skw. metallurgie

Annual Report 2006

Growth with **Substance**

What makes SKW Metallurgie special?

Clearly defined market focus on growing niche markets

Customers: Worldwide quality steel manufacturer

Critical raw materials with very low share in the costs for steel production

Benefits from the trend to high-quality steel and from the increase in total steel production

Competitive structure locally fragmented

Significant market share

Cored wire: Inventor of the technology and worldwide market leader, distinguished by improved cost efficiency for the customer

Powder and Granules: The larger of the two leading providers in the regional market of Central Europe, and market leader in India for carbide-based iron desulphurization products (joint venture: Jamipol)

Financially healthy company

Offers attractive and sustainable returns

Financially strong through a solid equity basis

Attractive and highly profitable growth potential

Expansion in new regional markets (e.g. Eastern Europe, Asia)

Acquisitions provide access to new markets as well as to critical raw materials

Introduction of new products / vertical integration for improvement of margins

Investment possibilities in attractive growth markets with threefold growth potential

Profitable growth in sales through

- Acquisitions
- Expansion through new production facilities in new regional markets

Margin growth through

- New products
- Vertical integration

Key Figures

	Unit	2006	2005
Turnover	€ thousand	185,828	192,738
Total revenue	€ thousand	186,054	198,343
EBITDA	€ thousand	13,600	13,169
EBIT	€ thousand	11,741	11,348
EBT	€ thousand	12,015	11,504
Consolidated net profit	€ thousand	9,233	10,524
Earnings per share	€	2.09	n/a
Tax margin		23,2%	8.6%
Gross margin		21.5%	20.5%
EBIT margin		6.3%	5.7%
RONA		28.7%	30.1%
Total equity & liabilities	€ thousand	112,109	77,562
Consolidated equity	€ thousand	66,769	25,943
Equity ratio		59.6%	33.4%
Net financial liabilities	€ thousand	19,408	-19,662
Gearing		29,1%	-75.8%
Cash flow from operating activities	€ thousand	10.444	6,281
Free cash flow	€ thousand	9.060	4,199
Depreciation of property, plant and equipment	€ thousand	1,859	1,821
Number of employees (average)		226	221

Products of the SKW Metallurgie Group are used in var

Raw iron
Melting of iron ore, coke and/or scrap iron

Desulphurisation
by the addition of calcium carbide ("CaC2") and/or calcium and magnesium

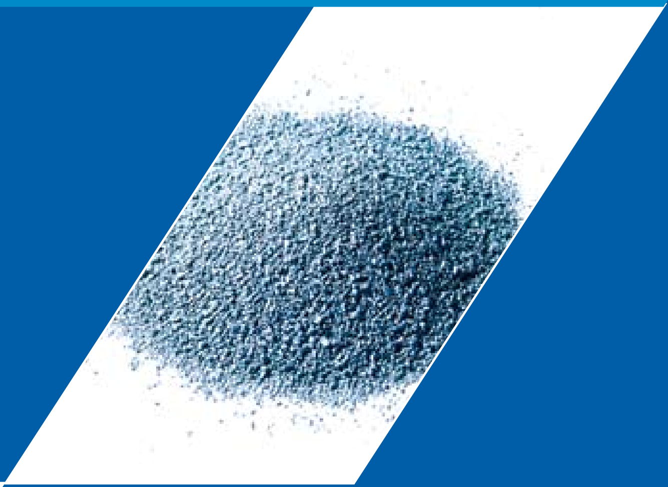
Refining
of iron to steel
Extraction of carbon

affival®

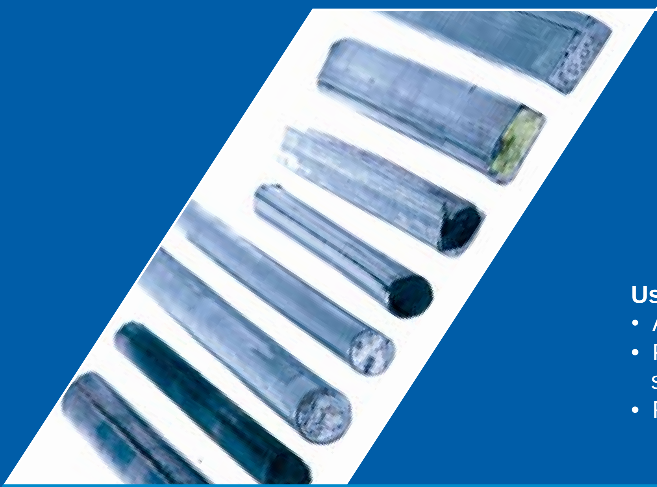
Two strong brands

skw. metallurgie

Powder and Granules segment



Used in primary and secondary metallurgical processing
- SKW's predecessor was the trailblazer of the sector in 1948
- Joint venture in India in 1995
- Percentage of sales in 2006: 25%



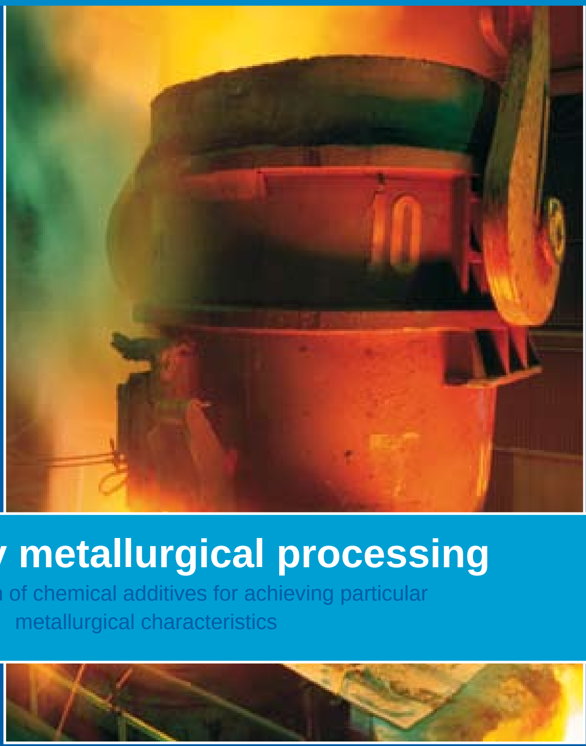
affival®

Cored Wire segment

Used in secondary metallurgical processing
- Affival was the trailblazer for cored wire in 1981
- Presence in the USA since 1985 and in East Asia since 1987 (initially Japan, later South Korea)
- Percentage of sales in 2006: 75%

Since 2004, the two units have operated under common management which makes use of considerable synergy in procurement, R&D and overhead.

ious crucial phases of steel manufacturing



skw. metallurgie

Secondary metallurgical processing

by the addition of chemical additives for achieving particular metallurgical characteristics

Casting

Further processing

SKW Metallurgie worldwide

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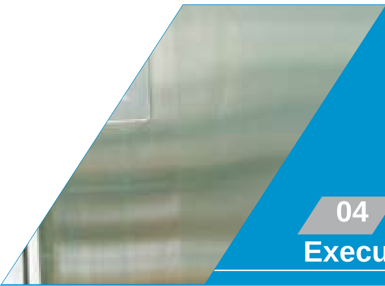

Application are:
Household Appliance
Metal surfaces such as
those in modern kitchens
have superb, defect free
surfaces through the precise
addition of aluminum and
calcium wire products

Foreword from the Executive Board

Dear Ladies and Gentlemen,
Dear shareholders of our Company,

With financial year 2006, a new era of the Company on the way to even more internationality began for the SKW Stahl-Metallurgie Group. After the corporate turnaround and strategic reorganisation of our business activities during the previous years, we set the course for new profit-oriented dynamic growth with the conversion of our Company to a stock corporation in April 2006 (entry in the commercial register: May 2006) and the successful IPO in December 2006.

Today, we are the worldwide market leader with our "Cored Wire" segment and the market leader in important regional markets with our "Powder&Granules" segment. We intend to further build on this outstanding competitive position in the coming years through targeted acquisitions, e.g. in Asia or North America as well as through the development of new production systems, e.g. in Russia, Turkey or India. Furthermore, we wish to strengthen the profitability of individual activities further, by introducing new innovative products to the market or securing access to strategically important raw materials or primary products through vertical integration. We will use the proceeds from the IPO for the planned activities to generate profits.

The recently closed takeover of the "Quab" activities from Degussa Group (part of the RAG Group) is a first growth step. More are expected over the course of the year.

Further growth potential for our products for steel refinement

With our further corporate development, we will also profit from the dynamic development of worldwide steel production. The economic cycles of the past were always characterised by a rise and fall in the price development for steel. Crucial for our business, however, is the production quantity, which has steadily grown in recent years and will also further increase in the future.

Furthermore, we have benefited from the worldwide trend for higher value steel. For steel refinement, our products are an indispensable raw material – with a very low share in the total costs of steel production, but having a great effect on the improvement of steel quality.

The ongoing consolidation in the worldwide steel sector is definitely positive in our view; with our international presence and the reputation of our brands and products, we have already become a long-term and reliable business partner for many large, well-known steel producers.

Stable business development and improved profitability

Development in operating activities in the year under review is part of our planning and expectations. The slight decline in the general revenue trend compared to the previous year is a result of our pushing ahead with the focus on profitability and the strategic reorientation from volume to margin products. Also in future, we will only then generate turnover if reasonable margins can be achieved.

With an EBITDA margin (earnings before interest, taxes, depreciation and amortisation in relation to total output, without income from participations) of 7.3% (previous year 6.6%), we continued our course of increased earnings this year.

We have improved our operating earnings before taxes (EBT) by 4.4% to €12.0 million. With an EBT margin (earnings before taxes in relation to total operating revenue) of 6.4% (previous year 5.8%), we compare quite favourably with competitors in the sector.

We improved the gross margin, an especially convincing indicator for our raw material-intensive business, from 20.5% in 2005 to 21.5% at present.

For consolidated net profit for the period, in the previous year we still benefited from the first-time capitalisation of deferred taxes on loss carryforwards from previous years. Due to the termination of this non-cash tax income, the rate of taxation for the year under review for the Group rose from 8.6% to 23.2%. We regard net earnings of €9.2 million and earnings per share of €2.09 for the year under review as a solid basis for further corporate development.

For the ongoing financial year, we expect significant growth steps primarily from planned investments. Our projects for organic growth and the build-up of new production capacities are expected to provide a sustainable, tangible impulse for growth and income in the following years.

In the foreseeable future, our priority will be to reinvest the profits from our business activities in the Company, in order to increase the value of the Company further. You, dear shareholders, should benefit decisively from this positive trend with increasing share prices. Nonetheless, it is our intention to propose to the Annual General Meeting 2008 that a dividend be distributed for financial year 2007 if the income and cash flow situation of our Company develops according to plan.

After a period of difficult years, today the SKW Stahl-Metallurgie Group is strategically, operationally, organisationally and financially well positioned for further interesting growth in the worldwide markets of steel production and steel refinement. This is the result of a remarkable cooperation of all employees carried by the appreciation of our customers and business partners as well as interested parties and the trust of our shareholders and investors. We personally thank everyone who has contributed to the successful development of the SKW Stahl-Metallurgie Group in the past year, in particular the employees, for their effort, loyalty and fair partnership.

We will also do everything possible to justify this trust in the future through successful corporate development, which secures jobs and through growth and income, creates added value for everyone.

Unterneukirchen, March 2007

Ines Kolmsee J. Klaus Frizen Gerhard Ertl

Application area: Stainless Steel

Fine cutlery is even more impressive and made brighter by adding titanium, chromium and niobium using Affival Cored Wire Injection Technology

The SKW Stahl-Metallurgie Share

Equity markets perform positively in 2006

Strong global economic development also had a positive impact on most global stock markets in 2006. In the second half of the year in particular, the key stock market indices also benefited from the fall in oil prices, recording double-digit growth compared with the previous year. The Dow Jones achieved year-on-year growth of 16% in 2006, while the Euro Stoxx 50 increased by 15% and the German benchmark index, the DAX, improved by as much as 22% to reach 6,597 points at year-end – its highest level since the start of 2001. The German blue chips were outperformed by small and mid caps, with the MDAX and the SDAX each recording year-on-year growth of around 30%.

Strong environment helps SKW Stahl-Metallurgie to a successful stock market debut

Strong overall sentiment on the stock markets and the growing acceptance for newcomers to the German capital markets helped SKW Stahl-Metallurgie Holding AG to make a successful stock market debut on 1 December 2006. The issue was implemented by a consortium of banks, with Viscardi Securities Wertpapierhandelsbank acting as lead manager and sole bookrunner, Norddeutsche Landesbank Girozentrale as co-lead manager and M.M. Warburg as a sales agent. A total of 1,697,250 bearer shares were sold to institutional and private investors between 23 and 29 November. A greenshoe option for 200,000 bearer shares was also placed in December. The price range was set at between €27.50 and €32.50 per share. The IPO was significantly oversubscribed at an issue price of €29.00. SKW Stahl-Metallurgie's shares have been traded on the Geregelter Markt (Prime Standard) of the Frankfurt Stock Exchange since 1 December 2006. It closed the year (29 December 2006) at €29.25 per share.

Sharp rise in SKW Stahl-Metallurgie share price in early 2007

In December 2006, SKW Stahl-Metallurgie's share price remained within a relatively narrow corridor of between €28.56 and €30.01. It closed the year at €29.25 on 29 December, giving a market capitalisation for the Company of €129.4 million. In early 2007, however, two optimistic analyst reports by German banks resulted in a significant rise in SKW Stahl-Metallurgie's share price. The price reached its high to date at €38.95 on 15 February 2007. SKW-Stahl-Metallurgie shares lost in value during the stock market turbulences of early March, during which stock quotes for the steel industry and steel suppliers such as SGL Carbon decreased significantly. Until the deadline for this report, the SKW Stahl-Metallurgie share improved again up to €34.00 (closing 8 March 2007).

The average daily trading volume in December 2006 was approximately 22,000 shares. It should be noted that the period immediately following an IPO is typically characterised by a substantially higher, and hence less representative, trading volume than would be the case in a regular calendar month. On the first day of trading alone, more than 120,000 shares changed hands. In January, trading activity slowed down in the second half of the month to a level of 17,000 shares per trading day.

[1] All share price quotes in this chapter refer to XETRA.

Characteristics of SKW Stahl-Metallurgie Share since IPO	
	2006
Number of shares (pieces)	4,422,250
IPO Price (1 December 2006) (€)	29.00
High Price (€)	30.01
Low Price (€)	28.56
Closing at Year-End (€)	29.25
Market Capitalization at year-end (Mio. €)	129.4
Average Trade Volume per Day (pieces)	ca. 22,000
Free Float	ca. 42.9%
EPS (€)	2.09
Cashflow per share (€)	2.36
Equity per share (€)	15.08
Basics of SKW Stahl-Metallurgie share	
Exchanges	Frankfurt/M., Germany
Codes	
WKN (German code)	SKWM01
ISIN	DE000SKWM013
Symbols	
Reuters	SK1G
Bloomberg	SK1:GR
Indices	
CDAX-GESAMTINDEX	
PRIME CHEMICALS	
PRIME ALL SHARE	
CLASSIC ALL SHARE	
PRIME IG CHEMICAL SPECIALTIES	

Shareholder structure

(as of 31 December 2006):

- ARQUES Industries approx. 57.1%
- Free float approx. 42.9% (predominantly United Kingdom, France, Switzerland, Germany and other West European countries), of that, retail approx. 3 percentage points (predominantly Germany)

Focus on dialogue with all shareholders

The overriding objective of our investor relations activities is to ensure that all capital market participants are informed comprehensively, quickly and simultaneously. Accordingly, SKW Stahl-Metallurgie not only held a number of roadshows and individual discussions with investors in Germany and abroad to coincide with its IPO, but has also continued this active, transparent dialogue with its investors in early 2007. In addition to direct contact, our website (www.skw-steel.com) is a key means of communication, providing all shareholders and interested parties with a wide range of information that can be either accessed online or downloaded. In addition, you can, of course, contact our Investor Relations department directly at all times:

SKW Stahl-Metallurgie Holding AG

Christian Schunck, Head of IR
Fabrikstrasse 6
84579 Unterneukirchen
Germany

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Fax: +49 8634-617594
E-Mail: ir@skw-steel.com
www.skw-steel.com

Corporate Governance Report

Introduction

Corporate governance involves responsible corporate management and supervision with a view to sustainable value creation. Efficient cooperation between the Executive Board and the Supervisory Board, clear rules, the observance of shareholder interests and open, transparent corporate communications are key aspects of effective corporate governance. As part of its IPO, SKW Stahl-Metallurgie Holding AG started to align its activities to reflect the provisions contained in Section 161 of the German Stock Corporation Act. The Company considers corporate governance to be a process that is constantly being developed and improved..

Declaration of conformity for the financial year 2006

The declaration of conformity with the German Corporate Governance Code for 2006 in accordance with Section 161 of the German Stock Corporation Act, which has been made permanently available to shareholders since the Company's IPO, reads as follows: "The Executive Board and Supervisory Board of SKW Stahl-Metallurgie Holding AG declare that, in the financial year 2006, they complied with all of the recommendations of the Government Commission on the German Corporate Governance Code in the version dated 12 June 2006 with the following exceptions, and that they intend to do so up until the end of the current financial year. The Executive Board and the Supervisory Board also intend to comply with the recommendations of the applicable version of the German Corporate Governance Code in the same way as previously in the financial year 2007."

Justified exceptions and justifications

In the year under review, the Company deviated from the recommendations contained in the German Corporate Governance Code in the version dated 12 June 2006 as follows:

Amendments to the Articles of Association

The authority of the Annual General Meeting in respect of amendments to the Articles of Association in line with section 2.2.1 is modified by the right of the Supervisory Board, defined in Article 11 of the Articles of Association, to resolve amendments to the Articles of Association that relate solely to their wording. This authority is only to be regarded as a delegation of responsibility and, from the Company's viewpoint, does not restrict the fundamental authority of the Annual General Meeting in respect of amendments to the Articles of Association.

D&O insurance

In derogation of section 3.8 of the Code, no general deductible has been agreed for the D&O insurance policy for the Executive Board and Supervisory Board. However, there is a deductible for specific cases, e.g. insurance claims relating to the USA. The Company believes that these partial deductibles in combination with the exceptions and upper limits generally applicable to D&O insurance appropriately reflect the individual responsibility of the management.

General Meeting via the Internet

To the extent that section 2.3.4 is interpreted in such a way that the shareholders must be able to cast their votes electronically, the Company does not comply with this recommendation. The Company takes the view that the proper and lawful casting of votes via electronic media up to the time of the ballot at the Annual General Meeting is an essential condition for the decision to broadcast the entire Annual General Meeting on the Internet.

Succession plan and age limit

In derogation of section 5.1.2 of the Code, there is currently no long-term succession plan for the members of the Executive Board. Due to the size of the Company, an internal succession plan for the Executive Board is only possible to a limited extent. In derogation of sections 5.1.2 and 5.4.1, an age limit for the members of the Executive Board and the Supervisory Board has yet to be specified. One of the main principles of the Company is not to discriminate against anybody on the grounds of personal characteristics such as age.

Compensation of the Supervisory Board

In derogation of section 5.4.7 of the Code, the members of the Supervisory Board do not receive any compensation above and beyond the reimbursement of expenses and any VAT incurred on such reimbursement, as well as the cost of D&O insurance. This rule reflects the fact that all Supervisory Board members belong to the Executive Board or Supervisory Board of ARQUES Industries AG and that these mandates provide sufficient incentives to act in the interests of SKW Stahl-Metallurgie, even without additional compensation.

Supervisory committees

In derogation of section 5.3, the Supervisory Board did not form committees in the year under review. The company believes that no reasonable committees may be formed of a Board consisting of three members.

Stock option plan

In derogation of section 4.2.3, the Company does not yet offer “variable compensation components with long-term incentive effect and risk elements”. A stock option plan is to be introduced during 2007.

Corporate Governance in 2007

In 2007 to date, the Company has complied with the German Corporate Governance Code in the same way as in the year under review, and intends to do so up until the end of 2007. In accordance with section 4.2.3 of the Code, a stock option plan is to be introduced during 2007.

The Company intends to comply with any further developments and amendments to the German Corporate Governance Code.

Securities transactions requiring disclosure (directors’ dealings)

The Company has informed the relevant persons of the provisions of Section 15a of the German Securities Trading Act (“directors’ dealings”). It did not receive any corresponding notices for the period under review.

To date, the Company has received the following notices for the financial year 2007:

Name	Date	Type of business	Price (Euro)	Vol. (pieces)	Vol. (Euro)
Ines Kolmsee	March 2, 2007	Purchase	32.65	1,000	32,650.00
Gerhard Ertl	March 6, 2007	Purchase	31.25	1,000	31,250.00

Shares held by the Executive Board and Supervisory Board

To the best of the Company's knowledge, the members of the Executive Board and the Supervisory Board did not hold any shares of the Company or related financial instruments in 2006.

This means that the entire holdings of all members of the Executive Board and Supervisory Board did not exceed 1% as described in section 6.6 of the German Corporate Governance Code.

Compensation report

Supervisory Board:

The compensation paid to the Supervisory Board for the year under review consisted exclusively of reimbursement of expenses. Expenses are reimbursed up to a maximum of the amounts permitted for income tax purposes plus any VAT incurred on such reimbursement.

The Company also bears the cost of concluding a D&O insurance policy for the members of the Supervisory Board.

Executive Board:

The tasks and contribution of each individual member of the Executive Board to the overall performance of the Group were taken into account when determining the compensation of the Executive Board.

A breakdown of compensation of the Executive Board members in terms of nature and extent in the year under review is set out in the following table:

TEUR	Ines Kolmsee	Gerhard Ertl	J. Klaus Frizen	Total
Periods of time	Jan. 1 - Dec. 31.	Oct. 1 - Dec. 31	Nov. 2 - Dec. 31	Jan. 1 - Dec. 31
Fixed remuneration	147	30	0	177
In-kind remuneration	0	1	0	1
Variable remuneration*	425	79	0	504
Total	572	110	0	682

* irrespective of the date on which such components fall due, which is usually in the following year

In addition, the Company covered half the contributions to the health and care insurance policies of Ms Kolmsee and Mr Ertl. For Mr Ertl, there is also an employer-financed company pension. In the year under review TEUR 10 was allocated to the provision set up for this pension commitment.

