Rheinmetall AG
Annual Report

2006

Rheinmetall in figures

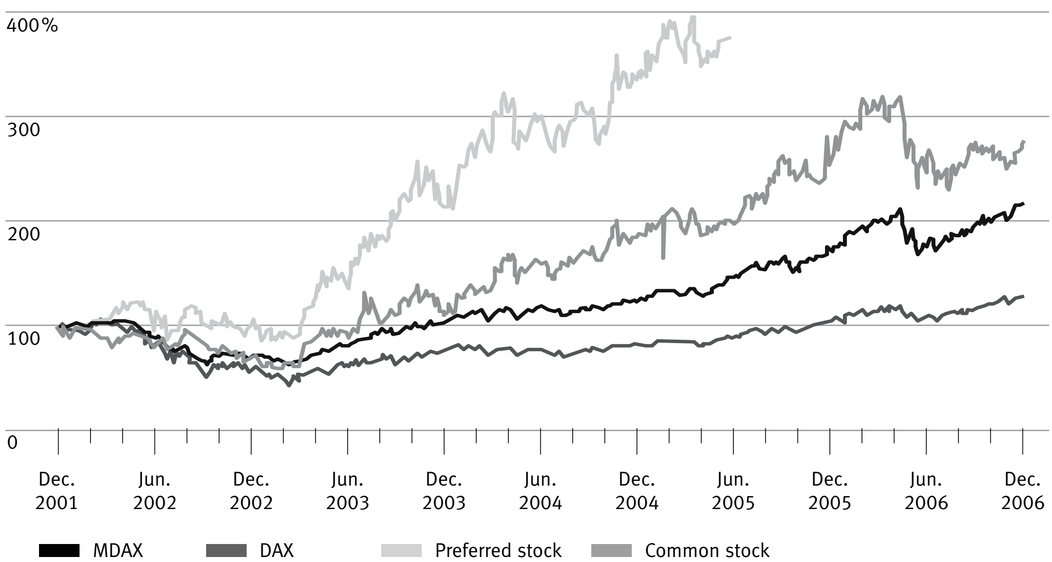
Rheinmetall Group indicators

		2002	2003	2004	2005	2006
Sales	*€ million*	4,571	4,248	3,413	3,454	3,629
Order intake	*€ million*	4,840	4,128	3,147	3,625	3,903
Order backlog (Dec. 31)	*€ million*	4,165	3,143	2,741	2,907	3,183
EBITDA	*€ million*	701	446	385	382	366
EBIT	*€ million*	392	204	217	225	215
EBT	*€ million*	290	120	146	170	164
Net income	*€ million*	274	68	101	118	123
Cash flow	*€ million*	587	308	264	277	284
Capital expenditures	*€ million*	248	203	183	198	193
Amortization/depreciation	*€ million*	268	211	168	157	151
Total equity	*€ million*	869	731	779	875	937
Total assets	*€ million*	4,087	3,442	3,100	3,423	3,337
EBIT margin	*in %*	8.6	4.8	6.4	6.5	5.9
ROCE [1]	*in %*	20.1	12.3	14.9	15.2	12.5
Earnings per common share	€	6.81	1.72	2.64	3.19	3.41
Dividend per common share [2]	€	0.64	0.64	0.74	0.90	1.00
Employees (Dec. 31)		25,949	20,888	18,283	18,548	18,799

[1] *as from 2006, CE incl. accumulated goodwill write-down*
[2] *including superdividend (€0.20 in 2002)*

Rheinmetall stock price trend in comparison to DAX and MDAX

December 28, 2001, to December 29, 2006

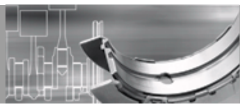


An overview of the Rheinmetall Group

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. As management holding company, Rheinmetall AG owned at year-end 2006 a total 97.59 percent of the stock of Kolbenschmidt Pierburg AG; the remaining shares are free floating.

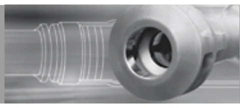
Corporate sector Automotive





Pierburg	**KS Pistons**	**KS Plain Bearings**	**KS Aluminum Technology**	**Motor Service**
Systems and components for air management and emission control Oil and water pumps, vacuum pumps	Passenger car pistons Piston modules Commercial-vehicle pistons Large-bore pistons	Plain bearings, bushings Thrust washers Dry bearings (Permaglide) Continuous NF castings	Aluminum engine blocks	Automotive parts for engine repair and workshops
Sales €923 million	Sales €707 million	Sales €196 million	Sales €224 million	Sales €158 million
Employees 3,391	Employees 6,047	Employees 1,028	Employees 1,035	Employees 376
Locations Germany France UK Italy Czech Republic Spain USA Brazil India China (joint venture)	Locations Germany France Czech Republic USA Mexico Canada Brazil Japan China (joint venture) India (assoc. affiliate)	Locations Germany USA Brazil	Locations Germany	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
€381 million

Employees
1,588

Locations
Germany

Air Defence Systems

Air defence systems

High-performance radar systems

Sales
€206 million

Employees
1,561

Locations
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
€419 million

Employees
2,172

Locations
Germany
Switzerland
Austria
USA

Defence Electronics

Command, control and reconnaissance systems

C^4I systems

Fire control units

Simulation systems

Sales
€467 million

Employees
1,438

Locations
Germany
Greece

Continuity, Change, Challenge. Automotive and Defence—for around 100 years these have been among the pivotal businesses at Rheinmetall. Core businesses in pursuit of which the Group has displayed strength, perseverance, and dependability when exposed to the challenges of change and new trends in technologies and markets. Challenges that have placed exacting demands on Rheinmetall's adaptability and renewability. Throughout these years new terrain has been trod, new technologies have been discovered, new products developed, new associates, customers and stockholders attracted.

Things haven't changed. With entrepreneurial courage, resolute action and in-depth industry intelligence, inviting markets of tomorrow have been entered well ahead of time. Capability, resources and capital have been and still are directed into the development of innovative and highly marketable products, into accessing and penetrating selected sectors, into strengthening the loyalty of existing and acquiring new customers.

More important than yesteryear's success stories are the business ambitions and technology options of the future. The seeds have been sown for expansion into future markets and applications. Clear in its business decisions, visionary in its exploitation of opportunities, Rheinmetall is braced to take on fresh challenges. 18,800 employees are doing their utmost to achieve the ambitious goals—for sustained success now and in future.

Contents

News flashes 2006

Q1/2006


■ The groundbreaking ceremony at Neckarsulm to mark construction commencement of the new Customer and Engineering Center intended to sharpen to auto industry customers the profile of the group companies clustered at this location.

■ Mercedes-Benz's R-Class uses Kolbenschmidt Pierburg technology. Pierburg, KS Pistons und KS Plain Bearings are all supplying ultramodern products installed into the newly engineered Grand Sport Tourer series—a six-seater with ample space that merges the hallmarks of a variety of auto genres.

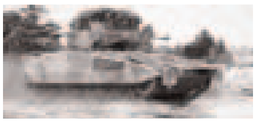
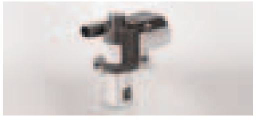
■ At the new Mexico location, around 300 employees manufacture gasoline and diesel engine pistons for car and commercial vehicle OEMs. For KS Pistons, KS de México represents an extension of production capacities while amplifying this company's NAFTA presence.

■ Following industrial and customer teams from Britain, Italy, and Spain, German pilots from the 73rd fighter squadron are now completing on simulators built by Rheinmetall Defence Electronics their first training phase as future Eurofighter instructors of the German Air Force.

■ In Dresden, Saxony's Minister-President Milbradt commissions the world's biggest capacitor bank costing around €10 million, the centerpiece of the new High Magnetic Field Laboratory of the Rossendorf Research Center (FZR). This ultramodern capacitive energy supply system was developed jointly with experts from Rheinmetall Weapon Munition.

■ At an Analysts Meeting held in Unterlüss, Defence presents its four divisions and its operating business.

Q2/2006

■ The renowned Society of Automotive Engineers (SAE) stages a major automotive technology conference in Detroit. In the Diesel, Gas and Hybrid section, the Automotive sector presents technologies and innovations aimed at reducing emissions and fuel consumption, improving engine performance and efficiency and minimizing engine noise and vibrations.

■ The world's biggest carmaker General Motors once again presents its Supplier of the Year Award to KS Kolbenschmidt, thus acknowledging the excellent quality and service provided by the Neckarsulm-based piston manufacturer.

■ The 10th Papenburg Industry Conference turns to the automotive industry. Some 100 representatives from industry and politics find out at KS Gleitlager about the production techniques involved in the manufacture of high-precision components and inspect Europe's largest vertical continuous red brass casting facility during a plant tour.

■ As part of the celebrations to mark the 50th anniversary of the establishment of the German Army, the prototype of the German armed forces' new PUMA infantry fighting vehicle is unveiled to the public for the first time in the presence of hundreds of personages from politics, the military, industry, and the media.

■ Rheinmetall Defence's exhibition stand at Eurosatory in Paris attracts notable visitors: French Defence Minister Michèle Alliot-Marie finding out about the numerous new developments and advancements that are making a major contribution to the armed forces' modernization.

■ In cooperation with Lufthansa Flight Training GmbH, Rheinmetall Defence Electronics is re-equipping an Airbus A340 full flight simulator with the AVIOR laser projection system. Following approval by the Braunschweig-based Federal Aviation Authority, AVIOR is the second projection system worldwide to be licensed for high-quality level-D simulators.

Q3/2006


■ Pierburg unveils a new exhaust gas recirculation cooler module for diesel engines through which the emission of harmful nitrogen oxides will be further reduced with the selective control of the recirculated exhaust gas volume and temperature. The new product will go into series production in 2007.

■ Following a mere seven-month construction period, KS Aluminum Technology holds the topping-out ceremony in a new factory for net-machining its engine blocks. The complex, which will include two production levels and a customer center on a space under roof of 10,000 square meters, will be ready to move into in March 2007.

■ R&D specialists from KS Plain Bearings inform some 130 guests from the automotive industry, its vendors and universities about the company's systems expertise in the development of innovative sliding elements at a two-day conference.

■ Rheinmetall Weapon Munition achieves a breakthrough onto the international market with the first delivery of 12 MLG 27-type light naval guns to the Kuwait navy. This follows the decision in favor of the MLG 27 by the German armed forces as the new standard gun for the German navy.

■ Rheinmetall Defence Electronics secures major orders from three countries for simulation systems worth some €50 million. In Germany, the central land forces combat simulator, in use since 1997, is to be completely modernized. Switzerland opts for an electronic firing training system as well as artillery system upgrades. Thailand is to upgrade the existing TACOS I tank gunnery and combat simulator and will receive in addition five ultramodern driving simulators for TACOS II.

■ "Future Soldier" is the name of one of the key modernization projects being undertaken by the German armed forces for which Rheinmetall is developing and designing the "expanded system." The aim of this technology program is through state-of-the-art equipment to enhance materially the efficiency of infantry forces across the operational spectrum while reducing the risk for individual soldiers.

Q4/2006


■ Kolbenschmidt Pierburg on board the new Audi R8: its 8-cylinder aluminum engine block is supplied by KS Aluminum Technology, the engine bearings and Permaglide parts by KS Plain Bearings while Pierburg provides the solenoid valves.

■ For the third time the Rheinmetall Foundation committee awards grants to four young scientists for their outstanding automotive work in automobile, electrical and automatic control engineering.

■ In establishing a company in Pune, one of India's most important auto industry centers, Pierburg takes another step forward in extending its global base and production network. The location will, to begin with, focus on application engineering, supplier quality assurance, purchasing, and marketing.

■ The Danish armed forces are the first to opt for a newly developed 120-mm KE Pele-type ammunition for hitherto unachieved target impact accuracy and hence much reduced collateral damage.

■ Possible solutions for addressing the expanded challenges facing the German armed forces available from Rheinmetall Defence Electronics. A new test unit for networked operations command maps out complex scenarios while testing the interaction of sensors, command systems, and avariety of combat agents deployed by all the services.

■ The newly developed wheeled armored vehicle GeFas has vast technological potential and offers strong military advantages on crisis missions. A life-size model is presented by Rheinmetall Defence to representatives from the armed forces, government agencies, and politics so that these are involved right from the project stage and able to input their expertise and suggestions.

Letter from the Executive Board

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

In fiscal 2006 Rheinmetall successfully maintained its position on the international markets and raised its sales to €3.6+ billion, thus achieving its self-imposed target of 5-percent average organic growth annually. Newly booked series-production contracts propelled order intake by 8 percent. Orders on hand for over €3 billion plus recent-month product innovations form a solid base for the organic growth planned for the Group over the years ahead.

For Rheinmetall, 2006 was a period in which important directions were taken regarding the necessary optimization of its global production structures; and it was a year in which the Group felt the impact of unforeseeably steep commodity price rises. The consequence: one-off burdens and cost inputs that depressed EBIT from €225 million to €215 million. Lower net interest expense and downscaled taxes, in contrast, raised net income from €118 million to €123 million and EpS from €3.19 to €3.41. We want our stockholders to share accordingly and so, together with the Supervisory Board, we will propose to the stockholders' meeting a 10-cent cash dividend increase to €1.00 per eligible share.

Clarity and continuity in matters of strategy, far-sightedness in the proactive exploitation of market opportunities, and value generation through profitable growth—this is Rheinmetall's way of doing business. We have two strong corporate sectors, Automotive and Defence, commanding foremost market positions with their demonstrably defined core capabilities.

The range of products and capabilities of the Defence sector is tailored to the overriding requirements posed by the global transformation of the armed forces and the new military mission scenarios. It is on this basis that the sector succeeded in repeating its year-earlier performance improvements to boost EBIT in fiscal 2006 by 14 percent to €111 million. Given the completed restructuring programs at Air Defence Systems and recent months' market successes we are highly optimistic regarding earnings being further improved by Rheinmetall Defence over the years ahead.

Kolbenschmidt Pierburg's products again benefited from major auto industry trends enabling this group to successfully uphold its position against tough competition. Sales at €2.2 billion in 2006 were at an all-time high and a reward for the innovation drive launched two years ago. As anticipated, the location improvements stepped up for further internationalization took their toll on earnings. These burdens were compounded by the higher commodity prices impacting on the entire industry and not downloadable in the form of higher selling prices. With an EBIT of €113 million, Kolbenschmidt Pierburg fell short of the prior-year figure. This still strong operating performance, on the other hand, encourages us to expect from this sector very soon a return to rising profits.

Given the presently sound position of Automotive and Defence we launched out confidently into fiscal 2007. We will continue on the course of profitable growth and hence further enhance Rheinmetall's already strong attraction for the capital market.

Our thanks go to all that have accompanied us through 2006: our customers, suppliers, stockholders, and Supervisory Board members. Most especially we thank our employees for their efforts and commitment over the past year.

Klaus Eberhardt   Dr. Gerd Kleinert   Dr. Herbert Müller

“We will continue on the course of profitable growth.” Rheinmetall’s Executive Board (from left): Klaus Eberhardt (59), Dr. Herbert Müller (53), and Dr. Gerd Kleinert (58).

Report of the Supervisory Board

Supervisory Board work in 2006. In fiscal 2006, the Supervisory Board fully performed the functions and obligations 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 Company's conduct of business.

Deliberations and votes. These were all based on the Executive Board's detailed written and viva voce reports. At the four quarterly Supervisory Board meetings in 2006, the Executive Board briefed the Supervisory Board in depth on the business trend, earnings and financial position of the Group and its corporate sectors, as well as on significant projects and transactions and on risk management. Furthermore, changes in the overall economic environment and the specific market, industry and competitor structures, as well as the associated effects on the Rheinmetall Group's sector parents were discussed. Additionally reported, explained and discussed were any plan or budget variances, deviations from defined targets, and their reasons. Actions and transactions of the Executive Board requiring approval were duly reviewed and Supervisory Board approval granted. Twelve members attended all Supervisory Board meetings, four being prevented from attending one meeting each. Between meeting dates, the CEO met with the Supervisory Board Chairman on many occasions to update him on major projects, extraordinary events, matters up for decision, and significant trends.

Key items on the agenda of the March 20, 2006 meeting of the Supervisory Board included Rheinmetall AG's separate and consolidated financial statements 2005, as well as the draft proposals to be submitted to the annual stockholders' meeting on May 9, 2006. At its meeting on May 8, 2006, the Supervisory Board obtained information about the current business trend and Q1/2006 and prepared for the annual general meeting the next day. On September 20, 2006, the Executive Board reported on the progress achieved in translating the corporate strategy into practice. This was followed by detailed deliberations on growth opportunities and further fine-tuning of the Group structure with its two sectors, Automotive and Defence. Moreover, that meeting dealt with the performance and business trends in H1/2006. On the agenda of the meeting on December 7, 2006, was the periodic debate on the strategic and operations corporate plan for 2007–2010, including financial, investment and HR issues. The investment master budget for 2007 was approved.

Committee activities. The Supervisory Board is assisted by three committees formed from among its members for efficient performance of its duties. At four meetings, the Personnel Committee conferred on matters such as the structure and magnitude of Executive Board member remuneration and the targets to be achieved by the Executive Board. 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 2006, mainly to review the separate and consolidated financial statements 2005, deal with accounting and risk management issues and the cooperation with the statutory auditor. The Supervisory Board Chairman reported to the plenary Supervisory Board on the gist of issues handled at Audit Committee meetings.

Corporate governance. At its December 7, 2006 meeting, the Supervisory Board together with the Executive Board endorsed the updated declaration of conformity under the terms of Art. 161 German Stock Corporation Act ("AktG"). The full declaration has been published on page 104 in the Corporate Governance section of this annual report and on the Company's website. At the same meeting, the Supervisory Board reviewed and assessed the efficiency of its own work, the routines of briefing by the Executive Board, as well as inter-board collaboration and committee work.

Change in Supervisory Board membership. Effective September 20, 2006, Johannes Frhr. v. Salmuth stepped down from this Board as stockholder representative and, for his remaining term of office according to court order dated October 4, 2006, was succeeded by DDr. Peter Mitterbauer. The Supervisory Board thanks Johannes Frhr. v. Salmuth for his many years of valuable input and commitment.

Financial statements 2006. The separate financial statements prepared by the Executive Board as of December 31, 2006, in accordance with German accounting standards (including Rheinmetall AG's management report), as well as the consolidated financial statements formulated on the basis of Art. 315a German Commercial Code ("HGB") in conformity with the International Financial Reporting Standards (IFRS) as adopted by the European Union (EU), together with the group management report, were all audited (including the accounting) by PricewaterhouseCoopers Aktiengesellschaft Wirtschaftsprüfungsgesellschaft, Frankfurt/Main, Düsseldorf branch, in accordance with legislative provisions. The statutory auditor, which had been elected by the annual stockholders' meeting on May 9, 2006, and engaged by the Supervisory Board to audit the separate and consolidated financial statements, issued its unqualified opinions thereon.

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

The March 14, 2007 preparatory, and the March 20, 2007 annual accounts, meetings of the Supervisory Board's Audit Committee were attended by the statutory auditor's report signatories who provided details of the scope, focal areas and conclusions of their audit as well as 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 has confirmed 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 fiscal 2006; the separate financial statements for 2006 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 €1.00 per share

Further disclosures. Rheinmetall AG's capital stock amounts to €92,160,000 and is divided into 36 million no-par shares of common stock. The provisions of Art. 84 AktG and Article 6 of the bylaws govern the appointment and removal of Executive Board members. Amendments of or to the bylaws are subject to the provisions of Arts. 179 et seq. AktG. The Executive Board's powers have been laid down in its rules of procedure and in a catalog issued by the Supervisory Board and listing all transactions subject to its approval. The annual meeting of stockholders on May 9, 2006, resolved to create authorized capital according to Art. 4(3) of the bylaws and authorized the Executive Board to repurchase treasury shares on or before October 31, 2007. As of December 31, 2006, Rheinmetall AG held 986,364 shares of treasury stock (up from 844,981 a year ago), equivalent to 2.7 percent of the capital stock.

Report of the Supervisory Board

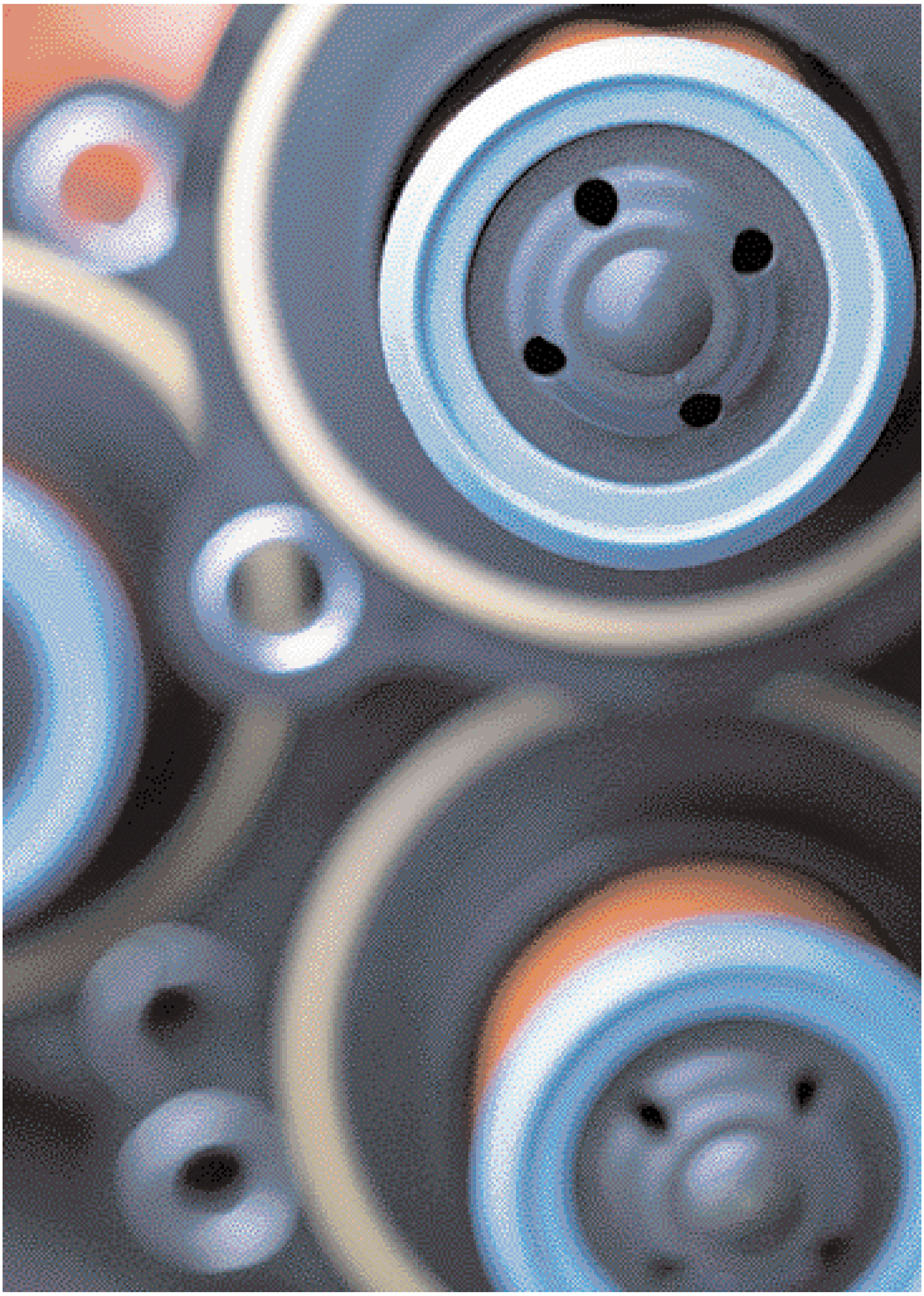
No preventive precautions have been taken against a public takeover offering, the successive acquisition of a controlling stake through share purchases via stock markets, or control being gained by buying share parcels. The German Foreign Trade & Payments Act requires for the acquisition of a defense technology company that the federal government give its prior approval before any nonresident party can purchase 25 percent of the shares. This Act aims to safeguard material interests of the Federal Republic of Germany.

Change-of-control clauses are included in the key financial instruments of Rheinmetall AG, the bond issue, as well as in the syndicated-loan agreement. These restrictive clauses would enter into force and effect if 50 percent or more of Rheinmetall AG's capital stock were held directly or indirectly by any one party or several persons acting jointly or in unison. In any such cases, bondholders are entitled to demand redemption of the bonds they own, and the syndicated loan will require a renegotiation of the agreed terms and conditions.

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 extends its thanks to the Executive Board, the other corporate officers, as well as all the employees for their dedicated efforts and their close personal commitment in the year 2006.

Düsseldorf, March 20, 2007
For the Supervisory Board

Klaus Greinert
Chairman



Small, cost efficient, and effective: electric divert-air valves from Pierburg.

