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MERCK

Annual Report 2006

More potential

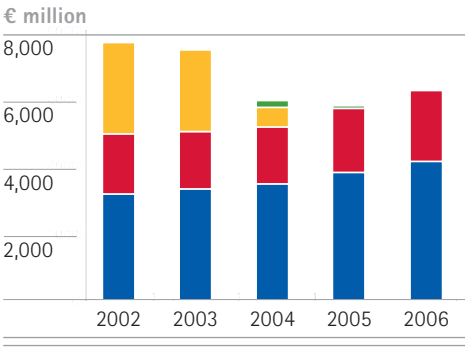
More information inside the cover:
Business Development 2002 – 2006
Business Sectors and Divisions

Merck 2006 at a glance

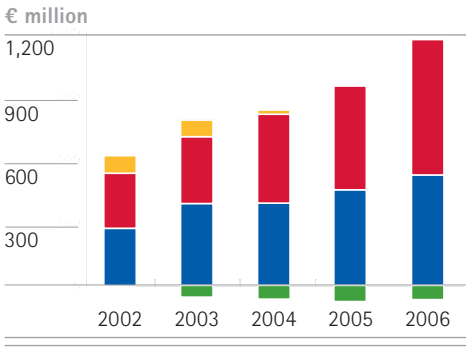
Key figures for 2006

€ million	Pharma-ceuticals	Chemicals	Corporate and Other	Total
Sales	4,119	2,106	34	6,259
Gross margin	2,607	1,234	4	3,845
Research and development (R&D)	615	137	0	752
Operating result	524	641	–60	1,105
Exceptional items	–35	–35	289	219
Free cash flow	–1,290	521	–304	–1,073
Return on sales (ROS) in %	12.7	30.5	–	17.7
Return on capital employed (ROCE) in %	15.9	33.0	–	21.0

Sales by business sector



Operating result by business sector



Major achievements of 2006

Group **sales** rose by 8.5% to € 6,259 million while gross margin increased by 13%. The **operating result** climbed by 25% to exceed the € 1 billion mark for the first time. Profit after tax also surpassed this threshold. Return on sales (ROS) increased to 17.7%, return on capital employed (ROCE) to 21.0%.

Erbitux® was approved in April 2006 by the European Medicines Evaluation Agency (EMEA) for an additional indication in head and neck cancer in the 27 Member States of the European Union as well as Iceland and Norway.

The **acquisition of Serono S.A.**, which was announced in September, creates a strategically compelling combination, the scope of which will raise Merck's competitiveness in the global pharmaceutical market. The relevant antitrust authorities cleared the transaction in the fourth quarter of 2006. Merck attained majority ownership in January 2007.

The **tremendous success of LCD televisions** impressively shows the superiority of this technology. Thanks to Merck's technology and market leadership, sales by the Liquid Crystals division grew by 21% and the operating result soared 40%.

Business Development 2002 – 2006

€ million	2002	2003	2004	2005	2006	Change in %
Sales	7,400	7,202	5,859	5,768*	6,259	8.5
Sales excluding VWR**	4,935	5,003	5,339	5,768*	6,259	8.5
Pharmaceuticals	3,153	3,303	3,452	3,792*	4,119	8.6
Ethicals	1,779	1,467	1,504	1,717*	1,902	10.8
Generics	1,064	1,515	1,597	1,701*	1,819	6.9
Consumer Health Care	309	321	352	374*	398	6.3
Chemicals	1,782	1,700	1,687	1,900	2,106	10.8
Liquid Crystals	377	438	583	739	892	20.7
Performance & Life Science Chemicals	1,212	1,081	1,104	1,161	1,213	4.5
Electronic Chemicals	192	180	–	–	–	–
Laboratory Distribution**	2,711	2,427	582	–	–	–
Laboratory Distribution intragroup sales	–246	–228	–63	–	–	–
Corporate and Other***	–	–	200	76	34	–55.5
Operating result	616	736	776	883	1,105	25.1
Operating result excluding VWR**	532	656	755	883	1,105	25.1
Pharmaceuticals	272	389	391	454	524	15.4
Chemicals	260	316	420	492	641	30.4
Laboratory Distribution**	84	79	21	–	–	–
Corporate and Other***	–	–48	–56	–63	–60	–4.5
Earnings before interest and tax (EBIT)	559	538	1,044	956	1,325	38.6
Profit before tax	412	423	961	893	1,273	42.5
Profit after tax	215	218	672	673	1,001	48.8
Free cash flow	441	442	1,889	657	–1,073	–
EBITDA	985	1,008	1,419	1,245	1,628	30.7
Capital expenditure on property, plant and equipment	377	281	234	268	253	–5.4
Research and development	608	605	599	713	752	5.4
Total assets	7,511	6,982	5,754	7,281	8,102	11.3
Net equity	2,054	2,363	2,800	3,329	3,807	14.4
Employees (number as of Dec. 31)	34,504	34,206	28,877	29,133	29,999	3.0
Return on sales (ROS) in % (ROS: operating result/sales)	8.3	10.2	13.2	15.3*	17.7	
Return on capital employed (ROCE) in % (ROCE: operating result/average operating assets)	9.6	12.1	15.9	20.5	21.0	
Earnings per share**** in €	1.18	1.15	3.47	3.40	5.07	49.1
Dividend per share in €	1.00	0.80	0.80	0.85	0.90	5.9
One-time bonus per share in €	–	–	0.20	–	0.15	

* In order to harmonize accounting practices within the Merck Group, as of 2006 the way in which certain customer rebates are reported has been changed. Costs previously included mainly under marketing and selling expenses are now deducted from sales. The previous year's figures have been presented accordingly on a comparable basis (for more information, please see page 100).

** The Laboratory Distribution business sector (VWR) was sold in April 2004.

*** This segment, which was introduced in 2004, includes for example the gain on the sale of the Electronic Chemicals division in April 2005 and the exceptional gain from the sale of the shareholding in Schering AG in the second quarter of 2006.

****The previous year's figure has been adjusted (for details, see page 107).

Pharmaceuticals business sector

Merck develops, manufactures and markets its pharmaceutical products for the three main drug markets: innovative prescription drugs, generics for cost-efficient basic health care, and over-the-counter products for consumer health care. Our aim is to improve quality of life.

Ethicals

The portfolio of the Ethicals division includes prescription drugs to treat major widespread diseases. Notable successes have recently been achieved in oncology as well as in cardiometabolic care, i.e. diabetes, cardiovascular diseases as well as thyroid and lipid disorders. By acquiring Serono, we will strengthen our product portfolio as well as our research efforts in key therapeutic areas.

Generics

Merck offers affordable standard therapies in nearly all major therapeutic areas through high-quality drugs containing active ingredients that are no longer patent-protected. A wide assortment of more than 400 different substances is available to patients and physicians; special dosage forms and delivery systems with high patient benefit round off the range.

Consumer Health Care

More and more consumers trust a large number of well-known over-the-counter brands that Merck develops, manufactures and markets in its Consumer Health Care division. The portfolio ranges from products for everyday health such as Bion®3 to classic cold remedies such as the well-known brand Nasivin® up to products for joint care.

Chemicals business sector

Merck offers a very wide range of specialty chemicals for technologically sophisticated applications in laboratories and industry. Many of these chemicals can be found in products that we encounter in everyday life. Top quality, technology-driven research and a customer-centric approach to product development characterize the two large divisions that make up this business sector.

Liquid Crystals

Close cooperation in developing and producing liquid crystals with the world's leading display manufacturers has made Merck number one worldwide in this market of the future. Modern life would be hard to imagine without displays based on LC technology. Merck continues to expand this important area together with industry customers, offering them customized mixtures and greater synthesis capacities.

Performance & Life Science Chemicals

Specialty chemicals from Merck are used in all stages of pharmaceutical production from development in the laboratory up to industrial-scale manufacture for patients. They ensure reliable analysis in research and dependable production processes.
Merck's expertise in chemistry, technology, quality assurance and approval processes has made the company a successful supplier not only to the pharmaceutical industry, but also to the cosmetics, food, optics, plastics, coatings and printing industries.

Merck is a global pharmaceutical and chemical group with a history of more than 300 years. Our employees develop, manufacture and market pharmaceuticals and chemicals to improve the quality of life of people everywhere. Their pioneering spirit and wealth of experience are assets to the many business fields in which they work.

In 2006, Merck took a significant step to strengthen itself in a highly promising sector by announcing its intention to join forces with Serono, Europe's number one biopharmaceutical company. This acquisition and combination with the Merck Ethicals division will create a new powerhouse in drug research. "Merck Serono" will stand for the link between innovative biotechnology and established pharmaceutical science – a link that is widely considered to offer tremendous potential. More evidence that Merck continues to explore and discover, to assess and analyze, and to seize breakthrough opportunities at the right time.

Merck – more potential.

Contents

The year 2006 was not only an extremely successful but also a very eventful time for Merck – putting us in the public spotlight as never before in our history of well over 300 years.

Undoubtedly, this was triggered by the realignment of our Pharmaceuticals business sector. We seized the opportunities that were open to us. Following the refusal of our offer to acquire Schering in March 2006, we announced the acquisition of Serono just six months later and are now Europe's leading biopharmaceutical company. On January 5, 2007, we acquired the majority of the capital in Serono S.A. of Geneva, Switzerland. Since then, the integration has been in full swing. The competencies in chemical and biotech drug research complement each other ideally. Advantages from both worlds will now converge and grow in the new "Merck Serono" division, thereby increasing our strength exponentially. It is helpful that also as a family-owned company, Serono shares our basic entrepreneurial convictions – Merck will become more.

With the largest acquisition in our corporate history and the preparation of a potential divestment of the Generics division, we are resolutely continuing our strategy of "focused diversification". Going forward, Merck will continue to stand on two pillars: Pharmaceuticals and Chemicals. In both business sectors, we are focusing on markets that need and reward innovation.

Our success confirms this. We increased the operating result by 25% and exceeded the € 1 billion mark for the first time. Profit after tax also surpassed this threshold for the first time. By distributing a dividend of € 0.90 plus a bonus of € 0.15 per share, we want you – our shareholders – to participate in this good result.

The performance of our Chemicals business sector was again superb. The operating result increased by a notable 30% and accounted for 58% of the Group operating result. Once again we were especially pleased with the Liquid Crystals business, which is being driven by the dynamic LCD market and Merck's leading market position. I would also like to make special mention of

our oncology drug Erbitux®. In 2006, we obtained approval for this innovative and targeted therapy in the additional indication of head and neck cancer. Investments in product innovations such as these are also made possible by a wide range of established products with good market positions. These include the businesses combined in the Performance & Life Science Chemicals division in early 2006, as well as our range of classic pharmaceuticals.

Long-term company management calls for trust from the providers of capital. Apart from regular contacts with our Supervisory Board and particularly with the representatives of the Merck family, two developments make me very optimistic: On the one hand, the development of our share price since I became chairman, and on the other hand the positive reaction to the capital increase that we announced on January 21, 2007. Here I would like to highlight the sustained commitment of the Merck family to the company: The family of owners took part in the capital increase with over € 1 billion. At the same time, the number of shares in free float increased and now the family holds an interest of 70% in the company.

Even in times of great change and major accomplishments, we will not forget that entrepreneurial success starts with people. My Executive Board colleagues and I would like to especially thank our nearly 30,000 employees for their commitment and flexibility in 2006. At the same time, I would like to warmly welcome the approximately 5,000 employees who have joined Merck as a result of our acquisition of Serono. Together, we want to continue writing the Merck success story.

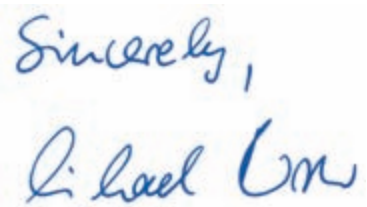
We have made several important changes to the executive management of the Merck Group: Walter W. Zywottek, who had already been appointed to the Executive Board in 2005, assumed the leadership of the Chemicals business sector at the beginning of the year. On September 1, Karl-Ludwig Kley joined the company as Vice Chairman of the Executive Board. And last but not least, Bernd Reckmann was appointed to the Executive Board as of January 1, 2007. At the end of 2006, Jan Sombroek retired after 31 successful years with Merck.

Michael Römer
Chairman of the Executive Board of Merck KGaA

I myself will hand over my Executive Board responsibilities upon conclusion of the Annual General Meeting on April 27, 2007 to Karl-Ludwig Kley, who has been appointed as my successor. As a former member of the Supervisory Board and the Board of Partners as well as Vice Chairman of the Executive Board, he knows the company well. Since becoming a Member of the Executive Board, he has been responsible for the integration of Serono and has consequently set the course for the future – a future with more potential.

After 29 years with Merck, including 14 on the Executive Board, no one would find it easy to say farewell. I was therefore delighted to accept the Merck family's offer to move to the Board of Management of E. Merck OHG – the parent company of the Group.

With the new Executive Board, a strong team has been created. The members of the new Board have my full confidence. I kindly ask you, dear shareholders and friends of Merck, to place your trust in the new Executive Board just as you did with my team.



From left:
Bernd Reckmann, Karl-Ludwig Kley, Michael Römer, Elmar Schnee, Walter W. Zywottek, Michael Becker

The Executive Board of Merck KGaA

www.management.merck.de

Michael Römer | Chairman of the Executive Board
Born in 1946, doctorate in Chemistry from the Technical University of Darmstadt; with Merck for 29 years; Member of the Executive Board for 14 years; Chairman since November 2005
- Legal, Patents, Trademarks, Auditing, Corporate Communications, Inhouse Consulting

Karl-Ludwig Kley | Vice Chairman of the Executive Board
Born in 1951, doctorate in Law from Ludwig-Maximilians University in Munich; Member of the Executive Board since September 2006
- Integration of Serono, Human Resources

Michael Becker
Born in 1948, doctorate in Law from the University of Augsburg; with Merck for eight years; Member of the Executive Board for six years
- Accounting and Controlling, Finance, Tax, Insurance, Business Development

Bernd Reckmann
Born in 1955, doctorate in Biochemisty from the University of Hannover; with Merck for 20 years; Member of the Executive Board since January 2007
- Management of the Darmstadt and Gernsheim sites, Polyproduction and Development, Engineering, Information Services, Environmental Protection, Health, Safety and Quality, Purchasing

Elmar Schnee
Born in 1959, degree in Marketing Management from the Swiss Institute for Business Administration in Zurich; with Merck for four years; Member of the Executive Board since November 2005
- Pharmaceuticals business sector

Walter W. Zywottek
Born in 1947, industrial manager; with Merck for 40 years; Member of the Executive Board since September 2005
- Chemicals business sector

More strength

The integration of Serono, Europe's leading biopharmaceutical company, will transform Merck's scale, making it even more fit for the future and global competition. In 2006, around 35,000 people generated pro forma sales exceeding € 8 billion. Our people and the results of their work, especially at our 63 research and production sites, stand for recognized quality. The acquisition has made Merck a major player in the capital market. Its increased performance capacity will create value for customers and investors. The "Merck Serono" division will have an annual R&D budget of around € 1 billion to bring more new active ingredients even faster to the market. Two biopharmaceuticals have already completed the lengthy approval process and are notably successful: the blockbuster Rebif® to treat multiple sclerosis and the monoclonal antibody Erbitux®, a targeted cancer therapy that has already been approved in more than 60 countries.

More opportunities

In research too, the impact of the integration will be greater than the sum of the individual parts. Serono and the Ethicals division will not simply be put together, but interwoven to truly leverage the research strength of the entire organization. Special dynamism will be created by combining two fundamentally different approaches: the search for biological active ingredients and research into the mode of action of new chemical substances. This will permit the cross-fertilization of methods and results only possible in very few companies at global level. Merck Serono – a powerhouse of scientific expertise with 31 different projects in clinical development. The higher budget available for research and development will further increase the potential offered, especially by the biological drugs of the future, the market for which is expected to grow by more than 15 % in 2007. Chemical research also offers new opportunities: for example in the emerging field of organic light-emitting diodes, or OLEDs, as materials for displays and lighting; likewise, the core liquid crystals business still offers vast potential for growth and continues to remain an excellent source of earnings for Merck.

More growth

Size alone is not the only important factor when it comes to further growth – even though the highly positive development of the Liquid Crystals division may make it seem so as it benefits impressively from the trend towards increasingly large panel sizes. Merck has grown sustainably through successful innovations and has focused on specific technologies such as liquid crystals for displays and on specific therapeutic areas such as oncology. The acquisition of Europe's leading biopharmaceutical firm will open up entirely new possibilities for Merck to develop further in specific areas, especially in neurology and reproductive health. At the same time, the acquisition of Serono is an addition that makes strategic sense for the entire company. Merck now has a well-balanced mix in both its Pharmaceuticals and Chemicals business sectors: leading technologies and dynamic growth drivers on the one hand, constant and reliable sources of income on the other. For the most part, this focused diversification balances out product and economic cycles, permits sustainable growth and is the best possible way for us to secure our future.

More presence

By integrating Serono, Merck will also directly market patented active ingredients in the United States. Complementing its traditionally strong market positions in Europe and Latin America, the Ethicals division will achieve a strong presence in the world's largest pharmaceutical market: the United States accounts for roughly half of the market volume of all industrialized countries or around € 200 billion. Serono is superbly positioned in the United States, which will help Merck to achieve the size needed to be able to launch new drugs in this market faster and better – and to successfully grow sales in clearly focused therapeutic areas in the United States as well. Overall, Merck Serono's pharmaceutical marketing and sales force will increase to around 7,000 people worldwide.

More courage

In 2006, Merck triggered the largest acquisition in its history. No doubt, the integration of Serono not only offers many opportunities but also poses many challenges. Major tasks inevitably involve major endurance tests. Yet we feel up to the challenge. Not least due to the exceptionally strong corporate culture that has developed through the diversity of experiences made by people working over the centuries for the world's oldest pharmaceutical and chemical company. One of the defining features of our culture is a mission statement that places high demands on entrepreneurial thinking and actions. This is also where perhaps the most important development ever made at Merck comes in: a sense of responsibility – for individuals, for the whole, for the world in which we live. For thinking in generations. This is how the biggest strategic move that Merck has ever made will be understood, supported and implemented – with judgment and courage, with a new joy for discovery and the pioneering spirit that has served us so well for so long.

Heinrich Emanuel Merck (1794–1855) took over the sixth generation of the Angel Pharmacy in 1816 and began the industrial-scale production of highly active drugs in 1827.

More potential

A much larger company with even more talented people. Well-positioned products. Technology and market leadership in liquid crystals. A research budget exceeding one billion euros. A much stronger presence in the U.S. pharmaceutical market. A clear focus on core therapeutic areas. All these factors represent the new and expanded potential of Merck to increase value – the ability to create innovations for customers as well as value for its owners and shareholders. We will make the best possible use of this potential, with enthusiasm for decision-making, creativity and patience. Our long-standing integration experience will enable us to engage and involve people with a wide variety of backgrounds. Customers, employees, business partners, investors – there's a lot for all of us to discover. And even more to achieve. That is what we'll work toward, and it is what we look forward to.

Management Report of the Merck Group

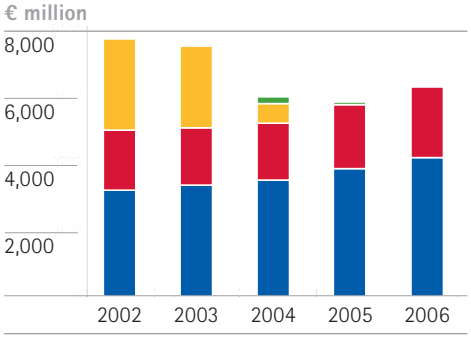
Sales development

Global upswing continues

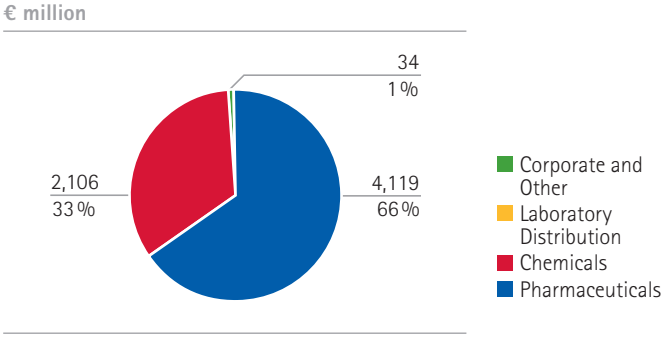
In 2006, the global economic upswing continued: According to estimates by the six leading German economic research institutes, global gross domestic product increased by 3.7%, while global trade grew by 8.5%. The much stronger dynamism in emerging economies compensated partly for the slowdown in the United States, where output has been weakening since spring 2006. Private consumption lost momentum, the housing market declined and strict monetary policy had a dampening impact. Overall, growth still amounted to 3.5% in 2006, as the real devaluation of the U.S. dollar improved competitiveness and led to higher exports. The Japanese economy grew by 2.7% after experiencing a strong upswing in 2005, however it lost some of its dynamism in the course of the year. China accelerated its already high growth rate in 2006 once again and exceeded the 10% mark – thanks to strong private consumption and a high level of investments. Southeast Asia achieved growth of 5.2% and benefited from the positive development especially in the information technology and electronics sectors. For Latin America, economic researchers expect output to grow by 4.6%, with the situation being very heterogeneous in the region.

The economy of the euro area experienced an upswing in 2006, above all thanks to strong foreign trade. For the full year, growth was 2.6% – nearly twice as much as in 2005. In the course of the year, the expansion slowed against the background of a higher euro. Growth in the new member states of the European Union was much stronger at 5.6%. The German economy once again supported European output. At 2.3%, it achieved its second-highest growth rate in the past ten years. Strong export growth and the continuing recovery of domestic demand helped to lower unemployment.

Sales by business sector



Sales by business sector



Sales development by quarter

€ million	1st quarter	2nd quarter	3rd quarter	4th quarter	2006	2005
Merck Group	1,576	1,521	1,536	1,625	6,259	5,768*
Pharmaceuticals	1,008	1,009	1,031	1,071	4,119	3,792*
Chemicals	560	503	496	546	2,106	1,900
Corporate and Other	8.6	8.4	8.4	8.4	34	76

Components of growth by quarter

in %	1st quarter*	2nd quarter*	3rd quarter*	4th quarter*	2006*	2005
Organic growth	14.1	4.7	7.0	12.1	9.4	10.8
Pharmaceuticals	10.3	4.0	8.6	11.1	8.5	11.6
Chemicals	23.6	6.5	4.4	14.5	12.0	10.8
Currency effects	4.6	–0.2	–1.9	–3.1	–0.3	1.4
Acquisitions/disposals	–2.7	0.0	–0.1	0.0	–0.6	–2.2
Total	16.0	4.5	5.0	9.0	8.5	9.9

*In order to harmonize accounting practices within the Merck Group, as of 2006 the way in which certain customer rebates are reported has been changed. Costs previously included mainly under marketing and selling expenses are now deducted from sales. The previous year's figures have been presented accordingly on a comparable basis (for more information, please see page 100).

Solid sales growth of 8.5%

Group sales increased by 8.5% to € 6,259 million in 2006. In order to harmonize accounting practices within the Merck Group, as of 2006 we changed the way we report certain customer rebates. Costs previously included mainly under marketing and selling expenses are now deducted from sales. The previous year's figures have been presented accordingly on a comparable basis.

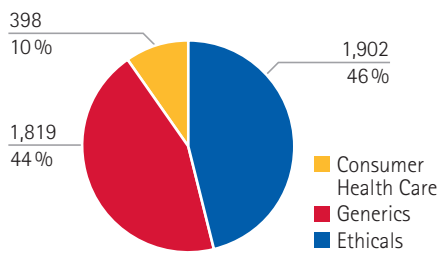
While we registered positive currency effects in the first quarter, the weakening of the U.S. dollar and the Japanese yen in the course of the year had a slightly negative effect – especially in the fourth quarter in the Chemicals business sector. Organic growth was 9.4%. The impact of acquisitions and disposals was minor.

In the first quarter, the Pharmaceuticals business sector surpassed the € 1 billion sales threshold for the first time. In the course of the year, we benefited from the additional indication for our cancer drug Erbitux® and the associated higher sales.

In 2006, the Pharmaceuticals business sector achieved an 8.6% increase in sales to € 4,119 million, to which all three divisions contributed. The strong growth in the fourth quarter is due to the good performance of the Generics and Ethicals divisions.

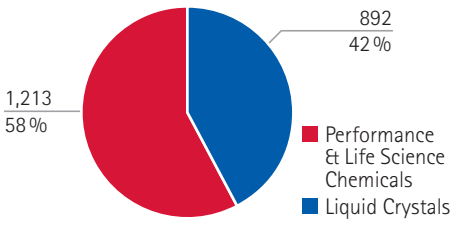
Pharmaceuticals | Sales by division

€ million



Chemicals | Sales by division

€ million



Following a very good first quarter in the Chemicals business sector attributable to strong growth in the Liquid Crystals division, high display inventory levels among our liquid crystal customers became noticeable in the course of the year. The Chemicals business sector increased total sales by 11% to € 2,106 million in 2006. This was mainly the result of a 21% increase in liquid crystals for displays and solid development of the newly created Performance & Life Science Chemicals division. The latter was formed in early 2006 by combining the previous Life Science & Analytics and Pigments divisions.