The income of Ms Kolmsee is shown for the entire calendar year, as she was the sole managing director of the then SKW Stahl-Metallurgie Holding GmbH from 1 January until her appointment as an Executive Board member.

The income of Mr Ertl relates to the period from conclusion of his contract as an Executive Board member (1 October 2006 to 31 December 2006). Mr Ertl previously held a managerial post at the Company.

Mr Frizen worked for free in the year under review.

The fixed income is paid as a monthly salary. The variable income consists of an individual bonus agreement in each case. The EBTDA of the respective year under review is used as the basis for calculating the variable compensation.

The disclosed compensation covers all of the activities of the Executive Board members within the Group and the payments from all Group companies.

In addition, the members of the Executive Board were reimbursed for expenses incurred on business trips up to a maximum of the amounts permitted for income tax purposes. The Company also bears the cost of concluding a D&O insurance policy for the members of the Executive Board.

The substantive content of severance awards from the Company for Executive Board members does not differ significantly from the awards granted to employees.

No payments were made to former directors or their surviving dependents, as the Company has no former directors.

Disclosures on stock option plans and similar securities-oriented incentive systems operated by the Company

The Company is planning to introduce a stock option plan for the Executive Board and other senior managers in 2007. No stock option plan existed in the year under review.

Additional information on corporate governance at SKW Stahl-Metallurgie

Comprehensive information on the activities of the Supervisory Board and the cooperation between the Supervisory Board and the Executive Board can be found in the Report by the Supervisory Board on page 78 of this annual report.

Details of current developments and key information, such as ad-hoc disclosures, the financial calendar, press releases and information on the Annual General Meeting, are published on the Company's website at www.skw-steel.com.

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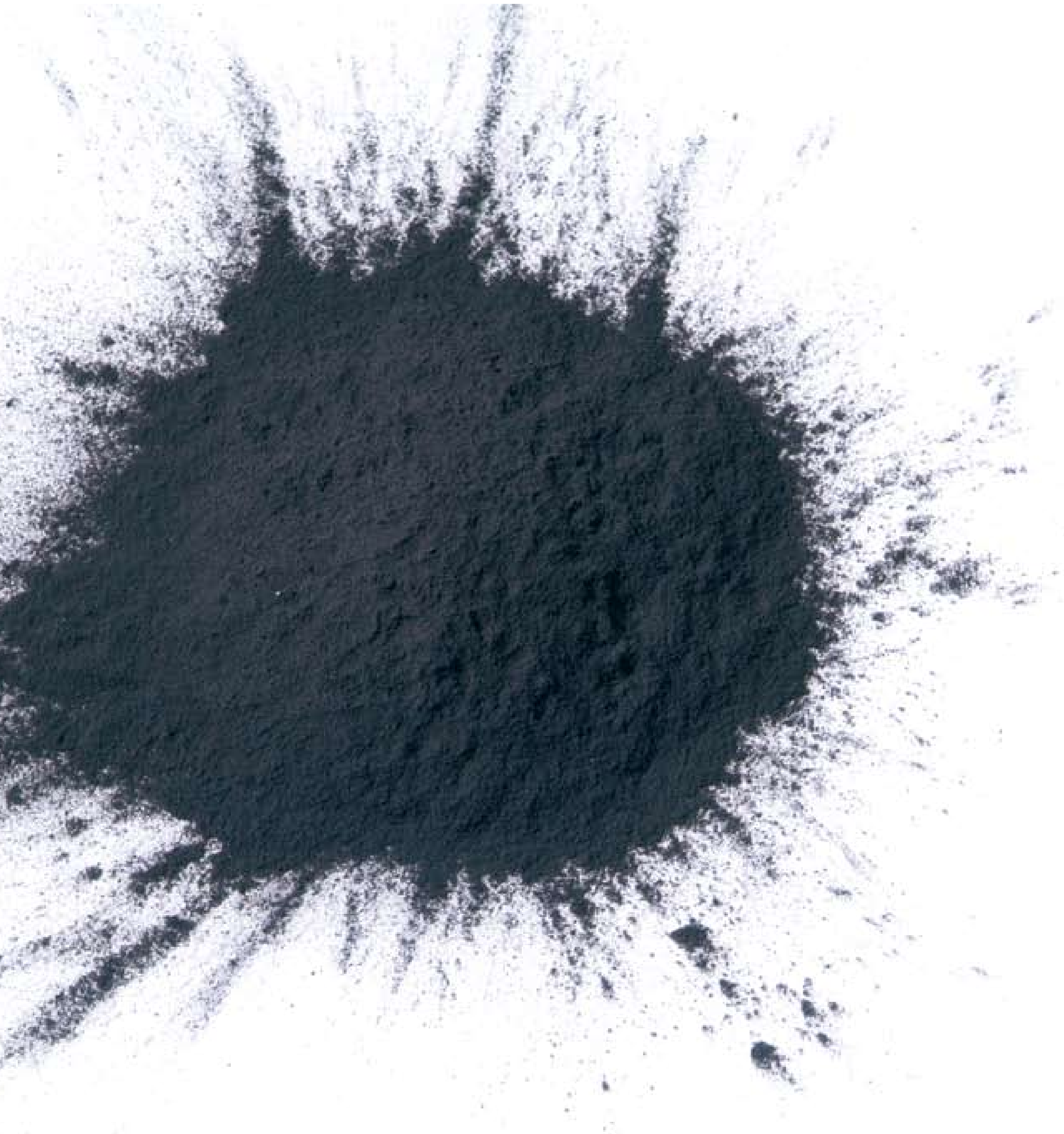


Application area: Pipelines

In the four corners of the globe and in the most drastic weather conditions, welded joints need to be particularly tough which is why niobium cored wire is often used in this area of production

Combined Management Report of SKW Stahl-Metallurgie Holding AG for the Financial Year 2006

Economic Conditions

Dynamic global economic development

According to estimates by the International Monetary Fund (IMF), global economic output increased by 5.1% in the period under review.[1] This substantial improvement was achieved despite a significant rise in the cost of raw materials and energy prices. As in previous years, global economic growth was primarily driven by the emerging economies of Asia and Eastern Europe. By contrast, the traditional industrialised countries of Europe, the USA and Japan were only able to record comparatively moderate growth.

South-East and East Asia in particular recorded highly dynamic economic development in 2006. In their report published in autumn 2006, the German economic research institutes forecast GDP growth of 5.2% for East Asia as a whole, while the IMF's figures showed that India was able to continue its economic boom with growth rates of 8.3%.[2]

Economic momentum in Central and Eastern Europe was also above average, with growth of 5.3%; Russia was the outperformer in this region at 6.5%.

The gross domestic product of the USA improved by 3.4% in 2006.[3] The Organisation for Economic Cooperation and Development (OECD) forecast growth of 2.7% for the euro zone. Germany recorded a clear upward trend compared with recent years, with GDP growth of 2.7% in 2006 according to the German Federal Statistical Office.[4] The OECD calculated the growth rate in the Japanese economy at 2.5%.

To limit inflation in the leading economies, the central banks in the USA, the euro zone and Japan increased their key interest rates at an early stage and on several occasions. On the currency side, the US dollar depreciated by more than 10% year-on-year against the euro, closing the year at an exchange rate of $1.3170/€.

Steel and metallurgy industries still on the up

The steel industry, to which most of the SKW Stahl-Metallurgie Group's customers belong, benefited from the positive macroeconomic environment in 2006. According to statistics published by the International Iron and Steel Institute (IISI), global crude steel production increased by around 9% to more than 1.24 billion tonnes.[5]

This meant that the structural changes observed in the industry in previous years continued in the period under review, with a growing trend towards consolidation within the industry on the one hand and the development of addition production capacity in East Asia on the other. A prime example of the consolidation process in the steel industry is the acquisition of the Arcelor Group by the Indian steel company Mittal.

Steel production in India developed particularly strongly in 2006, recording a double-digit growth rate and thus far outstripping the country's general economic growth. Steel producers in North America, Europe and Japan also recorded growth, albeit around the level of the increase in gross domestic product.

Steel production volume is the key indicator of change in demand in the metallurgy industry, which is crucial to the SKW Stahl-Metallurgie Group. Irrespective of price fluctuations, the volume of steel production has increased

1. International Monetary Fund: World Economic Outlook, Sept. 2006, p. 2.
2. International Monetary Fund: World Economic Outlook, Sept. 2006, p. 2.
3. International Monetary Fund: World Economic Outlook, Sept. 2006, p. 2.
4. German Federal Statistical Office, press release dated 13 February 2007.
5. International Iron and Steel Institute, press release dated 22 January 2007.

steadily throughout almost all of the last 50 years, and 2006 was no different.

Organisation and Company Structure of the SKW Stahl-Metallurgie Group

The Parent Company

Successful IPO on 1 December 2006

SKW Stahl-Metallurgie Holding AG (until 26 May 2006: SKW-Stahl-Metallurgie Holding GmbH), domiciled in Unterneukirchen, Germany, is the parent company of the SKW Stahl-Metallurgie Group, which develops, produces and distributes chemical additives for crude iron desulphurisation and steel refining. SKW Stahl-Metallurgie Holding AG is a strategic management holding company whose Executive Board is actively involved in managing the directly and indirectly held equity interests. The aim is to develop and help implement the optimum corporate strategy alongside the managers of the individual equity interests. To be able to implement the ambitious growth strategy of the SKW Stahl-Metallurgie Group in the near future, SKW Stahl-Metallurgie Holding AG was listed on 1 December 2006. In preparation for the IPO, SKW Stahl-Metallurgie Holding GmbH was converted into a stock corporation on 20 April 2006 and as such entered in the commercial register on 26 May 2006. In conjunction with the IPO, the former share capital of SKW Stahl-Metallurgie Holding GmbH of €25 thousand was increased to €4,422 thousand by the capital increases described below up as at the balance sheet date.

In April 2006, the share capital of the then SKW Stahl-Metallurgie Holding GmbH was increased from €25 thousand to €1,325 thousand. €1,000 thousand of the capital increase was carried out as a capital increase from company funds and €300 thousand was carried out a contribution in kind through transfer of a receivable of ARQUES Industries AG. The entry of this capital increase in the commercial register was completed on 23 May 2006.

In August, the company carried out another capital increase of €2,000 thousand, again in the form of a contribution in kind through transfer of a receivable of ARQUES Industries AG. This capital increase was entered in the commercial register on 21 August 2006.

Equity particulars

At the Annual General Meeting on 17 November 2006, the share capital of the Company was increased from €3,325,000 by up to €1,097,250 to €4,422,250 in exchange for cash contributions. The capital increase was successfully completed as part of the IPO through the issue of 1,097,250 no-par value bearer shares. The cash capital increase was entered in the commercial register on 29 November 2006.

The subscribed capital is therefore composed of 4,422,250 no-par value bearer shares each with a notional interest in the share capital of €1.00 (with full dividend rights from 1 January 2006). Shares have not been issued in different share classes; the Company has not issued any shares with special rights. The shares are freely transferable to the extent permitted by law. In the course of the Company's IPO, the selling shareholder and the Company entered into lock-up agreements for a period of twelve months (six months hard lock-up and a further six months soft lock-up); the issue of additional treasury shares is restricted by the aforementioned lock-up agreements.

Subject to their approval, the members of the Executive Board are appointed and dismissed by the Supervisory Board. The Executive Board manages the Company in accordance with the provisions of law and the Articles of Association. It is not authorised to buy back shares.

In accordance with Article 11 of the Company's Articles of Association, the Supervisory Board is entitled to resolve amendments to the Articles of Association that relate solely to their wording. Any other amendments to the Articles of Association require a resolution by the Annual General Meeting. There are no provisions in the meaning of numbers 8 and 9 of Section 289 (4) and 315 (4), respectively, of the German Commercial Code.

As at the balance sheet date, the Company had cash and cash equivalents of €32,795 thousand as well as a capital ratio of approx. 86%.

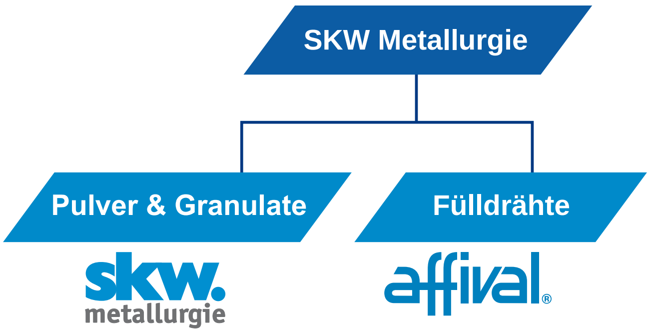
As of 31 December 2006, the principal shareholder of SKW Stahl-Metallurgie Holding AG was still ARQUES Industries AG, Starnberg, Germany, with an equity interest of around 57.1%. To the best of the issuer's knowledge, no other shareholder had a shareholding that reached the disclosure threshold.

The Operating Units – Strong Brands in Attractive Niche Markets Around the World

Classification of Activities into the "Cored Wire" and "Powder & Granules" Segments

The SKW Stahl-Metallurgie Group's operating activities are currently broking down into two segments: "Cored Wire" and "Powder & Granules". With the acquisition of the "Quab" specialist chemicals business of the RAG Group on 16 January 2007, an additional operating segment is likely to be added to the segment reporting from financial year 2007.

The following diagrams illustrate the segments relevant to 2006 and the brands of the SKW Stahl-Metallurgie Group used there.



In the "Cored Wire" segment, the Affival Group produces industrial cored wire in France, the USA and South Korea. In addition to these three production sites, a sales office in Japan supports the Affival Group's activities in the Asian region. With a market share of just under 35%, Affival is the global market leader for this key product for use in the steel refining process. One of the factors behind this market-leading position is Affival's global presence. All other competitors only serve selected geographical markets, meaning that their market share at a global level is low.

The "Powder & Granules" segment produces and distributes chemicals for crude iron desulphurisation. This segment is also active in terms of sales of steel refining products. The segment consists of the German distribution company SKW Stahl-Metallurgie GmbH and the Indian production joint venture Jamipol. SKW Stahl-Metallurgie GmbH not just a trading company. It also offers its customers applications-oriented support for its core competencies of crude iron desulphurisation and steel refining. In the "Powder & Granules" segment, the SKW Stahl-Metallurgie Group is market leader in the Central European desulphurisation business with a market share of just under 30%. Due to the restricted transportability of carbide-based crude iron desulphurisation materials, there is a regionally limited market here. The biggest competitor in terms of market share is the German company Almamet GmbH, with a market share of approx. 22%.

SKW Stahl-Metallurgie – High-quality Global Production and Customer Proximity

Global Presence and Production Sites in Direct Proximity with the Customer

The SKW Stahl-Metallurgie Group as a whole supplies its customers from its own production sites on the three continents of Europe, North America and Asia and sells its products in more than 35 countries around the world.

6. "Central Europe" is regarded as Germany, Austria, Switzerland, France and the Benelux states here.

In the “Cored Wire” segment (Affival Group), the company has a presence in these three continents with its own branches.

This regional structure enables close proximity to key customers and selection of the optimum production locations for specific customer requests. Cored wire is produced at all sites using the same production methods.

Capacity utilisation at the production sites in the year under review was approx. 90% on average.

In the “Powder & Granules” segment, European customers are served by our German distribution company, while customers in India are served by the local joint venture Jamipol. The SKW Stahl-Metallurgie Group does not have its own production facilities for desulphurisation mixes for the European market. The magnesium- and carbide-based crude iron desulphurisation materials are currently obtained from a primary supplier. To keep the dependency on these producers under control, the SKW Stahl-Metallurgie Group has already subjected other potential suppliers to a quality audit.

The joint venture Jamipol in India has its own production facilities at two locations: Jamshedpur in Jharkand state, in close proximity to its key customer The Tata Iron and Steel Company Limited, and Toranagallu in Karnataka state, which is close to another key customer, JSW Steel Ltd. Calcium carbide-based desulphurisation mixes are produced at these sites.

In the year under review, SKW Stahl-Metallurgie’s product range remained focused on crude iron desulphurisation and secondary metallurgy. Product innovations were developed in the “Cored Wire” segment. These are described in further detail in the Research and Development section.

Raw Material Supply Secured

Secure supply of high-quality raw materials is essential to the success of the SKW Stahl-Metallurgie Group. In procuring the key raw materials required by the “Cored Wire” segment, the Group’s management pursued a strategy aimed at countering the risk of becoming dependent on one producer or production country by entering into multiple strategic alliances. As things stand, these measures are expected to secure the SKW Stahl-Metallurgie Group’s raw material supply in the short and medium term. The “Powder & Granules” segment’s procurement activities focused on ensuring the availability of magnesium and carbide-based crude iron desulphurisation materials; a primary supplier existed for both products. No supply bottlenecks are envisaged in this sector.

Corporate and Business Development

Reinforcement of Competitive Position in Regional Markets

The SKW Stahl-Metallurgie Group’s business development in the 2006 year under review was encouraging. The Group largely succeeded in maintaining its position in all its existing markets and expanding into new markets such as Mexico, Turkey and Hungary.

It successfully pressed ahead with the strategy of reorientation from high-volume products towards high-margin products that was initiated in previous years.

Seasonal developments in business varied across the regions. While business performance in the USA was extremely dynamic in the first half of the year, the economic climate there weakened significantly in the last six months, which had a corresponding impact on the Group’s business. For instance, in the USA, raw materials production fell by 6% year-on-year in the fourth quarter.

By contrast, the first quarter of 2006 in particular was characterised by low levels of steel production in Europe, with a corresponding reduction in demand for the SKW Stahl-Metallurgie Group's products. However, demand increased substantially throughout the remainder of the year.

The SKW Stahl-Metallurgie Group's activities in Asia were impacted by high stock levels at steel producers at the start of the year; these were only reduced in the second quarter, which led to higher demand later in the year.

Production at all three of the Affival Group's production sites ran successfully and according to plan. Jamipol's second production site at Toranagallu in Karnataka state, India, successfully started operations in February 2006.

Additional Potential Through Product Innovations

The SKW Stahl-Metallurgie Group was able to generate new market momentum with the successful launch of its innovative cored wire product PapCal, resulting in important new customer contracts and strong interest among a large number of global steel producers.

Although there was an overall upward trend in raw materials costs and energy prices, the price of the raw material ferrotitanium, one of several feedstocks in the cored wire production process, fell significantly in 2006. With volumes and margins remaining unchanged, the revenue generated by the SKW Stahl-Metallurgie Group from ferrotitanium-based cored wire declined accordingly.

Earnings Situation of the Parent Company as well as the SKW Stahl-Metallurgie Group

Improvement in the Group's Earnings Power Through Strategic Focus on High-margin Activities

The SKW-Stahl Metallurgie Group generated revenue in the amount of €185.8 million in the year under review, down 3.6% on the prior-period figure of €192.7 million. This decrease of around €7 million is primarily attributable to the adjustment of some sales prices in the "Cored Wire" segment as a result of lower procurement costs for ferrotitanium at unchanged volumes and margins. The cumulative effect of this development for 2006 as a whole is around €5 million. The Company also streamlined its sales portfolio as planned with the aim of removing low-margin products (in particular aluminium scrap in the "Powder & Granules" segment); this impacted revenue to the tune of €6 million. The total fall in revenue of around €12 million was partially offset by higher sales volumes and higher prices for other product groups in both segments.

In both segments, SKW Stahl-Metallurgie's customers were almost entirely steel producers or their suppliers. The geographical breakdown of consolidated revenue is approx. 47% for Europe and approx. 43% for the NAFTA region (USA, Canada and Mexico). The remainder was primarily delivered to the Asian region.

Inventory Management Optimized

In financial year 2006, total output fell year-on-year by 6.2% from €198.3 million to €186.1 million. In addition to revenue, total output also includes inventory changes of finished goods and work in progress as well as own work capitalised. Targeted inventory management meant that one of the management's main targets of avoiding further stockpiling (previous year: €5.6 million) was achieved. In this respect, the logistical processes of production in France were largely improved.

In the year under review, the Company's total output was positively affected by the capitalisation of development costs in the amount of €0.8 million (entirely in the "Cored Wire" segment).

Gross Margin Significantly Improved

In the year under review, the Company's strategy was more towards earnings than revenues. The improved product mix compared with the previous year meant that the gross margin increased from 20.5% to 21.5%. At segment level, the successful implementation of this strategy was demonstrated in the year under review by the increase in the gross margin from 13.3% to 14.8% in the "Powder & Granules" segment and from 21.9% to 23.0% in the "Cored Wire" segment.

Targeted Insourcing Increases Effectiveness

Staff costs increased by 8.1% in the year under review, from €11.9 million to €12.9 million; this was largely due to the appointment of new employees at Affival, Inc. in the USA ("Cored Wire" segment). These employees assumed tasks that were previously performed by an external service provider. To ensure successful and fast recruitment, one-off bonuses were paid at the start of employment. The increase in staff costs – due to the above-mentioned bonuses as well as the increased number of employees – was more than offset by a reduction in other operating expenses as a result of the termination of the service agreement with the external service provider.

The year-in-year increase in other operating income from €2.7 million to €4.1 million is primarily due to damages payments arising from the PEM-SKW arbitration proceedings completed in the year under review (€0.7 million), additional damages (€0.5 million) and the sale of a property in France that was not required for operating purposes (€0.7 million).

In the year under review, operating expenses fell from €18.3 million in the previous year to €17.7 million (-3.3%). After adjustment of other operating expenses for the non-cash exchange losses of €0.7 million, other operating expenses fell by a total of €1.3 million. This is attributable to the above-mentioned insourcing at Affival, Inc. as well as reductions in other non-labour cost items.

Increase in the Operating Result

Earnings before interest, taxes, depreciation and amortisation (EBITDA)[7] amounted to €13.6 million, up 3.3% on the prior-period figure of €13.2 million.

