Annual Report
2005

RHEINMETALL

Rheinmetall in figures

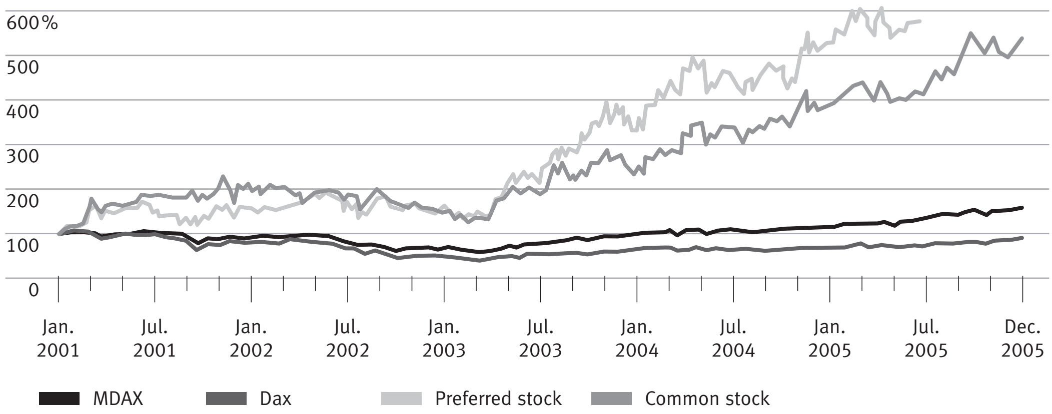
Rheinmetall Group indicators

		2001	2002	2003	2004	2005
Sales	€ *million*	4,603	4,571	4,248	3,413	3,454
Order intake	€ *million*	5,033	4,840	4,128	3,147	3,625
Order backlog (Dec. 31)	€ *million*	4,113	4,165	3,143	2,741	2,907
EBITDA	€ *million*	468	701	446	385	382
EBIT	€ *million*	195	392	204	217	225
EBT	€ *million*	84	290	120	146	170
Net income	€ *million*	38	274	68	101	118
Cash flow	€ *million*	315	587	308	264	277
Capital expenditures	€ *million*	284	248	203	183	198
Amortization/depreciation[1]	€ *million*	247	268	211	168	157
Accounting equity	€ *million*	717	869	731	779	875
Total assets	€ *million*	4,218	4,087	3,442	3,100	3,423
EBIT margin	*in %*	4.2	8.6	4.8	6.4	6.5
ROCE	*in %*	8.8	20.1	12.3	14.9	15.2
Earnings per common share	€	0.56	6.81	1.72	2.64	3.19
Earnings per preferred share	€	0.62	6.87	1.78	2.70	--
Total cash dividend	€ *million*	17	24	24	27	32
Dividend per common share[2]	€	0.44	0.64	0.64	0.74	0.90
Dividend per preferred share [2]	€	0.50	0.70	0.70	0.80	--
Employees (Dec. 31)		27,828	25,949	20,888	18,283	18,548

[1] *excluding goodwill*
[2] *including superdividend (€0.20 in 2002)*

Rheinmetall stock price trend compared to Dax and MDAX

January 2, 2001, to December 30, 2005



One Step Ahead is the motto behind this year's annual report illustrations. Staying One Step Ahead has been and will be the basis of Rheinmetall's success. Thanks to people who within their teams come up with fresh ideas and adopt new approaches—unwaveringly in the interests of customers and to the benefit of our group. Get to know some of them in this year's annual report as portrayed by Düsseldorf photographers Christoph Schuhknecht and Claudia Linnhoff.

An overview of the Rheinmetall Group

Rheinmetall AG—Management holding company. Rheinmetall stands for a solid, internationally successfully group operating in the automotive components and defence equipment markets. Guided by the principles of devolved management, Rheinmetall's sustained success story is based on the operational autonomy and vast flexibility enjoyed by the nine divisions.

Corporate sector Automotive

Pierburg

Systems and components for air supply and emission control

Oil and water pumps, vacuum pumps

Sales
€903 million

EBIT
€68 million

Employees
3,483

Locations
Germany
France
Italy
Czech Republic
Spain
USA
Brazil
China (joint venture)

KS Pistons

Passenger car pistons
Piston modules

Commercial-vehicle pistons

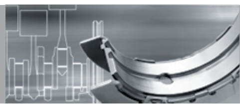
Large-bore pistons

Sales
€638 million

EBIT
€39 million

Employees
5,779

Locations
Germany
France
Czech Republic
USA
Canada
Brazil
Japan
China (joint venture)



KS Plain Bearings

Plain bearings, bushings
Thrust washers

Dry bearings (Permaglide)

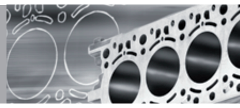
Continuous NF castings

Sales
€171 million

EBIT
€18 million

Employees
1,015

Locations
Germany
USA
Brazil



KS Aluminum Technology

Aluminum engine blocks

Sales
€210 million

EBIT
€9 million

Employees
1,007

Locations
Germany

Motor Service

Automotive parts for engine repair and workshops

Sales
€160 million

EBIT
€10 million

Employees
375

Locations
Germany
France
Turkey
Brazil

Corporate sector Defence

Land Systems

Armored wheeled and tracked vehicles

Support and mine-clearing systems

NBC protection systems

Turret systems

Sales
€349 million

EBIT
€28 million

Employees
1,476

Locations
Germany

Air Defence Systems

Air defence systems

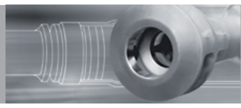
High-performance radar systems

Sales
€286 million

EBIT
€–1 million

Employees
1,728

Locations
Germany
Switzerland
Italy
Canada
Singapore
Malaysia



Weapon Munition

Weapons and ammunition for tank and artillery systems

Medium-caliber weapons and ammunition

Self-defence systems

Propellants and powder

Sales
€402 million

EBIT
€44 million

Employees
2,142

Locations
Germany
Switzerland
Austria

Defence Electronics

Command, control and reconnaissance systems

C^3I systems

Fire control units

Simulation systems

Sales
€383 million

EBIT
€27 million

Employees
1,365

Locations
Germany
Greece

One Step Ahead. The Rheinmetall Group companies symbolize solidity—commanding foremost positions in their specialized markets, vast technological capability, and strong brand values.

Pursued for years now, a policy of growth built on technological competence and existing strengths has proven itself. Backed by application-driven R&D, Rheinmetall systematically hones its product portfolio within the corporate sectors in order to tap new growth fields in line with corporate strategy.

These measurable successes result from a strategy that concentrates on innovation and internationalization. By bundling and selectively applying its resources, Rheinmetall is set to expand further its worldwide position of profitable technology- and market-leading supplier of advanced products and services in specific submarkets. Promising economic prospects and high-potential technological options are an assurance of a bright future.

The groundwork is laid for successfully exploiting market trends and developments. Skills, resources and capital are flowing into forward-looking technologies, in the coherent and systematic development of high-value, readily marketable products. Seizing opportunities ahead of others, one step ahead, that’s Rheinmetall and its people.

Contents

News flashes 2005

Q1/2005

■ The world's fastest hydrogen car—BMW's H2R prototype—comes with an aluminum engine block from KS Aluminium-Technologie and pistons from KS Kolbenschmidt. The record vehicle accelerates to 100 km/h in just under 6 seconds and achieves a top speed of 302.4 km/h.

■ At the North American International Auto Show in Detroit, Ward's Auto World, one of the most important US auto magazines, announces its ten best engines of 2005. Six of the award-winners feature the most modern engine components from the Kolbenschmidt Pierburg Group.

■ KS Aluminium-Technologie builds on its longstanding business relationship with Porsche, the renowned sports car manufacturer, and in its systems supplier role graduates to sole engine block supplier for the Boxster and 911 Carrera.

■ Premier of the world's biggest ever passenger plane. Airbus unveils in Toulouse its new A380 airliner to the world public. On board, the freight loader from Rheinmetall Defence Electronics.

■ During a visit by the German chancellor the armed forces of the United Arab Emirates award Rheinmetall Landsysteme a megacontract for the Fuchs NBC armored reconnaissance vehicle.

■ Rheinmetall Waffe Munition concludes with the British Defence Logistics Organisation a skeleton agreement for the supply of ammunition to this country's armed forces.

Q2/2005

■ 18,000,000 preferred shares are converted into voting common stock, a move that gives Rheinmetall stock much added weight in the MDAX.

■ The new corporate bond issue attracts great investor interest: a green shoe is added to the originally planned volume of €300 million to raise it to €325 million after the order book has been oversubscribed 2.5-fold.

■ At the Henry Ford Museum in Detroit, Ford Motor Company presents KS Kolbenschmidt's Brazilian piston plant with its coveted World Excellence Silver Award. Assessed are quality, cost efficiency, and delivery performance.

■ In planting a linden, the national tree of the Czech Republic, Pierburg officially inaugurates its newly built facility in Ústí nad Labem where some 60 employees assemble electric actuators, secondary air pumps and exhaust gas flaps.

■ Rheinmetall Landsysteme and IVECO-Magirus agree to cooperate on 6- to 8-t armored wheeled vehicles for the German market. Rheinmetall Landsysteme takes on systems responsibility for adapting IVECO's newly developed Light Modular Vehicle to the needs of the German armed forces. The vehicles will be marketed under the name of Caracal.

■ The lead in the market for land forces technology is lengthened through carefully targeted M&As. By acquiring a stake in the German AIM Infrarot-Module and taking over the Austrian medium-caliber specialist Arges, the Company is pushing ahead with its policy of globalization and rounding off the product portfolio.

Q3/2005

■ Together with the US company Miba Bearings, KS Bearings sets up a joint venture to produce the input materials for downstream treatment at the venturers' German, Austrian and US plants that manufacture plain bearings in cast bronze and brass composites. Other options open to the venturers are the concerted development of production materials and the reciprocal use of available assaying and testing facilities.

■ At the 61st International Motor Show in Frankfurt am Main once again leading-edge automotive components, engineering system highlights, and other new products from the various divisions are presented. A diesel engine exhibit illustrates the components, systems, and modules engineered and built by Kolbenschmidt Pierburg.

■ Rheinmetall Waffe Munition is contracted by the German armed forces to supply the newly developed tungsten-based DM 63 tank ammunition. The order is worth around €30 million.

■ In their battle against terrorism, special units at the Kuwait Ministry of the Interior opt for another eight of the ultramodern, armored multi-role tactical vehicles Condor 2. Developed by Rheinmetall Landsysteme, the Condor is remarkable for its outstanding off-road capabilities, all-round protection, and air transportability.

■ For the first time live at Rheinmetall Defence's own testing terrain in Unterlüss the integrated Protective Shield system was demonstrated to members of the German armed forces, Germany's Federal Bureau of Criminal Investigation, members of the Bundestag plus international delegations who during the three-day event obtain an impression of the capability of this modular protection system designed for deployment against the asymmetrical threats to forces in action.

Q4/2005

■ KS Kolbenschmidt strengthens its stance in the NAFTA region by taking over the Mexican pistons builder Pistones Moresa.

■ KS Aluminium-Technologie lays the foundation stone at its Neckarsulm base for a new two-storey shop which will feature state-of-the-art units for machining aluminum engine blocks. This had been preceded by an extension to the low-pressure foundry in the form of a shop with seven new casting stations.

■ The 6- and 8-cylinder models of the new Mercedes S-Class come with Kolbenschmidt Pierburg components: the two-stage variable-intake manifold in magnesium and the lightweight LiteKS pistons plus crankshaft main bearings and connecting-rod bearings.

■ Top-brass from the Defence Ministry and the German armed forces are introduced to the first Puma infantry fighting vehicle, which on an international comparison is unequaled in performance, uniting military requirements for vast strategic and tactical mobility with maximum protection and pronounced combat capability.

■ Rheinmetall Defence Electronics hands over to the artillery the first of six high-performance unmanned aerial reconnaissance systems (KZO) able to faithfully transmit in real time images and target data. In enabling the observation of danger zones from a safe standoff, these systems make an effective contribution to protecting the lives of troops in combat.

■ The trustees of the Rheinmetall Foundation award grants to four young scientists for their outstanding efforts in the fields of automotive, electrical and instrumentation engineering.

Letter from the Executive Board

Dear Stockholders, Customers, and Friends of the Rheinmetall Group:

Rheinmetall looks back on a successful 2005. The decision to concentrate on the core sectors of Automotive and Defence has brought about a very clear and consistent convergence of effort that is proving to be rewarding. As expected, the Group showed an organic growth of 4 percent to around €3.5 billion sales while order intake fueled by fresh momentum from new projects and product innovations climbed 15 percent to €3.6 billion. Versus 2004, EBIT rose 4 percent to €225 million. Net income mounted 17 percent to €118 million.

Stock prices kept pace, Rheinmetall stock benefiting from stockholder confidence to surge 40 percent to €55. In fact, Rheinmetall's market capitalization has multiplied sixfold over the past 5 years. So, just as in the years before, you, too, are participating in the Group's progress. The Supervisory and Executive Boards will thus propose to the annual general meeting to once again increase the cash dividend, this time to €0.90 per eligible share.

Operationally, Rheinmetall turned in highly commendable performances despite in some cases adverse environments. Automotive propelled its sales and earnings to new all-time highs. At €146 million, EBIT mounted 5 percent over the year-earlier magnitude. Defence's earnings benefited from higher sales volumes, improved product mix margins, and the process improvements and cost-reduction programs of previous years. Despite the burdens imposed by strategically rebuilding Oerlikon Contraves AG, Switzerland, EBIT surged 26 percent to €97 million.

Growth drivers proved to be the vast innovative capability and accelerated internationalization efforts propelling the proportion of exports to 67 percent. Automotive gained from the unabated trend to fuel and emission savings to push order intake up by 6 percent. Rheinmetall Defence exploited the migration to new forms of equipment aimed at promoting troop mobility, reconnaissance and protection. Its order intake surged 41 percent to just under €1.6 billion.

Our uppermost goals are a sustained rise in shareholder value through strict cost control and profitable growth. Within the Group, the points have been switched: innovative products, efficient deployment of resources, an ongoing accommodation of processes, lean structures. In view of this, for the years ahead we are counting on an average annual growth rate of 5 percent and improved net earnings.

The steadily improved results of recent years, bulging order books and further identified development potentials are considerations that have fueled our ambitions and prompted us to raise the bar: by 2010 an EBIT margin of 9 percent and a total ROCE of 20 percent. Hitherto the benchmarks had been 7 and 15 percent respectively.

Plenty has been achieved over the past fiscal year. On behalf of the Executive Board I thank all our employees whose skills, dedication and motivation have done so much to achieve what we are today. We thank our customers, stockholders and business associates for their confidence and support.

Sincerely,

Klaus Eberhardt

Klaus Eberhardt

Klaus Eberhardt (58) has been Rheinmetall's CEO for six years. Together with Executive Board members Dr. Gerd Kleinert (57) and Dr. Herbert Müller (52), he has systematically restructured the Group. And this has proved rewarding with surging returns and a market value up sixfold. **One Step Ahead**

Report of the Supervisory Board

Supervisory Board work in 2005. The Supervisory Board fully performed the functions incumbent on it under law, Rheinmetall AG's bylaws, the German Corporate Governance Code and the rules of procedure. The Supervisory Board regularly advised the Executive Board on group management issues and oversaw the conduct of business.

The Executive Board briefed the Supervisory Board in depth on all transactions and decisions of material significance to Rheinmetall, explaining and discussing any plan or budget variances, deviations from defined targets, and their reasons. Actions and transactions of the Executive Board requiring approval according to the Company's bylaws and the rules of procedure were duly submitted as informative written documents for approval by the Supervisory Board. Between meeting dates, the Supervisory Board Chairman regularly obtained information from the CEO about major trends, matters up for decision, and significant events.

Meetings and attendance. In fiscal 2005, the Supervisory Board convened on March 21, May 9, September 20, and November 24. All the Board members attended at least half of the meetings. Focal points of reporting and thorough deliberation by the Supervisory Board were—besides Rheinmetall's business trend—risk management, market and sales data, the operational strength of the corporate sectors, as well as the goal achievement potentials. Additional items at several Supervisory Board meetings were the changing market structure and competition, the ensuing repercussions on the Rheinmetall Group's corporate sector parents.

Deliberations and voting also focused on the floating of a new, and the redemption of the old, bond issue, the consolidation of the two stock classes, the execution of a merger agreement by and between Rheinmetall DeTec AG and Rheinmetall AG, the Group's development prospects and the ensuing options for Rheinmetall's strategic orientation, as well as measures and alternatives deemed expedient to securing Rheinmetall's growth and future. Moreover, the Supervisory Board dealt with the medium-term business plan, including financial, investment and HR issues.

Committee activities. Three standing committees assisted the Supervisory Board and report to the plenary Supervisory Board on their meetings. At two meetings, the Personnel Committee conferred on Executive Board matters, as well as on the structure and magnitude of Executive Board member remuneration. On the Personnel Committee's recommendation and thus ensuring senior management continuity, the Supervisory Board agreed to renew the appointment of Dr. Gerd Kleinert for another 5-year term, his responsibility for Automotive remaining unchanged. The Slate Submittal Committee, formed under the terms of Art. 27(3) German Codetermination Act ("MitbestG"), had no reason to convene in the year under review. The Audit Committee met twice in the year under review, mainly in preparation for the decisions of the Supervisory Board on the adoption of the separate financial statements and the approval of the consolidated financial statements. In addition, this committee dealt with accounting and risk management issues and the cooperation with the statutory auditor.

Corporate governance. At its November 24, 2005 meeting, the Supervisory Board discussed the adoption of the recommendations and suggestions of the German Corporate Governance Code as amended up to June 2, 2005, and—jointly with the Executive Board—endorsed the annual declaration of conformity under the terms of Art. 161 German Stock Corporation Act ("AktG"), stating that Rheinmetall AG has fully complied with the recommendations of the Code, subject to two duly substantiated exceptions. This declaration has been published on page 107 of this annual report and on the Company's website. At the same meeting, the Supervisory Board reviewed the efficiency of its own work and determined procedures for its future activities.

Composition of the Supervisory Board and its committees. Dr. Sabine Thürmel, Prof. Dr. Dirk Zumkeller and Dr. Bernd Michael Hönle stepped down from this Board as stockholder representatives and, for their remaining term of office, were succeeded by Dr. Peter Mihatsch, Retired General Henning von Ondarza and Prof. Dr. Frank Richter pursuant to Art. 104(1) AktG. The Supervisory Board thanks its resigned members for their knowledgeable cooperation and commitment in Rheinmetall's best interests. Prof. Dr. Frank Richter succeeds Dr. Bernd Michael Hönle as member of the Personnel and Audit Committees, while Dr. Peter Mihatsch was elected member of the Slate Submittal Committee.

Financial statements 2005. The Company's and the Group's annual accounts documentation, as well as the related statutory audit reports had been submitted to all Supervisory Board members early enough to ensure thorough and careful scrutiny.

Rheinmetall AG's separate financial statements and its management report, which were prepared in accordance with the German Commercial Code ("HGB"), and the consolidated financial statements as of December 31, 2005, and group management report, which were formulated in conformity with the IFRS and the supplementary financial-accounting provisions of Art. 315(1) HGB, were all (including the accounting system) examined as required by the law by PricewaterhouseCoopers Aktiengesellschaft Wirtschaftsprüfungsgesellschaft, Frankfurt am Main, Düsseldorf branch, the statutory auditor appointed by the annual stockholders' meeting of May 10, 2005, in accordance with the Supervisory Board's audit engagement letter. An unqualified auditor's opinion was issued on both sets of financial statements.

At its March 15, 2006 preparatory, and the March 20, 2006 annual accounts, meetings the Supervisory Board's Audit Committee and the plenary Supervisory Board were briefed by the attending statutory auditor on the annual audit in general and the major audit conclusions; the statutory auditor was, moreover, available for additional information.

The audit under the terms of Art. 91(2) AktG concluded that an efficient early risk identification system (ERIS) in accordance with the law existed that is suitable to identify in good time any developments that might jeopardize the Company's continued existence as a going concern. The auditor confirms that the methods defined by the Company for the management, identification and monitoring of risks incurred are suitable for these purposes and that the management report on Rheinmetall AG and the Group presents a true, fair and reasonable view of the risks and rewards of Rheinmetall's future development.

Following the final results of its own review and on the basis of the Audit Committee's report and recommendation, the Supervisory Board concurred with the statutory auditor's conclusions and approved the separate and consolidated financial statements for the fiscal year 2005; the separate financial statements for 2005 are thus adopted under the terms of Art. 172 AktG. Furthermore, the Supervisory Board agrees with the management reports on Rheinmetall AG and the Group, including the assessment of Rheinmetall's further development, as well as with the Executive Board's proposal for the appropriation of net earnings, which is based on a cash dividend of €0.90 per eligible share.

The Supervisory Board thanks the customers of all Rheinmetall companies and the stockholders for the trust they have placed in Rheinmetall. The Supervisory Board likewise thanks the Executive Board as well as all the employees for their dedicated efforts and their close personal commitment in the year 2005.

Düsseldorf, March 20, 2006
For the Supervisory Board

Klaus Greinert
Chairman

Rheinmetall stock

Consolidation of stock classes. On May 10, 2005, the vast majority of Rheinmetall stockholders voted in favor of converting the 18 million nonvoting preferred shares into common stock on a 1-for-1 basis. Since June 27, 2005, all 36 million shares of Rheinmetall AG have been quoted as common stock.

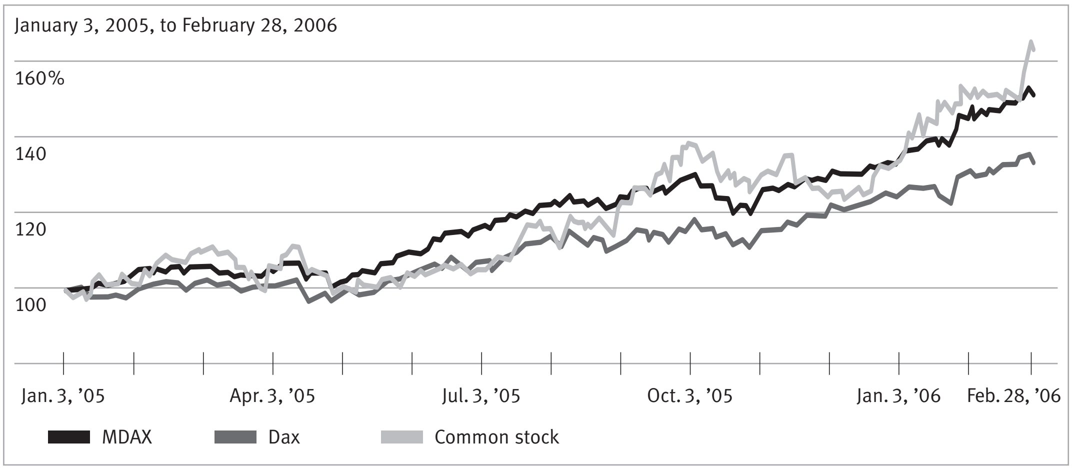
Added weight in the MDAX. The stock class consolidation combined with a free float of 100 percent has also benefited Rheinmetall's weight on the stock exchanges since Deutsche Börse AG, the German Stock Exchange Corporation, has included all 36 million Rheinmetall shares in its MDAX weight calculation. The market capitalization for index weight purposes soared to around €1.9 billion by year-end 2005 from the €0.7 billion as of December 31, 2004, where only the free-floating preferred stock had qualified. On September 19, 2005, Deutsche Börse switched to the recalculated index ranking thus required.

The creation of a single stock class and the late-2004 placement of the Röchling stake have also enhanced the liquidity of Rheinmetall stock. The average daily trading volume of common and preferred stock in 2004 had come to some 16,000 and 65,000 shares, respectively. In the year under review, the daily trading volume averaged 103,000 common shares.

The higher index-related market capitalization and the boosted liquidity of Rheinmetall stock also lifted Rheinmetall's rank within the MDAX. As of year-end, Rheinmetall was placed 11th (up from 27th) for market capitalization and 18th (up from 28th) for stock turnover.

Stock price surge. Besides the successful operating performance, the stock class consolidation considerably whetted investor appetite for Rheinmetall stock. After prices in 2004 had soared 55 and 63 percent for common and preferred stock, respectively, another surge succeeded in 2005. Starting from a 2004 closing price of €38.34, preferred shares climbed 9 percent to €41.65 by June 24, 2005, when this class was last quoted. The common shares, quoted at €39.10 on December 31, 2004, rallied by the end of 2005 to €53.26 (up 36 percent). This upswing continued into 2006, February 28 seeing a quotation at €65.20, equivalent to a gain of around 67 percent.

Rheinmetall stock price trend compared to Dax and MDAX



Rheinmetall thus slightly outperformed the MDAX, which rose 35 percent from 5,423 to 7,312. In comparison: the Dax mounted by 26 percent in 2005, from 4,292 to 5,408.

Peter Stonawski's (46) job is to find ways of protecting troops on international crisis missions. *Protective Shield* from Rheinmetall Defence is the world's first all-in system for the protection of mission infrastructures and the safeguarding of convoys.

One Step Ahead

Rheinmetall stock

Changed ownership structure. The placement by Röchling of its stakes in November 2004 had collapsed Rheinmetall's ownership structure, thereby widening the group of investors and increasing the percentage of international Rheinmetall stockowners. A survey completed in the fall of 2005 disclosed that German institutional investors owned about 21, and foreign some 61, percent of Rheinmetall stock, around 8 percent being held by German individuals.

In addition, investors informed Rheinmetall AG in 2005 about reportable changes in voting stakes in accordance with Art. 21 German Securities Trading Act ("WpHG"), whereupon Rheinmetall AG published the following notifications pursuant to Art. 25 WpHG:

- On February 10, Rheinmetall AG reported that Credit Suisse First Boston (Europe) Ltd., London, UK, held 5.03 percent of Rheinmetall common stock. Following common and preferred stock consolidation, Rheinmetall AG announced on July 18, 2005, that this stake had crossed below 5 percent and come to 2.95 percent.
- On March 5, Rheinmetall announced that Lombard International Assurance S.A., Luxembourg, had crossed below the threshold of 5 percent and retained a marginal percentage of voting stock.
- On April 29, Rheinmetall AG communicated that Perry Partners International Inc., Grand Cayman/Perry Capital International, New York, owned 6.39 percent of Rheinmetall common stock, this stake shrinking to 3.19 percent after stock class consolidation (notice of July 18, 2005).
- On August 18, Rheinmetall AG informed the public that Atlantic Investment Management Inc., a New York-based investment trust, owned 5.12 percent of Rheinmetall's common stock. In addition, Atlantic reported on January 30, 2006, that it had stepped up its stake to 6.70 percent.

Investor relations intensified. A proactive and forthright dialog with stockholders, prospective investors, and financial analysts aims at a true and fair valuation of Rheinmetall stock, as well as strengthening trust in Rheinmetall and its long-range growth strategy. At 11 conferences and 15 road shows in Germany, the UK, the United States, Switzerland, France, and Scandinavia, management reported on corporate development, explained the current position, and provided details on the Group's strategy, goals and results. Moreover, Rheinmetall staged another seven analysts meetings of its own, both as live meetings and teleconferences.