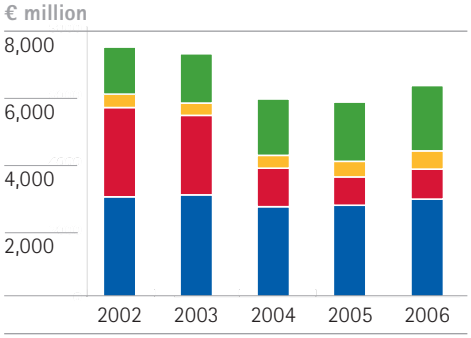
Double-digit growth in France – our largest market

Accounting for sales of € 2,891 million, Europe remained the Merck Group's most important region and posted growth of 6.7% in 2006. While sales stagnated to € 561 million in our home market of Germany, we grew sales by 14% to € 901 million in France, our largest market. Southern European countries such as Spain, Italy and Greece recorded double-digit growth and sales of € 220 million, € 169 million and € 21 million, respectively. Poland, the Czech Republic and Slovakia also grew notably at rates of more than 15%. In contrast, we sustained a decrease of 11% in the United Kingdom owing to the business decline in the Generics division.

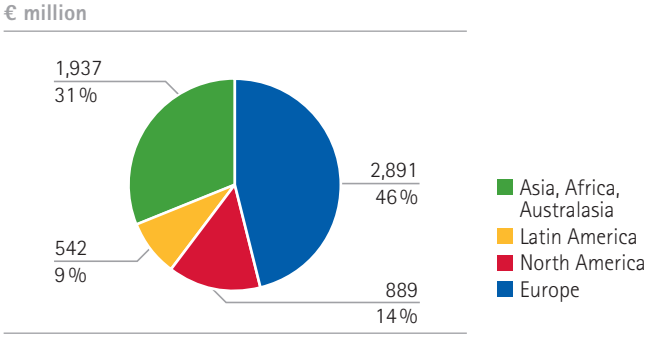
Sales in North America increased by 5.8% to € 889 million. Apart from moderate growth in the United States, sales in the Canadian market improved by 22%. The development of sales in Latin America, which rose by 17% to € 542 million, was again very positive. Special mention should be made of Mexico, Brazil and Venezuela, where we grew by 23%, 27% and 28%, respectively.

Sales in Asia, Africa and Australasia increased by 10% to € 1,937 million, mainly as a result of our liquid crystals business in Asia. The latter was responsible above all for the good performances in Taiwan and South Korea, where we achieved growth of 24% and 16%, respectively. We expanded our business in China by 19%. Indonesia and India also registered double-digit growth. Likewise, sales increased in South Africa by 11% to € 55 million, whereas we suffered a decline of 6.1% in Australia.

Merck Group | Sales by region



Merck Group | Sales by region



Financial position and results of operations

As in the previous year, the financial position and results of operations of the Merck Group developed positively once again in 2006. However, the balance sheet and the cash flow statement were heavily influenced by the acquisition of the shares in Serono. More information can be found in the consolidated financial statements starting on page 83.

Operating result rises 25%, exceeding the € 1 billion mark

The operating result of the Merck Group increased by 25% in 2006 to € 1,105 million, although the 2005 figures included one-time payments amounting to € 70 million. On the one hand, we received an upfront payment of € 60 million from Takeda of Japan to co-develop and co-market matuzumab, a humanized monoclonal antibody for use in the treatment of cancer. On the other hand, we received € 10 million from Organon for the outlicensing of an oral contraceptive. Adjusted for these upfront payments in 2005, the operating result climbed by 36% in 2006. The impact of currency translation as well as acquisitions and divestments was low; the operating result increased by 26% organically.

Return on sales (ROS) rose from 15.3% to 17.7% in 2006; return on capital employed (ROCE) increased from to 20.5% to 21.0%.

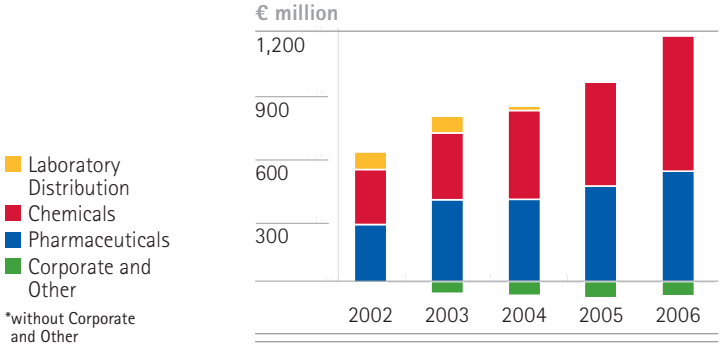
Chemicals business sector again more profitable than Pharmaceuticals

The operating result of the Pharmaceuticals business sector totaled € 524 million in 2006. This was 15% more than in 2005 despite the aforementioned one-time license income. Return on sales increased from 12.0% to 12.7%, and return on capital employed declined from 19.0% to 15.9% in 2006.

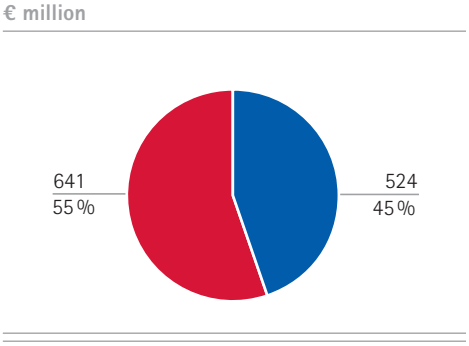
Among the individual divisions, Generics and Consumer Health Care recorded increases in operating result. By contrast, Ethicals sustained a decline of 2.3% due to the one-time income from license agreements booked in 2005. Adjusted for one-time effects, the operating result of the Pharmaceuticals business sector was 36% higher and 68% higher in the Ethicals division than in 2005. This excellent development is based on both the strong sales growth of Erbitux® as well as the good development of established products in the Commercial Unit CardioMetabolic Care.

The Generics division increased its operating result by 29% to € 307 million. Our U.S. subsidiary Dey contributed significantly to this increase thanks to the success of its high-margin products EpiPen®, an autoinjector for the emergency treatment of life-threatening allergic (anaphylactic) reactions, and DuoNeb®, a single-dose inhalation solution for treat-

Operating result by business sector



Operating result by business sector*



Key figures of the Merck Group

	Operating result € million	Exceptional items € million	EBIT € million	EBITDA € million	ROS %	ROCE %
Pharmaceuticals	524	–35	489	618	12.7	15.9
Chemicals	641	–35	607	775	30.5	33.0
Corporate and Other	–60	289	229	235	–	–
Merck Group	**1,105**	**219**	**1,325**	**1,628**	**17.7**	**21.0**

EBIT = Earnings before interest and tax
EBITDA = EBIT before depreciation and amortization
ROS = Return on sales = Operating result/Sales
ROCE = Return on capital employed = Operating result/Average operating assets

ing chronic obstructive pulmonary disease. Our subsidiaries in Canada and France also contributed to the increase in the operating result. The operating result of the Consumer Health Care division grew by 9.0% to € 55 million. This includes a gain of € 4 million from the sale of the French brand Moustifluid®.

The operating result of the Chemicals business sector increased by 30% to € 641 million in 2006. Return on sales (ROS) increased from 25.9% to 30.5%. Return on capital employed (ROCE) rose from 27.2% to 33.0%.

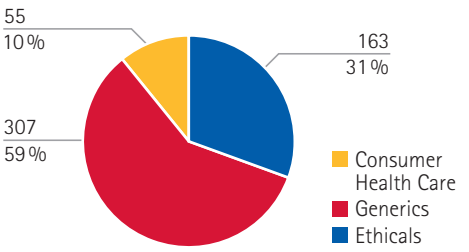
Liquid crystals contributed above all to this strong increase. The operating result of the Liquid Crystals division soared by 40% to € 486 million. At 54%, the EBIT margin (ratio of EBIT to sales), which is important to the assessment of business performance, was not only maintained, but even improved slightly although the exit from the ITO glass business at the end of 2006 involved a small accounting loss of around € 5 million.

The Performance & Life Science Chemicals division also recorded an increase of 6.4% to € 155 million. The rise in the division's operating result thus exceeded the increase in sales.

Aside from corporate overheads, which cannot be allocated to individual divisions on a cost-causative basis, the segment Corporate and Other also includes taxes on income as well as exceptional income and expenses. This segment includes for example the exceptional gain from the sale of the shareholding in Schering AG. In addition, it includes income and expenses from ongoing contract manufacturing in connection with the disposal of the Electronic Chemicals division in 2005.

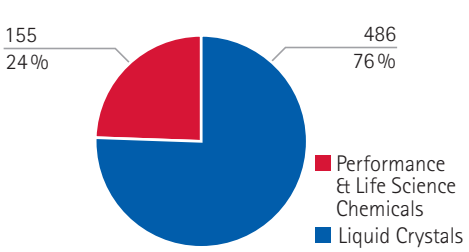
Pharmaceuticals | Operating result by division

€ million



Chemicals | Operating result by division

€ million



Exceptional items

Exceptional items amounted to € 219 million. They included the gain on the sale of the Schering shares amounting to € 378 million. Restructuring charges of € 22 million were recorded for the Ethicals division in France, the United States and Germany. The Generics division recorded restructuring charges of € 13 million for measures in the United Kingdom. Owing to strong price competition, our sales declined sharply there and we decided to close down a manufacturing facility at Generics UK in 2007. Impairment losses of € 34.5 million were recorded in the Pigments business field (Performance & Life Science Chemicals division). This was due to a strategic realignment of the business. The existing provision for litigation expenses in connection with the accusation of misleading price information at our U.S. subsidiary Dey was increased by € 80 million. In addition, we increased existing provisions for legal risks in connection with accusations of anticompetitive practices at Generics UK by € 4 million. Provisions of € 17 million were set up for soil and groundwater remediation at the Darmstadt site. The release of provisions set up for the vitamin cases generated income of € 12 million.

Financial result improves further

We improved the financial result once again: It amounted to € –51 million compared to € –62 million in 2005. At € 0.4 million, interest expense in 2006 was € 2.6 million higher than in 2005. The financial result was also positively affected by dividend income of € 12 million from the Schering shares which we held for a certain period in the course of the attempted takeover.

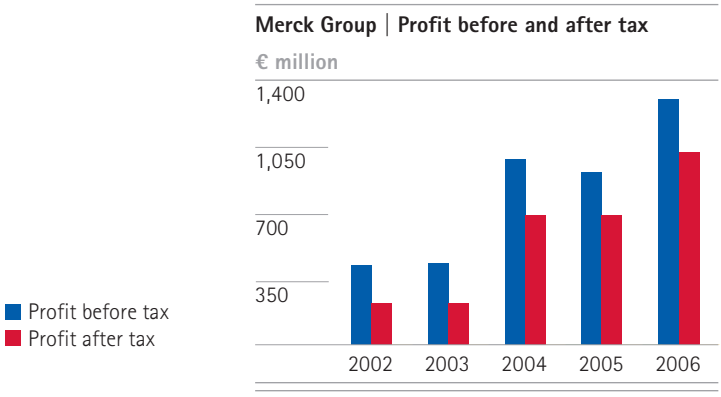
Sharp rise in profit after tax

Profit after tax increased by 49% to € 1,001 million, thereby exceeding the good result of € 673 million in 2005. The tax rate declined to 21.4% compared with 24.7% in 2005. Excluding exceptional items in 2005 and 2006, profit after tax would have increased by 30%. The tax rate before exceptional items declined slightly to 27.5%.

Dividend proposal

We intend to propose to the Annual General Meeting on April 27, 2007 the payment of a dividend of € 0.90 plus a bonus of € 0.15 per share.

Merck Group | Profit before and after tax



Free cash flow impacted by the acquisition of Serono

Cash flow from operating activities increased by 11% to € 812 million particularly as a result of the marked improvement in profit after tax. Cash used for investing activities amounted to € 1,462 million as compared with € 195 million in 2005. This includes the purchase of Serono shares amounting to € 1,575 million as of the balance sheet date. This was partly offset by the cash inflow of € 441 million from the sale of the Schering shares.

Due to expenses on Serono, free cash flow declined from € 657 million in 2005 to € –1,073 million in 2006. Adjusted for the impact of acquisitions and divestments, free cash flow increased markedly from € 479 million to € 577 million. Whereas the free cash flow of the Chemicals business sector increased by € 163 million to € 521 million, that of the Pharmaceuticals business sector fell by € 1,696 million to € –1,290 million due to the acquisition of Serono. Excluding the impact of acquisitions and disposals, free cash flow in the Pharmaceuticals business sector would have declined to a slighter extent from € 410 million in 2005 to € 329 million.

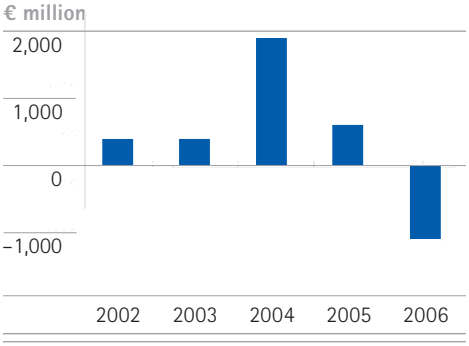
Capital spending with a focus on Europe

Capital spending on property, plant and equipment decreased by € 14 million or 5.4% to € 253 million in 2006. The capital spending ratio based on sales thus declined from 4.6% in 2005 to 4.0%. Individual investment projects with a value of more than € 0.5 million accounted for nearly one-half of capital spending. Regionally, more than two-thirds of the investments were attributable to Europe, with a focus on Germany. Here we invested € 127 million to initiate and expand numerous smaller construction projects at the two largest production locations: Darmstadt and Gernsheim. Capital spending in North America and Latin America totaled € 24 million and € 11 million, respectively. Companies in Asia accounted for a total capital spending volume of € 36 million. Spending was targeted mainly to the production of liquid crystal mixtures in Japan and Taiwan.

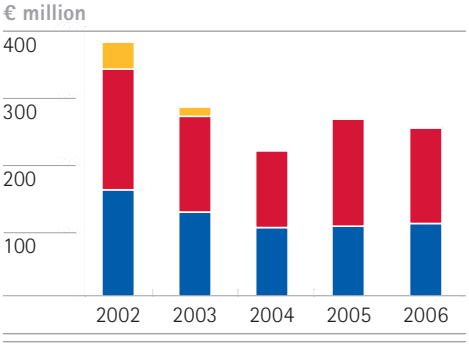
The Pharmaceuticals business sector invested € 108 million, with the Ethicals division accounting for nearly two-thirds, of which nearly half was again attributable to headquarters in Darmstadt. The Generics division invested € 34 million, with the focus on Europe, the United States and Australia.

Capital spending on property, plant and equipment amounted to € 142 million in the Chemicals business sector, with the Liquid Crystals division accounting for € 73 million and the Performance & Life Science Chemicals division for € 69 million of this total. Both divisions invested primarily at Darmstadt headquarters to expand and modernize production facilities as well as to improve the infrastructure.

Free cash flow



Capital spending on property, plant and equipment



Total assets include acquisition of Serono shares

As of December 31, 2006, total assets amounted to € 8,102 million, having increased by € 822 million or 11%. The increase was primarily due to the purchase of the shares amounting to € 1,572 million within the framework of the acquisition of Serono S.A as of December 31, 2006. As of the balance sheet date, this shareholding implied that Merck held 15% of the capital and 11% of the voting rights. In the course of the good business developments in 2006, working capital increased by € 188 million over the previous year. The equity ratio increased slightly from 45.7% in 2005 to 47.0% as of December 31, 2006. Gearing (ratio of net debt and pension provisions to net equity) rose from 0.21 in 2005 to 0.47.

Significant increase in value added

Value added is a measure of the economic strength of a company and indicates how the corporate result is achieved and for what it is used. Our corporate result, i.e. the sum of sales, other income and financial income, amounted to € 6,916 million in 2006. After deducting the costs of materials, other purchased services and expenses as well as depreciation, the net value added statement shows net value added of € 3,091 million, 20% more than in the previous year.

The distribution of net value added shows that the majority, or 55%, of net value added went towards personnel expenses, i.e. salaries, social security contributions and pension expenses. Taxes accounted for nearly 9% while net income was responsible for an especially large share, or 32%, due to the exceptional gain of € 378 million on the sale of Merck's shareholding in Schering AG.

Net value added statement

€ million	2006	2005
Sales	6,259	5,768
Other income	590	396
Financial income	68	31
Corporate result	6,916	6,196
Cost of materials	–1,633	–1,599
Other purchased services/expenses	–1,890	–1,740
Gross value added	3,393	2,858
Depreciation and write-downs	–303	–290
Net value added	3,091	2,568

Distribution of net value added

€ million	2006	2005
Personnel expenses	1,698	1,581
Financial expenses	119	94
Taxes on income	272	221
Net income	1,001	673
Net value added	3,091	2,568

Merck Executive Board Chairman Dr. Michael Römer (right) and Serono CEO Ernesto Bertarelli announce the acquisition at a press conference in Darmstadt on September 21, 2006.

An acquisition for the 21st century

The decision to acquire the pioneering biopharmaceutical company Serono is of major importance to the technological and economic future of Merck. This is due not least to the fact that growth in the global pharmaceutical market increasingly depends on the development of not only new chemical but especially biological molecules. A field in which Serono is internationally recognized, with innovative and successful products, with a well-stocked and promising development pipeline, with know-how in research and production – strengths that distinguish the company in the same way as they do Merck. The ability to ensure absolutely high-quality manufacturing is the key to success, particularly in the biopharmaceutical industry.

Serono focuses on four therapeutic areas: fertility treatments, growth and metabolic disorders, psoriasis, and above all multiple sclerosis: In this area, the blockbuster Rebif® is the global market leader. Another main driver of sales is the fertility hormone Gonal-f®. In 2005, Serono had 4,750 employees who generated sales of € 1.9 billion, € 565 million of which in the United States.

Access to the important U.S. market is another important advantage that makes the integration of Merck's Ethicals division with Serono into Merck Serono strategically compelling. Combining complementary businesses will increase competitiveness more than by simply adding their potential together. Following the decision to acquire Serono, objectives and framework conditions for a successful integration process were defined. Since January 2007, employees from both companies have been working in 25 integration teams to ensure efficient processes for a speedy integration. The syndicated loan required for the transaction received overwhelming support from international banks in November 2006.

MERCK SERONO

EMD SERONO

In the United States, the new division is called "EMD Serono".

Subsequent events until Feb. 19, 2007

Serono acquisition

Merck KGaA and its wholly-owned subsidiary, Merck Vierte Allgemeine Beteiligungsgesellschaft mbH, which acted as purchaser, and members of the Bertarelli family, as sellers, concluded a purchase agreement on September 21, 2006 pertaining to the acquisition of a majority shareholding in Serono S.A., Coinsins, Switzerland (now known as "Merck Serono S.A.") The shares of the Bertarelli family were largely held by the holding company Bertarelli Biotech S.A. (now known as "SeroMer Biotech S.A."). The shares of Bertarelli Biotech S.A. were also part of the share purchase agreement. The share purchase agreement was closed on January 5, 2007. On the basis of the share purchase agreement Merck acquired the majority of shares and voting rights. On January 9, 2007 Merck submitted a public tender offer in Switzerland. The offer price amounts to CHF 1,100 per bearer share. In addition, more shares were purchased in the market. All told, as of the expiration of the main public tender offer period on February 5, 2007, Merck held 97% of Serono's capital and 98% of the voting rights. The acquisition of Serono is expected to strengthen the former Ethicals division – together they form the new Merck Serono division within the Pharmaceuticals business sector.

To finance the acquisition of Serono, Merck KGaA concluded an € 11.5 billion syndicated multi-currency term loan and revolving credit facilities agreement with the lead banks Bear Stearns International Limited, Dresdner Bank AG and Société Générale S.A. on September 23, 2006. Various tranches of the loan agreement were drawn upon for the first time in January 2007. Subsequent to the partial repayment using the proceeds from the capital increase, around € 7.2 billion is still outstanding. Owing to the marked increase in outside financing, the financial result and the debt figures will change considerably in comparison with the previous year.

Capital increase

In addition, the Executive Board of Merck KGaA resolved on January 21, 2007 with the consent of the Supervisory Board and of E. Merck OHG, as the general partner holding an equity interest, to utilize the authorized capital to increase the share capital of € 133,416,111.40 by € 34,525,210.20 to € 167,941,321.60. The capital increase is part of the refinancing of the acquisition of Serono.

The transaction consists of a rights offering to the limited liability shareholders and an allocation of rights to E. Merck OHG as the general partner holding an equity interest in Merck KGaA. The total of 13,278,927 new shares were subscribed for by the members of an underwriting syndicate at a subscription price of € 78.00 per share in accordance with market practice. The new shares have been included in the quotation of the shares of Merck KGaA on the Frankfurt Stock Exchange since February 7, 2007 and are entitled to full dividends for 2006.

E. Merck OHG has increased its equity interest by a nominal amount of approximately € 34 million (with a premium of approximately € 1.019 billion). Merck KGaA generated proceeds amounting to approximately € 2.055 billion from the capital increase by issuing the 13,278,927 new shares and from the increase of the equity interest of the general partner E. Merck OHG. Subsequent to the capital increase, the equity interest of the limited liability shareholders amounts to around 30% and to around 70% for E. Merck OHG.

Divestment of the Generics business as a strategic option

On January 5, 2007, the Executive Board of Merck KGaA announced that the divestment of the Generics business (Generics division) is being evaluated as one strategic option.

Cross-divisional topics

Research and development strengthened further

In 2006, we invested a total of € 752 million in research and development (R&D). This was 5.4% more than in 2005. The Pharmaceuticals business sector accounted for € 615 million or 82% of the Group total. R&D intensity, or R&D as a percentage of pharmaceutical sales, was 15%. In the Ethicals division, which is particularly research-intensive, this figure remained at 25% – with spending increasing by 6.8% to € 472 million. In particular, we invested heavily in oncology research projects. The most extensive clinical trial program ever set up by Merck is currently underway. We increased our spending in the Chemicals business sector by 3.6% to € 137 million, with the two divisions accounting for roughly the same amount.

www.innovation.merck.de

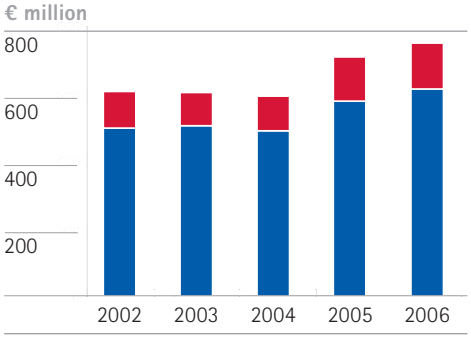
Around one-half of all research spending was attributable to research and development activities in Darmstadt. The Darmstadt site is home to our central facilities, such as our chemical analysis activities, the entire infrastructure for preclinical and clinical development, as well as many other departments necessary for drug research, including Regulatory Affairs and Patents. Other major pharmaceutical competence centers are located in Chilly-Mazarin, France, Mollet del Vallès, near Barcelona, Spain, Napa, CA and Billerica, near Boston, MA, United States. The most important chemical research sites, besides Darmstadt, are located in Atsugi and Onahama, Japan, Poseung, South Korea, Frankfurt and Mainz, Germany, Southampton, United Kingdom, and Madison, WI, United States. More information on the research and development activities of the individual divisions can be found starting on page 46.

New expertise in Purchasing successfully deployed for R&D

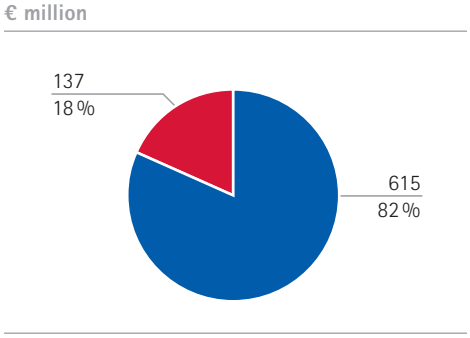
Strategic purchasing is becoming increasingly important for research and development. This applies specifically in terms of having the required knowledge of the procurement markets, selecting suitable, quality-assured suppliers and negotiating the best possible contracts. We purchase goods and services necessary for R&D with a value of around € 110 million annually. Savings ranging from 8% to 12% were achieved in close cooperation with the specialist departments.

We reduced the purchasing costs of production material by an average of 6.4% for our entire portfolio. Price increases for crude oil feedstock and materials traded on metal exchanges were offset by high savings for refined specialty raw materials and finished products. We purchase raw materials and supplies globally and succeeded in achieving price reductions in both Europe and Asia.

Merck Group | Research & development



Research & development



Workforce increases in Europe and Asia

As of December 31, 2006, the Merck Group was represented in 56 countries by 176 companies and had manufacturing facilities at 54 sites in 24 countries. The number of employees worldwide increased slightly to 29,999 as of December 31, 2006.

