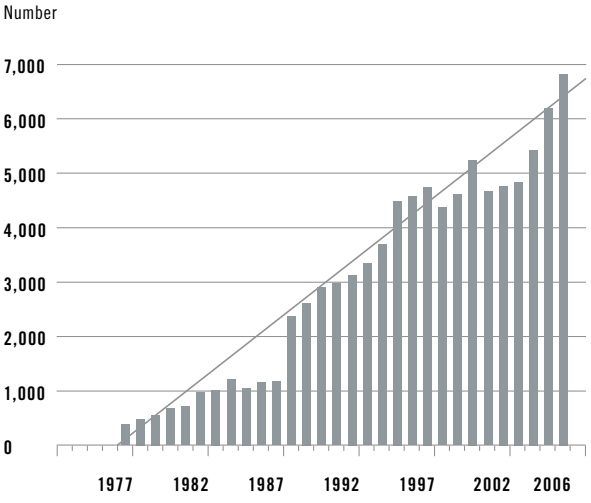


The works council structures were substantially simplified through the newly formed joint operation for Heraeus facilities in the Rhine-Main region. A single works council committee now represents 89 % of our German staff, where six works council committees had done so in the past. In addition, the joint operation makes internal staffing and job changes across business segments easier.

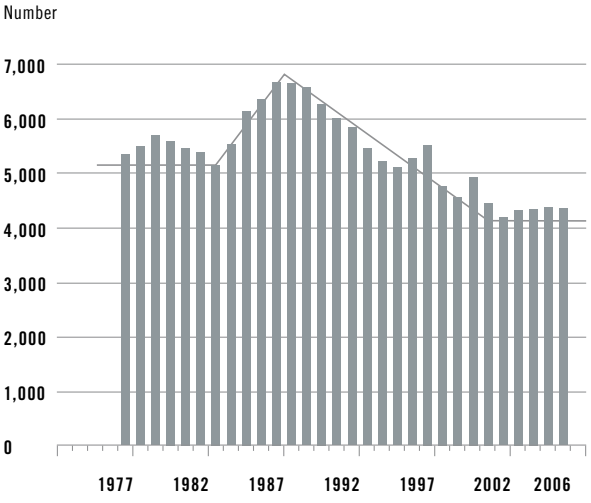
International personnel measures developed
Personnel management has intensified its international activity. In the United States this includes emphasis on personnel development, statutory benefits, and compliance with legal requirements for personnel management across multiple locations. A program was developed in China to increase understanding of the cultural differences between China and Europe and further improve intercultural collaboration. For the advancement of Chinese executives, German and local personnel representatives worked with Chinese location managers to develop a country-specific leadership program as well as an evaluation system to cover multiple locations.

Intensified efforts to promote health
The health of employees is an important concern for Heraeus. In fiscal year 2006, efforts to systematically promote health were intensified in Germany and the United States.

Global human resources development excl. Germany



Human resources development in Germany



With scientific guidance, critical factors relevant to health were examined in selected manufacturing areas and improvement measures were initiated. 4,000 employees took part in Heraeus Prevention Days, held at locations in the Rhine-Main region joint operation for the first time. The series of events focused on a health check and an extensive medical prevention and information program on the subject of cardiovascular disease. It will be continued in 2007 with a program dealing with the prevention and early diagnosis of cancer. Employees in the United States and their families have access to an Employee Assistance Program for health, family, legal, and financial issues.

Work/life balance promoted

The work/life balance activities begun in the previous year were pursued systematically. A total of 32 parents (80 %) took the opportunity to successfully reintegrate into the working world after the birth of a child.

The Heraeus Sozialstiftung, a foundation established in 1973, supports employees in Germany during special life situations. In 2006, it intensified its family services activities with an inaugural program of care during school vacations for children in the Rhine-Main region. The program, organized in conjunction with the Kathinka Platzhoff Foundation and the company, will continue in 2007.

420 million

SHANGHAI. China now accounts for more than 30 % of the world's steel production. That corresponds to 420 million tons per year. With our high-quality sensors produced in Shanghai, we are participating in this massive market growth. We are proud of our products, which offer customers in China maximum quality and process safety in steel production.

WEJJIANG QIAN – PRESIDENT OF HERAEUS ELECTRO-NITE SHANGHAI CO. LTD. (CHINA)

W.C. Heraeus

The W.C. Heraeus business segment steadily pursued its strategy of profitable growth in existing and future markets, profiting first and foremost from its broad attention to key markets. Most particularly, the company reaped the rewards of worldwide growth in the chemical, automotive, and electronics industries. In 2006, nearly every division contributed to this success.

Total revenues rose by 32 % from the previous year, to € 11.1 billion. Bolstered by the favorable global economic situation, product revenues including precious metals increased by 40 % or € 478 million; product revenues aside from precious metals increased by 18 % or € 85 million. With precious metals bringing high prices, trading in those commodities achieved record revenues of € 9.4 billion, a 30 % increase from the previous year. The positive trend in operating results continued as well.

Chemicals Division

The precious metals recycling business was extraordinarily successful in 2006, with a high throughput of precious metals. The facilities in Hanau and Hong Kong contributed to this, as did US subsidiary Heraeus Metal Processing Inc. in Santa Fe Springs (U.S.A.), with record throughput. Our worldwide recycling capacity further increased with the construction of a new precious metal processing plant in Port Elizabeth (South Africa), where Heraeus supports the fabrication of added-value products in that country.

Business with ingredients for the treatment of cancer maintained a very high level. In the United States, W.C. Heraeus retained its outstanding market position with carboplatin for the generics market. Demand also rose for new highly active pharmaceutical ingredients such as oxaliplatin and irinotecan. On the other hand, marketing of the fermentatively produced organic active ingredients (rubicin group agents) – an addition to the Chemicals Division's product portfolio – slowed somewhat.

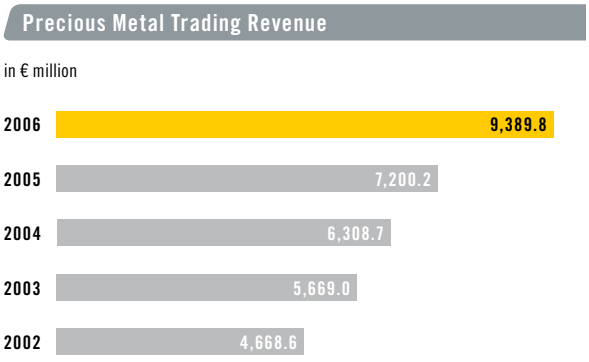
Contact Materials Division

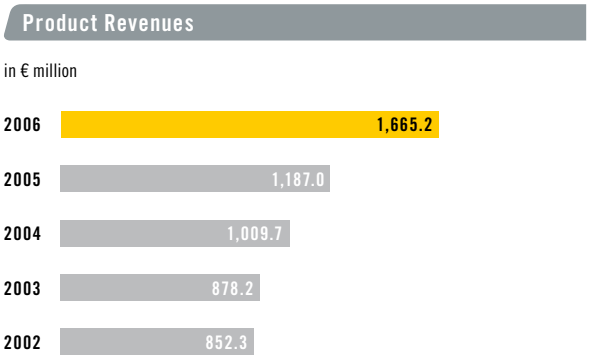
After combining the Bonding Wires and Surface Mount business units to form the Contact Materials Division, W.C. Heraeus has already attained its goal of improving synergies between marketing and customer service.

Carried by the continuing boom in the semiconductor industry, Heraeus produced record volumes in nearly all its production facilities for bonding wires in Asia, generating significant gains in sales and earnings. To strengthen its position in Asia, Heraeus increased its holdings in existing joint-venture bonding wire plants in Zhaoyuan and Changshu (China) from 50 % to 60 %. This lays a strong foundation for the expansion of these facilities.

The sustained trend toward miniaturization of electronic components enabled the Contact Materials Division to boost its use of technology acquired the year before when Heraeus took over Welco GmbH in Potsdam (Germany). The patented process for producing ultra-fine pitch solder powders used in the semiconductor packaging industry found expanded applications in Asia, especially for Heraeus customers in Taiwan.

Heraeus has introduced to the market the low-residue flux system that took third place in the 2005 Heraeus Innovation Prize, offering its customers in the automotive and semiconductor industries a new environmentally friendly product.





Engineered Materials Division

The Engineered Materials Division profited enormously from the strong demand for components and intermediate products for automotive electronics and the equally strong demand for products containing precious metals, especially platinum-alloy catalyst gauzes used in the production of nitric acid.