As depreciation and amortisation expense remained essentially unchanged in the year under review, earnings before interest and taxes (EBIT)[8] increased by a similar extent (3.5%), from €11.3 million in the previous year to €11.7 million. In the "Cored Wire" segment", earnings before interest and taxes improved significantly from €8.5 million to €9.4 million as a result of targeted cost reduction measures in non-labour cost items. In the "Powder & Granules" segment, earnings before interest and taxes fell from €3.7 million to €2.9 million, primarily due to non-cash foreign exchange effects in the amount of €0.5 million.

Taking into account the equity investment in Jamipol reported at equity and the year-on-year decrease in net interest expense, this results in profit from ordinary activities (EBT) in the amount of €12.0 million, up 4.4% as against the previous year (€11.5 million).

Earnings per Share €2.09

With the above-mentioned increases in EBIT and EBT, the SKW Stahl-Metallurgie Group substantially improved its key financial indicators in 2006 compared with the previous year.

Income tax expense increased in the year under review from €1.0 million to €2.8 million. This was due in particular to the deferred tax income recorded in the previous year as a result of the first-time recognition of tax loss carry-forwards.

7. The income from the participation in the Indian joint venture Jamipol is not contained in the EBITDA figure shown here.

8. The income from the participation in the Indian joint venture Jamipol is not contained in the EBIT figure shown here.

The higher income tax expense meant that consolidated net profit for the period was down 12.3%, totalling €9.2 million compared with €10.5 million in the previous year.

This results in earnings per share (EPS) of €2.09.[9]

Impressive Net Asset and Financial Structure as a Basis for Further Growth

Net Asset and Financial Position of the SKW Stahl-Metallurgie Group

The following table provides details of the net asset and financial position of 2006 and 2005 for the entire Group as at the balance sheet date of 31 December.

	Dec. 31, 2006	Dec. 31, 2005
	TEUR	TEUR
ASSETS	112,109	77,562
Long-term assets	18,853	16,574
Short-term assets	93,256	60,988
of which: cash and cash equivalents	34,905	1,362
LIABILITIES	112,109	77,562
Equity	66,669	25,943
Long-term debt	2,180	1,908
Short-term debt	43,160	49,711
of which: financial liablities	15,497	21,024

In financial year 2006, the SKW Stahl-Metallurgie Group's total assets increased by €34.6 million, from €77.6 million to €112.1 million. This was primarily due to the cash inflow from the Company's IPO on 1 December 2006. As a result, the consolidated capital ratio improved from 33.4% to 59.6%. In the year under review, the Group's financial position changed by €39.1 million from net financial debt of €19.7 million. As at 31 December 2006, a net asset surplus of €19.4 million was posted.[10]

The resultant key ratios are set out in the following table.

	2006	2005
Current Ratio	216.1%	122.7%
RONA	28.7%	30.1%

The Group's liquidity position is extremely positive. The "current ratio" – defined as current assets in relation to current liabilities – totalled 216.1% (previous year: 122.7%). This increase is primarily due to the net cash inflow from the IPO.

The return on net assets (RONA)[11] of 28.7% (previous year: 30.1%) serves to underline the successful attempts by the management to attain a strong operating result with the lowest possible capital commitment.

Working capital – defined as current assets (excluding cash and cash equivalents) less current liabilities (excluding financial liabilities) – amounted to €30.7 million at the balance sheet date (previous year: €30.9 million). In turn, the development of working capital serves to underline the management's objective of deploying the capital committed in the Company efficiently.

9. The figure of €2.09 refers to the number of shares as per 31 December 2006. Weighted by the pertinent number of shares, the annual EPS would be € 4.53. The significance of this latter figure is additionally restricted by the fact that the corporation has not traded as a joint-stock corporation for the entire year under review.

10. Net financial debt and net asset surplus, respectively, are defined as liquid positions minus financial liabilities.

11. Net assets are defined as follows: Immaterial assets plus fixed assets plus inventories plus receivables from sales plus other assets minus liabilities (incl. provisions; without financial liabilities).

Cash Flow of the SKW Stahl-Metallurgie Group

The following table provides details of the cash flow statement of the year under review and the previous year for the entire Group.

TEUR	Jan. 1 - Dec. 31, 2006	Jan. 1 - Dec. 31, 2005
Consolidated Net Profit	9,233	10,524
Gross Cashflow	9,838	10,114
Operating Cashflow	10,444	6,281
Net cash used in investing activities	-1,384	-2,082
Financial Cashflow	24,474	-3,814
Cash position at end of reporting period	34,905	1,362

Increase in Operating Cash Flow

Based on a consolidated net profit of €9.2 million, the Company generated a cash flow from operating activities of €10.4 million in the year under review (previous year: €6.3 million).

The cash flow from operating activities (or operating cash flow) indicates the surplus cash generated by the operating activities in the period under review.

Adjusted for currency effects (€9 thousand), the Group's cash and cash equivalents in the amount of €34,905 thousand (previous year: €1,362 thousand) correspond to the balance sheet item "Cash and cash equivalents", which is composed of cash-in-hand and current bank balances.

Significant Increase in Investment Activities Planned

Adjusted for net cash used in investing activities in the amount of €1.4 million, the SKW Stahl-Metallurgie Group reported a free cash flow – defined as the difference between net cash from in operating activities and net cash used in investment activities – of €9.0 million in the year under review.

Investments in the year under review largely related to replacement and maintenance measures. The Executive Board will use the proceeds from the IPO carried out in the year under review for significantly increased investment activities in 2007 and beyond.

The free cash flow after investments was used to finance the repayment of shareholder loans in the amount of €3,576 thousand. The net cash inflow from the IPO after offsetting against IPO costs totalled €27,701 thousand.

Central Financial and Liquidity Management

In order to minimise the cost of capital, external borrowing, Group-wide financial and liquidity equalisation and interest rate, exchange rate and raw material price risk are now coordinated centrally by the Group parent company. As part of this centralised financial planning, rolling (medium- and long-term) projections and short-term liquidity forecasts are performed.

In order to guarantee its financial stability and flexibility, the SKW Stahl-Metallurgie Group aims to achieve a balanced relationship between equity and debt, taking into account shareholders' expected returns on the one hand and the requirements of rating agencies on the other. The capital ratio at the end of the period under review was 59.6% (previous year: 33.4%).

Exchange rate risk arising from the Group's operating activities (transaction risk) is reduced by natural hedging, e.g. by entering into foreign-currency purchase and sale transactions. Group companies also hedge any exposures arising from the relevant foreign-currency forecasts at specific points after consulting Group management. However, any translation risk resulting from the transfer of income and expenses recorded by subsidiaries in other currency areas into euros cannot be hedged. At the end of 2006, there were no hedging transactions within the Group. The most important currency for the Group by some distance was its reporting currency (euros), followed by the US dollar. Other key currencies for the Group were the Japanese Yen, the Indian rupee and the South Korean won..

SKW Stahl-Metallurgie Holding AG – Financial Statements in Accordance with the German Commercial Code

As the parent company of the SKW Stahl-Metallurgie Group, SKW Stahl-Metallurgie Holding AG is a strategic management holding company that aims to cover its costs. For SKW Stahl-Metallurgie Holding AG, financial year 2006 was particularly defined by the IPO on 1 December 2006. The expenses of €2.3 million (net) associated with the IPO are posted separately as extraordinary income in the profit and loss account. The other items of the profit and loss account are therefore comparable with the prior-period figures.

Other operating income rose by €0.8 million, from €1.0 million to €1.8 million, in the period under review. This rise is chiefly due to income outside the period of €1.2 million resulting from claims under the purchase agreement dated 30 August 2004 between the former Degussa Group and the ARQUES Group. By contrast, additional charges to subsidiaries were down by €0.4 million. This is partly due to the first-time direct charging of insurance premiums to the subsidiaries.

Staff costs at the company increased from €0.6 million to €0.7 million in financial year 2006. This is mainly because of the expansion of the Executive Board in the financial year.

Other operating expenses were reduced from €0.8 million (previous year) to €0.4 million. This reduction is primarily attributable to lower insurance and consultancy expenses for operating activities compared with the previous year following the completion of the restructuring phase.

Earnings Set to be Used for Future Investments

SKW Stahl-Metallurgie Holding AG increased income from equity interests from same-period collection of profits of the subsidiaries to €1.6 million in the year under review (previous year €0.3 million). The Executive Board of the Company has decided not to pay a dividend.

The Executive Board and Supervisory Board of SKW Stahl-Metallurgie Holding AG will propose to the Annual General Meeting on 18 June 2007 that the unappropriated surplus of €30 thousand be carried forward.

Net Asset and Financial Position of the Group Parent Company

As at 31 December 2006, the total assets of the parent company SKW Stahl-Metallurgie Holding AG amounted to €40.9 million (previous year: €10.2 million). This increase is primarily attributable to the €31.8 million year-on-year rise in cash and cash equivalents (balance sheet date: €32.8 million), which resulted from the IPO carried out on 1 December 2006. Also as a result of the IPO, equity increased from €1.0 million to €35.2 million. This is associated with an increase in the Company’s capital ratio from 10.0% to 86.1%. This net asset and financial position means that the parent company is well-positioned to be able to finance the investments planned for financial year 2007 primarily from its own funds.

12 Now part of the RAG Group.

Research and Development

Rise in Investments in Innovations

Research and development is a strategically important unique selling point for the SKW Stahl-Metallurgie Group and helps to contribute towards the Group's market leadership by providing customers with high-quality technical advice, as well as developing new products. For this reason, the SKW Stahl-Metallurgie Group makes sustainable investments in research and development (R&D).

At the end of financial year 2005, the SKW Stahl-Metallurgie Group's R&D activities were structured as a separate organisational unit with the aim of intensifying the strategic importance of product and process innovations to the Company's continued development in a targeted manner.

In December 2005, an international R&D team was created within the SKW Stahl-Metallurgie Group. The aim of this team is to encourage the exchange of ideas relating to current R&D projects at a Group-wide level and to bundle activities for individual projects at specific locations.

Reorganisation of R&D Already Starting to Bear Fruit

This reorganisation of the Group's R&D activities started to bear fruit in 2006. For instance, on the basis of the innovative and successfully launched Affival product PapCal, another customer-oriented innovation was developed in the form of the No Splash Tip product. With this No Splash Tip, the Group enables its customers to operate an important, future-oriented production process. This Affival quality product includes an enhanced version of the successful Affival cored wire technology which means that the product can also now also be used not only in calcium applications, but also for other ferrous alloys.

In the year under review, the restructured R&D activities meant that over 50% of the development costs of approx. €1.5 million at the Group led to marketable products. This is much more than in the previous year. The Group's highly efficient R&D activities are also significant in comparison with competitors and other companies.

In 2006, the Affival Group submitted two patent applications in France and the USA. Further patent applications are in preparation. Just under 5% of the SKW Stahl-Metallurgie's employees are involved in R&D, working in close cooperation with laboratories, external research institutions and customers.

Sustainability and Environment

Corporate Responsibility for the Environment, People and Society

The SKW Stahl-Metallurgie Group is committed to the principle of ensuring equal living opportunities for present and future generations through a development policy that integrates ecological, economical and social aspects in a sustainable manner. Sustainable corporate action is a central element of the SKW Stahl-Metallurgie Group's business policy and helps to guarantee the Company's long-term success. This sustainability approach takes into account factors such as the environment, people and society, as well as economic success. The SKW Stahl-Metallurgie Group is planning to become increasingly involved in developing countries and emerging economies, and believes that it has a special responsibility here. At the same time, the Group is confident in its ability to make a positive contribution through its products and expertise.

In order to implement these principles in the everyday environmental practice of a production company, the SKW Stahl-Metallurgie Group has established an environmental centre of excellence at its site in Solesmes, France.

To date, none of the SKW Stahl-Metallurgie Group's production sites have been subject to contamination or other site-related risk. Nevertheless, constant workforce training and awareness campaigns have focused attention on the relevant expertise and the human and environmental risk associated with using dangerous materials such as lead at the environmental centre of excellence. Bundling responsibilities and expertise in this manner serves to improve the management, monitoring and, in particular, the minimisation of environmental risk.

The SKW Stahl-Metallurgie Group meets and, in some cases, exceeds all of the applicable statutory requirements and provisions applicable to it throughout the world. Here, the Group sees environmental protection not as a restriction, but as an opportunity to implement responsible corporate action.

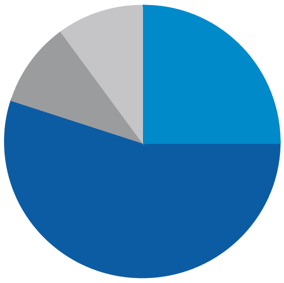
Personnel

Highly International Employee Structure

One of the key pillars of the SKW Stahl-Metallurgie Group's success is the knowledge and commitment of each of its employees.

In the year under review, the SKW Stahl-Metallurgie Group (excluding the Indian joint venture Jamipol) employed an average of 226 employees around the world; the figure at the balance sheet date of 31 December 2006 was 225 employees. Most of these are full-time employees. However, the Group is fundamentally amenable to the concept of part-time employment, including for a better balance between work and family life.

In regional terms, approximately 25% of the Group's employees are active in the USA, with around 55% in France and roughly 10% in Germany and East Asia (Japan and South Korea) respectively.



Broken down by segment, more than 90% of all the Group's employees – and 100% of its employees outside Germany – are allocated to the "Cored Wire" segment. The German employees work solely for the "Powder & Granules" segment and for the holding company. The low number of people employed in the "Powder & Granules" segment is explained by the fact that there is trading activity here.

Staff costs in the year under review totalled €12.9 million; this includes the compensation paid to the members of the executive bodies.

Market-oriented Compensation Systems

Employees of the SKW Stahl-Metallurgie Group are remunerated in line with the standard market conditions of the respective country. The majority of the Group's employees in Germany and France are covered by collective wage agreements for the chemical industry.

Statutory and other contractual or voluntary social security contributions also reflect the standard market conditions of the respective country. The SKW Stahl-Metallurgie Group promotes protection against employee healthcare and retirement benefit risk above and beyond the minimum statutory requirements. Accordingly, SKW Stahl-Metallurgie GmbH is a member of a closed, defined-benefit

[14] Den Mitarbeiterzahlen liegen die jeweiligen nationalen Definitionen (zum Beispiel zur Einberechnung oder Nicht-Einberechnung von Organmitgliedern oder Auszubildenden) zu Grunde.

superannuation scheme. The benefits granted to existing employees under this scheme are covered by provisions for pensions. The Group's employees in the USA have been granted the standard local healthcare and retirement benefits (e.g. 401 (k) plan). As things stand, this will not result in any future charges for the Company (defined contribution).

Successful Partnership with Employees

The SKW Stahl-Metallurgie Group was not obliged to implement employee co-determination in the year under review. Its low number of employees mean that it was not subject to the general statutory provisions on co-determination, nor is it an iron or steel producer within the meaning of the Coal, Iron and Steel Industry Co-determination Act.

In some cases, employee and union representatives are appointed at SKW Stahl-Metallurgie in accordance with the respective national provisions. Although the SKW Stahl-Metallurgie Group is active in several countries of the European Union, it was not a “Community-scale undertaking” within the meaning of the German Act on European Works Councils in the year under review. Accordingly, there are no cross-border employee representative bodies within the Group.

In addition, there is no separate representation of senior managers at the SKW Stahl-Metallurgie Group.

No working days were lost to strikes or lock-outs in the year under review.

Safety Comes First

In the year under review, no workplace accidents occurred at the SKW Stahl-Metallurgie Group resulting in death, serious injury or impairment of health. The topic of workplace health and safety enjoys high priority at the SKW Stahl-Metallurgie Group, and the Company strives to exceed the minimum statutory requirements.

Employees Directly Share in Corporate Earnings

The Executive Board of the SKW Stahl-Metallurgie Group welcomes employee investment in the Company's share capital.

The Company has yet to establish an employee equity compensation programme. Employees holding interests in the Company's share capital exercise their rights in the same way as all other shareholders. Some employees are subject to statutory restrictions on such investment (e.g. prohibitions on insider trading). In the year under review, there were no stock option plans or similar arrangements. However, the Company intends to introduce a management stock option plan in 2007.

Around 80% of employees receive earnings-related additional benefits in line with corresponding statutory or contractual provisions, and thus participate directly in the commercial success of the Company.

Positive Working Environment

The fluctuation rate at the SKW Stahl-Metallurgie Group in the year under review was extremely low. This underlines the management's philosophy of creating an attractive working environment with the aim of generating a competitive advantage for the Company as a result of employee satisfaction.

Well-educated employees are a key factor in the SKW Stahl-Metallurgie Group's success. The Group companies work in close cooperation with metallurgy-oriented universities such as the Institut National Polytechnique de Lorraine in France, as well as supporting and promoting the specialist doctoral studies of several employees. The continued and further education of the entire workforce, including management, is an integral part of the SKW Stahl-Metallurgie Group's corporate philosophy. In France, for example, 2% of total salaries – twice as much as required there by law – is spent on employee training.

Corporate Management Measured by Results

The tasks and contribution of each individual member of the Executive Board to the overall performance of the Group were taken into account when determining the compensation of the Executive Board. In financial year 2006, compensation consisted of fixed annual compensation as well as performance-related variable compensation measured on the basis of the EBTDA of the respective year under review. The fixed compensation is paid as a monthly salary; the variable compensation consists of an individual bonus agreement in each case. Executive Board member Mr J. Klaus Frizen worked for free in the year under review.

The Supervisory Board did not receive any compensation above and beyond the reimbursement of expenses and any VAT incurred on such reimbursement, as well as the cost of D&O insurance.

Opportunities and Risk Report

Active Risk Management

The SKW Stahl-Metallurgie Group's risk policy is aimed at steadily and systematically increasing enterprise value through a value-oriented management approach and active portfolio management, in particular of the product portfolio.

Risk is an accepted element of the SKW Stahl-Metallurgie Group's corporate activity. As in every company, the Group's future business development is characterised by both risks and opportunities. The objective of the Group's risk policy is to leverage the available opportunities while using suitable instruments to limit the related risk. SKW Stahl-Metallurgie aims to achieve a neutral risk position with an appropriate risk/reward balance.

At the SKW Stahl-Metallurgie Group, risk management is carried out in the context of Group-wide controlling. Each week, a report on the development of financial key figures is submitted to the Executive Board. A target-performance comparison is carried out in monthly reports, which help provide a detailed analysis of product results on a year-on-year or target-actual basis. Analysis meetings are held between members of the Executive Board and executives of the Group companies in a timely manner on the basis of these monthly reports, and the ongoing forecast is adapted promptly as required. Keeping the Executive Board and top-level management informed on a timely basis means that essential packages of measures can be quickly devised and implemented. Another element of risk management is regular strategy meetings involving the directors and top-level management at which the current status of various aspects of the Company's position as well as the opportunities and risks of the subsidiaries in the form of risk inventories are discussed. These meetings are regularly held every two months.

In 2006, in the form of the Cognos software, a Group-wide controlling instrument was implemented in the ARQUES

Group, including the companies of the SKW Stahl-Metallurgie Group. This allows the management to have direct access to prepared data of the individual companies and therefore to gain an improved overview of the net asset and earnings situation of the Group companies.

In order to ensure that SKW Stahl-Metallurgie's risk policy is applied on a Group-wide basis, the Executive Board also introduced risk strategy principles, a uniform Group risk management process model and a risk management manual in 2006; these have been valid within the Group from 1 January 2007. This means that the SKW Stahl-Metallurgie Group has a comprehensive risk management system that allows it to identify risks at an early stage, perform solutions-oriented risk analysis and initiate corresponding measures in order to meet statutory requirements and prevent developments that could endanger the continued existence of the Company. The risk management system contains a number of control mechanisms, including the recording, monitoring and control of both internal and external risks.

The future risk management system consists of standardised software for supporting the risk management process, which is still to be implemented, as well as Group-wide risk reporting, regular risk inventories, risk consolidation and risk assessment planning. The classification and assessment of the individual risk classes is performed on a uniform, Group-wide basis, and may take into account quantitative or qualitative aspects.

The Executive Board is to be provided with regular reports on the risk management information stored in the system. In addition, when an individual risk is identified, an immediate report must be submitted to the Executive Board as soon as the respective risk exceeds a certain threshold. SKW Stahl-Metallurgie's risk management manual and its risk management process model are regularly reviewed by an internal risk manager and adjusted as necessary. Adherence to the provisions of the risk management manual is controlled through targeted assessments by an internal risk manager. In the context of the audit, the auditor of SKW Stahl-Metallurgie Holding AG also performs an annual examination of the suitability of the risk management system for the early recognition of risks that could endanger the continued existence of the Company within the meaning of section 91 (2) of the German Stock Corporation Act.

Focus on Corporate Governance

The management of the SKW Stahl-Metallurgie Group has also introduced an internal corporate governance manual containing provisions on the decision-making powers of the various management bodies of the SKW Stahl-Metallurgy companies and the business transactions requiring the approval of the Supervisory Board, subject to legislation, the Articles of Association and the bylaws of the Supervisory Board.

In particular, these risk inventories arising from the regular strategy meetings serve to identify the business policy risk for the companies of the SKW Stahl-Metallurgie Group that are listed below. The order in which the risks are presented does not reflect the weighting or importance of the individual risks or the likelihood of their occurrence. The listed risks include all material risks that are currently identifiable. Other risks and uncertainties that are not currently known to the Company or that the Company currently considers to be immaterial could also have a significant impact on the Company's operations and a long-term detrimental effect on the business prospects and the net asset, financial and earnings situation of the SKW Stahl-Metallurgie Group.

Economic and Industry-specific Risk

The SKW Stahl-Metallurgie Group is dependent on macroeconomic development and the cyclical nature of its specific customer industries. The macroeconomic situation and the development of the markets served by the Group have a direct impact on demand for the Group's products and a significant effect on the Company's business situation. These customer industries are exposed to economic fluctuations that indirectly affect the SKW Stahl-Metallurgie Group.