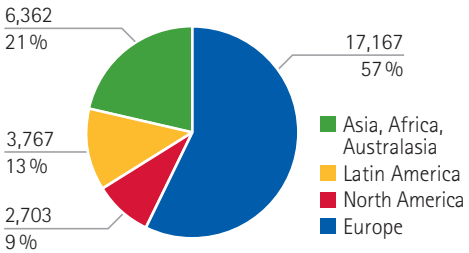
Good sales developments of the oncology drug Erbitux® and liquid crystals as well as our expectations for the future development of the Group were the precondition for new hirings. In Europe alone, 471 new positions were created, 411 of which in Germany. As of December 31, 2006, we had a total of 9,874 employees in Germany. However, not least due to German health care reforms, activities in the German pharmaceutical market will be reduced and around 100 positions will be eliminated by 2010.

The declining headcount in France resulted from the phase-out of pharmaceutical production in Lyon-Lacassagne, which was completed in mid-2006. In the United Kingdom, lower sales in the Generics division and the planned related closure of the manufacturing plant in Potters Bar led to a decrease in the headcount. We also had to terminate staff in the United States after discontinuing the development of sarizotan for use in Parkinson's disease. At the same time, we created 263 new positions in Latin America, particularly in Colombia, Mexico and Brazil. Our workforce increased substantially in Asia, with 225 additional employees, most of whom work in China, Indonesia and Japan. In terms of function, more than 27% of employees work in production, 23% in marketing and sales, and nearly 12% in research and development; the remainder work in central functions such as human resources and information services.

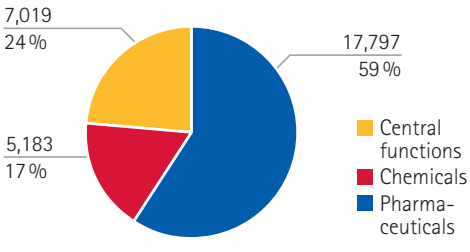
Driving employee development forward

The promotion of talented employees is a precondition for economic success and a special challenge for employee development. Within the scope of an internationally uniform process, Merck supports the individual promotion of talented employees and prepares them for management positions. By establishing clear succession rules in all business regions, another important precondition has been met and not least, the cornerstone for continued positive business development of the company has been laid. In addition, Merck supports advanced training possibilities for employees. The company has consolidated its training offers on the learning platform known as Platon. More than 3,000 users have already registered themselves and around 500 courses are currently offered via the platform.

Number of employees as of December 31, 2006



Number of employees by area



Fair and responsible marketing practices

When marketing its products, our Pharmaceuticals business sector must comply not only with our firmly anchored company Code of Conduct but also with numerous statutory rules. Moreover, as a member of the International Federation of Pharmaceutical Manufacturers Associations (IFPMA), the "IFPMA Code of Pharmaceutical Marketing Practices" is also binding on us. Subsequent to the publication of the new Code of Conduct in early 2006, we updated "Merck's Pharmaceutical Marketing Best Practices" with global effect from January 1, 2007. This guideline defines detailed global standards for various areas, from product promotion, through the remuneration of the sales force, to sponsoring activities.

International requirements pertaining to chemicals legislation

For Merck, the new EU chemicals regulatory framework known as REACH, which was formally adopted by the European Parliament in December 2006 and will enter into force on June 1, 2007, was an important topic. We worked hard to prepare our organization to be able to preregister our substances in a first step in 2008. In parallel, we completed the database of our substances with a view to the respective provisions of the REACH regulation so as to proceed with the first registrations in 2010. Merck also supports the Globally Harmonized System of Classification and Labelling of Chemicals (GHS), which was adopted by the United Nations and is to be implemented in the European Union by 2008. In order to improve hazard communication and to facilitate the sale and purchase of chemicals, this guideline will harmonize national regulations on classifying and labeling substances, transport law as well as safety data sheets worldwide.

Recording data globally to protect people and the environment

Against the background of global responsibility for people and the environment, we improved our processes in international environmental, safety and quality management by setting up a data collection network in 2006. Apart from key environmental figures from around 80 sites, we document all internal and external audits and certifications in a timely and detailed manner. Spending on environmental protection, health and safety totaled around € 115 million in 2006.

In order to secure its groundwater and soil remediation obligations as well as groundwater monitoring measures at the Darmstadt site, Merck set up provisions totaling € 29 million. In 2006, earlier provisions of around € 12 million were increased by € 17 million.

The Merck Group maintained its CO_2 emissions at a low level of around 130 metric tons in 2006. As part of the CO_2 emissions trading scheme within the European Union, this resulted in a surplus of around 48,000 credits. Emission credits such as these are issued to companies, entitling them to a certain emissions volume. The principle is the following: companies that produce excess emissions must buy additional credits. And vice versa, companies that reduce their emissions may sell their excess credits and profit in this way. In 2006 Merck sold 27,535 credits, generating proceeds of around € 800,000.

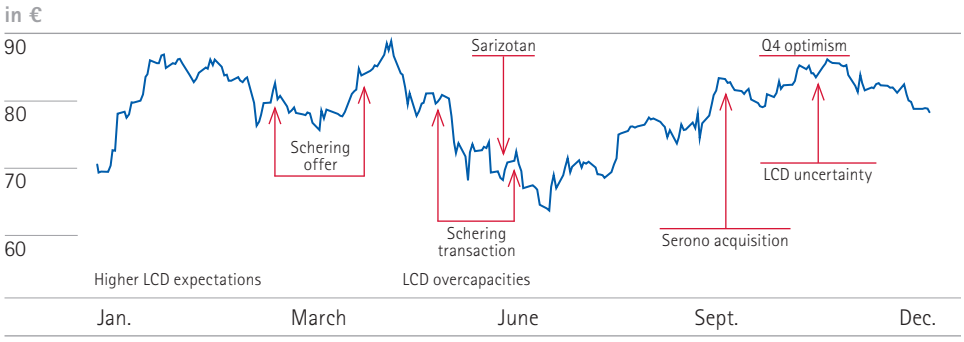
Merck shares

www.investors.merck.de

LCD news and strategic decisions influence development

In 2006, our share price was mainly influenced by news from the LCD industry and the new strategic direction of the Ethicals division. In early 2006, shares rose within only a few weeks from € 69.95 (year-end share price in XETRA trading) to more than € 85. The share price increase of more than 20% was accompanied by optimistic market expectations of the major LCD manufacturers. Although the announcement of plans to acquire Schering led to some uncertainty among investors as of March, the share price reached a historical high of € 89.10 in the first quarter, representing an increase of more than 25% over the year-end share price. The announcement on June 23 of the Phase III results for sarizotan, a drug for use in Parkinson's disease, but in particular the statements by LCD manufacturers concerning rising inventory levels led to a decline in the share price to the year low of € 63.96 on July 18. In autumn, as the market generally began to calm down, the share price recovered. This development continued with the publication of the third-quarter results. The announcement of the Serono acquisition gave the share price additional impetus: The strategic realignment of the Ethicals division led to a positive assessment from investors and analysts. The year-end share price was € 78.54. The company's market capitalization thus amounted to € 15,001 million at the end of 2006.

Share price development and factors influencing Merck shares in 2006



Sharp rise in share trading volumes

In the first few months of 2006, Merck shares clearly outperformed both the DAX and MDAX comparative indexes. As the year progressed, the share price then moved in line with the two indexes. However, Merck shares did not participate in the year-end stock market rally. In 2006, the share price rose 12% over the previous year, while the DAX and the MDAX posted increases of 22% and 29%, respectively. Higher volatility led to a sharp rise in share trading volumes in 2006: The average daily turnover during the year was 487,174 shares, 87% more than in 2005.

A comparison with other companies operating in the pharmaceutical or chemical industry shows that in terms of price-earnings (PE) ratio, the current share price puts Merck shares in midfield. On January 2, 2007, the PE ratio was 15.5 times expected 2008 earnings (according to a mean value calculated by the news agency Bloomberg on the basis of an analyst survey).

The performance of Merck shares vs. the DAX/MDAX in 2006

Share data[1]

	2006	2005
Earnings per share after tax and minority interest[2] in €	5.07	3.40
Dividend in €	0.90	0.85
One-time bonus in €	0.15	–
Share price high in € (May 11, 2006)	89.10	74.90
Share price low in € (July 18, 2006)	63.96	48.45
Year-end share price in € (Dec. 29, 2006)	78.54	69.95
Price-earnings ratio (Dec. 29, 2006)	15.49	20.57
Actual number of shares in millions (Dec. 29, 2006)	51.3	51.2
Theoretical total number[3] of shares in millions (Dec. 29, 2006)	191.0	190.9
Adjusted weighted average number of theoretical shares outstanding[4] (in millions)	194.0	193.8
Market capitalization[5] in € million (Dec. 29, 2006)	15,001	13,357

[1] Share-price relevant figures relate to the closing price in XETRA trading on the Frankfurt Stock Exchange.
[2] The previous year´s figure has been adjusted (for details, see page 107 of the Consolidated financial statements).
[3] The calculation of the theoretical number of shares is based on the fact that the general partner's equity capital is not represented by shares. As the share capital of € 133.2 million was divided into 51.2 million shares, the corresponding calculation for the general partner's capital of € 363.2 million resulted in 139.7 million theoretical shares on December 29, 2006. The number of shares increased slightly due to the exercise of stock options (see page 78).
[4] For details, see page 107 of the Consolidated financial statements.
[5] Based on the theoretical number of shares

U.S. investors dominate shareholder structure

The analysis performed in May 2006 to identify our shareholders accounted for a total of 37.8 million shares, equivalent to around 74% of the shares in free float. This provided information on both the regional distribution of our shareholders as well as the classification of the respective types of investor. Accounting for 52%, investors based in the United States dominated, followed by British and German investors. A standard classification by investment strategy gives a balanced picture of the different types of investor: "Value", "Growth" and "Growth at reasonable price" (see chart).

Investor Relations program introduced

In 2006, we finalized and introduced an extensive Investor Relations program. We will continue to explain our complex business activities in depth and report on company developments in a timely manner to the capital markets. Using targeted road shows, meetings with individual investors as well as chemical and health care conferences for analysts, Merck wants to attract more investors who support the corporate strategy. At the same time, we hope to further diversify our regional shareholder structure.

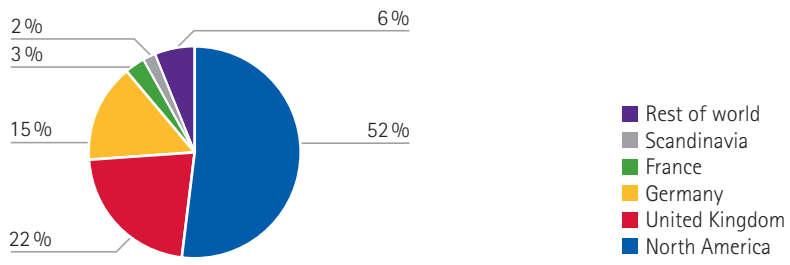
Information on capital and shares in accordance with Art. 315 para 4 of the German Commercial Code

In order to enhance the protection of investors and improve the efficiency of capital markets in Europe, various laws have been adopted to harmonize the disclosure obligations of companies. As a result of the German Takeover Directive Implementation Act (Übernahmenrichtlinie-Umsetzungsgesetz), Art. 315 of the German Commercial Code has been supplemented. We summarize the required additional information on capital and shares as follows.

As of the balance sheet date, the company's subscribed capital is divided into 51,313,889 no par value bearer shares as well as one registered share. The holder of the registered share is E. Merck Beteiligungen OHG. It is entitled and obliged to appoint one-third of the members of the Supervisory Board representing the limited liability shareholders. If the holder of the registered share is a general partner, he or she has no such right of appointment. The transfer of the registered share requires the Company's approval. The approval is granted at the sole discretion of the personally liable general partner with an equity interest, namely E. Merck OHG. There are no holdings in the company's share capital exceeding 10% of the voting rights.

Investors by region

in %



Source: Company data

According to the Articles of Association of the company, the general partners not holding an equity interest who form the Executive Board are admitted by E. Merck with the consent of a simply majority of the other general partners. A person may only be a general partner not holding an equity interest if he or she is also a general partner of E. Merck. In addition, at the proposal of E. Merck and with the approval of all general partners not holding an equity interest, further persons may be appointed to the Executive Board who are not General Partners not holding an equity interest. The Articles of Association of the company can be amended by a resolution by the General Meeting that requires the approval of the general partners. The resolutions of the General Meeting are, notwithstanding any statutory provisions to the contrary, adopted by a simple majority of the votes cast. Where the law requires a capital majority in addition to the voting majority, resolutions are adopted by a simple majority of the share capital represented in the vote.

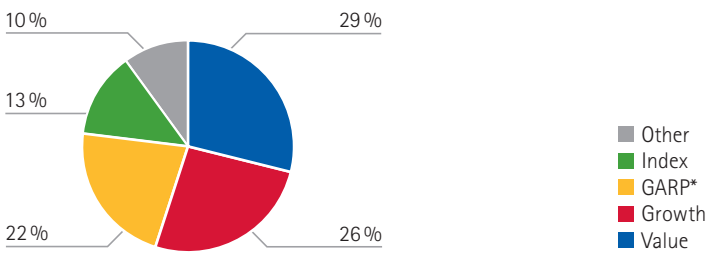
The Articles of Association of the company specify the share capital. The Executive Board is authorized, with the approval of the Supervisory Board and of E. Merck, to increase the share capital on one or several occasions until March 31, 2010 by up to a total of € 29,824,787.20 (following the capital increase made in the first quarter of 2007) by issuing new shares against cash or contributions in kind. The company is not authorized to acquire its own shares.

The company has not entered into any material agreements subject to a change of control pursuant to a takeover offer nor has it concluded any compensation agreements with the members of the Executive Board or employees in the event of a takeover offer.

More information on the structure of company can be found starting on page 77.

Investors by type

in %



*Growth at reasonable price
Source: Company data

Pharmaceuticals business sector

Discovering and developing pharmaceuticals that improve the quality of life of people – that's the overriding ambition of our Pharmaceuticals business sector. The scope of possibilities that Merck is successfully pursuing globally ranges from innovative drugs for the treatment of cancer, cardiovascular diseases and diabetes to generics and consumer health care products. By acquiring Serono, Europe's leading biopharmaceutical company, we are gaining additional research and development strength.

Ethicals
In its Ethicals division, Merck has been especially active in two core areas: oncology and cardiometabolic disorders such as diabetes, hypertension, dyslipidemia as well as thyroid disorders. By acquiring Serono, the new Merck Serono division will have a considerably broader product portfolio and a stronger research base. > **Page 40**

Generics
The Generics division is one of the world's three leading suppliers of affordable drugs for basic health care. In addition to rapidly registering and launching successful, off-patent active ingredients for nearly all major therapeutic areas, the Generics division develops generics with innovative dosage forms, especially for respiratory medicine. > **Page 50**

Consumer Health Care
Today's informed consumers are taking more responsibility for preventive health care and for treating minor illnesses themselves. The Consumer Health Care division offers well-known brands that enjoy a high level of confidence and trust in many countries. > **Page 54**

Growing more strongly than the market

International pharmaceutical market grew again by 5%

As in 2005, pharmaceutical sales in the key countries grew by around 5% in 2006 adusted for currency effects. According to the market research firm IMS Health, the United States accounted for more than half the sales generated by the 13 largest pharmaceutical markets, which totaled US $ 386 billion. At 7%, the growth rate in the United States was above-average. Sales in the five major pharmaceutical markets in Europe grew by a total of 4%, slightly more than in 2005. The Spanish market showed above-average growth of 6%, while France registered growth of 4%. The German market, which grew by 3%, remained the largest in Europe. The Japanese pharmaceutical market, the second-largest after the United States, stagnated at US $ 57 billion. At 12%, the countries of Latin America again posted the strongest growth: With a growth rate of 18%, Argentina was ahead of Mexico and Brazil.

Double-digit increases in France, Italy and Spain

Sales in the Pharmaceuticals business sector increased by 8.6% in 2006. Thanks to the good development of the Generics division, the operating result rose 15% (more information can be found on page 24/25).

In Europe, our largest market in terms of sales, we achieved an increase of 8.5% with sales of € 2,316 million. We were again particularly successful in France – our largest market – where sales grew by 15%, as well as in the likewise large markets of Spain and Italy, where sales increased by 22% and 30%, respectively. While our sales in Germany declined slightly due to health care cost-containment measures, they fell markedly in the United Kingdom, where we achieved growth with sales of products from the Ethicals division, but sustained declines, particularly in the Generics division. We generated strong sales increases in several eastern European markets, particularly Poland (+24%), the Czech Republic (+23%) and Slovakia (+52%). Sales in North America increased by 7.0% to € 625 million, thanks in particular to our subsidiary Dey.

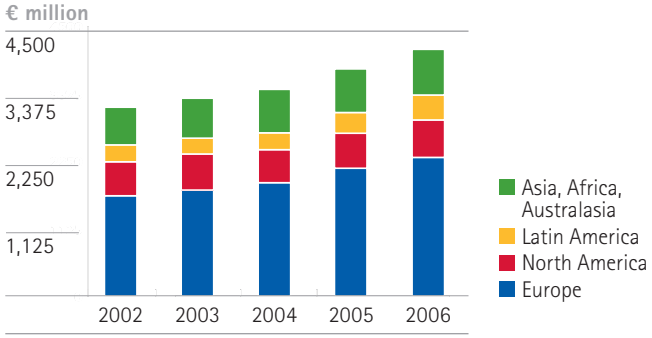
Business in Latin America improved significantly again: Sales increased by 20% to € 416 million. Sales in Asia, Africa and Australasia increased by 4.8%: While we posted growth rates ranging between 60% and 80% in China, South Korea and Taiwan, our Australian subsidiary Alphapharm suffered under government price intervention.

More information can be found in the consolidated financial statements on page 86 or at www.pharmaceuticals.merck.de

Pharmaceuticals | Key figures

€ million	2006	2005	Δ in %
Sales	4,119	3,792	8.6
Gross margin	2,607	2,326	12
R&D	615	579	6.1
Operating result	524	454	15
Exceptional items	–35	0.0	–
Free cash flow	–1,290	406	–
ROS in %	12.7	12.0	
ROCE in %	15.9	19.0	

Pharmaceuticals | Sales by region



Ethicals Profile

The focus of the former Ethicals division of Merck was on branded prescription drugs, especially for the treatment of cancer as well as cardiovascular diseases, diabetes, dyslipidemia and thyroid disorders (Commercial Unit CardioMetabolic Care). Following the successful acquisition of Serono, the Ethicals division was combined with the Swiss company to form the new Merck Serono division in early 2007.

Highlights of 2006:

- Announcement of the intention to merge the Ethicals division with the biopharmaceutical company Serono
- Erbitux® approved in the European Union for head and neck cancer – a new indication
- Acquisition of exclusive rights to develop and commercialize Stimuvax® globally outside of Canada
- New results from the CIBIS III study and the DECREASE II study for bisoprolol

The business model

A strict focus on selected therapeutic areas and markets is a key success factor for Merck in this business. Biopharmaceutical innovations for the growth market of oncology demonstrate this: After ranking among the most successful market launches in Europe to date, Erbitux® was granted approval in an important new indication in 2006. In addition, the division has a tight in- and outlicensing policy. Integrated approaches are another contributory element: The Commercial Unit CardioMetabolic Care is distinguishing itself not only through its successful life cycle management activities, e.g. with the Concor® family, but also through holistic concepts of health and disease.

Key products

Commercial Unit Oncology: Erbitux®, UFT®

Commercial Unit CardioMetabolic Care:

- Cardiovascular diseases: the Concor® family (active ingredient bisoprolol) with Concor®, Concor®COR, Lodoz®
- Type 2 diabetes: the Glucophage® family (active ingredient metformin) with Glucophage®, Glucovance®, Glucophage® XR
- Thyroid disorders: Euthyrox®

Additional therapeutic areas: Women's Health products, e.g. Lutenyl®, complement the portfolio as do niche products, e.g. the alcohol-dependency treatment Campral® and Cyanokit®, an emergency treatment for cyanide poisoning.

Market trends and future prospects

- Overall, the pharmaceutical market is expected to grow by 5–6% in 2007.
- According to IMS Health forecasts, the biotechnology sector will show much stronger growth of more than 15%.
- Oncology products will see the strongest growth rates: In 2007, they should account for 20% of overall growth.
- Increasingly, growth can be seen among products marketed to specialists. This market segment is estimated to increase by more than 10%. Smaller sales forces will consequently lead to greater efficiency.

Success in the growth market of oncology

Double-digit sales growth thanks to Erbitux®

In 2006, sales by the Ethicals division increased by 11% to € 1,902 million. At the beginning of 2007, this division was merged with Serono S.A. to form the new Merck Serono division. Our successful oncology drug Erbitux® continued to perform very well. Thanks to approval in a new indication for the treatment of head and neck cancer and market launches in additional countries, more and more physicians prescribed Erbitux®. We increased our research and development spending by 6.8%. Research and development now represents 25% of the division's sales. The operating result of the Ethicals division declined by 2.3% to € 163 million. This was due primarily to the high previous-year level, which included upfront payments from licensing agreements with Takeda and Organon. In 2006, milestone payments from Clinical Data for vilazodone had a positive effect. Negative free cash flow is largely attributable to the purchase of Serono shares totaling € 1,575 million in the third and fourth quarters. In addition, we made an upfront payment to Glenmark Pharmaceuticals to in-license an active ingredient for the treatment of type 2 diabetes. The lower operating result caused the return figures ROS and ROCE to decline; in the case of ROCE, the higher level of operating assets resulting from the share purchase also had an impact.

Strongest growth in Latin America

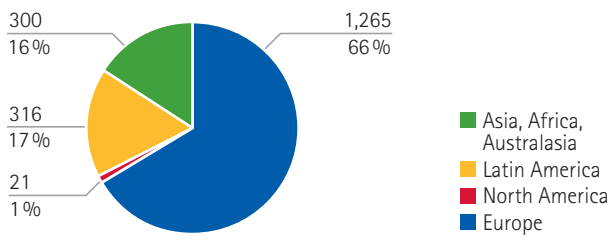
The Ethicals division generated two-thirds of its sales in Europe. Sales rose by 8.2% to € 1,265 million in 2006. Erbitux® sales were particularly strong, with nearly 85% coming from European countries. We recorded double-digit growth rates in Italy, the United Kingdom and Spain. In France, our largest market, sales increased by 6.3%. In Germany, our second-largest market, sales declined slightly. Government intervention in market pricing as well as imposed rebates on drug manufacturers are restricting room for maneuver in this important market. Sales in North America were again low as the division does not market most of its drugs, including Erbitux®, there. We achieved strong growth in all countries of Latin America, where sales increased by 23% to € 316 million. We were particularly successful in Brazil, where sales climbed by 39% and also in Mexico, Venezuela and Chile, which posted double-digit growth rates. These markets benefited not only from Erbitux® but also from the bisoprolol family of beta-blockers and the metformin group of antidiabetic agents. In the region Asia, Africa and Australasia, sales rose by 16% – attributable in particular to strong sales increases in China, South Korea and Taiwan as well as solid growth in India.

Ethicals | Key figures

€ million	2006	2005	Δ in %
Sales	1,902	1,717	11
Gross margin	1,426	1,277	12
R&D	472	442	6.8
Operating result	163	167	–2.3
Exceptional items	–22	0.0	–
Free cash flow	–1,551	118	–
ROS in %	8.6	9.7	
ROCE in %	8.2	14.9	

Ethicals | Sales by region

€ million



Commercial Unit Oncology

www.oncology.merck.de

Building on success with Erbitux® in a new indication

Sales of the targeted cancer therapy Erbitux® (cetuximab) in our territories, i.e. excluding North America, increased by 54% to € 337 million in 2006. Erbitux® represents an important treatment option in the battle against colorectal cancer – the form of cancer with the highest number of new cases. At the end of March 2006, the European Commission granted marketing authorization to extend the use of Erbitux® to head and neck cancer, giving patients with these types of tumor new grounds for hope. Worldwide, head and neck tumors are the sixth most common form of cancer. At 49 months, the highest median survival time was achieved with Erbitux® in combination with radiotherapy – nearly 20 months more than for radiotherapy alone. Erbitux® is used in this combination to treat patients with locally advanced squamous cell carcinoma of the head and neck (SCCHN) and is available in all 27 member states of the European Union as well as Iceland and Norway. In addition, Erbitux® has been approved for this indication in 22 other countries.

Erbitux® has been approved in 62 countries for combination therapy with the chemotherapeutic agent irinotecan in patients with metastatic colorectal cancer who no longer respond to standard chemotherapy with irinotecan. In 21 of these countries, Erbitux® is also approved as a monotherapy for metastatic colorectal cancer. Recent launches in other important markets such as China, India, South Korea and Belgium have led to increasing sales. The most extensive clinical trial program ever set up by Merck is currently underway for additional indications. Merck licensed the marketing and development rights to Erbitux® outside of the United States and Canada from ImClone in 1998. In Japan, we hold co-exclusive marketing rights with ImClone.

More information on Erbitux® is available at www.erbitux.com

As a targeted therapy, Erbitux® has a high specificity for cancerous cells, and so can provide additional patient benefit with minimal side effects. Erbitux® is a first-in-class and highly active IgG1 monoclonal antibody that specifically blocks the epidermal growth factor receptor (EGFR). EGF receptors are found on the surface of cells and are involved in cell growth and division when stimulated by growth factors. As an IgG1 monoclonal antibody, Erbitux® seems to put the immune system on alert and triggers antibody-dependent cellular cytotoxicity, or ADCC.