The success of these dedicated IR activities, which included more than 330 one-on-one and group discussions, is also mirrored in Rheinmetall stock coverage by analysts. Virtually all major broker firms in Germany list Rheinmetall in their research files. Another encouraging aspect is the swelling number of foreign financial institutions that observe and analyze this stock, UBS Warburg and Citigroup being the 2005 newcomers.

Repurchase of treasury stock. Due to the sustained improvement of the financial position and the results of operations, Rheinmetall has repurchased treasury stock since late 2004, reacquiring another 255,403 shares in 2005 alone. As of December 31, 2005, altogether 844,981 treasury shares (2.35 percent of the capital stock) were held by the Company.

Dividend up. The Supervisory and Executive Boards will propose to the annual stockholders' meeting on May 9, 2006, to raise the cash dividend to €0.90 per eligible share. The repurchased treasury shares do not rank for dividend. After €0.80 and €0.74 had been paid for 2004 per share of preferred and common stock, respectively, Rheinmetall thus consistently follows its investor-friendly path of previous years.

Rheinmetall on the debt market

Long-range funding strategy. The Rheinmetall Group pursues a financing strategy based on long-term concepts, its primary finance principles being to ensure, with the associated risks and rewards in mind, the availability of sufficient cash to meet payment obligations at all times. Particular attention is devoted to being independent of any specific funding sources or financial instruments.

Rheinmetall maintains borrower-lender relations with domestic and foreign banks most of which have the same international orientation as Rheinmetall itself. Moreover, the Group has for years operated as issuer on the world's money and capital markets.

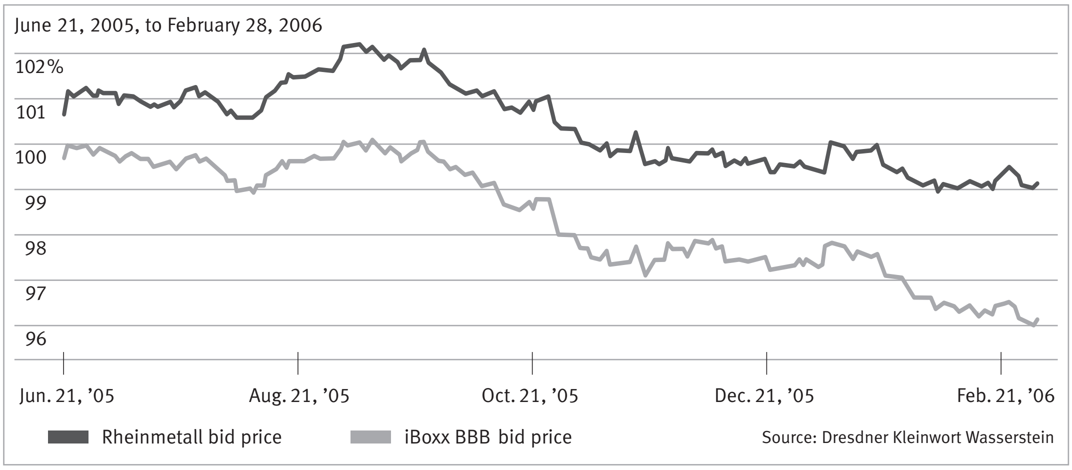
Inveterate good rating. The internationally renowned rating agencies Moody's and Standard & Poor's have rated the Rheinmetall Group investment grade since 2000. The unchanged 2005 ratings are:

Agency	Long-term	Outlook	Short-term	Outlook
Standard & Poor's	BBB	stable	A2	stable
Moody's	Baa2	stable	Prime-2	stable

Working capital management improved at Rheinmetall Defence. Besides the Group's medium- and long-term needs for funds, the cyclical volatility of Defence's cash requirements during the year must be covered throughout. This seesawing need for cash within a year, though quite common among companies dealing in project business with mostly public-sector customers, was further abated in 2005 through an upgraded working capital management system. The steady flows of cash at Automotive, which are evenly distributed over the year through standard-production business, assists the Group in achieving a better equilibrium of cash inflows and outflows.

Diversified set of debt instruments. As part of its funding strategy, Rheinmetall meets its long-term finance requirements by issuing bonds which are regularly well received by the international capital markets. In the year under review, Rheinmetall capitalized on the favorable market scenario and the associated historical low of interest rates. The first move was to offer the early redemption of the bonds issued in 2001 at a fixed annual rate of 6.125 percent and a total volume of €350 million. By the end of April 2005, Rheinmetall succeeded in redeeming a volume of €204 million at par of these bonds (which mature on May 21, 2006), leaving a residual €146 million recognized in the balance sheet as of December 31, 2005.

Price trend of Rheinmetall's 2005/2010 bond issue in comparison to the iBoxx BBB

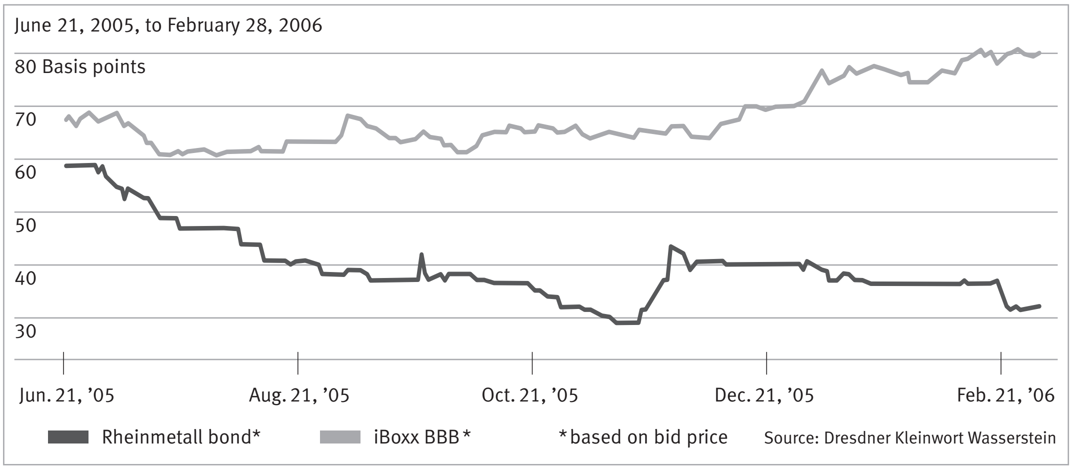


Rheinmetall on the debt market

New bond issue floated. As a parallel move, Rheinmetall prepared for the issuance of a new bond. Since the order book was oversubscribed by far, a green shoe was added to the original €300 million, bringing the total volume floated to €325 million. The bond has been listed since June 2005 on the Frankfurt am Main Exchange, thus ensuring another source of cash funds. Carrying a coupon of 3.500 percent annually up to its maturity on June 21, 2010, and selling at 99.896 percent on issuance, the bond's initial return comes to 3.523 percent per year.

Favorable trend of the new Rheinmetall bonds on the secondary market. As of December 31, 2005, the bond was quoted at a closing price of 99.85 percent, more or less equal to the price at issuance and thus significantly outperforming the iBoxx Non-Financials BBB index which receded in the same period by some 2.4 percentage points. While the spread for all bonds reflected in this index remained virtually unchanged on average, the risk premium (spread) asked by the market for the Rheinmetall bond halved. This trend underlines Rheinmetall's solid standing as seen by capital markets.

Spread trend of Rheinmetall's 2005/2010 bond issue in comparison to the iBoxx BBB



Besides the bond issue, the Rheinmetall Group resorts to various bilateral long-term loan agreements and leases to fund mainly specific capital outlays for fixed assets, substantially real estate.

Syndicated credit facility rescheduled. In April 2005, Rheinmetall AG succeeded in early rescheduling the €400 million credit facility granted in 2002 for a term expiring in 2007. This transaction, too, benefited from the favorable financial market environment by ensuring better loan agreement terms and a maturity up to 2010, all granted by a syndicate of prime domestic and international banks. This move further improved the maturity pattern of Rheinmetall's financial liabilities. The long-term facility presently suffices to meet substantially all requirements for short-term funds.

Moreover, the syndicated credit facility backs up the €500 million commercial paper program (CPP) which has existed since 2002. This financing instrument enables Rheinmetall, on a low-cost basis and independent of banks, to float short-term unsecured bonds with a maximum maturity of 364 days on the international money markets.

For an international player in the car component market such as Kolbenschmidt, a reliable and perfect logistics system is a strong competitive advantage. At the Czech location in Ústí, Irena Fiserova (31) makes sure that information and materials flow fluently. **One Step Ahead**

Rheinmetall on the debt market

Asset-backed securities program. A further funding tool is the Rheinmetall Group's asset-backed securities (ABS) program, relaunched in 2004 for a maximum volume of €170 million and terms expiring 2009. Under this program, twelve European group companies sell their trade receivables every month. Rheinmetall has thus indirectly inroaded the international, highly liquid market for asset-backed commercial paper. The maximum program volume was utilized as of December 31, 2005.

Beyond the scope of the financial instruments described above, Rheinmetall can draw on several firmly committed, bilateral credit agreements with additional financial institutions outside the group of banks which granted the syndicated facility. These supplementary credit agreements enable Rheinmetall to meet its short-term finance requirements and cover the Group's needs for guaranty bonds and other banking services in connection with day-to-day operations.

A wide variety of ultramodern simulation systems for virtual reality training is available from Rheinmetall where Dr. Hubert Burggraf (52) develops innovative laser projectors for a new generation of flight simulators. **One Step Ahead**

General economic conditions

World economy forging ahead in 2005. Despite surging energy and commodity prices, the world economy displayed solid growth in fiscal 2005. According to estimates by the International Monetary Fund (IMF) and the Organization for Economic Cooperation and Development (OECD), the leap in international economic output—the worldwide total of all gross domestic products—amounted globally to around 4.3 percent. The steep rise in raw-material costs was of special significance for the world economy. Within one year, crude oil prices climbed from almost $40 to nearly $60 at year-end 2005, which in turn fueled inflation rates on a global basis. While at almost 2.4 percent the price increase in the Eurozone was moderate according to Eurostat, the inflation rate in the United States amounted to almost 4 percent according to estimates by the National Association for Business Economics. Accordingly, the Fed and the European Central Bank prompted a more restrictive monetary policy by lifting their key lending rates.

One of the reasons for the still buoyant global economy in 2005 was the uninterrupted growth dynamism in China. India and Russia, too, were generating upbeat signals, with growth rates of more than 5 percent. According to the OECD and with a GDP gain ranging between 3 and 4 percent in the past year, it was the US economy that was in best domestic shape among the western industrial nations. In 2005, Japan's GDP advanced by around 2 percent. Driven by surging exports due to the weaker euro, the European economy remained robust, despite still sluggish domestic demand. According to IMF forecasts, the European Union's GDP advanced by around 1.5 percent in the past year. In its economic estimate of December 2005, the IFO institute expects a mere GDP growth of under 1 percent for Germany. This contrasts with 1.6 percent for 2004. Only in the first quarter of 2005 were any clear improvement trends in the German economy evident, according to estimates by the Kiel-based Institut für Weltwirtschaft. Thereafter, the relevant economic indicators were increasingly positive, mainly due to strong order intake by the manufacturing sector.

Auto markets remaining buoyant despite surging gasoline prices. In 2005, the rise in gasoline prices failed to have any negative effect on worldwide car production figures. The favorable global economy and the need to catch up on the part of buoyant Asian states ensured a very respectable automotive year in 2005. Compared to 2004, worldwide production of passenger cars and light commercial vehicles accelerated by more than 4 percent to 62.3 million units.

Again, it was the regions of the Far East and Southeast Asia that showed the strongest growth rates in 2005. According to estimates to date, production in these regions amounted to almost 12.9 million units, a good 15 percent more than in 2004. China and India, in particular, achieved the highest growths. With 4.3 million units (up 19 percent), indeed, China now ranks as the world's fourth-biggest production location. In Japan, production advanced from 9.6 million to 9.9 million units.

In 2005, European automotive production at just under 20 million vehicles slightly surpassed that of the previous year. Whereas growth in Central and Eastern Europe (up 8 percent) benefited exceptionally from the favorable economic climate and pent-up demand by consumers, production in Western Europe at a total 16.7 million units slipped by around 1 percent. With 5.3 million passenger cars and light commercial vehicles and a growth rate well over 5 percent, Germany, the most important automotive country in Europe, performed clearly better than expected, stable domestic demand and rising exports contributing toward this. In contrast, other traditional automotive nations had to accept losses. This again affected mainly the Italian carmakers which had to cope with a decline of around 10 percent. Great Britain and France, too, reported lower production figures.

In the NAFTA countries—USA, Canada, and Mexico—automotive production at around 15.8 million units remained unchanged over 2004, despite the upbeat economy and heavy discounting on the part of the carmakers. In South America, however, production climbed 14 percent to 2.8 million units.

Ongoing internationalization, accessing new markets, and analyzing additional areas of business—these are the duties of Jürgen Schwan (42) employed in Business Development at KS Aluminium-Technologie. **One Step Ahead**

General economic conditions

In 2005, surging gasoline prices encouraged the trend toward low-consumption and low-emission vehicles. Hence, light-construction materials such as aluminum and magnesium as well as products that integrate mechanical and electronic technologies are increasingly employed in automobiles. Diesel vehicles were still growing in popularity during 2005 due to their more favorable consumption and the lower retail price for this fuel. In Western Europe, for the first time more than 50 percent of all newly registered cars featured diesel engines in the year under review. This was a situation evidently in the interests of Kolbenschmidt Pierburg due to its leading competitive and technological positions and a product spectrum tuned to the market trends.

International joint missions typifying defence technology trends. The general economic environment for defence technology did not change fundamentally in 2005 compared with previous years. The sector's operations are relatively impervious to the prevailing economic climate. Rather, defence budgets are being increasingly influenced by globally heightened security requirements and the armed forces' modernization needs based on missions abroad. Obligations on the part of individual countries to international alliances such as Nato or the EU are an additional factor.

Prompted by these new deployment scenarios, the armed forces of many industrialized nations are undergoing transformation, a process which, compared with previous periods, reveals a great need for the modernization of ordnance. Mobility, reconnaissance capability, the protection of the soldiers in the field, and systems networking enjoy special priority. As a leading supplier of land forces systems, Rheinmetall Defence has readied itself in good time for these trends for which it is well poised with its product range.

Defence spending worldwide saw a further increase in 2005. US defence expenditures soared to pay for the bill being caused by the Iraq war, while the defence budgets of major European states—such as the UK and France—have also risen continuously in recent years.

The German defence budget remained steady at the prior-year level of around €24 billion in spite of the general necessity for savings in the federal budget. The initiated transformation of the German armed forces and the resulting modernization requirements were reflected in procurement planning. The proportion available for matériel procurement and R&D of relevance to Rheinmetall's military market operations increased from 24.6 percent a year ago to over 25 percent in 2005.

Privatization projects marching ahead in the German armed forces. An important trend for the Defence sector's business is the increasing outsourcing of services, previously performed by the German armed forces, from industrial service providers. This was exemplified in 2005 by the award of a training contract for crews of the multirole NH90 helicopter to training centers run by industry. In similar fashion, the repair of certain vehicle types and weapon systems belonging to the army was also shifted to the private sector in 2005. In both projects Rheinmetall is well represented in the respective industrial consortiums.

Rheinmetall Group

Rheinmetall Group indicators *€ million*

	2004	2005
Net sales	3,413	3,454
Order intake	3,147	3,625
Order backlog (Dec. 31)	2,741	2,907
Employees (Dec. 31)	18,283	18,548
EBIT	217	225
EBT	146	170
Average capital employed	1,456	1,480
EBIT margin (in %)	6.4	6.5
ROCE (in %)	14.9	15.2
When applying the adjusted EBIT as defined in Note (33) to the consolidated financial statements, the rebased indicators read as follows:		
Adjusted EBIT *€ million*	224	245
Adjusted EBIT margin *in %*	6.6	7.1
Adjusted ROCE *in %*	15.4	16.6

Fiscal 2005 highlights. With a view to further slimming the Group's organizational structure, Rheinmetall DeTec AG was merged into Rheinmetall AG with retroactive effect as of January 1, 2005, thus consolidating staff department functions, paring costs, and untangling complex cross relations. Within Rheinmetall AG, a separate management board is responsible for the management of the Defence sector.

Sales mounting again. In fiscal 2005, the Rheinmetall Group posted sales of €3,454 million (up from €3,413 million) of which 59 percent was contributed by the Automotive sector (up by 2 percentage points) while an unchanged 41 percent was inputted by Defence.

Sales by corporate sector *€ million*

	2004	Share of total sales	2005	Share of total sales
Automotive	1,941	57%	2,050	59%
Defence	1,384	41%	1,402	41%
Others/consolidation	88	2%	2	--
Rheinmetall Group	3,413	100%	3,454	100%

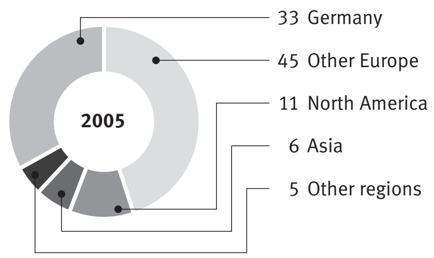
Automotive once again boosted its sales, generating €2,050 million in 2005 (up 5.6 percent). Unchanged, the chief sales contributors were the Pierburg and Pistons divisions which shared between them 75 percent of the Kolbenschmidt Pierburg Group's sales.

In the past fiscal year, Rheinmetall Defence's sales inched up €18 million to €1,402 million to which Weapon Munition again contributed the largest share, followed by Defence Electronics, Land Systems, and Air Defence Systems.

Rheinmetall Group

Business outside of Germany in 2005 accounted for a high 67 percent, thus edging up from the prior year's 64 percent. The key sales markets were Germany and other Europe, followed by North America and Asia. Around 70 percent of Automotive's sales was generated outside of Germany while Defence raised its sales to international customers from 62 to 64 percent.

Sales by region *in %*



Based on Rheinmetall Group sales of €3,454 million

Order intake revved up. The Rheinmetall Group showed an order intake for 2005 of €3,625 million (up from €3,147 million). The Kolbenschmidt Pierburg Group's order inflow swelled 6 percent to €2,068 million while Rheinmetall Defence's was boosted by 41 percent to €1,553 million. The steep upswing recorded by Land Systems (whose order influx shot up from €278 million a year ago to €655 million in 2005) spotlights the technology leadership of Rheinmetall Defence particularly in the field of vehicles for NBC protection and command vehicles.

At €2,907 million, the Rheinmetall Group reported a 6-percent higher order backlog at the end of 2005; orders on hand at Defence accounted for €2,565 million alone (up from €2,418 million) and includes high-volume projects extending over several years.

Operating profitability improved. The Rheinmetall Group's 2005 EBIT mounted by €8 million to €225 million and all Automotive and Defence divisions (except for Air Defence Systems) contributed a profit. The Group's future-oriented product strategy with a focus on growth markets, as well as a selective internationalization thrust, were the decisive factors in this improved economic performance, besides the groupwide cost-trimming and efficiency-enhancing programs in connection with the restructured operating business.

In the period, the Kolbenschmidt Pierburg Group posted an EBIT of €146 million, 5 percent up over the high year-earlier figure, while Defence's EBIT surged by €20 million or 26 percent to reach €97 million.

New ways of operating and controlling military vehicles are developed in the department of Dr. Christoph Hernekamp (40) and include state-of-the-art electronics, onboard power supply systems, and digital bus systems for Rheinmetall Defence's armored vehicles.

Rheinmetall Group

EBIT by corporate sector *€ million*

	2004	2005
Automotive	139	146
Defence	77	97
Others/consolidation	1	(18)
Rheinmetall Group	217	225

Adjusted EBIT *€ million*

	2004	2005
EBIT	217	225
Nonrecurring losses/gains from		
shareholdings	(23)	(4)
real estate	4	(1)
restructuring programs	26	17
finance rescheduling	--	8
Adjusted EBIT	**224**	**245**

Net interest expense down, net earnings up. The Rheinmetall Group's further improved finance structure and the additional reduction in net financial debt (mainly during the year) slashed net interest expense by €16 million to €–55 million. A contributory factor was the early redemption by April 2005 of a large quantity of the 6.125-percent fixed-rate bonds issued back in 2001 and their replacement by a lower-rate (3.500 percent annually) bond issue maturing in 2010. After income taxes of €52 million (up by €7 million), net income for 2005 totaled €118 million, up by €17 million. The minority interests therein have remained unchanged at €5 million in 2005.

Group net income *€ million*

	2004	2005
EBIT	**217**	**225**
Net interest expense	(71)	(55)
EBT	**146**	**170**
Income taxes	45	52
Group net income	**101**	**118**
Minority interests	(5)	(5)
Group earnings (after minority interests)	**96**	**113**

Asset and capital structure. As required by the current IFRS accounting rules, the revised IAS 1 entailed for 2005 a reclassification of the consolidated balance sheet according to maturities (including the prior-year comparatives). In the year under review, the Rheinmetall Group's total assets rose 10 percent to €3,423 million. The increase in noncurrent assets by €90 million or 6 percent was attributable not only to slightly stepped-up capital expenditures but also to the initial inclusion of investees carried at equity. Largely due to total cash & cash equivalents soaring by €150 million to €408 million, current assets climbed €233 million or 15 percent to €1,804 million.

The stockholders' equity mounted by €96 million to €875 million, which meant another improvement of the equity ratio by one point to 26 percent.

The Rheinmetall Group's noncurrent liabilities of €1,041 million substantially remained at the prior-year level while current liabilities grew by €218 million or 17 percent to €1,507 million, basically due to the old bond issue maturing in May 2006. The deduction of cash & cash equivalents of a total €408 million shrank net financial debt from €154 million a year ago to €151 million as of December 31, 2005. Net leverage (i.e., the ratio of net financial debt to equity) was again slashed, from 20 percent in 2004 to 17 in the period.

Asset and capital structure *€ million*

	12/31/2004	%	**12/31/2005**	%
Noncurrent assets	1,529	49	1,619	47
Current assets	1,571	51	1,804	53
Total assets	**3,100**	100	**3,423**	100
Total equity	779	25	875	26
Noncurrent liabilities	1,032	33	1,041	30
Current liabilities	1,289	42	1,507	44
Total equity & liabilities	**3,100**	100	**3,423**	100

Even more value added. In fiscal 2005, the value added by the Rheinmetall Group moved up to €1,286 million. While the Group's total operating performance came to €3,704 million (up from €3,660 million), the ratio of value added to total operating performance was maintained at 35 percent, the previous year's magnitude. The value added per capita (rounded) grew 5 percent to €70,000 (up from €67,000).

The workforce received 79 percent of the value added, the lion's share; the Treasury's slice of 5 percent corresponded to €63 million. The interest payable to lenders/banks rose in 2005 by 14 percent to €95 million, thus accounting for 7 percent of value added. At €27 million, stockholders received 2 percent. The residual 7 percent of value added, equivalent to €91 million (up from €77 million), remained within the Rheinmetall Group.

Source and use of value added *€ million*

	2004		**2005**	
Source				
Group's total operating performance	3,660		3,704	
Input	(2,220)		(2,261)	
Amortization/depreciation	(168)		(157)	
Value added	**1,272**		**1,286**	
Use		*in %*		*in %*
Employees	1,031	81	1,010	79
Treasury	57	4	63	5
Lenders/banks	83	7	95	7
Stockholders	24	2	27	2
Rheinmetall	77	6	91	7
Value added	**1,272**	100	**1,286**	100

Rheinmetall Group

Expenditures securing competitive lead. Rheinmetall's expenditure program in 2005 was again governed by the enactment of organic growth strategies, with funds allocated to strategic and operational targets designed to strengthen market positions and consolidate technological competence. Money was spent on plant and equipment, facilities, processes and manufacturing capacities for products. Rheinmetall's addition to tangible and intangible assets (excluding goodwill and revaluation step-up) amounted to €198 million (up from €183 million). In terms of total group sales this is equivalent to about 6 percent. Amortization and depreciation for the period came to €157 million (down from €168 million). At €162 million or 82 percent, Automotive accounted for the lion's share of the spending budget.

Capital expenditures by sector *€ million*

	2004	2005
Automotive	133	162
Defence	50	35
Others/consolidation	--	1
Rheinmetall Group	183	198

Automotive raising capital outlays. Pierburg in Germany invested in product launches and expanding capacities to address rising customer demands. This included the start-up of intake manifolds for 6-, 8- and 10-cylinder engines built by premium German carmakers, increased capacity for making electrical throttle bodies, and a new Customer Center in Neuss. Abroad, Pierburg invested in assembly capacities for EGR valves in Spain and the United States. The Italian and French companies concentrated on boosting oil, water and vacuum pump production capacities. Outlays in France went toward the implementation of a mini-factory concept. The new Czech Republic plant invested in setting up capacities for manufacturing exhaust gas flaps and secondary air pumps, as well as in the construction of an office building and the first production shop.

The Pistons division spent most of its funds on replacing existing equipment and on new gasoline, diesel and steel piston projects. Foundry and machining equipment was purchased. Outside of Germany items of expenditure included capacities for new projects and extensions to existing capacities plus equipment for producing new features in the existing piston ranges—indentations, bores, milled parts.

Domestic expenditures by Plain Bearings centered on extending capacities for the production of upstream material at St. Leon-Rot and expanding parts production at the Papenburg location. Other items included the construction of a new R&D Center. The US expenditures focused on a further productivity increase at the bronze casting line.

Aluminum Technology allocated its funds in 2005 once again to the growth sector of low-pressure casting. The procurement of plant and equipment for new products continued. Also, initial investments were made in a building in preparation for expanding finish-machining capacities. At Neckarsulm, the division started on the construction of a new Customer Center.

Essential to the success of Rheinmetall Defence in supporting the transformation process undergone by the international armed forces is an ability to network sensors, command and impact units into one overall system—the job of Joachim Dierig (47).

Rheinmetall Group

Spending held back at Rheinmetall Defence. The Defence sector pursued a more restrictive investment policy during the period under review and downsized expenditures to a total of €35 million in 2005 (down from €50 million in 2004). As a percentage of the corporate sector's sales, this is 2.5 percent (down from 3.6 percent).

Alongside expanded functions and additional tools in commercial software, the focus at Land Systems was on replacement and rationalization expenditures for existing industrial plant and machinery as well as factory and office equipment related to the relocation at the Kiel site.

Air Defence Systems continued to center on the development of the high-mobility autonomous Skyranger multimission system and the Millennium naval gun, investing particularly in industrial equipment and machinery for the manufacture of components for the Skyranger and Millennium products. Buoyant business at the Malaysian plant led to the expansion of plant facilities and increased machine capacity.

Spending by Weapon Munition emphasized upkeep and rationalization measures for steadily improving production cycles at Unterlüss and Neulüss. Nitrochemie Aschau GmbH continued to pursue the investment project started in the previous year aimed at improving the quality of polybasic propellant powder production.

Great efforts to meet the increased performance and quality requirements on the new drive technologies required extensive replacement spending. Notable individual projects included the procurement of an up-to-date powder-mixing machine as well as further automation of the existing kneading machines. As part of the scheduled expansion of specialty chemicals business a plant was built for the production of catalysts for the petrochemical industry. Replacement expenditures for a modern and flexible universal CNC machining center required for medium-caliber weapon components enabled the Mauser Oberndorf facility to rationalize its production processes.