The products produced by the SKW Stahl-Metallurgie Group in the two current "Cored Wire" and "Powder & Granules" segments, which are distributed primarily in Europe, North America and individual Asian countries, are used – directly or indirectly – almost exclusively in the steel production industry. Demand for high-quality steel products in the automotive, shipping and mechanical engineering industries and plant engineering for the chemical and petrochemical industries is particularly important for the SKW Stahl-Metallurgie Group.

In the future "Quab" segment, the Group is to manufacture additives for the production of industrial starch that will mainly be used in the paper industry. Although the emergence of electronic communication was predicted to bring an end to or a decline in the use of paper, this has proved not to be the case. On the contrary, in recent years, the revenue of the paper industry has consistently increased roughly in line with the growth of general economic output. This trend is also expected to continue over the next few years. Another customer industry for Quab products is personal care, where Quab is used in shampoos, conditioners and shower gels. This industry is also relatively resistant to economic slowdowns, and is posting above-average growth in emerging economies such as India and China.

Procurement Risk

In procuring the key raw materials required by the "Cored Wire" segment, the Group's management pursued a strategy aimed at countering the risk of becoming dependent on one producer or production country by entering into multiple strategic alliances. Accordingly, the Group procures calcium silicon from South America, France and China, among others, depending on the quality required by the respective customer.

The "Powder & Granules" segment's procurement activities are focused on ensuring the availability of magnesium and carbide-based crude iron desulphurisation materials. A primary supplier exists for both products. The Group's management intends to keep these supplier relationships at the current levels. In order to protect itself against the consequences of one of these supplier relationships ending, the management maintains regular, technical dialogue with other potential suppliers.

Staff Risk

The SKW Stahl-Metallurgie Group's success is dependent to a large extent on its employees in management positions, research and development and consulting. In the Company's opinion, one of the reasons for its current market position is that it performs its own research and development, as well as the fact that it offers its customers production-related metallurgical advice for crude iron desulphurisation and refining using chemical additives. Both of these areas require highly qualified employees with the required metallurgy expertise and the ability to precisely assess the characteristics of the Group's products within the steel production process on the basis of their experience. The Group's streamlined structure and the personalised nature of some elements of its business mean that it is dependent on key employees. To counteract this dependence, the Group's management has implemented a succession model for the levels below the Executive Board.

Financial Risk

The Company's financial situation is extremely stable. This is reflected in particular in the net asset surplus of €19.4 million. Despite this, the Company is exposed to financial risk, and in particular tax, currency and raw material price risk.

Exchange rate risk arising from the Group's operating activities (transaction risk) is reduced by natural hedging, e.g. by entering into foreign-currency purchase and sale transactions. Group companies also hedge any exposures arising from the relevant foreign-currency forecasts at specific points after consulting Group management. However, any translation risk resulting from the transfer of income and expenses recorded by subsidiaries in other currency areas into euros cannot be hedged. The most important currency for the Group by some distance is its reporting currency (euros), followed by the US dollar. Other key currencies for the Group are the Japanese yen, the Indian rupee and the South Korean won. At the end of 2006, there were no hedging transactions within the Group.

Furthermore, the SKW Stahl-Metallurgie Group could be subject to additional tax claims for previous assessment periods.

Overall Assessment

The overall assessment of the aforementioned risk areas shows that the Group is primarily subject to both sale- and procurement-side market risk relating to economic price and volume development. By contrast, internal service processes are subject to a significantly lower degree of risk. The level of financial risk is manageable.

All in all, it can be concluded that the present risks to which the SKW Stahl-Metallurgie Group is exposed are limited and that they do not pose a threat to the continued existence of the Company. Similarly, there is no evidence of any risks that could endanger its continued existence.

Recognising and Leveraging Opportunities

In particular, the Executive Board of the SKW Stahl-Metallurgie Group has identified the opportunities described below for the future operating activities of the Group.

Consolidation of the Steel Industry as an Opportunity for the SKW Stahl-Metallurgie Group

The Group's management believes that the customer concentration that is currently taking place offers an opportunity for it to expand its business in the markets it already supplies. In future, the steadily growing global steel conglomerates will cluster their suppliers on the basis of their ability to serve them internationally. The SKW Stahl-Metallurgie Group's unique international presence in its market means that this development offers additional growth potential. The SKW Stahl-Metallurgie Group's high degree of technical expertise and strong focus on R&D means that the Group is in a strong position to intensify its role as an expert global partner for international steel conglomerates. This opportunity is reinforced by the fact that competitors perform no or only minimal research and development.

New High-growth Markets as an Opportunity for the SKW Stahl-Metallurgie Group

In some emerging economies such as Russia, India or China, steel production is also set to post above-average growth over the next few years. For instance, some experts expect Indian steel production to double by 2012. However, the increase in steel production in general, is not the only important factor in the market prospects of the SKW Stahl-Metallurgie Group. Even more crucial is the rise in the production of high-quality and higher-quality steel. In the above-mentioned countries, this segment is set to post above-average growth. Consequently, demand for products such as those provided by the SKW Stahl-Metallurgie Group is also set for above-average growth. In the above-mentioned markets, the SKW Stahl-Metallurgie Group expects growth of the relevant markets in the region of 30% p.a. As a result of the capital increase carried out in the context of the IPO in December 2006, the SKW Stahl-Metallurgie Group has sufficient financial resources to enter the above-mentioned markets either organically or through acquisitions.

Growth by Increasing the Real Net Output Ratio

In the “Powder & Granules” segment (excluding the Indian joint venture Jamipol), the SKW Stahl-Metallurgie Group currently has no production facilities of its own. Instead, its products are manufactured on a contract basis. This structure is a win-win situation in the existing core market of Central Europe for all parties. However, with the planned entry into new geographical markets, the SKW Stahl-Metallurgie Group plans to develop its own production facilities in these countries, as there are no suitable suppliers here who can manufacture desulphurisation mixes to the quality required by the SKW Stahl-Metallurgie Group. This development of in-house production capacity provides the opportunity for a considerable increase in margins.

In the context of the identified growth strategy, the SKW Stahl-Metallurgie Group plans to increase its real net output ratio by developing or acquiring in-house raw-material production facilities. This allows for an increase in margins and also makes the SKW Stahl-Metallurgie Group less dependent on external suppliers. The SKW Stahl-Metallurgie Group still has the expertise required for this, as it was a strong vertically integrated Group in the recent past, and most of the expertise carriers from those days still work for the SKW Stahl-Metallurgie Group.

Margin Growth Through New Products

In the “Cored Wire” segment, the intensified sale of higher-margin products is set to increase the mean margin over the next few years. For instance, the PapCal product, patented until 2023, has significant market potential, which is likely to be fully realised over the next two years. The main characteristic of PapCal is that it is three times more effective than conventional calcium-filled cored wire. The resultant savings are shared between customers and the Affival Group, making use and sale of the product highly attractive for both parties.

In the context of the intensification of R&D activities, several other product ideas have also been generated and developed. Patent applications for some of them are to be registered in 2007.

In addition, the Group’s international research and development team is also working on further improving product quality and production efficiency. Both research topics are set to lead to a further increase in margin, partly through the possibility of achieving higher sales prices and partly through further cost reductions.

The SKW Stahl-Metallurgie Group has acquired the “Quab” business, which is likely to be reported on as a separate segment in future. This acquisition serves to further diversify the Group’s special chemical business, thus making it less exposed to sector risk.

Report on Post-Balance Sheet Date Developments

Significant Transactions and Events after the End of the Year under Review

The following significant transactions and events occurred between the end of the financial year on 31 December 2006 and the submission of this management report.

The SKW Stahl-Metallurgie Group acquired the “Quab” business of Degussa GmbH, a subsidiary of the RAG Group, in an asset deal. “Quab” is a specialised chemical product that is sold in more than 40 countries.

Quab’s customers are international starch producers, who in turn sell cationic starch to the paper industry. Quab products (or corresponding synthetic substances) can be found in almost all types of paper. Apart from paper manufacture, the product is also used as an additive for personal care products.

This acquisition serves to further diversify the Group’s special chemical business, thus making it less exposed to sector risk. The Group’s overhead situation in the USA will be substantially improved through the expansion of the business performed there and the potential synergies that will arise as a result. In particular, the costs per transaction will be reduced in the overhead functions to be shared in future.

Quab’s annual revenue amounts to approximately €27 million (2006). The unit has a production facility in Mobile, Alabama, USA, and an administrative office in New Jersey, USA. The signing of the agreement was announced in an ad hoc disclosure published on 22 December 2006, with closing taking place on 16 January 2007. The purchase price has not been disclosed by mutual agreement. The purchase price is largely financed by IPO proceeds which SKW Stahl-Metallurgie Holding AG is making available to the Group company SKW Quab Chemicals, Inc.

In “Memo/07/22” published on 18 January 2007, the European Commission announced that it had carried out unannounced inspections at the premises of calcium carbide suppliers in Austria, Germany, Slovenia and Slovakia on 16-17 January 2007. The SKW Stahl-Metallurgie Group is involved in this investigation. The Group has complied in full with its statutory duties of cooperation and forbearance in respect of the European Commission and all other responsible authorities with regard to this matter. The European Commission stated that it had reason to believe that the companies concerned may have violated Article 81 of the EC Treaty. The Executive Board deems the allegation arbitrary; nevertheless, a comprehensive internal investigation is being conducted. This investigation has not been completed, and is being pursued with a high degree of emphasis and priority.

Outlook

Growth-friendly Economic Climate Continues

The Organisation for Economic Cooperation and Development (OECD) and the International Monetary Fund (IMF) both expect the positive global economic environment to continue in 2007 and 2008. According to the IMF, global economic output is forecast to increase by around 4.9% in 2007.[14] US economic output is expected to grow by 2.9%, with Europe recording growth of 2.0%. For Germany, the OECD is projecting a 1.8% increase in GDP, while the IMF expects the Japanese economy to grow by 2.1%.[15]

The strong growth momentum enjoyed by the global economy in 2007 will again be driven by developments in the emerging economies of East and South-East Asia and Eastern Europe. In their autumn report, the German economic research institutes forecast overall growth of 6.3% for these regions.[16] India's economy is expected to grow by 7.3%, while the Russian economy will record growth of 6.0% on the back of high commodity prices.

Experts forecast that this positive development will continue into 2008. The OECD countries are expected to improve their overall economic output by 2.5%.[17]

Demand for Steel and Metallurgy Products Continues to Rise

The broad degree of confidence with regard to global economic development is expected to have a positive effect on the SKW Stahl-Metallurgie Group's sales markets once again in 2007 and 2008. As in previous years, the steel industry will benefit from high demand in the emerging economies of Asia and Eastern Europe. The Company is maintaining its forecast of continuing growth at the level of GDP growth in Europe and North America.

The metallurgy industry will record further growth in this and the coming year on the back of rising demand for steel and the trend towards higher-quality steel types, particularly in the emerging economies.

Targeted Acquisitions and Investments for Higher Growth and Income

Following its successful IPO in December 2006, the SKW Stahl-Metallurgie Group has set itself a number of growth targets for financial years 2007 and 2008. It intends to establish new production sites on a targeted basis in certain emerging economies in Eastern Europe, Asia and Latin America. By strengthening its market position in emerging economies in this way, their share in the revenue of the SKW Stahl-Metallurgie Group is set to rise considerably to approx. 30%.

In addition, a number of strategic alliances and possible acquisitions of competitors that are already active in local markets are being examined. Vertical integration through the launch of raw materials production is also being examined. Although the Executive Board cannot identify any risks that could jeopardise sufficient supply with raw materials, on the procurement side, the SKW Stahl-Metallurgie Group will remain exposed to fluctuations in raw material prices and the exchange rates of its procurement currencies, some of which may be substantial in nature. These risks can only be hedged to a certain degree, as they also depend on unforeseeable factors such as the political situation in certain mineral-rich countries.

14. International Monetary Fund: World Economic Outlook, Sept. 2006, p. 2.
15. International Monetary Fund: World Economic Outlook, Sept. 2006, p. 2.
16. Autumn report by the German economic research institutes, October 2006, p. 8.
17. Spiegel Online, 28 November 2006

Above-average Improvement in Pre-tax Profit Expected

Based on these plans, the Executive Board expects to record a significant increase in revenue in financial years 2007 and 2008, largely as a result of the planned acquisitions and growth projects, as well as an above-average improvement in pre-tax profit. If the SKW Stahl-Metallurgie Group's business development exceeds forecasts, the Executive Board and Supervisory Board will propose to the 2008 Annual General Meeting that a dividend be distributed for the first time.

The Company is forecasting growth in customer demand for crude iron desulphurisation and secondary metallurgy products in terms of volume.

At segment level, the "Powder & Granules" segment is to be significantly strengthened through the acquisition or construction of in-house production facilities. In the "Cored Wire" segment, the focus on high-tech, high-margin products will remain in place.

In all segments, the Group's growth strategy will be implemented, especially in developing countries and emerging economies. In particular, the Group is examining potential investments in Russia and Turkey, as well as the possibility of strengthening its market position on the Indian subcontinent and in Mexico.

Financing of Growth is Secure

Growth will be primarily financed from the net asset surplus of €19.4 million resulting from the IPO.

Heightened investment activity will result in increasing depreciation of property, plant and equipment.

Research and development will remain one of the SKW Stahl Metallurgie Group's unique selling points compared with its competitors, and will therefore be given the same high priority as previously. The R&D team was strengthened at the beginning of 2007; further significant measures are planned.

Although the production processes applied at the SKW Stahl-Metallurgie Group are not particularly staff-intensive, the Group's growth in 2007 and 2008 means that there will be a corresponding increase in the workforce.

The Group's organisational structure will keep pace with this growth without changing fundamentally; in particular, the classification of existing operating activities into the "Cored Wire" and "Powder & Granules" segments will be retained. With the acquisition of the "Quab" specialist chemicals business of the RAG Group on 16 January 2007, an additional operating segment is likely to be added to the segment reporting from financial year 2007.

Dependent Company Report

In accordance with section 312 of the German Stock Corporation Act, SKW Stahl-Metallurgie Holding AG prepared a separate report on its relationships with affiliated companies in the short financial year 2006 from 26 May 2006 onwards. On a voluntary basis, a report was also given on the transactions between the Group companies of SKW Stahl-Metallurgie Holding AG and ARQUES Industries AG and its associated companies. The report closes with the following declaration: “In conclusion, we confirm that the Company received appropriate compensation for all transactions listed in the dependent company report according to the circumstances known to the Company at the time that such transactions were entered into.”

DISCLAIMER

This management report contains statements on future developments that are based on currently available information and involve risks and uncertainties that could cause the actual results to differ from these forward-looking statements. These risks and uncertainties include, for example, unforeseeable changes to political and economic conditions, in particular in the steel production industry, the competitive situation, the development of interest rates and exchange rates, technological developments and other risks and unexpected circumstances. SKW Stahl-Metallurgie Holding AG and its Group companies accept no obligation to update such forward-looking statements.

Unterneukirchen, den 13. März 2007
SKW Stahl-Metallurgie Holding AG

Der Vorstand

Ines Kolmsee J. Klaus Frizen Gerhard Ertl

Application area: Ship building

Even in the most formidable circumstances plates can weather rough seas thanks to the treatment with SKW Stahl-Metallurgie refinement products

SKW Stahl-Metallurgie Holding AG Consolidated Income Statement for 1 January – 31 December 2006

	Note	2006 € thousand	2005 € thousand
Revenue	**1**	**185,828**	**192,738**
Change in the inventories of finished goods and work in progress		-614	5,605
Work performed by the enterprise and capitalised		840	0
Other operating income	2	4,108	2,669
Cost of materials	3	-145,914	-157,563
Staff costs	4	-12,911	-11,941
Other operating expenses	5	-17,737	-18,339
Amortisation of intangible assets and depreciation of property, plant and equipment	6	-1,859	-1,821
Income from associates	7	716	768
Other interest and similar income	8	274	217
Interest and similar expenses	9	-716	-829
Profit from ordinary activities		12,015	11,504
Income tax expense	10	-2,782	-980
Consolidated net profit for the period		**9,233**	**10,524**
Of which attributable to the parent company	*11*	*9,233*	*10,524*
Of which attributable to minority interests		*0*	*0*
Earnings per share in €	12	4.53	10.27
Earnings per share in € (not weighted)		2.09	10.27

SKW Stahl-Metallurgie Holding AG Consolidated Balance Sheet as at

ASSETS	Note	31 Dec. 2006 € thousand	31 Dec. 2005 € thousand
Non-current assets			
Intangible assets	13	989	23
Property, plant and equipment	14	9,690	9,754
Investments in associates	15	3,679	3,603
Other non-current assets		431	273
Deferred tax assets	16	4,064	2,921
Total non-current assets		**18,853**	**16,574**
Current assets			
Inventories	17	26,284	25,774
Trade receivables	18	27,113	30,211
Claims from income tax expense		196	0
Other assets	19	4,758	3,641
Cash and cash equivalents	20	34,905	1,362
Other current assets		**93,256**	**60,988**
Total assets		**112,109**	**77,562**

31 December 2006

EQUITY & LIABILITIES	Note	31 Dec. 2006 € thousand	31 Dec. 2005 € thousand
Equity	**21**		
Issued capital		4,422	25
Capital reserves		29,144	1,000
Other reserves		33,165	24,918
Minority interest		38	0
Total equity		**66,769**	**25,943**
Non-current liabilities			
Pension obligations	22	1,333	1,217
Obligations from finance leases	23	847	691
Total non-current liabilities		**2,180**	**1,908**
Current liabilities			
Provisions	24	873	926
Financial liabilities	25	15,497	21,024
Trade payables	26	21,305	21,755
Tax liabilities		2,318	239
Other liabilities	27	3,167	5,767
Total current liabilities		**43,160**	**49,711**
Total equity & liabilities		**112,109**	**77,562**

SKW Stahl-Metallurgie Holding GmbH Consolidated Cash Flow Statement

		Note 29	01 Jan. 2006 - 31 Dec. 2006 € thousand	01 Jan. 2005 - 31 Dec. 2005 € thousand
1.	Consolidated net profit for the period		9,233	10,524
2.	Write-downs/reversals of write-downs of non-current assets		1,859	1,821
3.	Increase/decrease in provisions for pensions		116	20
4.	Income from equity accounted investments		-326	-356
5.	Gains on disposal of non-current assets		-596	-16
6.	Foreign exchange losses		655	-745
7.	Income from deferred taxes		46	-1,173
8.	Work performed by the enterprise and capitalised		-840	0
9.	Other non-cash income		-309	-47
10.	**Gross cash flow**		**9,838**	**10,114**
	Changes in working capital			
11.	Increase/decrease in short-term provisions for pensions		-54	-305
12.	Increase/decrease in inventories (after advanced payments received)		-766	-5,062
13.	Increase/decrease in trade receivables		3,330	-4,859
14.	Increase/decrease in receivables from subsidiaries		-948	68
15.	Increase/decrease in other receivables		38	0
16.	Increase/decrease in other assets		-365	-900
17.	Increase/decrease in trade payables		-468	5,418
18.	Increase/decrease in trade payables to subsidiaries		17	-616

	Note 29	01 Jan. 2006 - 31 Dec. 2006 € thousand	01 Jan. 2005 - 31 Dec. 2005 € thousand
19. Increase/decrease in other payables		390	0
20. Increase/decrease in other equity & liabilities		-568	2,423
21. Net cash from/used in operating activities (net cash flow)		**10,444**	**6,281**
22. Proceeds (= income) from asset disposals		1,069	1,116
23. Payments for investments in non-current assets		-2,468	-3,198
24. Purchase price paid for business acquisitions		0	0
25. Cash and cash equivalents acquired in business acquisitions		15	0
26. Net cash from/used in investing activities		**-1,384**	**-2,082**
27. Proceeds from capital increase		30,184	0
28. IPO costs		-2,483	0
29. Dividend to parent company		0	-1,000
30. Redemption of shareholder loans		-3,576	-2,168
31. Proceeds from raising bank liabilities		349	0
32. Payments for the redemption of loans		0	-646
33. Net cash from/used in financing activities		**24,474**	**-3,814**
34. Cash and cash equivalents at the beginning of the period		1,362	980
35. Change in cash and cash equivalents		33,534	385
36. Currency translation of cash held		9	-3
37. Cash and cash equivalents at the end of the period		**34,905**	**1,3622**

SKW Stahl-Metallurgie Holding AG Statement of Changes in

€ thousand	Issued capital	Capital reserves	Net result of respective year
31 December 2004	**25**	**1,000**	
Capital increase	0	0	
Consolidated net profit for 2005	0	0	10,524
Changes in exchange rates	0	0	
Other changes	0	0	
Total equity as at 31 December 2005	**25**	**1,000**	
As at 1 January 2006	**25**	**1,000**	
Changes in exchange rates	0	0	
Other changes	0	0	
Expenses and income recognised in equity			
Consolidated net profit for 2006	**0**	**0**	**9,233**
Total expenses and income for the period			
Capital increase from non-cash contributions	2,300	0	
Increase in issued capital from corporate funds	1,000	-1,000	
IPO	1,097	30,723	
IPO transaction costs after taxes	0	-1,579	
Total equity as at 31 December 2006	**4,422**	**29,144**	

Consolidated Equity in Financial Years 2005 and 2006

Other reserves	Consolidated equity of the controlling shareholder	Minority interests	Total equity
13,518	**14,543**	**0**	**14,543**
0	0	0	0
10,513	10,513	0	10,513
1,123	1,123	0	1,123
-236	-236	0	-236
24,918	**25,943**	**0**	**25,943**
24,918	**25,943**	**0**	**25,943**
-1,376	-1,376	0	-1,376
390	390	38	428
-986	**-986**	**38**	**-948**
9,233	**9,233**	**0**	**9,233**
8,247	**8,247**	**38**	**8,285**
0	2,300	0	2,300
0	0	0	0
0	31,820	0	31,820
0	-1,579	0	-1,579
33,165	**66,731**	**38**	**66,769**

Notes to the Consolidated Financial Statements for Fiscal Year 2006

A. GENERAL INFORMATION AND PRESENTATION OF THE CONSOLIDATED FINANCIAL STATEMENTS

SKW Stahl-Metallurgie Holding AG, Unterneukirchen, Germany (hereinafter referred to as “SKW AG” or the “Company”) is headquartered on Fabrikstrasse 6 in 84579 Unterneukirchen, Germany, and is registered with the Traunstein Local Court (HRB 17037). The Company was created when SKW Stahl-Metallurgie Holding GmbH, Unterneukirchen, Germany, changed its legal form. The change was resolved on 20 April 2006 by the Shareholders’ Meeting and entered into the commercial register of the Traunstein Local Court on May 26, 2006.