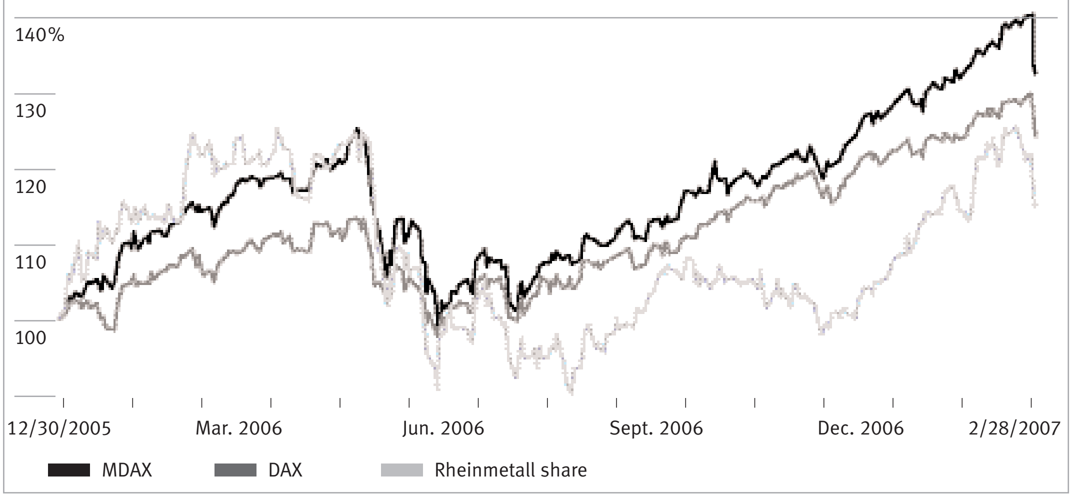
Rheinmetall stock

Upbeat stock market year. During the period under review, the German stock market maintained its upward momentum which had lasted since the start of 2003. Germany's lead index, the DAX, closed 2006 at 6,597, a gain of 22 percent. The MDAX, which includes Rheinmetall, reached 9,405 at year-end, a 29-percent advance.

Rheinmetall stock price progressing. At the start of 2006, Rheinmetall's stock price was surging. Having closed 2005 at €53.26, by April 4, 2006 it had shot to €66.39, thus clearly outracing the MDAX. Until mid-May, the price moved in a bandwidth of €62.00 to €67.00, but was then caught in the downward plunge of the market. The outcome: for periods of time in the months June, July, August, it slipped below €50.00. This was followed by a rally, the stock closing the fiscal year on December 29, 2006, at a price of €57.48. As part of the recovery observable as from January 2007, the price rebounded to €60.85 on February 28, 2007.

Rheinmetall stock price trend in comparison to DAX and MDAX

December 30, 2005, to February 28, 2007



Still an MDAX heavyweight. In 2006, Rheinmetall again defended its position as one of the MDAX heavyweights although its market capitalization and trading volume, essential criteria for index membership, changed in the course of the year. With an unchanged 36 million shares, Rheinmetall's market value grew parallel with the stock price. In index-relevant rankings of Deutsche Börse AG (the German Stock Exchange Corporation), Rheinmetall had a market capitalization of €2.0 billion at year-end 2006.

Its market capitalization ranking among Deutsche Börse's 50 MDAX members in December 2006 was 17 (down from 10 in January 2006). In the second essential MDAX criterion, trading volume, Rheinmetall rose from €1.8 billion at the start of the year to €2.7 billion in December, the ranking slipping from 18th to 24th during the same period.

Rheinmetall coveted by international investors. A comprehensive analysis of the results of the stockholder survey held in September 2006 indicates that 65 percent are European, 26 percent North American, 6 percent unidentified investors, just under 3 percent of the stock being held by Rheinmetall AG itself.

Investors informed Rheinmetall AG in 2006 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 (Art. 26 of amended WpHG):

- On March 10, 2006, Rheinmetall AG reported that the British banking group HBOS plc, London, together with its subsidiaries HBOS Insurance & Investment Group Limited, Insight Investment Management Limited and Insight Investment Management (Global) Limited, held 5.436 percent of the voting stock of Rheinmetall.
- On May 5, 2006, Rheinmetall AG reported that the British banking group Schroders plc as well as its subsidiaries Schroders Administration Limited and Schroders Investment Management Limited held 6.75 percent of the voting stock of Rheinmetall AG.

Then in January and February 2007, the following:

- On January 18, 2007, Rheinmetall AG reported that the TIAA Board of Overseers and its subsidiary, the Teachers Insurance and Annuity Association of America, held 5.24 percent of Rheinmetall AG's stock.
- On February 7, 2007, Rheinmetall AG reported that the TIAA Board of Overseers and its subsidiary the Teachers Insurance and Annuity Association of America held a 4.99-percent interest in Rheinmetall AG.

Investor relations commitment. A proactive and forthright dialog with stockholders, prospective investors, and financial analysts is the prime target of the Rheinmetall Group's investor relations efforts which last year provided information about corporate business, the newest trends and the outlook for the Group. Also outlined were the long-term growth strategy and the medium-term earnings and growth targets.

The close attention to, and unabated interest in, Rheinmetall stock on the part of analysts in 2006 are reflected in the many studies, nutshell analyses and reports regarding its fair market value. Over recent years, coverage by German brokers has risen continuously and last year they were joined by further international observers as exemplified by Merrill Lynch, London, which took up coverage in September 2006. With the addition of the international investors Credit Suisse, Frankfurt/Main, and Cazenove, London, interest is now even more international.

A major investor relations instrument is direct dialog with analysts and stockholders. At 15 investor and analyst conferences and 14 road shows held at a variety of venues including German, British, US, Canadian, Swiss, and French in the course of some 230 one-on-one discussions, Rheinmetall management successfully won the confidence of international investors. These efforts were supplemented by around 140 one-to-one talks, mostly on the occasion of company visits as well as teleconferences held with investors.

Repurchase of treasury shares. According to the votes of the annual stockholders' meetings 2005 and 2006, the Executive Board is authorized to repurchase treasury stock equivalent to 10 percent of the capital stock. In the period, 141,383 treasury shares were acquired at an average price of €54.60 per share.

As of December 31, 2006, Rheinmetall AG held 986,364 shares of treasury stock (up from 844,981 a year ago), equivalent to 2.7 percent of the capital stock. For further disclosures, especially regarding the capital stock breakdown and authorized capital, see Note (15) to the consolidated financial statements.

Rheinmetall stock

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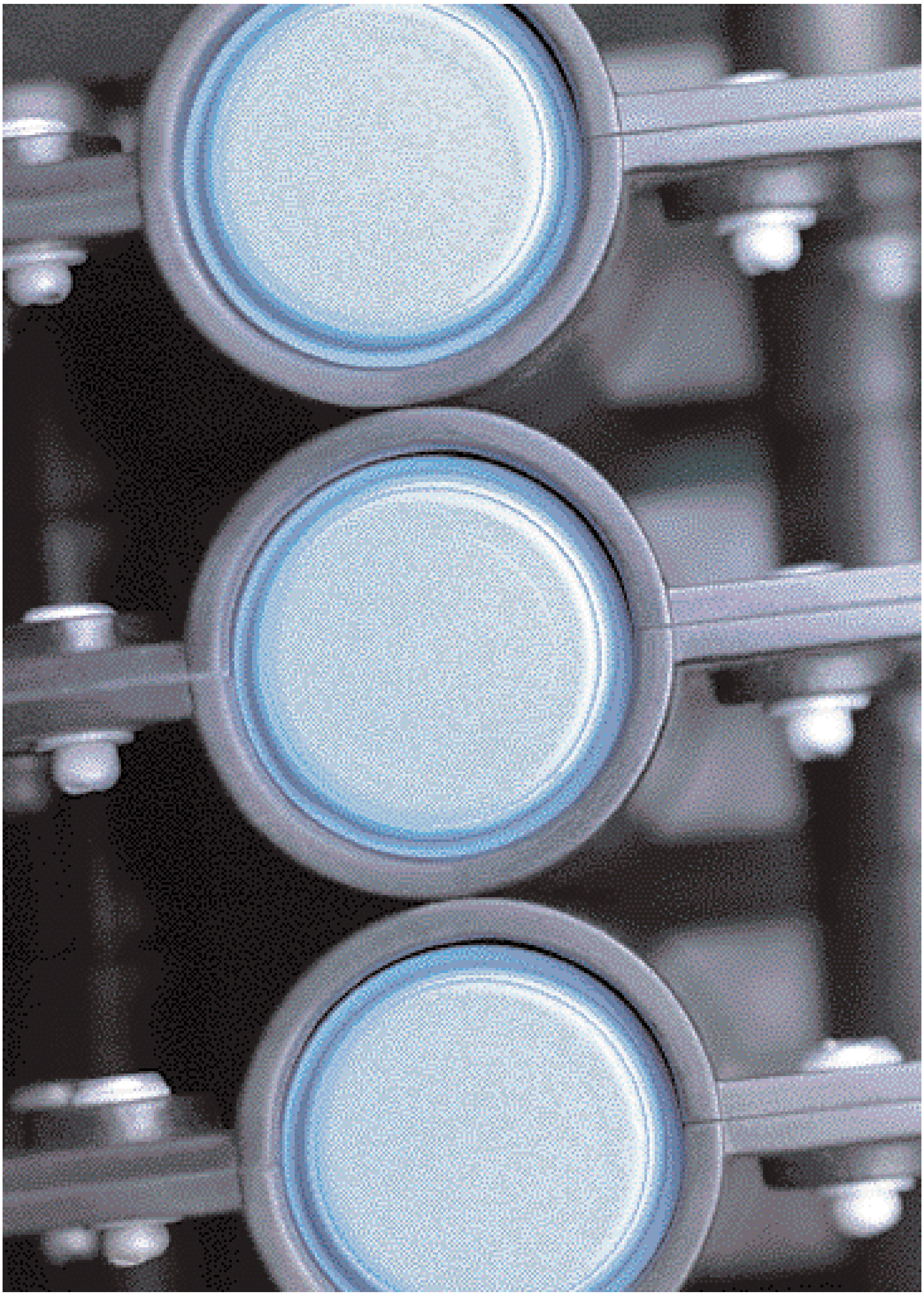
Attractive dividend. The Supervisory and Executive Boards propose to the annual stockholders' meeting on May 8, 2007, to distribute a cash dividend of €1.00 per share. The repurchased treasury stock held does not rank for dividend. €0.90 had been paid for 2005 per common share, and hence Rheinmetall is consistently pursuing its investor-friendly path of previous years.



Immediate protection for military and civilian vehicles offered by the lightweight smoke projectile launchers from Rheinmetall Waffe Munition.

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.

Investment grade rating. The internationally renowned rating agencies Standard & Poor's and Moody's have rated the Rheinmetall Group investment grade since 2000 (BBB and Baa2, respectively). In August 2006, Standard & Poor's downgraded the long-term outlook to negative and the short-term from A2 to A3.

Agency	Long-term	Outlook	Short-term	Outlook
Standard & Poor's	BBB	negative	A3	stable
Moody's	Baa 2	stable	Prime-2	stable

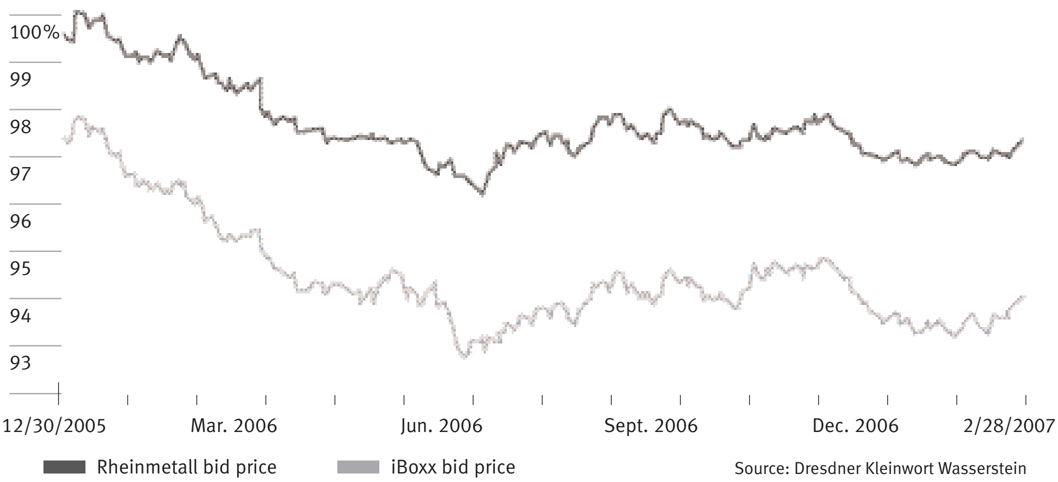
Working capital cyclicity within Defence. Besides the Group's medium- and long-term needs for funds, the cyclical volatility of Defence's cash requirements during the year must be covered throughout. This seesawing need for cash within a year, though quite common among companies dealing in project business with mostly public-sector customers, is controlled through a consistent 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 fiscal 2005, Rheinmetall had capitalized on the favorable market scenario and the associated historical low of interest rates and floated a new €325 million 3.500-percent bond issue. The bonds are listed on the Frankfurt Securities Exchange and mature June 21, 2010. Part of the old 6.125-percent €350 million bond issue of 2001 was repaid under the early-redemption offering, the remaining bonds for €146 million were redeemed at the maturity date on May 31, 2006.

Trend of Rheinmetall bonds on the secondary market. As of December 31, 2006, due to the substantial interest rate increase in 2006, the bond was quoted on the capital markets at a mean price of 97.20 percent, hence below the year's opening level. With turnover moderate, the Rheinmetall bond spread was significantly below that of the iBoxx Non-Financials BBB reference index (+33 bps at December 31, 2006).

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

December 30, 2005, to February 28, 2007



Source: Dresdner Kleinwort Wasserstein

Syndicated credit facility extended up to 2011. In February 2006, on its own initiative, Rheinmetall AG extended up to 2011 the €400 million credit facility renegotiated in 2005 for an original term expiring in 2010. This facility has been granted by a syndicate of prime domestic and international banks and, together with the €500 million commercial paper program (CPP), in existence unchanged since 2002, ensures the availability of all short-term financial resources needed during the year. The syndicated credit facility backs up the €500 million commercial paper program which 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.

Bilateral credit agreements. Moreover, Rheinmetall can draw on several firmly committed, bilateral credit agreements with additional financial institutions outside the group of banks which granted the syndicated credit 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.

Asset-backed securities program. A further funding tool is the Rheinmetall Group's asset-backed securities (ABS) program for a maximum volume of €170 million and terms expiring 2009 or later. Under this program, twelve European group companies sell their trade receivables every month without recourse. The maximum program volume was utilized as of December 31, 2006.

General economic conditions

Buoyant global economy in 2006. The global economic uptrend persisted in the period under review. According to the IMF, international economic output advanced by 5.1 percent from the previous period. A particular factor in 2006 was the emerging pressure of inflation especially as a consequence of global economic growth, higher crude oil quotations and the surge in commodity prices. However, with the price of oil receding significantly toward year-end following its all-time high in the summer of 2006, inflation rates were held in check. Nonetheless, the central banks of the USA, Euroland and Japan raised their key lending rates repeatedly during the period in order to combat the threat of inflation well in advance.

Toward midyear the United States lost some of its economic momentum partly because of a shrinking domestic real-estate market. In all, the IMF estimates a GDP of 3.4 percent for this country. The European economy, in contrast, went from strength to strength and for Euroland, the OECD in September 2006 revised its prediction upward from 2.2 to 2.7 percent. A major component in the steady upswing was the robust German economy which the OECD forecasts to have grown by 2.2 percent. Driving forces were sustained strong exports and private consumption which picked up.

According to estimates in the fall of 2006 by the six leading economic institutes in Germany, the East Asian economies advanced by 5.2 percent. Predictions so far indicate that the Japanese outgrew the prior-year GDP by 2.7 percent. The emerging markets once again delivered the most impressive performance, China and India leaping by 10 and 8.3 percent, respectively. Central and Eastern Europe did well, too. According to preliminary IMF estimates, this region's 2006 growth was 5.3 percent. At 6.5 percent, the Russian economy maintained its momentum unabated.

Carmakers cashing in on pent-up demand in growth regions. For the international auto industry, 2006 was yet another year of growth. A tall backlog of demand piled up in the growth markets of Asia, C&E Europe and South America pushed up production of autos and light trucks by a good 3 percent to some 64 million units.

The Asian carmakers accounted for over 90 percent of added production worldwide. Japan and Korea advanced their output by around 6 and 4 percent, respectively, propelled by accelerating exports to East Asia. With a production rise of 26 percent China strengthened its market position to a remarkable degree. The Indian auto industry likewise gained in significance, albeit its output of 2 million units was well short of China's five and Japan's 11 million.

Exports also drove up production for Europe's carmakers by 2 percent to 20 million units. Here, however, production tended to migrate from West to East, this latter region in some cases showing growth rates well into the double-digit range, specifically the Czech Republic, Hungary, and Poland. Whereas Germany maintained its prior-year output, France, the UK and Spain all suffered setbacks. Italy appears to have overcome its previous years' crisis. In all, Western Europe produced 16 million units or 1 percent fewer than a year before.

The structural crisis confronting the North American auto industry market endured through 2006. Its 15 million autos and light trucks were around 3 percent short of 2005. The drop is partly due to restructuring efforts on the part of the major carmakers leading to product range revamps and rigorous downsizing of inventories. South America, in contrast, again ranks among the growth regions, this continent's manufacturers advancing their production by 8 percent, shared equally by exports and growing domestic demand.

Global leadership positions in the relevant markets with replacement parts in OEM quality from Motor Service International.

General economic conditions

In terms of auto models, rising fuel costs once more spurred demand for shrinking-consumption and reduced-emission vehicles. There is repeated demand for lightweight materials such as aluminum and magnesium plus products converging mechanical and electronic technologies. Diesel vehicles were again popular. Lower consumption, the higher price of gasoline and reduced emission meant that in Western Europe more than 50 percent of newly registered cars in 2005 had diesel engines. This is a trend from which Kolbenschmidt Pierburg as market and technology pacemaker more than benefits.

Defence technology dominated by requirements of geopolitical change. Changed geopolitical realities and the resulting consequences continued to dominate the general economic environment for defence technology in 2006. At over US$1 trillion, defence spending worldwide once again almost matched the record levels of the 1980s. Crucial factors included the increasing number of military conflicts, the shift in the distribution of power toward Asia, and the stronger focus on combating international terrorism.

At the same time, any rise or fall in defence spending is largely unrelated to the prevailing economic climate. Rather, defence budgets are being increasingly influenced by the armed forces' modernization needs based on missions abroad, which are usually closely linked to the obligations on the part of individual countries to international alliances such as NATO, the UN or the EU. Spending within the respective defence budgets largely went on the modernization of ordnance, with mobility, reconnaissance capability, the protection of the soldiers in the field, and systems networking both nationally and internationally enjoying special priority.

Defence expenditures varied from one region to another. Influenced by the war in Iraq, US defence spending soared to well over $500 billion, a new all-time high. Based on the size of their defence budgets, Russia, China and the UK are the next three biggest military nations, albeit well behind the USA. At around 10 percent in some regions of the Near & Middle East, military spending's share of gross national product is also a pointer to regional centers of conflict. In the USA, defence spending's share of GNP is about 4 percent, in the UK and France approximately 2.5 percent, and in Germany 1.5 percent. Overall, the German defence budget remained unchanged in 2006 at just under €24 billion. The German armed forces' modernization requirements are largely based on a rising number of foreign missions and an increasing proportion available in the defence budget for matériel procurement and R&D, which rose from about 24.6 percent in 2005 to 25.2 percent in the year under review.

This incremental expenditure owing to transformation requirements is being partially funded by the outsourcing of military tasks from the private sector, affecting such areas as army maintenance logistics, fleets of vehicles and clothing. In addition, crews of the multirole NH 90 helicopter have been instructed at training centers run by industry since 2005, a project in which Rheinmetall is also playing a major part. All in all, these privatization measures amounted to a budget volume of more than €600 million in 2006.

Business trend Rheinmetall Group

Rheinmetall Group indicators *€ million*

	2005	2006
Net sales	3,454	3,629
Order intake	3,625	3,903
Order backlog (Dec. 31)	2,907	3,183
Employees (Dec. 31)	18,548	18,799
EBIT	225	215
EBT	170	164
Average capital employed [1]	1,480	1,725
EBIT margin (in %)	6.5	5.9
ROCE (in %) [1]	15.2	12.5
When applying the adjusted EBIT as defined in Note (32) to the consolidated financial statements, the rebased indicators read as follows:		
Adjusted EBIT *€ million*	245	222
Adjusted EBIT margin *in %*	7.1	6.1
Adjusted ROCE *in %*	16.6	12.9

[1] *as from 2006 redefined formula*

Sales again up. In fiscal 2006, the Rheinmetall Group generated sales of €3,629 million (up from €3,454 million), an increase of around 5 percent. Of this amount, Automotive accounted for 60 percent, Rheinmetall Defence contributed 40 percent.

Sales by corporate sector *€ million*

	2005	Share of total sales	2006	Share of total sales
Automotive	2,050	59%	2,181	60%
Defence	1,401	41%	1,445	40%
Rheinmetall Group	3,454	100%	3,629	100%

With sales of €2,181 million, the Automotive sector achieved an all-time high in fiscal 2006, topping the prior-year figure by €131 million or over 6 percent. Almost half of this rise is, however, due to the downloading of the higher cost of materials.

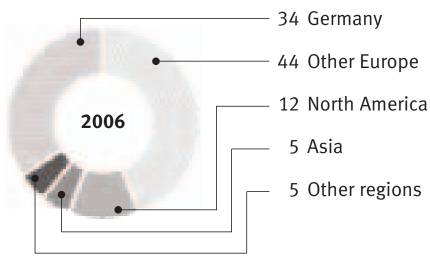
Allowing for this revenue-inflating factor, the growth shown by the Kolbenschmidt Pierburg Group matched that of the international auto industry, albeit easily superior to auto industry growth in the particularly important markets of Western Europe and NAFTA.

During the period, Rheinmetall Defence stepped up sales by 3 percent to €1,445 million. Declining sales by Air Defence Systems due to program delays were offset by in part significant hikes achieved by the other divisions.

At 66 percent, exports by the Rheinmetall Group almost matched the prior-year 67 percent. Besides the German market, focal regions were other European countries, followed by North America and Asia. At Automotive, 68 percent of sales were posted outside of Germany; at Defence, non-German customers accounted for 63 percent.

Business trend Rheinmetall Group

Sales by region in 2006 *in %*



Based on Rheinmetall Group sales of €3,629 million

Order intake buoyant. By balance sheet date, the Rheinmetall Group recorded an order intake for the period of €3,903 million (up from €3,625 million). Order intake at Automotive advanced 7 percent to €2,203 million; Defence lifted its order inflow to €1,696 million, up 9 percent.

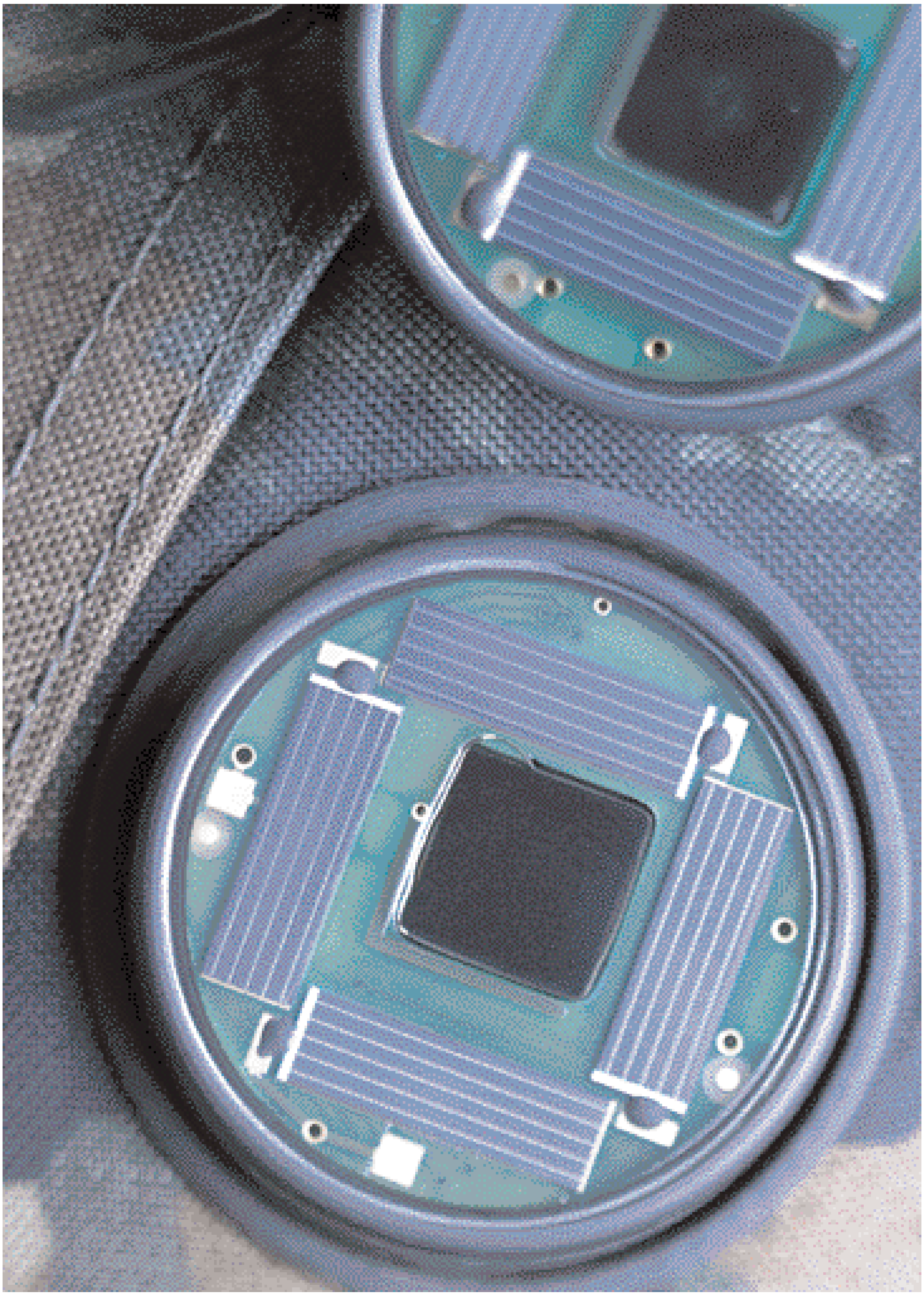
At €3,183 million, the Rheinmetall Group's year-end order backlog was roughly 10 percent higher than a year before. The year-end figure for Defence amounted to €2,819 million (up from €2,565 million) and includes high-volume contracts extending over several fiscal periods.