To further expand its business with products containing platinum, Heraeus took over the platinum activities of the French Fremapi Group effective November 1, 2006. With this acquisition, the Engineered Materials Division expanded its spectrum of products and services as a supplier of high-quality platinum products for a wide range of industrial applications. These include laboratory equipment made of platinum group metals for semifinished goods, components for manufacturing glass, and tiles for growing crystals. The acquisition also created new jobs at the Heraeus headquarters in Hanau. The integration of the new businesses is slated for completion by mid-2007.

In August 2006, Heraeus received official approval for use of its new environmentally friendly catalyst to reduce emissions of nitrous oxide (N_2O) in the production of nitric acid. The innovative multiphase platinum-based catalyst cuts emissions of this greenhouse gas by more than 90 %, making an important contribution to environmental protection.

The Precision Technology business unit featured record sales, with products for the automotive industry as well as with flexible substrates in which microchips are embedded during the production of ID-cards in China. The Metal Plastic business unit exceeded expectations, taking its first orders from automotive customers for a new generation of pressure sensors and new sensor housings.

By establishing a key accounts unit to coordinate its international activities across divisions, W.C. Heraeus strengthened its performance capability in the automotive sector.

Medical Components Division
The Medical Components Division – which manufactures products for the treatment of cardiovascular diseases, such as helix electrodes and conductive coils for pacemakers – can look back at a successful year in 2006.

It had to deal with a difficult market environment, marred by recalls of defibrillators by its customers and resulting anxiety on the part of physicians and patients. In response, the defibrillator manufacturers greatly increased their security requirements. Heraeus met these specifications, in large part by introducing the Six Sigma method.

With the consolidation of US production facilities at the Minneapolis site and the associated relocation of production from Chandler (U.S.A.) as well as expanded production in Hanau (Germany), the division geared up for further expansion.

Thick Film Materials Division
The goal of merging the Ceramic Colours and Thick Film business units was to take greater advantage of technological synergies and focus better on the needs of customers. The new technology pool facilitates development of new products as well as activity in new markets, such as sensors, photovoltaics, fuel cells, and automotive glass.

The Thick Film Materials Division especially benefited in 2006 from strong growth in the hybrid sector, which brought good sales of thick film pastes in the automotive, telecommunications, and construction industries.

The negative trend in the European porcelain industry – which has suffered for years from weak demand as well as the successive shift of production to Asia – worsened during 2006. Despite this difficult market situation, Heraeus managed to stabilize its ceramic colors business. To strengthen its position, starting in 2007 the unit will realign its marketing structure by region to provide even more targeted service to customers in the Middle East and Asia.

Thin Film Materials Division
With acquisition of the sputtering target business of Singapore-based manufacturer Electronic Materials Technologies Pte. Ltd. (EMAT), Heraeus expanded its position as a provider of sputtering targets for the display industry (flat screens), now experiencing a strong upturn especially in Asia. The new site joins Shanghai as an important production center for Heraeus coating materials in Asia.

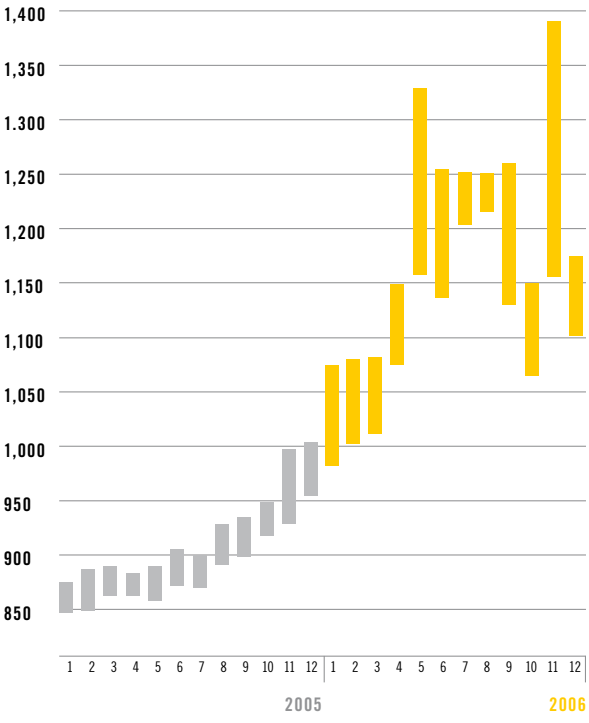
In the hard drive data storage sector, the shift from longitudinal to perpendicular recording technology and the different use of hard disks has created severe turbulence in the market. To secure a share of the future growth associated with the new technology, Heraeus significantly boosted its production capacities for oxide sputtering targets, for example.

The division logged strong growth with large area coatings for architecture glass, in the photovoltaics market, and with coatings for wear protection and decorative purposes. New developments in the rotating targets sector and investments in local manufacturing capacities in the United States and China secure the division's position for the following year.

Platinum prices

Highs and lows in US $ / oz

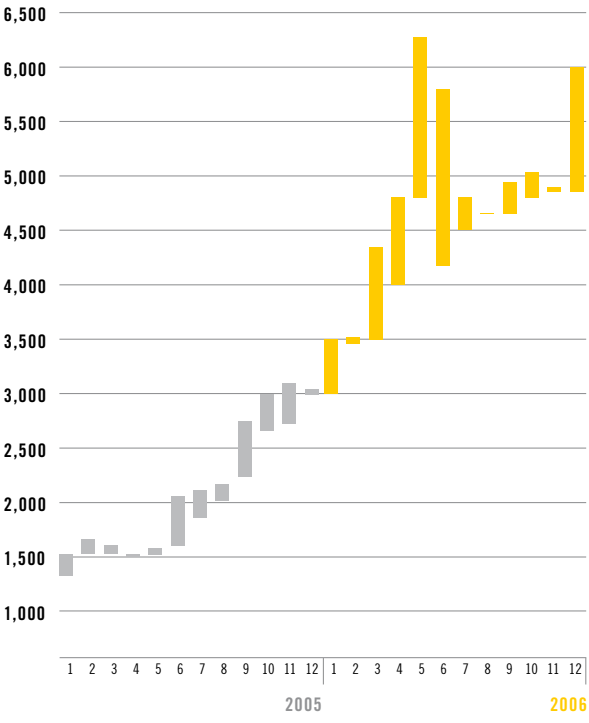
Source: London Fixings



Rhodium prices

Highs and lows in US $ / oz

Source: Heraeus



Trading Division – Precious Metal Trading

Volatile and skyrocketing prices for precious metals in fiscal year 2006 led to an extraordinary jump in revenues, which rose by 30 % over the previous year. At € 9.4 billion, trading revenue reached a new record. All three trading sites – Hanau, Hong Kong, and New York – contributed to this achievement. The outstanding development of the precious metal market reflected global economic growth, which contributed to greater industrial use of precious metal, a trend Heraeus shared. In addition, the rising prices sparked a renewed interest in precious metals as an investment object. The introduction of exchange traded funds (ETFs) also gave investors easier access to precious metals. (An ETF consists of a group of securities, commodities – such as precious metals – or derivatives that are traded as shares on a stock exchange.)

In particular, the year 2006 saw an increase in the importance and hence the price of the lesser known precious metals rhodium, ruthenium, and iridium, reflecting the overall economic situation and new industrial applications.

This trend was somewhat less dramatic in Europe. The euro stabilized significantly over the year, easing the situation for consumers.

Gold

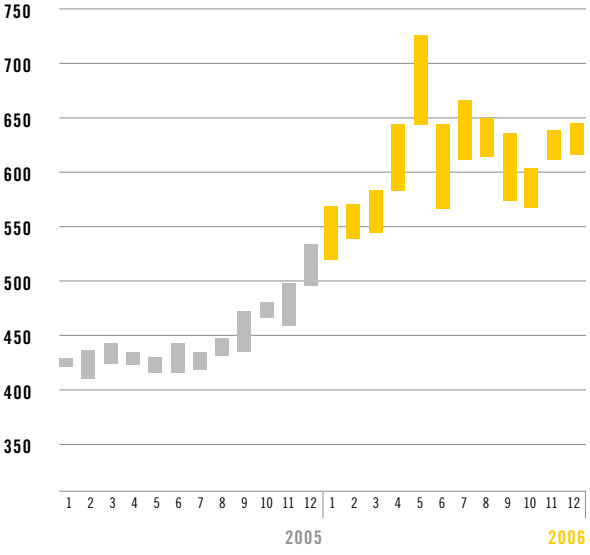
Gold prices ended the year at $ 635.70 an ounce, 22 % higher than at the start of the year. Gold thus beat the Dow Jones Industrial Average, which rose by a notable 17 %. The stabilization of the euro moderated the rise in gold prices to 10 % for the year. Gold averaged $ 604.34 an ounce for the year, $ 159.35 higher than for the previous year.