The Company’s shares have been traded on the regulated market (Prime Standard) of the Frankfurt Stock Exchange since 1 December 2006.

The business activities of the SKW Stahl-Metallurgie Group are the acquisition, production and distribution of chemical additives for crude iron desulphurisation and steel refining as well as the related applications-oriented support of the steelworks in these areas of use.

The consolidated financial statements were prepared using euro (€) as the reporting currency. Euro is the functional currency as most of the Group’s transactions are based on this currency. The amounts in the notes to the consolidated financial statements are generally in thousands of euros (€ thousand), unless otherwise stated. Differences may arise in the tables found in the notes to the consolidated financial statements due to figures being rounded up or down.

The nature of expense method has been used for the consolidated income statement. The consolidated balance sheet is structured by term. Assets and liabilities that are due within a year are considered to be current.

To improve the clarity of presentation, items of the consolidated balance sheet and of the consolidated income statement have been combined where practical and possible. These items are subdivided in the notes to the consolidated financial statements and explained accordingly.

B. SUMMARY OF THE MAIN ACCOUNTING POLICIES

SKW Stahl-Metallurgie Holding AG has compiled the following consolidated financial statements in accordance with International Financial Reporting Standards (IFRS). These consolidated financial statements of SKW AG were prepared in accordance with the International Financial Reporting Standards as they are to be applied in the European Union and the interpretations of the International Financial Reporting Interpretations Committee (IFRIC). The consolidated financial statements were compiled on the basis of the historical cost approach, limited by the recognition of derivative financial instruments which are measured at fair value.

All the mandatory IFRSs and IASs for financial year 2006 and interpretations of the International Financial Reporting Interpretations Committee (IFRIC) and the Standing Interpretations Committee (SIC) were complied with. The consolidated financial statements were supplemented by a Group management report and additional disclosures required in accordance with the Handelsgesetzbuch (HGB – German Commercial Code) and the Aktiengesetz (AktG – German Stock Corporation Act). The financial statements included of all fully-consolidated domestic and foreign companies that must be audited in line with national provisions or voluntarily audited were checked by an independent auditor or checked from an auditing perspective. The consolidated financial statements are prepared under the assumption that the Company is a going concern.

Application of the IASB or IFRIC standards below is mandatory for the first time for financial years beginning on 1 January 2006:

- Amendment to IAS 39 (The Fair Value Option)
- IFRS 6 (Mineral Resources)
- IFRIC 4 (Determining whether an arrangement contains a lease)
- IFRIC 5 (Interests in Decommissioning Funds)
- Amendment to IAS 19 (Actuarial Gains and Losses, Group Plans and Disclosures)
- Amendment to IAS 39 (Cash Flow Hedge Accounting)
- Amendment to IFRS 1 (First time Adoption of IFRS)
- Amendment to IFRS 6 (Exploration for and Evaluation of Mineral Resources)
- Amendment to IAS 39 and IFRS 4 (Financial Guarantee Contracts)
- IFRIC 6 (Waste Electrical and Electronic Equipment)
- Amendment to IAS 21 (Net Investment in a Foreign Operation)

The aforementioned standards were examined as to their impact on the accounting of the SKW Stahl-Metallurgie Group.

The standards below were not voluntarily applied early:

- IFRS 8 (Operating Segments)
- IFRS 7 (Financial Instruments: Disclosures)
- Amendment to IAS 1 (Capital Disclosures)
- IFRIC 12 (Service Concession Arrangements)
- IFRIC 11 (IFRS 2 – Group and Treasury Share Transactions)
- IFRIC 10 (Interim Financial Reporting and Impairment)
- IFRIC 9 (Reassessment of Embedded Derivatives)
- IFRIC 8 (Scope of IFRS 2)
- IFRIC 7 (Applying the Restate Approach under IAS 29)

The aforementioned standards were examined as to their impact on the accounting of the SKW Stahl-Metallurgie Group.

The annual financial statements of the companies included in the consolidated financial statements were based on the same accounting policies. The main accounting policies that were applied when preparing these consolidated financial statements are presented below.

C. CONSOLIDATED GROUP AND METHODS

Subsidiaries are all companies (including special purpose entities) in which the Group has a controlling influence over their financial and operating policies and always accompanied by a 50% interest in voting rights. When assessing whether there is a controlling influence, the existence and effect of any potential voting rights that may currently be exercised or converted is taken into account where applicable. Subsidiaries are included in the consolidated financial statements (fully-consolidated) from the date on which control was passed on to the Group. They are deconsolidated on the date on which control ends.

The capital consolidation of subsidiaries is carried out under IAS 27 (Consolidated and Separate Financial Statements) by offsetting the carrying amount of the ownership against the revalued equity of the subsidiary on the date of acquisition (revaluation method). The cost of the acquisition corresponds to the fair value of the assets given up, the equity instruments issued and the liabilities that arise or are assumed on the transaction date (date of exchange) plus the costs directly attributable to the acquisition. Assets, liabilities and contingent liabilities that can be identified in a business combination are measured at their fair values on the date of acquisition upon first-time consolidation, irrespective of the extent of the minority interests. Any excess of the cost of the acquisition over the interest of the Group in the net assets measured at fair value is carried as goodwill. If the costs of acquisition are lower than the net assets of the acquired subsidiary that are measured at fair value, the difference is reported directly in the income statement after being checked once more. The interests of minority shareholders are reported under the portion of the fair values of the assets and liabilities recognised that corresponds to the minority interest.

The profits/losses of subsidiaries acquired or sold in the course of the year are included in the consolidated income statement from the date on which the controlling influence begins or ends. During the period under review, SKW Stahl-Metallurgie Holding AG acquired 90% of the shares in Arques Chemicals Inc., Wilmington, Delaware, USA as part of a share deal. There were no companies sold within the SKW Stahl-Metallurgie Group in financial year 2006. Intragroup transactions, balances and unrealised profits from transactions between Group companies are eliminated. Unrealised losses are also eliminated, unless the transaction indicates impairment of the asset transferred.

Interests in consolidated equity and consolidated profit/loss for the period attributable to minority shareholders are reported separately from the interests attributable to the parent company.

Jamshedpur Injection Powder Ltd., Jamshedpur, India was included at equity in the consolidated financial statements.

The reporting dates of the consolidated companies correspond to the reporting date of the parent company's annual financial statements – except for the reporting date of the company consolidated at equity (Jamshedpur Injection Powder Ltd., Jamshedpur, India). Jamshedpur's balance sheet date is 31 March.

The list of shareholdings is appended to this report as an annex.

Associates

Associates are those companies that exercise significant influence over the Group but do have any control and are always accompanied by a 20% – 50% interest in voting power. Investments in associates are accounted for using the equity method. In line with this, differences from first-time consolidation are treated according to the principles of consolidation and initially carried at cost. The Group's interest in associates includes the goodwill that arose upon acquisition.

The Group's interest in the profit and loss of associates is reported in the income statement from the date of acquisition and the interest in changes to reserves in the Group reserves. The changes accumulated after acquisitions are offset against the carrying amount of the ownership.

Segment reporting

A business segment is a group of assets and operating activities that provides products and services which are different to those of other operations in terms of their risks and rewards. A geographical segment provides products or services within a specific economic environment, the risks and rewards of which differ from other economic environments.

In segment reporting, operations are structured by main activities (primary segmentation) and by geographical characteristics (secondary segmentation). The primary segments in the SKW Stahl-Metallurgie Group are the "Cored Wire" and "Powder&Granules" operations. Segments are reported in line with the carrying amount and the accounting methods of the underlying IFRS consolidated financial statements. Intrasegment consolidations were carried out. The amortisation and depreciation of the intangible assets and property, plant and equipment belonging to the segment are reported as segment depreciation and amortisation.

Generation of income and expenses

Revenue is measured at the fair value of the consideration received or to be received and constitute amounts that are to be received for goods and services in the ordinary course of business. Of this, discounts, VAT and other taxes connected with the sale must be deducted. The sale of goods is recorded upon delivery, when ownership and risk have been transferred to the purchaser.

Interest income is recognised an accrual basis, taking into account the outstanding loan principal and the interest rate to be applied. The interest rate to be applied is precisely the interest rate which discounts the estimated future cash flows over the term of the financial asset at its net carrying amount.

Dividend income from financial assets is recognised when the shareholder's right to receive payment is established.

Non-capitalisable expenses are recognised in the income statement when they are incurred.

Borrowing costs

Borrowing costs are recognised as an expense within the Group in the period during which they are incurred.

Income taxes

The income tax expense constitutes the total of the current tax expense and deferred taxes.

The current tax expense is calculated on the basis of the taxable income for the year. The taxable income differs from the net profit for the period in the income statement as it excludes expenses and income that are never taxable, taxable in later years or that are deductible for tax purposes. The liability of the Group for the current tax expense is calculated on the basis of the tax rates applicable or adopted by the balance sheet date.

Deferred tax obligations that arise due to temporary differences in connection with investments in subsidiaries and associates are recognised unless the timing of the reversal of temporary differences can be controlled by the Group and it is likely that the temporary differences will not reverse in the foreseeable future.

Deferred taxes are the tax benefits or tax burdens to be expected from the differences between the carrying amounts of assets and liabilities in the IFRS annual financial statements and the tax base from consolidation transactions as well as on loss carryforwards that are likely to be generated. The balance sheet liability method is applied here. Deferred tax liabilities are generally recorded for all taxable temporary differences and deferred tax assets if it is likely that there will be taxable gains for which the deductible temporary differences can be used. Such assets and liabilities are not recognised if the temporary difference arises from goodwill or from initial recognition (except in the case of business combinations) of assets and liabilities that result from events neither relating to the taxable income nor to the net profit for the period. Deferred tax receivables and liabilities are offset if they are to/from the same taxation authorities and have the same terms.

The carrying amount of the deferred tax assets is checked and reduced every year on the balance sheet date if it is no longer likely that sufficient taxable income is available to collect the claim in part or in full. Deferred taxes are calculated on the basis of the tax rates already adopted which apply at the time that the liability is settled or the asset is generated. Deferred taxes are generally recognised in the income statement, except for those items that are charged directly to equity.

Internally generated intangible assets – research and development costs

Expenditure for research activities is recognised as expenses. An internally generated intangible asset that arises from the development of the Group is only recognised as an asset if the criteria under IAS 38 exists. If an internally generated intangible asset is not permitted to be recorded under IAS 38, the development costs are recognised as expenses in the period in which they are incurred.

Patents, licenses (including software) and trade marks

Purchased patents, licenses and trade marks are recognised at historical cost. They have definite useful lives and are measured at cost less any accumulated amortisation.

If there are indications of impairment, the intangible assets are tested for impairment and, if necessary, reduced to their recoverable amount as defined under IAS 36.

Amortisation is charged on a straight-line basis over an expected useful life that was determined as standard for the following intangible assets:

- Patents, utility models, trade marks, publishing titles, copyrights, rights to benefits: 10 years
- Brands, corporate logos, ERP software and Internet domain names: 5 – 10 years
- Software protected by copyright : 3 years

Property, plant and equipment

All property, plant and equipment are measured at their historical cost less depreciation. Historical cost includes the costs directly attributable to the acquisition. Subsequent costs are only recognised as part of the cost of the asset if it is likely that the future economic benefits from it will accrue to the Group and the costs of the asset can be reliably determined. All other repairs and maintenance are recognised as expenses in the income statement in the financial year in which they are incurred.

Land is not depreciated. For all other assets, depreciation is charged on a straight-line basis. The cost is depreciated over the expected useful life of the assets to the remaining carrying amount as follows:

- Factory buildings: 15 – 20 years
- Office buildings: 15 – 20 years
- Other buildings: 7 years
- Operating facilities: 7 – 10 years
- Technical equipment and machinery: 3 – 10 years
- Furniture and fixtures: 5 – 10 years
- Office equipment: 3 – 10 years

The remaining carrying amounts and the economic useful lives are examined on each balance sheet date and adjusted if applicable. If the carrying amount of an asset exceeds its estimated recoverable amount, it is immediately depreciated to the latter. Gains and losses from disposals of assets are calculated as the difference between the proceeds on disposal and the carrying amount and recognised in income.

Impairment of non-financial assets

Assets that have an indefinite useful life are not depreciated/amortised but tested for impairment. Assets that are depreciated/amortised are only tested for impairment if corresponding events or changes to the circumstances indicate that it may no longer be possible to recover the carrying amount. An impairment loss is recognised at the carrying amount exceeding the recoverable amount. The recoverable amount is the higher of the asset's fair value less costs of disposal or the value in use. For the impairment test, assets are summarised at the lowest level for which cash flows can be separately identified (cash generating units).

If an impairment is then reversed, the carrying amount of the asset (of the cash generating unit) is increased to its estimated recoverable amount. In so doing, the increase in the carrying amount is limited to the value that would have been determined if no impairment loss had been recorded for the asset (cash generating units) in previous years. A reversal of the impairment loss is recognised immediately in income. Impairment losses charged on goodwill amounts are not reversed.

Leases

Leases are classified as finance leases if all the risks and rewards incident to ownership are substantially transferred to lessee. All other leases are classified as operating leases.

Non-current assets that were rented or leased and the beneficial ownership of which lies with the respective Group company (finance lease) are capitalised at the present value of lease instalments or at a lower fair value in accordance with IAS 17 and depreciated over their useful lives. If there is no reasonable certainty that the lessee will obtain ownership by the end of the lease term, the asset should be fully depreciated over the shorter of the lease term or its useful life.

The corresponding liability to the lessor is reported in the balance sheet as an obligation from a finance lease. Lease payments are divided across interest expenses and a reduction of the lease obligation such that the interest rate is constantly charged on the remaining liability.

Lease payments under an operating lease are recognised as an expense in the income statement on a straight-line basis over the term of the lease unless another systematic basis is more representative of the time pattern of the lessee's benefit.

In the year under review, the office building of Affival S.A.S. was sold to Arques Immobilien GmbH & Co. KG and leased again by the latter by means of a 10-year lease. No option to purchase is provided for in the lease. The Group generated net income of €593 thousand in the year under review through the sale of this building.

The Group was a party to finance leases and operating leases in the period under review. The Company is only the lessee.

Inventories

Inventories are measured at the lower of cost and net realisable value. Costs include direct material costs and, if applicable, prime costs as well as those overheads that have been incurred to bring the inventories to their present condition at their present location. The costs are calculated using the weighted average method. The net realisable value is the estimated selling price less the costs for marketing, sale and distribution.

Trade receivables

Trade receivables are initially carried at their fair value and then at amortised cost using the effective interest method and deducting write-downs. Write-downs are charged on trade receivables if there is objective evidence that the receivable amounts due cannot be collected in full. The amount of the write-down is determined as the difference between the carrying amount of the receivable and the present value of estimated future cash flows from this receivable, discounted at the effective interest rate. The write-down is recognised in income. If the reasons for write-downs in earlier periods no longer exist, they are reversed.

Cash and cash equivalents

Cash and cash equivalents comprise cash on hand, demand deposits, other current highly-liquid financial assets with a maximum original term of three months and bank overdrafts. Bank overdrafts used are shown in the balance sheet as amounts due to banks under current financial liabilities.

Non-current financial assets

Financial assets are subdivided into the following categories: assets measured at fair value through profit or loss, loans and receivables, assets held to maturity and available for sale assets. The classification depends on the respective purpose for which the financial asset was acquired. The Management determines the classification of the financial assets when they are recognised for the first time and checks the classification on each balance sheet date.

- Assets measured at fair value through profit or loss

  This category has two categories: financial assets that are classified as held for trading from the start, and those which were initially classified as "at fair value through profit or loss". A financial asset is allocated to this category if it was primarily acquired with an intention to sell it in the short term or the financial asset was designated accordingly by the Management. Derivatives also belong to this category. Assets in this category are reported as current assets if they are either held for trading or likely to be realised within 12 months of the balance sheet date.

- Loans and receivables

  Loans and receivables are non-derivative financial assets with fixed or determinable payments that are not listed on an active market. They arise if the Group provides a debtor with money, goods or services directly without intending to trade these receivables. They are considered current assets provided that their maturity does not exceed 12 months of the balance sheet date.

The latter are reported as non-current assets. Loans and receivables are included in the balance sheet under trade receivables and other receivables.

- Investments held to maturity

Investments held to maturity are non-derivative financial assets with fixed or determinable payments and fixed terms in the case of which the Group Management intends and is in a position to hold to maturity.

During this financial year, the Group had no investments in this category.

- Available-for-sale financial assets

Available-for-sale financial assets are non-derivative financial assets that were either allocated to this category or were not allocated to any of the other categories presented. They are classified as non-current assets if the Management does not intend to sell them within 12 months of the balance sheet date.

All purchases and sales of financial assets are recognised on the trading date on which the Group undertook to purchase or sell the asset. Financial assets that do not belong to the "at fair value through profit or loss" category are initially carried at their fair value plus transaction costs. They are derecognised when the rights to payments from the investment have expired or were transferred and the Group has substantially transferred all risks and rewards incident to ownership. Available-for-sale financial assets and assets belonging to "at far value through profit or loss" category are measured at their fair value after initial recognition. Loans and receivables and investments held to maturity are reported at amortised cost using the effective interest method.

Realised and non-realised gains and losses from the change in the fair value of assets in the "at fair value through profit or loss" category are recognised in profit or loss in the period in which they arise. Unrealised gains from the change in the fair value of non-monetary securities under the available-for-sale financial assets category are charged to equity. If securities of the category available-for-sale financial assets are sold or written down, the adjustments to the fair value accumulated in equity are recognised in income as gains or losses from financial assets in the income statement.

There were no available-for-sale financial assets in the SKW Stahl-Metallurgie Group as at the balance sheet date.

Equity

Ordinary shares are classified as equity. Costs that can be directly attributed to the issue of new shares or options are reported in equity in their net amount after taxes as a deduction from the issue proceeds.

Provisions

Provisions are recognised if the Group has a present legal or constructive obligation resulting from a past event; it is more likely than not that settling the obligation will impact assets and that the amount of the provision can be reliably determined. If there are a number of similar obligations, the likelihood of an impact on assets is calculated on the basis of the group of these obligations. Long-term provisions are discounted – to the extent that the effect is significant.

Employee benefits

Pension obligations

The occupational pension plans are based on corresponding Company agreements and are of a defined benefit arrangement. The amount of the retirement benefit is proportionate to the number of service years and depends on the upper limit of assessment for contributions under the statutory pension scheme. The pensionable income is based on the income of the past 24 or 36 months before the pension is drawn for the first time. The actuarial valuation of the pension provisions for occupational pension plans is performed in line with the projected unit credit method prescribed under IAS 19 (Employee Benefits). An actuarial valuation is carried out on every balance sheet date. In the projected unit credit method, the pensions known on the balance sheet date and the acquired benefits, the salary and pension increases to be expected in future as well as the expected returns on plan assets are taken into account. These assumptions can change and are subject to an estimate since their future course is not foreseeable. Actuarial gains or losses arising at the year-end between systematically calculated pension obligations and the actual defined benefit obligation are only reported if they are outside a 10% range of the obligation amount or of the plan assets. In this case, they are distributed from the following year onwards over the average remaining working life of the employees participating in the plan and recorded as income or expenses. The interest portion of addition to provisions contained in the pension expenses is shown as interest cost in the income statement.

Termination benefits

Termination benefits are paid if an employee is dismissed before the normal retirement age or if an employee accepts voluntary redundancy in exchange for a severance payment. The Group recognises severance payments if it is demonstrably committed to terminate the employment of present employees in line with a detailed formal plan that cannot be reversed or if it has to demonstrably make severance payments when employees voluntarily terminate their employment. Payments that fall due more than 12 months after the balance sheet date are discounted to their present value.

Profit participation and bonus plans

For bonus payments and profit participation, a liability based on a measurement procedure that takes into account the profit attributable to the Group shareholders after adjustments is recognised. The Group recognises a provision as a liability in cases where there is a contractual obligation or a constructive obligation due to a business practice in the past.

Foreign currency

Functional currency and reporting currency

The items included in the financial statements of each Group company are measured on the basis of the currency that corresponds to the currency of the primary economic environment in which the company operates (functional currency). The consolidated financial statements have been prepared in euro which constitutes the functional currency and the reporting currency of the Company.

Transactions and balances

Foreign currency transactions are translated at the exchange rates on the transaction date into the functional currency of the reporting company. Monetary items must be translated at the closing rate on the balance sheet date and the gains and losses resulting from such transactions being fulfilled and from the translation at the closing rate of monetary assets and liabilities managed in the foreign currency are recorded in the income statement. Non-monetary items remain translated at the rate on the transaction date. Non-monetary items that are measured using the revaluation model must be translated at the rate on the revaluation date. Exchange differences must be recorded using the method for recognising gains and losses as part of revaluation.

Group companies

The earnings and balance sheet items of all Group companies with a functional currency that differs from the (Group) reporting currency are translated as follows into the (Group) reporting currency:

- Assets and liabilities are translated at the closing rate for each balance sheet date; in contrast, equity is translated at historical rates.
- Income and expenses are translated at the average rate for each income statement.
- All exchange differences arising are recorded under their own equity item.

The foreign exchange rates of the key currencies used as a basis for currency translation changed as follows (equivalent of €1.00):

		Closing rate		Average rate	
€1,00		**31 Dec. 2006**	**31 Dec. 2005**	**2006**	**2005**
India	INR	58.2021	53.9200	56.8700	55.0900
Japan	JPY	156.9300	138.9000	146.0625	137.1010
Korea	KRW	1.224.8100	1.184.4200	1.198.1483	1.275.9100
USA	USD	1.3170	1.1797	1.2557	1.2441

Legal disputes and compensation claims

As part of general business operations, the companies of the SKW Stahl-Metallurgie Group are involved in legal proceedings that are insignificant for the earnings position of the Group. Even if the outcome of the individual proceedings cannot be predicted with certainty in view of the unpredictability with which legal disputes are fraught, it is less than 50% likely that any compensation payments can be expected from the pending processes. In line with this, no provisions were recognised as of the balance sheet date for compensation payments to be expected.