Since 2005, we have been marketing UFT® (tegafur-uracil) to complement our portfolio. We acquired the rights to this colorectal cancer drug from the Japanese company Taiho Pharmaceutical. UFT® is an oral chemotherapy agent that is used in combination with folinic acid, for example, in the first-line treatment of patients with metastatic colorectal cancer. As of January 2007, UFT® had been launched in 29 countries and generated sales of € 8.0 million in 2006.

Oncology market showing high growth rates

According to IMS Health market research forecasts, the unabated growth of the oncology market is set to continue. In the next five years, 50–55 new cancer drugs are to be introduced. Our definition of the oncology market includes hormone-based treatments, cytotoxic substances and monoclonal antibodies. Reuters Business Insight predicts that sales in these three groups will more than double from US $ 28 billion to US $ 60 billion from 2005 to 2011. Market researchers expect monoclonal antibodies for use in oncology – the group that also includes Erbitux® – to achieve average annual growth of 23% and sales of US $ 39 billion by 2011.

For more and more patients, Erbitux® stands for a new therapeutic advance.

Worldwide recognition for a new antibody

The battle against head and neck cancer is one of the greatest challenges facing the field of oncology. In Europe alone, around 100,000 people are diagnosed each year with this highly challenging and increasingly prevalent form of cancer. However, a major advance in treatment was achieved in March 2006. The European Commission granted marketing authorization to extend the use of Merck's targeted cancer therapy Erbitux® (active ingredient: cetuximab). Patients with locally advanced squamous cell carcinoma of the head and neck (SCCHN) can now be treated with Erbitux® in combination with radiotherapy.

An urgently needed therapeutic option is now available to people in 51 countries to date. Erbitux® is a monoclonal antibody that specifically targets and blocks the epidermal growth factor receptor (EGFR). This reduces the growth and division of tumor cells, penetration into healthy tissue, and the formation of secondary tumors in other parts of the body, a process called metastasis. Erbitux® is also believed to inhibit the ability of tumor cells to repair the damage caused by chemotherapy and radiotherapy and to inhibit the formation of new blood vessels inside tumors.

Further studies to expand the range of indications are currently underway. The EXTREME study is evaluating the efficacy of Erbitux® in first-line treatment of recurrent and/or metastatic head and neck cancer in combination with platinum-based chemotherapy. The CRYSTAL study has delivered initial results on first-line treatment with Erbitux® in metastatic colorectal cancer. This Phase III trial involving more than 1,000 patients is examining the effect of Erbitux® in combination with the FOLFIRI treatment regimen. At the beginning of 2007 we announced that the primary endpoint of the study – progression-free survival – had been met.

Erbitux® is now also approved in the United States and many countries of Latin America and Asia as a monotherapy.

www.erbitux.com

Commercial Unit CardioMetabolic Care

Solid growth with established products

www.cardiometaboliccare.merck.de

The Commercial Unit CardioMetabolic Care consists of our drugs for the treatment of diabetes, lipid disorders, cardiovascular diseases and thyroid disorders. More than 40% of the division's sales are attributable to these products, which generated solid growth of 3.0% with sales of € 774 million in 2006. From both a medical and a marketing perspective, there are many advantages to closely linking these therapeutic areas. In recent years, the understanding of the interrelationships that exist between hypertension, diabetes, lipid and thyroid disorders has steadily improved. For example, many patients with type 2 diabetes suffer from obesity, elevated cholesterol levels and hypertension. Physicians can treat the often complex symptoms more effectively by adopting a holistic approach. The use of integrated therapies can considerably lower the risk of concomitant diseases and complications.

Study results support success with Concor®COR in chronic heart failure

www.cardiovascular.merck.de

In 2006, total sales of bisoprolol, the active ingredient in our beta-blocker Concor®, rose by 5.0% to € 348 million. The bisoprolol franchise, which marked its twentieth anniversary in 2006, thus remained our top-selling product group. Increasing by 11%, sales of branded products from the Concor® family developed very well. The results of the DECREASE II study recommend perioperative therapy with Concor®. Preoperative cardiac stress testing can thus be dispensed with in cardiovascular risk patients as Concor® has been shown to significantly reduce sudden cardiac death in this patient population.

The growth in sales of the Concor® family was due mainly to the more advanced products: It amounted to 7.5% for the low-dose combination product Lodoz® for treating hypertension, and to 26% for ConcorCOR® for treating chronic heart failure. An additional evaluation of the CIBIS III study, which was completed in 2005, showed that initiating treatment of chronic heart failure with Concor®COR led to a decline in sudden cardiac death in the first year after treatment begins. To complement our portfolio of cardiovascular therapies, we offer the nicotinic acid product Niaspan® to treat lipid

www.dyslipidemia.merck.de

disorders. It primarily increases good HDL cholesterol. While experts are very positive about the effect, physicians in private practice still need to be made aware of the crucial role played by HDL. Our sales increased to € 7.0 million in 2006.

New recommendation for starting diabetes treatment with metformin

The recommendation published in 2006 by the American Diabetes Association (ADA) and the European Association for the Study of Diabetes (EASD) confirms the superb therapeutic value of metformin. According to this recommendation, newly diagnosed patients with type 2 diabetes should be treated immediately with metformin (for example Glucophage®) in conjunction with lifestyle modification. Traditionally, guidelines have recommended

www.diabetes.merck.de

lifestyle modification as the first step in intervention to reduce hyperglycemia before initiating metformin. More than six million patients worldwide in over 100 countries are benefiting from one of our oral diabetes therapies based on metformin. In line with our expectations, sales of the metformin group were maintained at € 249 million in spite of

strong generic competition, especially in Europe. Sales of more advanced products from the Glucophage® family such as Glucovance® (combination of metformin and glibenclamide) as well as Glucophage® XR (once-daily formulation) grew. Sales of Glucovance® increased by 40%. This product is particularly successful in the markets of Latin America and Asia as well as in South Africa with growth rates between 20% and 30%. We achieved a breakthrough with Glucophage® XR in the United Kingdom as an economical and well-tolerated alternative to classic metformin products. We have meanwhile launched the innovative dosage form in 23 countries.

Continued success of thyroid products

Merck is one of the three leading suppliers of thyroid drugs worldwide. In Europe and Latin America, we are number one. Our products were once again very successful in 2006: Sales grew by 11% to € 126 million. Sales of the thyroid hormone Euthyrox®, which is available in more than 60 countries, grew by 14% to € 103 million. More than nine million patients with hypothyroidism take this drug. We achieved strong growth particularly in Latin America and China, where sales increased by 23% and 38%, respectively. In Europe, the growth markets include Spain and Poland.

www.thyroid.merck.de

Products for other therapeutic areas

Our Women's Health business is managed by our subsidiary Théramex of Monaco. In 2005, Théramex transferred the global development and marketing rights for NOMAC/E2 (EMM 310066) to Organon; only selected marketing territories remain with Merck. Two Phase III clinical trials for this innovative birth control substance involving more than 4,200 women began in June 2006. The market environment for products to treat menopause complaints remained difficult in 2006. In several countries, however, there are signs that the market is stabilizing. At € 91 million, sales of Théramex remained virtually constant. In France – our largest market – we increased our market share to 29%.

www.womenshealth.merck.de

Interesting niche products such as the alcohol-dependency treatment Campral® and Cyanokit®, a life-saving treatment for cyanide poisoning, complement our portfolio. Sales of Campral® increased slightly to € 35 million in 2006. This product is also marketed in the United States by our licensee Forest. Cyanokit® has already been approved in France. At the end of 2006, we filed for European approval from the European Medicines Evaluation Agency (EMEA). The U.S. Food and Drug Administration approved Cyanokit® at the end of December 2006. The increase in demand for a safe and easy-to-use cynanide poisoning antidote is due to measures to counter the threat of terrorism.

Research

High level of investment in the future

In 2006, research spending in the Ethicals division increased by 6.8% to € 472 million. This again corresponded to 25% of the division's sales, well above the global average of research-based pharmaceutical companies. Our focus was on drugs for which there is a high unmet medical need, for example in oncology and the treatment of diabetes. Our research pipeline included 11 projects involving nine different compounds in various phases of clinical development. With the acquisition of Serono, we have considerably expanded our R&D activities (see page 29).

www.oncology.merck.de

Targeted cancer therapies enhance patient quality of life

Oncology research has made great strides in the fight against cancer in recent years. The focus is on novel therapies that specifically attack cancer cells and are better tolerated by patients. Our research activities are aimed at three areas: compounds that act on tumor cells, the tumor environment or the immune system, or a combination of these. The range of compounds comprises both chemical and biological active ingredients. Using this targeted approach, Merck aims to extend the survival of cancer patients and increase their quality of life. We currently have six oncology compounds in clinical development.

Additional indications and new formulations for Erbitux®

In view of the encouraging body of evidence supporting efficacy, Merck is working to expand the range of approved indications for Erbitux®. A study in second-line use of Erbitux® in combination with irinotecan in patients with metastatic colorectal cancer no longer responding to oxaliplatin-based treatment was recently completed. Initial results of the study show that Erbitux® had a positive impact of progression-free survival and response rate, however the primary endpoint of overall survival was not met. This could possibly be due to the fact that a considerable number of patients in the irinotecan arm who had progressed on their therapy subsequently received Erbitux® plus irinotecan, a highly active treatment. In another large-scale Phase III clinical trial called CRYSTAL involving Erbitux® for first-line treatment of colorectal cancer, the primary endpoint of progression-free survival was met. The study investigated the effect of Erbitux® in combination with the FOLFIRI treatment regimen (folinic acid, 5-fluoruracil and irinotecan) compared with FOLFIRI alone in more than 1,000 patients. A further Phase III study in the first-line treatment of non-small-cell lung cancer in combination with chemotherapy has enrolled more than 1,000 patients worldwide. In addition, we are evaluating the use of Erbitux® for first-line treatment of recurrent and/or metastatic head and neck cancer in combination with platinum-based chemotherapy. Clinical trials are also underway in pancreatic cancer.

In Erbitux® dosing studies, we are currently investigating whether the results of administering Erbitux® at 500 mg/m² every second week are equivalent to the current weekly standard dosing regimen of 250 mg/m², which would considerably improve patient quality of life. We will also develop the formulation of Erbitux® further: A more concentrated preparation that obviates the need for filtration will make handling and administration more convenient and will be introduced in 2007.

Regular exercise is important in preventing cardiovascular disease and supporting therapy.

New success in the battle against chronic heart failure

Sudden cardiac death remains the most frequent cause of death in the early stages of chronic heart failure, a disease that affects millions of people around the world. Yet as the evaluation of a major study has revealed, there are grounds for optimism. It was impressively shown that initiating treatment of chronic heart failure with the Merck beta-blocker Concor®COR (active ingredient bisoprolol) provided better protection against sudden cardiac death than the conventional treatment strategy of starting with an ACE inhibitor.

In September 2006, the latest results of the CIBIS III study (Cardiac Insufficiency Bisoprolol Study) were presented to a large group of experts at the World Congress of Cardiology in Barcelona.

CIBIS III is the first major study to compare the two possibilities of initiating therapy. A total of 1,010 patients aged 65 years and older were randomized to six months' treatment with bisoprolol or the ACE inhibitor enalapril, followed by combination therapy for all patients. By the end of the study, there was no significant difference in the general efficacy or tolerability of the treatment strategies. A major finding, however, was that during the first year, 29 out of 60 deaths of patients who were first treated with an ACE inhibitor were due to sudden cardiac death. By contrast, in the bisoprolol-first group, only 16 of the 42 deaths were attributable to sudden cardiac death. This corresponds to a significant reduction of 46%.

These results call into question the current treatment guidelines, according to which cardiac heart failure treatment should be initiated with an ACE inhibitor and then followed by a beta-blocker. The use of Concor®COR is opening up highly interesting new perspectives in the initial treatment of these patients.

Concor®COR improves the therapeutic options for patients with chronic heart failure.

www.cibis3.info

Status of our innovative compounds

Therapeutic area	Compound	Indication	Status[1]
Oncology	Erbitux® (cetuximab), EGFR-specific monoclonal antibody[2]	Colorectal cancer (CRC)	Approved/ Phase III
		Squamous cell carcinoma of the head and neck (SCCHN)	Approved/ Phase III
		Other EGFR-expressing tumors, e.g. non-small-cell lung cancer	Phase III
	Stimuvax® (L-BLP25), liposomal cancer vaccine[3]	MUC1-expressing tumors, e.g. NSCLC	Phase II/III
	Matuzumab[4] (EMD 72000), humanized EGFR-specific monoclonal antibody	EGFR-expressing tumors, e.g. NSCLC, gastric cancer, colorectal cancer	Phase II
	Cilengitide (EMD 121974), angiogenesis inhibitor	Glioblastoma[5]	Phase II
	EMD 273063 (hu14.18-IL2), immunocytokine	GD2-expressing tumors, e.g. melanoma and pediatric neoblastoma[5]	Phase II
	Tucotuzumab celmoleukin (EMD 273066/ huKS-IL2), immunocytokine	EPCAM-expressing tumors	Phase I/II
CardioMetabolic Care	GRC 8200 / EMD 675992[6]	Type 2 diabetes	Phase II
	EMD 387008	Type 2 diabetes	Phase II
	EMD 503982, oral factor Xa inhibitor	Arterial and venous thrombosis	Phase I

[1] Clinical status (for the most advanced indication)
[2] Developed in cooperation with ImClone; Erbitux® is a trademark of ImClone Systems Incorporated
[3] Further indications in development by the U.S. National Cancer Institute (NCI)
[4] Collaboration between Merck KGaA, Darmstadt, Germany, and Takeda Pharmaceuticals, Japan
[5] Clinical trials being conducted by U.S. National Cancer Institute (NCI), Children's Oncology Group and the University of Wisconsin
[6] Further development with Glenmark Pharmaceuticals

EGFR: Epidermal Growth Factor Receptor
EPCAM: Epithelial Cell Adhesion Molecule
MUC: Mucinous glycoprotein that is abnormally expressed in various cancers
GD2: Cancer-associated ganglioside

Initial Phase III study with the cancer vaccine Stimuvax® thanks to good survival data

Merck additionally acquired the exclusive rights to develop and commercialize Stimuvax® (L-BLP25) in the United States in early 2006, thereby expanding the existing license agreement with Biomira of Canada. Merck and Biomira continue to co-own the rights in Canada. Merck is assuming overall administrative and financial responsibility for the development and commercialization of the cancer vaccine and will make license payments to Biomira. Stimuvax® is an innovative cancer vaccine designed to induce an immune response to cancer cells that express MUC1, a protein antigen widely expressed in common cancers. Lung cancer claims more lives worldwide than any other type of cancer. Nearly 1.2 million new cases are diagnosed each year – about three-quarters of which are non-small-cell lung cancer. Owing to positive data from Phase IIb trials, Phase III trials will be started.

Matuzumab: Studies in different tumor types

Matuzumab (EMD 72000) is a humanized monoclonal antibody targeting the epidermal growth factor receptor (EGFR). We have been co-developing this compound, which was discovered by Merck, with Takeda of Japan since 2005. Three Phase II clinical trials are currently underway to investigate its use in colorectal, gastric and non-small-cell lung cancers.

Cancer drugs in early stages of development

We are developing the angiogenesis inhibitor cilengitide for the treatment of aggressive brain tumors (glioblastomas). Additional indications are the focus of cooperation with the U.S. National Cancer Institute (NCI). Cilengitide works by inhibiting the tumor from forming its own blood vessels, thus suppressing the growth and spread of tumor cells. The immunocytokine tucotuzumab celmoleukin EMD 273066 (huKS-IL2) is currently being studied in Phase I and Phase II clinical trials for different types of tumors that express the cell adhesion molecule EPCAM, for example in ovarian and small-cell lung cancers. Phase II studies in both tumor types will be initiated in early 2007. We are studying a different immunocytokine, EMD 273063 (hu14.18-IL2), in a Phase II clinical trial on melanoma in adults and on neuroblastoma in children.

www.merck-trials.de

Research projects in the Commercial Unit CardioMetabolic Care

EMD 387008, a compound in a new class of oral antidiabetic agents, recently completed Phase I clinical trials. Initial results were presented at a congress in South Africa at the end of 2006. The ability of this compound to control blood glucose levels matches that of standard treatments, e.g. metformin. As it has shown a superior tolerability profile, fewer side effects are expected. The compound entered Phase II clinical testing in October 2006.

We entered into an agreement with Glenmark Pharmaceuticals of Switzerland, a wholly owned subsidiary of the Indian company of the same name, for Glenmark's DPP-IV inhibitor GRC 8200 / EMD 675992, a treatment for type 2 diabetes. Merck will develop EMD 675992 for markets in North America, Europe and Japan, while Glenmark has retained commercialization rights for India. The compound, which is currently in Phase II clinical trials, works by inhibiting the activity of the DPP-IV enzyme, thereby stimulating the secretion of higher levels of insulin without the risk of hypoglycemia.

In the cardiovascular field, Merck is currently developing a direct and selective factor Xa inhibitor, which as a new class of orally active anticoagulants, differs from current treatments by its mechanism of action. A special advantage would be the ability to dispense with routine coagulation monitoring prior to surgery. There is a high unmet medical need for safe, effective and convenient anticoagulant drugs that do not require coagulation monitoring. Anticoagulants are used for the primary and secondary prevention of thrombotic events, for instance thrombosis in the veins of the legs after total hip replacement surgery.

In mid 2006, Merck made the decision to discontinue the development of sarizotan for use in Parkinson's disease. As the Phase III trials failed to achieve the primary endpoint of the study, the planned submission for approval and marketing of the product were not possible.

Generics Profile

In times of rising health care costs, when it comes to standard treatments doctors and patients can opt for attractive and economical alternatives: generic drugs. Our Generics division offers high-quality – and in most cases prescription – medicines containing active ingredients that are no longer patented yet still possess the properties of the original product and offer innovative dosage forms wherever possible.

Highlights of 2006:

- Strong performance in a competitive market, sales up 6.9%, operating result up 29%
- Market leadership expanded in France
- First to market with 25 products
- Acquisition of Prasfarma, a Spanish firm specializing in urology and oncology

The business model

The success of Merck Generics is based upon a broad portfolio of more than 400 substances. Once the patent on a successful active ingredient expires, the corresponding generic is launched quickly. The Merck Generics Group, which has nearly 5,000 employees, operates in more than 90 countries and maintains a global network of production and marketing capacities. Further investments are required to fully exploit the potential of this business and to strengthen its market presence. Merck is evaluating the potential sale of the Generics division as one strategic option.

Key products

We offer two strong branded generics:

- **EpiPen®**, an autoinjector for the emergency treatment of life-threatening (anaphylactic) allergic reactions and
- **DuoNeb®**, a single-dose inhalation solution for the treatment of chronic obstructive pulmonary disease.

Merck offers unbranded generics for many therapeutic areas, above all: Central Nervous System, Cardiovascular and Diabetes, Anti-infectives and Oncology.

Market trends and future prospects

- The market for generic drugs will continue to grow strongly in the coming years – according to estimates by IMS Health by about 13% in 2007.
- Products with sales of more than US $ 16 billion will lose their patent protection by 2007; for the period to 2010, this number will exceed US $ 100 billion.
- Competition between generic drug manufacturers is leading to market consolidation. This will create cost efficiency in purchasing, production and marketing.
- Merck announced in January 2007 that it is evaluating the potential divestment of the Generics division.

Good returns in the generics market

www.generics.merck.de

Solid growth in a competitive market

In 2006, sales by the Generics division rose 6.9% to € 1,819 million. This increase, which was achieved in a market environment characterized by strong competition, government-initiated price pressure and rigid reimbursement regulations, exceeded our expectations.

The 14% increase in gross margin to € 916 million significantly outpaced the rise in sales as we improved our efficiency and achieved higher product margins by strictly managing our manufacturing costs and improving our procurement effectiveness. We continued to increase our R&D spending, focusing our efforts on innovative dosage forms and drug delivery systems that offer added value for patients. Although marketing and selling expenses also increased, the operating result climbed by 29% to € 307 million – above all thanks to good performances by our subsidiaries Dey in the United States and Merck Génériques in France. At € 214 million, free cash flow remained at a high level; the decline compared to 2005 was due mainly to a payment for an acquisition. Return on sales (ROS) increased to 16.9%; return on capital employed (ROCE) grew sharply to 30.1%.

Hotly contested growth markets

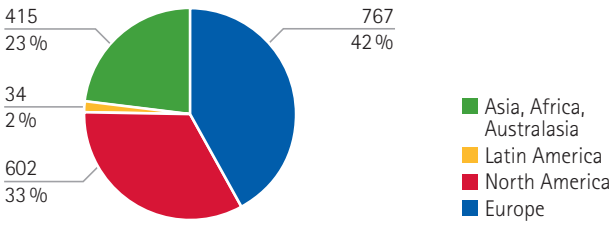
The market for generic drugs is taking on increasing importance worldwide. The market research firm IMS Health forecasts the market for generic drugs to continue to show strong growth in the coming years. In 2007, growth is expected to be between 13% and 14%, however, increasing competition will intensify consolidation among suppliers and necessitate cost efficiency. More treatment options are available to physicians in countries with a large range of affordable generics. Generic drugs are being promoted nearly everywhere with the help of government regulatory intervention as all industrialized countries are contending with rising health care costs. Mature markets, meaning countries where generic drugs already account for a large share of the pharmaceutical market, are primarily experiencing volume growth. At the same time, price pressure is rising. The mature markets include countries such as the United States, Canada, the United Kingdom and Germany. Comparatively young markets, where the proportion of generics is still low, for example France, Spain, Portugal and Italy, are showing much stronger growth. The Generics Group continues to pursue its strategy of early entries into young generic drug markets so as to participate in their strong growth potential.

Generics | Key figures

€ million	2006	2005	Δ in %
Sales	1,819	1,701	6.9
Gross margin	916	806	14
R&D	132	128	3.4
Operating result	307	238	29
Exceptional items	–13	0.0	–
Free cash flow	214	244	–13
ROS in %	16.9	14.0	
ROCE in %	30.1	23.8	

Generics | Sales by region

€ million



Patent expirations of blockbusters create growth potential

Additional market growth is being created in both young and mature markets as a result of patent expirations of blockbusters, i.e. drugs with sales in excess of US $ 1 billion. Products with sales of more than US $ 23 billion lost their patent protection in 2006. The sales of products going off patent in 2007 will exceed US $ 16 billion, and this number will rise to more than US $ 100 billion in total over the period to 2010.

We are exploiting the superb growth potential of patent expirations in all the major markets by launching new products at the earliest possible point in time. Our focus is on high-quality generics and branded generics. The Generics Group is one of the three leading generic drug companies worldwide, employing nearly 5,000 people and comprising more than 35 companies operating under different names in more than 90 countries.

Superb market position in France further expanded

In Europe, the division generated an 11% increase in sales to € 767 million. We were especially successful in France, our largest market within Europe, thanks to the performance of our subsidiary Merck Génériques. Sales in France rose by 30% to € 321 million. In Italy, where we set up our own company a few years ago, sales increased by 35% to € 40 million. We are already the third largest supplier of generic drugs in the country. In Spain, we increased sales by 47% to € 56 million and successfully completed the integration of Prasfarma. Specializing in the manufacture of cancer drugs, Prasfarma will enable us to enter the market for generic oncology products. We also recorded strong growth in the young markets of southern and eastern Europe, for example in Greece, Slovakia and Poland. Sales in Germany declined by 6.2% as government intervention further intensified price competition. On July 1, generic drug prices were lowered by an average of 20%. In the United Kingdom, sales fell sharply as a result of the low price level. Although we achieved cost savings, the decision to close the manufacturing plant in Potters Bar near London in 2007 was unavoidable. The exceptional charges in connection with this move totaled € 13 million in 2006.

Good performance in the United States and Canada

Sales in North America increased by 9.2% to € 602 million. Following a weak 2005, our Canadian subsidiary Genpharm performed well as one of the market leaders and we posted a 30% increase in sales to € 104 million in Canada. In the United States, sales grew by 5.7%. Our U.S. subsidiary Dey, which specializes in respiratory medicines, was again successful. Dey's two main growth drivers are EpiPen®, an autoinjector for the emergency treatment of life-threatening allergic (anaphylactic) reactions, which achieved a 12% increase in sales to € 138 million, as well as DuoNeb®, a single-dose inhalation solution for treating chronic obstructive pulmonary disease, sales of which increased by 7.0% to € 269 million. Dey has filed lawsuits against various manufacturers who have indicated an intent to market a generic version of DuoNeb® despite patent protection. Merck has settled with one generic drug manufacturer; two other lawsuits are still in progress.

As in numerous other lawsuits against pharmaceutical companies in the United States, Dey has been sued for improper reporting of drug prices that were reimbursed by Medicare and Medicaid programs. Dey is defending itself against these claims. To cover risks in connection with similar claims, provisions for potential damages and legal fees were increased by € 80 million.