Earnings generally stable. The Rheinmetall Group's EBIT for 2006 added up to €215 million (down from €225 million). Whereas the Defence sector with an EBIT of €111 million showed a clear improvement over the previous period, EBIT at Automotive dropped from €146 million to €113 million, mainly due to ongoing high commodity and energy prices. Apart from Air Defence Systems, all the divisions at Automotive and Defence contributed a profit in 2006. Decisive factors in improving profitability were, in addition to the groupwide program for cost reduction and efficiency enhancement through restructuring the business operations, the forward-looking focus of product strategy on growth markets as well as the selective expansion of globalization efforts.

EBIT by corporate sector *€ million*

	2005	2006
Automotive	146	113
Defence	97	111
Others/consolidation	(18)	(9)
Rheinmetall Group	**225**	**215**

The definitely improved performance of Others, which subsume the activities of Rheinmetall AG and its service companies, is basically ascribable to the prior year's €8 million one-time expenses for finance rescheduling.



Reliable data on any exercise situation delivered by the sensor units of the mobile infantry training system from Rheinmetall Defence Electronics.

Business trend Rheinmetall Group

Adjusted EBIT *€ million*

	2005	2006
EBIT	225	215
Nonrecurring losses/gains from		
shareholdings	(4)	(7)
real estate	(1)	(6)
restructuring programs	17	20
finance rescheduling	8	--
Adjusted EBIT	**245**	**222**

Net interest expense down, net earnings up. The Rheinmetall Group's enhanced finance structure pared net interest expense by €4 million to €51 million in 2006. A contributory factor was the residual redemption in May 2006 of the 6.125-percent fixed-rate bonds issued back in 2001. After income taxes of €41 million (down by €11 million), net income for 2006 totaled €123 million. The minority interests therein came to €3 million (down from €5 million).

Group net income *€ million*

	2005	2006
EBIT	**225**	**215**
Net interest expense	(55)	(51)
EBT	**170**	**164**
Income taxes	(52)	(41)
Group net income	**118**	**123**
Minority interests	5	3
Group earnings (after minority interests)	113	120
Earnings per share (€)	**3.19**	**3.41**

Asset and capital structure. In the year under review, the Rheinmetall Group's total assets inched down 3 percent to €3,337 million. The decrease in current assets by €118 million or 7 percent was mainly attributable to shrinking cash and cash equivalents in the wake of the May 2006 redemption of the bond issue then matured.

Equity mounted by €62 million to €937 million, which meant another improvement of the equity ratio from 26 to 28 percent.

The Rheinmetall Group's noncurrent liabilities of €1,032 million substantially remained at the prior-year level while current liabilities slipped by €139 million or 9 percent. The prior-year figure included the old bonds at €146 million due in May 2006. Deducting cash and cash equivalents of a total €197 million brings net financial debt to €205 million (up from €151 million). Net leverage (i.e., the ratio of net financial debt to equity) came to 22 percent (up from 17 percent).

Asset and capital structure *€ million*

	12/31/2005	%	12/31/2006	%
Noncurrent assets	1,619	47	1,651	49
Current assets	1,804	53	1,686	51
Total assets	**3,423**	100	**3,337**	100
Total equity	875	26	937	28
Noncurrent liabilities	1,041	30	1,032	31
Current liabilities	1,507	44	1,368	41
Total capital	**3,423**	100	**3,337**	100

Value again added. In fiscal 2006, the value added by the Rheinmetall Group moved up to €1,294 million. While the Group's total operating performance came to €3,935 million (up from €3,672 million), the ratio of value added to total operating performance was at 33 percent virtually maintained at the previous year's magnitude of 34 percent. The value added per capita (rounded) edged up to €69,000 (from €68,000).

The workforce received 82 percent of the value added, the lion's share; the Treasury's slice came to 4 percent. The interest payable to lenders/banks shrank in 2006 to 4 percent. At €35 million, stockholders receive 3 percent. The residual 7 percent (unchanged) of value added, equivalent to €89 million (up from €86 million), remains within the Rheinmetall Group.

Source and use of value added *€ million*

	2005		2006	
Source				
Group's total operating performance	3,672		3,935	
Input	(2,261)		(2,490)	
Amortization/depreciation	(157)		(151)	
Value added	**1,254**		**1,294**	
Use		%		%
Employees	1,010	81	1,060	82
Treasury	63	5	51	4
Lenders/banks	63	5	59	4
Stockholders	32	2	35	3
Rheinmetall	86	7	89	7
Value added	**1,254**	100	**1,294**	100

Business trend Rheinmetall Group
Capital expenditures

Expenditures securing competitive lead. Rheinmetall's expenditure program in 2006 was again dictated by the enactment of organic growth strategies, with funds allocated to strategic and operational targets designed to strengthen market positions and consolidate technological competence. Investing activities covered plant and equipment, facilities, processes and manufacturing capacities for products. Rheinmetall's additions in 2006 to tangible and intangible assets (excluding goodwill) amounted to €193 million (down from €198 million). In terms of total group sales this is equivalent to about 5.3 percent. Amortization and depreciation for the period came to €151 million (down from €157 million).

Capital expenditures by sector *€ million*

	2005	2006
Automotive	162	149
Defence	35	43
Others/consolidation	1	1
Rheinmetall Group	**198**	**193**

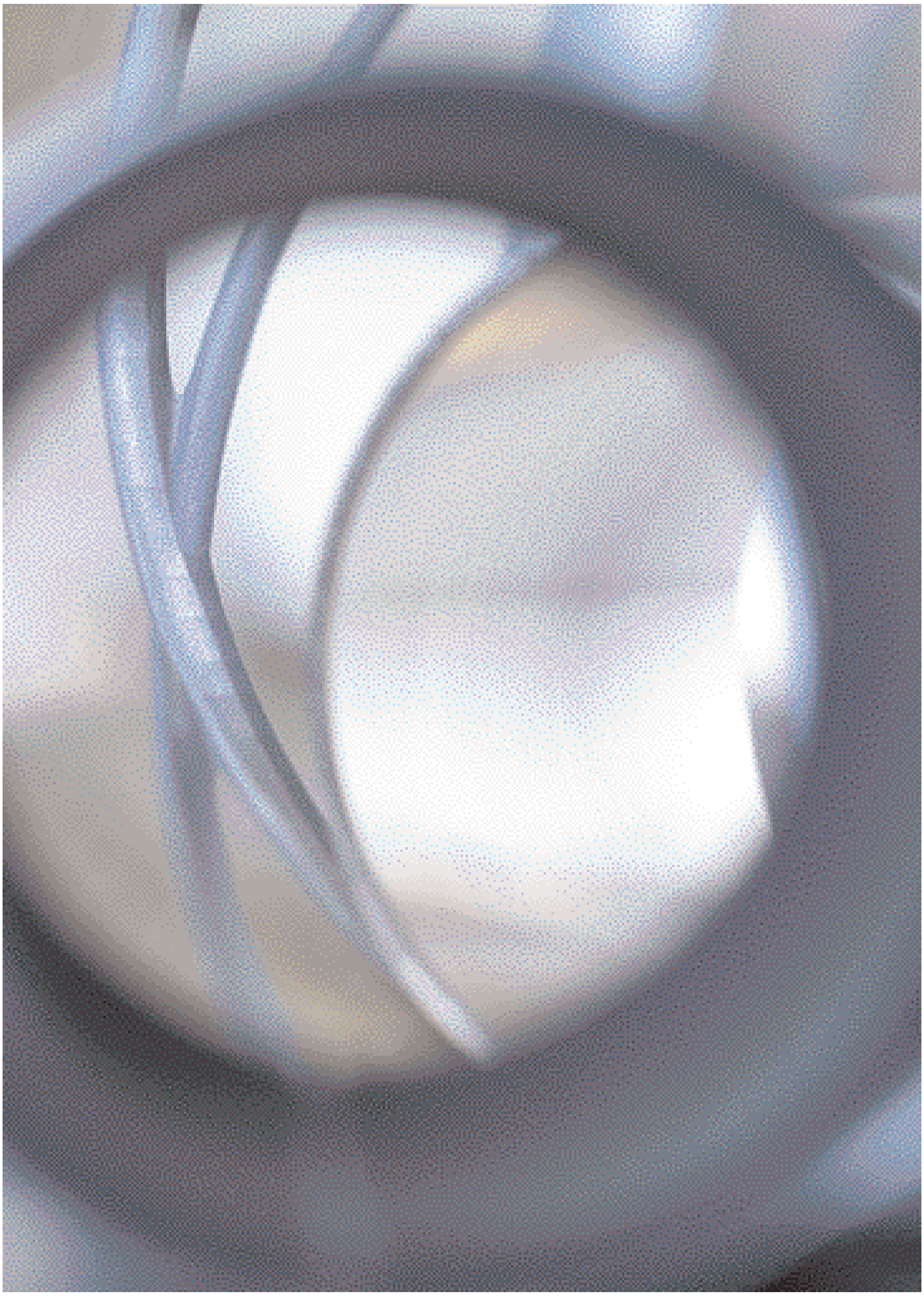
Automotive reduces expenditures. At €149 million or 77 percent, Automotive accounted for the lion's share of the Group's expenditure budget, equivalent to 6.8 percent (down from 7.9 percent) of segment sales.

Most of the domestic outlays by the Pierburg division were channeled into the start-up of new products and the expansion of existing capacities for the purpose of meeting rising customer demands, in particular for the manufacture of intake manifolds and electric water pumps. Other amounts went toward R&D equipment and the completion of the Neuss-based Customer Center. Outside of Germany, in Spain and the USA, the chief item of expenditure was EGR valve assembly capacities. The Italian and French companies concentrated on enlarging capacities for the manufacture of oil and water pumps. The Czech facility's expenditures targeted the setting-up and expansion of secondary air pump, exhaust flap and electric actuator module production. The Brazilian location focused its outlays on the construction of production and office buildings and on pressure-die casting and net-machining equipment as well as assembly line expansion.

At its domestic locations, the Pistons division (KS Kolben) spent chiefly on replacing existing equipment and new large-bore and steel piston projects. Outside of Germany, the division invested in the enlargement of existing capacities, especially in the Czech Republic and Japan. Other expenditures went toward the expansion of the Mexican facility acquired last spring.

The Plain Bearings division (KS Gleitlager) spent most of its funds in 2006 on widening the capacity of the upstream materials production at St. Leon-Rot and on enlarging parts production at Papenburg. Outlays in the USA concentrated on manufacturing facility peripherals, the improvement of production infrastructure and equipment for enhancing occupational safety.

With a view to accessing new and profitable areas of business, the Aluminum Technology (KS Aluminium-Technologie) division focused its investing activities on buildings in preparation for expanding the net-machining areas. By extending its downstream machining input, KS ATAG will be adding extra value to the engine blocks it ships out. Facilities and equipment were again procured for new product start-ups and full capacity production of low-pressure castings. Other expenditures concerned infrastructure. Work started at Neckarsulm on the construction of the new Customer Center scheduled for completion by March 2007.



Metallic and maintenance-free Permaglide plain bearings from worldwide foremost supplier KS Plain Bearings.

Business trend Rheinmetall Group
Capital expenditures

Rising capital spending at Rheinmetall Defence. In the period under review, the Defence sector increased its expenditures by €8 million to €43 million (up from €35 million in 2005). As a percentage of the corporate sector's sales, this is 3.0 percent (up from 2.5 percent).

Capitalized development costs at Land Systems centered on the GeFaS, a modular armored combat vehicle. Development of a demonstrator in the heavily protected medium-weight wheeled vehicle range is planned by the end of 2007. Alongside additions to existing IT systems, Rheinmetall Landsysteme GmbH invested in further industrial plant and machinery as well as factory and office equipment as part of the project to revamp the materials warehouse at the Kassel location.

Air Defence Systems continued to work on the development of the Millennium naval gun; other investments concerned industrial equipment and machinery for the manufacture of components for various products. Buoyant business at the Malaysian plant led to the procurement of additional automatic PCB assembly machines.

The Ratingen-based Rheinmetall Waffe Munition GmbH acquired the industrial property and trademark rights for technologies so as to substantially enhance the performance range of new and existing ammunition. At its Aschau location, Weapon Munition continued the investment project launched in 2004 and aimed at improving the quality of polybasic propellant powder production. In the year under review, the completely modernized powder-mixing machine was also commissioned, as was the plant built for the production of catalysts as part of the scheduled expansion of specialty chemicals. Replacement expenditures for a modern and flexible universal CNC machining center required for medium-caliber weapon components enabled Rheinmetall Waffe Munition Schweiz AG to rationalize its production processes.

As in the previous year, spending by Defence Electronics concentrated on modernizing and revamping the existing IT infrastructure, especially in R&D.

Business trend Rheinmetall Group
Research and Development

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 for Rheinmetall as an internationally operating technology group in securing further growth and safeguarding competitiveness on a sustained basis.

In fiscal 2006 groupwide R&D expenditures accounted for €169 million (up from €153 million) of which €151 million (up from €141 million) was directly expensed and another €18 million capitalized as development costs. The ratio of R&D expenditures to sales was 4.7 percent in 2006 (up from 4.4 percent).

R&D expenditures by corporate sector *€ million*

	2005	% of sales	**2006**	% of sales
Automotive	107	5.2	115	5.3
Defence	46	3.3	54	3.7
Rheinmetall Group	**153**	**4.4**	**169**	**4.7**

EGR cooler reduces emissions. The Pierburg division pushed ahead with its efforts to control emissions and cut fuel consumption. Intake manifolds for a variety of applications were successfully engineered to completion. One outcome of integrated intake system developments was the new EGR cooler which permits very efficient cooling of the recirculated exhaust gases, thus minimizing nitrogen oxide emissions and going a long way toward emission standard compliance.

Work continued on exhaust gas recirculation systems whose spin-offs include gasoline engine fuel consumption reduction. Essential characteristics of these new systems are optimized, highly dethrottled exhaust gas recirculation valves and high-integration EGR cooler modules which are needed by engines if they are to meet the future emission standards US'07 and Euro 6. For the commercial vehicles sector, a twin poppet EGR valve actuated by an electric motor was developed. With its electrically actuated exhaust flap for low-pressure EGR systems, Pierburg is the first to penetrate this submarket with such a product innovation.

Steps were taken with customers, especially in the USA and from the commercial vehicle sector, in the direction of variable-flow oil pump series production. Good progress was achieved in expanding product range and customer applications for electric coolant pumps featuring on-demand control. Moreover, a new generation of low-cost electropneumatic transducers was engineered. Apart from the divert-air valve on the non-diaphragm version, an integrated pneumatic actuator was developed for the new EGR cooler product group.

Increasing power density promotes the development of pistons. For years, increasing power density as well as further reducing consumption and emissions have been the driving forces for developing new engine components at KS Pistons. On gasoline engines, this is mainly achieved through turbo-charging and direct injection or by means of variable valve timing. With their special LiteKS technology as used on the majority of series-produced pistons to date, these products meet the highest demands in terms of strength with, at the same time, low weight. HispeKS is a bore geometry developed for cast gasoline pistons with coolant passage for high-temperature and high-stress environments at the piston pin/hub, especially at elevated engine speeds.

Business trend Rheinmetall Group
Research and Development

Due to increasing power density, pistons for new passenger car turbo-diesel engines are only feasible when using coolant passages. In addition to cooled ring carriers (GalleriKS), a coolant passage with variable cross section (ContureKS) is employed for series-produced pistons with large bowl dimensions. Designs and casting technology were developed for advanced variable geometries (DynamiKS). Bowl lip and groove temperature reductions in the region of 20°C are possible. Further developments were again directed at all-steel pistons for commercial vehicles. These pistons are compatible with cylinder pressures of up to 250 bar needed for engines to comply with future emission limits. High-duty single- and multi-component steel pistons for large engines were developed for testing purposes and shipped out to a number of customers.

Zero-lead plain bearings. Given the EU directive in force as from July 2008, concerning zero-lead plain bearings in series-produced vehicles of up to 3.5 t GVW, engineers at KS Plain Bearings applied their efforts to getting the newly developed plain bearing manufacturing processes ready for series-production conditions. Several specimens of a zero-lead composite produced by the Greensburg plant in Indiana, USA, illustrate the challenges of casting this tribologically high-performance sliding material which forms the basis for the new sputter bearing.

The St. Leon-Rot location produced in several batches a new zero-lead steel/bronze sinter material as a replacement for today's still lead-based materials on connecting rod bearing shells and bushings and, in combination with a sliding coating, serving as an alternative to low-stress sputter bearings. This new version addresses the fierce competition prevailing in the sputter parts segment. A newly developed steel/aluminum composite can replace sputter bearings under low stress operating conditions.

September 2006 saw the start-up of series production of the new high-performance steel/plastic composite at St. Leon-Rot's new hot-pressing line. Extreme wear resistance, especially under mixed friction conditions, are characteristic of this material which can cope with pump pressures of more than 200 bar, thus making it first choice for plain bearings in high-pressure injection pumps on diesel engines. The laser welding line at St. Leon-Rot was commissioned specifically for bearing bushings in this application. Quality geometry with, at the same time, an intact plastic sliding layer are the outstanding technical advantages of laser welding for plain bearing production.

Optimizing pressure-cast engine blocks. In the field of low-pressure permanent-mold castings for series-production development projects, the KS Aluminum Technology division continued working on the casting and net machining of aluminum engine blocks destined for the premium segment. To take into account foreseeable trends, pressure-cast engine blocks developments proceeded further.

In the international engine block business, low-cost pressure casting is of special significance, with emphasis on improving the functional quality of the pressure-cast aluminum engine blocks. This improves the prospects for such blocks to be used on V-cylinder as well as downsized engines, i.e., small, fuel-efficient yet very high-duty. Advanced technologies such as LOKASIL cylinder walls, closed-deck design and local aluminum/metal matrix composites have meanwhile graduated to industrial production stage.

With component stress reaching increasingly critical magnitudes, materials development is of rising significance. In 2006 and with the installation of further dynamic materials testing rigs, the division is pointed the way ahead. Increasing bearing block strength and cylinder wall wear resistance rank among the criteria dictating development efforts over the years ahead.

On the advance worldwide: commercial vehicle steel pistons from KS Kolbenschmidt.

Business trend Rheinmetall Group
Research and Development

Defence geared to broadened armed forces' requirements. With its forward-pointing products and services, innovative systems 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, development work commissioned by customers is being supplemented with R&D efforts financed from the sector's own resources.

The international deployment of rapid reaction forces on peacekeeping and peacemaking missions is gaining increasing importance and presenting new challenges for the armed forces of the 21st century. In order to protect troops in the field as well as stationary facilities and property, Rheinmetall Defence has developed its modular Protective Shield concept. Consisting of networked command, reconnaissance, surveillance, and impact systems, it can be flexibly integrated into various deployment scenarios. All the information relevant to the action converges in an operations center and is processed into a real-time scenario image. The Federal Defence Ministry was offered a basic configuration for use at the Mazar-e-Sharif field camp in Afghanistan in 2006. Based on the Protective Shield concept, design and development work has started on a system for protecting naval installations and convoys against asymmetric threats.

Armored vehicle system presented. R&D efforts at Land Systems also focused on implementing the new modular and lightweight vehicle concepts which can achieve the required level of crew protection through a combination of design and technology measures without substantially increasing vehicle weight. The GeFaS project aims at developing and constructing a modular vehicle system offering troops the greatest possible protection during assignments on a multitude of different missions.

Similar security concepts lie at the heart of the armored command and multipurpose vehicles (GFF) being developed within the Wisent development project as a modular range of transport vehicles offering maximum protection together with various axle arrangements. Protection against small arms fire and mines is concentrated on the three-man driver's cab as well as the armored, removable and autonomously usable container for command and multipurpose missions. In order to complete the GFF range, modification work was carried out on the armored Gavial all-terrain vehicle and the lightweight Caracal all-purpose vehicle so as to adapt them to the German armed forces' changed deployment requirements resulting from its participation in out-of-area missions.

In a bid to meet European demand for medium-caliber turret systems as a systems supplier, efforts to develop and build a demonstrator for a new modular medium-caliber P105 turret got underway. Thanks to its flexibility with regard to crew, protection, weapon system and optronics, the turret system is geared to various customer needs.

Air Defence optimizes systems capable of engaging extremely small missiles. Air Defence Systems continued its development work on the Skyshield air defence system, building on the capability to effectively engage extremely small targets such as rockets, artillery shells and mortars (Counter-RAM). In particular, new fire control algorithms are being examined which guarantee fast and clear target allocation. In addition, development work continued on the Skyguard3 fire unit. The additional benefits of Skyshield are also to be transferred to the Skyguard systems, thus enabling customers to upgrade their current air defence systems. Another key area of activity was the final official qualification tests on the Millennium naval gun system.

In order to complete the division's naval air defence capabilities, an X-band tracking radar is being developed so that targets can be engaged by the guns with pinpoint accuracy. An additional development project concerned the tactical and highly sensitive 3-D search radar in the X band for detecting very small targets over longish ranges.

Development of light universally deployable weapon systems. The Weapon Munition division's R&D activities focused on subsystems for the new Puma infantry fighting vehicle. The MK30/2-ABM automatic cannon's effectiveness was improved to such an extent that it is now suitable for firing future generations of enhanced ammunition. In addition, a passive vehicle rear protection system consisting of a grenade launcher and related ammunition was developed for the Puma.

Weapon Munition continued to develop the 60-mm, 81-mm and 120-mm mortar ammunition ranges on schedule. With the development and official qualification testing of a new cost-effective 120-mm KE practice ammunition, the first tests were successfully conducted with a prototype round. Concepts for light universally deployable weapon systems designed for integration into light carrier vehicles were further developed. In the field of nonlethal weapon (NLW) systems, development efforts centered on the applications of high-power microwaves especially aimed at disarming radio-based and sensor-controlled booby traps.

In addition, testing started of modern laser weapons for destroying unmanned systems and of a sensor-controlled automatic cannon with external drive for the 30-mm caliber designed for future integration into a light naval gun. Moreover, a 40-mm softkill protection system demonstrator designed for light vehicles was developed and tested. The range of ammunition available for 66-mm, 76-mm and 81-mm smoke projectiles was supplemented by practice ammunition posing no fire risk. In the field of shielding nuclear power plants from terrorist threats from the air, the official qualification tests were passed and the first system supplied to a German customer.

Panoramic imaging reconnaissance with automatic target detection. Defence Electronics' R&D activities financed from the division's own resources focused on sensor equipment. A visual system for combat vehicles consisting of several camera modules provides the crew with 360-degree panoramic imaging reconnaissance together with close-range automatic target detection and tracking. Another key project was the development of a 10-Hz laser rangefinder, which is much more effective and much lower in cost than other products on the market. Based on new alignment technologies, a clear improvement in image quality was achieved for the third-generation Saphir thermal imaging device. The 360-degree infrared reconnaissance sensor, known as First and developed for air defence systems, was used in various measuring campaigns following stability and software optimization.

Following approval by the Braunschweig Federal Office of Civil Aviation, Avior has become the second laser projection system worldwide to be released for high-quality level-D simulators. The prototype of a second-generation hand weapon duel simulator, which stands out from rival products thanks to its forward-pointing wireless technology, was successfully demonstrated on a customer's premises.