The industrial use of gold, especially in the electronics industry, continued to rise. The jewelry industry – by far the largest consumer of gold – showed a decline, but stronger interest among investors and a decrease in purchases by central banks more than compensated for this. In addition to the generally renewed interest in raw materials, decisions to invest in gold were influenced by crises in the Middle East. At the end of 2006, investors in ETF products held a total of 560 metric tons of gold, valued at $ 11.3 billion.

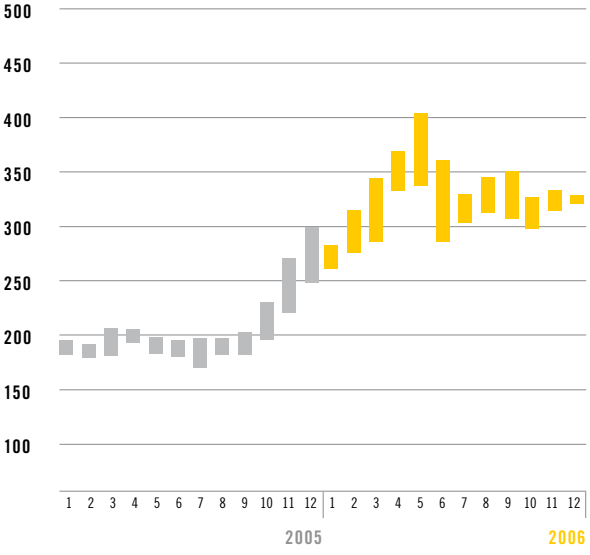
Silver

Silver benefited particularly from the combination of strong industrial demand and investor interest, with prices rising by 46 % in dollars and 28 % in euro. The average price of silver for the year was $ 11.55 an ounce, a gain of $ 4.24 from 2005. Analysts had worried that demand would decline in the photo industry as digital media broadened their hold, but this has not yet had a negative impact on total in-

Gold prices



Palladium prices



dustrial use. At the end of 2006, investors held 3,768 metric tons of silver in ETF products.

Platinum

The price of platinum rose by "only" 14 % in dollars and just 2.5 % in euro over the previous year. The average price for the year, at $ 1,110 an ounce, was 24 % higher than in 2005.

Platinum consumption was again greatly influenced by expanding applications in the automotive industry. Demand in this sector has doubled since 2000, driven by increasingly stringent emissions limits and the continued popularity of diesel engines in Europe. The availability of low-sulfur diesel fuel in the United States since 2006 could reinforce this effect. At present, not even 2 % of vehicles in that country have diesel engines.

Rising platinum prices slowed demand in the jewelry industry, where consumption dropped by more than 10 %. Discussion of possible ETF products for platinum led to extreme price volatility during the year. In November, fueled by speculation about a new platinum ETF, the price climbed from $ 1,200 to $ 1,400 an ounce. After potential issuers denied that any launch was imminent, the price plummeted within 48 hours by more than $ 250 an ounce, ending below the initial level for this spectacular event.

Because platinum lacks market liquidity, it has little if any utility as an investment object. Annual platinum production at the average price amounts to only $ 7.8 billion.

Palladium

Palladium benefited from the positive environment set by other precious metals. Despite lower consumption, the price in dollars posted a gain of 24 %. Annual production again exceeded industrial demand. The steady rise in platinum production in South Africa led to greater availability of palladium, a byproduct of that process. The partial replacement of platinum by palladium in catalysts for diesel engines was more limited in scope than expected. Consumption in the jewelry industry, which logged record sums in 2005, slowed somewhat in 2006 but nonetheless remained impressive.

Rhodium

Catalysts for automotive emissions control currently use 85 % of the world's annual supply of rhodium. Global economic growth and continual tightening of emissions limits increased the demand for this metal in 2006. Because supply did not keep pace with demand, the price of rhodium more than doubled, peaking at $ 6,300 an ounce. The average for the year was $ 4,560 an ounce, $ 2,500 above the 2005 average.

Ruthenium
Ruthenium, a precious metal largely unknown among the general public, exhibited the most spectacular trend in 2006. Starting at $93 an ounce in January, the price rose by a factor of 6.5 to end the year at $610. Behind this jump lay a spike in consumption in the electronics industry. The demand for storage capacity in computers, MP3 players and video recorders equipped with hard disk drives rose sharply, requiring new and innovative materials and technology. Ruthenium held the key to the breakthrough shift from longitudinal to perpendicular recording technology. The new hard disk drives are coated with gossamer-thin layers of ruthenium – just three atoms thick – using sputter technology. Heraeus expertise was instrumental in the development of this technology, and the company supplies hard drive manufacturers with the essential coating materials.

Iridium
Iridium is the scarcest of the precious metals. Riding on the coattails of demand for the others, its price more than doubled to $400. The most important applications for iridium are found in chemistry, electrochemistry, and electronics. The metal is used particularly in spark plugs.

Functional Materials Division
Effective September 1, 2006, W.C. Heraeus and Heraeus Metallhandelsgesellschaft combined their activities related to semifinished products for the jewelry industry and dental alloys to form a new business segment known as the Functional Materials Division. The goal is to expand activity in the jewelry sector in the rapidly growing Asian markets and to augment the sale of precious metals in the dental industry by further strengthening our market position in the highly competitive European market for dental alloys.

Investments
To manage the sustained positive demand for its products as well as to secure the company's future, W.C. Heraeus invested €49 million in fixed assets during this fiscal year. The investments went toward expanding production capacity in Germany, the United States, and Asia as well as developing new production technologies. The most significant large-scale projects included expanding capacity for the new perpendicular recording technology in Chandler (U.S.A.), increasing production capacity for medical products in Europe and the United States, and expanding production capacity in Hanau (Germany) and Asia. Additional products already initiated in the previous year included replacement of capital assets at the Santa Fe Springs (U.S.A.) facility, investment in a fermentation plant for producing rubicins in Hanau, and construction of a precious metals processing plant in Port Elizabeth (South Africa).

Research and development
W.C. Heraeus invested its €22 million research budget in the development of new products and methods. Extending throughout the various divisions and focusing on various outcomes, these projects yield an overall innovation rate (revenue from products less than three years old) of more than 30 %.

Notable product innovations

- Combination of miniaturized metallic components for implants
- Residue-free solder pastes for SMT and semiconductor applications
- New generation of acceleration sensors for the automotive industry
- Improvement of the microstructure of oxide targets for perpendicular recording technology (third prize in the 2006 Heraeus Innovation Prize)
- Tube targets made of molybdenum for the display industry
- Precious metal coatings for ceramics applications

Outlook

For the coming year, W. C. Heraeus anticipates growth opportunities in the semiconductor and electronics industries – opportunities that this business segment, with its robust and innovative product portfolio, can use to further strengthen its market presence. Products containing precious metals have become indispensable to many electronics applications in the automotive industry. But precious metals also play an increasingly significant role in the pharmaceuticals industry. The implementation of more stringent emissions legislation in the United States will lead to higher sales volumes in small-engine and chemical catalysts. New technologies – such as photovoltaics – will increase the demand for metal coating materials for solar cells, silver pastes, and sputtering targets.

Considering its international structure and balanced product portfolio, W. C. Heraeus is well equipped to consolidate existing market positions as well as to take advantage of new sales opportunities in growth markets. The most important production facilities in Germany, the United States, and Asia are being consistently expanded and adapted to changing market requirements. The growth of W. C. Heraeus continues to rest on two pillars: organic growth based on pioneering product innovations, and greater market penetration with existing products, especially in Asia. Underpinning its organic growth are targeted acquisitions to round out its business activities worldwide. To control and further develop its complex organization in dynamic markets, W. C. Heraeus continues to rely on the management cybernetics methods already successfully implemented in certain divisions.

To secure controlled and profitable growth, the investment volume for 2007 also stands at a high level and is targeted to expanding capacity and strengthening the product portfolio.