Liabilities

The financial liabilities comprise amounts due to banks, amounts due to the controlling shareholder and trade payables. Liabilities, including trade payables, are measured at amortised cost. This means that current liabilities are carried at their amount repayable or at their settlement amount. Non-current liabilities and financial liabilities are reported at amortised cost in accordance with the effective interest method. Liabilities from financial leases are disclosed at the present value of the minimum lease payments.

It is regulated under IAS 32 that equity only exists from the company's perspective if there is no obligation to repay the capital or to provide other financial assets instead. Repayment obligations from the company assets may exist if (minority) shareholders are entitled to withdraw and at the same time exercising this right justifies a claim to compensation against the company. Such capital provided by minority shareholders is reported as a liability, even if this is considered equity according to the country's legal provisions.

The current items reported are those with a remaining maturity of less than one year; non-current items have a remaining maturity of more than one year.

Financial risk management

Financial risk factors

The Group is exposed to various financial risks through its business activities: the market risk (includes the foreign currency risk, the fair value interest risk and the market price risk), the credit risk, the liquidity risk and the cash flow interest risk. The Group's centralized risk management activities reflect the unpredictability of developments on the financial markets and are aimed at minimising the potential negative impact of such developments on the Group's financial position. The Group uses derivative financial instruments to hedge against specific risks. Risk management is carried out by the finance departments of the individual Group companies, working closely with the persons responsible for finance within the Group. The Executive Board of SKW Stahl-Metallurgie Holding AG has the authority to establish guidelines.

Currency and interest rate risk

The Group operates internationally, as a result of which it is exposed to a foreign currency and interest rate risk. The foreign currency risk is based on changes in the exchange rates of various foreign currencies, mainly US dollars.

Foreign currency risks arise from expected future transactions, reported assets and liabilities and net investments in foreign operations. A foreign currency risk arises if future business transactions, reported assets and liabilities are denominated in a currency which is not the functional currency of the Company. To hedge such risks from expected future transactions and reported assets and liabilities, the Group companies use futures contracts that are concluded with the respective local banks, if necessary.

Credit risk

There are no significant concentrations in the Group as regards potential credit risks.

Liquidity risk

Prudent liquidity management includes holding sufficient reserves of cash and cash equivalents. It the aim of the Company's Executive Board to retain the necessary flexibility in financing in which there are sufficient unused credit lines, particularly in the case of the operating subsidiaries.

The currency forwards concluded in the year to date are recognised in the income statement. There were no open positions from derivative financial instruments as at the reporting date.

Accounting assumptions and estimates

When preparing the consolidated financial statements, assumptions and estimates had to be made to a certain extent which affected the amount and the disclosure of the reported assets and liabilities, income and expenses and contingent liabilities of the reporting period. They primarily relate to assessing the impairment of intangible assets, establishing economic useful lives Group-wide for property, plant and equipment and intangible assets as well as accounting for provisions. The assumptions and estimates are based on conditions relating to the information currently available in each case. In particular, the circumstances at the time the consolidated financial statements were prepared as well as the realistically assumed future development of the environment were used as a basis for the expected future business performance. As a result of developments in these conditions that differ from the assumptions and are beyond the Management's control, the amounts assumed may differ from the estimates originally expected.

At the time the consolidated financial statements were prepared, the assumptions and estimates were not subject to any significant risks with the result that at present the reported carrying amounts of the assets and liabilities in the consolidated balance sheet are not expected to be adjusted substantially in the following year.

D. INCOME STATEMENT AND BALANCE SHEET DISCLOSURES

The income statement figures cited below relate to the entire calendar years for the reporting years 2006 and 2005.

1. Revenue

The Group's revenue relates solely to the sale of merchandise and goods and is spread out over the following regions:

	2006	2005
	€ thousand	€ thousand
Germany	24,242	29,133
Europe	63,935	63,548
NAFTA	79,591	78,151
Asia	12,900	13,335
Rest of the world	5,160	8,571
	185,828	**192,738**

As regards the breakdown of revenue across the "Cored Wire" and "Powder&Granules" segments, we refer you to the disclosures below under segment reporting.

2. Other operating income

	2006	2005
	€ thousand	€ thousand
Income from the reversal of provisions	74	62
Income from exchange rate changes	187	1.302
Income from passing on charges to unrelated parties	233	847
Income from passing on charges to subsidiaries	910	0
Royalties	100	91
Income from the disposal of non-current assets	705	16
Income from compensation in the SKW/PEM arbitration proceedings	723	0
Income from claims – SKW La Roche de Rame S.A.S.	500	0
Miscellaneous other operating income	676	351
	4,108	**2,669**

Compared with the previous year, other operating income mainly includes income from passing on issuing costs in connection with the issue of existing shares by the parent company ARQUES Industries AG. Overall, the issue costs amounted to €3,416 thousand. Of this, €1,579 was charged directly to equity and €910 thousand was passed on to the parent company ARQUES Industries AG. The tax effect on the IPO costs credited directly to equity accounts for the difference of €927 thousand in the overall costs of €3,416 thousand. Furthermore, other operating income includes compensation from the SKW/PEM arbitration proceedings of €723 thousand and €500 thousand from the SKW La Roche de Rame S.A.S. claim. In the year under review, Affival S.A.S. sold all of the land portion of its office buildings to Arques Immobilien GmbH & Co. KG. The income from the disposal of non-current assets primarily relate to the sale of the office building to Affival S.A.S.

3. Cost of materials

	2006	2005
	€ thousand	€ thousand
Raw materials, consumables and supplies	96,434	96,373
Goods purchased and held for resale	48,997	58,729
Services purchased	174	1,592
Other	309	869

The cost of materials primarily relates to the “Cored Wire” segment at an amount of €107,722 thousand (previous year: €113,745 thousand).

4. Staff costs

	2006	2005
	€ thousand	€ thousand
Wages and salaries	10,387	9,950
Social security contributions and expenses for pensions and other benefits	2,524	1,991
	12,911	**11,941**

Staff costs in the period under review primarily relate to the “Cored Wire” segment at an amount of €10,915 thousand (previous year: €10,205 thousand), the majority of which is accounted for by Affival SAS and Affival Inc.

5. Other operating expenses

Other operating expenses are composed of the following:

	2006	2005
	€ thousand	€ thousand
Freight outwards/transport costs	6,748	6,284
Administration costs	2,982	2,872
Commissions	2,363	2,892
Expenses for land/buildings	1,360	2,040
Expenses from exchange rate changes	842	307
Expenses for the IPO (net)	750	0
French taxes chargeable as expenses (tax professionelle)	511	714
Fees and commissions paid to consultants	433	1,685
Marketing and representation expenses	303	523
Loss from asset disposals	109	0
Bad debt allowances and receivables charged on write-downs	58	24
Other	1,278	998

Other operating expenses in the period under review mainly relate to the “Cored Wire” segment at an amount of €13,167 thousand (previous year: €13,548 thousand). Expenses arising in the period under review from operating lease agreements of €954 thousand (previous year: €865 thousand). These are mainly incurred from leasing production buildings and office premises.

6. Amortisation and depreciation

For more information on changes in the depreciation of property, plant and equipment and amortisation of intangible assets, please refer to the statement of changes in non-current assets in the notes to the financial statements.

7. Income from associates

Income from associates of €716 thousand (previous year: €768 thousand) result solely from the company Jamshedpur Injection Powder Ltd., Jamshedpur, India.

8. Other interest and similar income

Other interest and similar income of €274 thousand (previous year: €217 thousand) primarily results from the interest on current bank balances (€139 thousand) as well as invoiced default interest from customers (€122 thousand).

9. Interest and similar expenses

Interest and similar expenses of €717 thousand (previous year: €829 thousand) mainly relate to interest from the financial loans of ARQUES Industries AG (amount: €371 thousand) and interest expenses from the companies in connection with current bank liabilities of €260 thousand.

10. Income tax expense

The income tax expense of €2,782 thousand reported in the year under review comprises the following:

	2006	2005
	€ thousand	€ thousand
Current tax expense	2,735	2,153
Deferred tax expense	1,717	145
Deferred tax income	-1,670	-1,318
Deferred tax expense, total	47	-1,173
Total income tax expense/income	2,782	980

Deferred tax income primarily relates to the capitalisation of loss carryforwards at SKW Stahl-Metallurgie Holding AG as well as the revaluation of loss carryforwards at Affival S.A.S.

The deferred tax expense takes into account the use of tax loss carryforwards at SKW Stahl-Metallurgie GmbH and at Affival S.A.S. Deferred tax expense from the recognition of the IPO costs in equity was also terminated.

The differences between the current tax income posted and the expected tax expense are reported in the statement of reconciliation below. The expected income tax expense arises from the earnings before taxes multiplied by the expected tax rate. The expected income tax rate contains the legal German corporate income tax, the solidarity surcharge and the trade tax and is carried unchanged in the period under review at 37%.

	2006	2005
	€ thousand	€ thousand
Earnings before taxes	12,015	11,504
Tax rate	37.00%	37.00%
Expected income taxes	4,446	4,199
Tax rate changes	-316	0
Tax-free dividends from subsidiaries	38	-257
Tax allocations and deductions	-77	-251
Deferred taxes	-1,520	-1,329
Effect from different income tax rates	-315	-1,768
Other tax effects	513	422
Current tax of prior periods	13	-36
Reported income tax expense/income	2,782	980
Effective tax rate	23.15%	8.64%

At a rate of 23.15%, the effective tax rate in the year under review differs from the expected German income tax rate of 37%. This primarily results from the use of loss carry-forwards not capitalised until now, from the recognition of tax-free dividends and from the different income tax rates of the individual Group companies.

11. Consolidated net profit attributable to minority interests

The consolidated net profit for the period of €9,233 thousand include minority interests of €0 thousand.

12. Earnings per share

The earnings per share (EPS) 2006 are derived from dividing the annual net profit by the number of no-par bearer shares issued (4,422,250 as per 31 December 2006). For the period under review, EPS amounts to €4.53 and to € 2.09 for the unweighted number of shares. In this context, the diluted EPS corresponds to the undiluted one of € 4.53.

In 2005, SKW Stahl-Metallurgie Holding was not organised into the legal form of an Aktiengesellschaft (German stock corporation). The cited figure for the previous year of €10.27 represents notional earnings per share, which are calculated by dividing the consolidated net profit for the period in 2005 of the then SKW Stahl-Metallurgie GmbH by the total of the issued capital and capital reserves. Therefore 2006 cannot be compared with 2005.

13. Intangible assets

In the year under review, development costs of €840 thousand were capitalised for the first time in accordance with IAS 38. R&D costs of approximately €1,500 thousand were incurred overall in the Group.

This intangible asset mainly relates to the “No Splash Tip” method. It serves to inject the cored wire into the steel bath. Now that the patent has been approved, the intangible asset will be amortised on a straight-line basis over the 20-year life of the patent.

	Concessions, industrial and similar rights and assets	Internally generated in-tangible assets	Advance payments	Total
	€ thousand	€ thousand	€ thousand	€ thousand
Cost on 1 Jan. 2006	**54**	**0**	**0**	**54**
Additions to consolidated group	0	0	0	0
Disposals from consolidated group	0	0	0	0
Currency translation	0	-21	0	-21
Additions	14	950	50	1.014
Disposals	0	0	0	0
Reclassification	50	0	-50	0
As at 31 Dec. 2006	**118**	**929**	**0**	**1,047**
Amortisation on 1 Jan. 2006	**-31**	**0**	**0**	**-31**
Additions to consolidated group	0	0	0	0
Disposals from consolidated group	0	0	0	0
Currency translation	0	0	0	0
Additions	-26	0	0	-26
Disposals	0	0	0	0
As at 31 Dec. 2006	**-57**	**0**	**0**	**-57**
Net carrying amount on 31 Dec. 2005	**23**	**0**	**0**	**23**
Net carrying amount on 31 Dec. 2006	**61**	**929**	**0**	**990**

Changes in the previous year were as follows:

	Concessions, industrial and similar rights and assets	Internally generated in-tangible assets	Advance payments	Total
	€ thousand	€ thousand	€ thousand	€ thousand
Cost on 1 Jan. 2005	**36**	**0**	**0**	**36**
Additions to consolidated group	0	0	0	0
Disposals from consolidated group	0	0	0	0
Additions	12	0	0	12
Disposals	0	0	0	0
Reclassification	6	0	0	6
As at 31 Dec. 2005	**54**	**0**	**0**	**54**
Amortisation on 1 Jan. 2005	**-8**	**0**	**0**	**-8**
Additions to consolidated group	0	0	0	0
Disposals from consolidated group	0	0	0	0
Currency translation	0	0	0	0
Additions	-23	0	0	-23
Disposals	0	0	0	0
As at 31 Dec. 2005	**-31**	**0**	**0**	**-31**
Net carrying amount on 31 Dec. 2004	**28**	**0**	**0**	**28**
Net carrying amount on 31 Dec. 2005	**23**	**0**	**0**	**23**

14. Property, plant and equipment

	Buildings, including buildings on third-party land	Technical equipment and machinery	Other equipment, operating and office equipment	Advance payments and assets under development	Total
	€ thousand	€ thousand	€ thousand	€ thousand	€ thousand
Cost on 1 Jan. 2006	**1,478**	**8,604**	**1,028**	**873**	**11,983**
Additions to consolidated group	0	0	0	0	0
Disposals from consolidated group	0	0	0	0	0
Currency translation	0	-310	-81	-24	-415
Additions	30	696	361	1099	2187
Disposals	-186	-71	0	0	-257
Reclassification	455	904	2	-1361	0
As at 31 Dec. 2006	**1,777**	**9,824**	**1,309**	**587**	**13,498**
Amortisation on 1 Jan. 2006	**-164**	**-1,815**	**-250**	**0**	**2,229**
Additions to consolidated group	0	0	0	0	0
Disposals from consolidated group	0	0	0	0	0
Currency translation	0	91	17	0	108
Additions	-137	-1,499	-197	0	-1,833
Reclassifications	0	0	0	0	0
Disposals	78	68	0	0	146
As at 31 Dec. 2006	**-223**	**-3,154**	**-430**		**-3,808**
Net carrying amount on 31 Dec. 2005	**1,314**	**6,789**	**778**	**873**	**9,754**
Net carrying amount on 31 Dec.2006	**1,554**	**6,669**	**879**	**587**	**9,690**

The property, plant and equipment of €9,690 thousand include leased property, plant and equipment of €985 thousand overall, the beneficial ownership of which can be attributed to the Group owing to the arrangement of the underlying leases (finance leases). €271 thousand of this is attributable to buildings and €714 thousand to technical equipment. A substantial portion of the amount reported for finance leases can be attributed to the PapCal facility at Affival S.A.S.

Changes in the previous year were as follows:

	Buildings, including buildings on third-party land	Technical equipment and machinery	Other equipment, operating and office equipment	Advance payments and assets under development	Total
	€ thousand	€ thousand	€ thousand	€ thousand	€ thousand
Cost on 1 Jan. 2005	**1,211**	**6,975**	**831**	**261**	**9,278**
Additions to consolidated group	0	0	0	0	0
Disposals from consolidated group	0	0	0	0	0
Currency translation	0	383	94	1	478
Additions	27	1,485	164	1,519	3,195
Disposals	0	-578	-63	-321	-962
Reclassification	240	339	2	-587	-6
As at 31 Dec. 2005	**1,478**	**8,604**	**1,028**	**873**	**11,983**
Amortisation on 1 Jan. 2005	**-42**	**-383**	**-68**	**0**	**-493**
Additions to consolidated group	0	0	0	0	0
Disposals from consolidated group	0	0	0	0	0
Currency translation	0	-62	-10	0	-72
Additions	-122	-1,477	-199	0	-1,798
Reclassifications	0	0	0	0	0
Disposals	0	107	27	0	134
As at 31 Dec. 2005	**-164**	**-1,815**	**-250**	**0**	**-2,229**
Net carrying amount on 31 Dec. 2004	**1,169**	**6,593**	**763**	**261**	**8,785**
Net carrying amount on 31 Dec. 2005	**1,314**	**6,789**	**778**	**873**	**9,754**

15. Investments in associates

The 30.22% of shares in the associate Jamshedpur Injection Powder Ltd., Jamshedpur, India are reported at equity. Since preparing separate interim financial statements as at 31 December 2006 was not enforceable, the company was consolidated based on estimated earnings as 31 December 2006. In the financial year from 1 April 2005 to 31 March 2006, the Company generated net profit for the period of €2,466 thousand. Assets totalled €7,289 thousand in the financial statements as at 31 March 2006, equity amounted to €5,492 thousand and liabilities €1,797 thousand.

The at equity approach was applied as follows in financial year 2006:

	2006	2005
	€ thousand	€ thousand
As at 1 Jan. 2006	**3,603**	**3,170**
Proportionate interest in net profit	716	768
Exchange rate differences	-195	135
Income taxes	-56	-57
Recognised profit distribution	-390	-413
As at 31 Dec. 2006	**3,678**	**3,603**

16. Deferred tax assets

The deferred tax assets reported on 31 December 2006 are primarily due to deferred tax assets from tax loss carryforwards generated in the past and deferred tax assets from temporary differences between the IFRS and tax base carrying amounts. The remaining unused loss carryforwards amount to €2,982 thousand. Deferred taxes were recognised from all temporary differences. These primarily relate to provisions, receivables and liabilities. They do not affect dividend proposals or payments. Taking the target earnings for financial year 2007 into account, €1,247 thousand of the deferred tax assets can be classified as current, i.e. can be used in the next 12 months. This item is for tax loss carryforwards that can be used in 2007. There are plans to form a fiscal entity for income tax from 2007 in order to use the loss carryforwards of SKW Stahl-Metallurgie Holding AG.

17. Inventories

Inventories are composed as follows:

	31 Dec. 2006	31 Dec. 2005
	€ thousand	€ thousand
Raw materials, consumables and supplies	14,090	13,146
Finished goods and goods for resale	12,100	12,456
Advance payments	94	172
	26,284	25,774

In each case, inventories are measured at the lower of cost or the net selling price realisable on the balance sheet date less costs to be incurred.

€22,989 thousand of the inventories held are attributable to the “Cored Wire” segment, particularly to Affival Inc. and Affival S.A.S. while €3,295 is attributable to the “Powder&Granules” segment. Of the total inventories of €26,284 thousand, inventories of €12,666 thousand are assigned as part of master loan agreements in the USA and Germany. In the year under review, a net write-down of €32 thousand was charged on the inventories due to lower market prices.

18. Trade receivables

	31 Dec.2006	31 Dec. 2005
	€ thousand	€ thousand
Receivables	26,903	30,235
Reversals of write-downs in the current financial year	268	0
Write-downs in the current financial year	-58	-24
	27,113	30,211

€17,559 thousand of the trade receivables as at the balance sheet date (€27,113 thousand) is attributable to the “Cored Wire” segment. Receivables within Germany of €4,133 thousand are assigned as a result of master loan agreements in the “Powder&Granules” segment.

19. Other assets

The other assets reported include the following amounts:

	31 Dec. 2005	31 Dec. 2005
	€ thousand	€ thousand
Tax receivables	2,263	2,973
Receivables from subsidiaries	948	0
Prepaid expenses	677	205
Employee receivables	32	18
Other receivables	1,034	445
	4,954	3,641

The tax receivables include €196 thousand of income tax expense claims.

20. Cash and cash equivalents

Cash and bank balances with a term of less than three months as well as financial instruments with an original maturity of less than 3 months are reported under this item. €426 thousand of the amount reported is attributable to the “Cored Wire” segment and €1,684 thousand to the “Powder&Granules” segment.

The majority of the cash and cash equivalents on the balance sheet date are due to proceeds from the IPO of the parent company.

21. Equity

The share capital of SKW AG was divided into no-par value shares. The shares are bearer shares. The Company's share capital of €4,422,250 comprises 4,422,250 shares. The capital reserves as at 31 December 2006 in the amount of €29,144 thousand (previous year: €1,000 thousand) only includes the premium from the capital increase of €1,097,250 against cash contributions. The costs of the IPO were passed on pro rata to ARQUES Industries AG. The percentage of costs remaining with SKW Stahl-Metallurgie Holding AG were charged directly to equity less a tax effect.

Issued capital

The Group's share capital amounted to €4,422,250 on the balance sheet date and is divided into 4,422,250 bearer shares.

The share capital of the then SKW Stahl-Metallurgie Holding GmbH was raised by €25 thousand to a total of €1,325 thousand by way of the resolution of the Shareholders' Meeting from 12 April 2006. The capital was increased by €1,000 by way of a capital increase from corporate funds and by €300 thousand by way of a non-cash contribution from the contribution of a receivable of ARQUES Industries AG. The value of the loan from the sole shareholder underlying the contribution of €300 thousand was confirmed by the report of S&P GmbH Wirtschaftsprüfungsgesellschaft dated 13 April 2006. Both capital increases, i.e. the share capital raised to a total of €1,325 thousand, were registered on 23 May 2006.

The Company's Annual General Meeting of 18 August 2006 resolved another capital increase of €2,000 thousand. This was another capital increase against non-cash contributions, again through the contribution of a receivable of ARQUES Industries AG. The value of the loan from the sole shareholder underlying the contribution of €2,000 thousand was also confirmed by a report from S&P GmbH Wirtschaftsprüfungsgesellschaft dated 17 August 2006. The resolutions of the General Meeting from 18 August 2006, including the capital increase mentioned, were entered in the commercial register with the Traunstein Local Court on 21 August 2006. The capital increase, i.e. the share capital raised to a total of €3,325 thousand, was registered on 21 August 2006.

Due to a resolution of the Extraordinary General Meeting held on 17 November 2006, the Company's share capital was raised by another capital increase by up to €1,097 thousand to up to €4,422 thousand.