Spending by Defence Electronics again concentrated on modernizing and revamping the existing computer infrastructure, especially in R&D, and on replacing office equipment. Apart from upgrading antenna systems for radio reconnaissance through the newly developed C-band antenna, the integration interfaces were adjusted to the respective program requirements in production.

Technological and product developments opening up growth potential. Alongside consistently improving the current product portfolio and tapping adjacent areas of business, forward-pointing and user-oriented products tailored to market needs are a key factor in securing further growth and safeguarding competitiveness on a sustained basis. Technology, market and industry sector trends and their implications are constantly investigated, analyzed, and assessed. The Group's own R&D efforts are complemented by close cooperation with universities and other research institutes with the aim of utilizing, among other things, complementary know-how and knowledge transfer in such disciplines as automotive, production and electrical engineering.

In fiscal 2005, the Group spent €144 million on R&D (up from €141 million), equivalent to 4.2 percent of aggregate sales (up from 4.1).

R&D expenditures by corporate sector *€ million*

	2004	% of sales	2005	% of sales
Automotive	97	5.0	104	5.1
Defence	39	2.8	40	2.9
Others	5	0.2	--	--
Rheinmetall Group	141	4.1	144	4.2

Staying close to the market in the Automotive sector. Once again, the primary objectives of the Pierburg R&D program in fiscal 2005 were improved engine performance coupled with emission and weight reduction. As in the past, numerous projects involved electrical and electric-motor products, which, unlike conventional mechanical components, lead to reduced fuel consumption and emissions thanks to demand-controlled operation.

Along with work on various applications for electric throttle bodies with a new technology and electric drive modules as a substitute for vacuum-controlled systems, the development of applications for intake manifolds, inclusive of three magnesium intake manifold projects for premium-class engines, was completed. Progress was made on an intake system with integrated exhaust gas recirculation that reduces the overall dimensions and diminishes the number of interfaces.

In the field of pollution control, particularly worthy of note are the ongoing development of the exhaust gas recirculation (EGR) systems consisting of optimized, very much dethrottled exhaust gas recirculation valves and highly integrated EGR cooler modules. These systems, destined for applications both in the EGR high-pressure range and in the EGR low-pressure range with its growing importance for the future, will permit the efficient cooling of recirculated exhaust gas with low-temperature cooling circuits. These functions are designed to minimize nitrogen oxide emissions and thus have a key bearing on compliance with emission ceilings. In this important segment, the first diesel engine projects conforming to Euro 5 emission limits were contracted. Electric motor-actuated exhaust gas recirculation, already widely introduced on the market, is being adopted with optimized costs for further applications fulfilling the Euro 5. In the exhaust flap sector, Pierburg unveiled a new application for the control of multiple turbochargers (sequential turbo).

Preliminary development work on electrohydraulic valves. A newly developed secondary air pump with smaller overall dimensions and lower weight was successfully positioned on the market. In the solenoid valve sector, the development of applications for the electrical divert-air valve continued. Preliminary development work on electrohydraulic valves was also initiated.

Research and development efforts in the Pumps product sector prioritized an on-demand electric coolant pump, also in the field of charge air cooling. Other development focuses were the variable oil pump, the mechanical water pump with an external bearing, and modularization, particularly of oil and vacuum pump functions.

In their quest to develop new engine components, the engineers in the Pistons division are constantly endeavoring to boost power density and cut fuel consumption and emission values. In gasoline engines this is primarily achieved with charging and direct fuel injection and/or with variable valve timing. Through special LiteKS technology, which is embodied by the majority of products currently in series development, the pistons combine extreme strength with low mass. LiteKS was expanded to include advanced groove protection features (ring carrier) and is now being employed in gasoline engines for the first time. Cast gasoline engine pistons with coolant ducts for engine applications in the high-temperature range were also developed.

Rheinmetall Group

Owing to further increasing power densities, pistons for new automobile turbo diesel engines require coolant ducts. Along with cooled ring carriers (GalleriKS) coolant ducts with a variable cross-section can be used for series-manufactured products (ContureKS) for pistons with large recess dimensions. The design and casting technology necessary for advanced variable geometries (DynamiKS) were developed this year.

Improved materials ready for production. In the commercial vehicles segment, all-steel pistons continued to be the prime focus of attention. These pistons are suitable for cylinder pressures of up to 250 bar, which engines will need in order to meet future emissions standards. Last year, enhanced materials capable of withstanding extreme thermal and mechanical stress in automobile and commercial-vehicle engines reached the point where they were ready for production.

The Plain Bearings division once again applied its efforts to improving its position as a developer for OEM customers in a rapidly changing competitive environment. In addition to the development of new and the refinement of existing sliding materials and sliding layers, attention was spotlighted on the analytic satisfaction of customers' key tribological needs. With newly developed design and simulation processes, the properties of coating layers are investigated in detail so that certainty can be obtained about the hardness and wear characteristics of organic compounds.

In engine tests, the new leadfree steel/brass composite confirmed the excellent performance as a connecting rod bearing material already established in preliminary tests. Connecting rod bearings with sputter layers specially optimized for this material are an innovation also distinguished by their attractive cost-benefit ratio. The requirements of existing and new applications are now fully satisfied by the new material/layer system.

The newly developed steel/aluminum composite, which achieved outstanding results in engine tests both as a connecting rod and crankshaft bearing material, also demonstrates extremely low wear combined with high dynamic load-bearing capacity.

New market openings for Plain Bearings. Newly formulated coating-based sliding layers underwent engine testing. The synthetic top layer supports the optimum adaptation of the metal intermediate layer, while reducing bearing friction particularly during the engine's cold-running phases. Sliding layers with varying combinations of fillers in the selected plastic matrix open up extra market potential for the division.

Fiscal 2005 saw the launch of a range of laser-welded flange bushings. The high-precision laser beam permits the welding of steel/plastic composites without impairing the plastic layers. Laser-welded flange bushings made of a high-duty composite were tested successfully and promisingly in high-performance diesel injection pumps. Development teams are now working on consolidating the input material and component production processes so that series start-up can go ahead in 2006.

Development activities at KS Aluminium-Technologie focused not only on low-pressure casting for premium aluminum engine blocks, but also on the die-casting process. Making use of new casting technologies, this division presented at the IAA in Frankfurt am Main an inline four-cylinder engine block with high bearing block strength and a closed deck produced with metal/matrix composites and cores in the die-casting process. This technologically superlative engine is the first mass-produced prime mover to exhibit the functions and features previously the prerogative of the premium segment. And this opens up new market opportunities for KS Aluminium-Technologie.

As customer consultant Nelly César (32) represents on the French market the Plain Bearings division which through its innovative technologies ensures reliable operation even under extreme conditions of the most powerful engines of globally renowned automakers worldwide. **One Step Ahead**

Rheinmetall Group

Targeted further development of systems expertise. With its innovative products and modern production methods the Defence sector is geared to the broader requirements being set by national and international armed forces. In order to safeguard the Group's competitive edge and strengthen its foremost market position, R&D work commissioned by customers is being supplemented with development efforts financed from the sector's own resources. Thanks to consistent exploitation of potential synergies within the Rheinmetall Group, the forward-pointing systems aspect is being increasingly taken into account in R&D activities. Intelligent system solutions, for patrolling borders or safeguarding military camps for example, are opening up additional market potential.

Against this backdrop, the Protective Shield concept was presented at a live demonstration held at the Unterlüss location in September 2005 as an integrated system for protecting troops, stationary facilities, and property. The modular protection concept consists of networked command, reconnaissance, surveillance, and impact systems. All the information relevant to the action converges in the operations center, Protective Shield's core, and is processed into a real-time situation and status report. Simply by networking existing resources, their effectiveness in the field is multiplied. Protective Shield is already available as a comprehensive system for protecting armed forces from asymmetric threats, enabling through open interfaces the integration of existing protection systems at national level and of the command and weapon deployment systems belonging to other countries.

The changing conflict-prevention and crisis-handling scenarios confronting the armed forces are sprouting a new global need for light, armored and air-transportable vehicles whose overriding function is to protect their crews.

The Puma, cutting-edge technology. Within this context, the new Puma infantry tank represents cutting-edge technology for the German land forces industry and, in fiscal 2005, again constituted Land Systems' foremost development project. In all, the German army is planning to procure 410 of these vehicles worth a total of around €2.7 billion. A decision regarding the award of contracts for the series production of the Puma is expected in 2007.

A truly revolutionary heavily protected medium-weight wheeled vehicle concept is emerging at Rheinmetall Landsysteme GmbH. The armored vehicle system, known as GeFaS, is a combat vehicle whose modular design guarantees easy transportability as well as flexibility in deployment thanks to combinability and fast repairability. The vehicle offers the highest possible protection against land mines and ballistic threats and can be equipped for a variety of different uses, ranging from a command vehicle via an armored personnel carrier to a high-technology weapons platform.

The development of an autonomous and portable bomb disposal robot for dealing with threatening situations in confined spaces, such as in aircraft, was successfully completed in 2005. This high-technology product is equipped with a robot control system which is unique in the manipulator vehicle segment.

The Air Defence Systems division continued its development work on the battle management systems, a command system designed for mobile and stationary use for networking guided missile- and cannon-based air defence systems, as well as on the highly sensitive 3-D XTar radar system for detecting and tracking very small targets over longish ranges. Further R&D projects included cannon systems capable of effectively engaging extremely small missiles and ground targets, the Skyguard 3 fire unit based on state-of-the-art technology, and the Millennium naval gun. This multimission naval gun system can be used against various targets, including aircraft, high-speed boats and coastal objects. The Skyshield air defence system underwent numerous studies, tests and trials which lay the basis of the small-target capability of all air defence systems manufactured by Oerlikon Contraves. This includes the ability to effectively engage missiles, artillery shells and mortars.

Rising demand for light weapon systems. The Weapon Munition division continued to develop the 60-mm, 81-mm and 120-mm mortar ammunition ranges on schedule. The development contract for 120-mm HE rounds was successfully completed with the passing of official qualification tests, as was the development of the long-range DM 131 155-mm artillery round. In line with the rising demand for light weapon systems, the universally deployable 105-mm weapon systems designed for integration into light carrier vehicles are at the design stage. In addition, the division focused on the development of a passive vehicle rear protection for the new Puma infantry fighting vehicle. A grenade launcher was unveiled in Kassel in December 2005 as part of the Puma prototype presentation. In the field of nonlethal weapon (NLW) systems, work concentrated on developing high-energy laser concepts. Further activities centered on the military and civilian applications of high-power microwaves especially aimed at disarming booby traps.

Another focal point of R&D efforts was the project involving the MK 30 mm/ABM automatic cannons for the new Puma infantry tank. In a feasibility study, the possibility of developing nonlethal medium-caliber ammunition for the 27-mm caliber was successfully examined. Apart from further air burst technology applications, the performance of existing munition products is being enhanced to improve the market position. Development work on a recoilless automatic cannon with caseless ammunition was successfully continued. In addition, as part of weapon-related R&D activities the basis for lightweight systems for mounting on light carrier vehicles was studied.

The production stage was reached for the new 155-mm multispectral smoke projectile DM 125. Following the successful conclusion of qualification tests for the MASS naval defence/decoy system during the previous year, the development of basic components for further modifications to this system was completed in 2005. An additional key activity based on this technology was the conduct of qualification tests on a system for shielding large power plants from terrorist attack from the air. Work started in 2005 on readying for production new highly efficient mock targets aimed at protecting aircraft.

Innovative concept for electro-optical ground surveillance. The Defence Electronics division largely completed the development of the Saphir thermal imaging device, a third-generation sensor system, in its reconnaissance, command and fire control product group. In order to display the benefits of an innovative electro-optical ground surveillance concept a demonstration model was created during the year under review. The sensors of this observation and reconnaissance equipment, which enable exact target detection by day or night with a high-range capacity, are based on the Saphir thermal imaging device. Development of the stabilized electro-optical Seoss periscope and of Iniochos, a tactical command and information system based on Nato standards and designed for use at company level within the military, was completed on schedule.

A key focus in the simulation and training unit was the further improvement of the high-technology Avior and Avior NV laser projection system, representing a revolution in the field of night flight simulation. The R&D work on these highly advanced visual components will continue to be of major significance to this unit in the coming years. In addition, the battlefield simulation unit successfully concluded the Computer-Generated Forces project in 2005, which includes both automated scenario generation for land combat and its evaluation.

Rheinmetall Group

18,548 Rheinmetall employees serving customers and business partners. The companies of the Rheinmetall Group work in fiercely competitive markets which are characterized by dynamic trends and require a high degree of specialized know-how. Experienced executives, qualified skilled staff, practice-oriented specialists, and highly motivated junior managers make a major contribution through their knowledge, skills, experience and motivation to the achievement of corporate objectives and to safeguarding and building on the Group's business success on a sustained basis.

Developing existing strengths. Only through well-trained and committed employees who identify with their duties and are aware of their responsibility to the customer can the high-quality products and services which the market and customers expect come about in continuously improving processes.

Wide-ranging business-oriented continuing training programs give employees the opportunity to improve the skills, competence and knowledge required for a successful working life and to acquire new qualifications. The demanding courses which are tailored to the needs of the individual employees and to the respective companies' requirements extend from conventional management topics via specialized training through to language and IT skills. Moreover, modern forms of learning such as blended learning, which combines e-learning courses with classical classroom sessions, are gaining increasing importance.

Employees with subject-specific tasks are given intensive support at various levels through tailor-made seminars. Project managers are trained in accordance with the standards of the International Project Management Association and can take a certification examination. Under the system integrator program, additional qualifications are attained for the management of complex technical system environments as part of joint projects. Employees learn to devise system solutions and to implement them based on analysis and harmonization spanning specialized fields and interfaces.

Assessing the potential of high-flyers through reviews. A crucial factor in the Rheinmetall Group's future growth is its ability to identify and promote executives in a targeted manner. Their performance and development potential is regularly ascertained based on systematic selection and assessment processes. Detailed feedback discussions provide them with information about their current strengths and weaknesses, from which personal advancement measures and career prospects can then be derived.

In addition to promising young managers with initial working experience, newly appointed executives undergo training within the Young Manager Program consisting of several modules and are thus systematically groomed for more senior specialized, managerial and project-related tasks.

In an environment of rising requirements and the increasing complexity of processes, experienced executives on the Executive Development program consistently hone their managerial qualities in preparation for the challenges ahead. Over a 10-month period, current know-how related to the fields of management, strategy, business process optimization, and change management is conveyed in three modules.

In fiscal 2005, the Rheinmetall Group invested some €4.7 million in skills-upgrading measures for its employees.

Low-cost design and proactive emission control are characteristic benefits from Pierburg's solenoid valves. Alvito Fernandes (33) is among the developers of the newest-generation valves working in engines of leading carmakers. **One Step Ahead**

Rheinmetall Group

Traditionally strong commitment to vocational training. At the end of fiscal 2005, the Rheinmetall Group's companies were providing hands-on training for a total of 709 youngsters. Industrial mechanic, metal-cutting machine operator, tool mechanic, and industrial clerk were among the preferred trades being learned. During the period, 157 new apprenticeship places were filled, the training ratio for the locations in Germany being 5.1 percent, the year-earlier level.

A good place to work. Attracting competent professionals to the Group is a key task of human resources management. Alongside traditional staff recruitment methods, the Rheinmetall Group relies especially on the targeted expansion of existing cooperation with higher-education institutions and research institutes and attends recruitment fairs. An international focus, wide-ranging products, individualized human resources development, and attractive pay systems make Rheinmetall an employer enjoying high regard.

Pay structures founded on personal and corporate performance. Attractive pay is a strong argument during the recruitment phase and thereafter just as important in holding on to capable and committed employees. The pay structures are based on criteria common to the industry and weighted, depending on the individual's management responsibility, according to personal and corporate performance results.

Additionally, the compensation received by executive or management board members, officers and other managerial staff consists of both a fixed amount and a portion tied to the achievement of agreed goals and quantified corporate results, this latter portion ranging between 0 and 200 percent, depending on the degree to which the agreed goals have been achieved.

Intended as a midterm incentive for executive board members and managerial staff, a scheme has been introduced that is based on the absolute increase in the Rheinmetall Group's shareholder value (actual-to-actual comparison of the "fundamental equity" value). This incentive is calculated according to average value added over the past three years.

The management by objectives instrument (MbO) meanwhile integrates most employees through a variable pay component directly into the goal-setting and achievement review system. Until this modern remuneration concept has been fully introduced, those employees not yet included enjoy a share of their division's profits in the form of a bonus.

Pension plans—a key component of human resources policy. The Rheinmetall Group provides its employees with innovative corporate pension plans, thus increasing financial security and employee retirement income. The plan is identically structured for employees and management alike, albeit patterned to enhance performance in the higher salary tiers. This forward-pointing pension plan, which applies to all domestic Rheinmetall locations, consists of three components: a reliable basic plan, an intermediate profit-related plan linked to the enhancement of shareholder value, and an employee-funded supplementary plan, which enables various forms of payment conversion (deferred compensation, direct insurance, partly employee-/partly state-funded pension based on the Riester model).

Personnel figures. As of December 31, 2005, the Rheinmetall Group employed a workforce of 18,548, which was 265 more than the prior year's 18,283. The gain is the balance of selective retrenchments (Automotive down 90, Defence down 175) and 525 newly recruited employees to cope with extra workloads (Automotive up 400, Defence up 125) in Germany and abroad. Automotive's share of the total workforce amounted to 63.1 percent, Defence's 36.3 percent, the remaining 0.6 percent employed in the holding and service companies.

The highest percentage of workforce was employed in Europe. With 10,744 employees, Germany still had the largest workforce (58 percent), followed by Switzerland (6 percent), the Czech Republic (5 percent), France and Italy (each 4 percent), and Spain (2 percent). Eleven percent of the total workforce was employed in North America, 8 percent in South America, and 2 percent in Asia.

Personnel expenses fell by €18 million to €992 million. Wages and salaries accounted for €812 million, social security taxes and related employee benefits amounted to €180 million. Personnel expenses per capita (rounded) totaled €54,000 (up from €53,000). The ratio of payroll to sales fell from 30 to 29 percent.

Sales per capita (rounded) advanced from €179,000 in 2004 to €188,000 in the year under review.

Rheinmetall AG

Rheinmetall AG performing strategic holding functions. Its central holding company function implies that Rheinmetall AG is in charge of the uniform management and economic control of its Group. Besides conducting business on the basis of specific targets and objectives, Rheinmetall AG has a strategic function and is responsible for optimizing the portfolio of shareholdings and focusing its capital market capabilities. Its corporate support and service functions include Finance, Human Resources, Corporate Communications, Legal Affairs, and Taxes.

Within the framework of the strategies, targets and policies determined by Rheinmetall AG's Executive Board, the clearly defined and functionally self-contained corporate sectors are autonomous operations acting on their own worldwide responsibility for business and having their own senior management, a structure that ensures great flexibility, ready market access, and close customer proximity.

The structure of the Group is continuously improved to cut complexity costs and slim management and organizational structures. In the year under review, Rheinmetall DeTec AG was merged into Rheinmetall AG.

As of December 31, 2005, the holding company functions were performed by a staff of 92 (up from 65), the 2005 headcount averaging 93 (up from 70). The increase was due to the takeover of staff from Rheinmetall DeTec AG as intermediate holding company in the wake of the merger into Rheinmetall AG with effect at January 1, 2005. On a like-for-like basis, the 2004 year-end and average headcounts were 104 and 119, respectively, for both holding companies.

As holding company, Rheinmetall AG basically earns financial income (from investments and interest) as well as rental income, service and management fees apportioned to group companies, less the related personnel and impersonal expenses. Unlike the consolidated financial statements, Rheinmetall AG's separate financial statements continue to be prepared in accordance with German GAAP (German Commercial Code ("HGB") regulations).

The net investment income for 2005 shrank from €48 million a year ago to €46 million and reflected the merger-related book loss at €35 million, write-up of investments and receivables at €11 million, and higher profits from P&L transfer agreements with Defence companies.

Rheinmetall AG's pretax loss for fiscal 2005 came to €4 million (down from a pretax profit of €23 million), largely due to merger-related expenses, a lower net interest income, and higher personnel expenses.

Net income for 2005 shrank to €3 million (down from €23 million) and, after transfer from the reserves retained from earnings, net earnings amounted to €32 million, which is proposed to be distributed as cash dividend.

Booby traps in all their variety are routine risks encountered by troops on foreign missions. Eliminating this threat is an application for high-performance microwave technology in the development of which Dr. Markus Jung (42) is employed.

One Step Ahead

Automotive sector

Automotive indicators *€ million*

Kolbenschmidt Pierburg AG	2004	2005
Sales	1,941	2,050
Order intake	1,950	2,068
Order backlog (Dec. 31)	324	342
EBIT	139	146
EBT	111	127
Employees (Dec. 31)	11,364	11,699
Average capital employed	695	722
EBIT margin (%)	7.2	7.1
ROCE (%)	20.0	20.2

Fiscal 2005 highlights. Together with the US company Miba Bearings US LLC, KS Bearings Inc. set up the joint venture ABM Advanced Bearing Materials LLC to produce the input materials for downstream treatment at the venturers' German, Austrian and US plants that manufacture plain bearings in cast bronze and brass composites.

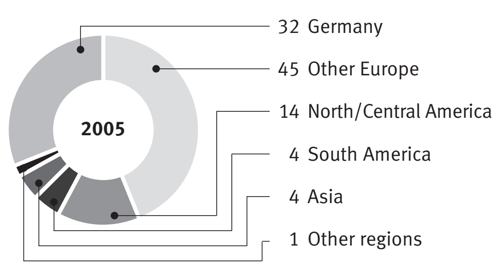
By gradually stepping up its stake in the Indian Shriram Pistons & Rings Ltd., New Delhi, to 20 percent, KS Pistons gains further ground on this up-and-coming market.

As part of the sector's policy of concentration on core areas, the airflow sensor group was sold to Texas Instruments Holland BV. Apart from the production rights, production lines and inventory, Texas Instruments Holland also acquired customer and supplier contracts for this product in two stages to ensure a smooth transition for customers in the automotive industry.

Sales and earnings at a record high. In the past year and at €2,050 million (up 5.6 percent), sales by the Kolbenschmidt Pierburg Group reached a new all-time high, hence outpacing the 4.2-percent expansion rate of global automotive production.

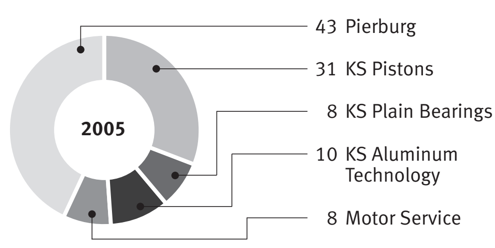
At €146 million, Kolbenschmidt Pierburg once again exceeded the previous year's very good EBIT of €139 million (up 5 percent). Last fiscal year, the Kolbenschmidt Pierburg Group's EBIT margin amounted to 7.1 percent (down from 7.2 percent).

Breakdown of Automotive sales by region *in %*



Based on corporate sector Automotive sales of €2,050 million

Breakdown of Automotive sales by division *in %*



Based on corporate sector Automotive sales of €2,050 million

Within the Kolbenschmidt Pierburg Group, sales were shifted from Germany to production plants of German carmakers elsewhere in Europe, mainly in Austria, Hungary, and Poland. The sales gain in North and Central America was mainly generated in the United States while Brazil was the most important growth market in South America. Efforts in Asia led to dynamic growth, mainly in terms of tripled exports to China. Customers in Japan and India, too, stepped up easily in double-digit range the number of components ordered under current contracts. The Asian sales do not account for those proratable to the Chinese joint ventures (which are carried at equity).

Earnings stable at Pierburg. In the Pierburg division, sales climbed by 1.6 percent to €903 million. Shrinking demand for secondary air systems was outcompensated by higher sales of throttle bodies and intake manifolds as well as water and vacuum pumps. As in 2004 and at €68 million, the Pierburg division again contributed the highest amount to the Automotive sector's EBIT. Alongside sales-related improvements in earnings at the Italian and French companies, the steep EBIT rise at the Czech company played an appreciable role, this company having been burdened by start-up costs a year ago. Lower sales (as budgeted) by Carbureibar, Spain, and sinking investment income at Pierburg GmbH, especially from the Chinese joint venture, were reflected in the division's earnings. In 2005, the Pierburg division's EBIT margin remained at a virtually unchanged 7.5 percent.

Vigorous sales growth at KS Pistons. The Pistons division closed 2005 with sales at €638 million. The reason for the almost 10-percent rise over the previous year, also reflected in earnings, was particularly the good operating performance of the German, Czech and Japanese companies as well as the large-bore piston plants in the United States, which posted double-digit sales growth. Apart from KUS Canada Inc., the other companies, too, broadened their sales volume.

At €39 million, EBIT reported for 2005 exceeded the year-earlier figure by 5.4 percent. Due to unfavorable currency parities when compared to the previous year, rising sales of the Brazilian company mainly exporting into the US dollar region, failed to translate into higher earnings. In fiscal 2005, the EBIT margin came to 6.1 percent, following 6.4 percent in 2004.

The Plain Bearings division continued the previous years' steady uptrend. In the year under review, sales climbed around 7 percent to €171 million, with all product groups contributing. Apart from the continuous casting product unit, not only showing a quantitative growth but also having managed to pass materials price increases on to customers, the main sales generator was the high demand in the Permaglide and Metal Bearings product groups.

Plain Bearings stepped up EBIT by €1 million to €18 million. Slightly lower earnings at the German and Brazilian companies were outperformed by the continuing upswing at the North American company benefiting from sales gains and further operating improvements. The EBIT margin amounted to 10.5 percent (down from 10.6 percent).

KS Aluminum Technology again on the road to success. The Aluminum Technology division continued on the course of success. Sales were revved up by around 15 percent to €210 million. The low-pressure diecasting unit benefited strongly from the start-up and capacity production of new products. The pressure-casting unit, too, generated higher sales.

Automotive sector

Mostly the incremental contribution margins from sales increases and an improved production cost structure boosted EBIT to €9 million. KS Aluminum Technology thus enhanced its EBIT margin to 4.3 percent (up from 2.7 percent).

Despite difficult market situations in Western Europe as well as the Near, Middle and Far East, the Motor Service division held its ground with sales at €160 million almost equaling the 2004 level of €161 million. Heavy pricing pressure in Germany was reflected in receding sales. Due to the also strong price competition in local currency, the division had to cope with lower sales in Brazil, too. In euro terms due to currency translation effects, sales rose.

At year-end 2005, Motor Services posted an EBIT of €10 million (down from €13 million). Apart from integration outlays for the Trost engine parts operations acquired in 2004, keener price competition meant that upstream material price increases were only partly, if at all, downloaded onto customers. In Brazil, adverse exchange rates depressed earnings additionally in dollar-based export business. In 2005, the Motor Service division's EBIT margin therefore dropped to 6.3 percent (down from 8.1 percent).