Heraeus Electro-Nite

The steel industry's good economic situation, as well as worldwide growth in the automobile industry, once again had a positive effect on the sale of sensors. Global steel production rose once more by 9 % over the previous year to 1.2 billion tons, bringing with it sales prospects for high-quality steel sensors. The increasing use of diesel particle filters in automobiles also affected sales of platinum temperature sensors positively.

Steel production, which has the greatest influence on Heraeus Electro-Nite's business development, grew further – primarily in Asia, but also in Europe and the Americas. Because of the ongoing building boom, China continues to be Asia's biggest steel producer, with an 18 % increase in growth over the previous year.

Heraeus Electro-Nite's revenues rose by 13 % to € 339 million because of excellent development in primary customers' individual segments. The corresponding positive trend in the financial position was sustained.

Electro-Nite business segment

Steel market booms for the fifth consecutive year

The business with sensors that measure the temperature and content of oxygen, sulfur, and other elements in liquid steel was in full swing during the reporting year, primarily with customers from China, who now handle 34 % of the world's steel production. Close on China's heels are the future markets India, where steel production climbed by 8 %, and Russia, with expansion of 7 %. Steel production also continued to intensify in Europe (6 %) and North America (3 %), and Heraeus Electro-Nite was able to participate in this growth. Furthermore, as the only true global supplier, this business segment has the best prerequisites for doing justice to the steel industry's consolidation trend.

Sensor market leadership extended to the foundry market

The foundry market, with an annual output in the range of 70 million tons, is substantially smaller than the steel market, but it is nonetheless an interesting one in which Heraeus Electro-Nite has been operating as a market leader for many years. Similar to the steel business, the foundry market was also marked by strong growth in Asia in 2006.

Expansion of the aluminum sensor business progresses

Heraeus Electro-Nite's decision to offer sensors for the aluminum industry based on its long-standing expertise in steel temperature measurement proved to be a good choice. During the reporting year the business segment was able to demonstrate its expertise in this field with customers in more than 25 countries on all continents.

Investments and acquisitions with a focus on Asia and Eastern Europe

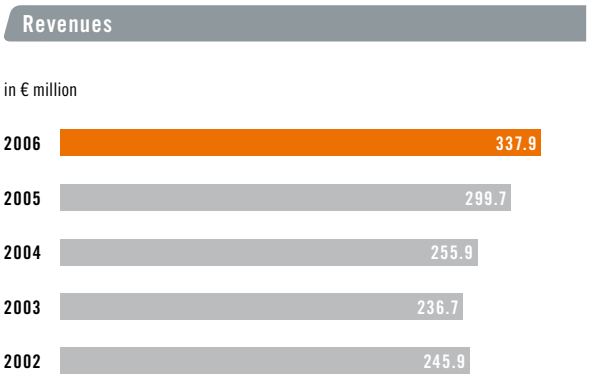
The continued positive demand for sensors in China required expansion of the production plants in Shenyang and Taicang as well as upgrading of the finishing and production lines at the Shanghai manufacturing facility. In addition, production capacities were increased in Poland, Turkey, and Brazil. Development has been positive at the production plant which was opened in the previous year in the Ukraine, one of the world's top ten countries for steel sales.

Heraeus Electro-Nite has persistently intensified its activities in Russia over the last two years. At the Heraeus Electro-Nite headquarters in Belgium, the division invested further in process optimization and efficiency increases.

To strengthen its global customer service, in recent years the business segment has gradually introduced an SAP platform to support distribution, reaching its companies in the United States, Canada, Poland, and Great Britain in fiscal year 2006.

Innovative market and technology leader

As a market and technology leader, Heraeus Electro-Nite invests in developing innovative products from the outset. The industry's highest development budget was increased in the reporting year to € 9 million. The development engineers emphasized creating new technologies in close collaboration with long-standing customers this year as well. The best example of this is a new sensor to determine slag density, which sets a new standard in steel production by contributing to increased productivity and cost savings for customers. In addition, Heraeus Electro-Nite engineers have developed additional innovative products for numerous industries – the steel industry, the aluminum industry, and foundries – helping the business segment further expand its technology leadership.



Sensor Technology Division

The business with temperature sensors for the automobile industry in particular demonstrated gratifying sales and revenue increases. In an effort to meet governmental environmental standards, more and more automobile manufacturers are being forced to use diesel particulate filters for which temperature sensors are the key components. In addition, the Sensor Technology Division benefited from high growth for standard elements in China.

With its extensive expertise in platinum thin-layer technology as well as expansion of the areas of application for high temperature elements – used in the process and oven industry – and the high rate of growth for standard elements, the division was able to further solidify its position as the world market leader in fiscal year 2006. On account of the good orders situation, production capacities were expanded and new manufacturing plants were put into operation. Heraeus Sensor Technology development engineers concentrated on further developing platinum element sensors – which in contrast to other types of sensors feature considerable technological advantages – as well as on expanding the product range to include sensors for higher temperatures, bio-sensor technology, and mass flow sensors, thereby increasing the Sensor Technology Division's technological advantage over the competition.

Outlook

Both Electro-Nite and the Sensor Technology Division can be optimistic about 2007. Global steel production, which is still on a course for growth, continues to be crucial for Heraeus Electro-Nite's business development. The division is very well prepared for it, but the development of steel capacities in China in comparison to domestic consumption must still be viewed with caution. If production and consumption get out of balance with each other, this could have negative effects on the traditional steel markets and thus also on Heraeus Electro-Nite's business. However, the expected continued consolidation process in the steel industry is an opportunity for the division to further expand its market and technology leadership through its capacity and market position.

Additional positive development can be anticipated for the Heraeus Sensor Technology Division due to the growing application potential for platinum thin-layer sensors, targeted expansion of the product portfolio, and its global market presence in growing sales regions, including the United States, Japan, Russia, China, and Europe.

Heraeus Kulzer

Continuing structural changes in the dental market led to a slight decline in Heraeus Kulzer revenues. The company was nonetheless able to improve its earnings in comparison to the previous year by strengthening sales and marketing activities in the divisions and regions, realigning product development, streamlining internal processes, and taking steps to increase cost efficiency.

Heraeus Kulzer revenues declined to € 327 million, down by a total of 2.5 % from the previous year. Despite the continuing overall decline in dental prosthetic work using classic mold technology, Heraeus Kulzer was able to maintain its hold on the precious metal alloy business. At the same time, the ceramic business profited from this same general development in the market. Against this backdrop, the business segment held its position in the dental laboratory business and, in part, expanded it. Heraeus Kulzer gained market share in the reporting year in particular in the removable and fixed prosthetics segments and the blend composites. As in previous years, business in dental products once again achieved growth rates. Especially in Germany and North America, revenues and earnings grew significantly for casting and filling materials.

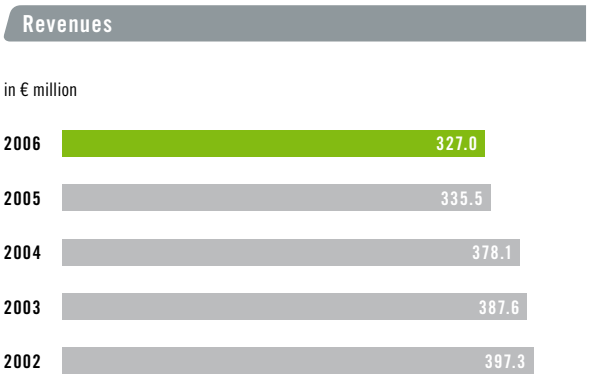
Heraeus Medical, producer of bone cement for orthopedic hip, knee and shoulder prostheses, largely completed the changeover to direct sales for its proven PALACOS® products in 2006. European sales of bone cement are now completely in its own hands. Heraeus Medical will continue to vigorously expand its market share on the foundation of this newly created sales structure and tap into additional potential with new products. In the United States, the sales partnership with Zimmer, the worlds´ largest orthopedics company, showed positive developments.

Strategic realignment vigorously pursued

Heraeus Kulzer had already responded to changing market conditions in 2004, introducing a timely strategic realignment with extensive restructuring elements that was rigorously continued in 2006. The product portfolio was further trimmed. With strengthened sales, the business segment further expanded its customer orientation. The development of a new umbrella trademark design aims to address its customers' growing communication needs. The entire trademark structure will be realigned with a clear focus on fewer umbrella trademarks that communicate the products' quality standard more clearly than previously.