An optimized concept offering broadband applications, variable payload, modularity and substantial cost savings was worked out for the unmanned aerial reconnaissance system (KZO). Development work was also carried out on small drones for air-assisted close-range reconnaissance with a view to expanding the product range.

Business trend Rheinmetall Group
Employees

18,799 employees working worldwide for Rheinmetall. In an environment of dynamic developments, growing challenges and rising complexity of technologies, products and processes, the individual skills and expertise of Rheinmetall employees play a major role in enabling the Group to achieve its goals. As of December 31, 2006, Rheinmetall employed a global workforce of 18,799 (up from 18,548). Of these, 63.4 percent worked for Automotive, 36.0 percent for Defence, and the remaining 0.6 percent for the holding companies and service enterprises. The percentage employed outside of Germany was again 42.

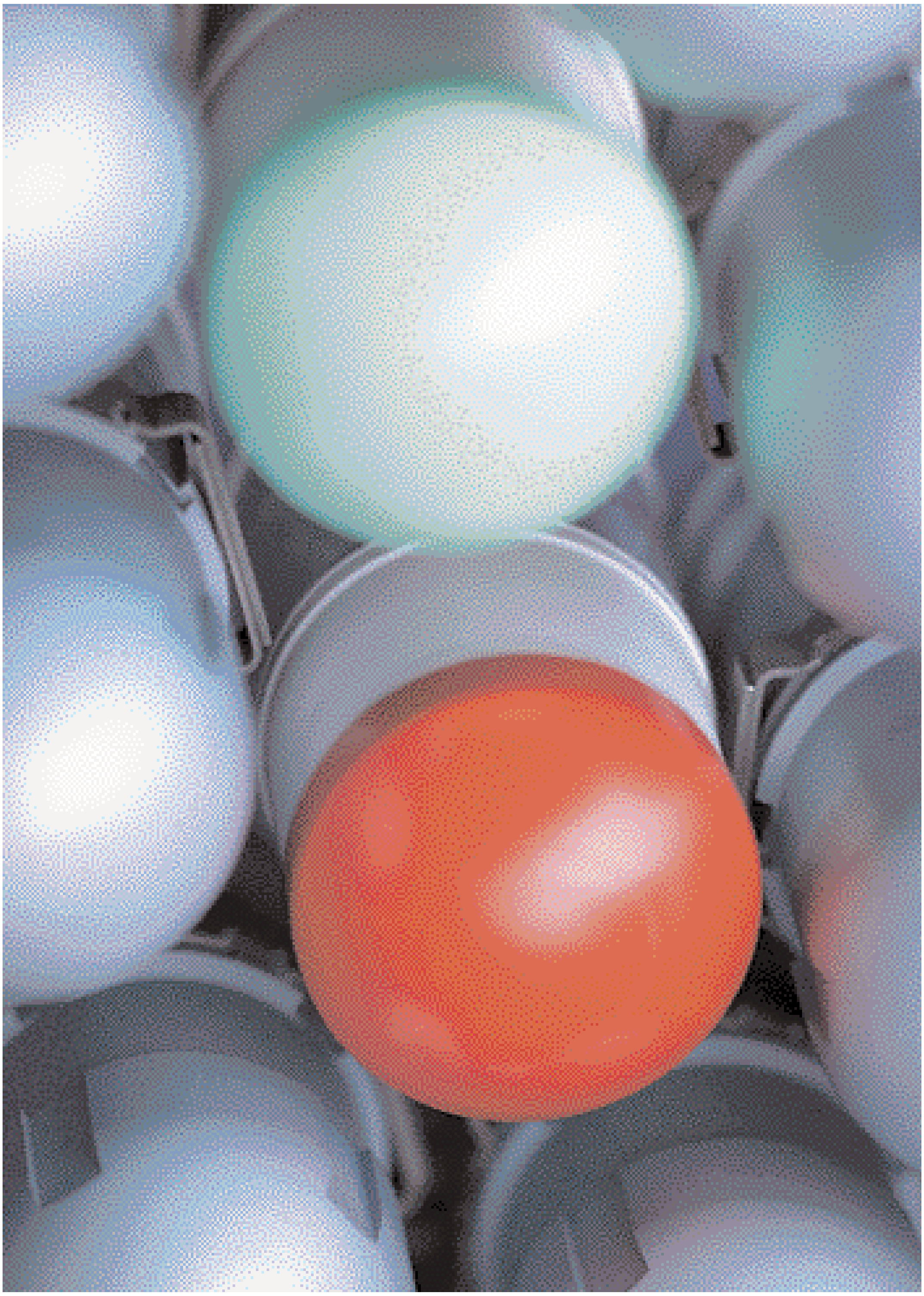
Initial and advanced training, pay. In the growth of the Rheinmetall Group a key component is the development of employees, junior management talent, and experienced specialists and executives in a manner that addresses present needs and future developments. On the basis of systematic screening and assessment processes, high-potential staff are advanced; the programs include multistage seminars and one-on-one training sessions. Rheinmetall's efforts to provide youngsters with hands-on apprenticeship training courses in technical, commercial and IT skills continued unabated. Altogether 556 young people in Germany are being taught 30 blue- and white-collar skills. The training ratio for the domestic locations was again 5.4 percent of the German workforce.

Besides a fixed amount, Rheinmetall offers its executives and other employees a variety of incentives and bonuses. Incentives range between 0 and 200 percent, depending on the achievement of personally agreed goals and quantitative corporate performance improvements. In addition to their contractually agreed pay, officers and other senior management are entitled to a long-term incentive tied to the absolute increase in the Rheinmetall Group's shareholder value (actual-to-actual comparison of the Rheinmetall Group's adjusted EBT for the past three years). Personnel expenses mounted €46 million to €1,038 million, wages and salaries accounting for €834 million, social security taxes and related employee benefits adding up to €204 million. Personnel expenses per capita (rounded) totaled €55,000 (up from €54,000). The ratio of personnel expenses to total operating performance slipped from 29 to 28 percent. Sales per capita (rounded) advanced from €188,000 to €192,000 in 2006.

Pension plans—a key component of HR policy. The Rheinmetall Group assists its employees in securing their retirement income. The plan is identically structured for employees and management alike, albeit patterned to enhance performance in the higher salary tiers. The pension plan, which applies to all domestic Rheinmetall locations, consists of a basic plan, an intermediate plan linked to performance and EBT increases, and a supplementary defined contribution plan, which enables various forms of deferred compensation.

Rheinmetall AG

Rheinmetall AG performing strategic holding functions. Heading the Rheinmetall Group is Rheinmetall AG as strategic management holding company. In charge of operating businesses are the two corporate sectors Automotive and Defence, each with its own management structure. This type of organization allows far-reaching autonomy on the part of the sectors regarding their market and customer-focused activities. Among the foremost functions of Rheinmetall AG are the definition of the corporate strategy, the setting of targets and guidelines, portfolio management, central financing and treasury, and risk management.



Tailored to expanded infantry deployment scenarios: 40-mm rounds from Rheinmetall Waffe Munition.

Automotive sector

Automotive indicators *€ million*

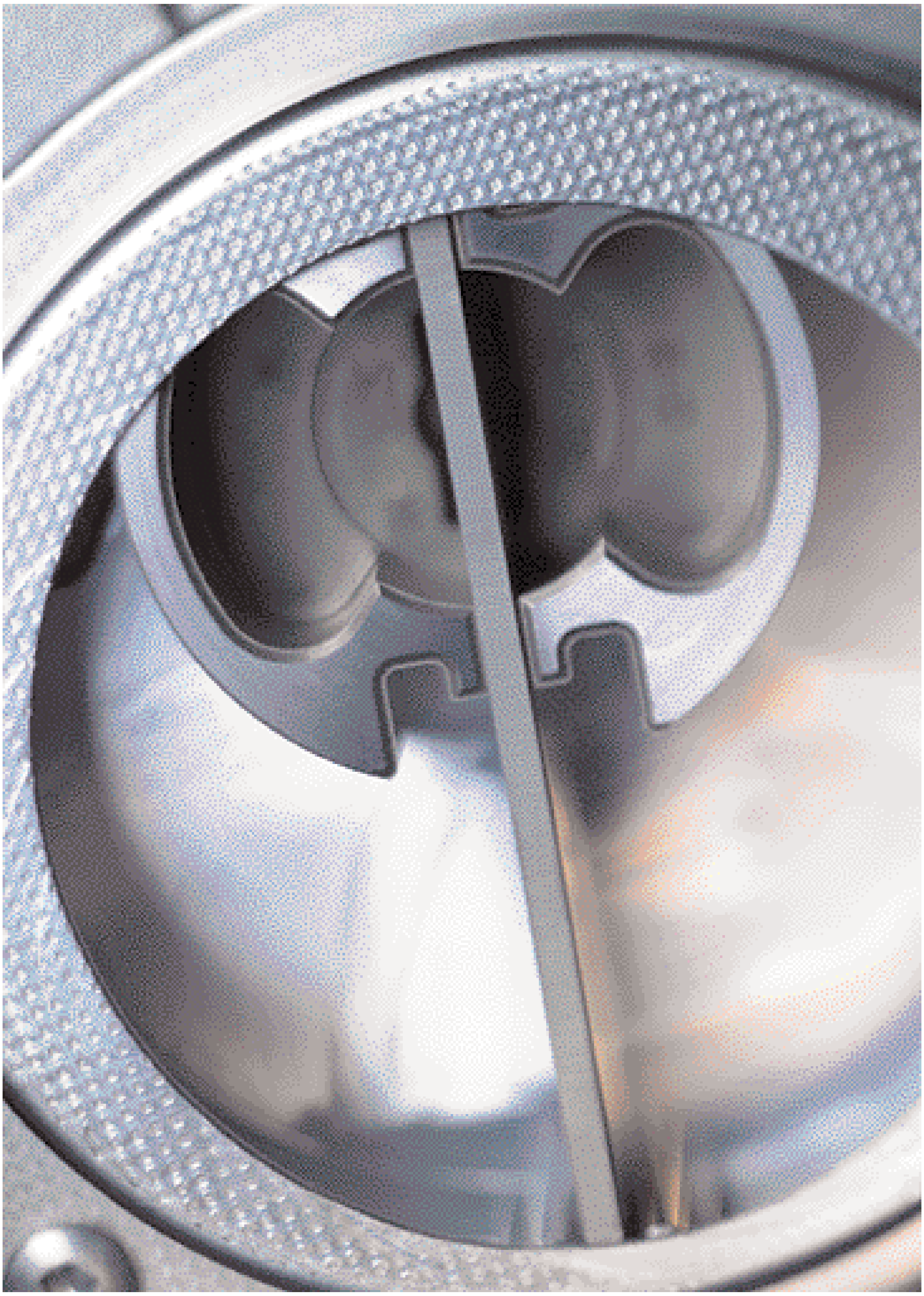
Kolbenschmidt Pierburg AG	2005	2006
Sales	2,050	2,181
Order intake	2,068	2,203
Order backlog (Dec. 31)	342	364
EBIT	146	113
EBT	127	90
Employees (Dec. 31)	11,699	11,922
Average capital employed [1]	722	962
EBIT margin (%)	7.1	5.2
ROCE (%) [1]	20.2	11.7

[1] *as from 2006 redefined formula*

Material events. In pursuance of its internationalization strategy, the Kolbenschmidt Pierburg Group stepped up its presence in 2006 in Europe, India, and North America. The Indian economy is mushrooming and to share in its growth, Pierburg India Private Ltd. was set up in Mumbai, Maharashtra. This new company will not only tap new sales and procurement markets but also has the option of forming a production plant in this important emerging market. KS Pistons acquired from the DESC Automotive Group, Mexiko City, the OEM pistons business of Pistones Moresa, Celaya, Mexico, integrating the newcomer into the Automotive sector through KS de México LLC, Celaya, Mexico.

Sales at an all-time high. Sales by the Kolbenschmidt Pierburg Group in 2006 reached a record €2,181 million (up 6.4 percent). Besides the added shipments, the chief revenue-driver was the commodity price increases downloaded onto customers on the basis of agreed cost escalator clauses. Adjusted for this latter factor and for consolidation group changes, the growth rate was 3.8 percent, slightly above the 3.4-percent global gain in automobile production.

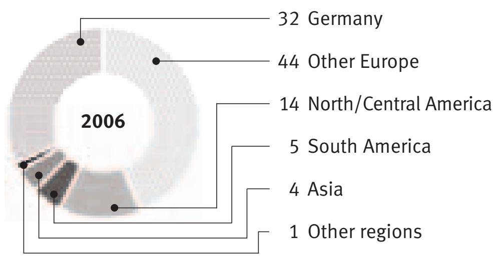
One-off factors erode earnings. The Automotive sector's EBIT of €113 million fell €33 million short of the 2005 figure. Added sales, a rigorous exploitation of cost-saving potentials plus productivity improvements all failed to compensate for the effects of soaring commodity prices, higher energy costs, increased restructuring expenses and unfavorable exchange rates. Moreover, the 2005 EBIT had included the capital gain from disposing of the airflow sensor group. ROS slipped from 7.1 to 5.2 percent.



A must on more and more of today's cars:
vacuum pumps from Pierburg.

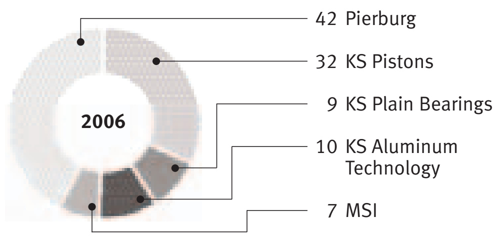
Automotive sector

Breakdown of Automotive sales by region *in %*



Based on corporate sector Automotive sales of €2,181 million

Breakdown of Automotive sales by division *in %*



Based on corporate sector Automotive sales of €2,181 million

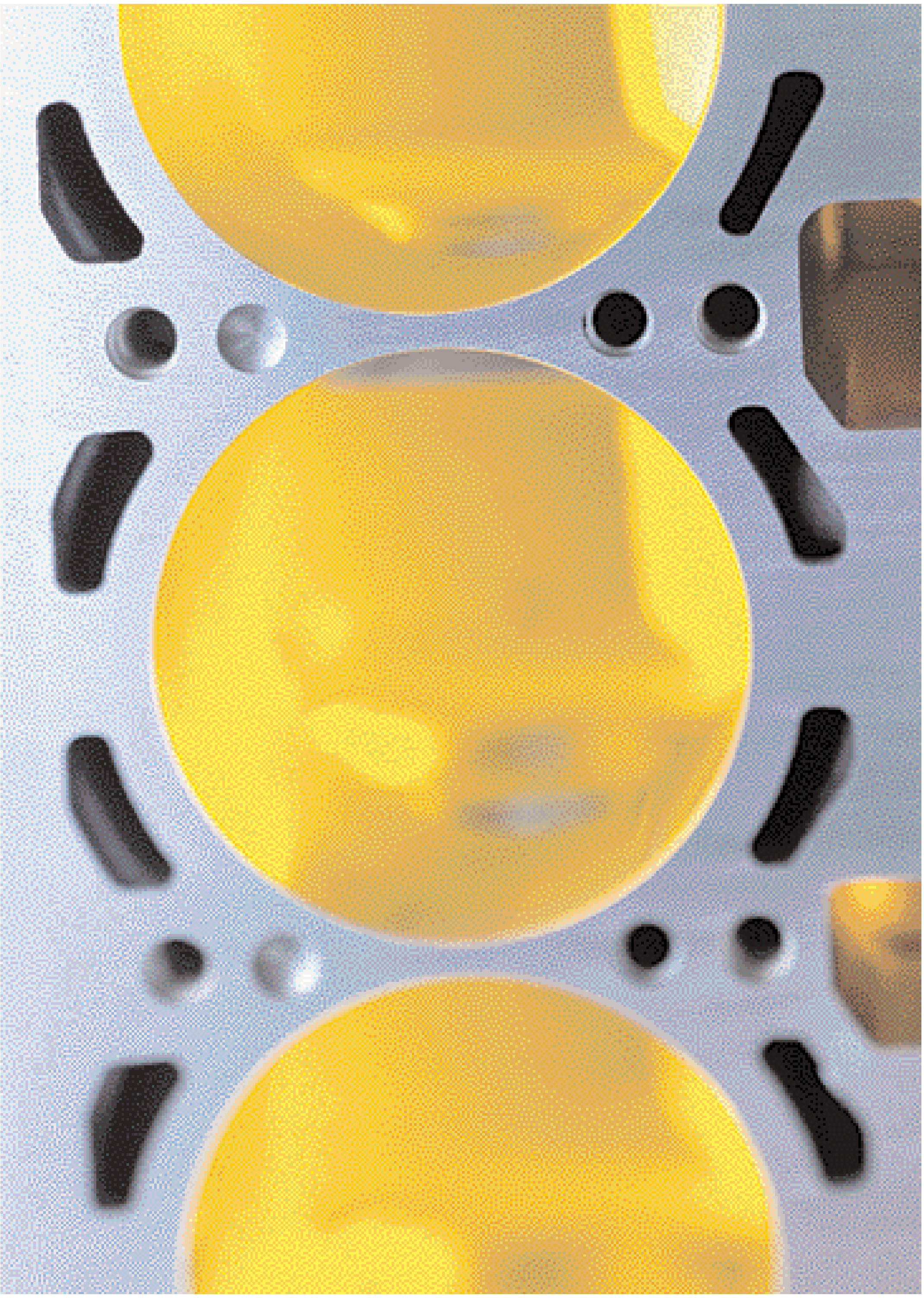
Pierburg division. At €923 million, sales mounted by a good 2 percent. Added sales of secondary air systems as well as oil and water pumps more than offset shrinking demand for intake manifolds and throttle bodies.

KS Pistons division. This division upped its sales by 11 percent to €707 million during the period. Incremental sales originated from increased shipments, the downloaded higher commodity prices plus the first-time consolidation of KS de México. Encouraging progress was also shown by Karl Schmidt Unisia in North America and the South American and Japanese subsidiaries.

KS Plain Bearings division. Business mounted by roughly 15 percent to €196 million, chiefly on account of more vigorous demand for continuous castings and Permaglide products, this outcompensating the weaker business in metallic bearings which was mainly due to price discounts offered to customers. In the case of continuous castings, sales advanced due to higher production tonnages and downloaded material price increases.

KS Aluminum Technology division. Advancing shipments of both low- and high-pressure die-castings (LPDC/HPDC), rising project-related sales plus commodity price increases partly downloaded onto customers, lifted sales by 7 percent to €224 million. Some revenue losses were suffered from the decision of a customer to insource machining work previously outfarmed to this division.

MSI division. At €157 million, sales approximated the prior-year €160 million. The German parent MSI Motor Service International defended its market position well despite the hostile conditions on the markets of Western Europe and the strained situation in the Near East. Vigorous growth in C&E Europe resulted in a slight rise in sales. The subsidiaries operating from France, Brazil, and Turkey, in contrast, had to accept shrinking sales due to ongoing adverse market conditions.



Playing a major role in substantial weight reductions, fuel savings and pollution abatement, engine blocks from KS Aluminum Technology.

Defence sector

Defence indicators *€ million*

Rheinmetall Defence	2005	2006
Sales	1,401	1,445
Order intake	1,553	1,696
Order backlog (Dec. 31)	2,565	2,819
EBIT	97	111
EBT	77	95
Employees (Dec. 31)	6,711	6,759
Average capital employed [1]	527	741
EBIT margin (%)	6.9	7.7
ROCE (%) [1]	18.4	15.0

[1] *as from 2006 redefined formula*

Material events. With the aim of strengthening and improving its market presence in Switzerland, the Defence sector established Rheinmetall Schweiz AG based in Zurich in the first quarter of 2006.

At the start of the year under review, Rheinmetall Landsysteme, Kiel, acquired the remaining 43-percent stake in Kiel-based telerob Gesellschaft für Fernhantierungstechnik mbH and, in Q1/2006, sold and transferred its 46.4-percent interest in Magnet-Motor Gesellschaft für magnetmotorische Technik mbH, Starnberg, to third parties.

In a bid to strengthen its presence in the USA, the joint venture N2 Defense LLC based in Arlington, Virginia, was established in June 2006, which is jointly owned by American Rheinmetall Munition (ARM) Inc., of Richmond, Virginia, a wholly-owned subsidiary of Rheinmetall Waffe Munition GmbH, Ratingen, and Nammo Inc., of Arlington, Virginia, each holding a 50-percent stake.

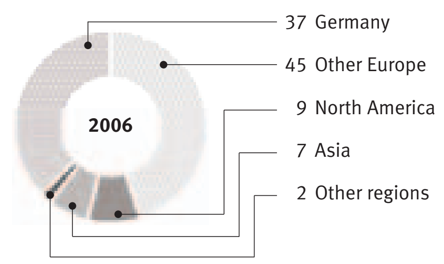
During the third quarter of 2006, within the Weapon Munition division, the merger of Nico Pyrotechnik Hanns-Jürgen Diederichs GmbH & Co. KG together with Hanns-Jürgen Diederichs GmbH as general partner and the wholly-owned subsidiary Nico-Pyrotec Automotive GmbH (all three based in Trittau) into Ratingen-based Rheinmetall Waffe Munition GmbH took effect.

In addition, within the Air Defence Systems division, the merger of Oerlikon Transtec Inc. and Oerlikon Contraves Inc., both located at St.-Jean-sur-Richelieu, Canada, was effected in December 2006.

Surging order intake. In the past fiscal year, the Defence sector achieved sales of €1,445 million, representing a 3-percent rise from €1,401 million. The Defence Electronics division accounted for 32 percent of these sales, Weapon Munition for 28 percent, and the Land Systems and Air Defence Systems divisions for 26 and 14 percent, respectively. At 63 percent, exports in 2006 virtually matched the prior-year 64 percent, thus underlining the significance of Rheinmetall's international operations. The chief export region remained Europe, which accounted for 45 percent of total export sales. North America and Asia contributed 9 and 7 percent of sales, with other regions making up 2 percent.

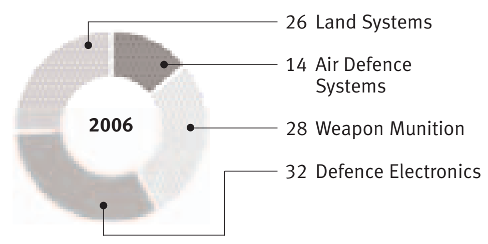
The sector's order intake climbed 9 percent on the previous year to €1,696 million. This encouraging rise was largely attributable to an increase in contracts awarded to the Air Defence Systems and Defence Electronics divisions. At Land Systems, order influx fell short of the high prior-year level. Order backlog at December 31, 2006, added up to €2,819 million and embraces numerous large-scale projects extending over several years. The current order backlog is enough to cover over 75 percent of sales budgeted for 2007.

Breakdown of Defence sales by region *in %*



Based on corporate sector Defence sales of €1,445 million

Breakdown of Defence sales by division *in %*



Based on corporate sector Defence sales of €1,445 million

Land Systems division. In the period under review, sales by Land Systems advanced by 9 percent from €349 million in 2005 to €381 million. The shipment of 51 BV 206 S-type command and transport vehicles to the German armed forces was a mainstay of sales during fiscal 2006. With their flexibility, air transportability and fast availability in the field, these light armored vehicles effectively support airborne task forces. Other significant revenue sources included work invoiced in connection with the development contract for the new Puma light infantry vehicle and business generated by the maintenance and servicing unit, which again boosted its sales by 16 percent to €72 million.

Land Systems' order book contracted from the prior-year €655 million to €584 million, representing a scheduled decline of 11 percent. At home, the division secured a major order for 65 ultramodern Boxer armored vehicles with a project value of €159 million. Thanks to its air transportability this ultramodern armored transport vehicle is geared to the rewritten military scenario, offering soldiers in the field the greatest possible protection. In addition, a contract to series-equip some 1,600 armored and unarmored vehicles with the German army's ultramodern FüInfoSys command and information system, worth €169 million in all, made a key contribution to domestic sales. Other sources included the booking of orders by the maintenance and servicing unit, especially related to ordnance maintenance, as well as the delivery of a prototype and eleven retrofit kits for the Pioneer tank project to the Swiss army.

Air Defence Systems division. This division's sales declined by 28 percent to €206 million, falling short of the prior-year €286 million owing to program delays and postponed contract awards, especially abroad. Terrestrial close-range air defence systems were the primary sales motor, air defence systems again accounting for an increasing share of sales.

In fiscal 2006, the division saw its order intake soar from the prior-year €169 million to €371 million. Combat upgrade and modernization programs outside of Europe together with orders for new systems and extensions to systems already in use formed a prime source of incoming orders. Significant orders were also booked for the Skyguard air defence systems, for drone systems, battlefield management projects, and the Millennium air defence naval gun. This order influx provides a solid foundation for the increase in sales budgeted for 2007.