When it comes to piston manufacture, cost efficiency, dependability and quality are the key criteria. To ensure compliance, Martin Weissert (43) continuously hones the manufacturing processes used in the newest generation of pistons.
One Step Ahead

Defence sector

Defence indicators *€ million*

Rheinmetall Defence	2004	2005
Sales	1,384	1,402
Order intake	1,102	1,553
Order backlog (Dec. 31)	2,418	2,565
EBIT	77	97
EBT	56	77
Employees (Dec. 31)	6,799	6,741
Average capital employed	496	527
EBIT margin (%)	5.6	6.9
ROCE (%)	15.5	18.4

Fiscal 2005 highlights. In February 2005, a contract for ordnance repair logistics was signed between HIL GmbH and the German armed forces. HIL GmbH is jointly owned by the Federal Government at 49 percent and, with a 51-percent interest, by Bonn-based HIL Industrie-Holding GmbH, in which Krauss-Maffei-Wegmann GmbH & Co. KG, Industriewerke Saar GmbH (Diehl) and Rheinmetall Landsysteme GmbH each hold a one-third stake.

With the acquisition of a 50-percent stake in AEG Infrarot-Module GmbH (AIM), Heilbronn, Rheinmetall Defence Electronics GmbH expanded its ability to produce and supply observation and reconnaissance equipment.

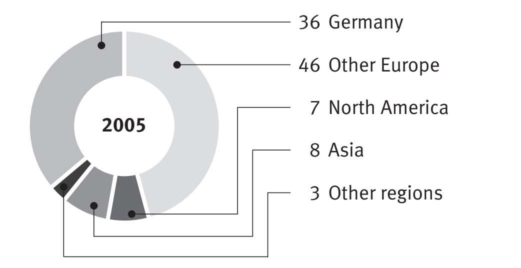
Rheinmetall Waffe Munition GmbH acquired 100 percent of the shares in ARGES GmbH, based in Schwanenstadt, Austria. With this takeover the protection systems/pyrotechnics unit expanded the 40-mm ammunition product range, thus strengthening its position as a leading supplier in this globally growing submarket.

A significant order booked by the Defence Electronics division in 2005 was the contract to supply simulators for the NH90 private finance initiative program worth €34 million. Rheinmetall Defence Electronics GmbH, Thales, Eurocopter, and CAE each hold a 25-percent stake in the company established for this purpose, HFTS (Helicopter Flight Training Services) GmbH.

In a bid to strengthen competitiveness and safeguard profitability, Oerlikon Contraves AG is to concentrate in future on the company's core capability as a leading supplier of close-range air defence systems. In the course of consistent orientation toward integrated systems, measures were taken in 2005 to adjust the structures of operations not directly related to this core business and to outsource accordingly. As a consequence, Oerlikon Contraves AG is gaining the required flexibility to respond quickly to market changes while taking the customers' rising local content requirements into account. The necessary restructuring measures also include the relevant headcount adjustment. The non-core nonmilitary Mass Transit business (communication for rail vehicles) located at St.-Jean-sur-Richelieu, Canada, will be discontinued due to poor profitability once the order backlog has been worked off by 2007 at the latest.

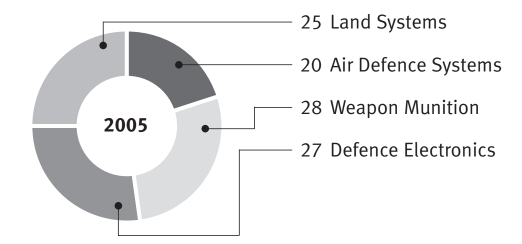
Business volume burgeoning. In fiscal 2005, the Defence sector achieved sales of €1,402 million, up from €1,384 million. The Weapon Munition division accounted for 28 percent of these sales, Defence Electronics for 27 percent, and the Land Systems and Air Defence Systems divisions for 25 and 20 percent, respectively. Business outside of Germany in 2005 once again rose, by two percentage points to 64 percent, thus underlining Rheinmetall Defence's continued efforts to expand its international activities. The chief export region remained Europe, which accounted for 46 percent of total export sales. Asia and North America contributed 8 and 7 percent of sales, with other regions making up 3 percent.

Breakdown of Defence sales by region *in %*



Based on corporate sector Defence sales of €1,402 million

Breakdown of Defence sales by division *in %*



Based on corporate sector Defence sales of €1,402 million

At €1,553 million, the sector's order intake exceeded the prior-year €1,102 million by 41 percent. This encouraging rise was largely attributable to an increase in megacontracts awarded to the Land Systems division.

In fiscal 2005, Defence's EBIT climbed 26 percent from the year-earlier €77 million to €97 million.

In the period under review, sales by Land Systems inched up 2 percent from €342 million in 2004 to €349 million. Work invoiced in connection with the development contract for the new Puma infantry fighting vehicle was a mainstay of sales during fiscal 2005. Other significant sources were the delivery of eight tank howitzers and six NBC Fuchs armored reconnaissance vehicles to the Dutch armed forces, the invoicing of recovery vehicles shipped to Switzerland and Greece, and the supply of recovery vehicle kits to Spain. The delivery of air start units (mobile devices for starting up aircraft engine), especially to the US Navy, also made a key contribution to sales.

Surging order intake at Land Systems. Land Systems' order book swelled from €278 million to €655 million, representing a 135-percent hike. The booking of an order for 32 Fuchs NBC armored reconnaissance vehicles from the United Arab Emirates boosted incoming business considerably. At home, Land Systems secured an order for five preseries units of the new Puma infantry tank. In addition, orders for 181 armored special-purpose vehicles, used to protect troops in the field, ramped up domestic order inflow. In detail, the procurement contract comprises the supply of 81 series-produced BV 206 S-type command and transport vehicles as well as 100 armored multipurpose Yak vehicles. With their flexibility, air transportability and fast availability in the field, these light armored vehicles effectively support airborne task forces.

Land Systems' EBIT increased by 27 percent to €28 million (up from €22 million), the EBIT margin coming to 8.1 percent (up from 6.4 percent).

Defence sector

The Air Defence Systems division's sales declined by 8 percent to €286 million, falling short of the prior-year €310 million owing to postponed contract awards and program delays, especially abroad. Stationary air defence systems remained the prime sales motor, the new-generation Skyshield and Millennium systems again accounting for an increasing share of sales. Notable individual projects included the supply of additional Skyshield fire control units to Spain as well as the modernization of Skyguard fire units with Sparrow missile launchers for Greece. Apart from air defence systems business, orders for battlefield and information management products made a significant contribution to sales.

Market applauds battle management systems. During the period under review, Air Defence Systems recorded an order intake of €169 million (up by 3 percent). Combat upgrade and modernization programs outside of Europe together with extensions to systems already in use formed a prime source of incoming orders. The battle management systems of the Canadian subsidiary again ensured success in the domestic market, with the first contracts also being secured from the Netherlands and Greece. In addition, the first significant orders were booked from Belgium for the Arrows weapon station, which will also serve as a reference for marketing the system in other European countries.

Owing to shrinking sales and the restructuring drive launched at the Zurich plant, Air Defence Systems posted a red EBIT of €1 million (down from a black €17 million a year ago).

At €402 million, the Weapon Munition division's sales matched the prior-year level and again contributed the lion's share of Defence's business volume. A domestic development contract for 120-mm high-explosive ammunition and ultramodern tank ammunition for engaging armored weapon systems and concealed surface targets as well as the shipment of the light naval gun to the German navy under long-term supply contracts generated most of the revenues in 2005. Shipments of the BK 27 board cannon for the Eurofighter and of the MASS naval protection system, an automated decoy system for protecting vessels against sensor-controlled missiles, also made a key impact on sales. The new, forward-pointing Public Security products segment generated its first sales with shielding systems for major power plants in Germany. In addition, propellant powder for tank ammunition supplied to the British army represented sizeable individual orders.

Weapon Munition ups order intake. The division's order inflow increased by 11 percent from the prior-year €415 million to €459 million. Most notable among the orders booked during the period were the contracts for the supply of new 120-mm DM 63 ammunition to the German armed forces and Turkey and for the shipment of artillery charge systems to various European customers, especially the UK. Other significant orders included contracts with the German armed forces for the supply of bazooka practice ammunition and the preseries contract for equipping the new Puma infantry tank with the 30-mm/ABM automatic cannon. Thanks to its ability to fire air burst ammunition, the Puma infantry tank can combat a broad range of modern battlefield threats. Additionally, the Public Security business booked further orders for shielding systems for large power plants in Germany.

Following the successful conclusion of restructuring measures in the large- and medium-caliber product groups, Weapon Munition's EBIT of €44 million exceeded the year-earlier €26 million by 69 percent. The EBIT margin came to 11.1 percent (up from 6.6 percent).

Megaprojects fuel growth at Defence Electronics. Thanks to encouraging sales of reconnaissance, command and fire control products, Defence Electronics' revenues increased by 7 percent to 383 million (up from €357 million). During the year under review, major contracts with delivery periods extending over several years were a prime source of the division's sales.

In the new Public Security unit Markus Vatheuer (39) works on solutions for maintaining domestic security—systems for safeguarding national borders and sensitive infrastructure elements against terrorist threat. **One Step Ahead**

Defence sector

For example, further fire command systems for the Leopard 2 battle tank were supplied to Spain and work was performed on a development contract from Germany for the series production of unmanned air vehicles for target detection (KZO drone). Approval was granted in September 2005 for the supply of six series systems up to 2007. In addition, 2005 saw the start of series production of training simulators for the new Tiger combat helicopter destined for the Franco-German training center based in Le Luc in southern France. Additional sources of sales were the shipments of the Asrad air defence system to Greece and Finland and of observation and reconnaissance equipment for the German-Dutch Fennek reconnaissance vehicle.

Defence Electronics' order intake increased by 11 percent from the year-earlier €275 million to €305 million chiefly due to increased orders for aircraft systems. The booking of an order for the supply of 180 freight loading systems for the Airbus A400M military aircraft worth €72 million was a key highlight. Additional significant new business included the order from the German armed forces linked to the project-related deployment guaranty for the KZO drone for target detection and the contract to supply four full-mission simulators for the Nato NH90 helicopter.

Defence Electronics' EBIT reached €27 million (up from €22 million), representing a rise of 23 percent. The EBIT margin came to 7.1 percent (up from 6.2 percent).

Risk management system

Risk policy. Given the growing dynamism and complexity of markets and market conditions, entrepreneurial decisions increasingly hinge on the reliable assessment of potential risks. As an internationally operating technology group, Rheinmetall is exposed to a variety of risks, differing according to division, industry, and region. Hence, there is a necessity to identify potential risks early on and to contain them so that any jeopardy for the Group as such may be ruled out. The corporate policy aims at seizing or optimizing potential rewards as they surface, exploiting and expanding success potentials, avoiding, minimizing or offsetting any accompanying risks insofar as possible.

Risk management. It is the Executive Board that formulates the Group's risk strategy and defines accountabilities, communication channels, the documenting of and response to identified risks besides laying down the thresholds and tolerance levels. This multitier groupwide uniform risk management system makes sure that decisions of major business impact and ongoing routine business activities stay within defined risk limits and comply with legal requirements.

On the basis of a comprehensive risk inventory, the operating units and corporate departments record, map, profile, examine and communicate monthly according to prescribed uniform parameters any risks associated with the present business situation and future developments, their financial impact and probability of occurrence as well as measures directed at adequately coping with these. This system is supplemented by an ad-hoc reporting obligation in the event of unexpectedly occurring material risks or undesirable developments. This anticipative risk surveillance procedure is completely integrated in the ongoing multistage planning, controlling and management processes with groupwide guidelines, monthly reporting, regular talks with risk owners/managers and periodic reports to the Executive and Supervisory Boards.

As an independent department, Internal Auditing examines processes, systems and structures throughout the Group for workability, adequacy, reliability and cost efficiency. Any deficiencies or weak points uncovered in the course of these audits are straightened out in conjunction with the management responsible. In the course of their annual auditing, the statutory auditors reviewed the early risk identification system for risks and found nothing to criticize.

Risk diversification. Rheinmetall works on the assumption that dissimilar economic trends in the Automotive and Defence sectors can be balanced by diversified product portfolios for customers in various branches and a broad geographic risk spread.

The Automotive sector companies contribute around 60 percent of sales at the Rheinmetall Group. The auto industry climate and the business situation in this market have a major impact on the Kolbenschmidt Pierburg Group, its sales and earnings. Parallel to the shortening product lifecycles, the carmakers are exposed to fierce competitive, innovative and cost pressure, which they attempt to hand down to their suppliers.

Kolbenschmidt Pierburg addresses the effect of such trends by investing in new products, applying modern manufacturing techniques and cost-saving process technologies, high internal process efficiency, the implementation of savings potential and cost reductions. Possibly declining developments in auto demand in individual countries are countered by targeted expansion of international presence. Advantageous economic conditions for expanding locations and extending production capacities are exploited. In addition, the diversified customer structure ensures compensation for production fluctuations at individual carmakers.

Risk management system

Rewards. At Automotive, rewards arise in particular through the upturn in the global auto market. Alongside the growth markets of Asia, the high-volume core markets of Western Europe and the United States play a major role. Against the backdrop of discussions being conducted in the United States regarding the diesel engine as an alternative to conventional gasoline engines due to the high price of fuel, the Kolbenschmidt Pierburg Group perceives additional opportunities because of its leading technological position. The Group also identifies substantial potentials for diesel technologies in Asia. In addition, innovative products are being developed for applications involving hybrid forms of prime movers.

The newly opened Customer Service Center in Japan is intended to exploit even more efficiently the market opportunities existing in the growth sectors of Asia. In addition, the possibility of entering into alliances in this part of the world is continuously being reviewed. The acquisition of the Mexican Pistones Moresa opens up new prospects in OEM pistons business by optimizing the American plant structures.

There are also potential rewards through acquiring additional orders from the high-growth Asian OEMs, presently underrepresented in the customer portfolio, as well as accelerating growth in the core markets hitherto through operating a low-cost base in this part of the world. Further business opportunities result from increasing outsourcing activity in piston production on the part of various carmakers.

Rheinmetall Defence specializes in equipment for the land forces, specifically armored vehicles, weapons and ammunition plus electronic equipment and the latest air defence systems. Most of the sector's market potential results from the defence budgets of prospective customer countries. The sector's divisions are not directly affected by the economy. The main risks are related to the dependence on public-sector spending in Germany and in a number of foreign countries as well as increasing competition from across the Atlantic. On the sector's export markets, there is also strong international competition.

Potential rewards for the four division of the Defence sector could be reaped from the changing military needs of the German armed forces, Nato, and the EU forces. The product range has been adapted to address these trends, R&D activities accordingly tuned. Alongside business with the defence ministries, there is growing demand in homeland security, both in Germany and abroad. To address this market, the Public Security unit has been formed. In fiscal 2005, by successively tapping adjacent markets, increased market penetration and project realization in high-growth markets, Rheinmetall Defence exploited market opportunities and lifted its order intake by around €450 million.

Risk areas. It is not possible to fully avert risks linked to economic, market and investment cycles, rapidly evolving technologies and fiercer competition. Uncertainties and changes in the political, economic, fiscal and legal parameters in those countries and regions of relevance to the Rheinmetall Group may impinge on business.

Market risks. In an age of progressing globalization, fiercer competition and growing market transparency, market risks are advancing. This, in turn, can lead to fluctuations in prices, volumes, and profit margins. By concentrating on sophisticated market segments, product innovations, process improvements, timely production adjustments, and strict cost management, the Group can strengthen its competitiveness in the respective sectors and secure and expand its profitability.

The market presence and customer proximity associated with international marketing structures enable the Group to respond in good time to trends and to tailor product strategies to current challenges. Risks in the development of new products are abated by feasibility studies, preinvestment and cost-efficiency analyses, comprehensive project management on the part of seasoned management staff and by monitoring projects for milestone and budget compliance. Technology positions are cemented by filing patent applications.

Developing innovative solutions for supporting troops on dangerous missions is the task of Thomas Drescher (50). Devised under his supervision is a system for day/night friend/foe identification even at long range. **One Step Ahead**

Risk management system

The threat of unexpected delivery problems or unpredicted price increases in the case of commodities, raw materials, parts and components is addressed by ongoing market observation and avoiding dependency on specific suppliers. Global sourcing operations, a careful screening of suppliers, annual supplier audits, alternative suppliers, long-term delivery contracts as well as adequate buffer inventories also reduce risk potentials. Moreover and where possible, contracts stipulate price escalation clauses in order to largely minimize the negative impact of price increases.

Environmental and product risks. Environmental and product risks are abated through eco-friendly production methods, high quality standards, and a host of measures designed to assure and secure quality. These include the certification and approval of processes according to international standards, the ongoing revamping of production plants, and the further development of products.

Technical disruptions at the production plants, unscheduled interruptions and the risk of machinery failures are abated through regular and professional testing, servicing and maintenance work, planned modernization campaigns and targeted investments as well as by concluding the corresponding contracts.

The achievement of ambitious corporate goals and the sustained economic success of the Rheinmetall Group largely depend on the skills, competence and knowledge of the employees. Personnel turnover as well as problems finding qualified technical and management staff with the necessary scientific, engineering or sector skills, may represent a risk which is addressed through attractive pay and pension systems, comprehensive training courses, individual development opportunities, the early identification and advancement of high-flyers as well as consistent management development efforts.

Legal risks include, among others, risks from product claims, implied and express warranties, claims for damages or indemnification, legal actions and pending litigation. Claims and liability risks from ordinary operations are either covered by insurance or reasonably provided for. Risks potentially arising from tax, patent, competition, cartel or antitrust laws or other regulations and statutes are avoided by strictly abiding by such laws, statutes, regulations and provisions. When deciding on and planning business processes, the Group relies not only on extensive advice from its own experts but also involves outside specialists on a case-by-case basis.

Structural reorganization moves. In connection with organizational restructuring processes, outside stockholders instituted three judicial review proceedings, challenging the adequacy of share exchange ratios or the level of cash compensation offered. The Higher Regional Court of Karlsruhe upheld the judgment by the Mannheim Regional Court, according to which a cash compensation of €6.38 is added to the exchange ratio of three Aditron common shares for one preferred share in former KIH Kommunikations Industrie Holding AG. This sum carries interest as from May 5, 2000, at the rate of 2 percentage points above the basis rate. The duration and outcome of the other two review proceedings, which had been instituted in 1998 and 2003 in connection with the Kolbenschmidt Pierburg merger and the Aditron AG squeeze-out, are currently unknown. Rheinmetall AG's Executive Board considers the claims to be unjustified.

M&A transactions, strategic alliances, joint ventures and capital expenditures for tangible assets secure the Rheinmetall Group's successful future development but are subject to risks. State-of-the-art due diligence and feasibility studies, as well as the implementation and subsequent check of such investment decisions are ensured through defined procedures, clearly assigned responsibilities, and multitier approval processes.

Liquidation risks may emanate from the disposal of enterprises and land. As soon as any such risk is identified as likely, it is duly provided for.

Information and data are subject to a variety and, in some cases, growing threats regarding availability, confidentiality, and integrity. Alongside high security standards and groupwide security guidelines, technical and organizational protection and precautionary measures limit the risk of grave disruptions such as system failures, unauthorized data access to communication and information systems as well as possible data loss. A continuous review and modification of the applied information systems ensures a safe processing of IT-based business mechanisms.

In the scope of their business operations, Rheinmetall Group companies are exposed to interest rate and currency risks. While the ongoing process of the globalization of sourcing, production and financing does gradually downscale the impact of exchange rate risks, appropriate marketable financial derivatives are additionally used to hedge against currency and interest rate risks, with the exclusion of any other purposes. Such instruments mainly include currency forwards and swaps, interest rate caps, and currency options. Short positions are avoided throughout. The central cash management system and the deployment of financial instruments (e.g. commercial paper, ABS program, bond issue, bilateral/multilateral credit facilities extended by banks, etc.) ensure that sufficient cash is at all times available to fund operating and investing activities. Adequate accruals provide for potential losses on long-term customer contracts or supply/purchase agreements, as well as for warranty, indemnity and similar risks. The Rheinmetall Group mainly supplies customers of prime standing and hence incurs only extremely few losses through defaulting customers. Credit or nonpayment risks that exist according to current information have been either allowed for or hedged through financial derivatives. The Rheinmetall Group is not exposed to any significant credit risk accumulation. The issuance of guidelines and corporate policies ensures that the framework for due and proper A/R management is established. No dependence on specific customers or countries exists that, upon occurrence of any aggravating circumstances, might jeopardize the Rheinmetall Group's continuance as a going concern.

Overall risk assessment. Major risks or developments with a potentially long-term adverse impact on the Group's net assets, financial position or results of operations are not identifiable. From today's vantage point and in terms of assets and liquidity, no risks exist that might jeopardize in the foreseeable future either the continued existence as a going concern or the future development of Rheinmetall AG or its corporate sectors.

Prospects

World economy on track for stable growth. According to the experts, the world economic climate will brighten again slightly in the current and following years, and growth rates should roughly match the levels of 2004 and 2005. The International Monetary Fund (IMF) forecasts world growth of 4.3 percent in 2006. Economic growth will remain focused on the countries of Asia and Central & Eastern Europe. The Organization for Economic Development and Cooperation (OECD) expects GNP in China to surge by over 9 percent. While the OECD considers the pace of growth in the United States and Japan to be slackening, its economists—noticeably more confident than in the last few years—are predicting a plus of over 2 percent in Euroland.

The key to this is above all the pickup of business activity in Germany. The IFO Institute sees growth potential here of 1.7 percent for 2006. This trend is driven by the consistently good forecasts for export business. And now, for the first time in years, a positive boost is expected from domestic demand.

This scenario is based on the assumption of stabilizing commodity prices and no more than moderate inflation in the industrialized nations. The IMF and OECD see risks for the world economy in the coming years primarily from a further massive increase in oil prices, a significant deterioration in the balance-of-payments situation, particularly in the United States, and changes in the exchange rate policies of the major trading nations. A damper on the international business cycle could also come from a marked rise in long-term interest rates and a reversal in the current uptrend on the capital and property markets.

Automotive industry confident about the future. In view of the generally optimistic economic data, auto manufacturers are also confident about the coming years. For the worldwide production of cars and light commercial vehicles, growth of about 4 percent to some 64 million vehicles is expected for 2006. In the year after, vehicle output is set to grow even faster. For the Triad markets—NAFTA, Western Europe and Japan—the predictions of growth in output of between 1 and 2 percent are somewhat modest. The forecasts for Asia (excluding Japan) and Eastern & Central Europe, on the other hand, with a strong increase in output, point to a continuation of the existing growth surge.

Automotive benefiting again from trends in the industry. The Automotive sector is benefiting from essential trends in the automotive industry. Its product portfolio, marked by its strong commitment to resource conservation, emission reduction, diesel motorization, and the use of lightweight materials, offers the sector further good opportunities for ongoing organic growth.

On the basis of current market forecasts and stable market conditions on the customer and procurement sides, particularly in terms of raw materials and energy, Kolbenschmidt Pierburg is anticipating a further rise in sales in the 2006/2007 two-year period. The motive force behind this growth is Pierburg's US business, set to pick up speed in 2007, and forecasted gains in market shares by the Pistons division in Asia. The growth opportunities for Kolbenschmidt Pierburg are also bolstered by the series start-ups of engine blocks scheduled for the current fiscal year and product innovations in Plain Bearings. Moderate growth in sales is anticipated in the after-market business for 2006 and 2007.

Against the background of still high operational performance, Kolbenschmidt Pierburg is reckoning with an EBIT that will edge down in fiscal 2006 because of additional internationalization efforts. The goal of these measures is to balance capacity within and between the various production regions for market, competition and cost reasons. This will pave the way for achieving the Rheinmetall Group's high financial indicator benchmarks. For 2007, Kolbenschmidt Pierburg expects earnings to return to buoyancy with further improved costs and higher sales.

Heinrich Dismon's (42) team develops new and innovative products such as EGR systems and components that go into alternative propulsion systems to ensure that rising standards of emission control and fuel consumption are comfortably addressed. **One Step Ahead**

Prospects

Multinational missions making their mark on defence budgets. The defence technology business factors crucial to Rheinmetall are set to improve further in 2006 and 2007. The defence budgets of numerous nations are being increasingly influenced by modernization requirements resulting from obligations to international missions. A growing proportion of defence budgets is being invested in order to meet military requirements for enhanced mobility, reconnaissance capability, and increased protection for soldiers, as well as improved systems networking.

At about €24 billion, the German defence budget remains unchanged but the proportion of matériel spending in the total budget volume is set to rise from 25.6 percent in 2005 to over 28 percent in 2007. The defence budgets of the two high-spending European nations, France and the UK, are expected to climb by around 3 percent to around €34 billion and over €40 billion, respectively.

High order backlog guaranteeing Rheinmetall Defence's growth. Rheinmetall Defence is basing its future corporate development on a product range that is geared to the new deployment scenarios and to the correspondingly adjusted requirements of international armed forces as well as increasingly on the sector's system integration capabilities. Moreover, Rheinmetall Defence's organic growth is guaranteed by the high volume of orders presently on hand.

Rheinmetall Defence is set to match the exceptionally favorable order intake situation with a very encouraging book-to-bill ratio achieved in fiscal 2005, in the current fiscal year and in 2007. Major contributors will be the German armed forces contract for the supply of the new series-produced Boxer armored vehicle, which is anticipated in the current fiscal year, as well as the contract for the series production of the new Puma infantry fighting vehicle in 2007. Alongside these national projects Rheinmetall Defence is also expecting to continue to attract new business internationally, with its export share likely to stabilize at over 60 percent in the years ahead.

Based on the comparatively high proportion of planned sales currently covered by existing contracts, the Defence sector predicts rising sales for the current fiscal year coupled with steady growth in subsequent years. Apart from the start of shipments of series-produced items from the sector's portfolio, crucial additional factors in trend will be growing repair services and modernization programs resulting from the sale of armored vehicles from the German armed forces' stocks to other countries.

Against this background and based on the forecasted growth, Rheinmetall Defence, following a substantial earnings surge in 2005, sees good prospects for consolidating this performance during fiscal 2006 and matching the prior-year earnings. This is dependent on the Land Systems, Weapon Munition and Defence Electronics divisions again making solid profit contributions. Because a number of contracts are being postponed, Air Defence Systems will again have to contend with poorer earnings but on completion of the restructuring steps initiated will then return to profitability starting from 2007.

Rheinmetall looking to strong earnings in 2006. With its two corporate sectors of Automotive and Defence, Rheinmetall has established itself as a respected development partner and systems supplier commanding positions of superiority throughout its markets. What's more, Rheinmetall has the certainty of co-shaping and addressing with its R&D and product ranges major trends in automobile manufacture and in the development of defence equipment.

These are key factors to enable Rheinmetall to continue along the path of profitable growth over the years to come. Assuming no major economic disruptions, Rheinmetall is predicting for both this year and 2007 another advance in sales. The Group reaffirms its goal of an annual organic growth rate of 5 percent.

Rheinmetall has set itself new profitability benchmarks: an EBIT margin of 9 percent and a ROCE of 20 percent within the Group—to be achieved inside a timespan of three to five years. The groundwork for achieving the higher goals has been laid over the past years and is reflected in terms of steadily rising returns. Outstanding action for further strengthening the international customer and production bases in automobile components and for remolding air defence system capacities has been or will be initiated during the months ahead.

Against this backdrop and by further whittling down net interest expense in the wake of its 2005 group finance and debt restructuring moves, Rheinmetall expects 2006 to see a stable level of earnings and 2007 to yield another profit upturn.