In the context of its extensive restructuring and consolidation efforts, Heraeus Kulzer has invested in promising technologies and products and divested itself from businesses that have incurred losses. This includes ZL-Microdent Attachment GmbH & Co. KG, Breckerfeld, a precision mechanics subsidiary, and part of the North American dental materials business, the Jelenko dental alloys. Heraeus Kulzer also transferred its shares in Heraeus Kulzer Dental India Private Ltd. to the management there. By assuming the remaining shares of a joint venture partner during the reporting year, Heraeus Kulzer strengthened its position in the Chinese market.

On November 9, 2006, Dormagen (Germany) became the first Heraeus Kulzer production site to successfully complete inspection by the Food and Drug Administration (FDA) and receive confirmation of its high-quality standards. Heraeus Kulzer develops and produces precision dental casting materials, such as the addition silicone Flexitime and the polyether P2, at the Dormagen facility. The Dentistry



Division completed an extensive strategy process and a large part of its R&D projects and thus created important prerequisites for future growth.

From laboratory specialists to dental engineering company

Step by step, Heraeus Kulzer has developed from a traditional primary supplier of dental alloys and laboratory specialists to a dental engineering company, an enterprise that uses integrative systems to combine proven, functional designs with state-of-the-art production and materials technology while consistently pursuing the principle of economic efficiency and esthetics. To that end, Heraeus Kulzer invested in promising new technologies and increased its research budget by 40 % during the reporting year.

Heraeus Kulzer responded to increasing demands for dental implants by developing a new implant system, IQ:NECT, distinguished by its revolutionary connecting technology. The system, which had already won a technology transfer prize the previous year, was launched on the market in 2006.

In April 2006, Fixed Prosthetics addressed the continuing decline in the dental alloys business with GoldGarant alloys, a new service package of high-quality Heraeus gold alloy in combination with a lifetime materials replacement guarantee as well as a five-year guarantee on the finished dental prosthesis.

Outlook

Worldwide, the health industry will only gain in significance in the coming years. Markedly longer life expectancy will mean that the need for services to maintain health will include dental prosthesis as well. So Heraeus Kulzer will continue to concentrate strategically on the manufacture and sale of dental and medical products. With its strategy of "growth and pruning" – which Heraeus Kulzer rigorously pursued in the reporting year – the course has been set for future profitable growth. The entire product range is oriented toward customer success, with systems and solutions that are economical and efficient. Heraeus Kulzer will be represented at the 2007 International Dental Show (IDS) in Cologne, the world's largest dental trade show, with a completely new trademark image, showcasing product innovations that should contribute decisively to ensuring the business segment's future.

Heraeus Quarzglas

Developments in the semiconductor industry, marked by great investment activity and significant volume growth, contributed to a 30 % increase in Heraeus Quarzglas revenues compared to the previous year, to € 184 million. The good market situation, together with productivity advances and ongoing reduction in primary costs, had a positive impact on earnings as well. Staff was reduced in both Hanau and Kleinostheim (Germany) and the facility in Nijmegen (the Netherlands) was closed.

Microlithography: Strong growth in a revived semiconductor industry

The Microlithography business unit sells products made of fused silica for high-tech applications in optical microlithography.

Positive business developments in the semiconductor industry found expression during the reporting year in a significant increase in orders of approximately 80 % for microlithography products. Heraeus Quarzglas was well prepared for the unexpectedly strong demand, in no small part with its new products – quartz glass materials for the newest generation of 193-nm immersion lithography – and so was able to further expand its already strong market position by gaining greater market share. The technology leadership position of Heraeus Quarzglas products, combined with quick adjustment to market needs and high supplier flexibility, proved to be factors for success over the competition. Contemporaneous customized development of new materials for the semiconductor industry is the development focus of Heraeus Quarzglas and will continue to be the decisive factor in the market success of this business unit.

Basic Materials: High utilization through strong demand

The Basic Materials business unit produces semi-finished goods in the form of rods, tubes, plates, and opaque preformed parts made of high-purity silica.

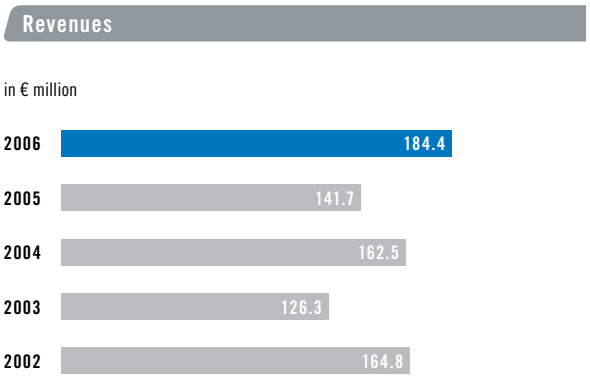
Strong demand for basic materials led to volume growth of around 50 % compared to the previous year and a correspondingly high production utilization that required selective expansion of capacity. To increase productivity, Heraeus Quarzglas further reduced production costs. The acquisition of new customers also contributed to a very good increase in revenues and significant improvement in earnings for this business unit during the reporting year.

Fabrication: New products for new markets

The Fabrication business unit produces equipment and apparatuses made of high-purity silica for the production of microchips.

Strong demand resulted in high utilization of production capacity at all facilities. Rationalization measures, such as streamlining production capacities and improving organizational structure and production processes in the previous year, took full effect. In order to be able to respond more quickly to market demands and reduce costs, production was reorganized in Germany.

The new products in 300-mm wafer technology introduced the previous year enabled Heraeus Quarzglas to gain market share for the first time during the reporting year. Heraeus Quarzglas also opened a promising new market with new products for the solar industry: special large tubes of silica that are used in the coating of solar panels. Earnings development in this area is still not satisfactory.



Crucibles: Increasing market share
The Crucibles business unit manufactures quartz crucibles for growing silicon monocrystals that are subsequently processed into wafers.

The Crucibles business unit participated in a market that continued to grow. The production capacity for quartz crucibles in Bitterfeld (Germany) was expanded. Investing in state-of-the-art production technologies created the foundation for the manufacture of crucibles for the production of the newest generation of wafers. Heraeus Quarzglas strengthened its market position in the field of crucibles by acquiring new customers.

Lamp Materials: Improved competitiveness
The Lamp Materials business unit offers a broad spectrum of high-quality quartz glass tubes and plates for light sources, specialty lamps, and radiation applications.

Revenues from premium products, which were already successful in the previous year, were increased once again during the reporting period through the development of the product range and quality improvements. Positive qualification of another digital projection customer in Asia has set the course for a growing business in this new market segment. The business unit improved its competitiveness with the expansion of its product portfolio to include economical products in growing market segments.

Standard Optics
The Standard Optics business unit offers a broad spectrum of custom-tailored solutions made of silica for optical applications.

In addition to solid day-to-day business, the Standard Optics unit achieved high revenue in 2006 by participating in major scientific projects. These include in particular high-energy laser projects, the aim of which is to generate energy by means of laser-induced nuclear fusion and the gravitation wave detectors that use highly sensitive interferometers to provide proof of the gravitation waves Albert Einstein predicted. These projects on the frontier of scientific research entail large requirements for high-quality silica.

Innovations

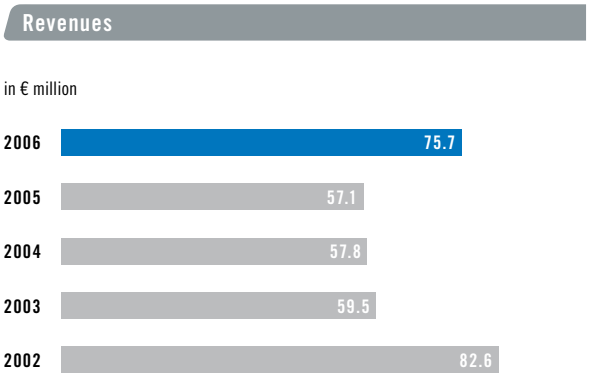
The farsighted, customized development of new products was again the focus of development activities in fiscal year 2006. The R&D budget was increased by 7 % to € 8.4 million and, at 5 % of revenue, was higher than the previous year's level. In all, almost 40 % of revenue was earned with products less than three years old. The Microlithography area invested in the continuing optimization of product features to expand its technological leading position. The Crucibles business unit developed new products for the growing 300-mm wafer market and for new customers. The Lamp Materials business unit was successful in developing innovative coating technologies with opaque silica. In the area of Fabrication, the introduction of new process techniques led to the first customer-specific product solutions. As in previous years, another important focus was the development of production processes to reduce manufacturing costs and improve quality.