Authorised capital

The Executive Board was authorised to raise the share capital against cash or non-cash contributions with the approval of the Supervisory Board in the period until 30 November 2010 on one or several occasions by up to €662 thousand by issuing new no-par value bearer shares (Authorised Capital 2006/I). This authorisation was annulled by the resolution of the Annual General Meeting from 18 August 2006.

The Executive Board has now been authorised by the resolution of the Annual General Meeting from 18 August 2006 to raise the share capital against cash or non-cash contributions with the approval of the Supervisory Board in the period until 30 June 2011 on one or several occasions by up to €1,650 thousand by issuing new no-par value bearer shares (Authorised Capital 2006/I).

Capital reserves

The Group's capital reserves as at the balance sheet date amounts to €29,144 thousand and includes the costs of €1,579 thousand in connection with the IPO charged directly to equity. This amount corresponds to the net of tax amount in accordance with IAS 22. The gross amount of the IPO costs offset directly in equity after deduction of the IPO costs passed on to ARQUES Industries AG pro rata amounts to €2,506 thousand. Consequently, this gives rise to a tax effect on the IPO costs recognise directly in equity of €927 thousand.

Changes in exchange rates

The changes of €1,376 thousand arise from changes in the exchange rates of the euro (EUR) to the US dollar (USD), the Japanese yen (JPY) and the Korean won (KWD). The exchange rate change is primarily due to the USD, the rate of which changed from EUR/USD 1.1797 as at 31 December 2005 to a rate of EUR/USD 1.3170 as at 31 December 2006.

22. Pension obligations

Provisions for pensions were recognised at a total of four Group companies. The total provision amount of €1,333 thousand is particularly attributable to the following companies:

- SKW Stahl-Metallurgie GmbH (€741 thousand),
- Affival S.A.S. (€463 thousand)

The provisions for pensions and similar obligations changed as follows in the year under review:

	2006	2005
	€ thousand	€ thousand
As at 1 January	**1,217**	**1,196**
Currency translation	-10	0
Addition	149	139
Utilisation	-24	-118
As at 31 December	**1,332**	**1,217**

The defined benefit obligation developed as follows as at the balance sheet date:

	2006	2005
	€ thousand	€ thousand
Defined benefit obligation as at 1 Jan.	1,968	1,351
Current service cost	85	82
Interest cost	83	77
Pension payments	-73	-106
Plan adjustments	29	0
Actuarial gains/losses	270	564
Currency translation	-10	0
Defined benefit obligation as at 31 Dec.	**2,352**	**1,968**

Changes in fund assets were as follows:

	2006	2005
	€ thousand	€ thousand
Fair value of fund assets as at 1 Jan.	348	326
Return on fund assets	15	22
Fair value of fund assets as at 31 Dec.	363	348

The fund assets relate to the benefit plan in France.

	31 Dec. 2005	31 Dec. 2005
	€ thousand	€ thousand
Plans covered by fund assets	912	890
Plans not covered by fund assets	1,440	1078
	2,352	**1,968**

	31 Dec. 2006	31 Dec. 2005
	€ thousand	€ thousand
Defined benefit obligation of the pension obligations	2,352	1,968
Non-recognised actuarial gains	-657	-403
Fair value of fund assets	-362	-348
Provision as at 31 Dec.	**1,333**	**1,217**

The following was reported under pension expense in the financial year:

	2006	2005
	€ thousand	€ thousand
Current service cost	85	82
Accrued interest of the expected pension obligations	83	77
Actuarial gain	-33	2
Effects from plan adjustments	29	0
Expected return on plan assets	-15	-22
Total pension expense	**149**	**139**

The calculation is based on the following actuarial assumptions:

	31 Dec. 2006	31 Dec. 2005
Discounting rate	4.5	4.5
Salary trend	2.5 - 3.0	2.5 - 5.0
Pension trend	1.25 - 1.5	1.25
Fluctuation	0	0
Expected return on plan assets	4.0	4.0

	31 Dec. 2006	31 Dec. 2005
	€ thousand	€ thousand
Defined benefit obligation of the pension obligations	2,352	1,968
Fund assets	363	348

23. Obligations from finance leases

In the year under review, the Group's property, plant and equipment included technical equipment and machinery, the beneficial ownership of which can be attributed to the Group owing to the arrangement of the underlying leases (finance leases). The Group's lease obligations for finance leasing for 2006 and thereafter can be seen in the table below:

	Nominal amount	Discount amount	Present value
	€ thousand	€ thousand	€ thousand
Residual term of less than 1 year	271	59	212
Residual term of 1 to 5 years	714	79	635
	985	**138**	**847**

The reported obligations from finance leases are primarily due to the finance lease regarding the PapCal production facility set up at Affival S.A.S. in financial year 2004. The underlying lease has a term of five years.

24. Provisions

	As at 1 Jan. 2006	Utilisation	Addition	Re-versal	As at 31 Dec. 2006
	€ thousand	€ thousand	€ thou-sand	€thou-sand	€ thou-sand
Provi-sions	926	-824	845	-74	873

The provisions include smaller items. The term of the provisions including provisions for pensions are divided as follows:

	2006	2005
	€ thousand	€ thousand
Long-term provisions	1,333	1,217
Short-term provisions	873	926
	2,206	**2,143**

The long-term provisions relate solely to provisions for pensions and similar obligations.

25. Financial liabilities

The financial liabilities of €15,497 thousand (previous year: €21,024 thousand) result from financial liabilities to the controlling shareholder ARQUES Industries AG of €8,148 thousand (previous year: €14,040 thousand) as well as amounts due to banks of €7,333 thousand (previous year: €6,984 thousand) and to Arques Wert Invest GmbH of €16 thousand. The term of the shareholder loans is indefinite and the term of the amounts due to banks is short to medium-term. The majority of the amounts due to banks of €6,043 thousand are due in less than a year and the remaining amounts due to banks of €1,290 thousand are due by 2011.

The financial liabilities are mainly denominated in the euro currency at an amount of €9,287 thousand. The remaining financial liabilities are divided between the US dollar, at an amount of €4,776 thousand and the yen currency at an amount of €1,434 thousand.

The interest charged on financial liabilities is within a range of 0.96% to 7.75% p.a. The range is due to the different interest rates of the currencies underlying the financing. The lower end of the range arises from the interest conditions for the financing in Japanese yen and the upper end from interest conditions for the US dollar financing.

26. Current trade payables

The trade payables of €21,305 thousand (previous year: €21,755 thousand) as at the balance sheet date were primarily to third parties. The current trade payables are carried at their nominal amount or amount repayable and are due in full within a year.

27. Current other liabilities

	31 Dec. 2006	31 Dec. 2005
	€ thousand	€ thousand
Wages and salaries	1,273	1,583
Social security contributions	702	771
Other taxes	698	1,990
Advanced payments received	195	888
Miscellaneous other liabilities	299	535
Total	**3,167**	**5,767**

28. Segment reporting

The Group is currently subdivided into business segments – in line with the provisions of IAS 14. These areas form the basis of segment reporting.

The primary business segments are broken down as follows:

a) Cored Wire
b) Powder&Granules

The activities of the Affival Group, which include the global market leadership (without taking the Chinese market into account) regarding the use of cored wire for steel refining, are combined in the "Cored Wire" segment. The "Powder&Granules" segment includes SKW Stahl-Metallurgie GmbH and the Indian production company Jamipol which is consolidated at equity. This segment operates in both crude iron desulphurisation and steel refining. The profit recognised in line with the 30.22% investment in the production company Jamipol amounted to €716 thousand in the period under review. In accordance with IAS 14, the Holding and Arques Chemicals Inc. do not constitute a separate segment since their activity does not result in any proceeds from revenue with unrelated parties. Both of these companies are included in the "Other" column.

The segment information for the primary business segments in 2006 are listed overleaf:

	Cored Wire	Powder & Granules	Other	Elimination	Consolidated
	2006	2006	2006	2006	2006
	€ thousand	€ thousand	€ thousand	€ thousand	€ thousand
Revenue					
External revenue	139,729	46,099	0	0	185,828
Internal revenue	0	8,090	0	-8,090	0
Total revenue	139,729	54,189	0	-8,090	185,828
Segment result	**9,354**	**2,885**	**-322**	**-176**	**11,741**
Dividends from subsidiaries	0	0	1,550	-1,550	0
Income from associates	0	716	0	0	716
Interest income	15	165	311	-217	274
Interest cost	-514	-215	-209	222	-716
Profit/loss before taxes	**8,855**	**3,551**	**1,330**	**-1,721**	**12,015**
Income tax expense	-1,048	-1,294	-440	0	-2,782
Consolidated net profit for the period					**9,233**
Balance sheet					
Assets					
Segment assets	58,852	16,883	42,296	-9,601	108,430
Investments in associates	0	3,679	0	0	3,679
Group assets					**112,109**
Equity & liabilities					
Segment liabilities	32,770	13,814	5,711	-6,956	45,339
Group liabilities					**45,339**
Other information					
- Average number of employees throughout the year	210	15	1	0	226
- Ongoing capital expenditure (Property, plant and equipment, intangible assets)	3,191	8	2	0	3,201
- Amortisation and depreciation	1,832	13	2	12	1,859

* The item includes the net proceeds from the IPO of € 27,701 thousand.

As can be seen from the Elimination column, there are a number of trade relationships between the segments of the SKW Stahl-Metallurgie Group. The Group transfer prices used here are based on the cost plus method.

The segment information on the secondary business segments are presented in the following table:

	Europe 2006	NAFTA 2006	Other regions 2006	Elimination 2006	Consolidated 2006
	€ thousand	€ thousand	€ thousand	€ thousand	€ thousand
Revenue – external customers	105,314	67,345	13,169	0	185,828
Revenue - intrasegment	13,433	356	2,932	-16,721	0
Revenue – total	118,747	67,701	16,101	-16,721	185,828
Capital expenditure	1,332	1,772	97	0	3,201
Segment assets	96,668	21,309	6,751	-12,620	112,109
Segment liabilities	33,205	12,691	5,154	-5,711	45,339

The corresponding primary segment information for the previous year is presented in the table overleaf:

	Cored Wire	Powder & Granules	Other	Elimination	Consolidated
	2005	2005	2005	2005	2005
	€ thousand	€ thousand	€ thousand	€ thousand	€ thousand
Revenue					
External revenue	140,065	52,673	0	0	192,738
Internal revenue	11	13,817	0	-13,828	0
Total revenue	140,076	66,490	0	-13,828	192,738
Segment result	**8,492**	**3,676**	**-392**	**-428**	**11,348**
Dividends from subsidiaries	0	0	320	-320	0
Income from associates	0	768	0	0	768
Other expenses	0	-320	0	320	0
Interest income	58	195	333	-369	216
Interest cost	-597	-352	-278	398	-829
Profit/loss before taxes	**7,953**	**3,967**	**-17**	**-399**	**11,504**
Income tax expense	-57	-1,459	536	0	-612
Consolidated net profit for the period					**10,524**
Balance sheet					
Assets					
Segment assets	61,038	15,235	10,235	-12,549	73,959
Investments in associates	0	3,603	0	0	3,603
Group assets					**77,562**
Equity & liabilities					
Segment liabilities	37,256	12,443	9,082	-7,162	51,619
Group liabilities					**51,619**
Other information					
- Average number of employees throughout the year	205	14	2	0	221
- Ongoing capital expenditure (Property, plant and equipment, intangible assets)	3,163	42	1	0	3,206
- Amortisation and depreciation	1,805	16	0	0	1,821

The segment information on the secondary business segments of the previous year are presented in the following table:

	Europe	NAFTA	Other regions	Elimination	Consolidated
	2005	2005	2005	2005	2005
	€ thousand	€ thousand	€ thousand	€ thousand	€ thousand
Revenue – external customers	114,356	64,756	13,626	0	192,738
Revenue – intrasegment	17,953	7	1,071	-19,031	0
Revenue – total	132,309	64,763	14,697	-19,031	192,738
Capital expenditure	3,064	739	69	0	3,873
Segment assets	58,186	20,172	6,527	-7,323	77,562
Segment liabilities	41,216	12,483	5,119	-7,199	51,619

29. Cash flow statement

The cash flow statement shows how the SKW Stahl-Metallurgie Group's cash and cash equivalents changed in the year under review and in the previous year. In accordance with IAS 7, the cash flows are broken down into net cash from/used in operating activities, investing activities and financing activities.

Adjusted for currency effects of €9 thousand, the Group's cash and cash equivalents in the amount of €34,905 thousand (previous year: €1,362 thousand) correspond to the balance sheet item "Cash and cash equivalents", which is composed of cash and current bank balances.

The cash flow statement starts with the consolidated net profit for the period. The gross cash flow of €9,838 thousand shows the excess of income over expenses before any utilisation of funds. The income from equity measurement item of €-326 thousand arises from the investment earnings for 2006 of the Indian production company Jamipol of €716 thousand less the distribution received in 2006 of €390 thousand. Net cash from operating activities also includes changes in working capital. The fall in revenue of 3.6% in the year under review (revenue in 2006: €185,828 thousand) compared with the previous year (revenue for 2005: €192,738 thousand) was also related to a reduction in working capital of €606 thousand. Accordingly, net cash from operating activities amounted to €10,444 thousand.

Net cash from investing activities include cash and cash equivalents of €15 thousand acquired in business acquisitions which originate from the acquisition of Arques Chemicals Inc. The purchase price from the acquisition was paid after the reporting date. Following net cash used in investing activities of €1,384 thousand, the SKW Stahl-Metallurgie Group reports free cash flow after investments of €9,060 thousand for the year under review.

The repayment of shareholder loans in the amount of €3,576 thousand was financed with this amount. Furthermore, €27,701 thousand accrued to the SKW Stahl-Metallurgie Group from the IPO after deduction of costs for placement fees, for consulting services and for other costs incurred in relation to the IPO totalling €2,483 thousand. The remaining cash flow after the measures described, which amounted to €33,534 thousand, corresponds to the change in cash and cash equivalents as against the previous year.

The period under review includes interest paid to third parties of €238 thousand and interest from third parties of €127 thousand. €1,199 thousand was paid in 2006 as taxes to third parties.

30. Other financial obligations

There were other financial obligations as of the balance sheet date, particularly from rental agreements and leases for buildings. The total of future payments from non-cancellable agreements is made up of the following terms:

	31 Dec. 2006	31 Dec. 2005
	TEUR	TEUR
Rent and lease obligations, due		
- in less than 1 year	1,403	910
- between 2 and 5 years	4,504	2,558
- more than 5 years	4,438	5,040
Other obligations, due		
- in less than 1 year	11,048	26,253
- between 2 and 5 years	40	0
- more than 5 years	0	0

The other financial obligations totalling €11,088 thousand is almost exclusively due to obligations to duties to take deliveries from the long-term supply contracts of SKW Stahl-Metallurgie GmbH.

31. Contingent liabilities

The following contingent liabilities existed in the SKW Group as at the balance sheet date:

Affival S.A.S. issued guarantees for the benefit of third parties. As at the balance sheet date, these guarantees furnished amounted to €296 thousand. The likelihood of them being used is classified as less than 50%. In the course of the purchase of the Quab assets from Degussa Corporation (part of RAG Group), the company issued a guarantee to the benefit of ARQUES Industries AG, Starnberg, in the amount of US$ 10,0 million. To hedge the resulting contingent liability, the company bought pertinent environmental liability insurance, with a self a deductible of US$ 100.000.

At Affival Inc. there was a contingent liability from preferential payments in connection with the Chapter XI case of Bethlehem Steel from financial year 2001. If the court concerned with the matter considers this to be given, a payment obligation of €1,303 may arise for Affival Inc. The likelihood of such a payment obligation occurring is classified as less than 50%.

32. Executive bodies of the company

Supervisory Board	Executive Board
Markus Zöllner, Bichl Executive Board member of ARQUES Industries AG Chairman of the Supervisory Board (Since 20 April 2006)	Ines Kolmsee, Tutzing Chairman of the Executive Board of SKW Stahl-Metallurgie Holding AG (The sole Executive Board member since 26 May 2006) Chairman of the Executive Board (Since 16 August 2006)
Dr. Martin Vorderwülbecke, Munich CFO of ARQUES Industries AG Vice Chairman (Since 20 April 2006)	J. Klaus Frizen, Mettmann Chairman of the Executive Board of SKW Stahl-Metallurgie Holding AG (Since 2 November 2006)
Dr. Georg Obermeier, Maisach Managing Director of Obermeier Consult GmbH (Since 20 April 2006)	Gerhard Ertl, Garching a. d. Alz CFO of SKW Stahl-Metallurgie Holding AG (Since 16 August 2006)

33. Remuneration of the executive bodies

The remuneration of the Executive Board totalled €682 thousand in the year under review. €178 thousand of this was attributable to the fixed salary components and €504 thousand to variable components. The table below shows the remuneration of the Executive Board per member:

	Ines Kolmsee	Gerhard Ertl	J. Klaus Frizen	Total
Fixed remuneration	147	30	0	177
Non-cash compensation	0	1	0	1
Variable remuneration	425	79	0	504
Total	**572**	**110**	**0**	**682**

Mr Frizen performed his services in the year under review free of charge. In the remuneration specified for the Executive Board member Ines Kolmsee, the proportionate managing director salary for the period from January to May 2006 of €240 thousand is included in the amount. €63 thousand of this is attributable to the fixed salary components and €177 thousand to variable components. The remuneration listed for Executive Board member Gerhard Ertl relates to the period from October to December 2006.

The Supervisory Board did not receive any remuneration in financial year 2006, apart from the reimbursement of expenses and any VAT incurred on such reimbursement.

In financial year 2006, the proportionate annual premium for the existing D&O insurance for the Supervisory Board and Executive Board were recognised in the income statement at €9 thousand. The premium was primarily paid in the Company's own interest and is not part of the remuneration of the Company's executive bodies.

Information on additional memberships of supervisory boards and other executive committees of the Executive Board and Supervisory Board members are appended as a separate annex to these notes to the consolidated financial statements.

34. Related party disclosures

In accordance with IAS 24, persons or companies defined as related are those who/which directly or indirectly control the company, who/which are controlled by the company or are under common control, who/which hold an interest in the company which grants them significant influence or who/which are jointly involved in the management of the company. This also includes persons in key positions within the company or the parent company and close members of their family. The following reportable related party (non-individuals) relationships in accordance with IAS 24 exist within the Group:

	2006 € thousand	2005 € thousand
Expenses generated with related parties		
Arques Consult AG	31	298
ARQUES Industries AG	512	452
Arques Immobilien GmbH & Co. KG	17	0
Income generated with related parties		
Jamshedpur Injection Powder Ltd. (Dividend)	716	768
Jamshedpur Injection Powder Ltd. (Service Agreement)	86	30
ARQUES Industries AG	910	23
Arques Value Investment Ltd.	13	0
Arques Immobilien GmbH & Co. KG	593	0

The companies of the Group maintain diverse relationships with the controlling company ARQUES Industries AG and other companies controlled by it. As part of its ordinary course of business, all contracts with these companies were carried out under the standard market terms and conditions as is and would be customary for unrelated parties.

Before the period under review, SKW Stahl-Metallurgie Holding AG concluded a service level agreement with the company Arques Consult AG, Starnberg, relating to the acquisition of consulting services in the fields of management, communication, marketing and general consultation. On 7 November 2006, Arques Consult AG was merged into ARQUES Industries AG, retroactively effective March 31, 2006. The term of the service level agreement was indefinite and the period of notice amounted to two months as at the end of a calendar month. Fixed payments of €24 thousand per month were agreed for the period under review on the basis of this agreement. In addition, external costs incurred for the subject of the agreement were passed on to SKW Stahl-Metallurgie Holding AG without markups, as per contract. These costs are mainly the travel costs of the consultants employed as well as €23 thousand for legal advice from Heussen Rechtsanwaltsgesellschaft mbH. Overall, €316 thousand was generated in the period under review based on this existing service level agreement.

Financial controlling software by the name of Cognos is used for the entire SKW Stahl-Metallurgie Group. It is provided by the ARQUES Group and the charges are passed on to the users. Overall, SKW Stahl-Metallurgie Holding AG was charged €25 thousand for six users within the SKW Stahl-Metallurgie Group.

The costs of the IPO of SKW Stahl-Metallurgie Holding AG were initially borne in full by the issuer. Through the cost assumption declaration of 1 November 2006, ARQUES Industries AG declared that it was prepared to assume the costs of the company's IPO in the amount of ARQUES Industries AG' share in the proceeds from the IPO. Based on this declaration, SKW Stahl-Metallurgie Holding AG charged ARQUES Industries AG an amount of €910 thousand. Along with the proportionate external costs of the IPO, ARQUES Industries AG also bore the proportionate staff costs for the Executive Board of SKW Stahl-Metallurgie Holding AG which can be attributed to the IPO. This amount of €220 thousand is already included in the invoiced amount of €910 thousand.

The office buildings of Affival SAS in Solesmes, France were sold to ARQUES Immobilien GmbH & Co. KG for €700 thousand by way of a notarial agreement dated 29 September 2006, thus generating unrealised profit of €593 thousand. The notary commissioned with the sale determined a sales price for the property in line with the market based on various criteria and calculations, particularly the comparative rent on the market for the Solesmes region. A 10-year lease was concluded between Affival S.A.S. and the purchaser at an annual, market rent of €70 thousand. This lease was also concluded with effect from 29 September 2006. Pro rata rent of €17 thousand was attributable to the period under review as a result of this.

SKW Stahl-Metallurgie Holding AG granted a loan of €1,000 thousand and bearing interest of 7% p.a. to Arques Value Invest Ltd., Malta, from October to December 2006 (investment currency: euro). This investment resulted in interest income in the period under review of €13 thousand which was paid in December 2006 with repayment of the total loan.

Along with the subsidiaries included in the consolidated financial statements, SKW-Stahl-Metallurgie Holding AG deals directly or indirectly with non-subsidiaries, non-consolidated companies and non-associates in performing its ordinary business activities. In the period under review, this was the Indian company Jamshedpur Injection Powder Ltd.; SKW Stahl-Metallurgie GmbH mainly performed consulting services for a fixed fee, which is settled quarterly, based on a consultation agreement dated 1 January 2005 with Jamshedpur Injection Powder

Ltd. As part of its ordinary course of business, all sales and service contracts with companies not included in the group of consolidated companies were carried out under the standard market terms and conditions as is and would be customary for unrelated parties.