Düsseldorf, March 6, 2006

Rheinmetall AG
The Executive Board

Eberhardt Dr. Kleinert Dr. Müller

This management report contains statements and forecasts referring to the Rheinmetall Group's future development which are based on assumptions and estimates by management. If the underlying assumptions do not materialize, the actual figures may differ from such estimates. Elements of uncertainty include changes in the political, economic and business environment, exchange and interest rate fluctuations, the introduction of rival products, poor uptake of new products, and changes in business strategy.

Consolidated financial statements 2005
Rheinmetall AG

Consolidated balance sheet as of December 31, 2005

ASSETS *€ million*

	12/31/2004	12/31/2005	Note
Intangible assets	411	417	(6)
Tangible assets	991	1,052	(7)
Investment properties	31	13	(8)
Shares in investees carried at equity	32	64	(9)
Noncurrent financial assets	8	7	(13)
Other noncurrent assets	8	5	(12)
Deferred tax assets	48	61	(30)
Total noncurrent assets	**1,529**	**1,619**	
Inventories	653	638	(10)
less prepayments received	(28)	(32)	
	625	606	
Trade receivables	387	481	(11)
Current financial assets	29	26	(13)
Other current receivables and assets	267	271	(12)
Income tax assets	5	12	
Cash & cash equivalents	258	408	(14)
Total current assets	**1,571**	**1,804**	
Total assets	**3,100**	**3,423**	

EQUITY & LIABILITIES *€ million*

	12/31/2004	12/31/2005	Note
Capital stock	92	92	
Additional paid-in capital	208	208	
All other reserves	355	449	
Group earnings (after minority interests)	96	113	
Treasury stock	(22)	(34)	
Stockholders' equity	**729**	**828**	
Minority interests	50	47	
Total equity	**779**	**875**	(15)
Accruals for pensions and similar obligations	487	514	(16)
Other noncurrent accruals	134	107	(17)
Noncurrent financial liabilities	391	397	(18)
Other noncurrent liabilities	8	8	(20)
Deferred tax liabilities	12	15	(30)
Total noncurrent liabilities	**1,032**	**1,041**	
Current accruals	283	290	(17)
Current financial liabilities	21	162	(18)
Trade payables	385	399	(19)
Other current liabilities	550	598	(20)
Income tax liabilities	50	58	
Total current liabilities	**1,289**	**1,507**	
Total equity & liabilities	**3,100**	**3,423**	

Consolidated income statement for fiscal 2005

€ million

	2004	2005	Note
Net sales	**3,413**	**3,454**	(21)
Net inventory changes, other work and material capitalized	27	9	(22)
Total operating performance	**3,440**	**3,463**	
Other operating income	141	144	(23)
Cost of materials	(1,641)	(1,679)	(24)
Personnel expenses	(1,010)	(992)	(25)
Amortization/depreciation/write-down	(168)	(157)	(26)
Other operating expenses	(560)	(552)	(27)
Operating result	**202**	**227**	
Net interest expense [1]	(71)	(55)	(28)
Net investment income and other financial results [2]	15	(2)	(29)
Net financial result	**(56)**	**(57)**	
Earnings before taxes (EBT)	**146**	**170**	
Income taxes	(45)	(52)	(30)
Group net income	**101**	**118**	
Minority interests	(5)	(5)	(31)
Group earnings (after minority interests)	96	113	
EpS, common stock	€2.64	€3.19	(32)
EBITDA	385	382	
EBIT	217	225	
Adjusted EBIT	224	245	(33)

[1] *incl. €94 million interest expense (up from €82 million)*
[2] *incl. €3 million from investees carried at equity (down from €7 million)*

Consolidated statement of cash flows for fiscal 2005

€ million

	2004	2005
Cash & cash equivalents at January 1 (BoP)	**336**	**258**
Group net income	101	118
Amortization/depreciation/write-down/write-up of intangibles and tangibles	168	157
Change in pension accruals	(5)	2
Cash flow	**264**	**277**
Net result from fixed-asset disposal	(25)	(8)
Change in other accruals	--	(6)
Change in inventories	--	30
Change in receivables, nonfinancial liabilities and prepaid & deferred items	(72)	(40)
Other noncash expenses and income, net	(3)	--
Net cash provided by operating activities [1]	**164**	**253**
Cash outflow for additions to tangible and intangible assets	(183)	(190)
Cash inflow from the disposal of tangible and intangible assets	32	36
Cash outflow for additions to consolidated subsidiaries and financial assets	(25)	(50)
Cash inflow from the disposal of consolidated subsidiaries and financial assets	108	4
Net cash used in investing activities	**(68)**	**(200)**
Dividend paid out by Rheinmetall AG	(24)	(27)
Other profit distribution	(2)	(2)
Treasury stock	(22)	(12)
Financial liabilities incurred	1	325
Financial liabilities repaid	(126)	(193)
Net cash (used in)/provided by financing activities	**(173)**	**91**
Net change in cash & cash equivalents	**(77)**	**144**
Parity-related change in cash & cash equivalents	(1)	6
Total change in cash & cash equivalents	**(78)**	**150**
Cash & cash equivalents at December 31 (EoP)	**258**	**408**

For comments on the cash flow statement, see Note (34).

[1] *included are*
net interest paid at €28 million (down from €43 million)
net income taxes paid at €51 million (up from €46 million)

Statement of changes in equity

€ million

	Capital stock	Additional paid-in capital	*Reserves retained from earnings*	*OCI: currency translation differences*	*OCI: reserves from fair and other valuation*	All other reserves	Group earnings after minority interests	Treasury stock	**Stock-holders' equity**	Minority interests	**Total equity**
Balance at January 1, 2004	**92**	**208**	*293*	*(41)*	*65*	**317**	**63**	**--**	**680**	**56**	**736**
Dividend payments	--	--	*(24)*	--	--	(24)	--	--	(24)	(2)	(26)
Currency translation differences	--	--	--	--	--	--	--	--	--	--	--
Consolidation group changes	--	--	--	--	--	--	--	--	--	(9)	(9)
Transfer to/from reserves	--	--	*63*	--	--	63	(63)	--	--	--	--
Accumulated OCI	--	--	--	*1*	*(2)*	(1)	--	(22)	(23)	--	(23)
Group net income	--	--	--	--	--	--	96	--	*96*	5	101
Balance at December 31, 2004/January 1, 2005	**92**	**208**	*332*	*(40)*	*63*	**355**	**96**	**(22)**	**729**	**50**	**779**
Dividend payments	--	--	*(27)*	--	--	(27)	--	--	(27)	(2)	(29)
Currency translation differences	--	--		*22*	--	22	--	--	22	1	23
Consolidation group changes	--	--	--	--	--	--	--	--	--	(6)	(6)
Transfer to/from reserves	--	--	*96*	--	--	96	(96)	--	--	--	--
Accumulated OCI	--	--	--	--	*3*	3	--	(12)	(9)	(1)	(10)
Group net income	--	--	--	--	--	--	113	--	113	5	118
Balance at December 31, 2005	**92**	**208**	*401*	*(18)*	*66*	**449**	**113**	**(34)**	**828**	**47**	**875**

For comments on equity, see Note (15).

Notes (Group)
Segment reports according to IFRS

Primary segments *€ million*

Corporate sectors	Automotive		Defence		Others/ Consolidation		**Group**	
	2004	**2005**	**2004**	**2005**	**2004**	**2005**	**2004**	**2005**
Net external sales	1,941	2,050	1,384	1,401	88	3	**3,413**	**3,454**
Intersegment transfers	--	--	--	1	--	(1)	**--**	**--**
Total segment sales	1,941	2,050	1,384	1,402	88	2	**3,413**	**3,454**
Net P/L from investees carried at equity	7	2	--	1	--	--	**7**	**3**
Income from write-up	--	--	--	--	--	--	**--**	**--**
Write-down	(3)	(1)	2	(1)	(3)	--	**(4)**	**(2)**
Segment EBIT	139	146	77	97	1	(18)	**217**	**225**
Cash flow from operating activities	222	150	--	143	(58)	(40)	**164**	**253**
Segment assets	1,237	1,379	1,421	1,442	131	121	**2,789**	**2,942**
thereof goodwill	*150*	*151*	*203*	*206*	--	--	***353***	***357***
thereof book values of investees carried at equity	*30*	*40*	*2*	*24*	--	--	***32***	***64***
Segment liabilities	697	725	1,069	1,126	81	65	**1,847**	**1,916**
Segment expenditures (excl. revaluation)	139	163	54	39	--	1	**193**	**203**

Secondary segments *€ million*

Regions	Germany		Other Europe		North America		Asia		Other Regions/ Consolidation		**Group**	
	2004	**2005**	**2004**	**2005**	**2004**	**2005**	**2004**	**2005**	**2004**	**2005**	**2004**	**2005**
Net external sales by customer location	1,236	1,146	1,495	1,561	372	393	194	206	116	148	**3,413**	**3,454**
in % of Group sales	36.2	33.2	43.8	45.2	10.9	11.4	5.7	5.9	3.4	4.3	**--**	**--**
Segment assets[1]	1,664	1,746	717	720	222	252	22	38	164	186	**2,789**	**2,942**
Segment expenditures (excl. revaluation)[1]	97	109	70	53	14	22	5	6	7	13	**193**	**203**

For comments on the segment reports according to IFRS, see Note (35).

1) *Prior-year comparatives restated*

Segment reports according to management structure

€ million

Corporate sectors		Automotive 2004	Automotive 2005	Defence 2004	Defence 2005	Others/ Consolidation 2004	Others/ Consolidation 2005	**Group 2004**	**Group 2005**
Balance sheet (December 31)									
Total equity	(1)	428	516	408	447	(57)	(88)	**779**	**875**
Pension accruals	(2)	241	246	221	243	25	25	**487**	**514**
Net financial liabilities	(3)	(4)	16	(93)	(173)	251	308	**154**	**151**
Capital employed (CE)	(1)+(2)+(3)	665	778	536	517	219	245	**1,420**	**1,540**
Average CE	(4)	695	722	496	527	265	231	**1,456**	**1,480**
Income statement									
Net external sales		1,941	2,050	1,384	1,401	88	3	**3,413**	**3,454**
Intersegment transfers		--	--	--	1	--	(1)	**--**	**--**
Total segment sales		1,941	2,050	1,384	1,402	88	2	**3,413**	**3,454**
thereof Germany (%)		*34.3*	*31.4*	*38.3*	*35.6*	--	--	*36.2*	*33.2*
thereof abroad (%)		*65.7*	*68.6*	*61.7*	*64.4*	--	--	*63.8*	*66.8*
EBITDA		261	263	118	134	6	(15)	**385**	**382**
Amortization/depreciation/write-down		(122)	(117)	(41)	(37)	(5)	(3)	**(168)**	**(157)**
Segment EBIT (acc. to mgt. structure)	(5)	139	146	77	97	1	(18)	**217**	**225**
Net interest expense		(28)	(19)	(21)	(20)	(22)	(16)	**(71)**	**(55)**
EBT		111	127	56	77	(21)	(34)	**146**	**170**
Income taxes		(31)	(41)	(20)	(27)	6	16	**(45)**	**(52)**
Net income/(net loss)		80	86	36	50	(15)	(18)	**101**	**118**
EBIT margin *(%)*		7.2	7.1	5.6	6.9	--	--	**6.4**	**6.5**
Other data									
ROCE *(%)*	(5)/(4)	20.0	20.2	15.5	18.4	--	--	**14.9**	**15.2**
Segment expenditures (excl. revaluation)		133	162	50	35	--	1	**183**	**198**
Order intake		1,950	2,068	1,102	1,553	95	4	**3,147**	**3,625**
Order backlog at December 31		324	342	2,418	2,565	(1)	--	**2,741**	**2,907**
Prepayments received [1]		29	39	435	523	--	--	**464**	**562**
Headcount at December 31		11,364	11,699	6,799	6,741	120	108	**18,283**	**18,548**

For comments on the segment reports according to management structure, see Note (35).

[1] *Prior-year comparatives restated*

Notes (Group)
Fixed-asset analysis

€ million

2004	Gross values				
	01/01/2004	Additions	Disposals	Book transfers	Changes in consolidation group/share-holding
Intangible assets					
Development costs and other internally created intangible assets	32	13	--	--	(5)
Concessions, franchises, industrial property rights and licenses	82	14	3	4	(20)
Goodwill	345	--	--	--	9
Prepayments on intangibles	4	--	--	(4)	--
	463	**27**	**3**	**--**	**(16)**
Tangible assets					
Land, equivalent titles, and buildings (incl. buildings on leased land)	981	9	10	3	(68)
Production plant and machinery	1,593	60	71	44	(107)
Other plant, factory and office equipment	530	28	52	8	(51)
Prepayments on tangibles, construction in progress	71	52	10	(55)	(4)
	3,175	**149**	**143**	**--**	**(230)**
Investment properties	**85**	**7**	**14**	**--**	**(8)**
Total	**3,723**	**183**	**160**	**--**	**(254)**

2005	01/01/2005	Additions [1]	Disposals	Book transfers	Changes in consolidation group/share-holding
Intangible assets					
Development costs and other internally created intangible assets	40	12	1	--	--
Concessions, franchises, industrial property rights and licenses	77	4	2	(3)	--
Goodwill	353	--	1	--	5
Prepayments on intangibles	--	1	--	--	--
	470	**17**	**4**	**(3)**	**5**
Tangible assets					
Land, equivalent titles, and buildings (incl. buildings on leased land)	914	27	8	9	--
Production plant and machinery	1,505	68	71	39	--
Other plant, factory and office equipment	462	29	35	3	--
Prepayments on tangibles, construction in progress	53	64	--	(48)	--
	2,934	**188**	**114**	**3**	**--**
Investment properties	**70**	**--**	**45**	**--**	**--**
Total	**3,474**	**205**	**163**	**--**	**5**

[1] *incl. noncash additions:*
€7 million reclassified from operating into capital leases; €7 million step-up (upon revaluation)

		Amortization/depreciation/write-down								Net values
Currency translation differences	**12/31/2004**	01/01/2004	Additions	Disposals	Book transfers	Write-up	Changes in consolidation group/share-holding	Currency translation differences	**12/31/2004**	**12/31/2004**
--	40	12	2	--	--	--	--	--	14	26
--	77	54	11	3	--	--	(17)	--	45	32
(1)	353	--	--	--	--	--	--	--	--	353
--	--	--	--	--	--	--	--	--	--	--
(1)	**470**	**66**	**13**	**3**	**--**	**--**	**(17)**	**--**	**59**	**411**
(1)	914	446	24	6	--	--	(40)	--	424	490
(14)	1,505	1,227	91	66	1	--	(96)	(10)	1,147	358
(1)	462	425	39	48	(1)	--	(42)	(1)	372	90
(1)	53	9	--	9	--	--	--	--	--	53
(17)	**2,934**	**2,107**	**154**	**129**	**--**	**--**	**(178)**	**(11)**	**1,943**	**991**
--	**70**	**47**	**1**	**4**	**--**	**--**	**(5)**	**--**	**39**	**31**
(18)	**3,474**	**2,220**	**168**	**136**	**--**	**--**	**(200)**	**(11)**	**2,041**	**1,433**

Currency translation differences	**12/31/2005**	01/01/2005	Additions	Disposals	Book transfers	Write-up	Changes in consolidation group/share-holding	Currency translation differences	**12/31/2005**	**12/31/2005**
--	51	14	3	1	--	--	--	--	16	35
1	77	45	9	2	--	--	--	1	53	24
--	357	--	--	--	--	--	--	--	--	357
--	1	--	--	--	--	--	--	--	--	1
1	**486**	**59**	**12**	**3**	**--**	**--**	**--**	**1**	**69**	**417**
10	952	424	23	6	--	--	--	5	446	506
44	1,585	1,147	89	65	6	--	--	30	1,207	378
10	469	372	33	33	(6)	--	--	6	372	97
2	71	--	--	--	--	--	--	--	--	71
66	**3,077**	**1,943**	**145**	**104**	**--**	**--**	**--**	**41**	**2,025**	**1,052**
--	**25**	**39**	**--**	**27**	**--**	**--**	**--**	**--**	**12**	**13**
67	**3,588**	**2,041**	**157**	**134**	**--**	**--**	**--**	**42**	**2,106**	**1,482**

Notes (Group)
Accounting principles

(1) General. The consolidated financial statements of Rheinmetall AG and its subsidiaries for fiscal 2005 have been prepared in due accordance with all current International Financial Reporting Standards (IFRS) whose application in the European Union (EU) was obligatory at the balance sheet date, as well as with the supplementary regulations of Art. 315a (1) German Commercial Code ("HGB").

The revised IAS 1 has entailed a balance sheet reclassification and, therefore, the consolidated balance sheet has been classified according to maturities; the prior-year comparatives have been restated accordingly. Assets and liabilities falling due or maturing within one year are generally deemed current, while pension accruals and deferred taxes are throughout considered noncurrent. The remaining changes in new and revised Standards have not resulted in any substantive changes in comparison to prior periods.

When applying the revised Standards, the transitional provisions have been duly observed.

Application of the published IFRS 6, *Exploration for and Evaluation of Mineral Resources*, the IAS 19 appendix for *Actuarial Gains and Losses*, the amendment to IFRS 4 for *Financial Guarantee Contracts* and the appendix to IAS 39 *Fair Value Option*, as well as of the Interpretations published by the IFRIC (IFRIC 4, *Determining whether an Arrangement Contains a Lease*, and IFRIC 5, *Rights to Interests Arising from Decommissioning, Restoration and Environmental Rehabilitation Funds*), is obligatory as from January 1, 2006. IFRIC 6, *Liabilities Arising from Participating in a Specific Market—Waste Electrical and Electronic Equipment*, must be applied for fiscal years commencing on or after December 1, 2005. Moreover, the IFRIC published IFRIC 7, *Applying the Restatement Approach under IAS 29 Financial Reporting in Hyperinflationary Economies*, IFRIC 8, *Scope of IFRS 2* (both to be applied for fiscal years commencing on or after March 1, 2006), and IFRIC 9, *Reassessment of Embedded Derivatives* (application obligatory for fiscal years commencing on or after June 1, 2006), but these Interpretations have not yet been adopted by the EU. Application of IFRS 7, *Financial Instruments: Disclosures*, and of the IAS 1 amendment, *Capital Disclosures*, is mandatory as from January 1, 2007. While none of the aforementioned Standards or Interpretations have been applied early by Rheinmetall, no significant effects on the consolidated financial statements are expected from their future application.

In contrast, Rheinmetall opted for the voluntary early application of the amendment to IAS 39, *Cash Flow Hedge Accounting of Forecasted Intragroup Transactions*, but this early application has not had any significant impact on Rheinmetall's consolidated financial statements.

For enhanced transparency of presentation, certain items of the consolidated balance sheet and income statement have been subsumed in captions but are broken down and detailed further below in these notes. The consolidated income statement has been prepared in the total-cost format. Additional financial statements include a consolidated statement of cash flows and a statement of changes in equity.

The consolidated financial statements are presented in euro (€). Unless otherwise stated, amounts are throughout indicated in € million (including prior-year comparatives).

The fiscal year of Rheinmetall AG and its consolidated subsidiaries equals the calendar year. Rheinmetall AG (Local Court of Registration: Düsseldorf, Commercial Register no. HRB 39401) has its registered office in Düsseldorf at Rheinmetall Allee 1.

Based on the provisions of Art. 264 (3) HGB, disclosure of the following German subsidiaries' financial statements has been waived: Rheinmetall Berlin Verwaltungsgesellschaft mbH, Rheinmetall Verwaltungsgesellschaft mbH, Rheinmetall Industrie Ausrüstungen GmbH, Rheinmetall Industrietechnik GmbH, MEG Marine Electronics Holding GmbH, Rheinmetall Versicherungsdienst GmbH, Rheinmetall Immobiliengesellschaft mbH, Rheinmetall Waffe Munition GmbH, Rheinmetall Defence Electronics GmbH, and Rheinmetall Wohnungen GmbH.

(2) Consolidation group. Besides Rheinmetall AG, the consolidated financial statements include all German and foreign subsidiaries in which Rheinmetall AG holds the majority of voting rights (whether directly or indirectly) or whose financial and business policies are otherwise controlled by the Group. Generally, companies are newly consolidated or deconsolidated when the interest therein is transferred (acquired or disposed of). Associated affiliates (i.e., companies in which a stake between 20 and 49 percent is owned and over which a controlling influence is exercised) and joint ventures are stated at equity.

Consolidation group: companies included

	12/31/2004	Additions	Disposals	**12/31/2005**
Fully consolidated companies				
Germany	53	--	5	48
abroad	40	5	3	42
	93	**5**	**8**	**90**
Investees carried at equity				
Germany	3	4	--	7
abroad	5	2	--	7
	8	**6**	**--**	**14**

In the year under review, five subsidiaries were newly consolidated while 8 companies (including 3 non-German) retired from the consolidation group.

The shares (newly or additionally) acquired in the year under review in the following fully consolidated companies are reportable in particular:

– Rheinmetall Waffe Munition ARGES GmbH, Schwanenstadt/Rüstorf, Austria: 100 percent of the shares taken over in March 2005 at a price of €8 million (€8 million goodwill);
– Kolbenschmidt Pierburg AG, Düsseldorf, Germany: additional stock acquired by December 2005 (now 97 percent held) at a total price of €3 million; newly created goodwill: €1 million;
– Eurometaal Holding N.V., Amstelveen, Netherlands: stake increased in May 2005 from 85 to 100 percent at a price of €4 million.

In the year under review, a total €15 million has been negotiated for the acquisition of shares in subsidiaries (down from €21 million).

The following divestment in 2005 of shares in a fully consolidated subsidiary is reportable:

– MEG Marine Electronics GmbH, Hamburg, Germany: sold and transferred in August 2005 at a price of €16 million.

The prices negotiated for the disposal of fully consolidated subsidiaries totaled €16 million (down from €110 million).

All major consolidated subsidiaries and the material investees stated at equity are listed separately after these notes to Rheinmetall's consolidated financial statements. A comprehensive listing of the shareholdings of Rheinmetall AG has been deposited with the Commercial Register of the Local Court of Düsseldorf (HRB 39401).

Notes (Group)
Accounting principles

(3) Consolidation principles. The financial statements of consolidated German and foreign companies are prepared in accordance with groupwide uniform accounting and valuation methods.

Subsidiaries included for the first time are consolidated according to the purchase method, specifically the full revaluation method under the terms of IFRS 3, by contrasting the cost of shares acquired against the subsidiaries' prorated equity revalued as of acquisition date. Cost equals the fair values of the assets given, liabilities assumed, and equity instruments issued by the acquirer, in exchange for the acquisition, plus any related direct costs. Any remaining difference is capitalized as goodwill within intangible assets.

Any residual badwill is immediately released to other operating income.

When additional shares in consolidated subsidiaries are acquired, the difference between purchase price and minority interests is recognized as goodwill.

The value of goodwill is tested once annually for, and during the year if signs hint at, impairment by comparing the book value to the recoverable amount, the latter generally being determined from the value in use. If and when the value in use is below book value, it is tested whether the net fair value (NFV: fair value less costs to sell) is higher. The impairment loss is then charged as write-down at the difference between book value and recoverable amount. A cash-generating unit's value in use is calculated according to the DCF method, discounting future cash flows over a 3-year detailed corporate planning period and based on empirical and current forecast data.

Key planning assumptions by Automotive are based on the sector forecasts underlying sales plans and covering the worldwide automotive market trend, the planned engine programs of carmakers, specific customer commitments to individual projects, as well as on Automotive-specific adjustments to allow for planned product innovations and cost savings.

Within the Defence sector, planning is substantially predicated—besides on projects and inquiries already included in its order backlog—on national defence budgets of EU nations and the Nato, duly allowing for new-market access and cost-paring programs.

The discount rate applied is the current WACC of an unchanged 9.0 percent. For the period after the last planning year, a growth allowance of 0 percent (Automotive) or 1 percent (Defence) is deducted from the risk-specific pretax discount rate.

Goodwill impairment losses are immediately recognized as write-down in the corresponding income statement line.

Minority interests in the consolidated equity of subsidiaries (including those in profit and loss) are recognized and disclosed as such in the balance sheet. The hidden reserves and burdens, as well as the related profits or losses, are disclosed on acquisition through the recognition at fair value of minority interests.

Expenses, losses, income and gains from intragroup transactions, as well as intercompany receivables/payables and contingent liabilities are all mutually offset. Intragroup trade transfers are based on both fair market prices and intragroup transfer prices as if at arm's length. Intercompany profits and losses are eliminated unless insignificant. Unless allocable to goodwill, deferred taxes are recognized for all temporary differences from the consolidation of receivables/payables, income/expenses, and the elimination of intercompany profits/losses.

Shares in associated affiliates and joint ventures are throughout stated at equity. Taking the historical cost of the shares as of the date of their acquisition, the investment book value is increased or decreased to reflect such changes in the equity of these associated affiliates/joint ventures as are allocable to the Rheinmetall Group.

To determine the goodwill (if any) of investees carried at equity, principles analogous to full consolidation are adopted, capitalized goodwill being mirrored in the investment book value and tested once a year for impairment.

(4) Currency translation. The functional currency concept has been adopted to translate the annual financial statements of non-German group companies into euros. As a rule, their functional currency corresponds to the local currency as the currency of the primary business environment in which such companies operate. Therefore, assets and liabilities are translated at the mean current, and the income statements at the annual average rates. The translation differences resulting herefrom are recognized in, and only in, equity as accumulated other comprehensive income (OCI). Goodwill created from the capital consolidation of a newly acquired non-German company is assigned to the acquiree and translated at the current rate of the acquiree's functional currency, the goodwill of pre-2004 acquirees being carried at amortized cost and also translated at the current rate.

In the local-currency financial statements of consolidated companies, currency receivables and payables as well as cash & cash equivalents are all translated at the current closing rate. Currency translation differences are duly recognized in the net financial result.

(5) Accounting and valuation methods. Rheinmetall AG's consolidated financial statements are prepared on the basis of groupwide uniform, consistently applied accounting and valuation principles.

The proratable equity of investees carried at equity is valued according to analogous principles.

Cost. Intangible and tangible assets as well as inventories are stated at (purchase or production) cost.

Purchase cost includes the purchase price and all direct purchase incidentals.

The production cost of internally made assets which from future economic benefits are likely to flow to the Group and whose value can be reliably determined, includes the costs directly allocable to the production or conversion process, as well as reasonable portions of production-related overheads, the latter comprising, inter alia, indirect materials and indirect labor, as well as production-related depreciation and social security expenses, all based on normal workloads.

Financing or borrowing costs are not capitalized as part of cost.

Subsidies and grants. Public subsidies and customer grants or allowances which by their nature are considered investment grants are directly offset against the capital expenditures, whereas any grants or allowances for expenses for purposes other than investing activities are deferred as income and released to net income when the related expenses are incurred. Where the effect of interest from discounting is material, long-term deferred income is carried at the settlement amount discounted as of the balance sheet.

Notes (Group)
Accounting principles

Impairment of assets. Where certain signs indicate that the value of an intangible or tangible asset may be impaired, and if the recoverable amount is below amortized or depreciated cost, write-down is charged. When the reasons for write-down have ceased to exist, the asset is written up to an amount not exceeding its amortized or depreciated cost excluding write-down.

For goodwill impairment testing, see Note (3), *Consolidation principles*.