Outlook

We can expect a stable business environment in the semiconductor industry during the first half of 2007. Cyclically driven softer investment activity can be expected in the second half of the year. Overall, revenues are not expected to reach the high level of fiscal year 2006. Heraeus Quarzglas is well prepared for this development, with its high production flexibility and measures to further increase productivity in all areas.

Heraeus Tenevo

Strong growth in the market for fiber optics, especially in China and the United States, had a positive impact on the business development of Heraeus Tenevo. Revenues rose 33 % from the previous year, to € 76 million. Strong order volumes for high-purity fused silica tubes for optical waveguides and special fiber preforms for optical data transfer, as well as related production utilization, clearly improved earnings compared to the previous year.



The global market for fiber optics continued to recover during the reporting year. With continued strong pressure on costs, Heraeus Tenevo, together with its key customers, was able to win greater market share in growth markets in the United States and China. With the RIC (rod in cylinder) technology developed by Heraeus, the business division achieved another cost and quality advance for its customers compared to the competition. The European market grew moderately at 10 % compared to the previous year, mainly through investment projects to expand broadband networks in rural areas.

The US optical fiber market grew by more than 40 % in 2006, a development similar to the previous year's trend. The essential growth engine was the increasing need for broadband connections (fiber-to-the-home technology) in which fiber optics are laid up to the house, facilitating enormously high broadband. Heraeus Tenevo profited from this development.

After a restrained 2005 with an almost stagnant optical fiber market, China registered very high demand of more than 40 % over the previous year, driven by telecom and data network requirements for the Olympics in 2008. As the main supplier to a major Chinese customer that supplies fiber-optics cables for the Chinese network, Heraeus Tenevo profited from this development.

Based on very strong demand, Heraeus Tenevo not only fully utilized existing production capacity; Plant 1 in Bitterfeld, which had been closed down, was temporarily put into service again. This measure allowed all customer needs to be met while simultaneously keeping investments at a low level.

The Fluosil® preforms for specialty fibers made it possible for Heraeus Tenevo to further expand its market position, especially in medicine, and thus continue the positive trend of the previous year.

Innovations

The RIC (rod in cylinder) technology developed by Heraeus, which concentrates the manufacture of fiber optics into a single production step, was taken up by key customers in China and the United States, and went into series production. In the context of this series production, the quality and efficiency of RIC technology, which is used to manufacture both preforms and optical fibers directly, was further optimized.

Outlook

Continued strong fiber optics markets worldwide are expected for 2007. Volume growth will not develop quite so strongly, however, since some preform and fiber optics manufacturers are already working at full capacity. All market participants view the construction of new production facilities very cautiously. The focus is therefore on technological developments and optimization of existing production capacity. Heraeus Tenevo will support its customers in this development with technologically sophisticated products and customized solutions.

The merger of the business segments Heraeus Quarzglas and Heraeus Tenevo at the beginning of 2007 has consolidated the silica expertise at Heraeus – a move that will improve the development of new products and technologies and be especially beneficial to our customers. The new company, operating under the name of Heraeus Quarzglas GmbH & Co. KG, earned revenues of around € 260 million, with more than 1,400 employees at eight facilities around the world.

Heraeus Noblelight

In 2006, Heraeus Noblelight achieved a new record in company history in both revenues and earnings. Revenues rose by 11 % to € 88 million. Products from almost all business areas accounted for this positive development. The good market response to high-performance long-life lamps for water disinfection, strong revenue growth with infrared lamps, and stable business with UV-curing and arc and flash lamps contributed to this success.

The Optics and Analytics business unit developed positively in 2006, with stable growth after the successful integration of two recently acquired companies. Bucking the industry trends, Original Hanau SunCare posted a gain in revenues, although earnings remained below expectations due to the continuing difficult situation in the industry.

Industrial Process Technology:
Intelligent heat finds new applications

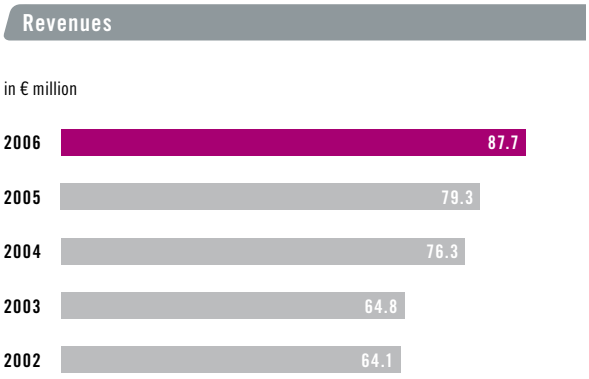
The Industrial Process Technology business unit was able to rely on two strong growth drivers during the reporting year and noticeably increase revenues and earnings. For one, orders received for infrared lamps increased from the machinery and plant manufacturing industry as longstanding customers saw growing demand for their products. For another, Heraeus Noblelight, with its customer-oriented innovations, was able to tap into new applications for infrared heat, with which processes can be made more efficient and energy saved. Here there were successful market launches in the food industry and in the production of photovoltaic cells in 2006. With energy prices rising, infrared radiation as an especially efficient form of heat transmission will be an increasingly attractive alternative for more and more industrial applications.

Optics and Analytics:
Growth in the wake of successful integration

In the first full fiscal year after acquiring two competitors, positive development in revenues and earnings of the Optics and Analytics business unit showed that the integration was successful. Supply bottlenecks that surfaced at the start of the year through the high demand and realignment of production were resolved. The combination of a comprehensive product portfolio and expert service enabled the business unit to acquire new customers. With compact photoionization lamps (PID), Heraeus Noblelight offers an ideal product for the growing market for devices for online process monitoring and mobile gas analysis. The reorganization of its dealer network will facilitate even more intensive support to dealer partners and thus better customer service in the future.

Surface and Environmental Technology:
Green technology with blue light

The Surface and Environmental Technology business unit is active, supplying UV lamps for disinfection and degermination of water, air, and packaging for a market that profits from growing environmental consciousness. Heraeus Noblelight believes strongly in technology leadership and products with superior performance. The long-life amalgam lamps from Heraeus not only offer the longest life span on the market but also facilitate the design of more efficient water treatment plants. Plant constructors worldwide have responded very positively to these advantages and increasingly use Heraeus lamps. At the leading trade show Aquatech Amsterdam, Heraeus Noblelight was the first manufacturer to exhibit a functional 600-watt amalgam lamp. Heraeus also set new standards in the area of packaging disinfection with an excimer system for fast-running machinery. In all, revenues and earnings of this business unit grew noticeably during the reporting year.



Heraeus Amba:
Stable business and satisfied customers
UV curing lamps with the Amba Lamps brand are very popular with customers around the world for their reliability and uncomplicated service. Heraeus Amba was able to increase revenues and earnings again during the reporting year. Strengthened marketing activities succeeded in convincing more customers of the advantages of Amba lamps. Heraeus is also successful in new applications for UV curing lamps, for example in renovating waste water systems.

Heraeus Noblelight Limited:
Investments in laser technology
Forty years after the introduction of the first Rubin lasers, lamp-pumped lasers are still being consistently developed and improved. The Arc and Flash Lamps business unit supports leading laser manufacturers through investments in research and development and in new production processes for lamps. During the reporting year, this business unit was able to acquire new customers and thus put its growth on a broader basis. Revenues and earnings met high expectations.

Original Hanau SunCare:
Revenue growth in a difficult environment
Original Hanau SunCare was able to increase revenues compared to the previous year in the midst of a stagnating market. New products introduced last year, such as the VARIUS system, and increased sales activities contributed to this. However, this positive development has not yet boosted earnings. The imminent regulation of tanning beds in the EU poses new challenges for Original Hanau SunCare that this business unit intends to utilize to gain market share.

Outlook

UV light and infrared heat are cross-sectional technologies that are used in many industries and have the potential for additional applications. Through close cooperation with customers, Heraeus Noblelight opens up targeted new applications and thus new growth areas for the company. It also develops existing applications to ensure competitive advantages for customers that rely on high tech from Heraeus Noblelight. To that end, Heraeus Noblelight invests in production in Germany and other countries. Technical sales are being further expanded, primarily through subsidiaries in North America and China. The business segment is planning additional targeted acquisitions and cooperative ventures in attractive markets as well.