In Latin America, we generated a 14% increase in sales to € 34 million and expanded our position particularly in Brazil (37%) and Mexico (10%).

Sales in Asia, Africa and Australasia decreased by 2.9% to € 415 million. In Australia, our largest market in this region, our subsidiary Alphapharm remains the market leader in the generic drug market. Sales suffered from government-imposed cost-containment measures. Thanks to a new logistics project, Alphapharm has been awarded ongoing incentive payments from the government for ensuring complete delivery to every pharmacy in Australia within 24 hours. Sales in New Zealand also declined. Due to the very harsh government-imposed tender environment in this country's generic drug market, we have decided to close our production site at the end of 2007. In Japan, where our subsidiary now operates as Merck Seiyaku, sales remained at the previous year's level. Adjusted for negative currency effects, organic growth amounted to 6.9%. As the fourth largest company in the Japanese generic drug market, we are the largest international supplier. Our focus is on marketing high-quality products. Emerging markets such as India, Taiwan and China are developing well and offer high growth potential for the future.

Innovative dosage forms – the key to growth

In 2006, we received 34 further approvals for new products. We now offer more than 400 drug molecules for nearly all therapeutic areas. The Generics Group is sustaining its growth and profitability by further optimizing production planning, warehousing and logistics. In addition, it is focusing on value-added generics, meaning innovative dosage forms and drug delivery systems, patented wherever possible. The U.S. subsidiary Dey is at the core of this strategy. Dey develops and markets respiratory medicines and allergy drugs based on generic substances. Their special dosage forms offer added value for patients. We have also taken this strategy into Europe and in 2006, we launched Clickhaler®, a patient-friendly, cost-effective dry powder inhaler that delivers formoterol and budesonide, two very popular treatments for asthma and chronic obstructive pulmonary disease. Our inhalers benefit from being easy to use and can deliver the required dose from low inspiratory flow rates. In addition, a dose counter records each individual dose and can help both patient and prescriber to monitor compliance.

The generics market offers significant growth opportunities in the coming years. At the same time, government regulations with respect to pricing and reimbursement as well as the patent dispute over DuoNeb® continue to present challenges for the Generics Group. In early 2007, Merck began evaluating the potential divestment of the Generics division as one strategic option.

Consumer Health Care Profile

The Consumer Health Care division offers consumers high-quality over-the-counter products for preventive health care and self-treatment of minor ailments. Many of these products are sold under well-known names. With them, Merck is helping to promote health and improve quality of life.

Highlights of 2006:

- Sales growth of 6.3% well above market growth of about 4%
- Eight strategic brands strengthened and focus on health themes with high consumer benefit
- Sale of the Moustifluid® brand in France
- Strong development of the Lamberts Healthcare (UK) mail-order business by 6.4%
- European market launch of the first patented product containing Metafolin®

The business model

The Consumer Health Care division sees itself as a niche supplier and is recording above-average growth. Since the market is growing moderately yet steadily, business with prescription-free drugs and health products is relatively stable. The main distribution channels for over-the-counter products, some of which rely heavily on physician recommendations, are pharmacies, drug stores, retail outlets, and also mail order. In recent years, the portfolio of brands has been consolidated and targeted to large, international markets where they enjoy a high level of trust.

Key products

- Mobility: Products to strengthen the joints, including the brands Seven Seas®, Seven Seas® JointCare and Kytta®
- Everyday health protection: Vitamins and minerals sold under international brand names such as Cebion®, Diabion® and the world's first probiotic multivitamin product Bion®3/Multibionta®
- Women's and children's health: Femibion®, a multivitamin product with folic acid for pregnant and nursing women; Kidabion® (Haliborange®), a vitamin product for children
- Cough and cold: Cold remedy Nasivin®, flu remedy Sedalmerck®

Market trends and future prospects

- The market research firm Nicholas Hall expects average annual growth of 4.2% by 2010.
- Strong impetus is coming from the emerging countries of central and eastern Europe, Latin America as well as east and southeast Asia owing to demographic developments and higher disposable incomes.
- The general wellness trend and greater patient self-responsibility in the health care systems of many industrialized countries are increasing the importance of over-the-counter medicines.

Strong brands for consumer health care

www.consumerhealthcare.merck.de

Sales increase for the fifth year in succession

Sales by the Consumer Health Care division increased by 6.3% to € 398 million in 2006, clearly exceeding the growth of the global consumer health care market, which grew by around 4% according to the market research firm Nicholas Hall. In terms of growth, we are one of the top three companies among the leading 20 consumer health care firms and have been showing steady and largely above-average growth for the past five years. Gross margin increased by 8.9% thanks in particular to the growth of high-margin products in our portfolio. Research and development spending rose by 8.5% as we continue to develop our products and dosage forms further. The 9.0% increase in the operating result is due in part to the disposal of the insecticide Moustifluid® in France to Laboratoires AIM in the third quarter. We are investing the proceeds from the divestment in marketing and sales to further optimize our strategic brands. Free cash flow increased by 7.0%, return on sales (ROS) and return on capital employed (ROCE) improved to 13.7% and 19.6%, respectively.

Sales increase in Europe – our largest market

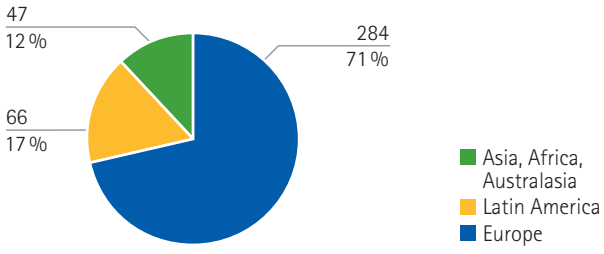
Europe accounted for more than 70% of sales, which rose slightly by 4.2% to € 284 million. France and the United Kingdom were our largest markets in 2006, each generating € 86 million in sales, followed by Germany with € 35 million. Following a weaker year-earlier period, sales in France by our French subsidiary Merck Médication Familiale increased by 7.0% thanks to the good development of the probiotic multivitamin product Bion®3, sales of which jumped 79%, and to the market launch of Diabion®, a vitamin product specifically for patients with diabetes. Both products are benefiting from physician recommendations and patient recognition. In the United Kingdom, sales remained virtually constant. This was due to an impurity found in our fish oil products caused by a supplier, which led to the withdrawal of several products in the second quarter of 2006 by our subsidiary Seven Seas. Once the problem had been resolved, sales improved in the second half of the year. Sales of the JointCare product range for the prevention and treatment of joint ailments increased by 8.3%.

Consumer Health Care | Key figures

€ million	2006	2005	Δ in %
Sales	398	374	6.3
Gross margin	265	243	8.9
R&D	10	9.6	8.5
Operating result	55	50	9.0
Exceptional items	0.0	0.0	–
Free cash flow	47	44	7.0
ROS in %	13.7	13.4	
ROCE in %	19.6	18.0	

Consumer Health Care | Sales by region

€ million



Innovative Femibion® with Metafolin® successfully launched in Germany

Sales in Germany increased by 3.7%. The continued success of our subsidiary Merck Selbstmedikation with Femibion® contributed substantially. Sales of this product surged by 42%. The new product Femibion® 800 folic acid plus Metafolin® was launched in Germany in June 2006. Other European countries will follow. The new combination prevents malformations such as neural tube defects and congenital heart defects from developing in unborn children. Its unique benefit is that it provides folate in its natural, bioavailable form suitable for all women who are pregnant or wish to conceive including those 15–20% who cannot metabolize normal folic acid. Sales of Kytta® f ointment, which in the recent CODEC study demonstrated at least equivalent efficacy and tolerability compared to diclofenac gel, also developed very positively.

Sales in Poland grew by 12%, thanks mainly to a 33% increase in sales of Femibion® and the launch of Kidabion®, a group of omega-3 and vitamin products for children. In the Benelux countries, total sales increased by 17%. We increased sales of Nasivin® by 18% in Belgium, while sales of Bion®3 were more than 2.5 times higher than in the previous year. We successfully market this product under the leading Omnibionta® brand in the Belgian market.

Double-digit growth rates in Latin America as well as in Asia, Africa and Australasia

In Latin America, we posted a strong 11% increase in sales. In Mexico, our largest market, sales grew by 29%. We more than doubled sales of Diabion® thanks to a television advertising campaign. Sales of Sedalmerck® also developed positively, increasing by 8.1%. We achieved double-digit growth rates in Venezuela and Ecuador. Sales in Asia, Africa and Australasia increased by 12%. While we sustained a decline in sales in Hong Kong because of the negative headlines on fish oil products, sales performances in Malaysia (+21%), India (+15%) and Indonesia (+24%) were excellent. Indonesia is our largest market in Asia and benefited primarily from the good development of the vitamin products Neurobion® and Sangobion®. In South Africa, the division achieved a 12% increase in sales.

Good prospects thanks to growth of strategic brands

All told, our eight strategic brands generated an 11% increase in sales in 2006. These brands include products to strengthen the joints sold under the Seven Seas® and Kytta® brands, the vitamin products Cebion®, Bion®3 (Multibionta®) and Diabion®, the women's and children's health products Femibion® and Kidabion® (Haliborange®) as well as the cold remedy Nasivin®. By using additional distribution channels and developing new marketing concepts, we will be able to better reach our customers. Our UK mail order business, operating under the name Lamberts Healthcare, achieved a good growth rate of 6.4% in 2006. Customers can choose from an extensive range of over 160 products.

We will secure our strong position in the consumer health care market by achieving further growth, especially in Latin America and Asia, and also by investing in China. Smaller acquisitions are planned. We are testing innovative concepts, for example in mail order so as to reach new customer groups we haven't been able to address via classic distribution channels. According to forecasts by Nicholas Hall, the global consumer health care market will grow by 4.2% in the next five years. The Consumer Health Care division expects sales to continue to clearly outperform the sector average.

It is literally in the nature of things that the manufacture of biopharmaceuticals requires the utmost accuracy and care and, above all, an exceptional emphasis on quality.

Biopharmaceuticals – new therapeutic options for many patients

Is drug research departing from classical approaches? Or are new ones emerging in parallel? One thing is certain above all: Major recent breakthroughs in the treatment of complex diseases are increasingly due to the use of biopharmaceuticals, in other words active ingredients that have been developed or produced using biotechnology. In contrast to classic pharmaceutical chemistry, medical biotechnology makes use of biological processes, with production taking place in living cells. Large biomolecules, i.e. proteins such as antibodies or interferons, are the research focus, instead of compounds with a comparatively small molecular structure as is the case in pharmaceutical chemistry.

An innovative cancer drug such as Erbitux® from Merck is an antibody originally derived from the immune system of mice. Thanks to its high affinity for structures on the surface of cancer cells, it can target these – and spare healthy cells in the process. However, this high specificity of action with few side effects calls for extreme care during production in living mammalian cells. The biopharmaceutical product is a sensitive biological drug. It cannot be administered orally – like a tablet that is swallowed – but in most cases is administered intravenously in order to avoid the digestive effect of gastric acid.

As a company that has been committed for generations to exceptionally high quality standards, the move into the innovative, high-growth sector of biopharmaceuticals came easy to Merck.

We are working on many new developments that hold the promise of therapeutic progress, without neglecting the still important development of small molecules based on the methods used in pharmaceutical chemistry. Researchers at Merck have expertise and experience in both technologies and apply both to drug development in a complementary way.

Chemicals business sector

High-quality industrial and laboratory chemicals for sophisticated applications – that is the common denominator of a range of products that make up the diversity of the Chemicals business sector. Pioneering spirit in research and a consistent, customer-centric approach to development have made us the market leader in many segments. Merck offers chemicals globally through two different divisions, each of which steer their research, production and marketing activities independently, supported by a central development unit offering new, forward-looking technologies and substances.

Liquid Crystals
The demand for liquid crystals for the world's leading display technology also grew further in 2006. By supplying innovative LC mixtures, Merck's Liquid Crystals division met this demand in close cooperation with its many customers. The success story that began over one hundred years ago continues.
> **Page 60**

Performance & Life Science Chemicals
Merck's second Chemicals division comprises three large business fields: laboratory products such as solvents, analytical reagents and test kits; products and services along the entire process chain of the pharmaceutical, cosmetics and biotech industries; as well as effect pigments for the automotive coatings, printing, plastics and cosmetics industries.
> **Page 64**

High double-digit earnings growth

A good year for the chemical industry

The positive development of the global economy also impacted the chemical industry in 2006 – although the dynamism weakened somewhat in the course of the year. In Europe, production output increased by 3.7%, while higher prices helped sales to increase by 7.0%. For the first time, Asia is on a par as a manufacturer of chemical products with the European Union, each of which commanding market shares of around 31% and ahead of North America with 24%. With a market share of 8.2%, China moved up to third place – behind the United States and Japan while ahead of Germany. Germany remained the world's largest exporter for the third year in succession. Following a strong previous year, chemical production increased by 3.6% again and sales rose by 6.2%. The chemicals business in the United States registered a higher level of imports than exports despite the low value of the U.S. dollar. Production increased only slightly by 2.2%, whereas sales grew by 5.4%. Towards year-end, both indicators were on the decline.

Strongest growth in Asia: Sales of over € 1 billion

By combining the Pigments and Life Science & Analytics divisions to form the new Performance & Life Science Chemicals division in early 2006, we raised our efficiency – especially in terms of customer service with the customer groups of both divisions having grown closer together. Accordingly, the previous year's figures of the two divisions have been combined. The Chemicals business sector now comprises two divisions offering industrial and laboratory chemicals for sophisticated applications in innovative sectors. Sales increased by 11%, gross margin grew 17% and the operating result climbed by 30% (for more information, see page 25).

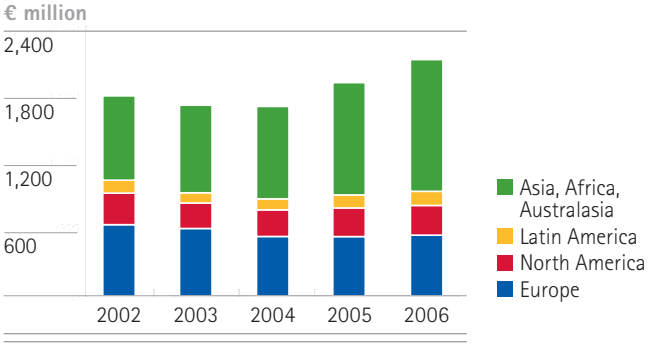
www.chemicals.merck.de

At € 543 million, sales in Europe were 2.5% higher than in 2005. In Germany, our largest market within Europe, sales increased by 7.6% to € 177 million. In France, our second-largest market, sales rose 3.4%. With sales of € 42 million, corresponding to an increase of 7.6%, Italy is now in third place, followed by the United Kingdom, where sales declined markedly. The markets of eastern Europe developed well with growth of 13%. Sales increased by 3.7% in North America and by 8.1% in Latin America – with strong growth of 19% in Mexico, 12% in Argentina and 9.6% in Brazil. We achieved the strongest regional sales growth of 17% in Asia, Africa and Australasia. The main contributor to these sales, which totaled € 1,172 million, were liquid crystals for displays. Thanks to their good development, we grew especially in Taiwan, South Korea and Japan with increases of 32%, 15% and 9.3%, respectively. While sales were 13% higher in China, we also grew significantly in Indonesia, India and Malaysia.

Chemicals | Key figures

€ million	2006	2005	Δ in %
Sales	2,106	1,900	11
Gross margin	1,234	1,058	17
R&D	137	132	3.6
Operating result	641	492	30
Exceptional items	–35	–10	246
Free cash flow	521	357	46
ROS in %	30.5	25.9	
ROCE in %	33.0	27.2	

Chemicals | Sales by region



Liquid Crystals Profile

All over the world, liquid crystals from Merck are found inside most LCD televisions, computer monitors, notebooks, digital cameras, mobile phones, PDAs, MP3 players and many other high-quality displays. Merck is the global market leader and, thanks to long-term investments in research and production, also the technology leader.

Highlights of 2006:

- Market leadership in liquid crystals successfully maintained
- Division sales up 21% and operating result up 40%
- Sales of LCD televisions remain top growth driver
- Sales of LCs for notebooks and LCD monitors also increase
- New Liquid Crystal Center in Taiwan meets rapidly rising local demand

The business model

The division's success is based on close cooperation between interdisciplinary teams with display manufacturers in the Far East. We secure our success through a broad portfolio and customized LC mixtures, reliable just-in-time deliveries in a highly demanding market with high innovation rates, and a large number of patents. More than 100 researchers are responding in particular to the ever-increasing demand for shorter switching times. Like our production facilities, they are based in Germany as well as close to our customers in Japan, Korea and Taiwan.

Key products

- licristal® – Liquid crystals and mixtures for super-fast and high-performance displays
- licrivue™ – Superior materials used in optical films for enhanced image quality of displays
- livilux™ – High-performance OLED (organic light-emitting diode) materials for displays and lighting
- isishape™ – Efficient and environmentally friendly structuring tools for photovoltaic products and displays
- lisicon™, isitron™, isitag™ – Printable polymers for flexible displays, solar cells and RFID chips

Market trends and future prospects

- According to forecasts by the market research firm DisplaySearch, from 2006 to 2010, an average increase in LCD panels (by units sold) of 17% is anticipated for notebooks, 8% for monitors and 27% for LCD TVs.
- The major growth driver for LCD monitors will be sales in emerging markets, for notebooks the trend toward new flat-panel formats and for televisions diagonal screen sizes exceeding 39 inches (99 cm).
- Sales of LCD televisions are expected to already exceed those of cathode-ray televisions by 2008.

Innovation and foresight pay off again

In 2006, sales by the Liquid Crystals division rose 21% to € 892 million, although they were impacted by negative currency effects. Sales were generated almost exclusively with display manufacturers in Asia. Sales growth over time reflects the development of the consumer electronics market with a slight time shift: Despite an imbalance between supply and demand for liquid crystal displays (LCDs) during the second quarter and early in the third quarter, our sales grew steadily. We benefited again from the very good market development of large displays, particularly for large-screen televisions.

Gross margin was € 612 million. The operating result rose 40% to € 486 million, leading to a significant increase in return on sales to 54.5%. This is the result of decades of investment in this area, particularly in research and development, which we increased again in 2006 to € 70 million. Return on capital employed (ROCE) was 57.2%, compared to 50.3% in 2005.

Liquid crystals sales grow with the booming LCD market

Again in 2006, Merck benefited from the trend toward ever-larger flat panels. The success of notebooks and other mobile devices such as mobile telephones – containing almost exclusively LC displays – also contributed to the excellent key figures achieved again in 2006.

The market share of LCD computer monitors by units sold has now grown to around 80%. In 2006, LCD televisions already commanded a 27% share of the market. Since the first quarter of 2006, sales of LCD TVs have exceeded those of LCD computer monitors. Market forecasts by DisplaySearch, one of the industry's leading market research institutes, underline the good prospects for liquid crystals sales development.

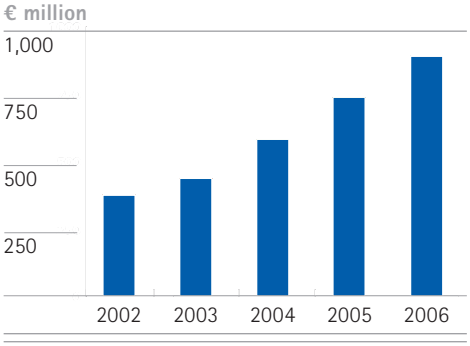
www.liquidcrystals.merck.de

Although televisions with a diagonal screen size of 32 inches (81 cm) are still the best-selling category, sales of televisions with a diagonal screen size of more than 39 inches are growing very rapidly. Market research institutes anticipate that LCD televisions will account for more than half of the television market by 2008 – investments in LC display manufacturing plants were reportedly four times higher than for other technologies in 2006. Accordingly, the two largest suppliers of LCD televisions plan to sell approximately 16 million TVs altogether in 2007.

Liquid Crystals | Key figures

€ million	2006	2005	Δ in %
Sales	892	739	21
Gross margin	612	477	28
R&D	70	69	1.1
Operating result	486	346	40
Exceptional items	0.0	–10	–
Free cash flow	377	166	127
ROS in %	54.5	46.8	
ROCE in %	57.2	50.3	

Liquid Crystals | Sales development



Following strong growth in earlier years, our sales of ITO glass (ITO = Indium Tin Oxide) declined in 2006 – as already in 2005. In order to focus on core businesses, Merck decided to divest its glass coating and color filter activities at Merck Display Technologies Ltd. in Taiwan, which was founded eleven years ago. The sale to Shin An SNP Taiwan Co., Ltd. (SNP Taiwan), a subsidiary of the Korean company Shin An SNP, was completed in December 2006.

Investing in a growth market

In 2005 we commissioned a new Liquid Crystal Center in Taiwan for customized mixtures and in 2006 we opened the new research building in Darmstadt. In addition, further modernization of the plants began in Atsugi, Japan. We are continuously adapting our production capacities and research facilities to current and expected development of the liquid crystal market. The good results of over one hundred years of LC history at Merck are enabling us to offer our customers state-of-the-art solutions. By investing € 70 million in research in 2006, we continue to improve our product portfolio for the highly innovative and very dynamically growing LCD market.

Research in technologies of the future

Merck invests not only in cutting-edge LCD technologies of the present, but also in new technologies of the future. Merck OLED Materials GmbH at the Höchst Industrial Park in Frankfurt, Germany, is pursuing an innovative area, which in the long term could grow into a high-potential technology, especially for small displays. OLEDs, organic light-emitting diodes, could also be used as light sources. The OLED materials business and research activities in the polymer electronics field at Southampton Science Park, United Kingdom, fulfilled our expectations in 2006. Our “reactive mesogens” are used in special foils for improving contrast and viewing angle dependency in particular for large-screen televisions. At the Technical University of Darmstadt, a sum of € 1 million was invested in the construction of a new laboratory to attract aspiring young scientists to physical and chemical research; in Asia we also have a variety of cooperation partnerships with research institutes. A new branding for our different materials in the LCD field is intended to support our marketing activities and to further strengthen the Merck brand.

Merck wants to remain the leading global supplier of liquid crystals: We will continue to meet the high demands of the LCD industry in direct contact with our key customers – both in terms of the number of new LC mixtures we produce and the speed with which we implement new developments. By expanding our production capacities in Germany and Asia, building on a comprehensive patent portfolio and investing heavily in research, we will further expand our strong market position. Parallel to the growth of the display industry, we are also predicting dynamic development in the coming years for our Liquid Crystals division.

Unimaginable without liquid crystals – innovations in the consumer electronics industry.

Setting new records with liquid crystals

Sharper, faster, bigger – and, above all, more and more widespread: that is a brief description of the global success story of LC displays. It also describes the development of liquid crystals from Merck, the undisputed global leader in liquid crystals. There's hardly a flat-screen television, PC monitor, notebook, mobile phone or navigation system not containing our key product. Yet the discovery of liquid crystals by the botanist Friedrich Reinitzer in 1888 was a coincidence more than anything. While heating cholesteryl benzoate he noticed that, although liquid at a temperature of 145.5° Celsius, it did not become a clear liquid until 178.5° Celsius. However, at that time and in the decades that followed, technical applications for this fascinating discovery of a special state of aggregation were simply lacking.
The advent of digital displays in quartz watches and clocks in the 1970s, however, marked the spectacular rise in LCD technology, as ever more application possibilities began to emerge. With increasing display size, the first notebooks with monochrome displays were introduced to the market at the end of the 1980s. The triumphant success of mobile phones and color PC monitors began in the 1990s, and presently that of large flat-screen televisions. Today we know that LCDs are the communication display technology par excellence and will remain the dominant technology for many years to come. Today, Merck owns more than 2,500 patents on LC materials and their applications. In close cooperation with LCD manufacturers, we continue to work on improved properties, in particular on even shorter switching times. In order to constantly meet the high quality requirements of our customers and growing market demand, we have significantly expanded our synthesis capacities in Darmstadt and Gernsheim and have invested in our three Asian locations for the production of LC mixtures close to our customers. In this way we ensure the supply for a growing market, which enables high investments thanks to good returns.

Somewhere between perfect crystal alignment and the "chaos" of liquid: liquid crystals.

www.liquidcrystals.merck.de

Performance & Life Science Chemicals Profile

Specialty chemicals from Merck are used in all stages of the pharmaceutical production process from development in the laboratory up to industrial-scale manufacture. They ensure reliable analysis in research and dependable production processes. Expertise in chemistry and customer-centric innovations have made Merck a successful supplier to the pharmaceutical, cosmetics, food, plastics, coatings and printing industries.

Highlights of 2006:

- Sales growth again at a high level, ROS improves to 12.8%, ROCE to 14.2%
- Synergies created thanks to the integration of the Life Science & Analytics and Pigments divisions in early 2006
- Acquisition of Agribiotics to expand our successful niche business in crop bioscience
- U.S. Food and Drug Administration approval for Candurin® pigments for use in food and pharmaceuticals opens new markets worldwide

The business model

The division's success is rooted in a personal guarantee that Heinrich Emanuel Merck gave for the purity of his products back in 1851. This made Merck the reference standard in meeting the highest quality demands for chemicals used in research and production. Today, Merck is a preferred partner for moving from laboratory scale to industrial production – innovations by Merck often help our customers to achieve key competitive advantages.