Defence sector

Weapon Munition division. The division's sales climbed 4 percent on the previous year to €419 million. Projects related to the supply of the new 120-mm DM 63 tank ammunition to the German armed forces and Turkey as well as the shipment of the Leopard 2 L55 weapon system to Greece generated most of the revenues in 2006. Other significant exports included the delivery of tank howitzers to Italy and the Netherlands, with the shipment of the light naval gun to the German navy under long-term supply contracts making a contribution to domestic sales. 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, and of sizeable volumes to Great Britain of propellant powder for artillery and tank ammunition also made a key impact on sales.

At €459 million, the division's order inflow matched the prior-year level. Most notable among the orders booked during the period was the export contract for the supply of ultramodern medium-caliber MLG 27 light naval guns to the Kuwaiti navy. Another significant order was for the shipment of onboard aircraft ammunition to the British armed forces. With the in-house development of 27-mm FAP (Frangible Armor Piercing) ammunition, Rheinmetall has laid the foundations for new, effective and explosive-free all-purpose ammunition for combat and fighter aircraft.

Further orders were booked for 120-mm DM 33 and DM 53-type KE tank ammunition and for the newly developed HE RH40 artillery rounds. With the expansion of market activities in the USA, the first orders were received for the shipment of 40-mm shells.

Defence Electronics division. This division's sales rose from €383 million in 2005 by 22 percent to €467 million. At 32 percent, this accounted for the lion's share of the Defence sector's total sales. Such significant growth was especially due to high delivery volumes under master agreements for the supply of Asrad air defence systems to Greece and Finland as well as the supply of additional fire command systems for the Leopard 2 battle tank to Spain and Greece. Another key contributor to sales was the work performed for the German armed forces on a development contract for unmanned air vehicles for target detection (KZO drone) and the start of their series production. Additional sources of sales included the supply of cargo-loading systems for the Airbus A400M military aircraft as well as the continued 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.

The division's order intake edged up by around 4 percent from the prior-year €305 million to €316 million. The German armed forces commissioned Defence Electronics to develop an expanded version of its Future Soldier System within a key modernization project. As a comprehensive equipment concept for the soldier it comprises a full range of voice and other communications systems and can be integrated into the German army's FüInfoSys command and information system in full compliance with NATO standards.

The development contract also includes integration into various armored vehicle systems such as Puma, Boxer or air-transportable combat vehicles. Additional significant new business included the order for extra cargo-loading systems for the Airbus A400M military aircraft and the contracts for testing equipment for the Leopard 2's weapon-stabilizing systems from Greece and Turkey.

Extreme brightness, exceptional contrast and low life-cycle costs—key features of the AVIOR laser projection systems from Rheinmetall Defence Electronics.

Board compensation report

Remuneration of the Executive Board. Executive Board members are appointed and removed in accordance with the provisions of Art. 84 AktG.

The overall structure of Executive Board remuneration is defined by the Personnel Committee of Rheinmetall AG's Supervisory Board. The yardstick for determining an Executive Board member's performance-related compensation is, in particular, the scope of his responsibilities, as well as his individual and the Group's economic situation and performance in comparison to industry peers. Total compensation is incentive-based and encompasses a number of components: it breaks down into a fixed portion, a performance-related profit share and, where applicable, a bonus, a long-term incentive, as well as fringes and pension benefits. For the fixed portion and the performance-related profit share, an annual target salary is specified, to be reviewed at intervals of 2–3 years. This annual target salary comprises a 60-percent fixed, and a 40-percent variable, portion.

The fixed component is paid out as monthly salary. In addition, Executive Board members receive fringes in kind, such as contributions to their statutory social security insurance (or any exempting life insurance in lieu) plus the use of a company car. The target level of the performance-related component is based on the fiscal year's budget and is fixed by the Personnel Committee. It depends on how EBT and ROCE develop—weighted at 50 percent each—and ranges within a bandwidth of 0 to 200 percent.

Additionally, a long-term incentive program (LTIP) has been installed that is pegged to the increase in the Rheinmetall Group's adjusted EBT as the mean of the three preceding fiscal years in comparison with the mean value determined the year before. An incentive bonus is distributed if this actual-to-actual comparison shows an increase. After deducting personal income taxes, about one-half of the incentive bonus is granted in Rheinmetall shares which are subject to a 3-year resale blockage.

€ '000	Fixed salary incl. fringes	Performance-related income	LTIP	Total	Annual postretirement pension	Service cost
Klaus Eberhardt	744	1,405	835	2,984	275	311
Dr. Gerd Kleinert	479	694	417	1,590	180	354
Dr. Herbert Müller	356	758	417	1,531	140	85
Total	**1,579**	**2,857**	**1,669**	**6,105**		

Executive Board members are entitled to defined pension benefits, based on 25 percent of the annual target salary. The retirement age has been fixed at 63 years. The Company has provided for these pension obligations (DBO). No further postretirement benefits have been granted to any Executive Board member, nor has any Executive Board member received benefits or equivalent entitlements from a third party in 2006 for his services on the Executive Board.

Remuneration of the Supervisory Board. The remuneration of Rheinmetall AG's Supervisory Board is governed by Art. 13 of the bylaws, according to which Supervisory Board members, in addition to being reimbursed for advanced costs and receiving meeting attendance fees, are paid a fee that comprises a fixed and a variable portion. The latter is pegged to the year's dividend payout. The Supervisory Board Chairman and Vice-Chairman receive double this compensation. The fixed fee is €5,500, the variable portion being €1,500 for each percent of dividend in excess of 6 percent paid for the capital stock, however, with a cap of 24 percent.

Supervisory Board members receive an additional 25 percent of their fixed and variable fees for any committee membership, subject to a ceiling of 50 percent in the case of multiple offices. A committee chairman is paid an addition of 50 percent, however, not more than a total 100 percent if chairing several committees.

The attendance fee for Supervisory Board meetings amounts to €600, that for committee meetings not held the same day to €300. Meeting attendance fees in 2006 totaled around €41,000. Subject to the vote by the annual stockholders' meeting on May 8, 2007, Supervisory Board members will receive the following remuneration for 2006:

€

	Fixed fee	Variable fee	Committee membership fee	Total remuneration 2006
Klaus Greinert	11,000	54,000	32,500	97,500
Joachim Stöber	11,000	54,000	16,250	81,250
Dr. Eckhard Cordes	5,500	27,000		32,500
Dr. Andreas Georgi	5,500	27,000		32,500
Dr. Peter Mihatsch	5,500	27,000		32,500
DDr. Peter Mitterbauer	1,329	6,525		7,854
Henning von Ondarza	5,500	27,000		32,500
Prof. Dr. Frank Richter	5,500	27,000	8,125	40,625
Johannes Frhr. v. Salmuth	3,973	19,500		23,473
Dr. Dieter Schadt	5,500	27,000		32,500
Dr. Ludwig Dammer	5,500	27,000		32,500
Heinrich Kmett	5,500	27,000	8,125	40,625
Dr. Rudolf Luz	5,500	27,000		32,500
Wolfgang Müller	5,500	27,000		32,500
Harald Töpfer	5,500	27,000		32,500
Wolfgang Tretbar	5,500	27,000	16,250	48,750
Peter Winter	5,500	27,000		32,500
Total	**98,802**	**485,025**	**81,250**	**665,077**

In addition, Rheinmetall refunds to Supervisory Board members the VAT on their fees.

Risk and reward report

Groupwide risk management. In the businesses of its two corporate sectors, Automotive and Defence, the internationally operating Rheinmetall Group encounters a plethora of opportunities which are inextricably tied to certain risks if these challenges are accepted. With the aid of a multitier risk management system, the operating units as well as the parent holding company identify, assess, control, and monitor their respective risk situations. A monthly reporting system embedded in the integrated planning, management and information process, briefs the Executive Board and senior management on the status of any essential changes to significant and reportable risk exposure as well as on the progress of or any remedial action undertaken. If necessary, such reports are issued on an ad-hoc basis. An annual risk inventory reviews all risks for their relevancy, and where necessary, makes adjustments and/or widens the inventory to include any new risk aspects. Internal Auditing additionally regularly audits for workability and efficiency the internal control and monitoring systems as well as for observance of the Group's organizational security measures. The early risk identification system (ERIS) is among the objects of the annual audit and complies with statutory requirements.

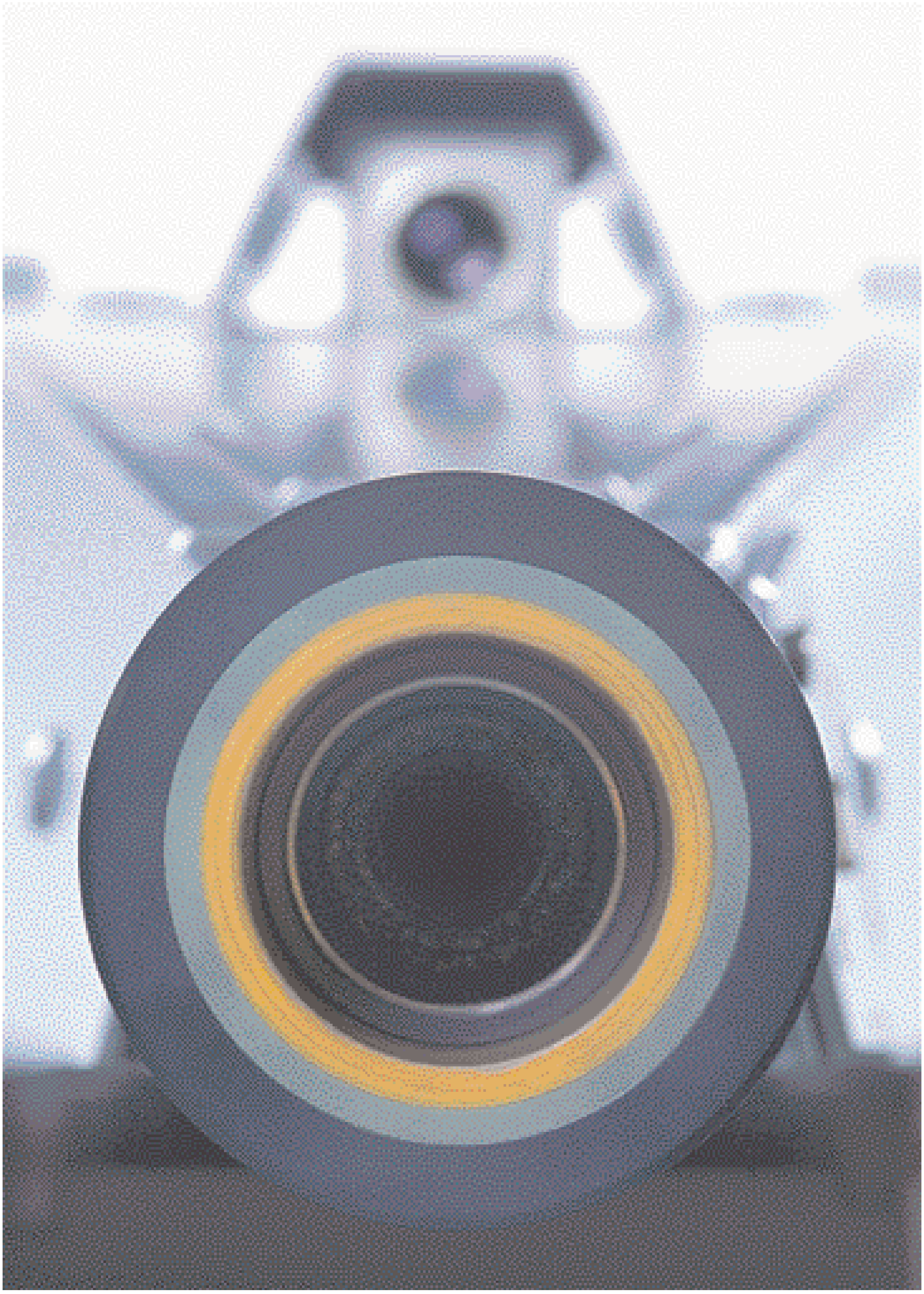
Business risks. The Rheinmetall companies are exposed to the general economic and political risks of the regions and countries in which they operate. Additionally, the various divisions are exposed to the risks typical of the automotive and defence industries. By focusing efforts on the major economic areas—Europe, USA, and Asia—risks in specific countries are contained. Furthermore risk dilution is achieved through the heterogeneous structure comprising nine divisions, ongoing international expansion, and a diversified product portfolio.

Marketing and sales risks are counteracted by such measures as selectively expanding in existing markets, product and customer segments, greater emphasis on key account management and long-term agreements. Strict cost management, product innovations, process improvements, quality assurance and accessing new customer groups all play a role in consolidating and further sharpening the competitive edge of the group companies.

The procurement of raw materials, parts, components and services may be exposed to risks in the form of unexpected supply bottlenecks and/or price hikes. Such risks are diluted by seeking alternative sources, repeated supplier ratings, checks for quality and dependability on the part of suppliers, accumulating adequate backup supplies, and by efficient contract management.

Backed by its vast engineering skills, Rheinmetall systematically applies its resources in coming up with customer-focused technological and product-related new and further developments enabling it to achieve sustained business success. State-of-the-art project management designed to review the technical and economic success criteria, an early involvement of customers in the definition and tryout of new products as well as a policy of safeguarding technological growth through patents help lessen possible R&D-specific risks such as misdevelopments and budget overruns.

Potential production risks are combated by compliance with high standards of safety and engineering. Production plant availability is ensured by preventive maintenance accompanied by ongoing checks, repeated revamps, and selective capital expenditures. For possible damage or loss and the resultant production outages as well as for all conceivable loss occurrences and liability risks, insurance cover has been taken out to an economically reasonable degree to ensure that the financial consequences are contained or completely offset. The extent of such insurance cover is regularly reviewed and adapted, where necessary.



For close-range protection against air, land, and sea threats:
the Millennium naval gun system from Oerlikon Contraves.

Risk and reward report

Financial risks. Rheinmetall AG's central tasks include ensuring the financial resources required for operating and investing activities, always with optimum group funding and financial risk containment in mind. Based on short-, medium- and long-term cash budgets and plans, the Rheinmetall Group manages its liquidity risk by ensuring that a sufficient volume of funds and credit facilities is definitely available in excess of the total needed by the Group in the foreseeable future. The financial instruments deployed to this end include money & capital market products along with bilateral and syndicated loans. Interest rate risks emanate from the inherent volatility of a financial instrument if subject to a change in market rates. Interest rate caps are used to minimize such risks.

The forex risks ensuing from a multitude of cash flows in different currencies are hedged when arising, by contracting currency forwards and cross-currency swaps. The use of financial derivatives for purely speculative purposes is prohibited at Rheinmetall. Settlement risks from transacting such hedges are limited by dealing with counterparties of prime standing only.

IT risks. Information and data are vulnerable to a variety of threats in terms of availability, confidentiality, and integrity. To safeguard such assets from external attack and to secure company data and the complex IT infrastructures, the Group deploys state-of-the-art security and backup technologies. The server and storage systems for applications essential to the Group feature high availability and failsafe installation. Security criteria determine not only the technical design of both the hardware and software but also include functional security structures and organizational measures.

Personnel risks. The risk of a shortage of skilled personnel is addressed by attractive compensation systems, in-house and external courses, and modern pension plans.

Legal risks. Risks potentially arising from a wide variety of tax, competition, fair-trade, patent, cartel or antitrust laws or other regulations and statutes are continuously monitored and carefully reviewed, examined and minimized when making business decisions. The Group relies not only on extensive advice from its own experts but also involves outside specialists on a case-by-case basis. Given the imponderabilities of any litigation, the outcome of the two review proceedings, which had been instituted in 1998 and 2003 in connection with the Kolbenschmidt/Pierburg merger and the Aditron AG squeeze-out, cannot be assessed. Rheinmetall AG's Executive Board considers the claims to be unjustified. Within the Rheinmetall Group, no litigation is presently pending that could materially impact on the Group's economic position.

Environmental risks. Potential environmental risks are abated by eco-friendly production processes, high standards of quality, and very many quality assurance measures. These include process certification to international standards, the ongoing update of production plant, and the further development of products.

Risks and rewards in the segments. Automotive stands to gain from the worldwide congenial automotive climate. Alongside the burgeoning Asian markets—the target of the sector's internationalization thrust—it is the high-volume core markets of Western Europe and the USA that are still predominant. Prospects of a surge in market share for diesel-engine vehicles are more probable given the still high gasoline prices, also in the USA and Asia. With their diesel engine expertise, the Automotive companies are benefiting from this trend. Worldwide there is a general trend toward tighter emission standards and this offers additional sales opportunities for products, already existing or under development, which assist cars to comply with these standards.

The year under review saw another improvement in the sector's international presence which through closer customer proximity, has made it easier to tap additional growth potentials. Possibilities are perceived for booking additional contracts from the vigorously growing Asian OEMs—still underrepresented in the customer portfolio, and then on the basis of competitive economies of scale also generating growth in the traditional core markets. Such a process is being assisted by an exploitation of manufacturing process potentials and further quality enhancements for reduced reject rates. Other opportunities exist through the accelerated trend toward outsourcing on the part of various automakers regarding pistons and their parts and through efforts to access new areas of business by deploying existing know-how.

Growing globalization and enhanced market transparency might result in a dependence on individual customers, unexpected changes in demand structure, fiercer competition, and rising price pressure. Surging commodity prices represent cost risks which we contain through appropriate contracts with price escalator clauses, especially in the case of aluminum and copper. We also control and optimize procurement timing and volumes; we devise accompanying plans for backup supplies. Rising energy costs are addressed by coordinated groupwide invitations to bid and, in some cases, extended contract terms.

The Defence sector may benefit from potential ad-hoc procurement needs linked to the deployment of European forces in crisis regions. Other opportunities of external growth on the part of Rheinmetall Defence are tied to the expected ongoing consolidation of the European defence equipment market.

Referable projects commissioned by the German army—the series contract for the Puma, the infantry soldier of tomorrow, and mortar combat systems—are critical to winning orders abroad. Likewise essential is an innovative product range tailored to the new challenges facing the armed forces and able to compete with international rivals.

Defence's divisions as such are not directly dependent on the shape of the economy. Nonetheless, their chief risks are reliance on public spending in Germany and other countries plus accelerating transatlantic competition. Budget restrictions and funding/financing problems in customer countries might lead to risks in the form of delays and/or non-award of contracts. Other possible risk-related obstacles are higher advance funding, financial involvement in projects and unforeseen difficulties in contract performance. Those export markets which are accessible to this sector are exposed to strong international competition.

The general risk situation. The aforementioned risks are not the only ones to which the Rheinmetall Group is exposed. Risks, hitherto unidentified or assessed as insignificant, might under changing circumstances materialize and adversely impact on the asset and capital structure, financial position, or results of operations.

Major risks or developments with a potentially long-term unfavorable impact on the Group's asset and capital structure, financial position or results of operations were not identifiable during the period. From today's vantage point and in terms of assets and liquidity, no risks exist that might jeopardize to a serious degree in the foreseeable future either the continued existence as a going concern or the future development of Rheinmetall AG or its subsidiaries.

Prospects

Economic confidence and industry optimism set to continue in 2007 and 2008. The current economic upswing should continue in 2007, according to estimates by the International Monetary Fund (IMF), albeit no longer at the same momentum as in 2006. Growth in international economic output of 4.9 percent is predicted for 2007, falling 0.2 percentage points short of the prior-year level. According to IMF forecasts, the US economy is set to grow by 2.9 percent this year, with a plus of 2 percent expected for Euroland. Expansion in Germany will slacken to 1.3 percent on the back of the VAT raise, whereas growth of 2.1 percent is forecasted for Japan. In their fall 2006 report, Germany's key economic research institutes predicted continued high growth potential in emerging markets, on the other hand. This applied to Russia with growth forecasted at 6 percent and even more so to China, whose GDP is set to soar by 10 percent, according to the leading economists, with newly industrialized countries expected to achieve growth of 6.3 percent overall.

The Organization for Economic Cooperation and Development (OECD) is also optimistic about 2008, with Euroland, the USA and Japan predicted to grow by 2.3, 2.7 and 2 percent, respectively. The OECD's 30 key industrialized member states are forecasted to expand their economic output by 2.7 percent overall.

These assumptions are based on moderate inflation and interest rates as well as no dramatic reversals in capital and property markets. This scenario is also predicated on the expectation that commodity prices will stabilize at a high level. Experts regard the latter and unforeseeable geopolitical tensions as the greatest risks to the optimistic overall picture.

Automotive industry confident about the future. The continued pent-up demand in the newly industrialized states of Asia, C&E Europe and South America is still impacting favorably on worldwide vehicle production. In the view of the experts, worldwide production of vehicles up to 3.5 tonnes could reach the 70-million mark for the first time in 2008, following a 3.7-percent rise in vehicle output to 67 million units in 2007. Significant changes in production figures among the major long-established car manufacturers of North America, Western Europe and Japan are not anticipated over the coming two years.

Growth rates of just over 10 percent are forecasted for Asia's auto manufacturers, on the other hand, with production figures for Asia (excluding Japan) likely to climb to 15.9 million in 2007 and then to 17.8 million units in the following year. Carmakers in C&E Europe could achieve similar growth rates—albeit with around 4.5 million units at a significantly lower level.

Automotive benefiting from product innovations. In recent years, the Automotive sector has consistently geared its product innovations to long-term trends in vehicle manufacture while increasing its R&D spending. Products aimed at reducing fuel consumption and emissions have been the chief new developments to reach the production stage. In addition, the use of new (also lightweight) materials and composites has laid the foundations for product portfolio renewal. With this innovations drive, to be continued in the coming years, Kolbenschmidt Pierburg has prepared the groundwork for continuous growth as a key developer partnering major auto manufacturers.

Based on current forecasts on the development of international automotive markets as well as market conditions on the customer and procurement sides, which are difficult to assess, Kolbenschmidt Pierburg is anticipating moderate sales growth and an EBIT above the prior-year level for 2007. A further rise in earnings is expected for 2008 based on the product innovations currently available in the marketplace as well as improved cost structures. This will pave the way for achieving the Rheinmetall Group's higher return benchmarks.

120-mm high-performance KE rounds from Rheinmetall Waffe Munition.

Prospects

Rising defence budgets. In view of the continuing high incidence of geopolitical unrest and the need for significant modernization resulting from obligations to international missions, industry experts assume that defence budgets are set to rise further. It is estimated, for example, that US military spending will advance by some 12 percent to just under $600 billion in 2007, taking into account the country's commitments in Iraq and Afghanistan.

Europe is also seeing an increasing trend toward higher military expenditures. Whereas only a somewhat moderate rise in total spending is expected in the UK, the proportion of matériel spending is forecasted to rise by about 5 percent in 2007 and 9 percent in 2008. It is difficult to predict French defence expenditure, on the other hand, owing to the impending parliamentary elections in May 2007. In Germany, the proportion of matériel spending in the total budget volume is set to gradually rise from 25.2 percent in 2006 to 27.1 percent in 2007 and then to 28.1 percent in 2008. This is occurring against the background of generally moderate growth in the defence budget from €24.3 billion in 2007 (up 1.7 percent) to €24.6 billion in 2008 (up 1.2 percent).

Defence forecasting growth and improved earnings. Rheinmetall Defence has geared its range of products and services to the new deployment scenarios as well as increasingly making its mark as a global supplier of systems solutions that place the emphasis on protecting the soldiers in the field. Extensive national and international orders have resulted in a very encouraging book-to-bill ratio. On this basis, Rheinmetall Defence's planned organic growth is guaranteed in the years ahead.

Rheinmetall Defence is also predicting a favorable order intake situation in the current fiscal year and in 2008. Defence entered fiscal 2007 with a high proportion of budgeted sales covered by existing contracts and predicts rising sales for the current fiscal period coupled with steady growth in subsequent years. In fiscal 2007, Rheinmetall Defence is set to match the good performance of preceding years and to achieve an improved EBIT. For 2008, the Defence sector is predicting further growth in earnings.

Rheinmetall expecting earnings to rise. With its two corporate sectors of Automotive and Defence, Rheinmetall is exceptionally well positioned throughout its markets. The core competencies in the two sectors are well-developed with a clearly defined focus. As respected development partners, Automotive and Defence have secured commanding market positions while enjoying a high level of customer loyalty.

It is Rheinmetall's aim to step up the two sectors' strategic development with regard to their innovative power and internationalization so as to guarantee the Group's profitable growth and shareholder value enhancement in the long term. As medium-term target figures, Rheinmetall has set itself the following profitability benchmarks: an EBIT margin of 9 percent and an ROCE of 20 percent within the Group.

For fiscal 2007 and 2008, Rheinmetall predicts further organic sales growth within the Group. Assuming stability in the automotive industry worldwide and a steady uptrend in defence spending, Rheinmetall reaffirms its goal of an average annual organic growth rate of 5 percent.

Based on a favorable operating performance in the Automotive and Defence sectors on a sustained basis and in view of the economic and industry outlook outlined, Rheinmetall expects fiscal 2007 to see a rising level of earnings and 2008 to yield another profit upturn.