80%

KLEINOSTHEIM. Positive developments in the semiconductor industry have boosted orders for quartz glass for microlithography by 80 %. With our new products – quartz glass for the latest generation of 193-nm immersion lithography – we were well prepared for the unexpectedly high demand. This enabled us to build on our already strong market position.

DR. BRUNO UEBBING, DR. RALF TAKKE, DR. STEPHAN THOMAS, ROLAND ECKL –
THE MICROLITHOGRAPHY TEAM OF HERAEUS QUARZGLAS GMBH & CO. KG (GERMANY)

Consolidated Balance Sheet

of Heraeus Holding GmbH, Hanau, as of December 31, 2006

Assets in € million	Dec. 31, 2006	Dec. 31, 2005
Cash and cash equivalents	127.0	134.8
Securities	208.3	269.1
Trade receivables	432.5	342.4
Current tax receivables	47.7	49.0
Miscellaneous receivables and other assets	58.1	48.9
Inventories – excluding precious metal	293.1	259.1
Precious metal	459.8	490.9
Current assets	**1,626.5**	**1,594.2**
Goodwill	25.0	26.6
Other intangible assets	34.3	46.4
Property, plant and equipment	596.1	598.2
Investments at equity	80.9	76.3
Other financial assets	10.7	5.8
Non-current tax receivables	17.3	–
Deferred tax assets	37.6	81.0
Non-current assets	**801.9**	**834.3**
Total assets	**2,428.4**	**2,428.5**

Shareholders' equity and liabilities in € million	Dec. 31, 2006	Dec. 31, 2005
Trade payables	127.9	142.5
Liabilities due to banks	71.2	40.2
Tax liabilities	57.0	42.9
Other current liabilities	89.3	105.8
Current provisions	83.4	81.0
Current liabilities	**428.8**	**412.4**
Bonds	149.4	248.2
Promissory notes	95.8	146.9
Liabilities due to banks	49.7	66.4
Other non-current liabilities	15.0	13.6
Provisions for pensions and similar obligations	263.3	246.1
Other non-current provisions	77.6	80.0
Deferred tax liabilities	61.9	55.6
Non-current liabilities	**712.7**	**856.8**
Capital subscribed	105.0	105.0
Retained earnings	1,210.4	1,062.6
Other comprehensive income	–42.2	–22.2
Minority interests	13.7	13.9
Shareholders' equity	**1,286.9**	**1,159.3**
Total shareholders' equity and liabilities	**2,428.4**	**2,428.5**

Consolidated Income Statement

of Heraeus Holding GmbH, Hanau, for the period January 1 to December 31, 2006

in € million	2006	2005
Revenue	**12,079.5**	**9,311.4**
Other operating income	78.2	59.9
Cost of materials	–10,974.6	–8,380.6
Personnel expenses	–503.5	–496.0
Amortization, depreciation and impairment	–89.7	–71.0
Other operating expenses	–307.2	–249.8
Income from investments accounted for using the equity method	8.0	4.5
Earnings before interest and taxes (EBIT)	**290.7**	**178.4**
Financial result	–23.5	–14.8
Interest share of provisions for pensions	–10.4	–10.8
Income before taxes	**256.8**	**152.8**
Income taxes	–56.3	–29.3
Exceptional German corporate tax	17.3	–
Deferred taxes	–44.5	–18.5
Net income	**173.3**	**105.0**
Minority interests	–3.9	–2.9
Net income after minority interests	**169.4**	**102.1**

Consolidated Cash Flow Statement

of Heraeus Holding GmbH, Hanau, for the period January 1 to December 31, 2006

in € million	2006	2005
Net income	**173.3**	**105.0**
Amortization of intangible assets	21.1	5.3
Depreciation and impairment/write-ups of property, plant and equipment	68.3	65.1
Impairment/write-ups of financial assets	–	0.2
Changes in non-current provisions	15.5	12.3
Other non-cash expenses/income	39.8	16.4
Gross cash flow from operating activities	**318.0**	**204.3**
Profit/losses from the disposal of non-current assets	1.8	–2.7
Changes in current provisions	5.9	13.4
Changes in inventories	–37.8	–166.1
Changes in trade receivables	–104.9	–48.9
Changes in trade payables	–1.3	30.4
Changes in other assets and liabilities	20.6	–17.2
Cash flow from operating activities	**202.3**	**13.2**
Cash inflows from the disposal of non-current assets	6.7	13.3
Cash outflows for investments in non-current assets	–113.2	–119.8
Changes in other financial assets	62.3	231.3
Cash flow from investing activities	**–44.2**	**124.8**
Cash inflows from minority interests	0.3	1.3
Dividends paid, including dividends to minority interests	–27.6	–28.4
Changes in interest-bearing liabilities	–133.9	–37.9
Cash flow from financing activities	**–161.2**	**–65.0**
Net change in cash and cash equivalents	**–3.1**	**73.0**
Effect of exchange rate differences on cash and cash equivalents	–4.7	9.4
Cash and cash equivalents at the beginning of the period	134.8	52.4
Cash and cash equivalents at the end of the period	**127.0**	**134.8**

In addition to cash and cash equivalents, securities are held as a liquidity reserve. Pursuant to IAS 7, the changes in this balance sheet item are presented within the changes in other financial assets.

Extract from the Notes to the Consolidated Financial Statements

of Heraeus Holding GmbH, Hanau, as of December 31, 2006

Basis of presentation

The consolidated financial statements of Heraeus Holding GmbH, Hanau, Germany, for the fiscal year 2006 were prepared in accordance with the International Financial Reporting Standards (IFRS). All standards of the International Accounting Standards Board (IASB) applicable as of December 31, 2006, and relevant interpretations of the International Financial Reporting Interpretations Committee (IFRIC) have been taken into account.

The fiscal year encompasses the calendar year.

The requirements of Section 315a (1) HGB for an exemption from the duty to prepare an additional set of consolidated financial statements in accordance with HGB have been met. In order to achieve equivalence with German HGB statements, all disclosures and explanations required under HGB have been made, thus exceeding the disclosure requirements under IFRS.

The consolidated financial statements were prepared in euro. Unless noted otherwise, all amounts are stated in millions of euro (€ million).

To improve the clarity of presentation and transparency of the annual financial statements, various items in the balance sheet and income statement have been combined and stated separately in the notes to the consolidated financial statements.

The income statement has been prepared using the nature of expense method. In order to improve transparency, the financial result has been included in the income statement. In addition to the net interest income and expenses, the financial result also includes the other expenses and income related to the disposal and measurement of the financial instruments.

Principles of consolidation

The financial statements of companies included in the consolidated financial statements are generally prepared as at the Group's closing date using uniform accounting and measurement principles in accordance with IFRS.

For companies that were initially consolidated before January 1, 2004, the acquisition was accounted for using the book value method according to Section 301 (1) No. 1 HGB. The acquisition costs of the shares in subsidiaries were offset against the carrying value of the Group's share in equity at the date of the acquisition or first-time consolidation.

For companies that were initially consolidated after the transition to IFRS (January 1, 2004), the acquisition was accounted for using the purchase method according to IFRS 3. This method prescribes a revaluation of the acquired Company, where all hidden reserves and hidden charges must be disclosed and all identifiable intangible assets must be recognized separately. Any excess of cost of acquisition over net assets acquired remaining after the purchase price allocation is capitalized as goodwill and tested for impairment once a year to determine if the acquisition has maintained its value. If this is not the case, an impairment loss is recognized.

Investments in associates valued using the equity method are stated at the respective share in equity.

In the consolidation of income and expenses, intercompany sales and other intercompany income were offset against the corresponding expenses. Profits and losses from intercompany sales and services were eliminated. Due to their immateriality, intercompany profits of associated companies have not been eliminated. Intercompany receivables and liabilities have been offset.

Deferred taxes are recognized for temporary differences related to consolidation entries.

Currency translation

The financial statements of foreign subsidiaries prepared in foreign currency were translated using the modified closing rate method as defined in IAS 21, following the functional currency concept. As the subsidiaries are financially, economically, and organizationally independent, their functional currency is identical with the respective local currency. In the case of one foreign subsidiary, the functional currency is the US dollar instead of the national currency. Income and expense items from statements prepared in foreign currency are translated at average rates for the year. Assets and liabilities are translated at closing rates and equity at historical rates. Any differences arising from the translation of equity are recognized directly in shareholders' equity, as are exchange differences from translating items of the income statement.