ARQUES Industries AG extended several loans to the Group companies. The details are as follows:

Debtor	2006 € thousand	2005 € thousand	Interest rate p. a.
SKW Stahl-Metallurgie Holding AG	60	2,889	4%
SKW Stahl-Metallurgie Holding AG	3,997	6,078	1-month Euribor+0.5%
SKW Stahl-Metallurgie GmbH	4,091	5,015	1-month Euribor+0.5%

All three loans are for an indefinite period.

All related companies that are controlled by SKW-Stahl-Metallurgie Holding AG, or on which the Group can exert a significant influence, are recorded in the list of shareholdings.

Related party (individuals) disclosures

In accordance with IAS 24, SKW Stahl-Metallurgie Holding AG also reports on transactions between these individuals and the parties related to them or their close family members. The Executive Board, the Supervisory Board, and the members of the managing executive bodies of the key operating subsidiaries and their family members were defined as related parties.

A pension provision of €52 thousand was recognised in the balance sheet for the Executive Board member Gerhard Ertl due to an existing agreement. The obligation was transferred as part of an asset transfer.

In addition, there were no significant transactions between SKW Stahl-Metallurgie Holding AG and the related parties in financial year 2006.

35. Employees

In financial year 2006, an average of 226 persons (previous year: 221 persons) were employed in the Group. 127 of these were hourly-paid workers (previous year: 131) and 99 were salaried employees (previous year: 90). The rise in employees is primarily due to the increase in the staff count at Affival Inc.

36. Significant events after the balance sheet date

The following significant events as defined by Section 315 (2) sentence 1, number 1 of the HGB, occurred after the end of the Group's financial year but before the consolidated financial statements were prepared.

The Quab business was acquired from Degussa Corporation, a subsidiary of the RAG Group, as part of an asset deal. Production facilities, inventories, receivables and liabilities were all acquired but no land. Quab is a specialised chemical product that is primarily used in the global production of industrial starch for the paper industry. The signing was communicated by ad hoc disclosure on 22 December 2006 and the deal was closed on 16 January 2007. The annual revenue for 2006 was approximately €27 thousand. Quab has a production facility in Mobile, Alabama, USA and an administrative office in New Jersey, USA.

The values of the assets and liabilities communicated by the seller upon closing the deal were as follows:

Item	In USD thousand
Property, plant and equipment	4,632
Inventories	3,020
Receivables	7,629
Liabilities	-1,105

The property, plant and equipment solely involves production facilities. No fair values have been determined to date. The final purchase price had not yet been determined by the time of this report, since the post-closing procedure is still under way. During that process, the final working capital will be determined. Hence, the final purchase price will be reported as part of the Q1 report. The purchase price allocation will also take place in the first quarter of 2007.

In Memo/07/22 published on 18 January 2007, the European Commission announced that it had carried out unannounced inspections at the premises of calcium carbide suppliers in Austria, Germany, Slovakia and Slovenia on 16 – 17 January 2007. The SKW Stahl-Metallurgie Group is involved in this investigation. The Group has complied in full with its statutory duties of cooperation and forbearance in respect of the European Commission and all other competent authorities with regard to this matter. The European Commission stated that it had reason to believe that the companies concerned may have violated Article 81 of the EC Treaty. The Executive Board considers the accusations levied to be unfounded but will nevertheless carry out a thorough internal inspection. The examination has not yet been concluded but will be forcefully continued as a matter of priority.

Preparations were undertaken in South Korea to relocate production to a new and more efficient site at the beginning of 2007.

37. Auditor's fee

The auditor's fee for financial year 2006 amounts to €449 thousand and comprises the expenses for the audit of €146 thousand and for other confirmation or valuation services of €303 thousand.

38. Declaration of Compliance for financial year 2006

The Executive Board and Supervisory Board of SKW Stahl-Metallurgie Holding AG issued their annual declaration of compliance with the recommendations of the "Government Commission on the German Corporate Governance Code" in December 2006 in accordance with Section 161 of the AktG and made it permanently accessible to the shareholders on the Company's Internet website (www.skw-steel.com).

39. Approval of the consolidated financial statements in accordance with IAS 10.17

The Executive Board approved these consolidated financial statements for publication on 13 March 2007.

Unterneukirchen, 15 March 2007

SKW Stahl-Metallurgie Holding AG

The Executive Board

E. LIST OF PARTICIPATING INTERESTS OF SKW STAHL-METALLURGIE HOLDING AG (€ THOUSAND)

Name	Registered office	Equity interest (in %)	Equity (as of 31 Dec 2006)	Subscribed Equity (as of 31 Dec.2006)	Result of business year (2006)
SKW Stahl-Metallurgie GmbH	Unterneukirchen, Germany	100.00	2,730	25	2,170
Jamshedpur Injection Powder Ltd. *)	Jamshedpur, India	30.22	5,492	1,933	2,466
SKW France S.A.S.	Solesmes, France	100.00	6,592	7,309	2
Affival S.A.S.	Solesmes, France	100.00	16,497	5,483	3,168
Affival Inc.	Williamsville, N.Y., USA	100.00	8,145	1	1,632
Affival Korea Co Ltd.	Dangjin, South Korea	100.00	1,071	867	202
Affival K.K.	Tokyo, Japan	100.00	476	159	80
Affival do Brasil Ltda.	Rio de Janeiro, Brasil	99.99	N/A	N/A	N/A
SKW La Roche de Rame S.A.S.	La Roche de Rame, France	100.00	N/A	3,160	N/A
Arques Chemicals Inc.	Wilmington, Delaware USA	90.00	380	38	0

*) The company operates on a business year different from the calendar year (April 1 to March 31). Hence, no current financials were available at Dec. 31, 2006. Therefore, figures pertaining to March 31, 2006 are shown in this list.

Independent Auditor's Report

We have audited the consolidated financial statements prepared by the SKW Stahl-Metallurgie Holding AG, Unterneukirchen, comprising the balance sheet, the income statement, statement of changes in equity, cash flow statement and the notes to the consolidated financial statements, together with the group management report, which is combined with the management report of the SKW Stahl-Metallurgie Holding AG, Unterneukirchen, for the business year from January 1st, 2006 to December 31st, 2006. The preparation of the consolidated financial statements and the group management report in accordance with the IFRSs, as adopted by the EU, and the additional requirements of German commercial law pursuant to § (Article) 315a Abs. (paragraph) 1 HGB ("Handelsgesetzbuch": German Commercial Code) are the responsibility of the parent Company's Board of Managing Directors. Our responsibility is to express an opinion on the consolidated financial statements and the combined management report based on our audit.

We conducted our audit of the consolidated financial statements in accordance with § 317 HGB and German generally accepted standards for the audit of financial statements promulgated by the Institut der Wirtschaftsprüfer (Institute of Public Auditors in Germany) (IDW). Those standards require that we plan and perform the audit such that misstatements materially affecting the presentation of the net assets, financial position and results of operations in the consolidated financial statements in accordance with the applicable financial reporting framework and in the combined management report are detected with reasonable assurance. Knowledge of the business activities and the economic and legal environment of the Group and expectations as to possible misstatements are taken into account in the determination of audit procedures. The effectiveness of the accounting-related internal control system and the evidence supporting the disclosures in the consolidated financial statements and in the combined management report are examined primarily on a test basis within the framework of the audit. The audit includes assessing the annual financial statements of the companies included in consolidation, the determination of the companies to be included in consolidation, the accounting and consolidation principles used and significant estimates made by the Company's Board of Managing Directors, as well as evaluating the overall presentation of the consolidated financial statements and the combined management report. We believe that our audit provides a reasonable basis for our opinion.

Our audit has not led to any reservations.

In our opinion based on the findings of our audit the consolidated financial statements comply with the IFRSs, as adopted by the EU, the additional requirements of German commercial law pursuant to § 315a Abs. 1 HGB and give a true and fair view of the net assets, financial position and results of operations of the Group in accordance with these provisions. The combined management report is consistent with the consolidated financial statements and as a whole provides a suitable view of the Group's position and suitably presents the opportunities and risks of future development.

Munich, March 15, 2007

PricewaterhouseCoopers
Aktiengesellschaft
Wirtschaftsprüfungsgesellschaft

(Wagner)	(ppa. Schwarzfischer)
Wirtschaftsprüfer	Wirtschaftsprüfer

Report of the Supervisory Board

Dear shareholders,

The successful 2006 financial year of the SKW Stahl-Metallurgie Group was dominated the IPO of the parent company SKW Stahl-Metallurgie Holding AG, which has been listed in the Prime Standard of the Frankfurt Stock Exchange since 1 December 2006.

At the beginning of financial year 2006, the now listed stock corporation traded as SKW Stahl-Metallurgie Holding GmbH and did not have a Supervisory Board, as is customary for limited companies with no obligation to implement employee co-determination. The Supervisory Board was formed with the resolution to convert the Group parent company into a stock corporation on 20 April 2006. It then performed the duties assigned to it by law and the Articles of Association in the remainder of the financial year, including supporting and monitoring the activities of the Executive Board. In particular, the Executive Board regularly informed the Supervisory Board in a timely and comprehensive manner of all issues concerning the Company's planning and strategic development, business development and the financial position of the Group, including budgeting, risks and risk management, both orally and in writing.

The Supervisory Board's activities included the following measures in particular:

- Requesting and examining quarterly reports on the fundamental issues concerning corporate planning (particularly financial, investment and human resource planning), business development (particularly the Company's revenue and financial position) and transactions that could be of material importance to the Company's profitability or liquidity (cf. Section 90 (1) of the German Stock Corporation Act);
- Questioning the Company's management on the reports presented, current developments and imminent decisions at the meetings of the Supervisory Board;
- Holding discussions between the Chairman of the Supervisory Board and the members of the Executive Board on various issues and questioning the Company's management on current developments and imminent decisions in the course of these discussions;
- Examining the annual financial statements, consolidated financial statements, dependent company report in accordance with Section 312 of the German Stock Corporation Act, management report and Group management report prepared by the Executive Board and questioning the members of the Executive Board on these publications.

The Supervisory Board was involved in all major strategic decisions of the Company, discussed and examined these decisions in detail and, where necessary, approved them. Members of the Executive Board attended the meetings of the Supervisory Board as required. The balance sheet meeting in accordance with Section 171 (1) of the German Stock Corporation Act held on 20 March 2007 was also attended by the Company's auditor. The Supervisory Board did not form any committees in financial year 2006. The main subjects addressed by the Supervisory Board were current business development, corporate strategy and its implementation, personnel issues relating to the Executive Board, and the Company's capital market activities. In financial year 2006, the Supervisory Board intensively discussed the current business situation and the continued strategic development of the Company, as well as its IPO and the related financial communication requirements. In particular, the financial and human resource challenges and the opportunities and risks of the Company's development and investment plans were discussed in detail. The Supervisory Board paid particular attention to the standards on responsible and effective corporate governance set out in the German Corporate Governance Code. As part of the Company's IPO, on December 1, 2006, the Executive Board and Supervisory Board issued a declaration of conformity as required under Section 161 of the German Stock Corporation Act, which was made permanently available to shareholders via the Company's website. The Company only diverges from a few of the recommendations of the Code. Further details can be found in the Corporate Governance Report on page 11 onwards. At the shareholders' meeting of SKW Stahl-Metallurgie Holding GmbH on 20 April 2006, which approved the conversion to the current SKW Stahl-Metallurgie Holding AG, PwC PricewaterhouseCoopers AG, Wirtschaftsprüfungsgesellschaft, München (Munich), was also appointed as the Company's auditor for financial year 2006. On November 15, 2006, the Supervisory Board obtained a declaration by the auditor as to whether and to what extent there are any professional, financial or other relationships between the auditor and the Company that could give rise to doubts with regard to its independence (declaration of independence). This declaration also covers consulting services performed for the Company in the past financial year.

The annual financial statements and the consolidated financial statements as of 31 December 2006, the management report and the Group management report, including the bookkeeping system, were audited by the elected auditors, PwC PricewaterhouseCoopers AG Wirtschaftsprüfungsgesellschaft, München (Munich), and issued with an unqualified audit opinion. All of the members of the Supervisory Board were provided with all documents relating to the financial statements and audit reports in a timely manner prior to the Supervisory Board's balance sheet meeting. These documents were carefully examined by the Supervisory Board as a whole and discussed in detail by the Supervisory Board in the presence of the auditor. The Supervisory Board concurred with the results of the audit and, based on the final results of its own examination, did not raise any objections. The Supervisory Board approved the annual and consolidated financial statements prepared by the Executive Board in the version forming the basis of the audit report by PwC PricewaterhouseCoopers AG by way of a resolution dated 20 March 2007. The annual financial statements have therefore been adopted. The Supervisory Board endorses the Executive Board's proposal to carry forward the unappropriated surplus and therefore to pay no dividend for 2006.

PwC also audited the Executive Board's report on affiliated companies (dependent company report) prepared in accordance with Section 312 of the German Stock Corporation Act and issued the following audit opinion:

"On completion of our audit in accordance with professional standards, we confirm that
1. the factual statements made in the report are correct,
2. the Company's compensation with respect to the transactions listed in the report was not inappropriately high."

The dependent company report was examined by the Supervisory Board for completeness and accuracy. The Executive Board prepared the list of affiliated companies with an appropriate degree of care. It took the necessary precautions in recording the transactions and other measures that the Company undertook or refrained from undertaking in the past financial year from 26 May 2006 onwards, either with, at the instigation of or in the interest of the controlling company, ARQUES Industries AG, or one of its affiliated companies. These are listed in detail in the notes to the consolidated financial statements. According to the findings of this examination, there is no evidence to suggest that transactions or measures have not been recorded in full. The Supervisory Board therefore endorses the results of the audit conducted by the auditor. There are no objections to be raised in respect of the declaration of the Executive Board at the end of the report.

At the constitutive Supervisory Board meeting, held after the shareholders' meeting of SKW Stahl-Metallurgie Holding GmbH on 20 April 2006 that approved the conversion to the current SKW Stahl-Metallurgie Holding AG, Ms Ines Kolmsee was initially appointed as the sole director. There were the following changes in the composition of the Executive Board in the period under review: Mr Gerhard Ertl, who had previously occupied senior positions within the Group, was appointed to the Executive Board with effect from 16 August 2006. Mr J. Klaus Frizen, who had previously occupied various senior positions within the steel industry, was appointed to the Executive Board with effect from 2 November 2006. With this expansion of the Executive Board, the Supervisory Board is recognising the heightened requirements made of listed companies and the rapid growth path that the Company is taking. The expansion of the Executive Board to at least two people also meets the corresponding requirement of the German Corporate Governance Code. As at 16 August 2006, the Executive Board consisted of one person, meaning that no Chairman of the Executive Board could be appointed.

With a resolution dated 16 August 2006, Ms Ines Kolmsee was appointed as the Chairman of the Executive Board of SKW Stahl-Metallurgie Holding AG.

In order to ensure the full ability of the Executive Board to act, especially in the months immediately before and after the IPO in the event of Ms Ines Kolmsee being unavailable to perform her professional duties in full in the last weeks of her pregnancy and possibly in the ensuing period, Mr J. Klaus Frizen was appointed as Chairman of the Executive Board on 2 November 2006.

There were no changes in the composition of the Supervisory Board in the year under review.

The Supervisory Board would like to express its gratitude to the Executive Board for the work performed in the past financial year and the ongoing and productive exchange of information in an atmosphere of confidence. We would also like to extend our particular thanks to all employees, whose commitment and successful efforts are a key factor in the success of the SKW Stahl-Metallurgie Group.

Unterneukirchen, March 2007

Markus Zöllner, Chairman of the Supervisory Board

Executive Board and Supervisory Board of SKW Stahl-Metallurgie Holding AG in the Year Under Review

Supervisory Board:

On 20 April 2006, the Supervisory Board of the Company was formed by shareholder resolution. As a company not subject to co-determination requirements, the Company did not have a Supervisory Board before this date.

In the period under review of 20 April to 31 December, the Supervisory Board consisted of:

- Mr Markus Zöllner
  (Chairman of the Supervisory Board)
- Dr Martin Vorderwülbecke
  (Deputy Chairman of the Supervisory Board)
- Dr Georg Obermeier

The further mandates of the members of the Supervisory Board generally entail functions as Supervisory Board member with associated companies within the ARQUES Group, but outside the SKW Stahl-Metallurgie Group. Deviations from this are indicated below:

* Mandates outside the SKW Stahl-Metallurgie Group and outside the ARQUES Group

Of the members of the Supervisory Board of SKW Stahl-Metallurgie Holding AG, Mr Zöllner and Dr. Vorderwülbecke are members of the Executive Board of a listed company. Item 5.4.5 of the Corporate Governance Codex (no more than five Supervisory Board mandates in listed companies external to the Group) has been satisfied without restriction.

To the extent that no time periods have been specified, the duration of the mandates was from 20 April to 31 December 2006 without interruption.

Unless stated otherwise, the location of all indicated companies is Starnberg, Germany.

Markus Zöllner

Legally required Supervisory Boards:

- XERIUS AG (Chairman)
- Arques Industrie Asset AG (Deputy Chairman)
- Arques Industrie Wertbeteiligungs AG
  (Deputy Chairman)
- Arques Industries Capital AG (Deputy Chairman)
- SOMMER Holding AG, Bielefeld (Deputy Chairman)
- Zugspitze 66. VV AG, Munich (Deputy Chairman)

- ARQUANA International Print & Media AG

Comparable mandates within Germany:

- GOLF HOUSE Direktversand GmbH,
  Hamburg (member of the Advisory Council)

Comparable mandates outside Germany:

- Arques Austria Invest AG, Vienna, Austria (since 13 October 2006; member of the Supervisory Board)
- Arques Industries AG, Vienna, Austria
  (since 7 July 2006; member of the Supervisory Board)

- Evotape S. p. A., San Pietro Mosezzo, Italy
  (President)

Dr. Martin Vorderwülbecke

Legally required Supervisory Boards:

- SOMMER Holding AG, Bielefeld (Chairman)
- tiscon AG Infosystems, Neu-Ulm (Chairman)

- ARQUANA International Print & Media AG (Deputy Chairman)
- XERIUS AG (Deputy Chairman)

- MDI Mediterranean Direct Invest AG

Comparable mandates within Germany:

- GOLF HOUSE Direktversand GmbH, Hamburg (member of the Advisory Council)

Comparable mandates outside Germany:

- Arques Industries AG, Vienna, Austria (since 7 July 2006; Deputy Chairman of the Supervisory Board)
- Arques Austria Invest AG, Vienna, Austria (since 13 October 2006; Deputy Chairman of the Supervisory Board)

- Evotape S. p. A., San Pietro Mosezzo, Italy (member of the Supervisory Board)

Dr. Georg Obermeier

Legally required Supervisory Boards:

- ARQUES Industries AG

- Billfinger Berger Industrial Services AG, Munich (formerly: Rheinhold & Mahla AG) (*)

Comparable mandates within Germany:

- Illbruck Elements GmbH, München (Munich)-Unterföhring (member of the Advisory Council) (*)

Comparable mandates outside of Germany:

- Energie-Control Gesellschaft mbH, Vienna, Austria (member of the Supervisory Board) (*)
- Österreichische Regulierungsbehörde für Strom & Gas, Vienna, Austria (member of the Supervisory Board) (*)

- Kühne & Nagel International AG, Schindellegi, Switzerland (member of Management Board) (*)

1 Mandate will end by the Annual General Meeting 2007 of ARQUANA International Print&Media AG.
2 Mandate ended on January 5, 2007.

Executive Board:

As a result of the conversion of the Company to an Aktiengesellschaft (stock corporation) (20 April 2006, entry in the commercial register 26 May 2006), the Executive Board of the Company was appointed by the Supervisory Board and consisted of three persons at the end of the year under review:

Ines Kolmsee

Since the conversion of the Company to a stock corporation, **Ms Ines Kolmsee** has been a member of the Executive Board, of which she was the sole member until 16 August 2006. Before the conversion of the Company to a stock corporation, Ms Kolmsee was the sole Director of the Company.

Comparable mandates abroad:

- Affival, Inc., Williamsville, NY, USA (Chairman)

The mandate of Ms Kolmsee is a mandate within the SKW Stahl-Metallurgie Group.

Gerhard Ertl

Mr Gerhard Ertl was appointed to the Executive Board on 16 August 2006. Mr Ertl was previously in a managing position with the SKW Stahl-Metallurgie Group.

Mr Ertl did not have any further mandates within the year under review.

J. Klaus Frizen

Mr J. Klaus Frizen was appointed to the Executive Board on 2 November 2006.

Comparable mandates within Germany:

- Deutsche Bank AG, Frankfurt/M. (member of the Council, Central Germany Region)
- Talanx AG, Hanover (member of the Gerling Advisory Council West)
- Wirtschaftsvereinigung Stahl, Betriebswirtschaftliches Institut Stahl, Düsseldorf (Chairman of the Committee - Organisation and Information Technology)

The mandates of Mr Frizen are mandates outside both the SKW Stahl-Metallurgie Group and the ARQUES Group.

Until 16 August 2006, there was no Chairman of the Executive Board since the Executive Board consisted of only one person. On 16 August 2006, the Supervisory Board named Ms Ines Kolmsee as Chairman of the Executive Board.
On 2 November 2006, the Supervisory Board named Mr Klaus Frizen as Chairman of the Executive Board.

Unless time periods have been specified, the duration of the mandates of the Executive Board was until 31 December 2006 without interruption.

Financial Calendar

15 May 2007
Publication of financial figures, 1st quarter 2007
18 June 2007
Annual General Meeting in Munich, Germany
14 August 2007
Publication of financial figures, 2nd quarter 2007
15 November 2007
Publication of financial figures, 3rd quarter 2007
31 December 2007
End of financial year 2007

Subject to modifications.

The current financial calendar can be found at www.skw-steel.com.

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