Düsseldorf, March 6, 2007

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 2006
Rheinmetall AG

Consolidated balance sheet as of December 31, 2006

ASSETS *€ million*

	Note	12/31/2005	12/31/2006
Intangible assets	(6)	417	439
Tangible assets	(7)	1,052	1,057
Investment properties	(8)	13	15
Investments	(9)	64	68
Noncurrent financial assets	(13)	7	9
Other noncurrent assets	(12)	5	3
Deferred tax assets	(29)	61	60
Total noncurrent assets		**1,619**	**1,651**
Inventories	(10)	638	681
less prepayments received		(32)	(54)
		606	627
Trade receivables	(11)	481	499
Current financial assets	(13)	26	29
Other current receivables and assets	(12)	271	322
Income tax assets		12	12
Cash & cash equivalents	(14)	408	197
Total current assets		**1,804**	**1,686**
Total assets		**3,423**	**3,337**

EQUITY & LIABILITIES *€ million*

	Note	12/31/2005	12/31/2006
Capital stock		92	92
Additional paid-in capital		208	208
All other reserves		449	516
Group earnings (after minority interests)		113	120
Treasury stock		(34)	(42)
Stockholders' equity		**828**	**894**
Minority interests		47	43
Total equity	(15)	**875**	**937**
Accruals for pensions and similar obligations	(16)	514	519
Other noncurrent accruals	(17)	107	97
Noncurrent financial liabilities	(18)	397	388
Other noncurrent liabilities	(20)	8	9
Deferred tax liabilities	(29)	15	19
Total noncurrent liabilities		**1,041**	**1,032**
Current accruals	(17)	290	305
Current financial liabilities	(18)	162	14
Trade payables	(19)	399	465
Other current liabilities	(20)	598	534
Income tax liabilities		58	50
Total current liabilities		**1,507**	**1,368**
Total equity & liabilities		**3,423**	**3,337**

Consolidated income statement for fiscal 2006

€ million

	Note	2005	2006
Net sales		**3,454**	**3,629**
Net inventory changes, other work and material capitalized		9	110
Total operating performance	(21)	**3,463**	**3,739**
Other operating income	(22)	144	144
Cost of materials	(23)	(1,679)	(1,951)
Personnel expenses	(24)	(992)	(1,038)
Amortization/depreciation/write-down	(25)	(157)	(151)
Other operating expenses	(26)	(552)	(530)
Operating result		**227**	**213**
Net interest expense [1]	(27)	(55)	(51)
Net investment income and other financial results [2]	(28)	(2)	2
Net financial result		**(57)**	**(49)**
Earnings before taxes (EBT)		**170**	**164**
Income taxes	(29)	(52)	(41)
Group net income		**118**	**123**
Minority interests	(30)	*5*	*3*
Group earnings (after minority interests)		*113*	*120*
EpS	(31)	3.19 EUR	3.41 EUR
EBITDA		382	366
EBIT		225	215
Adjusted EBIT	(32)	245	222

[1] *incl. €59 million interest expense (down from €62 million)*
[2] *incl. €5 million from investees carried at equity (up from €3 million)*

Consolidated statement of cash flows for fiscal 2006

€ million

	2005	2006
Cash & cash equivalents at Jan. 1 (BoP)	**258**	**408**
Group net income	118	123
Amortization/depreciation/write-down/write-up of intangibles/tangibles and investment properties	157	151
Change in pension accruals	2	10
Cash flow	**277**	**284**
Net gain/loss from fixed-asset disposal	(8)	(14)
Change in other accruals	(6)	(2)
Change in inventories	30	(20)
Change in receivables, nonfinancial liabilities and prepaid & deferred items	(40)	(79)
Other noncash expenses and income, net	--	3
Net cash provided by operating activities [1]	**253**	**172**
Cash outflow for additions to tangible/intangible assets and investment properties	(190)	(186)
Cash inflow from the disposal of tangible/intangible assets and investment properties	36	13
Cash outflow for additions to consolidated subsidiaries and financial assets	(50)	(24)
Cash inflow from the disposal of consolidated subsidiaries and financial assets	4	16
Net cash used in investing activities	**(200)**	**(181)**
Dividend paid out by Rheinmetall AG	(27)	(32)
Other profit distribution	(2)	(3)
Treasury stock	(12)	(8)
Financial liabilities incurred	325	--
Financial liabilities repaid	(193)	(157)
Net cash provided by/(used in) financing activities	**91**	**(200)**
Net change in cash & cash equivalents	**144**	**(209)**
Parity-related change in cash & cash equivalents	6	(2)
Total change in cash & cash equivalents	**150**	**(211)**
Cash & cash equivalents at Dec. 31 (EoP)	**408**	**197**

For comments on the cash flow statement, see Note (33).

[1] *included are*
net interest paid at €23 million (down from €28 million)
net income taxes paid at €43 million (down from €51 million)

Statement of changes in equity

€ million

	Capital stock	Additional paid-in capital	Reserves retained from earnings	*OCI from currency translation differences*	*OCI from statement at FV and other re-measurem.*	Total OCI	Group earnings after minority interests	Treasury stock	**Stock-holders' equity**	Minority interests	**Total equity**
Balance at January 1, 2005	**92**	**208**	**332**	*(40)*	*63*	**23**	**96**	**(22)**	**729**	**50**	**779**
Dividend payout	--	--	(27)	--	--	--	--	--	(27)	(2)	(29)
Currency translation differences	--	--	--	*22*	--	22	--	--	22	1	23
Consolidation group changes	--	--	--	--	--	--	--	--	--	(6)	(6)
Transfer to/from reserves	--	--	96	--	--	--	(96)	--	--	--	--
Accumulated OCI	--	--	--	--	*3*	3	--	(12)	(9)	(1)	(10)
Group net income	--	--	--	--	--	--	113	--	113	5	118
Balance at December 31, 2005/January 1, 2006	**92**	**208**	**401**	*(18)*	*66*	**48**	**113**	**(34)**	**828**	**47**	**875**
Dividend payout	--	--	(32)	--	--	--	--	--	(32)	(3)	(35)
Currency translation differences	--	--	--	*(19)*	--	(19)	--	--	(19)	(2)	(21)
Consolidation group changes	--	--	--	--	--	--	--	--	--	(4)	(4)
Transfer to/from reserves	--	--	113	--	--	--	(113)	--	--	--	--
Accumulated OCI	--	--	6	--	*(1)*	(1)	--	(8)	(3)	2	(1)
Group net income	--	--	--	--	--	--	120	--	120	3	123
Balance at December 31, 2006	**92**	**208**	**488**	*(37)*	*65*	**28**	**120**	**(42)**	**894**	**43**	**937**

For comments on equity, see Note (15).

Net comprehensive income, which consists of total OCI and Group net income, amounts to €109 million (down from €143 million). The accumulated OCI reflects only the changes in fair value due to currency translation differences and other remeasurement.

Notes (Group)
Segment reports according to IFRS

Primary segments *€ million*

Corporate sectors	Automotive		Defence		Others/ Consolidation		Group	
	2005	**2006**	**2005**	**2006**	**2005**	**2006**	**2005**	**2006**
Net external sales	2,050	2,181	1,401	1,445	3	3	**3,454**	**3,629**
Intersegment transfers	--	--	1	--	(1)	--	**--**	**--**
Total segment sales	2,050	2,181	1,402	1,445	2	3	**3,454**	**3,629**
Net P/L from investees carried at equity	2	3	1	2	--	--	**3**	**5**
Income from write-up	--	--	--	1	--	--	**--**	**1**
Write-down	(1)	--	(1)	--	--	--	**(2)**	**--**
Segment EBIT	146	113	97	111	(18)	(9)	**225**	**215**
Cash inflow from operating activities	150	167	143	18	(40)	(13)	**253**	**172**
Segment assets	1,379	1,417	1,442	1,631	121	20	**2,942**	**3,068**
thereof goodwill	*151*	*154*	*206*	*211*	--	--	***357***	***365***
thereof book values of investees carried at equity	*40*	*42*	*24*	*26*	--	--	***64***	***68***
thereof investment properties	--	*3*	*1*	--	*12*	*12*	***13***	***15***
Segment liabilities	725	742	1,126	1,119	65	68	**1,916**	**1,929**
Segment expenditures	163	153	39	47	1	1	**203**	**201**

Secondary segments *€ million*

Regions	Germany		Other Europe		North America		Asia		Other Regions/ Consolidation		Group	
	2005	**2006**	**2005**	**2006**	**2005**	**2006**	**2005**	**2006**	**2005**	**2006**	**2005**	**2006**
Net external sales by customer location	1,146	1,230	1,561	1,601	393	449	206	188	148	161	**3,454**	**3,629**
in % of group sales	33.2	33.9	45.2	44.1	11.4	12.4	5.9	5.2	4.3	4.4	**--**	**--**
Segment assets	1,746	1,946	720	763	252	243	38	40	186	76	**2,942**	**3,068**
Segment expenditures	109	106	53	41	22	27	6	7	13	20	**203**	**201**

For comments on the segment reports according to IFRS, see Note (34).

Segment reports according to management structure

€ million

Corporate sectors		Automotive		Defence		Others/ Consolidation		Group	
		2005	2006	2005	2006	2005	2006	**2005**	**2006**
Balance sheet (Dec. 31)									
Total equity	(1)	516	537	447	519	(88)	(119)	**875**	**937**
Pension accruals	(2)	246	248	243	244	25	27	**514**	**519**
Net financial liabilities	(3)	16	30	(173)	(42)	308	217	**151**	**205**
Capital employed (CE)	(1)+(2)+(3)	778	815	517	721	245	125	**1,540**	**1,661**
Added due to redefined CE (as from 2006)		--	167	--	77	--	(120)	**--**	**124**
CE at Dec. 31		778	982	517	798	245	5	**1,540**	**1,785**
Average CE [1]	(4)	722	962	527	741	231	22	**1,480**	**1,725**
Income statement									
Net external sales		2,050	2,181	1,401	1,445	3	3	**3,454**	**3,629**
thereof Germany (%)		*31.4*	*32.0*	*35.6*	*36.6*	--	--	***33.2***	***33.9***
thereof abroad (%)		*68.6*	*68.0*	*64.4*	*63.4*	--	--	***66.8***	***66.1***
EBITDA		263	226	134	147	(15)	(7)	**382**	**366**
Amortization/depreciation		(117)	(113)	(37)	(36)	(3)	(2)	**(157)**	**(151)**
Segment EBIT (acc. to management structure)	(5)	146	113	97	111	(18)	(9)	**225**	**215**
Net interest expense		(19)	(23)	(20)	(16)	(16)	(12)	**(55)**	**(51)**
EBT		127	90	77	95	(34)	(21)	**170**	**164**
Income taxes		(41)	(25)	(27)	(24)	16	8	**(52)**	**(41)**
Net income/(net loss)		86	65	50	71	(18)	(13)	**118**	**123**
EBIT margin (%)		7.1	5.2	6.9	7.7	--	--	**6.5**	**5.9**
Other data							--		
ROCE (%) [1]	(5)÷(4)	20.2	11.7	18.4	15.0	--	--	**15.2**	**12.5**
Segment expenditures		162	149	35	43	1	1	**198**	**193**
Order intake		2,068	2,203	1,553	1,696	4	4	**3,625**	**3,903**
Order backlog at Dec. 31		342	364	2,565	2,819	--	--	**2,907**	**3,183**
Prepayments received		39	38	523	463	--	--	**562**	**501**
Headcount at Dec. 31		11,699	11,922	6,711	6,759	138	118	**18,548**	**18,799**

For comments on the segment reports according to management structure, see Note (34).

[1] *redefined as from 2006*

Notes (Group)
Fixed-asset analysis

€ million

2005	Gross values				
	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)*

2006	01/01/2006	Additions	Disposals	Book transfers	Changes in consolidation group/share-holding
Intangible assets					
Development costs and other internally created intangible assets	51	18	--	--	--
Concessions, franchises, industrial property rights and licenses	77	10	3	1	--
Goodwill	357	--	--	--	8
Prepayments on intangibles	1	1	--	(1)	--
	486	**29**	**3**	**--**	**8**
Tangible assets					
Land, equivalent titles, and buildings (incl. buildings on leased land)	952	14	16	--	--
Production plant and machinery	1,585	62	43	47	--
Other plant, factory and office equipment	469	18	30	5	--
Prepayments on tangibles, construction in progress	71	70	1	(57)	--
	3,077	**164**	**90**	**(5)**	**--**
Investment properties	**25**	**--**	**1**	**5**	**--**
Total	**3,588**	**193**	**94**	**--**	**8**

		Amortization/depreciation/write-down								Net values
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**

Currency translation differences	**12/31/2006**	01/01/2006	Additions	Disposals	Book transfers	Write-up	Changes in consolidation group/share-holding	Currency translation differences	**12/31/2006**	**12/31/2006**
--	69	16	5	--	--	--	--	--	21	48
--	85	53	10	2	--	--	--	(1)	60	25
--	365	--	--	--	--	--	--	--	--	365
--	1	--	--	--	--	--	--	--	--	1
--	**520**	**69**	**15**	**2**	**--**	**--**	**--**	**(1)**	**81**	**439**
(13)	937	446	22	12	(1)	--	--	(8)	447	490
(30)	1,621	1,207	84	42	2	--	--	(22)	1,229	392
(3)	459	372	29	30	(3)	--	--	(3)	365	94
(2)	81	--	--	--	--	--	--	--	--	81
(48)	**3,098**	**2,025**	**135**	**84**	**(2)**	**--**	**--**	**(33)**	**2,041**	**1,057**
--	**29**	**12**	**1**	**1**	**2**	**--**	**--**	**--**	**14**	**15**
(48)	**3,647**	**2,106**	**151**	**87**	**--**	**--**	**--**	**(34)**	**2,136**	**1,511**

Notes (Group)
Accounting principles

(1) General The consolidated financial statements have been prepared in due accordance with the regulations of Art. 315a German Commercial Code ("HGB") and hence with the International Financial Reporting Standards (IFRS) as adopted by the European Union (EU). A groupwide accounting guideline binding on all companies included in the consolidated financial statements ensures that all current rules and principles are consistently applied and interpreted.

The first-time obligatory application in 2006 of new and revised IASB Standards and Interpretations has not resulted in any substantive changes in comparison to prior periods; the transitional provisions have been duly complied with. The Standards and Interpretations concerned are:

IAS 19	Actuarial gains and losses
IAS 21	Effects of exchange rate changes
IAS 39	Fair value option
IAS 39 and IFRS 4	Financial guaranties
IFRS 6	*Exploration for and Evaluation of Mineral Resources*
IFRIC 4	*Determining whether an Arrangement Contains a Lease*
IFRIC 5	*Rights to Interests Arising from Decommissioning, Restoration and Environmental Rehabilitation Funds*
IFRIC 6	*Liabilities Arising from Participating in a Specific Market—Waste Electrical and Electronic Equipment*

The following IASB Standards and Interpretations have not yet been adopted by the EU, which has prevented them from being applied voluntarily. However, no significant effects on the consolidated financial statements are expected from their future application:

IFRS 8	*Operating Segments*
IFRIC 10	*Interim Financial Reporting and Impairment*
IFRIC 11	*IFRS 2—Group and Treasury Share Transactions*
IFRIC 12	*Service Concession Arrangements*

The following Interpretations, though adopted by the EU, have not been applied early:

IFRIC 7	*Applying the Restatement Approach under IAS 29 Financial Reporting in Hyperinflationary Economies*
IFRIC 8	*Scope of IFRS 2*
IFRIC 9	*Reassessment of Embedded Derivatives*

Their application has no significant effects on the consolidated financial statements.

The following IASB rules require application as from January 1, 2007:

Amendment to IAS 1	*Presentation of Financial Statements*—Capital disclosures
IFRS 7	*Financial Instruments: Disclosures*—Summary of the financial instrument disclosures previously stated in IAS 39 and IAS 32.

The first-time application of the amended IAS 1 and of IFRS 7 will entail additional disclosures in the notes.

The consolidated financial statements are presented in euro (€). Unless otherwise stated, amounts are throughout indicated in € million (including prior-year comparatives). Non-rounded amounts may differ. The consolidated income statement has been prepared in the total-cost format.

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, Rheinmetall Wohnungen GmbH, Rheinmetall Landsysteme GmbH, Oerlikon Contraves GmbH, telerob Gesellschaft für Fernhantierungstechnik mbH

(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 control is transferred. 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

	12/31/2005	Additions	Disposals	**12/31/2006**
Fully consolidated companies				
Germany	48	1	(4)	45
abroad	42	5	--	47
	90	**6**	**(4)**	**92**
Investees carried at equity				
Germany	7	--	--	7
abroad	7	2	--	9
	14	**2**	**--**	**16**

In the year under review, six subsidiaries (including five abroad) were newly consolidated while four German companies were merged.

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

- KS de México, LLC, Celaya, Mexico: asset deal in February 2006 at a price of €7 million (€1 million badwill);
- Kolbenschmidt Pierburg AG, Neckarsulm, Germany: additional stock acquired by July 2006 (now 98 percent held) at a total price of €6 million; newly created goodwill: €4 million;
- telerob Gesellschaft für Fernhantierungstechnik mbH, Kiel: stake increased in January 2006 from 57 to 100 percent at a price of €3 million; newly created goodwill: €1 million.

In the year under review, prices totaling €16 million were agreed upon for the acquisition of new or additional shares (up from €15 million).

The above asset deal added €8 million in assets.

No shares in fully consolidated subsidiaries were disposed of in 2006.

All major consolidated subsidiaries and all significant investees stated at equity are listed separately. A comprehensive listing of the shareholdings of Rheinmetall AG, together with the financial statements and management report, will be published in the digital version of the German Federal Gazette and included in the new companies register website.

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 (involving full revaluation) by contrasting the cost of shares acquired against the subsidiaries' prorated equity revalued as of the date of change of control. 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 already fully 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. The Rheinmetall Group assigns goodwill in line with the value in use to the divisions. 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 the medium-term corporate planning period. In the Rheinmetall Group, the corporate plan is prepared on the basis of 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 defense budgets of EU nations and NATO, duly allowing for new-market access and cost-paring programs.

The discount rate applied is the current WACC of 8.9 percent (down from 9.0). For the period after the last planning year, the following growth allowance is deducted from the risk-specific pretax discount rate:
Automotive: 0.5 percent (up from 0)
Defence: 1.0 percent (unchanged)

Neither the rate increase by 0.5 percentage points nor the growth allowance change to 0.5 percent have impaired goodwill. Goodwill impairment losses are immediately recognized as write-down in the corresponding income statement line; any write-up upon future value rebound is, however, prohibited.

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 are all mutually offset. 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, principles analogous to full consolidation are adopted, capitalized goodwill being mirrored in the investment book value. Consolidation transactions substantially conform with the principles described above for fully consolidated subsidiaries.

(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 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. 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 The key accounting and valuation methods applied on the basis of the groupwide uniform accounting guideline to Rheinmetall AG's consolidated financial statements are described below.

Cost Intangible and tangible assets as well as investment properties and 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 from which 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.

Notes (Group)
Accounting principles

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.

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. Research costs are always expensed. Development costs are not capitalized unless a newly developed product or process can be clearly defined, technologically realized and used either internally or is destined for marketing, and if there is a reasonable assurance that its costs will be recovered by future cash inflows. Any other development costs are immediately expensed.

Finite-lived intangible assets are amortized by straight-line charges from the date of first use over their economic lives.

The following unchanged useful lives underlie amortization:

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

Goodwill is not amortized but its value tested once annually, or whenever deemed appropriate, for impairment.

Tangible assets Tangible assets are carried at depreciated cost less any write-down. Tangible assets (if finite-lived) are 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 within tangible assets:

	Years
Buildings (incl. investment properties)	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 revaluation method at fair value, which regularly equals market value. 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.

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).

Monetary assets Securities throughout belong in the category *available for sale* and are therefore carried at fair value. Where fair market values are not reliably determinable, such assets are carried at amortized cost. Gains and losses, while unrealized, are shown as OCI from statement at fair value and other valuation but, upon monetary-asset disposal, are recognized in net income. However, if and when substantiated evidence hints at a monetary asset's impairment, even unrealized losses are recognized in net income.

Initial measurement is based on the value at settlement date.

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 stated at amortized cost. Adequate allowances provide for bad debts and doubtful accounts. Receivables sold under an ABS program are offset against trade receivables and, at the amount of the continuing involvement (i.e., the risk retained), 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 the 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 PoC, is shown as PoC receivable 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. If the net result from a PoC contract cannot be reliably estimated, expected revenue is recognized only at the amount of contract costs actually incurred. Expected losses on manufacturing contracts (so-called onerous contracts) are either covered by an appropriate write-down or else provided for, all with due regard to all foreseeable risks. Milestone payments or other prepayments received are directly offset against the PoC receivables up to a ceiling that corresponds to the contract's actual PoC, any sums received in excess being recognized as PoC payables.

Deferred taxes Deferred taxes are duly recognized on the temporary differences between the values of assets and liabilities in the IFRS-based 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 announced 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 (unchanged).

The deferred tax liabilities for the €4 million temporary differences of shares in subsidiaries and associated affiliates (down from €7 million) were not recognized since Rheinmetall can control the reversal of such differences and the reversal is not probable in the foreseeable future.

Accruals Accruals for pensions and similar obligations are determined for defined benefit plans 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 fair value of any existing pension plan assets is deducted from pension accruals. Any excess of plan assets over the DBO volume is not recognized unless the company can actually utilize or realize it.

The actuarial gains and losses ensuing from differences between actuarial assumptions as well as actual trends of the underlying parameters and the calculation of fair value of plan assets give rise to actuarial gains and losses which, if outside a 10-percent corridor of the higher of the DBO's present value or the plan assets' fair value, are added to the accrual (and recognized in the income statement) over the average residual service years of employees.

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 provide for all identifiable legal and constructive commitments and obligations to third parties if based on past transactions or events and if likely to result in an outflow of resources (which can be reliably estimated) embodying economic benefits. 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 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.

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 The Rheinmetall Group uses financial derivatives to hedge future fair values and cash flows against currency, interest rate and commodity price risks; financial derivatives are used solely to hedge current or planned underlyings.

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.

Fair value changes of financial derivatives are generally recognized immediately in net income unless an effective hedge exists that meets the criteria of IAS 39. If the derivative is a cash flow hedge (CFH) and hence used to effectively hedge expected future cash inflows/outflows, changes in the financial derivative's fair value are recognized in, and only in, OCI. 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.

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.

Notes (Group)
Accounting principles

Estimates Preparing the consolidated financial statements requires certain assumptions and estimates which impact on the application of accounting principles within the Group and the disclosure of assets and liabilities, income and expenses. Such assumptions and estimates mainly refer to the measurement of pension provisions/accruals (determining the underlying parameters) and the discount rate used in goodwill impairment testing.

These assumptions and estimates are based on the latest conditions and findings and, moreover, are regularly reviewed. If the underlying assumptions develop differently, the actual figures may differ from such estimates. Such differences, if impacting on the accounting, are recognized in the period of change where affecting this period only. Changes are duly accounted for in the period of change and future periods if the change affects both the current and future periods.

Notes to the consolidated balance sheet

(6) Intangible assets In the year under review, non-contracted R&D expenses of €169 million were incurred (up from €153 million). Thereof, development costs of €18 million met the capitalization criteria according to IFRS (up from €12 million).

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

R&D costs *€ million*

	2005	2006
Research costs and noncapitalized development costs	141	151
Amortization of capitalized development costs	3	5
Total R&D costs expensed	**144**	**156**

Goodwill as of December 31, 2006, totaled €365 million (up from €357 million) and breaks down into €108 million for the entire Automotive sector (up from €104 million) and €46 million for the Automotive divisions (virtually unchanged), as well as €211 million (up from €207 million) for the Defence divisions, the latter, in turn, into €73 million for Air Defence (down from €86 million), €80 million for Defence Electronics (up from €67 million), and €40 million for Land Systems (up from €39 million).

Amortization of intangibles totaled €15 million (up from €12 million).

(7) Tangible assets The total disclosed as depreciation in 2006 does not comprise any write-down, while the year before, it included €2 million (charged to land and buildings, production plant and machinery, and other plant, factory and office equipment).

In accordance with the revaluation method of IAS 16, essential plots of land have been stated at fair value, which generally equals their market values. The fair value of such land, carried at €202 million (up from €197 million), includes step-up of €105 million (down from €106 million). Regarding the movement of the revaluation reserve, see the comments on total equity in Note (15).

The disposal of €23 million of tangible assets (up from €6 million) is restricted by land charges, similar encumbrances and the assignment as security. Moreover, standard commercial liens totaling €42 million (down from €65 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:

€ million

	12/31/2005			12/31/2006		
	Capital leases	Consolidation of special-purpose leasing firms	Total	Capital leases	Consolidation of special-purpose leasing firms	Total
Land and buildings	18	53	71	--	51	51
Production plant and machinery	8	--	8	5	--	5
	26	**53**	**79**	**5**	**51**	**56**

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:

€ million

	2005				2006			
	2006	2007–2010	after 2010	Total	2007	2008–2011	after 2011	Total
Lease payments	5	13	19	37	2	5	--	7
Discount	(1)	(4)	(4)	(9)	--	(1)	--	(1)
Present values	**4**	**9**	**15**	**28**	**2**	**4**	**--**	**6**

The purchasing obligation from firm capital expenditure contracts totals €23 million (down from €33 million).