As a global supplier, we ensure that our customers receive consistent quality and reliable deliveries.

- We develop customized solutions for each industrial application and offer customer-centric service extending beyond products such as special documentation for authorities and online services.
- We find innovative answers to many challenges in environmental protection, production safety and product security by utilizing cutting-edge technologies.

Overview of the three business fields

The business models and key products of each of the three business fields are presented starting on page 66.

Market trends and future prospects

- The laboratory market is characterized by relatively stable growth of 2% to 5%, in biotechnology growth exceeds 10%.
- Statutory regulations on production and product safety, the related process documentation and safety requirements as well as quality controls are increasing.
- Thanks to its own expertise in pharmaceutical research, Merck can develop customer-centric solutions for this growth sector early on.
- In the field of alternative technologies, we can benefit from nanoproducts for solar cells and biological crop-enhancing technologies.

Stable growth in laboratory and industrial chemicals

www.pls.merck.de

In 2006, sales by the Performance & Life Science Chemicals division, which was formed in 2006, increased to € 1,213 million. This was 4.5% more than the previous year's adjusted sales of € 1,161 million – comprising the combined sales of the Pigments and Life Science & Analytics divisions, which we combined in order to address the changes in the competitive environment of specialty chemicals and to capture new businesses in existing markets. Different market developments in the business fields impacted sales performance over time. Sales increased steadily, except for the third quarter. However, when adjusted for currency effects, third-quarter sales also increased by 2.2%. Gross margin grew by 7.0% to € 622 million. Besides spending on research and development, which totaled € 67 million, we also invested heavily to harmonize the global IT structure. The operating result rose by 6.4% to € 155 million, leading to a further increase in return on sales to 12.8%. Return on capital employed (ROCE) was 14.2%, compared to 13.0% in 2005.

Growth potential exploited in Asia

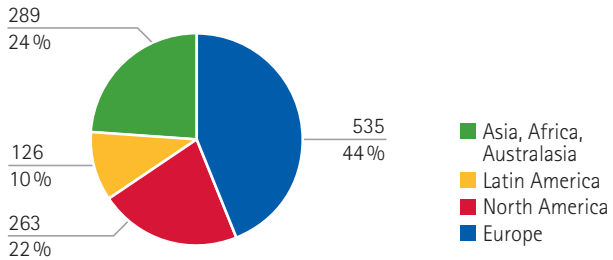
Posting a 2.5% increase in sales to € 535 million, Europe remained by far our largest market – however, growth rates of 7.8% in Asia, Africa and Australasia and 8.1% in Latin America showed the increasing importance of these regions. Within Europe, sales grew 8.1% in Germany, which is our most important market, while countries in eastern Europe and Italy also posted strong growth. Although Japan continued to be our largest market in Asia, we also achieved significant double-digit sales growth in China, India, Pakistan, Indonesia and Malaysia. In North America, where we operate as EMD Chemicals, EMD Biosciences and EMD Crop BioScience, we grew by 4.0%. Good sales developments in Mexico, Argentina and Colombia contributed significantly to the growth in Latin America.

Performance & Life Science Chemicals | Key figures

€ million	2006	2005	Δ in %
Sales	1,213	1,161	4.5
Gross margin	622	581	7.0
R&D	67	63	6.4
Operating result	155	146	6.4
Exceptional items	–35	0.0	–
Free cash flow	144	192	–25
ROS in %	12.8	12.6	
ROCE in %	14.2	13.0	

Performance & Life Science Chemicals

Sales by region | € million



Profiles of the business fields within Performance & Life Science Chemicals

Laboratory Business

The business model
The success of this business field is based on a long tradition of offering researchers, teachers and industry a broad spectrum of laboratory chemicals in a range of quality grades with certificates of analysis ensuring consistent and comparable results. Today we offer specific solutions and top-rate services for many different laboratory requirements worldwide. We are a single-source supplier serving a global market with local representatives.

Key products
We know that our customers need full-service solutions that exploit the latest technologies. In order to find the best answers to their requirements, we have organized our marketing and customer segments to focus on universities as well as the pharmaceutical, biotech, food, beverage and chemical industries. We are pursuing targeted approaches so that laboratory work can be performed safely, reliably and with maximum efficiency. Merck supplies a global market with important laboratory chemicals:

- Reagents for analysis and other applications, particularly standards for instrumental analysis
- Products for analytical chromatography, microbiology, food and environmental analysis
- A broad range of solvents, salts, acids, alkalis and organic chemicals

Life Science Solutions

The business model
This business field, which is oriented toward customer needs in a wide variety of sectors, offers products and solutions covering the entire range of the latest technological expertise in chemical and physical processes. Understanding the problems and processes of every aspect of the entire value-added chain of our customers makes us an important partner in the following sectors:

- Health care, which includes above all the major pharmaceutical and biotech companies, and also increasingly the food industry
- Cosmetics, for which Merck provides decorative effect pigments as well as ingredients for skin care and protection products
- Technical industries, for example the optics, electronics and solar industries

Key products
We support the entire life sciences process chain from research to market launch:

- Separation and purification materials
- "Ionic liquids", which are used to simplify biotechnological processes
- Active ingredients for drugs, sunscreen and skin care products
- Active ingredients for nutritional supplements
- Biological crop-enhancing technologies in crop bioscience
- Products for technical applications, e.g. in the optics industry

Pigments

The business model
Merck is a successful supplier of effect pigments used to differentiate and position packaging and product design in a large number of branded products. In particular, our new developments help to strengthen the brand identity of products and to attract attention to them. Not only decorative, but also security-relevant aspects, for example brand protection, are important here. First-rate service and extensive application expertise make us a strong partner, for example to the automotive industry.

Key products
Merck offers established and innovative effect pigments for the following applications:

- Iriodin® mica-based pearl-luster pigments for plastics, coatings and printing inks
- highly developed, weather-resistant pigments for automotive coatings and other outdoor applications
- Xirallic® effect pigments with attractive glitter effects
- Colorstream® effect pigments with angle-dependent color travel
- optically variable, highly transparent and shimmering pigments for decorative and personal care cosmetics (e.g. Xirona® and Ronastar®)
- functional pigments, e.g. for laser markings or solar heat reflection

Laboratory Business

Solid growth with products marketed globally

With an increase in sales of 3.0%, growth of the division's largest business field met our expectations. The newly launched "Ready-to-use Media" product range for microbiology developed particularly well. We also increased sales of the two largest product groups, reagents and inorganic salts. The still young product line CertiPUR® comprising 68 chemical element solutions sold very well, for example, to customers who calibrate their chemical measurement instruments with these ISO-certified standards. In the food and environmental analysis segments, we recorded growth of 5.8%. The newly launched, innovative 3-mm thick Chromolith® separation column for analytical chromatography met with a high level of customer acceptance.

www.analytics.merck.de
www.chromatography.merck.de
www.microbiology.merck.de
www.bioprocessing.info

New laboratory products with future prospects

In the laboratory business, we are supporting four major trends: On the one hand, the ever-increasing regulatory requirements placed on products, reagents and test assays by regulatory and control authorities, on the other hand the ever-growing demand for products from validated processes, which is required in particular by major brand manufacturers. In addition, we are capable of meeting the growing demand for easy-to-use test assays that can also be reliably applied by non-experts. Not least, the trend toward the miniaturization of test kits, particularly in mobile analysis, is still underway. Thanks to the breadth of our technological expertise and our customer centricity, we have the potential to further expand our share of innovative products to achieve further growth.

Life Science Solutions

Strategic acquisition in the growth market of agrobioscience

This business field, which was established in 2006, recorded sales growth of 7.2%, fulfilling our expectations. In the two largest product categories "Organics and Ingredients" and "Pharmaceutical Salts" we grew by 13% and 8.3%, respectively. In "Cosmetic Actives" we were particularly successful for example with our skin protection products, which are used in sprays and creams and are enjoying growing popularity. We also increased sales of nutritional supplements (nutraceuticals), for example Metafolin®, a biologically active form of folic acid. In order to strengthen our agrobioscience business, at the end of March 2006 we acquired the Canadian crop bioscience company Agribiotics Holdings Inc. headquartered in Cambridge, Ontario for around € 22 million. This company, operating since August 2006 together with our subsidiary Nitragin as EMD Crop BioScience headquartered in Milwaukee, Wisconsin, U.S., expands our portfolio of products for crop-enhancing technologies. This makes us one of the leading suppliers in this strongly growing market of natural alternatives to conventional fertilizers.

www.merck4food.com
www.merck4pharma.com
www.merck4biosciences.com
www.lifescienceanalytics.merck.de

Good future prospects with biotech products

The international pharmaceutical market is forecasted to grow by 5% to 6% in 2007. The biotechnology sector, included therein, is even expected to show double-digit growth. Prospects for the end-user markets of the food and cosmetics segments are also positive. Our approach of offering timely solutions for future requirements in the life sciences sector based on our own research experience will enable us to grow in precisely those markets that are driven by innovations. Our Web portal "Merck4pharma.com" is a vital medium for us to offer products and special, application-based services for the entire process chain. We also see good potential for growth with our biotech products for agriculture, as crops will become increasingly important in the future not only as sources of nutrition and raw materials, but also as sources of energy.

Pigments

www.pigments.merck.de
www.merck4cosmetics.com
www.merck4coatings.com
www.merck4printing.com
www.merck4plastics.com

Successful again with innovative effect pigments

The Pigments business field expanded its market position also in 2006 with high-grade effect pigments and first-rate technical service. All applications contributed to the high single-digit sales growth of 8.5%: Pigments for automotive coatings developed particularly well. Overall, sales increased in all four regions that we supply with pigments produced in Gernsheim, Germany, Savannah, GA, United States, and Onahama, Japan.

Besides our basic products, our future focus will be on innovative, high-grade effect pigments, for which we see substantially higher growth opportunities. The strong growth rates of our new product lines such as Miraval® and Ronastar® for the printing and cosmetics industries, respectively, as well as Xirallic® prove the success of this strategy. Due to the shift of our product portfolio and the decline in prices for simple pearl-luster pigments, we took measures that led to a one-time impairment loss of € 34.5 million on production facilities and inventories.

We invest to consistently develop new, high-quality products for specific customer needs and are entering new niche areas: In 2006, we received approvals from the U.S. Food and Drug Administration (FDA) for Candurin® pigments for use in food and oral pharmaceuticals. Candurin® pigments can reduce potential medication and dosage errors and strengthen brand identity – for Merck this opens the door to the growing food and pharmaceutical markets.

New opportunities in niche markets

The effect pigments market is currently undergoing many changes, resulting on the one hand from the consolidation of several major competitors as well as from new competition from China on the other. We are repositioning ourselves by consistently developing certain high-quality products further and by entering new niche markets such as effect pigments for food and pharmaceuticals. In this way we expect to achieve sustainable growth despite more intense competition. In the automotive sector, we expect sales and market share to grow significantly – not least due, for example, to the increasing trend toward color coatings.

Thanks to their attractive crystal luster, our innovative Xirallic® effect pigments are helping to make striking impressions all over the world.

Xirallic® – color-intensive crystal luster with shining prospects

Effect pigments create eye-catching color effects for a wide variety of products – in both product design and packaging. Important impetus to the further development of effect pigments is coming from the automotive industry, which places special demands on their technical properties, such as weather resistance. One of Merck's latest product successes in this sector is Xirallic®: a range of extremely color-intensive effect pigments, which are impressive due to their exceptional crystal effect.

The high gloss and pronounced shimmer of Xirallic® pigments appeal especially to automotive manufacturers for use in their color coatings. The effect, which closely resembles the diamond glitter of a layer of frost on an ice-cold winter morning, is currently being used in about 300 serial colors of well-known automotive manufacturers, such as Daimler-Chrysler, Audi and Toyota.

The substrate on which the crystal effect of Xirallic® is based is, in fact, a crystal that is produced in a high-tech process. Researchers at Merck discovered these crystal effect pigments and developed them to market launch. Aluminum oxide flakes (corundum) are coated with titanium oxide to create a very even, highly reflective surface and high transparency. Also, by virtue of their optimum particle size and particle-size distribution, it is easy to process them in all fields of application.

In view of the growing demand for these pigments, we commissioned a third production plant in Onahama, Japan, in February 2006. Xirallic® is meanwhile a main pillar of Merck's Pigments business field and a brand enjoying double-digit growth.

www.xirallic.com

Corporate and Other

The segment Corporate and Other comprises Group administrative costs with respect to holding companies, taxes as well as certain exceptional items not assigned to the individual divisions. Overall, the sales recorded under Corporate and Other amounted to € 34 million, exceptional items to € 289 million and free cash flow to € –304 million in 2006. This segment includes for example the exceptional gain from the sale of the shareholding in Schering AG in the second quarter of 2006. In 2005, this segment included the gains on the sale of the Electronic Chemicals business to BASF AG as well as expenses and income from ongoing contract manufacturing in connection with this business.

Risk report

Diversification in Pharmaceuticals and Chemicals reduces risk

Risk management system

Risk management within the Merck Group is described for all risk owners in a detailed guideline. This defines the principles of risk management, outlines roles and responsibilities, and helps those responsible to implement the legal and operational requirements. Specific terminology and standard risk reports harmonize the risk management process worldwide. Risk reports are submitted to the Executive Board at six-monthly intervals or, in special cases, on an ad-hoc basis. The Internal Auditing department reviews the risk management system.

Overall risk position

No risks have been identified that pose a risk to the continued existence of the Merck Group. This is the finding of this risk report, which was prepared in accordance with German Accounting Standard 5.

Business-related risks

Merck integrates the risk management system into its ongoing business planning processes. Potential negative developments are described and evaluated in the risk reports, so that we can take timely countermeasures if any events should lead to deviations from our business plan. As of December 31, 2006, the Merck Group had 54 production sites in 24 countries and has taken appropriate measures to minimize the risk of a supply bottleneck for its main products. The sales and operating result of the Merck Group are sustained by a large number of pharmaceutical and chemical products for various industries. This diversification itself minimizes risk, since the markets differ in their structure and economic cycles.

We try to prepare for the potential risks of a changing market environment by continually observing market developments and acting with the appropriate foresight. The special risks in pharmaceutical development are constantly monitored by the portfolio and project management system that has been introduced throughout the Merck Group. As a research-based pharmaceutical company, there is the risk for Merck of development projects having to be discontinued or canceled – after substantial investment – at a late phase of clinical development, before the product can be marketed. The important decisions we make – such as those relating to the transition to the next clinical phase – are taken responsibly in order to minimize risk. The same applies to investment decisions, for which we use detailed guidelines.

Financial risks

Merck uses derivatives to control the currency risk related to transactions disclosed in the balance sheet. Financing transactions in foreign currencies are generally hedged. In certain cases, we also hedge anticipated sales for a period of up to one year, preferably in U.S. dollars, Japanese yen and Taiwan dollars. The purchase price for the acquisition of the Bertarelli family's interest in Serono S.A., which was payable in Swiss francs in January 2007, was likewise largely hedged. More information can be found on page 132 of the Consolidated Financial Statements.

Legal risks

Merck is engaged in legal proceedings, the outcome of which cannot currently be predicted. These proceedings relate in particular to cases in the United States and the United Kingdom in connection with generic drug pricing. We have taken all possible measures to protect our own legal position. More information can be found on page 122 of the Consolidated Financial Statements. As a research-based company, Merck has a valuable portfolio of industrial property rights, such as patents and brands. This can become the target of attacks and infringements. We have taken the necessary precautions to identify threats and defend our rights where necessary.

Generally, we do everything we can to try and prevent legal risks from arising. Our employees participate worldwide in a compliance program that enjoins them to comply with laws and guidelines, and provides them with the relevant training and support. The core of the program is the Merck Code of Conduct, which defines ethical behavior guidelines. This is supplemented by an intranet-based training and testing program, as well as by employees in a global network of compliance officers. Insofar as possible and practical, we limit liability and damage risks through insurance coverage, the type and scope of which we continually adjust to current requirements.

Information technology risks

Our business-critical application systems are set up in such a way that, even in the event of individual failures, they are continually available thanks to redundant technical components, networks and sites. Access to business-related data is secure. There are global security guidelines that include appropriate organizational, technical and software-related precautions for access control, access rights, virus protection and data protection. We monitor the adherence to and efficacy of these measures continuously.

Environmental and safety risks

Global adherence to high technical standards prevents potential damage, minimizes the potential effects of such damage, and thus ensures the continuity of plant and equipment. We update these preventive measures regularly; we systematically conduct internal health and environmental safety audits, and through inspections we endeavor to minimize the risks to people and the environment.

Report on expected developments

Forecast on the development of the global economy in 2007

For 2007, German research institutes expect strong world economic activity: According to their forecasts, real gross domestic product is expected to grow by 3.1%. OECD calculations predict that the growth rate will be 2.5% in 2007 and 2.7% in 2008. This would mark a continuation of the dynamics currently underway as the international integration of the markets for goods and capital helps individual regions to support each other. Emerging economies will expand by more than 6%, clearly exceeding the industrialized countries, which will grow by 2.4%. The United States – the world's largest economy – is expected to grow by 2.7% in 2007. It is affected by weaker consumer spending. Its high current account deficit is leading to devaluation of the dollar, which will stimulate exports in the medium term.

The EUROFRAME group of the ten leading European economic research institutes predicts growth of 1.9% for the euro area in 2007 and 2.0% in 2008. For Germany, the German research institutes are forecasting growth of only 1.4% in 2007 owing to restrictive finance policies, while the OECD expects growth of 1.8% for 2007 and 2.1% for 2008 – overall the upswing will be maintained. By contrast, after a period of weakness, growth in the United Kingdom will amount to 2.5%. The forecasts for Russia (+6%) and eastern Europe (+4.7%) depend heavily on the development of raw material prices. China is expected to show continued dynamic growth of more than 10%, as consumer demand increases steadily. In Japan, growth is expected to weaken slightly and amount to around 2%. Latin America will expand at a slightly more moderate pace of 3.8%.

Assumptions regarding expectations for the Merck Group

Our forecasts take into account our assessment of opportunities and risks and are based on the operational planning of Merck and the medium-term outlook of Merck. We do not predict exchange rates. For Serono, we have used forecasts that we prepared in connection with the acquisition. Our planning assumes a moderate development of energy and raw material prices as well as rising personnel costs.

Forecast for the Pharmaceuticals business sector

The pharmaceutical market is expected to grow by 5% to 6% in 2007. The biotechnology sector, included therein, should even see growth of more than 15% according to forecasts by IMS Health. By 2015, the neurology sector is expected to show the highest level of sales. By contrast, oncology products will see the strongest growth rates: In 2007, they are expected to account for 20% of overall growth.

By acquiring Serono, Merck is increasing its innovative strength. The new Merck Serono division will further expand existing business fields and drive the oncology and autoimmune diseases businesses forward with a planned R&D budget of around € 1 billion and currently 31 projects in the development pipeline. R&D as a percentage of sales will total more than 20% in this highly research-intensive division in 2007. This includes, among other things, the costs of the Phase III clinical studies that have already commenced. A stronger presence in the U.S. market not only creates potentials for growth but also makes us an interesting cooperation partner for other companies.

Accordingly, we expect the good sales development of our Pharmaceuticals business sector to continue in 2007 and 2008, particularly in the Merck Serono and Consumer Health Care divisions. We expect the operating result to continue to develop positively in 2007 – despite the impairment losses resulting from the purchase price allocation.

We expect the Merck Serono division to post increases in both sales and operating result. Sales by the Generics division depend heavily on DuoNeb®: with € 269 million, or a share of around 15%, it was the division's top-selling product in 2006. DuoNeb®, a single-dose inhalation solution for the treatment of chronic-obstructive pulmonary disorders, contains patent-free active ingredients, however the dosage form is patented. Government authorities in the United States continue to analyze changes in Medicare reimbursement for inhalation products. The final decision is expected in the first half of 2007. In addition, lawsuits concerning the product's patent protection are still pending in the United States (for more details, please see page 122). Due to these developments, we expect a sharp decline in sales of DuoNeb®, potentially also at short notice. We want to compensate for this decline with new products over the longer term.

For the Consumer Health Care division, we expect sales and the operating result to continue to grow strongly in the next two years, with sales clearly exceeding the growth of the global consumer health care market, which, according to Nicholas Hall, is predicted to grow by an average of 4.2% in the next five years.

Forecast for the Chemicals business sector

According to the German Chemical Industry Association (VCI), the global growth of the chemical industry in 2007 will no longer be as strong as in 2006. For Germany, the German Chemical Industry Association (VCI) expects that economic activity in the chemical industry will weaken. Production should increase by 2.0% in 2007. According to the European Chemical Industry Association CEFIC, the prospects for Europe are slightly muted with production increasing by around 3.0%. In the United States, chemical industry production should also increase by 3.0% despite inflation risks and the current account deficit. Growth is expected to be significantly more dynamic in the countries of Asia. Going forward, Asia will play an even more important role for Merck.

Sales and earnings growth for the Chemicals business sector will again be strongly influenced by the Liquid Crystals division in 2007 and 2008. Market forecasts by Display-Search, one of the leading market research institutes of the industry, underline the good prospects for sales development of liquid crystals. Accordingly, both the notebook market and the market for LCD monitors will increase. Double-digit growth is expected for televisions – the largest LCD market. LCD televisions are expected to account for more than half of the television market by 2008. We expect to see dynamic developments in our Liquid Crystals division in the coming years, and consequently, further increases in both sales and the operating result.

In the two following years, the Performance & Life Science Chemicals division should sustain the positive trend of previous years in terms of both sales, thanks to segment-specific and innovative offers, and the operating result.

Development of Merck

Taking into consideration the aforementioned uncertainties in the Generics division, we expect that the sales and operating result of the Merck Group – excluding Serono – will increase by a single-digit percentage in 2007.

Since early 2007 we have been evaluating the disposal of Generics as a strategic option. Excluding the division, we expect sales growth in the high single digits and a double-digit increase in the operating result. Including Serono, the Group operating result will increase by Serono's contribution. However, this will be impacted by additional impairment losses on intangible assets and property, plant and equipment within the scope of the purchase price allocation.

In 2007, profit after tax will also be negatively impacted by a one-time impairment loss of around € 0.7 billion on the revaluation of Serono's inventories within the scope of the purchase price allocation. Due to the non-recurring nature and size of these amounts, we will disclose them under exceptional items. In addition, profit after tax will decline as a result of the interest expense resulting from the financing of the Serono purchase price. Overall, we therefore expect profit before and after tax to decline markedly in 2007.

In view of the increase in financial liabilities and total assets due to the financing and acquisition of Serono, our gearing will rise and our equity ratio will decline in the two following years. We continue to expect free cash flow to increase in the following years despite the high interest expense.

Dividend development

Changes to our dividend policy are not planned. Based on our earnings expectations, the family of owners and our shareholders can again expect to receive an earnings-oriented dividend.

Corporate Governance

Joint Report of the Executive Board and the Supervisory Board according to section 3.10 of the German Corporate Governance Code

The German Corporate Governance Code is geared exclusively toward the conditions at a German stock corporation (Aktiengesellschaft). Merck KGaA has therefore independently examined and decided how the Code can be applied logically to a partnership limited by shares (Kommanditgesellschaft auf Aktien) to serve the interests of shareholders.

In order to enable shareholders to compare the situation at other companies more easily, we have decided to base corporate governance on the conduct recommendations made by the Code Commission relating to management and supervision (governance) and to forego having our own, also permissible, code. With a few exceptions, the recommendations of the Code, the intent and meaning of which are applied, are complied with. To improve understanding, the following gives a general explanation of the KGaA company form followed by the specific situation at Merck.