Exchange differences arising from debt consolidation were recognized as profit or loss and reported as other operating income or expenses.

Foreign currency receivables and liabilities in the separate financial statements of local subsidiaries are valued at the closing rate. Any unrealized exchange gains or losses are taken to the income statement.

Revenue

Revenue attributable to the individual divisions is as follows:

in € million	2006	2005
Precious Metal	11,055.0	8,387.2
Sensors	337.9	299.7
Dental Health	327.0	335.5
Quartz Glass / Tenevo	260.1	198.8
Specialty Lighting Sources	87.7	79.3
Others	11.8	10.9
Revenue	**12,079.5**	**9,311.4**

The revenue broken down by region totals:

in € million	2006	2005
Germany	1,213.9	996.4
Europe excluding Germany	4,659.0	3,998.3
Americas	3,659.2	2,412.6
Asia	2,343.4	1,808.1
Others	204.0	96.0
Revenue	**12,079.5**	**9,311.4**

The product revenue broken down by region totals:

in € million	2006	2005
Germany	512.2	411.5
Europe excluding Germany	579.0	443.4
Americas	500.8	456.7
Asia	1037.1	744.5
Others	60.6	55.1
Product revenue	**2,689.7**	**2,111.2**

Personnel expenses

The following expense types are included in personnel expenses:

in € million	2006	2005
Wages and salaries	416.9	396.3
Social security, pension and other benefits	86.6	99.7
(thereof: for pensions)	(20.6)	(34.8)
Personnel expenses	**503.5**	**496.0**

The average number of employees breaks down as follows:

	2006	2005
Precious Metal	3,780	3,449
Sensors	3,021	2,806
Dental Health	1,580	1,637
Quartz Glass / Tenevo	1,474	1,486
Specialty Lighting Sources	654	679
Others	497	484
Total	**11,006**	**10,541**

The extract above was taken from the complete Consolidated Financial Statements. PricewaterhouseCoopers Aktiengesellschaft, Wirtschaftsprüfungsgesellschaft has issued us an unqualified auditor's report for the complete Consolidated Financial Statements and the Group Management Report.

Key Financial Indicators for the Group 1997 – 2006

	2006	2005	2004[1]	2003	2002	2001	2000	1999	1998	1997
Financial performance in € million										
Revenue	12,080	9,311	8,260	7,412	6,415	6,838	8,020	4,583	4,109	4,626
Product revenue	2,690	2,111	1,951	1,743	1,747	1,975	2,291	1,667	1,554	1,694
Precious metal trading revenue	9,390	7,200	6,309	5,669	4,668	4,863	5,729	2,916	2,555	2,932
Earnings before interest and taxes (EBIT)	291	178	196	131	114	156	245	170	126	220
Net income	173	105	104	73	53	280	150	88	90	98
Financial position in € million										
Total assets	2,428	2,429	2,254	1,952	1,781	1,750	1,633	1,577	1,397	1,305
Shareholders equity	1,287	1,159	1,027	702	899	862	723	610	542	462
Equity-to-assets ratio in %	53%	48%	46%	36%	50%	49%	44%	39%	39%	35%
Cash flow in € million										
Gross cash flow from operating activities	318	204	238	167	164	137	254	190	218	205
Capital expenditure	84	67	71	70	80	105	118	59	134	175
Depreciation	69	66	73	73	61	64	88	80	105	99
Working capital[2]	1,057	950	701	484	505	587	572	434	425	399
Employees										
Employees at year-end	11,275	10,625	9,832	9,219	9,007	9,181	10,244	9,223	9,196	10,328
In Germany	4,381	4,399	4,369	4,350	4,211	4,484	4,964	4,589	4,796	5,550
Outside of Germany	6,894	6,226	5,463	4,869	4,796	4,697	5,280	4,634	4,400	4,778
Personnel expenses	503	496	464	431	437	471	481	411	435	446

[1] Transition of accounting to IFRS.

[2] Inventories plus trade receivables less trade payables.

The Year 2006 at a Glance

Heraeus Quarzglas subsidiary honored

In a festive awards ceremony, HeJian Technology (Suzhou) Co., Ltd. saluted Heraeus ShinEtsu Quartz Inc (HSQC) as an outstanding supplier. The Chinese subsidiary of Heraeus Quarzglas, which has provided silica glass products to the leading Chinese chip manufacturer since 2004, quickly established its position as top supplier.

February

Acquisition in sputtering target business

W. C. Heraeus took over the sputtering target business of Singapore-based manufacturer Electronic Materials Technologies Pte. Ltd. from US owner International Specialty Alloys. With this acquisition, Heraeus expands its position as a provider of sputtering targets for the display industry, now experiencing a strong upturn, especially in Asia. The new site in southwest Singapore joins Shanghai as an important production center for Heraeus in Asia.

March

May

June

September

Platinum resistance thermometers mark 100 years

Modern temperature measurement technology was born about 100 years ago. In 1906, the German Imperial Patent Office awarded the W. C. Heraeus Company of Hanau a patent for an “electric resistance thermometer made of platinum wire.” But that thermometer, invented by Richard Küch (1860–1915), was just the first in a long series of innovative sensors and temperature measurement devices. Sensor specialists Heraeus Electro-Nite and Heraeus Sensor Technology continue this tradition as market leaders and technology pioneers, introducing one first-rate innovation after another.

Production of solar cells with infrared heat

The photovoltaics industry is now booming in China as well. The Chinese government heavily promotes the technology as the energy carrier of the future, and Shanghai, China, is expanding its position as a photovoltaics center. Heraeus Noblelight Shenyang maintains close contact with companies building large plants there. This business strategy was recently validated by a major contract with a leading Chinese photovoltaics company.

Heraeus business segments Quarzglas and Tenevo consolidate resources

With the strategic decision to recombine the two business segments Heraeus Quarzglas and Heraeus Tenevo on January 1, 2007, Heraeus Quarzglas GmbH & Co. KG was formed. Heraeus has consolidated its quartz glass expertise in a single entity, and strengthened its foundation for long-term profitable growth.

Heraeus Electro-Nite wins 2006 Ambiorix Prize

Heraeus Electro-Nite receives the 2006 Ambiorix Prize from the Limburg Employers Association at a ceremony in Houthalen (Belgium). The prestigious award recognizes outstanding achievement, both qualitative (organization, leadership, environmental awareness) and quantitative (innovations, earnings). The honor reflects many years of hard work and dedication on the part of the entire staff at Heraeus Electro-Nite's Houthalen headquarters.

Innovation Prize 2006

A fast sensor (the Smart Sensor from Heraeus Electro-Nite) that makes steel production more efficient, a filling material from Heraeus Kulzer that restores defective teeth more effectively and safely than existing materials, and a coating material developed by W. C. Heraeus that makes it possible to increase tenfold the storage capacity of hard drives – these are the pioneering developments recognized with the 2006 Heraeus Innovation Prize.

Takeover of joint venture in China completed

Its organizational structures have been revamped, its sales and marketing have been refocused, and the full takeover of Heraeus Kulzer Dental Ltd. (HKCN) is now complete. One of the first international dental materials companies to set up shop in China, HKCN celebrated its 20th anniversary in November.

September | October | November

Environmental protection with innovative UV lamps

Heraeus Noblelight launched an innovative high-powered UV-amalgam lamp for water treatment at the Aquatech Amsterdam trade show. At 600 watts, this is the most powerful UV-amalgam lamp on the market. In comparison to its highest-powered predecessor, a 400-watt lamp, it produces 50% more ultraviolet radiation over a long life span. As a renowned manufacturer of UV lamps for the water treatment industry, Heraeus Noblelight is the partner of choice for many systems builders in this growth market.

Heraeus strengthens platinum business in Europe

W. C. Heraeus took over the European activities of the French Fremapi Group, bolstering its position as the leading provider of platinum components and alloys, especially for the glass industry. With this acquisition, the company expands its spectrum of products and services as a supplier of high-quality platinum products for a wide range of industrial applications. It also strengthens its business of processing catalysts containing precious metals.

2nd Heraeus Platinum Metals Forum

Heraeus Metallhandelsgesellschaft hosted the second Heraeus Platinum Metals Forum, an event that premiered in 2005. The company welcomed 120 customers to the symposium in Hanau, where top-flight industry representatives and research experts presented papers on the latest developments in the precious metals market.

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