Intangible assets. Intangible assets are capitalized at cost. R&D costs are principally expensed. However, development costs are capitalized and amortized on a straight-line basis if a newly developed product or process can be clearly defined, technologically realized and used either internally or is destined for marketing (IAS 38), and if there is a reasonable assurance that its costs will be recovered by future cash inflows.

Intangibles break down into indefinite-lived and finite-lived assets, the latter-category intangible assets being amortized by straight-line charges from the date of first use over their economic lives.

The following unchanged useful lives underlie amortization:

Intangible assets

	Years
Concessions, franchises, and industrial property rights	3–15
Development costs	5–7

Intangible assets with an indefinite useful life are defined as assets from which a company will derive benefits for an unforeseeable period of time, and are hence not amortized but their value is tested once annually for impairment. Within the Rheinmetall Group, this applies solely to goodwill.

Tangible assets. Tangible assets are carried at depreciated cost less any write-down. Tangible assets (if finite-lived) are generally depreciated on a straight-line basis over their estimated useful lives unless in exceptional cases another method better reflects the pattern of use.

The following unchanged asset depreciation ranges (ADR) apply to buildings, plant and equipment within tangible assets:

Tangible assets

	Years
Buildings	20–50
Other structures	8–30
Equivalent titles	5–15
Production plant and machinery	3–20
Other plant, factory and office equipment	3–15

Essential plots of land owned for business purposes are stated according to the alternative revaluation method of IAS 16 at their fair values, which regularly equal market values. Generally accepted valuation techniques are used to determine fair market values, which are in most cases based on the expert reports of an independent appraiser (updated as of December 31, 2005).

Capital leases. Tangible assets obtained under capital leases are capitalized at the lower of their fair values or the present value of minimum lease payments and depreciated over the shorter of their estimated useful lives or underlying lease terms (IAS 17).

Investment properties. These are properties held for investment, i.e., to earn rental income or benefit from long-term capital appreciation, and not for use in production or administration.

Investment properties are carried at depreciated cost. The fair market value of investment properties, determined according to generally accepted valuation techniques and substantially based on values indicated by an independent appraiser (updated as of December 31, 2005), is stated in Note (8).

Financial assets. The shares in nonconsolidated group companies and in associated affiliates other than those carried at equity and the other long-term securities, are all shown as financial assets available for sale and therefore carried at their fair values. Where such fair market values are not reliably determinable, such assets are carried at amortized cost. Gains and losses, while unrealized, are shown in the OCI as reserves from fair and other valuation but, upon financial-asset disposal, are recognized in net income. However, if and when substantiated evidence hints at a financial asset's impairment, even unrealized losses are recognized in net income.

Initial measurement is based on the value at settlement date.

In accordance with IAS 39, long-term loans bearing interest at fair market rates are carried at amortized cost, whereas non- or low-interest loans are discounted and shown at their present values.

Receivables. Receivables are capitalized at fair value and thereafter carried at amortized cost. Adequate allowances provide for bad debts and doubtful accounts. Receivables sold under an ABS program are offset at their principal against trade receivables and, at the amount of the continuing involvement, shown as both other current receivables and other current liabilities.

Inventories and prepayments received. Inventories are recognized at cost. Risks inherent in inventories due to reduced utility or to obsolescence are adequately allowed for. If the net realizable value (NRV) of any inventories at balance sheet date is below their carrying amount, such inventories are written down to NRV. The write-down either raises the cost of materials (raw materials and supplies) or reduces the net inventory level of finished products and work in process. If the NRV of inventories previously written down rebounds, the ensuing write-up is principally offset against cost of materials (raw materials and supplies) or shown as increase in inventories of finished products and WIP.

Notes (Group)
Accounting principles

Prepayments received from customers for contracts other than dedicated manufacturing or construction contracts under the terms of IAS 11 are, if production cost has already been incurred, openly deducted directly from inventories, any other prepayments being recognized as liabilities.

PoC accounting. Where the criteria and requirements of IAS 11 are met, (longer-term) manufacturing orders or construction contracts from customers are recognized in accordance with their percentage of completion. This method implies that the production cost incurred, plus a markup in line with the percentage of completion, is shown as receivable under manufacturing contracts and within net sales. As a rule, the PoC is determined on a cost-to-cost basis, i.e., at the ratio the expenses incurred bear to anticipated total expenses. Expected losses on manufacturing contracts (so-called onerous contracts) are either covered by appropriate write-down or else provided for, all with due regard to all foreseeable risks. Prepayments received are directly offset against the receivables under manufacturing contracts (“PoC receivables”). If resulting in a negative balance, the corresponding liability is recognized as payable under manufacturing contracts (“PoC payables”).

Deferred taxes. In accordance with IAS 12, deferred taxes are duly recognized on the temporary differences between the values of assets and liabilities in the consolidated balance sheet and those in the individual companies’ tax accounts. Deferred tax assets also include the tax assets receivable from the expected future utilization of tax loss carryovers (if their realization is reasonably certain). Deferred taxes are determined by applying the local tax rates current or reliably anticipated in each country at the balance sheet date.

An unchanged 40 percent is applied to calculate German deferred taxes (corporate income tax, solidarity surtax thereon and municipal trade income tax). Deferred taxation rates outside of Germany range between 20 and 40 percent, comparing with the year-earlier range of 21 to 40 percent.

The deferred tax liabilities for the €7 million temporary differences of shares in group companies and associated affiliates (down from €11 million) were not recognized since Rheinmetall can control the reversal of such differences and the reversal is not probable in the foreseeable future.

Accruals. As required by IAS 19, accruals for pensions and similar obligations are determined, where defined benefit obligations (DBO) are involved, according to the projected unit credit (PUC) method, which is predicated on assumptions such as mortality, expected future pay and pension increases, plan participant turnover rates, interest rate variations, as well as other actuarial parameters. The actuarial gains and losses ensuing from differences between actuarial assumptions and actual trends of the underlying parameters give rise to a gap between the present value of the DBO and the pension liabilities accrued in the balance sheet. Actuarial gains and losses outside a 10-percent corridor of the higher of the DBO’s present value or the plan assets’ fair value are expensed over the average residual service years of employees (as a rule, 10 years). The fair market value of any existing pension fund assets is deducted from pension accruals. Payments to defined contribution plans (DCP), under which the company incurs no obligations other than to pay the contributions to earmarked pension funds, are recognized in net income in the year of their incurrence.

The remaining accruals according to IAS 37 provide at balance sheet date for all identifiable legal and constructive commitments and obligations to third parties if based on past transactions or events and if their amount, due date or maturity is uncertain. Accruals are measured at the best estimate of their settlement amounts. Noncurrent accruals are shown, if the effect of discounting is significant, at the settlement amount discounted as of the balance sheet date. The settlement amount also accounts for identifiable future cost increases.

Liabilities. Pursuant to IAS 39, liabilities are measured at amortized cost, which as a rule equals the settlement or repayment amount.

Payables under capital leases are recognized at the present value of future lease payments.

Contingent liabilities/assets. Contingent liabilities are potential or current obligations arising from past events or indicating that an outflow of resources is unlikely.

Contingent assets are potential assets whose existence hinges on the occurrence (or otherwise) of one or several future events not wholly controllable by a company.

Contingent liabilities and assets are disclosed in the notes at their probable settlement amounts.

Income and expenses. Net sales and other operating income are recognized upon performance of the contract for goods/services or upon passage of risk to the customer. Under (longer-term) manufacturing contracts with customers, sales are prorated according to the percentage of completion. Operating expenses are recognized when caused or when the underlying service, etc. is used. Interest income and expenses are recognized on an accrual basis.

Financial derivatives. Companies of the Rheinmetall Group use financial derivatives solely to hedge future fair values and cash flows.

Pursuant to IAS 39, *Financial Instruments: Recognition and Measurement*, all financial derivatives are recognized at cost at the trading/contracting date and thereafter remeasured to their fair values. Financial derivatives with a positive or negative fair value are disclosed under *other assets* or *other liabilities*, respectively.

Changes in the fair value of financial derivatives are generally recognized in net income immediately unless an effective hedge exists that satisfies the criteria of IAS 39. If the derivative is a cash flow hedge (CFH) and is hence used to effectively hedge expected future cash inflows/outflows, changes in the financial derivative's fair value are recognized under *all other reserves* only and not in net income. In this case, the changes in the derivative's value would not impact on net income until after the hedged underlying transaction has fallen due or been settled.

Notes (Group)
Accounting principles

Changes in the value of financial derivatives used in fair value hedges (FVHs) to effectively hedge the fair value of recognized assets and liabilities are posted to net income, as are any changes in the hedged assets or liabilities (where appropriate, by adjusting their book values), with the result that the compensatory effects are all reflected in the income statement.

The ineffective portion of a hedge is recognized in net income.

Estimates. Preparing the consolidated financial statements requires certain assumptions and estimates which impact on the amount and disclosure of recognized assets and liabilities, income and expenses, and contingent liabilities. Such assumptions and estimates mainly refer to the forecast of economic lives, the level of write-down or other allowances, the recognition and measurement of provisions and accruals, as well as the future realizability of deferred tax assets, in addition to the assumptions and estimates used in goodwill impairment testing.

These assumptions and estimates are based on the latest known conditions and findings. If the underlying assumptions do not materialize and are beyond management's reasonable control, the actual figures may differ from such estimates. Such differences are recognized in net income when identified.

Notes to the consolidated balance sheet

(6) Intangible assets. In the year under review, non-contracted R&D expenses of €153 million were incurred (up from €152 million). Thereof, development costs of €12 million (down from €13 million) met the capitalization criteria according to IFRS.

Operating expenses included the following R&D-related items:

R&D costs *€ million*

	2004	2005
Research costs and noncapitalized development costs	139	141
Amortization of capitalized development costs	2	3
Total R&D costs expensed	**141**	**144**

Goodwill as of December 31, 2005, totaled €357 million (up from €353 million) and break down into €104 million for the entire Automotive sector (up from €103 million) and €47 million for the Automotive divisions (virtually unchanged), as well as €206 million (up from €203 million) to the Defence divisions, the latter, in turn, into €86 million for Air Defence (down from €90 million), €67 million for Defence Electronics (virtually unchanged), and €39 million for Land Systems (virtually unchanged).

Amortization of intangibles totaled €12 million (down from €13 million).

(7) Tangible assets. The total disclosed as depreciation includes write-down at €2 million (down from €4 million), of which €1 million (down from €2 million) was charged to land and buildings, another €1 million (down from €2 million) to production plant and machinery, and to other plant, factory and office equipment.

In accordance with the revaluation method of IAS 16, essential business plots of land have been stated at their fair values, which generally equal market values. Valuation of the land situated in Germany and abroad, which was revalued on the basis of independent appraisal reports prepared as of December 31, 2005, resulted in the step-up of the essential land's net carrying amounts as of December 31, 2005, by €106 million (up from €99 million). Regarding the development of the revaluation reserve, see the comments on total equity in Note (15).

The disposal of €6 million of tangible assets (down from €7 million) is restricted by land charges, similar encumbrances and the assignment as security. Moreover, standard commercial liens totaling €79 million (up from €76 million) rest on assets which are held under capital leases and are allocable to the Group under the terms of IAS 17, as well as on properties of consolidated special-purpose leasing firms.

Notes (Group)
Notes to the consolidated balance sheet

Tangible assets have been capitalized under leases at the following amounts:

Capitalized leased tangible assets *€ million*

	12/31/2004			12/31/2005		
	Capital leases	Consolidation of special-purpose leasing firms	Total	Capital leases	Consolidation of special-purpose leasing firms	Total
Land and buildings	8	54	62	18	53	71
Production plant and machinery	14	--	14	8	--	8
	22	**54**	**76**	**26**	**53**	**79**

At €10 million, the increase in capital-leased land and buildings is attributable to the addition of one property while the year before, two properties had been disposed of for a total €16 million.

As a rule, leases for real or movable property include a purchase option. The remaining lease terms vary between 1 and 16 years (down from 1–17 years). Depending on market conditions and contracting date, the interest rates underlying leases range from 5.3 to 8.0 percent. The future lease payments under capital leases, the interest portions included therein, and the present values of future lease payments, which are recognized as financial liabilities, are shown in the table below:

Capital leases *€ million*

	2004				2005			
	2005	2006–2009	after 2009	Total	2006	2007–2010	after 2010	Total
Lease payments	7	14	15	36	5	13	19	37
Discount	(2)	(4)	(4)	(10)	(1)	(4)	(4)	(9)
Present values	**5**	**10**	**11**	**26**	**4**	**9**	**15**	**28**

The cash inflow from subleasing tangible assets totaled €4 million in 2005 (down from €5 million). During the noncancelable lease term of the subleased tangible assets, a future cash inflow of an aggregate €14 million (up from €12 million) is expected.

(8) Investment properties. The investment properties have a fair value of €27 million (down from €42 million). In the year under review, rental income of €4 million (virtually unchanged) was earned which contrasts with direct operating expenses of €2 million (down from €7 million).

(9) Investees carried at equity. The proratable assets, liabilities, income and expenses of major joint ventures and associated affiliates break down as follows:

Joint ventures *€ million*

		2004[1]	2005
Assets	(Dec. 31)	50	81
thereof noncurrent		*17*	*34*
Equity	(Dec. 31)	21	25
Debt	(Dec. 31)	29	56
thereof noncurrent		*12*	*11*
Income		137	103
Expenses		130	101
Net income		7	2

[1] *2004 figures adjusted*

Associated affiliates *€ million*

		2004[1]	2005
Assets	(Dec. 31)	4	27
Equity	(Dec. 31)	--	5
Debt	(Dec. 31)	4	21
Net sales		4	30
Net income		--	1

[1] *2004 figures adjusted*

The 2004 figures were adjusted since some associated affiliates were reclassified into joint ventures.

Analysis of investees carried at equity *€ million*

2004	**Book value 01/01/2004**	Addition	Disposal	Consolidation group change	Prorated P/L	Dividend payment	**Book value 12/31/2004**
Joint ventures	31	--	--	−1	7	7	30
Associated affiliates	11	--	8	−1	--	--	2
	42	**--**	**8**	**−2**	**7**	**7**	**32**

2005	**Book value 01/01/2005**	Addition	Disposal	Consolidation group change	Prorated P/L	Dividend payment	**Book value 12/31/2005**
Joint ventures	30	3	--	--	2	3	32
Associated affiliates	2	29	--	--	1	--	32
	32	**32**	**--**	**--**	**3**	**3**	**64**

Notes (Group)
Notes to the consolidated balance sheet

(10) Inventories.

Inventories *€ million*

	12/31/2004	12/31/2005
Raw materials and supplies	188	196
Work in process	231	222
Finished products	67	71
Merchandise	44	44
Prepayments made	123	105
	653	**638**
less prepayments received	(28)	(32)
	625	**606**

The book value of inventories stated at the lower NRV totals €39 million (down from €73 million). Write-down in fiscal 2005 totaled €8 million (down from €11 million). In the year under review, no inventories previously written down were written up as NRV had risen (down from €3 million). Unchanged, inventories do not collateralize any liabilities.

(11) Trade receivables.

Trade receivables *€ million*

	12/31/2004	12/31/2005
Trade receivables	387	481

€22 million of trade receivables has a remaining term above one year (down from €24 million).

No accounts were due from nonconsolidated subsidiaries, whether in 2005 or 2004. Accounts due from joint ventures and associated affiliates totaled €14 million (up from €2 million).

Under an ABS program, the Rheinmetall Group sells trade receivables on a revolving basis up to a maximum volume of €170 million (down from €175 million). According to IAS 39, sold receivables are treated as disposed of and continue to be recognized only at the amount of any continuing involvement since the residual recourse risks are insignificant for Rheinmetall. As of December 31, 2005, the principal of receivables sold came to €170 million (up from €167 million).

(12) Other receivables and assets.

Other receivables and assets *€ million*

	12/31/2004	thereof current	thereof noncurrent	12/31/2005	thereof current	thereof noncurrent
Other receivables and assets						
PoC receivables	175	175	--	168	168	--
sundry assets	100	92	8	108	103	5
	275	**267**	**8**	**276**	**271**	**5**

Breakdown of PoC receivables:

PoC receivables *€ million*

	12/31/2004[1]	12/31/2005
Production cost incurred	244	269
plus markup (less losses)	60	78
	304	**347**
less prepayments received	(129)	(179)
	175	**168**
thereof noncurrent	57	63

[1] *2004 figures restated, cf. Note (20).*

Breakdown of sundry assets:

Sundry assets *€ million*

	12/31/2004	thereof current	thereof noncurrent	12/31/2005	thereof current	thereof noncurrent
Other receivables						
Non-income tax assets	21	20	1	19	18	1
Prepayments made	24	24	--	26	26	--
Financial derivatives	11	9	2	6	5	1
Prepaid expenses and deferred charges	5	4	1	5	5	--
Miscellaneous	39	35	4	52	49	3
	100	**92**	**8**	**108**	**103**	**5**

(13) Financial assets.

Financial assets *€ million*

	2004			2005		
	Total	thereof current	thereof noncurrent	**Total**	thereof current	thereof noncurrent
Available for sale						
Securities available for sale	7	3	4	7	3	4
Receivable						
Share selling prices receivable	19	19	--	19	19	--
Loans	5	1	4	6	3	3
Miscellaneous	6	6	--	1	1	--
	37	**29**	**8**	**33**	**26**	**7**

The securities of €7 million (virtually unchanged) have been stated at fair value (in 2004, €1 million thereof carried at cost). Liens of €7 million (up from €6 million) rest on securities to protect employees from insolvency risks, the sale of these securities being hence restricted. All remaining securities are readily available for sale.

In accordance with IAS 39, the loans of €6 million (up from €5 million) are carried at amortized cost.

Notes (Group)
Notes to the consolidated balance sheet

(14) Cash & cash equivalents.

Cash & cash equivalents *€ million*

	12/31/2004	12/31/2005
Cash on hand and in bank (incl. checks)	258	408

Disposal of cash & cash equivalents is not restricted (unchanged). The term “cash & cash equivalents” covers the same assets in the balance sheet and the cash flow statement.

(15) Total equity. Rheinmetall AG’s capital stock amounts to an unchanged €92.16 million and has been divided into 36 million no-par bearer shares of voting common stock since the annual and special meetings of the Company’s common and preferred stockholders on May 10, 2005, resolved to convert the 18 million preferred shares into common shares on a 1-for-1 basis and this resolution was entered into the Commercial Register on June 27, 2005.

The caption *all other reserves* comprises earnings retained by the Rheinmetall Group at €401 million (up from €332 million), as well as the accumulated other comprehensive income (OCI) which breaks down into unrealized losses of €18 million from currency translation (down from €40 million) and reserves of €66 million from the remeasurement to fair value and other valuation gains (up from €63 million).

A breakdown and analysis of the OCI from fair and other valuation are shown below:

OCI: reserves from fair and other valuation *€ million*

	Land revaluation reserve	Hedge reserve	Reserves from fair and other valuation
Jan. 1, 2004	**61**	**4**	**65**
Change in fair values	(3)	(2)	(5)
Deferred taxes	2	1	3
Dec. 31, 2004	**60**	**3**	**63**
Change in fair values	7	(3)	4
Deferred taxes	(3)	2	(1)
Dec. 31, 2005	**64**	**2**	**66**

Breakdown of the land revaluation reserve:

Land revaluation reserve *€ million*

	12/31/2004	12/31/2005
Revaluation of land within tangible assets	99	106
Deferred taxes	(39)	(42)
	60	**64**

In fiscal 2005, the Executive Board exercised the authority conferred by the annual stockholders' meeting on May 10, 2005, to repurchase Rheinmetall stock. Another 255,403 treasury shares (down from 589,578 shares) were repurchased at a total cost of €12 million (down from €22 million), which was deducted from equity in one sum.

Rheinmetall AG's separate financial statements close the fiscal year with net earnings of €32 million (up from €27 million), €32 million thereof being earmarked for the distribution of a cash dividend (up from €27 million). The proposed cash dividends amount to €0.90 per share of common stock (up from €0.74, and for preferred stock, from €0.80).

The minority interests mainly refer to the Automotive sector at €20 million (up from €18 million), and to Defence at €27 million (down from €32 million).

(16) Accruals for pensions and similar obligations. These accruals provide for obligations under vested rights and current pensions payable to eligible active and former employees and their surviving dependants. Such obligations primarily encompass pensions, both basic and supplementary. The individual, confirmed, pension obligations entitle employees to benefits that vary according to country and company and, as a rule, are measured according to service years and pensionable pay. Moreover, at the German subsidiaries, a performance-related pension obligation has been incurred whose amount hinges on the achievement of certain benchmarks for the ROCE formula. Being a noncurrent provision for the accumulated postretirement benefit obligation, the accrued health care obligations to the retirees of some US subsidiaries are also included in the pension accruals recognized hereunder.

Moreover, the pension funds of the Swiss Group companies have for the first time been classified as defined benefit plans and accounted for as such, mainly in the wake of the amendment to the Swiss Federative Retirement, Survivorship and Disability Pensions Act ("BVG").

The company pension systems consist of both defined contribution and defined benefit plans. Under the DCPs, Rheinmetall incurs no obligation other than the payment of contributions to earmarked pension funds. These pension expenses are shown within personnel expenses and need not be provided for. In the year under review, a total €58 million (down from €61 million) was paid to DCPs, specifically the Statutory Social Security Insurance in Germany.

Under its defined benefit plans, Rheinmetall is obligated to meet its confirmed benefit obligations to active and former employees.

Notes (Group)
Notes to the consolidated balance sheet

The following actuarial parameters have been assumed:

Assumptions underlying pension accruals %

	12/31/2004		12/31/2005		
	Germany	USA	Germany	USA	Switzerland
Discount rate	4.75	5.60	4.25	5.60	3.25
Pay rise (general)	3.00	4.00	2.75	4.00	1.50
Pay raises (fixed sums)	0.50 – 1.25	--	0.50	--	--
Pension uptrend	1.25	--	1.25	--	--
Expected return on plan assets	--	8.50	--	8.50	4.25

Due to the lower capital market interest rate level, the discount rate for German pension obligations was reduced by 0.5 percentage points.

The non-German DBO primarily refer to benefit obligations incurred by US and Swiss subsidiaries, most of which are plan-funded.

Pension accrual analysis *€ million*

	2004	2005
Balance at January 1	**530**	**487**
Pension payments and contributions to plans	(48)	(39)
Service cost	13	20
First-time inclusion of pension obligations	--	23
Effects of plan curtailments/settlements	--	(11)
Past service cost/revenue	(1)	(1)
Amortized actuarial gains and losses	2	5
Compounding of expected pension obligations	32	59
Expected return on plan assets	(5)	(32)
Consolidation group changes	(35)	--
Currency translation differences/other	(1)	3
Balance at December 31	**487**	**514**

The pension accruals are derived from the present value of the DBO as well as from the plan assets as follows:

Pension accruals *€ million*

	2004			2005		
	Germany	Abroad	**Total**	Germany	Abroad	**Total**
Analysis: present value of the DBO						
Present value of the DBO at Jan. 1	506	128	**634**	527	117	**644**
Consolidation group changes	(38)	--	**(38)**	--	--	**--**
First-time inclusion of pension obligations	--	--	**--**	--	851	**851**
Currency translation differences	--	(9)	**(9)**	--	16	**16**
Service cost	11	2	**13**	12	8	**20**
Interest cost	25	7	**32**	25	34	**59**
Pension payments	(25)	(15)	**(40)**	(27)	(71)	**(98)**
Plan curtailments/settlements	--	--	**--**	--	(11)	**(11)**
Actuarial (gains)/losses	48	4	**52**	50	3	**53**
Present value of the DBO at Dec. 31	**527**	**117**	**644**	**587**	**947**	**1.534**
Analysis: plan assets						
Fair value of plan assets at Jan. 1	--	58	**58**	--	65	**65**
First-time inclusion of plan assets	--	--	**--**	--	828	**828**
Currency translation differences	--	(5)	**(5)**	--	10	**10**
Expected return on plan assets	--	5	**5**	--	32	**32**
Contributions paid to plans	--	21	**21**	--	12	**12**
Pensions paid by plans	--	(13)	**(13)**	--	(71)	**(71)**
Actuarial gains/(losses)	--	(1)	**(1)**	--	3	**3**
Fair value of plan assets at Dec. 31	**--**	**65**	**65**	**--**	**879**	**879**
Plan-unfunded pension obligations at Dec. 31	**527**	**52**	**579**	**587**	**68**	**655**
Unrecognized actuarial gains/(losses)	(66)	(29)	**(95)**	(113)	(30)	**(143)**
Unrecognized past service revenue	--	3	**3**	--	2	**2**
Pension accrual as of Dec. 31	**461**	**26**	**487**	**474**	**40**	**514**

As of December 31, 2005, the present value of plan-funded pension obligations amounted to €920 million (up from €104 million). The unrecognized actuarial losses of €143 million (up from €95 million) are largely attributable to previous interest rate adjustments, as well as to the variance of the actual from the expected return on plan assets. In the year under review, plan assets actually returned €35 million (up from €4 million) before the exchange-related (currency translation) losses recognized in equity only. The gains from plan settlements and curtailments mainly originated from the restructured Swiss pension plans.

Notes (Group)
Notes to the consolidated balance sheet

Breakdown of pension expense:

Pension expense *€ million*

	2004			2005		
	Germany	Abroad	**Total**	Germany	Abroad	**Total**
Service cost	11	2	**13**	12	8	**20**
Amortized actuarial gains and losses	--	2	**2**	2	3	**5**
Past service revenue	--	(1)	**(1)**	--	(1)	**(1)**
Effects of plan settlements/curtailments	--	--	**--**	--	(11)	**(11)**
Compounding of expected pension obligations	25	7	**32**	25	34	**59**
Expected return on plan assets	--	(5)	**(5)**	--	(32)	**(32)**
Total	**36**	**5**	**41**	**39**	**1**	**40**

Except for the interest portion of the annual provision and for the expected return on plan assets, which are shown within the net interest result, all of the above lines are recognized as personnel expenses.

(17) Other accruals.

Analysis of accruals *€ million*

2004	Personnel	War-ranties	Identi-fiable losses	Restruc-turing	Yet unbilled costs	All other	**Total**
Balance at Jan. 1, 2004	**121**	**59**	**38**	**75**	**54**	**96**	**443**
Utilized	69	8	11	27	30	42	187
Released	3	11	3	5	4	8	34
Added/provided for	82	17	9	20	38	56	222
Compounded	--	--	--	1	--	--	1
Consolidation group changes	(8)	(5)	(3)	(3)	--	(7)	(26)
Currency translation differences/other	1	3	1	(1)	(2)	(4)	(2)
Balance at December 31, 2004	**124**	**55**	**31**	**60**	**56**	**91**	**417**
Cash outflows							
short-term (within 1 year)	**93**	**38**	**22**	**14**	**53**	**63**	**283**
long-term	**31**	**17**	**9**	**46**	**3**	**28**	**134**
thereof >1–5 years	20	17	9	45	3	24	118
thereof >5 years	11	--	--	1	--	4	16

Analysis of accruals *€ million*

2005	Personnel	War-ranties	Identi-fiable losses	Restruc-turing	Yet unbilled costs	All other	**Total**
Balance at Jan. 1, 2005	**124**	**55**	**31**	**60**	**56**	**91**	**417**
Utilized	72	17	11	20	38	28	186
Released	4	12	4	5	6	13	44
Added/provided for	87	23	13	19	30	49	221
Compounded	--	--	--	--	--	1	1
Currency translation differences/other	(7)	3	(1)	(8)	1	--	(12)
Balance at December 31, 2005	**128**	**52**	**28**	**46**	**43**	**100**	**397**
Cash outflows							
short-term (within 1 year)	**99**	**37**	**20**	**21**	**39**	**74**	**290**
long-term	**29**	**15**	**8**	**25**	**4**	**26**	**107**
thereof >1–5 years	21	15	8	24	4	18	90
thereof >5 years	8	--	--	1	--	8	17

The restructuring accruals mainly cover the measures required for personnel retrenchment (termination indemnities, preretirement part-time work, etc.).