(8) Investment properties The investment properties have a total fair value of €29 million (up from €27 million); in 40 percent of all cases (up from 5), the individual values were determined by internal experts, largely by updating external appraisal reports. In the year under review, rental income of €6 million (up from €4 million) was earned, contrasting with direct operating expenses of an unchanged €2 million.

(9) Investments The proratable assets, liabilities, income and expenses of major joint ventures and associated affiliates break down as follows:

Joint ventures *€ million*

		2005	2006
Assets	(Dec. 31)	81	96
thereof noncurrent		*34*	*23*
Equity	(Dec. 31)	25	29
Debt	(Dec. 31)	56	67
thereof noncurrent		*11*	*3*
Income		103	85
Expenses		101	83
Net income		2	2

Associated affiliates *€ million*

		2005	2006
Assets	(Dec. 31)	27	36
Equity	(Dec. 31)	5	13
Debt	(Dec. 31)	21	23
Net sales		30	51
Net income		1	3

Analysis of investees carried at equity *€ million*

2005	**Book value 01/01/ 2005**	Addition	Prorated net profit	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**

2006	**Book value 01/01/ 2006**	Addition	Prorated net profit	Dividend payment	**Book value 12/31/ 2006**
Joint ventures	32	2	2	(1)	35
Associated affiliates	32	--	3	(2)	33
	64	**2**	**5**	**(3)**	**68**

(10) Inventories

€ million

	12/31/2005	12/31/2006
Raw materials and supplies	196	210
Work in process	222	297
Finished products	71	72
Merchandise	44	43
Prepayments made	105	59
	638	**681**
less prepayments received	(32)	(54)
	606	**627**

The book value of inventories stated at the lower NRV totals €44 million (up from €39 million). Write-down of €5 million was charged in fiscal 2006 (down from €8 million). In the year under review, no inventories previously written down were written up (unchanged). Equally unchanged, inventories do not collateralize any liabilities.

Notes (Group)
Notes to the consolidated balance sheet

(11) Trade receivables

€ million

	12/31/2005	12/31/2006
Trade receivables	481	499

€12 million of trade receivables has a remaining term above one year (down from €22 million).

Accounts due from joint ventures and associated affiliates totaled €8 million (down from €14 million).

Under an ABS program, the Rheinmetall Group sells trade receivables on a revolving basis up to a maximum volume of €170 million (unchanged). These sold receivables are derecognized since the residual recourse risks are insignificant for Rheinmetall. As of December 31, 2006, the principal of receivables sold came to €170 million (virtually unchanged).

(12) Other receivables and assets

€ million

	12/31 2005	thereof current	thereof noncurrent	12/31 2006	thereof current	thereof noncurrent
PoC receivables	168	168	--	204	204	--
Sundry assets	108	103	5	121	118	3
	276	**271**	**5**	**325**	**322**	**3**

For improved transparency, all PoC contract disclosures are subsumed below, the statement of net values being waived.

Breakdown of PoC receivables:

PoC receivables *€ million*

	12/31/2005	12/31/2006
Production cost incurred	977	1,146
plus markup (*less* losses)	145	216
	1,122	**1,362**
Billed on account	(954)	(1,158)
	168	**204**
thereof noncurrent	63	56

Breakdown of PoC payables:

PoC payables *€ million*

	12/31/2005	12/31/2006
Production cost incurred	--	12
Losses incurred acc. to PoC	--	(2)
Anticipated losses	--	(2)
	--	**8**
Billed on account	--	(10)
PoC payables	**--**	**2**
thereof noncurrent	--	1

Revenue from PoC contracts in 2006 came to €671 million (up from €585 million).

Breakdown of sundry assets:

€ million

	31/12/ 2005	thereof current	thereof noncurrent	31/12/ 2006	thereof current	thereof noncurrent
Non-income tax assets	19	18	1	21	20	1
Prepayments made	26	26	--	25	25	--
Financial derivatives	6	5	1	10	9	1
Prepaid expenses and deferred charges	5	5	--	10	9	1
Miscellaneous	52	49	3	55	55	--
	108	**103**	**5**	**121**	**118**	**3**

(13) Monetary assets

€ million

	2005			2006		
	Total	thereof current	thereof noncurrent	**Total**	thereof current	thereof noncurrent
Securities available for sale	7	3	4	7	3	4
Selling prices receivable (share transfer/real estate)	19	19	--	21	21	--
Loans	6	3	3	10	5	5
Miscellaneous	1	1	--	--	--	--
	33	**26**	**7**	**38**	**29**	**9**

The securities of €7 million (virtually unchanged) have been stated at fair value, their sale being restricted to protect employees from insolvency risks.

The selling prices receivable refer to the transfer of shares and the conveyance of real estate.

In accordance with IAS 39, the loans of €10 million (up from €6 million) are carried at amortized cost.

Notes (Group)
Notes to the consolidated balance sheet

(14) Cash & cash equivalents

€ million

	12/31/2005	12/31/2006
Cash on hand and in bank (incl. checks)	408	197

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 is divided into 36 million shares of common stock.

The caption *all other reserves* comprises earnings retained by the Rheinmetall Group at €488 million (up from €401 million), as well as the accumulated other comprehensive income (OCI) which breaks down into unrealized losses of €37 million from currency translation (up from €18 million) and unrealized gains of €65 million from the statement at fair value and other remeasurement (down from €66 million).

A breakdown and analysis of OCI from the statement at fair value and other remeasurement are shown below:

OCI from statement at FV and other remeasurement *€ million*

	Land revaluation reserve	Hedge reserve	OCI from statement at FV and other remeasurement
Jan. 1, 2005	**60**	**3**	**63**
Change in fair value	7	(3)	4
Deferred taxes	(3)	2	(1)
Dec. 31, 2005	**64**	**2**	**66**
Change in fair value	(1)	2	1
Deferred taxes	--	(2)	(2)
Dec. 31, 2006	**63**	**2**	**65**

Breakdown of the land revaluation reserve:

Land revaluation reserve *€ million*

	12/31/2005	12/31/2006
Step-up of land within tangible assets	106	105
Deferred taxes	(42)	(42)
	64	**63**

By resolution of the annual stockholders' meeting on May 9, 2006, the Executive Board has been authorized, after first obtaining approval from the Supervisory Board, to increase on or before May 8, 2011, Rheinmetall AG's capital stock by issuing once or several times new no-par shares in return for contributions in cash and/or in kind, up to an aggregate €18.432 million (authorized capital). The new shares may also be issued to employees of Rheinmetall AG or any subsidiary it controls. The Company has not exercised this authority to date.

The authority to repurchase treasury shares equivalent to 10 percent of the current capital stock, which was conferred on the Executive Board by resolution of the annual stockholders' meeting of May 9, 2006, was exercised. As of December 31, 2006, the portfolio of treasury stock amounted to 986,364 shares (up from 844,981), repurchased at a total cost of €42 million (up from €34 million), which was deducted from equity in one sum.

Rheinmetall's separate financial statements close the fiscal year with net earnings of €40 million (up from €32 million), €35 million thereof being earmarked for the distribution of a cash dividend (up from €32 million), the balance of €5 million to be transferred to the other reserves. The proposed cash dividend amounts to €1.00 per share of common stock (up from €0.90).

The minority interests mainly refer to the Automotive sector at €18 million (down from €20 million), and to Defence at €25 million (down from €27 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.

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

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 €60 million (up from €58 million) was paid to DCPs, specifically the Statutory Social Security Insurance in Germany.

Notes (Group)
Notes to the consolidated balance sheet

The following actuarial parameters have been assumed:

Parameters for pension accruals %

	12/31/2005			12/31/2006		
	Germany	USA	Switzer-land	Germany	USA	Switzer-land
Discount rate	4.25	5.60	3.25	4.75	5.72	3.25
Pay rise (general)	2.75	4.00	1.50	2.75	4.00	1.50
Pay raises (fixed sums)	0.50	--	--	1.25	--	--
Pension uptrend	1.25	--	--	1.25	--	--
Expected return on plan assets	--	8.50	4.25	--	8.50	4.25
Health care expense rise	--	11.0–5.0	--	--	11.0–5.0	--

The non-German DBO primarily refer to benefit obligations incurred by Swiss and US subsidiaries, most of which are plan-funded. The Swiss plan assets have been carved out as an independent Pension Fund and benefit exclusively eligible pensioners, any flowback of income or assets to the contributing trustor being irreversibly blocked.

Reconciliation of pension accruals:

Pension accrual analysis *€ million*

	2005	2006
Balance at January 1	**487**	**514**
Pension payments	(27)	(28)
Employer contributions to plans	(12)	(8)
Pension expense	40	50
First-time inclusion of pension obligations	23	--
Currency translation differences/other	3	(9)
Balance at December 31	**514**	**519**

Due to the changed disclosure requirements (especially the open disclosure of the asset value cap under the terms of IAS 19.58), the prior-year pension accrual reconciliation from the present value (PV) of the DBO and the plan assets has changed, too.

Pension accruals *€ million*

	2005			2006		
	Germany	Abroad	**Total**	Germany	Abroad	**Total**
Analysis of the PV of the DBO						
PV of the DBO at Jan. 1	527	117	**644**	587	935	**1,522**
First-time inclusion of pension obligations	--	851	**851**	--	--	**--**
Currency translation differences	--	16	**16**	--	(38)	**(38)**
Current service cost	12	8	**20**	14	9	**23**
Interest cost	25	34	**59**	25	31	**56**
Employee contributions	--	5	**5**	--	5	**5**
Pension payments	(27)	(56)	**(83)**	(27)	(53)	**(80)**
Effects of plan curtailments/settlements	--	(43)	**(43)**	(1)	(2)	**(3)**
Actuarial gains and losses	50	3	**53**	(51)	1	**(50)**
Past service cost/revenue	--	--	**--**	--	(1)	**(1)**
Book transfers	--	--	**--**	--	(6)	**(6)**
PV of the DBO at Dec. 31	**587**	**935**	**1,522**	**547**	**881**	**1,428**
thereof wholly or partly plan-funded	--	*886*	***886***	--	*846*	***846***
thereof internally funded	*587*	*49*	***636***	*547*	*35*	***582***
Analysis of plan assets						
Fair value of plan assets at Jan. 1	--	65	**65**	--	903	**903**
First-time inclusion of plan assets	--	854	**854**	--	--	**--**
Currency translation differences	--	10	**10**	--	(35)	**(35)**
Expected return on plan assets	--	42	**42**	--	40	**40**
Employer contributions	--	12	**12**	--	8	**8**
Employee contributions	--	5	**5**	--	5	**5**
Pensions paid by plans	--	(56)	**(56)**	--	(52)	**(52)**
Effects of plan curtailments/settlements	--	(32)	**(32)**	--	--	**--**
Actuarial gains and losses	--	3	**3**	--	18	**18**
Fair value of plan assets at Dec. 31	**--**	**903**	**903**	**--**	**887**	**887**
Plan-unfunded pension obligations at Dec. 31	**587**	**32**	**619**	**547**	**(6)**	**541**
Unrecognized actuarial gains/(losses)	(113)	(30)	**(143)**	(58)	(23)	**(81)**
Unrecognized past service revenue	--	2	**2**	--	1	**1**
Asset value cap acc. to IAS 19.58	--	36	**36**	--	58	**58**
Pension accrual as of Dec. 31	**474**	**40**	**514**	**489**	**30**	**519**

The unrecognized actuarial losses of €81 million (down from €143 million) are largely attributable to previous interest rate adjustments. In the year under review, the plan assets actually returned €58 million (up from €45 million) before the exchange-related (currency translation) losses recognized in equity only.

Notes (Group)
Notes to the consolidated balance sheet

Plan asset structure:

%

	2005	2006
Equities	29	23
Treasuries and corporates/fixed-income bonds	26	19
Real estate and property investment funds	31	32
Other	14	26
Total	**100**	**100**

The long-term return is determined by the investment strategy defined for each asset class.

The empirical adjustments mainly refer to non-German pension plans, the obligations accounting for 0.3 percent of the present value of the DBO and for 2.0 percent of plan assets.

Breakdown of pension expense:

Pension expense *€ million*

	2005			2006		
	Germany	Abroad	**Total**	Germany	Abroad	**Total**
Service cost	12	8	**20**	14	9	**23**
Actuarial gains and losses	2	3	**5**	6	2	**8**
Past service revenue	--	(1)	**(1)**	--	(2)	**(2)**
Effects of plan settlements/curtailments	--	(11)	**(11)**	(1)	(2)	**(3)**
Effects of the asset value cap acc. to IAS 19.58	--	10	**10**	--	8	**8**
Expected return on plan assets	25	34	**59**	25	31	**56**
Total	--	(42)	**(42)**	--	(40)	**(40)**
	39	**1**	**40**	**44**	**6**	**50**

The effects of the asset value cap to be recognized according to IAS 19.58 for the DBO in Switzerland, as well as the related amortized actuarial gains and losses are shown within the net interest result, on a netted basis as economically appropriate and together with the expected return on plan assets and the reversed discount, the remaining items shown above being part of personnel expenses.

(17) Other accruals

Analysis of accruals *€ million*

2005	Personnel	Warranties	Identifiable losses	Restructuring	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 (‹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

2006	Personnel	Warranties	Identifiable losses	Restructuring	Yet unbilled costs	All other	**Total**
Balance at Jan. 1, 2006	**128**	**52**	**28**	**46**	**43**	**100**	**397**
Utilized	72	14	11	20	21	28	166
Released	6	7	3	3	3	21	43
Added/provided for	86	21	11	20	22	49	209
Compounded	1	1	--	1	--	--	3
Currency translation differences/other	(1)	(1)	(1)	5	(1)	1	2
Balance at December 31, 2006	**136**	**52**	**24**	**49**	**40**	**101**	**402**
Cash outflows							
short-term (‹1 year)	**104**	**38**	**16**	**23**	**38**	**86**	**305**
long-term	**32**	**14**	**8**	**26**	**2**	**15**	**97**
thereof 1–5 years	28	14	8	25	2	10	87
thereof ›5 years	4	--	--	1	--	5	10

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 €6 million of legal, consulting and audit fees (up from €5 million), €27 million of contractual penalties (up from €17 million), €6 million of discounts, allowances and rebates (up from €5 million), and €6 million due to environmental risks (up from €5 million).

Notes (Group)
Notes to the consolidated balance sheet

(18) Financial liabilities

€ million

	12/31/2005	thereof current	thereof noncurrent	12/31/2006	thereof current	thereof noncurrent
Bonds	470	146	324	324	--	324
Due to banks	24	11	13	34	12	22
Lease payables	59	5	54	37	2	35
Other	6	--	6	7	--	7
	559	**162**	**397**	**402**	**14**	**388**

€23 million of financial debts (up from €6 million) is collateralized by land charges and similar encumbrances, as is another €31 million (down from €32 million) borrowed to finance the real property owned by consolidated special-purpose leasing firms and encumbered with land charges of €11 million (virtually unchanged).

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*

				12/31/2005		12/31/2006	
Interest terms	Rate (%)	Currency	Maturing in	Book value	Fair value	Book value	Fair value
Fixed	6.125	EUR	2006	146	147	--	--
Fixed	3.5	EUR	2010	324	324	324	316
				470	**471**	**324**	**316**

Due to banks *€ million*

				12/31/2005		12/31/2006	
Interest terms	Weighted rate (%)	Currency	Maturing in	Book value	Fair value	Book value	Fair value
Fixed	6.0	CAD	2005/2006	2	2	--	--
Fixed	2.7	EUR	2006	2	2	--	--
Fixed	3.9	EUR	2007	--	--	3	3
Fixed	5.0	EUR	2007	7	7	--	--
Fixed	3.0	USD	2008	2	2	1	1
Fixed	5.5	EUR	2009/2011	4	5	--	--
Fixed	4.9	EUR	2013	2	2	2	2
Fixed	3.7	EUR	2016	--	--	5	5
Fixed	4.4	EUR	2020	--	--	8	6
Fixed	3.7	EUR	2026	--	--	6	5
Variable		EUR	2006/2007	3	3	7	7
Variable		BRL	2006/2007	2	2	2	2
				24	**25**	**34**	**31**

Lease payables *€ million*

Interest terms	Weighted rate (%)	Currency	Maturing in	12/31/2005 Book value	12/31/2005 Fair value	12/31/2006 Book value	12/31/2006 Fair value
Fixed	5.9	EUR	2006	2	2	--	--
Fixed	5.1	EUR	2008	24	26	22	23
Fixed	6.5	EUR	2010–2012	5	5	4	4
Fixed	8.0	EUR	2020	17	20	--	--
Variable		EUR	2022	11	13	11	11
				59	**66**	**37**	**38**

Other financial liabilities *€ million*

Interest terms	Weighted rate (%)	Currency	Maturing in	12/31/2005 Book value	12/31/2005 Fair value	12/31/2006 Book value	12/31/2006 Fair value
Fixed	7.5	EUR	2009	3	4	3	3
Variable		EUR	sdry. ≤2015	3	3	4	4
				6	**7**	**7**	**7**

(19) Trade payables

€ million

	12/31/2005	12/31/2006
Trade payables	399	465

The remaining term of trade payables (€465 million) was less than one year, in both 2005 and 2006. Altogether €1 million is due to joint ventures and associated affiliates (virtually unchanged). The book value of trade payables substantially equals their fair value.

(20) Other liabilities

€ million

	12/31/2005	thereof current	thereof noncurrent	12/31/2006	thereof current	thereof noncurrent
Prepayments received	351	351	--	311	311	--
Sundry	255	247	8	232	223	9
	606	**598**	**8**	**543**	**534**	**9**

Notes (Group)
Notes to the consolidated balance sheet

€146 million of the prepayments received on orders has a remaining term above one year (down from €150 million). The payables for financial derivatives are stated at fair value, the carrying amount of the remaining liabilities approximates their fair value.

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

€ million

	12/31/ 2005	thereof current	thereof noncurrent	**12/31/ 2006**	thereof current	thereof noncurrent
Invoices outstanding (unbilled costs)	51	51	--	45	45	--
Social security	26	25	1	13	12	1
Due to board members and employees	12	11	1	10	10	--
Non-income taxes	36	36	--	37	37	--
Monies in transit from debt collection	75	75	--	79	79	--
Financial derivatives	7	6	1	5	4	1
Deferred income	10	8	2	12	8	4
Miscellaneous	38	35	3	31	28	3
	255	**247**	**8**	**232**	**223**	**9**

Notes to the consolidated income statement

(21) Total operating performance

€ million

	2005	2006
Net sales	3,454	3,629
Change in inventories of finished products and WIP	(17)	83
Other work and material capitalized	26	27
	3,463	**3,739**

(22) Other operating income

€ million

	2005	2006
Gains from fixed-asset disposal	14	14
Income from the release of accruals	44	43
Income from bad-debt allowances reversed	3	2
Income from compensation and refunds	17	15
Sundry rental income	12	11
Income from grants and subsidies	5	3
Income from canteens and ancillary operations	3	3
Income from credit notes for prior years	12	11
Income from prototype and tooling costs refunded	5	7
Income from the utilization of residues	4	7
Other secondary income	25	28
	144	**144**

(23) Cost of materials

€ million

	2005	2006
Cost of raw materials, supplies, and merchandise purchased	1,472	1,768
Cost of services purchased	207	183
	1,679	**1,951**

Notes (Group)
Notes to the consolidated income statement

(24) Personnel expenses

€ million

	2005	2006
Wages and salaries	812	834
Social security and related employee benefits	109	118
Pension expense	71	86
	992	**1,038**

Annual average headcount *Employees*

	2005	2006
Automotive	11,539	11,968
Defence	6,735	6,794
Rheinmetall AG/Others	141	123
	18,415	**18,885**

Due to the merger in 2005 of Rheinmetall DeTec AG into Rheinmetall AG, the allocation of employees taken over to either Rheinmetall AG or Defence has been adjusted in the prior-year comparatives.

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

No write-down was charged (down from €2 million).

(26) Other operating expenses

€ million

	2005	2006
Losses on fixed-asset disposal	6	1
Exit plans, termination benefits, preretirement part-time work	19	22
Selling expenses, commissions	73	62
Maintenance and repair (M&R)	88	82
Promotion and advertising	13	13
Other general administration	127	142
Rents	39	35
Payroll incidentals	23	23
Facility cleaning, security/vigilance	10	9
Outsourced services	7	9
Legal and consultancy fees	30	24
Audit and consultancy fees of external accountants	6	6
Write-down of receivables	4	3
Non-income taxes	11	11
Additional provisions	65	56
All other	31	32
	552	**530**

(27) Net interest expense

€ million

	2005	2006
Other interest and similar income	7	8
Total interest income	**7**	**8**
Interest expense		
from capital leases	(2)	(2)
for pension obligations	(27)	(24)
compounding of noncurrent other accruals	(1)	(3)
other interest and similar expenses	(32)	(30)
Total interest expense	**(62)**	**(59)**
Net interest expense	**(55)**	**(51)**

(28) Net investment income and other financial results

€ million

	2005	2006
Net profit from joint ventures and associated affiliates	3	5
Investment income	**3**	**5**
Net currency/exchange gain	8	(7)
Guaranty commissions	(1)	(2)
Net gain/(loss) from financial derivatives	(2)	2
Sundry	(10)	4
Other financial results	**(5)**	**(3)**
Net investment income and other financial results	**(2)**	**2**

The joint ventures and associated affiliates serve the expansion of the operating activities of Automotive and Defence.

The sundry other financial results included 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.

(29) Income taxes

€ million

	2005	2006
Current income tax expense	55	35
Prior-period income tax expense	4	1
Deferred taxes	(7)	5
	52	**41**

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*

	2005	2006
EBT	170	164
Expected income tax expense (tax rate of 40%)	**68**	**66**
Foreign tax rate differentials	(3)	(2)
Effects of loss carryovers and write-down of deferred taxes	(11)	(13)
Reduction of tax expense due to previously unrecognized loss carryovers	(7)	(11)
Tax-exempt income	(5)	(5)
Nondeductible expenses	6	5
Other	4	1
Effective tax expense	**52**	**41**
Effective tax rate in %	**30**	**25**

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

Deferred taxes *€ million*

	12/31/2005		12/31/2006	
	Deferred tax assets	Deferred tax liabilities	Deferred tax assets	Deferred tax liabilities
Loss carryovers and tax credits	83	--	87	--
Fixed assets	24	89	14	93
Inventories and receivables	14	31	21	25
Pension accruals	29	1	29	2
Other accruals	29	2	33	12
Liabilities	13	1	3	7
Sundry	(12)	10	(5)	2
	180	**134**	**182**	**141**
Offset	(119)	(119)	(122)	(122)
	61	**15**	**60**	**19**
thereof noncurrent	48	11	46	15
thereof not affecting net income		42	2	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 €327 million (down from €391 million) which are not utilizable or whose deferred tax assets were adjusted by write-down. Thereof, €178 million (up from €177 million) is allocable to German, another €138 million (down from €204 million) to foreign, loss carryovers and another €11 million to tax credits (up from €10 million). The German loss carryovers are not subject to expiration, out of the foreign ones, €80 million (up from €79 million) is not either. Most of the foreign loss carryovers subject to expiration can be utilized for more than 9 years (virtually unchanged). The adjustment of deferred tax assets changed in 2006 by €0 million (down from a €2 million decrease). Outside of Germany, companies have capitalized deferred tax assets of €7 million (up from €2 million) which have been incurring ongoing losses due to expanded/realigned business operations. In addition, €2 million of income tax assets is deemed noncurrent for the purposes of Art. 37(4) German Corporation Income Tax Act ("KStG").

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

(30) Minority interests Minority interests in profit came to €3 million (down from €5 million).

(31) 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, 2006 nor 2005, 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. The weighted average number of shares accounts for the repurchased shares of treasury stock.

Earnings per share (EpS)

	2005	2006
Net earnings (after minority interests) *€ million*	113	120
Number of common shares	35.35 million	35.08 million
Earnings per common share	**€3.19**	**€3.41**

(32) Adjusted EBIT EBIT after adjustment for nonrecurring expenses, losses, income and gains relating to equity interests, real estate and restructuring programs breaks down as follows:

€ million

	2005	2006
EBIT	**225**	**215**
Nonrecurring expenses, losses, income, gains related to		
shareholdings	(4)	(7)
real estate	(1)	(6)
restructuring	17	20
finance restructuring	8	--
Adjusted EBIT	**245**	**222**

Notes (Group)
Note to the cash flow statement

(33) Cash flow statement The net cash provided by operating activities included a cash inflow from interest of €8 million (virtually unchanged) and a cash outflow for interest of €31 million (down from €36 million). Income taxes paid came to €43 million (down from €51 million).