Partnership limited by shares (Kommanditgesellschaft auf Aktien)

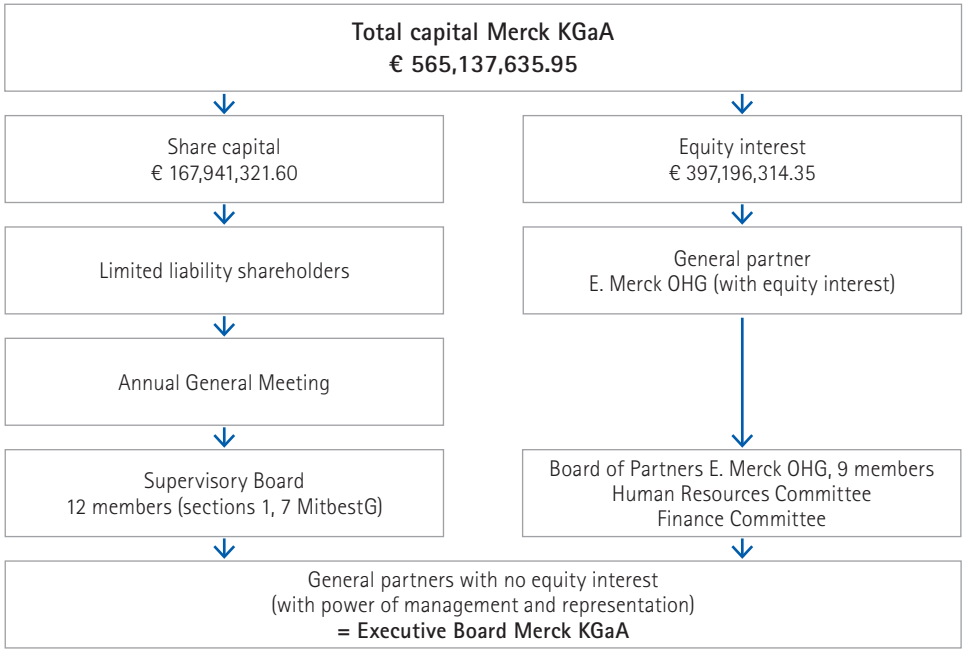
"The partnership limited by shares (Kommanditgesellschaft auf Aktien or KGaA) is a company with its own legal personality, at which at least one partner has unlimited liability for the company's creditors (general partner) and the others hold an interest in the share capital without any personal liability for the company's debts (limited liability shareholders)" (section 278 (1) of the German Stock Corporation Act (AktG)). It is therefore a hybrid of an Aktiengesellschaft (German stock corporation) and a Kommanditgesellschaft with a focus on German stock corporation law. Distinctive differences to the Aktiengesellschaft include the presence of general partners, who essentially also manage the company's business activities, the absence of a management board and the restriction of rights and obligations of the supervisory board. In particular, the supervisory board is not responsible for appointing general partners or for regulating the terms and conditions of contracts, while at the Aktiengesellschaft it appoints the management board; at the KGaA, it also does not have the legal authority to issue rules of procedure for the executive board or a catalog of business transactions requiring approval. The KGaA also has some special features with regard to the Annual General Meeting; for example, many of the resolutions made require the approval of the general partners (section 285 (2) AktG), including the adoption of the annual financial statements (section 286 (1) AktG). A large number of the conduct recommendations contained in the Code, which is geared toward Aktiengesellschaften, can therefore only be applied to a KGaA as appropriate.

Merck KGaA

Following the capital increase of January/February 2007, the general partner E. Merck OHG holds around 70% of the total equity of Merck KGaA (equity interest); the limited liability shareholders hold the remainder, which is divided into shares (share capital). As a result of the capital increase, the share capital of currently € 133,416,111.40 increased nominally by € 34,525,210.20 to € 167,941,321.60. E. Merck OHG is excluded from the management of business activities. The general partners with no equity interest (Executive Board), on the other hand, manage business activities. Nevertheless, due to its substantial capital investment and unlimited personal liability, E. Merck OHG is an influential authority with a strong interest in compliance with procedures and efficiency of business operations at Merck KGaA. Merck KGaA's participation in the profit/loss of E. Merck OHG in accordance with sections 26 et seq. of the Articles of Association provides for further harmonization of the interests of the limited liability shareholders and E. Merck OHG.

E. Merck OHG appoints and dismisses the Executive Board. In addition, E. Merck OHG has created bodies – complementing the expertise and activities of the Supervisory Board – to ensure that the Executive Board is monitored and advised. This applies primarily to the Board of Partners of E. Merck OHG. Based on the provisions of the German Stock Corporation Act, the Articles of Association of Merck KGaA and the rules of procedure of the various committees, Merck KGaA has a set of regulations for the Executive Board and its supervision that meet the requirements of the Code. The investors, who bear the entrepreneurial risk, are protected as foreseen by the Code.

This is illustrated in the following chart.



Deviations from the Corporate Governance Code:
1. Contrary to section 3.8 (2), the Directors & Officers ("D&O") liability insurance policy, which Merck KGaA maintains for its committee members, does not include a deductible. The company has dispensed with a deductible because D&O insurance policies with the required deductible are not actively offered by the insurance sector and the individual agreement on a deductible is not countered by a substantial reduction in the premium.
2. Contrary to section 4.2.4, the remuneration paid to the members of the Executive Board is not reported individually. As it is E. Merck OHG, not Merck KGaA and especially not its Supervisory Board, which has personal sovereignty over the members of the Executive Board and also pays for the compensation of the Executive Board members, the Company has chosen not to disclose such information.
3. Contrary to section 5.4.7 (1), sentence 3, membership of committees is not remunerated separately. In view of the limited number of tasks as compared with the duties of the Supervisory Board of a stock corporation, separate compensation for membership of committees would not be appropriate.
4. Contrary to section 5.4.7 (3), the remuneration paid to the members of the Supervisory Board is not reported individually. The amount of compensation received by the members of the Supervisory Board can be calculated in accordance with the Articles of Association of Merck KGaA, making a separate disclosure unnecessary.

Main features of the Executive Board compensation system and structure of the stock option program
(Section 4.2.3 of the German Corporate Governance Code)

The compensation of the general partners, who comprise the Executive Board of Merck KGaA, is composed of salary payments (fixed portion), profit participation and additions to pension provisions. Profit participation is based on the rolling three-year average of profit after tax. Payments in fiscal year 2006 were as follows: fixed salary € 3.0 million, profit sharing (based on the results of 2006, 2005 and 2004) € 10.5 million. This compensation is paid by the general partner E. Merck OHG.

Merck KGaA's Annual General Meeting in 2000 resolved a stock option program for senior executives, in which members of the Executive Board also participate. Since October 2002, the options in the first tranche could be exercised at an exercise price of € 37.41, provided that Merck shares had reached a price of at least € 48.63. Since mid May 2004, the stock options in the second tranche could be exercised at an exercise price of € 34.35, provided that Merck shares have reached a price of at least € 44.66. Since then, this has been the case several times. The Members of the Executive Board exercised their share options to the full extent possible in 2005.

Remuneration of Supervisory Board Members
(Section 5.4.7 of the German Corporate Governance Code)

Subject to the approval of the Annual General Meeting on the proposed distribution of € 0.90 dividend and a one-time bonus of € 0.15 per share, the remuneration of the Supervisory Board in 2006 amounting to € 350 thousand consists of a fixed portion of € 95 thousand and a variable portion of € 255 thousand.

Ownership, purchase or sale of shares in the company by members of the Executive Board and the Supervisory Board
(Section 6.6 of the German Corporate Governance Code)

As of December 31, 2006, the members of the Executive Board and the Supervisory Board held 28,375 shares. Their total ownership represents less than 1% of the issued shares of Merck KGaA.

No Members of the Executive Board or the Supervisory Board notified Merck KGaA of any reportable transactions in 2006.

Board of Partners of E. Merck OHG

Dr. Frank Stangenberg-Haverkamp (Chairman)
Jon Baumhauer (Vice Chairman) | Karl-Heinrich Kraft
Dr. Karl-Ludwig Kley (until June 30, 2006) | Prof. Dr. Dr. h.c. Rolf Krebs
Albrecht Merck | Dr. Arend Oetker | Dr. Norbert Schweickert
Prof. Dr. Theo Siegert (as of July 1, 2006) | Prof. Dr. Wilhelm Simson

Report of the Supervisory Board

As of the balance sheet date, the company's subscribed capital is divided into 64,592,816 no par value bearer shares as well as one registered share. The holder of the registered share in E. Merck Beteiligungen OHG. It is entitled and obliged to appoint one-third of the members of the Supervisory Board representing the limited liability shareholders. If the holder of the registered share is a General Partner, he or she has no such right of appointment. The transfer of the registered share requires the Company's approval. The approval is granted at the sole discretion of the personally liable general partner with an equity interest, namely E. Merck OHG. There are no holdings in the company's share capital exceeding 10% of the voting rights.

According to the Articles of Association of the company, the general partners not holding an equity interest who form the Executive Board are admitted by E. Merck with the consent of a simply majority of the other general partners. A person may only be a general partner not holding an equity interest if he or she is also a general partner of E. Merck. In addition, at the proposal of E. Merck and with the approval of all general partners not holding an equity interest, further persons may be appointed to the Executive Board who are not General Partners not holding an equity interest. The Articles of Association of the company can be amended by a resolution by the General Meeting that requires the approval of the general partners. The resolutions of the General Meeting are, notwithstanding any statutory provisions to the contrary, adopted by a simple majority of the votes cast. Where the law requires a capital majority in addition to the voting majority, resolutions are adopted by a simple majority of the share capital represented in the vote.

The Articles of Association of the company specify the share capital. The Executive Board is authorized, with the approval of the Supervisory Board and of E. Merck, to increase the share capital on one or several occasions until March 31, 2010 by up to a total of € 29,824,787.20 (following the capital increase made in the first quarter of 2007) by issuing new shares against cash or contributions in kind. The company is not authorized to acquire its own shares.

The company has not entered into any material agreements subject to a change of control pursuant to a takeover offer nor has it concluded any compensation agreements with the members of the Executive Board or employees in the event of a takeover offer.

During fiscal year 2006, the Executive Board provided the Supervisory Board with regular written and verbal reports on the business development of Merck KGaA and the Merck Group. In particular, the Supervisory Board was informed about the market and sales situation of the company against the background of the macroeconomic development, the financial position of the company and its subsidiaries, as well as their earnings development and corporate planning. The major business policy transactions were also discussed in five joint meetings with the Executive Board, specifically the takeover offer extended to the shareholders of Schering AG and the acquisition of Serono S.A. At its meeting on October 23, 2006, the Supervisory Board carried out an extensive examination of the efficiency of its activities: The results were positive. No Supervisory Board committees were set up.

The annual financial statements of Merck KGaA, the consolidated financial statements of the Merck Group and the management reports for Merck KGaA and the Merck Group, including the accounts, were audited by KPMG Deutsche Treuhand-Gesellschaft Aktiengesellschaft Wirtschaftsprüfungsgesellschaft. The auditors issued an unqualified audit certificate on the annual financial statements and management report for Merck KGaA in accordance with German Auditing Standards. For the consolidated financial statements prepared in accordance with International Financial Reporting Standards, the auditors issued the auditor's certificate, reproduced in the Annual Report of the Merck Group, in accordance with the International Standards on Auditing (ISA) as well as German Auditing Standards. In addition, the auditors audited the calculation of Merck KGaA's participation in the result of E. Merck OHG in accordance with Art. 27 (2) of the Articles of Association. The annual financial statements of Merck KGaA, the consolidated financial statements of the Merck Group, the management reports for Merck KGaA and the Merck Group, and the proposal by the Executive Board for the appropriation of net retained profits were presented and distributed to the Supervisory Board, together with the auditor's reports.

In accordance with Art. 14 (2) of the Articles of Association, the Supervisory Board also examined the annual financial statements of Merck KGaA, the management report for Merck KGaA, the proposal for the appropriation of net retained profits and the auditor's report presented in accordance with Art. 27 (2) of the Articles of Association. It also examined the consolidated financial statements of the Merck Group, the management report for the Merck Group, and took note of the auditor's report of KPMG Deutsche Treuhand-Gesellschaft Aktiengesellschaft Wirtschaftsprüfungsgesellschaft.

The discussion of the relevant agenda item at the Supervisory Board's meeting on February 27, 2007 to approve the financial statements was also attended by the auditors signing the audit opinion on the annual financial statements of Merck KGaA and the consolidated financial statements of the Merck Group, who reported on their audit. The Supervisory Board took note of and approved the results of the audit. On completion of its examination, the Supervisory Board found no objections and thus approves the annual financial statements and management report for Merck KGaA, the consolidated financial statements of the Merck Group and the management report of the Merck Group prepared by the Executive Board, as well as the report presented by the auditors in accordance with Art. 27 (2) of the Articles of Association. The Supervisory Board gives its consent to the proposal for the appropriation of net retained profits.

The Annual General Meeting of June 30, 2006 newly elected the members of the Supervisory Board representing the shareholders. Prior to this, the employee representatives had been elected in the procedure established for this purpose. Mr. Peter Zühlsdorff, who was a member of the Merck KGaA Supervisory Board since it was set up in 1995 and also served at times as its Chairman, did not stand for reelection. He therefore resigned from the Supervisory Board on conclusion of the Annual General Meeting. The general partner E. Merck OHG, the Supervisory Board and the Executive Board expressed their thanks to Mr. Zühlsdorff. They especially acknowledged Mr. Zühlsdorff's support of

the development of the company from a family-run general partnership into a listed Kommanditgesellschaft auf Aktien (partnership limited by shares). They additionally emphasized his extensive business experience, which he applied to serve the company. Dr. Karl-Ludwig Kley did also not stand for reelection. Since September 1, 2006, Dr. Kley is Vice Chairman of the Executive Board of Merck KGaA. The general partner E. Merck OHG, the Executive Board and the Supervisory Board thanked Dr. Kley for his excellent work as a Member of the Supervisory Board and wished him every success for the tasks that lie ahead. Professor Dr. Rolf Krebs and Professor Dr. Theo Siegert replaced Mr. Zühlsdorff and Dr. Kley.

Dr. Michael Kasper, who – as representative of the Senior Executives – also was a Member of the Supervisory Board since it was set up, likewise resigned on conclusion of the Annual General Meeting as he did not stand for reelection. E. Merck, the Supervisory Board and the Executive Board thanked him for his dedicated, professional and consistently fair cooperation as a member of this body. He was replaced by Dr. Daniele Bruns.

Darmstadt, February 27, 2007
The Supervisory Board of Merck KGaA

Prof. Dr. Wilhelm Simson
Chairman

Supervisory Board of Merck KGaA

Prof. Dr. Wilhelm Simson, Chairman
Flavio Battisti*, Vice Chairman | Jon Baumhauer | Klaus Brauer*
Dr. Daniele Bruns* (as of July 1, 2006) | Claudia Flauaus* | Michael Fletterich*
Dr. Michael Kasper* (until June 30, 2006) | Dr. Karl-Ludwig Kley (until June 30, 2006)
Prof. Dr. Dr. h.c. Rolf Krebs (as of July 1, 2006) | Albrecht Merck | Dr. Arend Oetker
Prof. Dr. Theo Siegert (as of July 1, 2006) | Osman Ulusoy*
Peter Zühlsdorff (until June 30, 2006)

*Employee representative

Consolidated Financial Statements of the Merck Group

Income Statement

Notes to the Income Statement: see page 100

€ million	Note	2006	2005*
Sales	[1]	**6,258.6**	**5,768.2**
Cost of sales	[2]	–2,413.7	–2,367.2
Gross margin		**3,844.9**	**3,401.0**
Marketing and selling expenses	[3]	–1,475.4	–1,367.8
Administration expenses	[4]	–386.7	–354.7
Other operating income and expenses	[5]	–150.6	–181.1
Research and development	[6]	–751.6	–713.0
Patent and license revenues	[7]	25.0	97.1
Investment result	[8]	–0.2	1.8
Operating result		**1,105.4**	**883.3**
Exceptional items	[9]	219.4	72.3
Earnings before interest and tax (EBIT)		**1,324.8**	**955.6**
Financial result	[10]	–51.3	–62.2
Profit before tax		**1,273.5**	**893.4**
Income tax	[11]	–272.2	–220.7
Profit after tax		**1,001.3**	**672.7**
Minority interest	[12]	–18.2	–13.8
Net profit after minority interest		**983.1**	**658.9**
Earnings per share (in €) basic	[13]	5.07	3.40**
Earnings per share (in €) diluted	[13]	5.07	3.40**

* The previous year's figures for sales, cost of sales as well as marketing and selling expenses have been adjusted (see page 92)

** The previous year's figures for earnings per share have been adjusted (see page 107)

Balance Sheet

Notes to the Balance Sheet: see page 108

€ million	Note	Dec. 31, 2006	Dec. 31, 2005
Current assets			
Cash and cash equivalents	[14]	460.1	1,321.7
Marketable securities and financial assets	[15]	133.1	154.2
Trade accounts receivable	[16]	1,252.9	1,161.3
Inventories	[17]	1,218.3	1,121.7
Other current assets	[18]	172.1	175.3
Tax receivables	[19]	77.5	97.4
		3,314.0	**4,031.6**
Non-current assets			
Intangible assets	[20]	1,063.5	986.4
Property, plant and equipment	[21]	1,779.8	1,858.0
Investments at equity	[22]	1.3	1.5
Non-current financial assets	[22]	1,640.4	69.6
Other non-current financial assets	[18]	34.4	65.6
Deferred tax assets	[11]	269.1	268.1
		4,788.5	**3,249.2**
Total assets		**8,102.5**	**7,280.8**
Current liabilities			
Current financial liabilities	[23]	498.4	291.3
Trade accounts payable	[24]	608.0	608.0
Other current liabilities	[25]	552.3	546.8
Tax liabilities	[26]	205.5	172.2
Current provisions	[27]	201.0	182.1
		2,065.2	**1,800.4**
Non-current liabilities			
Non-current financial liabilities	[23]	613.6	654.0
Other non-current liabilities	[25]	7.3	9.0
Non-current provisions	[27]	284.6	218.5
Provisions for pensions and other post-employment benefits	[28]	1,282.3	1,229.6
Deferred tax liabilities	[11]	42.1	40.2
		2,229.9	**2,151.3**
Net equity	[29]		
Equity capital		496.6	496.5
Reserves		3,256.7	2,780.2
Minority interests		54.1	52.4
		3,807.4	**3,329.1**
Total liabilities and stockholders' equity		**8,102.5**	**7,280.8**

Segment Reporting

Notes to the Segment Reporting: see page 129

	Ethicals		Generics		Consumer Health Care		Pharmaceuticals	
€ million	2006	2005	2006	2005	2006	2005	2006	2005
External sales	1,902.4	1,716.5*	1,818.5	1,701.1*	398.3	374.5*	4,119.2	3,792.1*
Gross margin	1,426.2	1,277.0*	915.7	805.6*	264.9	243.3*	2,606.8	2,325.9*
Operating result	162.9	166.7	306.8	237.6	54.5	50.0	524.2	454.3
Exceptional items	–21.9	–	–13.2	–	–	–	–35.1	–
Earnings before interest and tax (EBIT)	141.0	166.7	293.6	237.6	54.5	50.0	489.1	454.3
Net operating assets	2,841.5	1,138.7	1,042.3	997.9	276.0	280.3	4,159.8	2,416.8
Segment liabilities	272.3	271.2	332.1	364.1	55.0	53.4	659.4	688.7
Capital spending on property, plant and equipment	69.9	60.5	33.7	37.8	4.5	5.9	108.1	104.2
Investments in intangible assets	38.5	3.5	13.5	9.2	1.0	0.8	53.0	13.5
Free cash flow	–1,550.6	117.6	213.5	244.2	47.5	44.4	–1,289.6	406.1
Research and development	472.2	442.0	132.1	127.8	10.4	9.6	614.7	579.5
Impairment losses	12.9	1.8	–	2.7	0.3	0.2	13.2	4.7

	Germany		France		Rest of Europe	
€ million	2006	2005	2006	2005	2006	2005
External sales by customer location*	561.4	560.9	901.1	792.4	1,428.3	1,355.7
External sales by company*	871.1	859.5	1,010.5	905.4	1,220.4	1,155.4
Intragroup sales with other regions	1,310.9	1,048.8	108.7	97.6	138.5	143.3
Operating result	340.5	193.8	154.7	138.0	164.2	143.7
Exceptional items	335.9	28.1	–6.0	–	–17.6	115.9
Earnings before interest and tax (EBIT)	676.4	221.9	148.7	138.0	146.6	259.6
Net operating assets	3,294.5	1,518.3	558.6	524.8	958.4	935.6
Capital spending on property, plant and equipment	138.8	129.7	9.0	17.0	26.1	25.0
Investments in intangible assets	37.0	18.8	7.3	3.6	4.3	5.1
Research and development	380.8	378.6	138.7	129.9	61.2	58.6
Number of employees	9,874	9,463	2,703	2,754	4,590	4,479

* The previous year's figures have been adjusted (see page 92)

Liquid Crystals		Performance & Life Science Chemicals		Chemicals		Corporate and Other		Group	
2006	2005	2006	2005	2006	2005	2006	2005	2006	2005
892.4	739.1	1,213.3	1,161.2	2,105.7	1,900.3	33.7	75.8	6,258.6	5,768.2*
612.4	477.3	622.0	581.2	1,234.4	1,058.5	3.7	16.6	3,844.9	3,401.0*
486.1	346.0	155.4	146.1	641.5	492.1	–60.3	–63.1	1,105.4	883.3
–	–10.0	–34.5	–	–34.5	–10.0	289.0	82.3	219.4	72.3
486.1	336.0	120.9	146.1	607.0	482.1	228.7	19.2	1,324.8	955.6
897.2	802.4	1,073.4	1,110.2	1,970.6	1,912.6	34.0	55.7	6,164.4	4,385.2
96.2	80.5	178.0	177.9	274.2	258.4	5.9	45.0	939.5	992.1
72.8	92.6	68.8	66.7	141.6	159.3	3.5	4.1	253.2	267.6
0.6	16.9	2.9	1.4	3.5	18.3	0.1	0.1	56.6	31.9
376.5	165.6	144.1	191.8	520.6	357.4	–304.4	–106.5	–1,073.4	657.0
70.0	69.2	66.8	62.8	136.8	132.0	0.1	1.5	751.6	713.0
0.3	7.1	33.7	4.9	34.0	12.0	0.3	12.2	47.5	28.9

North America		Latin America		Asia		Rest of World		Group	
2006	2005	2006	2005	2006	2005	2006	2005	2006	2005
889.2	840.1	541.9	462.8	1,532.7	1,341.8	404.0	414.5	6,258.6	5,768.2
865.3	799.6	521.2	434.5	1,413.7	1,237.8	356.4	376.0	6,258.6	5,768.2
64.3	68.4	4.5	6.9	37.2	31.7	36.7	40.7	1,700.8	1,437.4
124.0	122.9	85.1	66.7	193.8	176.3	43.1	41.9	1,105.4	883.3
–92.9	–67.3	–	–	–	–4.6	–	0.2	219.4	72.3
31.1	55.6	85.1	66.7	193.8	171.7	43.1	42.1	1,324.8	955.6
443.9	470.2	212.8	235.4	562.0	561.4	134.2	139.5	6,164.4	4,385.2
23.9	20.7	11.2	12.7	35.6	54.3	8.6	8.3	253.2	267.6
0.5	0.9	1.6	0.3	5.5	2.5	0.4	0.7	56.6	31.9
127.6	108.8	5.3	4.3	26.0	24.0	12.0	8.8	751.6	713.0
2,703	2,745	3,767	3,504	5,029	4,804	1,333	1,384	29,999	29,133

Cash Flow Statement

Notes to the Cash Flow Statement: see page 130

€ million	Note	2006	2005
Profit after tax		**1,001.3**	**672.7**
Depreciation/amortization and impairment losses (non-current assets)		303.0	289.5
Changes in inventories		–139.5	–56.0
Changes in trade receivables		–152.5	–180.4
Changes in trade payables		17.4	90.6
Changes in provisions		132.4	–0.4
Changes in other assets and liabilities from operating activities		53.7	54.5
Gains/Losses on disposal of assets		–403.7	–135.0
Other non-cash income and expenses		–0.4	–3.0
Net cash flows from operating activities	[30]	**811.7**	**732.5**
Purchase of intangible assets		–56.6	–31.9
Purchase of property, plant and equipment		–253.2	–267.6
Acquisitions and investments in other financial assets		–1,651.1	–67.9
Disposal of assets		72.1	280.5
Changes in securities		3.7	11.4
Changes in other financial assets		423.4	–119.7
Net cash flows from investing activities	[31]	**–1,461.7**	**–195.2**
Dividend payments		–49.7	–57.8
Capital increase		2.4	23.7
Profit transferred to and reserve appropriation by E. Merck OHG		–229.4	–177.2
Changes in liabilities to E. Merck OHG		–146.1	199.5
Bonds issued		–	495.5
Changes in current and non-current financial liabilities		227.3	–41.2
Other changes from financing activities		–	–2.1
Net cash flows from financing activities	[32]	**–195.5**	**440.4**
Changes in cash and cash equivalents		**–845.5**	**977.7**
Changes in cash and cash equivalents due to currency translation		–16.1	18.0
Cash and cash equivalents as of January 1		1,321.7	326.0
Cash and cash equivalents as of December 31	[33]	**460.1**	**1,321.7**

Free Cash Flow

€ million	Note	2006	2005
Net cash flows from operating activities		**811.7**	**732.5**
Purchase of intangible assets		–56.6	–31.9
Purchase of property, plant and equipment		–253.2	–267.6
Acquisitions and investments in other financial assets		–1,651.1	–67.9
Disposal of assets		72.1	280.5
Changes in securities		3.7	11.4
Free cash flow	[34]	**–1,073.4**	**657.0**
Free cash flow before acquisitions and divestments		**576.6**	**478.9**

Presentation of Comprehensive Income

€ million	2006		2005	
Profit after tax		**1,001.3**		**672.7**
Gains/Losses recognized immediately in equity				
Unrealized gains/losses from the fair value measurement of financial instruments	–91.8		0.3	
Actuarial gains/losses from defined benefit pension commitments and similar obligations	–24.8		–113.6	
Deferred taxes on gains/losses recognized immediately in equity	7.9		25.4	
Currency translation difference	–128.6	–237.3	155.3	67.4
Comprehensive income		**764.0**		**740.1**
of which attributable to minority shareholders		18.2		13.8
of which attributable to shareholders of the Group		745.8		726.3

Statement of Changes in Net Equity including Minority Interest

	Equity capital		Reserves				
€ million	General partner's equity Merck KGaA	Subscribed capital Merck KGaA	Capital reserves (share premium) Merck KGaA	Retained earnings/Net retained profits/ Consolidated items	Gains/losses recognized immediately in equity	Minority interest	Total
Balance as of January 1, 2005	**363.2**	**131.5**	**1,801.9**	**878.9**	**–417.8**	**41.9**	**2,799.6**
Profit after tax	–	–	–	658.9	–	13.8	672.7
Dividend payments	–	–	–	–51.0	–	–6.8	–57.8
Profit transfers to/from E. Merck OHG including transfers to reserves	–	–	–	–177.2	–	–	–177.2
Capital increase due to the exercise of stock options	–	1.7	22.0	–	–	–	23.7
Other changes in equity	–	–	–	–	67.4	–	67.4
Changes in companies consolidated/Other	–	–	–	–2.8	–	3.5	0.7
Balance as of December 31, 2005	**363.2**	**133.2**	**1,823.9**	**1,306.8**	**–350.4**	**52.4**	**3,329.1**
Balance as of January 1, 2006	**363.2**	**133.2**	**1,823.9**	**1,306.8**	**–350.4**	**52.4**	**3,329.1**
Profit after tax	–	–	–	983.1	–	18.2	1,001.3
Dividend payments	–	–	–	–43.6	–	–6.1	–49.7
Profit transfers to/from E. Merck OHG including transfers to reserves	–	–	–	–229.4	–	–	–229.4
Capital increase due to the exercise of stock options	–	0.2	2.2	–	–	–	2.4
Other changes in equity	–	–	–	–	–237.3	–	–237.3
Changes in companies consolidated/Other	–	–	–	1.4	–	–10.4	–9.0
Balance as of December 31, 2006	**363.2**	**133.4**	**1,826.1**	**2,018.3**	**–587.7**	**54.1**	**3,807.4**

Notes

Preliminary remarks

The accompanying consolidated financial statements have been prepared with Merck KGaA – which manages the operations of the Merck Group – as parent company. The authoritative German version of these financial statements is filed with the electronic German Federal Gazette (elektronischer Bundesanzeiger) and can be accessed at www.unternehmensregister.de. In accordance with the provisions of the German financial reporting disclosure law (Publizitätsgesetz), consolidated financial statements are also prepared for E. Merck OHG, the general partner of Merck KGaA with an equity interest of 73.1% on December 31, 2006. The financial statements of E. Merck OHG include Merck KGaA and its subsidiaries and are also filed with the electronic German Federal Gazette.