The *all other accruals* provide mainly for €5 million of legal, consulting and audit fees (down from €8 million), €17 million of contractual penalties (up from €10 million), €5 million of discounts, allowances and rebates (down from €9 million), and €5 million due to environmental risks (down from €7 million).

(18) Financial liabilities.

Financial liabilities *€ million*

	12/31/2004	thereof current	thereof noncurrent	**12/31/2005**	thereof current	thereof noncurrent
Bonds	316	--	316	470	146	324
Due to banks	32	15	17	24	11	13
Lease payables	59	6	53	59	5	54
Other liabilities	5	--	5	6	--	6
	412	**21**	**391**	**559**	**162**	**397**

The bond issue floated in 2001 matures on May 31, 2006. In 2005, Rheinmetall repurchased €171 million (at par) of the bond issue (up from €33 million).

In fiscal 2005, a 3.5-percent €325 million bond issue maturing on June 21, 2010, was floated.

Notes (Group)
Notes to the consolidated balance sheet

€6 million of financial debts (down from €8 million) is collateralized by land charges and similar encumbrances, as is another €32 million (down from €33 million) borrowed to finance the real property owned by consolidated special-purpose leasing firms and encumbered with land charges of €11 million (down from €12 million) whose consolidation is mandatory pursuant to IAS 27 in conjunction with SIC 12.

The analyses below reflect the terms, and book and fair values, of financial liabilities, the fair values being determined on the basis of interest rates current at the balance sheet date for corresponding maturities/redemption patterns:

Bonds *€ million*

				12/31/2004		12/31/2005	
Interest terms	Rate (%)	Currency	Maturing in	Book value	Fair value	Book value	Fair value
Fixed	6.125	€	2006	316	332	146	147
Fixed	3.500	€	2010	--	--	324	324
				316	**332**	**470**	**471**

Due to banks *€ million*

				12/31/2004		12/31/2005	
Interest terms	Weighted rate (%)	Currency	Maturing in	Book value	Fair value	Book value	Fair value
Fixed	3.8	€	2005	2	2	--	--
Fixed	6.0	Can$	2005/2006	2	2	2	2
Fixed	1.0	¥	2006	2	2	--	--
Fixed	2.7	€	2006	--	--	2	2
Fixed	5.0	€	2007	8	9	7	7
Fixed	5.0	€	2008	2	2	--	--
Fixed	3.0	US$	2008	1	1	2	2
Fixed	5.5	€	2009/2011	5	5	4	5
Fixed	4.9	€	2013	2	2	2	2
				24	**25**	**19**	**20**
Variable		€	2005/2006	7	7	3	3
Variable		Rs	2006/2007	1	1	2	2
				8	**8**	**5**	**5**

Lease payables *€ million*

Interest terms	Weighted rate (%)	Currency	Maturing in	12/31/2004 Book value	12/31/2004 Fair value	12/31/2005 Book value	12/31/2005 Fair value
Fixed	5.9	€	2005–2006	5	6	2	2
Fixed	5.3	€	2008/2009	26	28	24	26
Fixed	6.6	€	2010–2012	5	6	5	5
Fixed	8.0	€	2020	11	13	17	20
Fixed	6.4	€	2022	12	13	11	13
				59	**66**	**59**	**66**

Other financial liabilities *€ million*

Interest terms	Weighted rate (%)	Currency	Maturing in	12/31/2004 Book value	12/31/2004 Fair value	12/31/2005 Book value	12/31/2005 Fair value
Fixed	7.5	€	2009	3	4	3	4
Variable		€	sdry. ≤ 2015	2	2	3	3
				5	**6**	**6**	**7**

(19) Trade payables.

Trade payables *€ million*

	12/31/2004	12/31/2005
Trade payables	385	399

The remaining term of trade payables was less than one year, in 2004 a total of €5 million had fallen due after one year. Trade payables include notes payable at €4 million (down from €10 million). Altogether €1 million is due to joint ventures and associated affiliates (down from €2 million).

Notes (Group)
Notes to the consolidated balance sheet

(20) Other liabilities.

Other liabilities *€ million*

	12/31/ 2004	thereof current	thereof noncurrent	12/31/ 2005	thereof current	thereof noncurrent
Other liabilities						
prepayments received[1)]	307	307	--	351	351	--
sundry	251	243	8	255	247	8
	558	**550**	**8**	**606**	**598**	**8**

1) *Prior-year comparatives restated*

In the year under review, the prepayments received under PoC contracts have for the first time only been offset up to the actual level of contract completion. Previously, any prepayments in excess thereof had been disclosed as PoC payables and are as of December 31, 2005, reported for the first time as *prepayments received*. The prior-year comparatives have been restated accordingly.

€150 million of the prepayments received on orders have a remaining term above one year (down from €217 million). Besides the payables for financial derivatives, the carrying amounts of trade payables and other liabilities approximate their fair values. The payables for financial derivatives are stated at fair value.

The sundry liabilities shown under *other liabilities* break down as follows:

Sundry liabilities *€ million*

	12/31/ 2004	thereof current	thereof noncurrent	12/31/ 2005	thereof current	thereof noncurrent
Invoices outstanding (unbilled costs)	67	67	--	51	51	--
Social security	26	25	1	26	25	1
Due to board members and employees	8	8	--	12	11	1
Non-income taxes	28	27	1	36	36	--
Monies in transit from debt collection	69	69	--	75	75	--
Financial derivatives	5	4	1	7	6	1
Deferred income	11	9	2	10	8	2
Miscellaneous	37	34	3	38	35	3
	251	**243**	**8**	**255**	**247**	**8**

Notes to the consolidated income statement

(21) Net sales.

Net sales *€ million*

	2004	2005
Net sales (excl. PoC)	3,339	3,397
Revenues according to PoC	74	57
	3,413	**3,454**

(22) Net inventory changes, other work and material capitalized.

Net inventory changes, other work and material capitalized *€ million*

	2004	2005
Change in inventories of finished products and WIP	4	(17)
Other work and material capitalized	23	26
	27	**9**

(23) Other operating income.

Other operating income *€ million*

	2004	2005
Gains from fixed-asset disposal	28	14
Income from the release of accruals	34	44
Income from bad-debt allowances reversed	5	3
Income from compensation and refunds	3	17
Sundry rental income	13	12
Income from grants and subsidies	5	5
Income from canteens and ancillary operations	2	3
Income from credit notes for prior years	8	12
Income from prototype and tooling costs refunded	7	5
Other secondary income	36	29
	141	**144**

€16 million of the gains from fixed-asset disposal originated in 2004 from the divestment of subsidiaries (virtually unchanged).

(24) Cost of materials.

Cost of materials *€ million*

	2004	2005
Cost of raw materials, supplies, and merchandise purchased	1,425	1,472
Cost of services purchased	216	207
	1,641	**1,679**

Notes (Group)
Notes to the consolidated income statement

(25) Personnel expenses.

Personnel expenses *€ million*

	2004	2005
Wages and salaries	822	812
Social security taxes and related employee benefits	113	109
Pension expense	75	71
	1,010	**992**

Pension expense also reflects the employer contributions to DCPs (Statutory Social Security Insurance in Germany and comparable foreign institutions).

Annual average headcount *Employees*

	2004	2005
Automotive	11,442	11,539
Defence	6,992	6,766
Others/holding company	611	110
	19,045	**18,415**

(26) Amortization/depreciation/write-down. For the allocation of these charges to intangible/tangible assets and investment properties, see the fixed-asset analysis.

Write-down was charged at €2 million (down from €4 million).

(27) Other operating expenses.

Other operating expenses *€ million*

	2004	2005
Losses on fixed-asset disposal	12	6
Exit plans, termination benefits, preretirement part-time work	21	19
Selling expenses, commissions	88	73
Maintenance and repair (M&R)	81	88
Promotion and advertising	12	13
Other general administration	129	127
Rents (incl. incidentals)	49	44
Payroll incidentals	24	23
Facility cleaning, security/vigilance	11	10
Outsourced services	7	7
Legal and consultancy fees	30	30
Audit and consultancy fees of external accountants	6	6
Write-down of receivables	4	4
Non-income taxes	12	11
Additional provisions	51	65
All other	23	26
	560	**552**

The losses on fixed-asset disposal refer at €1 million to the disposal of subsidiaries (down from €7 million).

(28) Net interest expense.

Net interest expense *€ million*

	2004	2005
Interest income		
expected return on plan assets	5	32
other interest and similar income	6	7
	11	**39**
Interest expense		
from capital leases	(3)	(2)
compounding of pension obligations	(32)	(59)
compounding of noncurrent other accruals	(1)	(1)
other interest and similar expenses	(46)	(32)
	(82)	**(94)**
Net interest expense	**(71)**	**(55)**

(29) Net investment income and other financial result.

Net investment income and other financial result *€ million*

	2004	2005
Income from investments		
net income from joint ventures and associated affiliates	7	3
gains from the disposal of joint ventures and associated affiliates	8	--
	15	**3**
Other financial result		
net currency/exchange gain	3	8
guaranty commissions	(2)	(1)
net gain from financial derivatives	2	(2)
sundry	(3)	(10)
	--	**(5)**
Net investment income and other financial result	**15**	**(2)**

The *sundry other financial result* includes for 2005 the expense for the prepayment penalty for the old bond issue and the early redemption of the previous syndicated credit facility, totaling €8 million.

(30) Income taxes.

Income taxes *€ million*

	2004	2005
Current income tax expense	43	55
Prior-period income tax expense	5	4
Deferred taxes	(3)	(7)
	45	**52**

Notes (Group)
Notes to the consolidated income statement

The table below reconciles the expected to the recognized tax expense. The expected tax expense is determined by multiplying EBT by an unchanged tax rate of 40 percent. This rate covers German corporate income tax, the solidarity surtax thereon, and municipal trade tax.

Income tax expense reconciliation *€ million*

	2004	2005
EBT	146	170
Expected income tax expense (tax rate of 40%)	**58**	**68**
Foreign tax rate differentials	(4)	(3)
Effects of loss carryovers and write-down of deferred taxes	(4)	(11)
Reduction of tax expense due to previously unrecognized loss carryovers	(4)	(7)
Tax-exempt income	(14)	(5)
Nondeductible expenses	8	6
Other	5	4
Effective tax expense	**45**	**52**
Effective tax rate in %	**31**	**30**

The deferred taxes are allocable to the following balance sheet lines:

Deferred taxes *€ million*

	12/31/2004		12/31/2005	
	assets	liabilities	assets	liabilities
Loss carryovers and tax credits	75	--	83	--
Fixed assets	13	77	24	89
Inventories and receivables	19	27	14	31
Pension accruals	28	1	29	1
Other accruals	33	2	29	2
Liabilities	8	14	13	1
Sundry	(10)	9	(12)	10
	166	**130**	**180**	**134**
Offset	(118)	(118)	(119)	(119)
	48	**12**	**61**	**15**
thereof not affecting net income		41		42

Apart from the capitalized deferred tax assets from loss carryovers and tax credits, further tax loss carryovers and tax credits exist in Germany and abroad at €391 million (up from €378 million) which are not utilizable or whose deferred tax assets were adjusted by write-down. Thereof, €177 million (up from €107 million) is allocable to German, another €204 million to foreign, loss carryovers (down from €265 million), plus €10 million to tax credits (up from €6 million). The German loss carryovers are not subject to expiration, neither is 40 percent of the foreign ones. Most of the foreign loss carryovers subject to expiration can be utilized for more than 9 years. The adjustment of deferred tax assets decreased in 2005 by €2 million (up from €1 million).

€42 million of the deferred taxes recognized in equity only (up from €39 million) is allocable to land revaluation, another €0 million to hedges (down from €2 million).

(31) Minority interests. Minority interests in profit came to an unchanged €5 million.

(32) Earnings per share (EpS). EpS is obtained by dividing the weighted average number of shares issued and outstanding in the fiscal year into the Group's net earnings. Neither as of December 31, 2005 nor 2004, were any shares, options or equivalent outstanding that could dilute earnings per share. Therefore, both in the year under review and the previous year, undiluted EpS equals diluted EpS. EpS is for the first time determined for common stock only. The weighted average number of shares accounts for the repurchased shares of treasury stock of €12 million (down from €22 million).

Earnings per share (EpS) *€ million*

	2004	2005
Group earnings (after minority interests)	96	113
Excess dividend (preferred over common = €0.06 per share)	(1)	--
Group net earnings after elimination of excess dividend	95	113
Number of common shares	18.00 million	35.35 million
Number of preferred shares	17.95 million	--
Earnings per common share	**€2.64**	**€3.19**
Earnings per preferred share	**€2.70**	**--**

(33) Adjusted EBIT. EBIT after adjustment for nonrecurring expenses, losses, income and gains connected with equity interests, real estate and restructuring programs breaks down as follows:

Adjusted EBIT *€ million*

	2004	2005
Accounting EBIT	**217**	**225**
Nonrecurring expenses, losses, income, gains related to		
shareholdings	(23)	(4)
real estate	4	(1)
restructuring programs	26	17
finance rescheduling	--	8
Adjusted EBIT	**224**	**245**

Notes (Group)
Note to the cash flow statement

(34) Cash flow statement. The net cash provided by operating activities included a cash inflow from interest of €8 million (up from €7 million) and a cash outflow for interest of €36 million (down from €50 million). Income taxes paid came to €51 million (up from €46 million).

The cash outflow for acquiring consolidated subsidiaries totaled €15 million (down from €21 million) and substantially concerned the acquisition of Rheinmetall Waffe Munition ARGES GmbH, the purchase of the remaining shares in Eurometaal Holding and further shares in Kolbenschmidt Pierburg AG. A cash inflow of €3 million (down from €91 million) was produced by the disposal of consolidated subsidiaries. The acquisitions and disposals were substantially settled in cash. For purchase price details, see the explanations in Note (2) to the consolidation group.

No cash or cash equivalents were taken over in the M&A transactions (unchanged) while €16 million (up from €10 million) in cash & cash equivalents was disposed of in divestments.

Note to the segment reports

(35) Segment reports. In accordance with the Rheinmetall Group's internal controlling organization, the Group breaks down into two corporate sectors (primary segments), viz. Automotive and Defence.

The *Others/Consolidation* column includes, besides the Group's parent (Rheinmetall AG), intragroup service and other nonsegment companies, plus consolidation transactions.

The Rheinmetall Group publishes two segment report formats. In the segment report according to IFRS, directly allocable transactions and group-level valuations have been assigned to the appropriate segment.

Contrary to this reporting format, the Rheinmetall Group is managed and controlled according to different indicators and, therefore, while the accounting policies and methods applied to the IFRS-based consolidated financial statements have been retained, Rheinmetall has published a second report in a format that reflects its management and controlling structure. In this format, goodwill write-down and effects of the revaluation of operating land (neither of which are included in the financial statements of the subgroups or segments) are indicated in the *Others/Consolidation* column.

The intersegment transfers are principally priced as if at arm's length.

IFRS segment report. Sales generated by non-German Defence companies are reported according to country of destination.

Self-explanatory, segment EBIT means the segment's earnings before interest and income taxes.

Segment assets and liabilities include the operating assets (excluding cash, cash equivalents and income taxes) and liabilities (excluding financial debts and income taxes).

The segment capital expenditures refer to tangible and intangible assets, investment properties, and goodwill and, therefore, depreciation and amortization also comprise goodwill write-down.

Segment report by management structure. The balance sheet lines are reported in line with the Rheinmetall Group's shareholder value concept.

Net financial debt reflects financial liabilities less cash & cash equivalents. Capital employed (CE) is determined as the aggregate sum of total equity, pension accruals and net financial debt and thus mirrors the net capital employed to generate EBIT. The return on capital employed (ROCE) equals EBIT (according to management structure) divided by average CE (average of the balances at December 31, 2004 and 2005).

EBITDA means earnings before interest, taxes, depreciation and amortization. EBIT is calculated according to management structure. The EBIT margin equals EBIT (according to management structure) divided by total segment sales.

Capital expenditures reflect the additions to tangible/intangible assets and investment properties.

Notes (Group)
Supplementary disclosures

(36) Contingent liabilities and assets.

Contingent liabilities and assets *€ million*

	2004	2005
Contingent liabilities		
under bonds and guaranties (incl. for drafts, notes and checks)	20	20
under warranty and indemnity agreements	43	35
	63	**55**

A joint and several liability exists for the debts assigned under the split-up of Bremen-based STN Atlas Elektronik GmbH, to ATLAS Elektronik GmbH, Bremen, at a non-specifiable amount.

In the judicial review proceedings pending since 1998, the share exchange ratio determined during the Kolbenschmidt Pierburg merger (Rheinmetall Beteiligungen) is examined for fair valuation. In 2005, the expert appointed by the Heilbronn Regional Court submitted his final report that arrives at different values for the companies merged in January 1998. Kolbenschmidt Pierburg AG has caused the court-appointed expert to review said final report. Given the results of this review, Kolbenschmidt Pierburg AG continues to see no reason for departing from the originally determined value relations as these had been determined by two independent accounting and auditing firms when the merger was transacted and then endorsed by a court-appointed merger accounting specialist. Kolbenschmidt Pierburg assumes that the values determined by three independent experts will prevail in a final review and re-examination. No further disclosures are made lest the outcome of the proceedings be biased.

Moreover, a performance bond exists at an unchanged €98 million in favor of a nonconsolidated Rheinmetall investee; however, in the relationship of the investee's shareholders inter se, Rheinmetall's liability is limited to an unchanged 14 percent.

(37) Other financial obligations. As of December 31, 2005, the commitments to purchase tangible and intangible assets for capital expenditure projects totaled €33 million (up from €24 million). In addition, obligations under other agreements and contracts exist at €18 million (up from €7 million).

In the year under review, rents of €42 million (down from €46 million) were expensed as paid under all operating leases for computer hardware/software and other assets.

The following cash outflows under operating leases are expected in future periods:

Cash outflows under operating leases *€ million*

	2004				2005			
	2005	2006–2009	after 2009	**total**	2006	2007–2010	after 2010	**total**
Buildings	20	58	53	**131**	20	53	52	**125**
Other leases	17	31	--	**48**	19	36	7	**62**
	37	89	53	**179**	39	89	59	**187**

(38) Stock appreciation rights (SARs). As from 2005, reporting on the SAR program 1998–2001 is discontinued for lack of materiality.

(39) Hedging policy and financial derivatives. The operations and financing transactions of Rheinmetall as an international group are exposed to financial risks, mainly from liquidity, counterparty failure, exchange rate volatility and interest rate changes. In accordance with the groupwide implemented risk management system of Rheinmetall AG, such risks are not only identified, analyzed and measured but also managed through derivative financial instruments. No such derivatives may be acquired for speculation. All transactions involving financial derivatives are subject to stringent monitoring, which is particularly ensured through the strict segregation of the contracting, settlement and control functions.

Liquidity risk. Sufficient liquidity at all times is ensured by the Rheinmetall Group especially by a cash budget and forecast over a specified period, as well as through existing, unutilized financial facilities, including besides credit lines granted by banks and other financial institutes on a bilateral or syndicated basis, also a commercial paper (CP) program, an asset-backed securities (ABS) program, and bond issues.

Counterparty risk. The Rheinmetall Group supplies mostly customers of prime standing, which downscales the risk of counterparty failure or default to an extremely low level. According to current facts, the collection risk is covered by bad-debt and equivalent allowances. Over and above this scope, the Rheinmetall Group has not extended any major credits to specific parties. Corporate policies and standards specify the framework for a proper A/R management system.

The default risk from financial derivatives is the potential failure of a counterparty and is therefore capped at the positive fair value due from any such counterparty. Counterparties of Rheinmetall Group companies for contracting financial derivatives are exclusively German and foreign banks of prime standing. By setting these high standards on counterparties, the risk of uncollectible debts is minimized.

Commodity price risk. The Rheinmetall Group is exposed to price volatility risks from commodity buying, such as metals. By agreeing with customers on materials cost escalator clauses, the major part of these risks from rising metal prices is eliminated. In addition, Rheinmetall continuously explores further risk avoidance or containment options, such as long-term fixed-price sourcing or the use of financial derivatives.

Currency risk. Due to the international nature of the Rheinmetall Group's business, certain operational currency risks arise from the fluctuating parity of the transaction currency to other currencies. Open positions exposed to a currency risk are principally hedged through financial derivatives, generally currency forwards, as well as currency options and swaps. These hedges are contracted at corporate sector level. In certain cases—especially within Automotive—natural hedging options exist, too.

Notes (Group)
Supplementary disclosures

Interest rate risk. For the Rheinmetall Group's financing activities, such funding tools as floating-rate facilities are used, too. Interest rate hedges like caps and interest rate swaps contain the risks emanating from market rate changes. These hedges are contracted centrally by Rheinmetall AG, as well as locally at subsidiary or subgroup level.

As of December 31, 2005, the currency and interest rate hedges listed in the tables below existed, their notional volumes being shown non-netted and thus reflecting the total amounts of each and every such contract. Being marked to the market at December 31, the fair values of financial derivatives correspond to prices in at arm's length transactions.

Hedges *€ million*

	Notional volume		Maturing after 1 year		Fair market values	
	12/31/2004	**12/31/2005**	**12/31/2004**	**12/31/2005**	**12/31/2004**	**12/31/2005**
Currency hedges						
Currency forwards	268	314	61	104	5	--
Other	54	22	2	1	--	--
	322	**336**	**63**	**105**	**5**	**--**
A/R hedges						
Credit default swap	--	**29**	**--**	**--**	**--**	**1**
Interest rate hedges						
Interest rate options	160	160	160	160	1	1
Interest rate swaps	25	40	11	35	--	–3
	185	**200**	**171**	**195**	**1**	**–2**

Although the derivative transactions contracted within the Rheinmetall Group as part of the corporate risk management policy represent hedges at the economic level, they are not so accounted for unless they satisfy the stringent IFRS hedge accounting criteria.

(40) Other details of related-party transactions. The volume of services provided by or to material related companies is broken down below:

Volume of services provided by/to related companies *€ million*

Company	Volume of services rendered 2004	Volume of services rendered 2005	Volume of services utilized 2004	Volume of services utilized 2005	Volume of unpaid items 2004	Volume of unpaid items 2005
GIWS Gesellschaft für Intelligente Wirksysteme mbH	23	--	--	--	1	12
PSM Projekt System & Management GmbH	25	26	--	--	(2)	(2)
OY Finish Defence Power Systems AB	4	--	--	2	3	(1)
AIM Infrarot-Module GmbH	--	--	--	1	--	--
Kolbenschmidt Pierburg Shanghai Nonferrous Components Co.Ltd.	1	2	--	3	--	1
Kolbenschmidt Shanghai Piston Co. Ltd.	2	2	2	1	1	1
Advanced Bearing Materials LLC.	--	1	--	--	--	--
Shriram Pistons & Rings Ltd.	--	6	--	--	--	--
	55	**37**	**2**	**7**	**3**	**11**

There were no reportable transactions with individuals related to the Rheinmetall Group.

The expenses for compensation paid or payable to senior officers and Supervisory Board members break down as follows:

Expenses for compensation *€ million*

	2004	**2005**
Short-term payments due	13	12
Pensions	2	2
Termination indemnities	--	1
	15	**15**

(41) Statutory auditor's fees. Unchanged, the fees of statutory auditor PricewaterhouseCoopers AG amount to €2 million and refer almost fully to the annual audit.

Notes (Group)
Supplementary disclosures

(42) Supervisory and Executive Boards.

Supervisory Board. Supervisory Board fees amounted to €0.7 million in fiscal 2005 (down from €0.8 million). Neither was any further compensation paid, nor were any other benefits granted, to Supervisory Board members for personally rendered advisory, agency or other services in the year under review.

Executive Board. For their duties performed on behalf of the parent and its subsidiaries, Executive Board members received a total €5.2 million in the year under review (down from €5.6 million), breaking down into €1.5 million of fixed remuneration (virtually unchanged) and €1.4 million of profit shares (down from €1.9 million), plus compensation in kind at an unchanged €0.1 million. The latter was substantially paid noncash in the form of company car use and grants for statutory social security insurance. In addition, the Executive Board members received a total bonus of €2.2 million under an incentive program for 2005 that is based on the amount added to the Rheinmetall Group's shareholder value (up from €2.1 million).

A total €1.3 million was paid to former Executive Board members and their surviving dependants (down from €1.7 million). Pension obligations to former Management or Executive Board members and their surviving dependants exist at a total €15.6 million (up from €12.3 million).

Shareholdings. As of December 31, 2005, none of Rheinmetall AG's Executive Board members held any legally reportable shares in the Company.

In 2005, one Supervisory Board member reported a stock purchase, which has duly been, and remains, published as prescribed by Art. 15 WpHG.

(43) Corporate Governance Code. In November 2005, Rheinmetall AG published on the Internet at www.rheinmetall.com, and thus made available to its stockholders, the declaration of conformity according to the German Corporate Governance Code pursuant to Art. 161 AktG.

Regarding the listed subsidiary included in the consolidated financial statements of Rheinmetall AG, viz. Kolbenschmidt Pierburg AG, the declaration of conformity under the terms of Art. 161 AktG has been published since November 2005 on the Internet at www.kolbenschmidt-pierburg.com.