The cash outflow for acquiring consolidated subsidiaries totaled €16 million (up from €15 million) and substantially concerned the acquisition of KS de México LLC (under an asset deal) and the purchase of further shares in Kolbenschmidt Pierburg AG and telerob Gesellschaft für Fernhantierungstechnik mbH. Another cash outflow of €5 million was produced by minor additional share purchases and the payment of residual purchase prices for companies acquired in previous years. The cash inflow from the disposal of consolidated subsidiaries totaled €9 million (up from €3 million). The acquisitions and disposals were substantially settled in cash. For purchase price details, see the explanations in Note (2) to the consolidation group. For more information about the dividends received from joint ventures and associated affiliates, turn to Note (9).

No cash or cash equivalents were taken over in the M&A transactions (unchanged) while €16 million in cash and cash equivalents had in 2005 been disposed of in divestments.

Note to the segment reports

(34) 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, the effects of the revaluation of operating land (some of which are not 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 the cash and cash equivalents of €197 million (down from €408 million) and the income taxes of €72 million (down from €73 million), as well as on the liabilities side, equity of €937 million (up from €875 million), financial debts of €402 million (down from €559 million) and income taxes of €69 million (down from €73 million).

The segment capital expenditures refer to tangible and intangible assets, investment properties, and goodwill.

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 and cash equivalents. Capital employed (CE) is determined as the aggregate sum of total equity, pension accruals, net financial debt and, as from fiscal 2006, the goodwill amortization and write-down accumulated in the past. Furthermore, Automotive and Defence are assigned the effects of operating land revaluation and the higher-level goodwill. The return on capital employed (ROCE) equals EBIT (according to management structure) divided by average CE (average of the balances at December 31, 2005 and 2006).

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

(35) Contingent liabilities As in previous years, the suretyships and guaranties existing in connection with the divestment of former operations mainly include rental loss guaranties and performance bonds in favor of divestees. These divestees regularly and duly perform their obligations and there are no signs of any future enforcement of such guaranties or bonds.

A joint and several liability expiring in 2008 exists for the debts assigned under the split-up in 2003 of Bremen-based STN Atlas Elektronik GmbH, to ATLAS Elektronik GmbH, Bremen, at a non-specifiable amount. No claims under this liability are believed to be asserted.

Furthermore, several performance bonds have been furnished in favor of some nonconsolidated Rheinmetall investees (joint project ventures). In the relationship to third parties, Rheinmetall may also be held liable for the performance of the other joint venturers while in the relationship of the parties *inter se*, by virtue of certain agreements on the liability upon recourse, Rheinmetall is only liable for its own share of products and services. At present, no cash outflows are expected from such bonds.

In the judicial review proceedings pending since 1998, the share exchange ratio determined during the Kolbenschmidt Pierburg merger 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.

(36) Other financial obligations Various financial commitments in line with customary business standards exist under master agreements with suppliers, as well as under contracts for services. For the tangible-asset purchasing obligations for capital expenditure projects, see Note (7).

In the year under review, rents of €35 million (down from €39 million) paid under operating leases were expensed, which also include all rents paid for computer hardware and software.

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

€ million

	2005 [1]				2006			
	2006	2007–2010	after 2010	**Total**	2007	2008–2011	after 2011	**Total**
Buildings	16	39	28	**83**	15	38	28	**81**
Other leases	19	35	7	**61**	15	32	4	**51**
	35	**74**	**35**	**144**	**30**	**70**	**32**	**132**

[1] *Prior-year data restated*

In addition, under an agreement on the divestment of a business segment in earlier years, Rheinmetall committed itself to take over the lease for a partly-let property. The future (unrecognized) accumulated obligations under this commitment totaled €14 million as of year-end 2006 (down from €21 million).

€4 million was earned in the period from subleasing properties leased by Rheinmetall. The future income expected during the noncancelable lease term totals €10 million (down from €14 million). €11 million has been provided for the accrued lease-out risks (up from €10 million).

(37) 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, commodity prices, 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 by taking actions to avoid, contain or limit such risks, including by contracting 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, partly 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 shifted to customers, albeit with a time lag. 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. The most important currency hedges contracted by German companies refer to US$ sales transactions while the foreign companies mostly hedge euro-based purchasing and sales transactions. 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 level.

As of December 31, 2006, the currency, interest rate and credit default 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 arm's length transactions.

€ million

	Notional volume		Maturing after 1 year		Fair market values	
	12/31/2005	12/31/2006	12/31/2005	12/31/2006	12/31/2005	12/31/2006
Currency hedges						
Currency forwards	314	424	104	99	--	3
Other	22	51	1	--	--	--
	336	**475**	**105**	**99**	**--**	**3**
Credit default hedges						
Credit default swap	**29**	**--**	--	--	**1**	**--**
Interest rate hedges						
Interest rate options	160	160	160	160	1	1
Interest rate swaps	40	38	35	21	(3)	1
	200	**198**	**195**	**181**	**(2)**	**2**

The derivative transactions contracted within the Rheinmetall Group as part of the corporate risk management policy represent hedges at the economic level. Out of the year-end portfolio, hedges with a notional volume of €243 million (up from €221 million) which meet the stringent IFRS hedge accounting criteria have been accounted for as such.

(38) Other details of related-party transactions The volume of services provided by or to material related companies mainly originates from project work with joint ventures and associated affiliates and is broken down below:

€ million

	Volume of services rendered		Volume of services utilized		Volume of unpaid items	
	2005	2006	2005	2006	2005	2006
GIWS Gesellschaft für intelligente Wirksysteme mbH	--	11	--	--	12	--
PSM Projekt System & Management GmbH	26	21	--	--	(2)	3
OY Finish Defence Power Systems AB	--	5	2	9	(1)	2
AIM Infrarot-Module GmbH	--	1	1	2	--	--
Kolbenschmidt Pierburg Shanghai Nonferrous Components Co.Ltd.	2	1	3	5	1	1
Kolbenschmidt Shanghai Piston Co.Ltd.	2	1	1	1	1	--
Advanced Bearing Materials LLC	1	5	--	--	--	1
HFTS Helicopter Flight Training Services GmbH	--	2	--	--	--	--
Shriram Pistons & Rings Ltd.	6	2	--	3	--	--
	37	**49**	**7**	**20**	**11**	**7**

Remuneration of the Executive and Supervisory Boards The reportable compensation of senior management within the Group comprises that paid to active Executive and Supervisory Board members.

The expenses for compensation paid or payable to active members of the Executive Board break down as follows:

€ ’000

	2005	2006
Short-term payments due	4,862	5,777
Deferred compensation	341	328
	5,203	**6,105**
Postretirement benefits in addition	685	750

The postretirement benefits in addition amounts reflect the current service cost for pension entitlements. Supervisory Board fees amounted to €0.706 million in fiscal 2006 (up from €0.705 million) and are all due short term. For further details and itemization of each member’s remuneration, see the Board Compensation Report within the group management report. An unchanged €2 million was paid to former Executive Board members or their surviving dependants, the accruals for pension obligations to them totaling €18 million (down from €19 million).

Shareholdings As of December 31, 2006 and 2005, none of Rheinmetall AG’s Executive Board members held any legally reportable shares in the Company.

In 2005, Supervisory Board Chairman Klaus Greinert reported the purchase of 250,000 shares; the purchase has duly been, and remains, published as prescribed by Art. 15 German Securities Trading Act (“WpHG”).

(39) Statutory auditor’s fees

€ ’000

	2005	2006
Auditing services	1,967	1,882
Tax consultancy	28	204
Other services	144	289
	2,139	**2,375**

Solely services were rendered that are compatible with the engagement as auditor.

(40) Corporate Governance Code In December 2006, 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 December 2006 on the Internet at www.kspg-ag.com.

Düsseldorf, March 6, 2007
The Executive Board

Eberhardt Dr. Kleinert Dr. Müller

Notes (Group)
Major Group companies

Fully consolidated companies

	Interest held %	Net sales **2006** € million
Rheinmetall AG, Düsseldorf		
Automotive		
Kolbenschmidt Pierburg AG, Neckarsulm	97.59	--
Pierburg GmbH, Neuss	97.59	423
Pierburg S.A., Abadiano, Spain	97.59	154
Pierburg S.à r.l., Basse-Ham (Thionville), France	97.59	152
Pierburg S.p.A., Lanciano, Italy	97.59	168
Pierburg Inc., Fountain Inn, USA	97.59	44
KS Kolbenschmidt GmbH, Neckarsulm	97.59	250
KS Pistões Ltda., Nova Odessa, Brazil	97.59	124
Karl Schmidt Unisia Inc., Marinette, USA	89.78	217
Société Mosellane de Pistons S.A.S., Basse-Ham (Thionville), France	97.59	55
Kolbenschmidt K.K., Yokohama, Japan	97.59	39
Metal a.s., Ústí, Czech Republic	97.59	48
KS Gleitlager GmbH, St. Leon-Rot	97.59	187
KS Aluminium-Technologie AG, Neckarsulm	97.59	223
MSI Motor Service International GmbH, Neckarsulm	97.59	107
Defence		
Rheinmetall Landsysteme GmbH, Kiel	100.00	359
Oerlikon Contraves AG, Zurich, Switzerland	100.00	75
Oerlikon Contraves S.p.A., Rome, Italy	100.00	46
Oerlikon Contraves Inc., St.-Jean-sur-Richelieu, Canada	100.00	71
Rheinmetall Waffe Munition GmbH, Ratingen	100.00	303
Nitrochemie Aschau GmbH, Aschau	55.00	69
RWM Schweiz AG, Zurich, Switzerland	100.00	41
Rheinmetall Defence Electronics GmbH, Bremen	100.00	452

Investees carried at equity

	Interest held %	Net sales **2006** € million
Joint ventures		
Kolbenschmidt Pierburg Shanghai Nonferrous Components Co. Ltd., Shanghai, China	48.80	83
Kolbenschmidt Shanghai Piston Co. Ltd., Shanghai, China	48.80	24
GIWS Gesellschaft für Intelligente Wirksysteme mbH, Nürnberg [1), 2)]	50.00	2
PSM Projekt System & Management GmbH, Kassel [1)]	50.00	177
Associated affiliate		
AIM Infrarot-Module GmbH, Heilbronn [1)]	50.00	57

1) *local financial statements*
2) *prior-year data*

Auditor's report and opinion

Rheinmetall AG, Düsseldorf. Independent 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, 2006. 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 on 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 asset and capital structure, 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, largely 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 asset and capital structure, 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, 2007

PricewaterhouseCoopers
Aktiengesellschaft
Wirtschaftsprüfungsgesellschaft

(Bovensiepen)
Wirtschaftsprüfer

(Dr. Husemann)
Wirtschaftsprüfer

Balance sheet of Rheinmetall AG as of December 31, 2006 (acc. to German GAAP*)

ASSETS *€ million*

	12/31/2005	12/31/2006
Fixed assets		
Intangible assets	0.147	0.100
Tangible assets	33.442	31.858
Financial assets	785.404	788.626
	818.993	**820.584**
Current assets		
Receivables and sundry assets	275.739	337.948
Securities	34.087	41.806
Cash on hand and in bank	310.034	89.733
	619.860	**469.487**
Prepaid expenses & deferred charges	**2.230**	**2.084**
	1,441.083	**1,292.155**

STOCKHOLDERS' EQUITY & LIABILITIES *€ million*

	12/31/2005	12/31/2006
Capital stock	92.160	92.160
Additional paid-in capital	208.262	208.262
Reserves retained from earnings	54.446	109.596
Net earnings	31.639	39.712
Stockholders' equity	**386.507**	**449.730**
Untaxed/special reserves	**3.383**	**3.298**
Accruals		
	107.647	**117.102**
Liabilities		
Bonds	470.836	325.000
All other liabilities	472.709	397.020
	943.545	**722.020**
Deferred income	**0.001**	**0.005**
	1,441.083	**1,292.155**

** German Commercial Code ("HGB")*

Income statement of Rheinmetall AG for fiscal 2006 (acc. to German GAAP*)

€ million

	2005	2006
Income from investments	54.568	134.156
Net interest expense	(30.813)	(18.659)
Net financial result	**23.755**	**115.497**
Other operating income	40.428	47.381
Personnel expenses	(24.786)	(25.571)
Amortization of intangible and depreciation of tangible assets	(1.880)	(1.824)
Other operating expenses	(33.270)	(30.823)
EBT	**4.247**	**104.660**
Income taxes	(1.316)	(9.798)
Net income	**2.931**	**94.862**
Transfer from reserves retained from earnings	40.984	--
Transfer to reserves retained from earnings	(12.276)	(55.150)
Net earnings	**31.639**	**39.712**

** German Commercial Code ("HGB")*

Corporate governance report

Corporate governance. Corporate governance is tantamount to the effective and transparent organization, management and control of a company. 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 internationally established standards), for the corporate governance and control of stock corporations. Rheinmetall AG is committed to a responsible, fair, dependable and transparent corporate policy oriented toward the development and exploitation of business potentials, the achievement of medium-term financial benchmarks, as well as the systematic and sustained addition of value to Rheinmetall.

Stockholders' meeting. Rheinmetall AG's stockholders exercise their codetermination and control rights at their general meeting where one share grants one vote. If prevented from personally attending a general meeting, stockholders may appoint a proxy at their discretion or give voting power to a Rheinmetall-appointed voting proxy. To prepare stockholders for their general meeting, the invitation, as well as all reports and information relevant to voting are published on the Company's website and also sent to stockholders on request. The Executive Board presentation and the voting results, too, are published on Rheinmetall's website.

Management and control of Rheinmetall AG. Through constructive frequent dialogs, the Executive and Supervisory Boards closely work together in an atmosphere of mutual trust in the best interests of the Group's control and supervision. The responsibilities of either board along with membership rules, tasks, duties, authorities and transactions subject to approval are defined in rules of procedure.

The three Executive Board members jointly manage the Group on their own responsibility. The Executive Board is committed to safeguarding Rheinmetall's interests as well as to adding sustained shareholder value. This Board's key management functions include the development of the basic strategic orientation, the formulation of business goals and targets, corporate policy and organization, as well as the determination of focal R&D areas. Moreover, the Executive Board briefs the Supervisory Board at regular intervals on details of the general business trend, the asset and capital structure, financial position, results of operations, plans, budgets and target achievement levels or variances, as well as on business risks, rewards and opportunities.

The Supervisory Board (which is subject to codetermination statutes) 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 critical import to Rheinmetall. Its members do not include any former Executive Board members. Wherever practicable, Supervisory Board membership is governed by the principles of adequate technical know-how and a reasonable level of independence. In its work, the Supervisory Board is assisted by its Personnel, Audit and Slate Submittal Committees, whose members are equally stockholder and employee representatives, deal with complex issues, give recommendations and prepare resolutions for submittal to, and voting by, the plenary Supervisory Board meeting.

In the year under review, no clashing interests affecting Executive or Supervisory Board members were reported, since they would require immediate disclosure, to the Supervisory Board.

The offices held by Executive and Supervisory Board members are itemized on pages 106—109.

Compensation of board members. Details of the total and individual remuneration of Executive and Supervisory Board members in 2006 and the underlying compensation structures are described and explained in the board compensation report on pages 44 et seq. The Supervisory Board Chairman briefed the annual stockholders' meeting on May 9, 2006, on the basic elements and components of Executive Board remuneration, which have also been disclosed on the Company's website.

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

Detailed reporting and communication system. True to its principle of equal treatment, Rheinmetall timely informs private and institutional investors, prospective stockholders, financial analysts and the general public about the Group's situation, latest developments and significant intragroup changes by publication on its website at www.rheinmetall.com. The information includes press releases, annual and quarterly reports, presentations and background information on specific subjects and topics, besides the dates of periodical financial reporting. Any information likely to significantly impact on stock prices is published in ad-hoc notifications and on the website.

In addition to the current declaration of conformity under the terms of Art. 161 AktG, the previously published declarations relating to the German Corporate Governance Code are downloadable, too. The annual document according to Art. 10 German Securities Prospectuses Act ("WpPG") summarizes the notices published by the Company between January 3, 2005, and March 20, 2006. The corresponding annual document for 2006 will be available on the Internet in March 2007. Reports from business papers and the trade press round off the information made available on Rheinmetall's website.

Director's dealings. The provisions of Art. 15a German Securities Trading Act ("WpHG") require that any Executive or Supervisory Board member, any other managerial staff with regular access to so-called insider information about the Company, and parties (individuals or entities) related to these officers and managers report the purchase or sale of Rheinmetall AG securities to both the Company and BAFin, the Federal Financial Supervisory Authority, provided that the aggregate total of any such deals exceeds €5,000 in the calendar year. No such reportable transactions were communicated to the Company in 2006, nor did any shareholding exist that would have been reportable under the terms of 6.6 of the Code as amended up to June 12, 2006.

Provident and responsible risk management. Groupwide integrated, multitier budgeting, planning, reporting and control systems supply reliable information about the current risk position and contribute toward goal achievement, besides minimizing risk-related costs. The systematic identification of the business and financial risks the Group is exposed to in connection with its international operations, enables Rheinmetall to detect risks early on, take appropriate counteractions and thus control its risk positions. Risk assessment parameters are probability and level of loss. Rheinmetall refines and updates the early risk identification system (ERIS) in a continuous process in response to the changing business environment. ERIS effectiveness is assessed annually by the statutory auditors.

Accounting, financial reporting and statutory audits. Rheinmetall AG formulates its consolidated financial statements and interim reports in conformity with the current rules of the International Financial Reporting Standards (IFRS) while its separate financial statements are prepared according to the German Commercial Code (HGB).

The Supervisory Board engaged PricewaterhouseCoopers Aktiengesellschaft Wirtschaftsprüfungsgesellschaft, Frankfurt/Main, Düsseldorf branch, as the statutory auditor elected for 2006 by the annual stockholders' meeting, to audit Rheinmetall AG's consolidated and separate financial statements. The audit procedures were performed in accordance with German auditing standards and in due compliance with the generally accepted principles of statutory audits of financial statements as established by IDW, the Institute of Sworn Public Accountants & Auditors in Germany. The audit work also covered the risk management system and compliance with the corporate governance reporting obligations pursuant to Art. 161 AktG. The Supervisory

Corporate governance report

Board ensured that the audit work was not adversely affected by clashing interests, and obligated the statutory auditor to promptly disclose any reasons for non-eligibility or partiality, as well as to report any material findings, conclusions or events. The 2006 annual audit has not indicated any such reportable facts.

Declaration of conformity 2006. 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 December 7, 2006, and refers to the Code as amended up to June 2, 2005, and June 12, 2006.

Joint declaration of conformity of the Executive and Supervisory Boards pursuant to Art. 161 German Stock Corporation Act ("AktG") on the recommendations of the German Corporate Governance Code Government Commission

"Rheinmetall AG's Executive and Supervisory Boards declare

(1) THAT, since the issuance of the preceding declaration of conformity in November 2005, Rheinmetall AG had fully carried out 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 were not implemented:

Neither was the remuneration paid to each individual Executive Board member disclosed in the notes to the consolidated financial statements (§ 4.2.4 of the Code), nor was that paid to each Supervisory Board member reported in the corporate governance section (§ 5.4.7).

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

(2) THAT Rheinmetall AG will fully carry out the recommendations of the German Corporate Governance Code Government Commission as amended up to June 12, 2006, and officially published on July 24 2006, in the digital Federal Gazette, except for the following recommendation that will not be implemented:

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

Düsseldorf, December 2006
Rheinmetall Aktiengesellschaft

Executive Board Supervisory Board"

Supervisory Board

Klaus Greinert
Mannheim

Chairman

Advisory board of Gebr. Röchling KG
(chairman)

Advisory board of Röchling Immobilien GmbH
(chairman)

DURAVIT AG
(chairman)

DURAVIT S.A.

Stockholder committee of Gebr. Röchling KG

Joachim Stöber *)
Biebergemünd

Vice-Chairman

Member of the Metalworkers Union's General Secretariat

GEA Group AG

Pierburg GmbH
(vice-chairman) (as from 1/1/2007)

Dr. Eckhard Cordes
Düsseldorf

Executive board chairman of
Franz Haniel & Cie GmbH

Air Berlin PLC

Aktiebolaget SKF

Celesio AG
(chairman)

Fiege Holding Stiftung & Co. KG
(chairman)

METRO AG
(chairman)

N M Rothschild & Sons Ltd.

TAKKT AG
(chairman)

Dr. Ludwig Dammer *)
Düsseldorf

Head of Production System/Technology,
Pierburg GmbH

Kolbenschmidt Pierburg AG

Dr. Andreas Georgi
Glashütten

Executive board member of Dresdner Bank AG

Allianz Dresdner Global Investors Deutschland GmbH
(up to 10/31/2006)

Asea Brown Boveri AG

Deutsche Schiffsbank AG
(vice-chairman)

Deutscher Investment-Trust
Gesellschaft für Wertpapieranlagen mbH
(up to 10/31/2006))

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

Dresdner Bank (Schweiz) AG
(chairman)

Dresdner Mezzanine Verwaltungs GmbH
(vice-chairman)

Eurohypo AG
(up to 3/31/2006)

Felix Schoeller Holding GmbH & Co. KG

Oldenburgische Landesbank AG
(chairman) (as from 5/23/2006)

Reuschel & Co. KG
(vice-chairman)

RWE Dea 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

3i Group plc
(up to 7/31/2006)

Arcor AG

Alcatel S.A.
(up to 9/7/2006)

Giesecke & Devrient GmbH
(chairman)

Vodafone Deutschland GmbH

Vodafone D2 GmbH

DDr. Peter Mitterbauer
Gmunden, Österreich
(as from 10/4/2006)

CEO of Miba AG

Andritz AG

Erste Österreichische Spar-Casse Privatstiftung

FFG Österreichische Forschungs-förderungsgesellschaft mbH
(chairman)

Generali Holding Vienna AG

Oberbank AG

ÖIAG Österreichische Industrieholding AG
(chairman)

Wolfgang Müller *)
Bad Rappenau

Works council chairman of
KS Aluminium-Technologie AG

KS Aluminium-Technologie AG

KS ATAG GmbH

Henning von Ondarza
Bonn

Retired general

Prof. Dr. Frank Richter
Ulm

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

Advisory board of Gebr. Röchling KG

GSW Gemeinnützige Siedlungs- und Wohnungsbaugesellschaft Berlin mbH

Johannes Frhr. v. Salmuth
London, UK
(up to 9/20/2006)

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

Advisory board and shareholder committee of
Gebr. Röchling KG
(vice-chairman)

Dr. Dieter Schadt
Mülheim/Ruhr

Former CEO of
Franz Haniel & Cie. GmbH

A.S. Creation TAPETEN AG
(as from 5/17/2006)

LSG Lufthansa Service Holding AG

TAKKT AG

Harald Töpfer *)
Kassel

Works council chairman of
Rheinmetall Landsysteme GmbH,
Kassel operation

Rheinmetall Landsysteme GmbH

Wolfgang Tretbar *)
Nettetal

Works council chairman of
Pierburg GmbH, Nettetal plan

Peter Winter *)
Achim

Works council member of
Rheinmetall Defence Electronics GmbH

Executive Board

Klaus Eberhardt
Düsseldorf

Chairman (CEO)
Director of Industrial Relations

Chairman of the Defence sector

Membership in supervisory boards

Hirschmann Electronics Holding S.A.
(chairman)

Kolbenschmidt Pierburg AG
(chairman)

MAN AG

Nitrochemie AG
(president)

Nitrochemie Wimmis AG
(president)

Oerlikon Contraves AG
(president)

Rheinmetall Defence Electronics GmbH
(chairman)

Rheinmetall Landsysteme GmbH
(chairman)

Rheinmetall Waffe Munition GmbH
(chairman)

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 Shanghai Piston Co. Ltd.
(vice-chairman) (up to 10/9/2006)

Läpple AG
(chairman)

Läpple Holding AG
(chairman)

Pierburg GmbH
(chairman)

Dr. Herbert Müller
Düsseldorf

Finance & Controlling (CFO)

Membership in supervisory boards

Kolbenschmidt Pierburg AG

Senior Executive Officers

Dr. Andreas Beyer, LL.M.
Sindelfingen
Law, Internal Auditing, M&A

Ingo Hecke
Meerbusch
Human Resources and Senior Management

Executive Board Automotive

Dr. Gerd Kleinert
Gottmadingen
Chairman
Strategy, Marketing, Operations

Dr. Peter P. Merten
Herrsching
Finance & Controlling, IT

Dr. Jörg-Martin Friedrich
Ludwigsburg
HR, Law

Management Board Defence

Klaus Eberhardt
Düsseldorf
Chairman

Helmut P. Merch
Erkrath
Finance & Controlling, IT

Detlef Moog
Mülheim/Ruhr
Land Systems and Weapon Munition divisions

Heinz Dresia
Krefeld
Defence Electronics and Air Defence divisions

Ingo Hecke
Meerbusch
Human Resources

Financial diary for 2007

March 21, 2007
Annual accounts press conference

March 21, 2007
Analysts meeting

May 7, 2007
Q1/2007 report

May 8, 2007
Annual stockholders' meeting

August 8, 2007
Q2/2007 report

November 12, 2007
Q3/2007 report

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.

Annual Report 2006 Rheinmetall AG

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