Düsseldorf, March 6, 2006

The Executive Board

Eberhardt Dr. Kleinert Dr. Müller

Major Group companies

Fully consolidated companies

	Interest held %	Equity as of **Dec. 31, 2005** [1] € million	Net sales **2005** [1] € million
Rheinmetall AG, Düsseldorf			
Automotive			
Kolbenschmidt Pierburg AG, Düsseldorf	97.04	376	0
Pierburg GmbH, Neuss	97.04	113	467
Carbureibar S.A., Abadiano, Spain	97.04	26	136
Pierburg S.à r.l., Basse-Ham (Thionville), France	97.04	29	149
Pierburg S.p.A., Lanciano, Italy	97.04	20	130
Pierburg Inc., Fountain Inn, USA	97.04	9	42
KS Kolbenschmidt GmbH, Neckarsulm	97.04	196	249
KS Pistões Ltda., Nova Odessa, Brazil	97.04	62	105
Karl Schmidt Unisia Inc., Marinette, USA	89.28	33	210
Société Mosellane de Pistons S.A.S., Basse-Ham (Thionville), France	97.04	23	55
Kolbenschmidt K.K., Yokohama, Japan	97.04	10	31
Metal a.s., Ústí, Czech Republic	97.04	26	44
KS Gleitlager GmbH, St. Leon-Rot	97.04	19	159
KS Aluminium-Technologie AG, Neckarsulm	97.04	25	210
MSI Motor Service International GmbH, Neckarsulm	97.04	22	106
Defence			
Rheinmetall Landsysteme GmbH, Kiel	100.00	44	335
Oerlikon Contraves AG, Zurich, Switzerland	100.00	103	177
Oerlikon Contraves S.p.A., Rome, Italy	100.00	44	50
Oerlikon Contraves Inc., St.-Jean-sur-Richelieu, Canada	100.00	29	39
Rheinmetall Waffe Munition GmbH, Ratingen	100.00	102	265
Nitrochemie Aschau GmbH, Aschau	55.00	23	63
RWM Schweiz AG, Zurich, Switzerland	100.00	24	38
Nico Pyrotechnik Hanns-Jürgen Diederichs GmbH & Co. KG, Trittau	100.00	5	34
Rheinmetall Defence Electronics GmbH, Bremen	100.00	52	381

1) *acc. to IFRS*

Investees carried at equity

	Interest held %	Equity as of **Dec. 31, 2005** [1] € million	Net sales **2005** [1] € million
Joint ventures			
Kolbenschmidt Pierburg Shanghai Nonferrous Components Co. Ltd., Shanghai, China	48.52	25	60
Kolbenschmidt Shanghai Piston Co. Ltd., Shanghai, China	48.52	24	16
GIWS Gesellschaft für Intelligente Wirksysteme mbH, Nürnberg [2][3]	50.00	1	52
PSM Projekt System & Management GmbH, Kassel [2]	50.00	0	0
Associated affiliate			
AIM Infrarot-Module GmbH, Heilbronn [2]	50.00	9	51

1) *acc. to IFRS*
2) *local financial statements*
3) *prior-year data*

Auditor’s report and opinion

Rheinmetall AG, Düsseldorf. Independent group auditor’s report and opinion. We have audited the consolidated financial statements (consisting of balance sheet, income statement, statement of changes in equity, cash flow statement, and notes) and the group management report, all as prepared by Rheinmetall AG, Düsseldorf, for the fiscal year ended December 31, 2005. The preparation of the consolidated financial statements and group management report in accordance with the IFRS, whose application is mandatory in the European Union (EU), and the additional financial-accounting provisions of Art. 315a(1) HGB, is the responsibility of the Company’s Executive Board. Our responsibility is, based on our audit, to express an opinion on the consolidated financial statements and group management report.

We have conducted our annual group audit in accordance with Art. 317 HGB and with due regard to generally accepted standards for the audit of financial statements as established by IDW, the Institute of Sworn Public Accountants & Auditors in Germany. Said standards require that we plan and perform the audit to obtain reasonable assurance that any misstatement or fraud which has a material impact on the view of the net assets, financial position and results of operations as presented by the consolidated financial statements in accordance with applicable accounting principles and by the group management report is identified. When planning the audit procedures, knowledge and understanding of the Group’s business, its economic and legal environment as well as sources of potential errors are given due consideration. An audit includes examining, on a test basis, the accounting-related internal control system's effectiveness and the evidence supporting the amounts and disclosures in the consolidated financial statements and group management report. An audit also includes assessing the financial statements of companies included in the consolidated financial statements, the definition of the consolidation group, the accounting and consolidation principles used, and significant estimates made, by the Company’s Executive Board, as well as evaluating the overall presentation of the consolidated financial statements and group management report. We believe that our audit provides a reasonable basis for our opinion.

Our audit has not resulted in any objections or exceptions.

It is our opinion that, based on our audit conclusions, the consolidated financial statements are in conformity with the IFRS, whose application is mandatory in the EU, and the additional financial-accounting provisions of Art. 315a(1) HGB, and, with due regard to these standards, regulations and provisions, present a true and fair view of the Group’s net assets, financial position and results of operations. The group management report is in conformity with the consolidated financial statements and presents fairly, in all material respects, the Group’s position and the risks and rewards inherent in its future development.

Düsseldorf, March 7, 2006

PricewaterhouseCoopers
Aktiengesellschaft
Wirtschaftsprüfungsgesellschaft

(Bovensiepen)	(Dr. Husemann)
Wirtschaftsprüfer	Wirtschaftsprüfer

Corporate governance report

Corporate Governance. Corporate governance is tantamount to responsible management and control in order to add value and ensure long-term growth. The German Stock Corporation Act (AktG) sets the legal framework, and the German Corporate Governance Code (the "Code") formulates a uniform code of best corporate practice (modeled on international standards), for the corporate governance and control of stock corporations, all with a view to rendering corporate structures more transparent and thus strengthening long term stakeholder confidence in listed companies. The Rheinmetall Group attaches great importance to practiced responsible and value-oriented corporate governance.

Stockholders' meeting. One share grants one vote at general meetings of stockholders. Where stockholders elect not to exercise their voting rights themselves, they may appoint a proxy at their discretion or give voting power to a Rheinmetall-appointed voting proxy. The documentation for the stockholders' meeting, the Executive Board presentation and the voting results are all published on the Company's website.

Management and control. Within their respective responsibilities, which—along with the duties, authorities and transactions subject to approval—are defined in rules of procedure, the Executive and Supervisory Boards work together in an atmosphere of mutual trust in the best interests of the entire Group. The Executive Board members jointly manage the Group on their own responsibility. The Executive Board is responsible for compliance with the law and accountable for the installation of a reasonable risk management system, develops the strategic orientation, and determines corporate goals and targets, cost budgets and focal R&D areas. Moreover, the Executive Board briefs the Supervisory Board at regular intervals on details of the general business trend, the net-asset and financial position, results of operations, plans, budgets and target achievement levels or variances, as well as on business risks.

The Supervisory Board appoints the members of, provides advisory services in management issues to, and oversees the conduct of business by, the Executive Board. The Supervisory Board is directly and closely involved in decisions of fundamental import to Rheinmetall. Its members do not include any former Executive Board members.

With a view to best performing its functions and enhancing its efficiency, the Supervisory Board has formed from among its members three technical committees to which certain responsibilities have been assigned. The Personnel, Audit and Slate Submittal Committees, whose members are equally stockholder and employee representatives, deal with complex issues and prepare resolutions for submittal to, and voting by, the plenary Supervisory Board meeting.

In the year under review, there were no clashing interests affecting Executive or Supervisory Board members; such conflicts require immediate disclosure to the Supervisory Board.

Compensation of board members. The remuneration of Executive Board members is fixed by the Supervisory Board's Personnel Committee. The yardstick for determining an Executive Board member's performance-related compensation is the scope of his responsibilities, as well as his individual and the Group's performance. The target income breaks down into a 60-percent fixed, and 40-percent variable, portion. Additionally, a midterm incentive program has been installed that is pegged to the absolute increase in the Rheinmetall Group's shareholder value. The actual-to-actual comparison of the "fundamental equity" value is based on the mean of three successive fiscal years. The Supervisory Board Chairman briefed the annual stockholders' meeting on May 10, 2005, on the basic elements of Executive Board remuneration, which have also been outlined on the Company's website.

Corporate governance report

The remuneration of Supervisory Board members has been laid down in Rheinmetall AG's bylaws. In accordance with Article 13, Supervisory Board members receive a fixed fee plus a variable compensation linked to dividend payout to stockholders. Chairmanship, vice-chairmanship and membership in the Supervisory Board and/or its committees are recompensed differently.

The Company has taken out a D&O policy (Directors' & Officers' liability insurance, including consequential loss) with a reasonable deductible for its Executive and Supervisory Board members.

Corporate communications. Transparency and information enjoy a high priority with Rheinmetall. The various target groups must be provided with the same information at the same time. The Rheinmetall website informs stockholders and the general public timely about current developments and significant intragroup changes.

Moreover, major transactions or events and new facts are published in press releases. While no shareholding existed that would have been reportable under the terms of 6.6 of the Code as amended up to June 2, 2005, all Rheinmetall securities deals transacted in the year under review and notifiable pursuant to Art. 15a WpHG (so-called directors' dealings) were duly published on the Company's website. On August 26, 2005, the Company communicated that on August 23, 2005, Supervisory Board Chairman Klaus Greinert had acquired 250,000 shares of Rheinmetall common stock at a price of €44 per share off the floor.

Risk management. The groupwide reporting and control system is designed to identify, detect, profile, map, assess and control the business and financial risks the Group is exposed to in connection with its international operations. The monitoring system components supply reliable information about the current risk position and contribute toward goal achievement, besides minimizing risk-related costs. The statutory auditor examines whether the Executive Board took the steps required under the terms of Art. 91(2) AktG to establish a suitable early risk identification system (ERIS) and that the ERIS is suited to identify in good time any developments that might jeopardize the Company's continued existence as a going concern. Rheinmetall refines and updates the monitoring system in a continuous process in response to the changing business environment.

Accounting, financial reporting and statutory audits. For enhanced transparency and ready comparison to international competitors, Rheinmetall AG formulates its consolidated financial statements and interim reports in accordance with the International Financial Reporting Standards (IFRS) where obligatory. As prescribed by the law, Rheinmetall AG's separate financial statements are prepared according to the German Commercial Code (HGB).

The annual stockholders' meeting elected PricewaterhouseCoopers Aktiengesellschaft Wirtschaftsprüfungsgesellschaft, Frankfurt am Main, Düsseldorf branch, as statutory auditor for fiscal 2005. The Supervisory Board defines certain focal audit areas, ensures that the audit work is not adversely affected by clashing interests, and obligates the statutory auditor to promptly disclose any reasons for non-eligibility or partiality. Further, the statutory auditor would report any material findings, conclusions or events that are contradictory to the declaration of conformity issued by the Executive and Supervisory Boards under the terms of Art. 161 AktG. The 2005 annual audit has not indicated any such contradictions.

Declaration of conformity. Rheinmetall AG's Executive and Supervisory Boards annually issue the declaration of conformity (published on the website and in the annual report) as required by Art. 161 AktG for compliance with the German Corporate Governance Code. The latest version is dated November 24, 2005, and refers to the Code as amended up to June 2, 2005.

Joint declaration of conformity of the Executive and Supervisory Boards pursuant to Art. 161 AktG on the recommendations of the German Corporate Governance Code Government Commission

"Rheinmetall AG's Executive and Supervisory Boards declare that Rheinmetall AG has fully carried out since the issuance of the preceding declaration of conformity in November 2004, or will act on, the recommendations of the German Corporate Governance Code Government Commission as amended up to June 2, 2005, and officially published on July 20, 2005, in the digital Federal Gazette, except for the following recommendations that neither have been nor will be implemented:

The remuneration paid to each individual Executive and Supervisory Board member (§§ 4.2.4 and 5.4.7 of the Code, respectively) neither has been nor will be disclosed in the notes to the consolidated financial statements or in the corporate governance section.

Court appointments of Supervisory Board members are not limited to the succeeding annual stockholders' meeting (§ 5.4.3) but have been and will be applied for to cover the residual term of the resigned Supervisory Board member.

Düsseldorf, November 2005
Rheinmetall AG

Executive Board Supervisory Board"

Balance sheet of Rheinmetall AG
as of December 31, 2005 (acc. to German GAAP*)

ASSETS *€ million*

	12/31/2004	12/31/2005
Fixed assets		
Intangible assets	0.005	0.147
Tangible assets	30.716	33.442
Financial assets	425.863	785.404
	456.584	**818.993**
Current assets		
Receivables and sundry assets		
Due from subsidiaries	319.455	251.072
Sundry assets	18.247	24.667
Securities	21.811	34.087
Cash on hand and in bank	118.549	310.034
	478.062	**619.860**
Prepaid expenses & deferred charges	**2.468**	**2.230**
	937.114	**1,441.083**

STOCKHOLDERS' EQUITY & LIABILITIES *€ million*

	12/31/2004	12/31/2005
Capital stock	92.160	92.160
Additional paid-in capital	208.262	208.262
Reserves retained from earnings	83.155	54.446
Net earnings	27.252	31.639
Stockholders' equity	**410.829**	**386.507**
Untaxed/special reserves	**3.472**	**3.383**
Accruals		
Accruals for pensions and similar obligations	21.263	71.724
All other accruals	38.538	35.923
	59.801	**107.647**
Liabilities		
Bonds	317.000	470.836
Trade payables	0.604	0.688
Due to subsidiaries	124.803	440.201
Sundry liabilities	20.604	31.820
	463.011	**943.545**
Deferred income	**0.001**	**0.001**
	937.114	**1,441.083**

** German Commercial Code ("HGB")*

Income statement of Rheinmetall AG for fiscal 2005 (acc. to German GAAP*)

€ million

	2004	2005
Income from investments	47.852	46.263
Net interest expense	(16.742)	(30.813)
Net financial result	**31.110**	**15.450**
Other operating income	38.352	40.428
Personnel expenses	(16.685)	(24.786)
Amortization of intangible and depreciation of tangible assets	(1.547)	(1.880)
Other operating expenses	(28.449)	(33.270)
EBT	**22.781**	**(4.058)**
Income taxes	0	6.989
Net income	**22.781**	**2.931**
Transfer from reserves retained from earnings	26.282	40.984
Transfer to reserves retained from earnings	(21.811)	(12.276)
Net earnings	**27.252**	**31.639**

** German Commercial Code ("HGB")*

Supervisory Board

Klaus Greinert
Mannheim

Chairman

DURAVIT AG
(chairman)

DURAVIT S.A.

Rheinmetall DeTec AG
(chairman, up to 7/19/2005)

Advisory board chairman of Gebr. Röchling KG

Advisory board chairman of Röchling Immobilien GmbH

Joachim Stöber *)
Biebergemünd

Vice-Chairman

Vorstand der IG Metall

GEA Group AG

Pierburg GmbH

Rheinmetall DeTec AG
(vice-chairman, up to 7/19/2005)

Dr. Eckhard Cordes
Stuttgart

Executive board chairman of
Franz Haniel & Cie. GmbH

Carl Zeiss Vision GmbH

Dr. Ludwig Dammer *)
Düsseldorf

Head of Strategic Production Planning,
Pierburg GmbH

Kolbenschmidt Pierburg AG

Dr. Andreas Georgi
Glashütten

Executive board member of
Dresdner Bank AG

Allianz Dresdner Global Investors Deutschland GmbH

Asea Brown Boveri AG

Deutsche Schiffsbank AG
(vice-chairman)

Deutscher Investment-Trust
Gesellschaft für Wertpapieranlagen mbH

Dresdner Bank Luxembourg S.A.
(vice-president)

Dresdner Bank (Schweiz) AG
(president)

Dresdner Mezzanine Verwaltungs GmbH
(vice-chairman)

Eurohypo Aktiengesellschaft

Felix Schoeller Holding GmbH & Co. KG

Reuschel & Co. KG
(vice-chairman)

RWE Dea AG

Dr. Bernd Michael Hönle
Weisenheim am Sand
(up to 12/31/2005)

Managing partner of Gebr. Röchling KG

BEA Holding AG

DeTeWe-Deutsche Telephonwerke Beteiligungs AG

Francotyp-Postalia Beteiligungs AG
(up to 4/20/2005)

Kolbenschmidt Pierburg AG

PFEIFFER & MAY Grosshandel AG

Rheinmetall DeTec AG
(up to 7/19/2005)

Seeber Beteiligungs AG

Heinrich Kmett *)
Fahrenbach/Robern

Works council chairman of
Kolbenschmidt Pierburg AG
KS Kolbenschmidt GmbH
MSI Motor Service International GmbH

Kolbenschmidt Pierburg AG

Dr. Rudolf Luz *)
Neckarsulm

1st delegate of the Metalworkers Union
Heilbronn-Neckarsulm

Kolbenschmidt Pierburg AG
(vice-chairman)

Bechtle AG

*) *employee representative*

Dr. Peter Mihatsch
Sindelfingen
(as from 8/22/2005)

Giesecke & Devrient GmbH
(chairman)

3i Group plc

Vodafone Deutschland GmbH

Vodafone D2 GmbH

Arcor AG

Alcatel S.A.

Wolfgang Müller *)
Bad Rappenau

Works council chairman of
KS Aluminium-Technologie AG

KS Aluminium-Technologie AG

KS ATAG GmbH

Henning von Ondarza
Bonn
(as from 8/22/2005)

Retired general

Rheinmetall DeTec AG
(up to 7/19/2005)

Johannes Frhr. v. Salmuth
London, UK

Executive Board member of
Aluminium-Werke Wutöschingen AG & Co.

Vice-chairman of the advisory board and partners' committee of Gebr. Röchling KG

Prof. Dr. Frank Richter
Ulm
(as from 1/1/2006)

Professor, Chair of Strategic Corporate Governance and Finance, Ulm University

Advisory board of Gebr. Röchling KG

GSW Gemeinnützige Siedlungs- und Wohnungsbaugesellschaft Berlin mbH

Dr. Dieter Schadt
Mülheim/Ruhr

Former Executive board chairman of Franz Haniel & Cie. GmbH

Delton AG

Esso Deutschland GmbH

ExxonMobil Central Europe Holding GmbH

LSG Lufthansa Service Holding AG

Advisory board of Gebr. Röchling KG

TAKKT AG

Wolfgang Tretbar *)
Nettetal

Works council chairman of Pierburg GmbH,
Nettetal plant

Dr. Sabine Thürmel
Grünwald
(up to 7/31/2005)

Computer scientist

DeTeWe-Deutsche Telephonwerke Beteiligungs AG
(up to 5/11/2005)

Shareholder committee of
Röchling Industrie Verwaltung GmbH
(up to April 2005)

Partners' committee of Gebr. Röchling KG

Harald Töpfer *)
Kassel

Works council chairman of
Rheinmetall Landsysteme GmbH,
Kassel operation

Rheinmetall Landsysteme GmbH

Peter Winter *)
Achim

Works council member of
Rheinmetall Defence Electronics GmbH

Professor Dr. Dirk Zumkeller
Munich
(up to 7/31/2005)

Full professor of Transport & Transit Systems,
Technical University of Karlsruhe

Advisory board of Gebr. Röchling KG

Shareholder committee of
Röchling Industrie Verwaltung GmbH

Kolbenschmidt Pierburg AG

Executive Board

Klaus Eberhardt
Düsseldorf

Chairman
Director of Industrial Relations

Defence

Chairman of the Defence sector
(as from 7/19/2005)

CEO of Rheinmetall DeTec AG
(up to 7/19/2005)

Membership in supervisory boards

Hirschmann Electronics Holding S.A.
(chairman)

Kolbenschmidt Pierburg AG
(chairman)

MAN AG
(as from 6/3/2005)

Rheinmetall Defence Electronics GmbH
(chairman)

Rheinmetall Landsysteme GmbH
(chairman)

Rheinmetall Waffe Munition GmbH
(chairman)

Oerlikon Contraves AG
(president)

Nitrochemie AG
(president)

Nitrochemie Wimmis AG
(president)

Eckart Wälzholz-Junius Familienstiftung

Dietrich Wälzholz Familienstiftung

Dr. Gerd Kleinert
Gottmadingen

Automotive

CEO of Kolbenschmidt Pierburg AG

Membership in supervisory boards

Kolbenschmidt Pierburg Shanghai
Nonferrous Components Co. Ltd.
(vice-chairman)

KS Aluminium-Technologie AG
(chairman)

KS ATAG GmbH
(chairman)

KS Gleitlager GmbH
(chairman)

KS Kolbenschmidt GmbH
(chairman)

KS International Investment Corp.

KS Piston Shanghai Co. Ltd.

Läpple AG
(chairman as from 12/8/2005)

Läpple Holding AG
(chairman as from 12/8/2005)

Pierburg GmbH
(chairman)

Dr. Herbert Müller
Düsseldorf

Finance & Controlling (CFO)

Membership in supervisory boards

Kolbenschmidt Pierburg AG

Rheinmetall DeTec AG
(up to 7/19/2005)

Senior Executive Officers

Dr. Andreas Beyer, LL.M.
Sindelfingen

Law, Internal Auditing, M&A

Membership in supervisory boards

Bachofen + Meier AG

Jagenberg AG

Kolbenschmidt Pierburg AG

Pierburg GmbH

Ingo Hecke
Meerbusch

Human Resources and Senior Management

Executive Board, Defence sector
(as from 7/19/2005)

Senior executive officer of Rheinmetall DeTec AG
(up to 7/19/2005)

Membership in supervisory boards

Rheinmetall Defence Electronics GmbH

Rheinmetall Landsysteme GmbH

Rheinmetall Waffe Munition GmbH

Financial glossary

Actuarial gains and losses. The actuarial computation of pension accruals is largely based on forecasted parameters (such as pay, pension and interest rate trends). If these assumptions are changed on the basis of actual developments, actuarial gains or losses result.

Capital employed (CE). CE provided by →stakeholders and comprising net financial debt, pension accruals and total equity. The meaningful interpretation of this indicator requires →EBIT to calculate →ROCE. EBIT should ensure a sufficient return on CE to satisfy the stakeholders concerned.

Cash flow (gross, but after taxes). Net income/net loss plus amortization/depreciation and changes in accruals for pensions and similar obligations. This indicator shows a company's ability to internally fund its expenditures and processes and to distribute cash dividends.

Corporate governance. Responsible management and control of a company. The German Corporate Governance Code has compiled certain standards to facilitate comparisons of governance structures between internationally operating German companies. All German listed corporations are required by the law to annually issue a declaration on the extent of past and/or present compliance with the Code's recommendations.

DCF method. The discounted-cash flow method is mainly used to determine the value of a company. In the standard two-step gross approach, first the value of a company as a whole is calculated as the total present value of all future free cash flows, on the assumption that the company has no financial debts and based on the company's current finance structure. Secondly, the company's total debt at fair value is deducted from the total value of the debt-free company.

Deferred taxes. Balance sheet lines to disclose temporary differences between tax bases and IFRS accounting values in order to report tax expense in line with the IFRS accounting income.

Earnings per share (EpS). Net earnings related to the number of shares issued and outstanding; not identical with the dividend and primarily used to assess a company's results of operations. To compare several companies, the investor calculates the price-earnings ratio (PER) by relating EpS to the stock price.

EBIT. Earnings before interest and taxes; used to assess a company's performance irrespective of its financing structure. Key indicator for the Rheinmetall Group's management to control group performance.

EBIT margin. Ratio of EBIT to net sales; the percentage is used to compare the profitability of companies of different size. EBIT margins typically vary by type of business.

EBITDA. Earnings before interest, taxes, depreciation and amortization; being a pretax performance indicator that disregards the corporate financing structure and all noncash expenses, EBITDA reflects the gross cash inflow generated by a company.

EBT. Earnings before taxes: the pretax profit/loss after financing expenses is better suited to inform stockholders about the year's performance than net income/loss since tax payments may distort the picture due to past events or special factors.

Financial derivatives. Financial instruments (e.g., options, futures) derived from straight instruments (such as equities, bonds, foreign currency) and used, inter alia, to hedge against currency and interest rate risks. The prices of derivatives hinge directly or indirectly on the value of the underlying transaction.

Free float. Self-explanatory, the freely exchange-tradable shares available to the general public as opposed to stakes owned long term by major investors.

Goodwill. In company acquisitions or business combinations, net equity under cost (or prorated net assets over cost); requires capitalization as an intangible.

Interest rate swap. Swaps interest payments between two parties, such as variable for fixed rates or vice versa.

International Accounting Standards Board (IASB). Private-law organization that issues the →International Financial Reporting Standards (IFRS). At its inception in 2001, the IASB adopted the entire set of International Accounting Standards (IAS) published by its predecessor, the IASC.

International Financial Reporting Interpretations Committee (IFRIC). Once approved by the →IASB, the IFRIC Interpretations resolve potentially contentious accounting issues and, when declared effective, are binding on all IFRS users.

International Financial Reporting Standards (IFRS). Standards developed by the →IASB primarily to represent financial information for decision-making purposes that is addressed to a broad range of users, mainly investors.

Investment ratio. Ratio of additions to tangible and intangible assets (excl. goodwill) to net sales.

MDAX®. This German mid-cap index covers 50 midsize companies (in terms of order book sales and market capitalization) of the prime standard from classical sectors.

Net financial debt. The total of interest-bearing liabilities (such as bonds, accounts due to banks) less cash & cash equivalents. This figure provides information about a company's net indebtedness.

Net leverage. Ratio of →net financial debt to equity: the lower this ratio is the less depends a company on debt.

Net fair value. The amount obtainable from the sale of an asset in an arm's length transaction between knowledgeable, willing parties, less the costs of disposal (therefore a.k.a. *fair value less costs to sell*).

Percentage of completion. According to IAS 11, method of accounting for longer-term construction or service contracts with customers. Net sales, contract costs and contract profits/losses are recognized at their percentage of completion (PoC), although the contract may not have been fully completed and billed to the customer.

Projected unit credit (PUC) method. The PUC method (under IAS 19) is used to provide for pensions and similar obligations. Based on the present value of the defined benefit obligations, not only the pensions and vested rights (entitlements) as of the balance sheet date are taken into account but also future pay and pension rises.

Recoverable amount. Corresponds to the higher of an asset's →net fair value (NFV) or →value in use.

Financial glossary

ROCE (return on capital employed). Rheinmetall determines this performance indicator as the ratio of →EBIT to the annual average →capital employed. The stakeholders concerned can thus assess and rate the profitability of the capital employed within the Group. To add value, ROCE should exceed the percentage cost of capital (WACC). If defined identically, ROCE permits a comparison of the profitability of different companies. The ratio is used by management within the Rheinmetall Group for controlling purposes in line with the shareholder value concept.

Segment assets. All assets less cash & cash equivalents and income tax assets.

Segment liabilities. All liabilities less financial and income tax liabilities.

Stakeholders. Parties that contribute to corporate performance and put demands on the company in various ways; they mainly include stockholders, banks, lenders, customers, employees, government agencies.

Syndicated loan. Credit facility provided to a company not only by one but several banks (banking syndicate).

Value added. Value added to assets used in production. The Rheinmetall Group derives added value from income statement data by deducting from the entire annual economic output the year's input, such as cost of materials and amortization/depreciation.

Value in use. The present value of the estimated future cash flows expected to arise from an asset's continuing use and its disposal at the end of its useful life.

Working capital. Net inventories plus trade receivables (including PoC), less prepayments received (including under PoC contracts) and trade payables. This short definition of (net) working capital (WC) within the Rheinmetall Group includes only parameters relevant to corporate governance and control and provides information about the financial resources tied up in WC, which is a material, readily controllable component of →capital employed. Reducing WC releases financial resources, raises →ROCE and also shareholder value.

Financial diary for 2006 and 2007

March 22, 2006
Annual accounts press conference

March 22, 2006
Analysts meeting

May 9, 2006
Annual stockholders' meeting

May 9, 2006
Q1/2006 report

May 10, 2006
Teleconference with financial analysts

August 8, 2006
Q2/2006 report
Teleconference with financial analysts

November 8, 2006
Q3/2006 report
Teleconference with financial analysts

March 21, 2007
Annual accounts press conference

March 21, 2007
Analysts meeting

May 2007
Annual stockholders' meeting

Imprint

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Rheinmetall's homepage at **www.rheinmetall.com** contains detailed business information about the Rheinmetall Group and its subsidiaries, present trends, 15-minute stock price updates, press releases, and ad hoc notifications. In fact, investor information is a regular fixture of this website from where all the relevant details may be downloaded.

Our annual report is downloadable from **www.rheinmetall.com** in both English and German, the latter version prevailing in any case of doubt, or may be obtained directly from the Company.

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