Application of International Financial Reporting Standards (IFRS)

The consolidated financial statements of the Merck Group – with Merck KGaA as parent company – have been prepared in accordance with consistent accounting policies. The International Financial Reporting Standards (IFRS) that are in force on the balance sheet date and have been adopted for use in the European Union have been applied.

The following standards and amendments to standards took effect in 2006: IFRS 6 "Exploration for and Evaluation of Mineral Resources", the amendment to IAS 21 "The Effects of Changes in Foreign Exchange Rates – Net Investment in a Foreign Operation". Also applicable for the first time were: The amendment to IAS 39 "Financial Instruments: Recognition and Measurement for the Fair Value Option", the amendment to IAS 39 "Financial Instruments: Recognition and Measurement for Cash Flow Hedges of Forecast Intragroup Transactions", the amendments to IAS 39 "Financial Instruments: Recognition and Measurement" and IFRS 4 "Insurance Contracts" for financial guarantee contracts. The following also took effect in 2006: The amendment to IFRS 1 "First-time Adoption of International Financial Reporting Standards".

The following interpretations were also effective for the first time in 2006: IFRIC 4 "Determining Whether an Arrangement Contains a Lease", IFRIC 5 "Rights to Interests Arising from Decommissioning, Restoration and Environmental Rehabilitation Funds" and IFRIC 6 "Liabilities Arising from Participating in a Specific Market – Waste Electrical and Electronic Equipment".

Neither the new nor the amended rules had any material effects on the consolidated financial statements of the Merck Group. The amendment to IAS 19 "Employee Benefits" was applied in advance in fiscal 2005.

The following standards or amendments to standards and interpretations will not take effect until fiscal 2007: IFRS 7 "Financial Instruments: Disclosures", the amendment to IAS 1 "Presentation of Financial Statements – Capital Disclosures", IFRIC 7 "Applying the Restatement Approach under IAS 29 Financial Reporting in Hyperinflationary Economies", IFRIC 8 "Scope of IFRS 2" and IFRIC 9 "Reassessment of Embedded Derivatives". We do not expect the new or amended rules to have any material effects on the consolidated financial statements of the Merck Group. IFRS 7 "Financial Instruments: Disclosures" and the amendment to IAS 1 "Presentation of Financial Statements – Disclosures about Capital" will result in additional notes to the accounts as of fiscal 2007.

Furthermore, the following standards and interpretations have been issued by the International Accounting Standards Board (IASB) but not yet adopted by the EU: IFRS 8 "Operating Segments", IFRIC 10 "Interim Financial Reporting and Impairment", IFRIC 11 "IFRS 2: Group and Treasury Share Transactions" and IFRIC 12 "Service Concession

Agreements". We do not expect the new rules to have any material effects on the consolidated financial statements. IFRS 8 is likely to result in additional disclosures in the notes as of fiscal 2009.

Changes in the reporting structure

During 2006, the former Pigments and Life Science & Analytics divisions were combined to form the new Performance & Life Science Chemicals division. The aim of combining these two divisions is to capture new opportunities in existing markets and to maximize the efficiency of the Chemicals business sector worldwide. The previous year's figures are presented on a comparable basis.

With a view to the harmonization of accounting practices in the Merck Group, we changed the disclosure of certain customer rebates as of 2006. In this connection, costs previously reported mainly under marketing and selling expenses and to a small extent under cost of sales are deducted from sales. The previous year's figures are presented accordingly on a comparable basis. This change lowered sales reported in 2005 by € 102.1 million, with the Ethicals division accounting for € 6.1 million, the Generics division for € 94.9 million and the Consumer Health Care division accounting for € 1.1 million of the decline. Contrary to this effect, the Merck Group's cost of sales decreased by € 2.2 million and marketing and selling expenses fell by € 99.9 million.

Companies consolidated

Including the parent company Merck KGaA, Darmstadt, 176 companies are fully consolidated in the annual financial statements of the Merck Group. A further 2 associates are included using the equity method. 34 investments are not consolidated due to secondary importance and a further 21 investments are not consolidated due to the absence of control and are disclosed under non-current financial assets. In 2006, 10 companies were included in the consolidated financial statements for the first time and two companies were deconsolidated.

On January 6, 2006, Merck acquired a 100% shareholding in the Danish company Survac ApS of Copenhagen for € 10.8 million (incl. transaction costs of € 0.1 million). The company is strengthening our oncology research activities. The first-time consolidation took place on February 1, 2006.

On February 20, 2006, the transaction in the Generics division to acquire a 100% shareholding in the Spanish firm Prasfarma Oncológicos S.L., Barcelona from Almirall Prodesfarma SA was completed for € 20.0 million. The company was consolidated for the first time on February 1, 2006.

On March 24, 2006, Merck acquired a 100% shareholding in Agribiotics Holding Inc. of Cambridge (Ontario), Canada, for € 21.9 million (incl. transaction costs of € 1.0 million). The company, which has meanwhile been renamed EMD Crop BioScience Canada Inc., is part of the crop bioscience business of the Performance & Life Science Chemicals division and was consolidated for the first time on May 1, 2006.

On April 28, 2006, the outstanding 6.5% interest in the fully consolidated Japanese company Merck Hoei Ltd. was acquired for € 13.8 million (incl. transaction costs of € 0.6 million). The company, which is headquartered in Tokyo, has been renamed Merck Seiyaku Ltd.

On November 14 and December 22, 2006, the interest in the fully consolidated French company Société de Participation Pharmaceutique S.A.S., Lyon, was increased by 30.4% to 96.0% for a price of € 9.1 million.

Overall, the changes in the companies consolidated due to acquisitions had the following effects on the consolidated balance sheet:

	Acquisitions			Disposals/ Deconsoli-dations
€ million	Pre-acquisition book value	Adjustment	Fair value	Disposal at book value
Goodwill	0.0	14.9	14.9	–
Other intangible assets	1.0	56.1	57.1	–
Property, plant and equipment	3.3	–0.1	3.2	–
Other non-current assets	1.0	–0.5	0.5	–
Cash and cash equivalents	1.8	0.0	1.8	–
Other current assets	3.6	0.1	3.7	–
Current and non-current liabilities	0.9	13.9	14.8	–

Including acquisitions in 2006 as well as acquisitions that were only recorded on a pro rata basis in the previous year as well as intraperiod disposals, the impact on sales and the operating result in the fiscal year was as follows:

€ million	Acquisitions/ First-time consolidations	Disposals/ Deconsolidations
Sales	11.5	–47.8
Operating result	–4.1	–1.8

Consolidation methods

The consolidated financial statements are based on the single-entity financial statements of the consolidated companies as of December 31, 2006, which were prepared applying consistent accounting polices in accordance with IFRS and audited by independent auditors.

Acquisitions are accounted for using the purchase method in accordance with IFRS 3. Subsidiaries consolidated for the first time in the reporting period are measured at the carrying values at the time of acquisition on the basis of corresponding interim financial statements. Resulting differences are recognized as assets and liabilities to the extent that their fair values differ from the values actually carried in the financial statements. Any remaining difference is recognized as goodwill within intangible assets, which is subjected to a regular impairment test. To the extent that this measurement results in lower fair values, any impairment is recognized in income.

Intragroup sales, expenses and income, as well as all receivables and payables between the consolidated companies, were eliminated. The carrying value of assets from intragroup deliveries reported under non-current assets and inventories was adjusted by eliminating any intragroup profits.

Currency translation

In accordance with IAS 21 (The Effects of Changes in Foreign Exchange Rates), assets and liabilities are translated at the closing rate, and income and expenses are translated at weighted average annual rates to euros, the reporting currency. If Group companies are deconsolidated, existing currency differences are reversed and recognized in income.

The functional currency concept applies to the translation of financial statements of consolidated companies prepared in foreign currencies. The majority of the Merck Group companies conduct their operations independently. The functional currency of these companies is the respective local currency. Business transactions that are conducted in currencies other than the local currency are recorded using the current exchange rate on the date of the transaction. Foreign currency monetary items (cash and cash equivalents, receivables and payables) in the single-entity financial statements of the consolidated companies prepared in the local currency are translated at the respective closing rates. Exchange differences from the translation of monetary items are recognized in the income statement with the exception of cases of IAS 21.15, 21.15A and 21.33 (Net investment in a foreign operation). Hedged items are likewise carried at the closing rate in accordance with IAS 21. The resulting gains or losses are eliminated in the income statement against offsetting amounts from the fair value measurement of derivatives. Non-monetary items denominated in foreign currencies are carried at historical cost.

Goodwill in the context of foreign entities is translated at the closing rate. In accordance with the transitional provisions, goodwill arising prior to the date of first application of IFRS 3 (March 31, 2004) continues to be stated in euros, the reporting currency of the Group.

Accounting policies

The preparation of the consolidated financial statements in accordance with IFRS requires the use of estimates when reporting and measuring assets and liabilities. These are reviewed on an ongoing basis. Changes are prospectively recorded in the reporting period or in future periods. Assumptions and estimates are made in particular in connection with the measurement of goodwill and provisions. The material assumptions and parameters for the estimates made are disclosed in the Notes.

Recognition of sales revenue and other revenue

Sales are recognized net of rebates, discounts and related taxes. They are deemed realized once the goods are delivered, the services have been rendered or the material opportunities and risks of ownership have been transferred. In addition, payment must be sufficiently probable. Sales also include revenue from services, but the volume involved is insignificant. Interest revenue is recognized on a time-proportionate basis using the effective rate method. Compensation for use of assets by others and license royalties are recognized either immediately or on an accruals basis, depending on the substance of the relevant agreements. Dividend revenue is recognized when the shareholders' right to receive the dividend is established. This is normally the date of the dividend resolution.

Research and development

The breakdown of research and development by business sectors and regions is presented under "Segment Reporting". In addition to the costs of research departments and process development, this item also includes the cost of purchased services and the cost of clinical trials. The costs of research and development are expensed in full in the period in which they are incurred. Development expenses in the Pharmaceuticals business sector cannot be capitalized since the high level of risk up to the time that pharmaceutical products are marketed means that the requirements of IAS 38 are not satisfied in full. Costs incurred after regulatory approval are insignificant. In the same way, the risks involved until products are marketed means that development expenses in the Chemicals business sector cannot be capitalized. In addition to our own research and development, Merck is also a partner in collaborations aimed at developing marketable products. These collaborations typically involve payments for the achievements of certain milestones. With respect to this situation, an assessment is required as to whether these upfront or milestone payments represent ongoing research and development expense or whether the payments represent the acquisition of the right to capitalize the R&D expense. Reimbursements for R&D are offset against research and development costs.

Cash and cash equivalents

Cash and cash equivalents are carried at their principal amount and include cash and monetary deposits with a maturity of normally 90 days from the date of acquisition.

Receivables and other assets

Receivables and other assets are carried at amortized cost. Insofar as not covered by insurance, default risks are covered by write-downs. Non-interest-bearing or low-interest receivables are carried at their present value. Derivative financial assets are carried at fair value (see also "Financial Instruments").

Inventories

Inventories are carried at cost using the weighted average method. In accordancewith IAS 2, in addition to directly attributable unit costs, manufacturing costs also include overheads attributable to the production process, including an appropriate share of depreciation charges on production facilities, which are determined on the basis of normal capacity utilization of the production facilities. Financing costs are not included.

Inventories are written down if the net realizable value is lower than the acquisition or manufacturing cost carried in the balance sheet.

Intangible assets

Acquired intangible assets are capitalized at cost and are classified as assets with finite and indefinite useful lives. Intangible assets acquired within the scope of business combinations are capitalized at fair value on the date of acquisition. Assets with a finite useful life are depreciated using the straight-line method. The useful lives of acquired concessions, property rights, licenses, patents, brand names, trademarks and software are between 3 and 15 years. Depending on the type of asset concerned, depreciation is allocated to the corresponding operating expense line in the income statement. If there are any indications of a decline in value, an impairment test is performed, and if necessary, impairment losses are recognized. Assets with indefinite useful lives are not amortized, but tested annually for impairment instead. Goodwill is likewise not amortized. For goodwill incurred prior to March 31, 2004, the fair value as of December 31, 2004 is measured at cost. Goodwill is tested annually for impairment. Goodwill is allocated to cash-generating units. A cash-generating unit is normally a segment as presented under "Segment Reporting". In a few cases, the cash-generating unit is a company or a business field (reporting level within a segment). The recoverable amount of a cash-generating unit is determined by the higher of the two following values: Fair value less costs to sell or value in use, which is determined with the help of the discounted cash flow method. The discounted cash flow method discounts future cash flows based on both a medium-term business plan and a long-term growth rate forecast. The after-tax discount rate is 7.8% and orients towards the weighted average cost of capital (WACC). Necessary write-downs are determined by comparing the book value of the cash-generating unit with the recoverable amount.

Property, plant and equipment

Property, plant and equipment is carried at the cost of acquisition or manufacture less depreciation. The component approach is applied here in accordance with IAS 16. Subsequent acquisition and manufacturing costs are only capitalized if it is probable that future economic benefits will arise for the Group and the cost of the asset can be measured reliably. The cost of manufacture of self-constructed property, plant and equipment is calculated on the basis of the directly attributable unit costs and an appropriate share of overheads, including depreciation and write-downs. Financing costs are not capitalized.

In the case of acquisitions denominated in foreign currencies, subsequent exchange rate movements do not affect the carrying value at the original cost of acquisition or manufacture.

In accordance with IAS 20, costs of acquisition or manufacture are reduced by the amount of government grants in those cases where government grants or subsidies have been paid for the acquisition or manufacture of assets (investment grants). Grants related to expenses which no longer offset future expenses are recognized in income.

Property, plant and equipment is depreciated by the straight-line method over the useful life of the asset concerned. The useful life applied to production buildings is a maximum of 33 years. Administration buildings are depreciated over a maximum of 40 years. The useful lives of machinery and technical equipment is between 8 and 20 years, and between 4 and 10 years for other facilities, factory and office equipment. The useful lives are reviewed regularly and adjusted if necessary. Impairment losses are charged in accordance with IAS 36 where required, and these are subsequently reversed if the original grounds for the impairment no longer apply.

Financial investments in real estate

Assets of this category are of minor importance to the Merck Group and are carried at cost.

Leasing

Where assets are rented or leased and economic ownership lies with the Group company (finance lease), the asset is recorded at the lower of present value of the lease payments and fair value in accordance with IAS 17 and depreciated over its useful life. The corresponding payment obligations from future lease payments are recorded as liabilities.

Marketable securities, investments and other financial assets

Marketable securities and financial assets are recorded in the balance sheet in accordance with IAS 39. Marketable securities and non-current financial assets classified as "available-for-sale" are generally carried at fair value. Unrealized gains and losses arising from changes in the fair value are recognized in equity. If the fair value of a security or financial asset cannot be reliably determined, the asset is carried at cost less any applicable write-downs. Held-to-maturity securities are valued at acquisition cost. The investments in subsidiaries reported under "Other investments" that are not consolidated due to their secondary importance are likewise carried at cost.

Interests in companies over which Merck has significant influence but does not control are normally included using the equity method of accounting and are recognized at amounts corresponding to their net equity. Associates of secondary importance are recognized at cost.

Non-interest-bearing or low-interest loans are carried at their present value, otherwise at amortized cost.

All securities and financial assets are subject to an impairment test whenever there is an indication that the asset may be impaired. The resulting write-downs are charged to income. If the reasons for the impairment no longer exist, the impairment is reversed. The carrying amount of the asset is increased to no more than the amortized cost.

Deferred taxes

Deferred tax assets and liabilities result from temporary accounting differences in the IFRS and tax accounts of Group companies as well as from consolidation measures. In addition, deferred tax assets are recorded in particular for tax loss carryforwards if and insofar as their utilization is probable in the foreseeable future. In accordance with the liability method, the tax rates applicable or enacted as of balance sheet date are used.

Liabilities

Liabilities are generally carried at their repayment amount in accordance with IAS 39. Any differences arising between the amounts already paid and the amount payable at final maturity are amortized. Liabilities in foreign currencies are translated at the closing rates. Hedged items in foreign currency are likewise translated at the closing rates in accordance with IAS 21.

Provisions

In accordance with IAS 37, provisions are recognized in the balance sheet for legal or de facto obligations if the net cash outflow used to settle the obligation is probable and can be reliably estimated. The carrying value of provisions takes into account the amounts used to cover future payment obligations, recognizable risks and uncertain obligations of the Group. Non-current provisions are discounted and carried at their present value.

Provisions for pensions and other post-employment benefits are recorded in the balance sheet in accordance with IAS 19. Depending on the legal, economic and fiscal circumstances prevailing in each country, different retirement benefit systems are provided for the employees of the Merck Group. In principle, these systems are based on length of service and salary of the employees. Pension obligations of the Merck Group include both defined benefit and defined contribution plans and comprise both obligations from current pensions and accrued benefits for pensions payable in the future.

In the Merck Group, defined benefit plans are funded and unfunded. The bulk of obligations from current pensions and accrued benefits for pensions payable in the future is covered by the provisions recognized in the balance sheet, while the rest is externally funded. These provisions also contain other post-employment benefits, such as accrued future health care costs for pensioners (U.S.A.).

The obligations of our companies under defined benefit plans are measured using the projected unit credit method. Under the projected unit credit method, dynamic parameters are taken into account in calculating the expected benefit payments after an insured event occurs; these payments are spread over the entire period of service of the participating employees. Actuarial valuations are prepared annually for this purpose. Actuarial gains and losses resulting from changes in actuarial assumptions and experience adjustments (the effects of differences between the previous actuarial assumptions and what has actually occurred) are recognized immediately in equity when they are incurred.

Notes to the income statement

[1] Sales

In order to harmonize accounting practices within the Merck Group, as of 2006 certain customer rebates previously reported mainly under marketing and selling expenses and to a small extent under cost of sales are now deducted from sales. The previous year's figures are presented on a comparable basis. This led to the following adjustments of the figures reported in 2005: Sales decreased by € 102.1 million, cost of sales by € 2.2 million and marketing and selling expenses by € 99.9 million.

Sales totaled € 6,258.6 million in 2006. This corresponds to an increase of 8.5% over the previous year. Adjusted for the impact of currency and acquisitions, organic growth amounted to 9.4%. Sales are presented by business sector, division and region under "Segment Reporting".

[2] Cost of sales

The cost of sales includes the cost of manufactured products as well as goods purchased for resale. In accordance with IAS 2, the cost comprises overheads directly attributable to the production process, including depreciation charges on production facilities, in addition to directly attributable costs, such as the cost of materials, personnel and energy.

[3] Marketing and selling expenses

In addition to the cost of sales and marketing departments and of the sales force, marketing and selling expenses include advertising, logistics and license costs. Suspense items for oncharged freight expenses amounting to € 10.3 million have been deducted from marketing and selling expenses (previous year: € 9.7 million). In addition, the net amount from commission expenses amounting to € 18.7 million (previous year: € 17.8 million) and commission income amounting to € 25.9 million (previous year: € 21.3 million) are also included in this item.

[4] Administration expenses

Personnel costs and material expenses of management and administrative functions are disclosed under this item unless they have been charged to other cost centers as internal services.

[5] Other operating income and expenses

Other operating income and expenses can be broken down as follows:

€ million	2006	2005
Inventory adjustments	–78.5	–63.2
Exchange rate differences from operating activities	24.3	–2.8
Losses from disposals of assets/Impairment losses	–18.2	–11.8
Write-downs on receivables	–0.8	–7.5
Project costs	–39.4	–27.8
Premiums, fees and contributions	–36.4	–34.6
Non-allocated personnel expenses	–9.9	–22.3
Special environmental protection costs	–3.6	–3.3
Restructuring	–12.6	–6.0
Litigation	–16.2	–31.6
Other operating expenses	–88.5	–64.7
Gains from disposal of assets	27.2	10.8
Other operating income	102.0	83.7
	–150.6	**–181.1**

Other operating expenses also include expenses for services performed for third parties. Other operating income mainly includes income from the release of provisions, prior-period income as well as income from ancillary business and payments from third parties for services performed.

[6] Research and development

Reimbursements for R & D amounting to € 20.1 million (previous year: € 16.5 million) were offset against research and development costs.

[7] Patent and license revenues

In 2006, as in the previous year, this item mainly includes income from active pharmaceutical ingredients such as bisoprolol, metformin and isotretinoin. In 2005, Merck received an upfront payment of € 60.0 million from Takeda Pharmaceutical Company Ltd. to co-develop and co-market matuzumab, a humanized monoclonal antibody for cancer treatment. This item also includes income from an upfront, one-time payment of € 9.6 million for the outlicensing of an oral contraceptive from Merck to Organon NV.

[8] Investment result

€ million	2006	2005
Dividend income from associates	0.0	0.2
Other investment income/expenses	–0.2	1.6
	–0.2	**1.8**

[9] Exceptional items

Exceptional items comprise:

€ million	2006	2005
Gain on sale of the Schering shares	377.9	–
Litigation	–72.4	–56.3
Restructuring	–69.6	–10.0
Soil and groundwater remediation at the Darmstadt site	–16.5	–
Gain on the disposal of the Electronic Chemicals business	–	138.6
Exceptional items	**219.4**	**72.3**

Apart from the gain on the sale of the shares in Schering AG, the following individual items are disclosed here. The existing provision for litigation expenses in connection with the accusation of misleading price information at our U.S. subsidiary Dey was increased by € 79.6 million. In addition, existing provisions for legal risks in connection with accusations of anticompetitive practices at Generics UK were increased by € 4.4 million. The release of provisions set up for the vitamin cases generated income of € 11.6 million. Restructuring charges of € 21.9 million were recorded for the Ethicals division in France, the United States and Germany. Restructuring charges for the closure of the manufacturing facility at Generics UK amounted to € 13.2 million. Impairment losses of € 34.5 million were recorded in the Pigments business field (Performance & Life Science Chemicals division). Provisions of € 16.5 million were set up for soil and groundwater remediation at the Darmstadt site.

[10] Financial result

€ million	2006	2005
Interest income and similar income	55.9	31.4
Interest expenses and similar expenses	–55.5	–33.6
	0.4	**–2.2**
Interest component of the addition to pension provisions and other provisions for personnel expenses	–55.5	–55.1
Exchange rate differences from financing activities	–8.0	–4.9
Measurement of interest rate derivatives	0.2	0.0
Income from financial interests	11.6	0.0
	–51.3	**–62.2**

[11] Income tax

€ million	2006	2005
Taxes in the period under review on operating activities	–303.2	–253.6
Taxes in the period under review on exceptional items	–8.5	–11.5
Taxes for other periods	26.5	2.4
Deferred taxes on operating activities	–13.2	16.0
Deferred taxes on exceptional items	26.2	26.0
	–272.2	**–220.7**
Tax rate	21%	25%
Tax rate before exceptional items	28%	29%

The tax expense consists of corporation and trade income taxes for the companies domiciled in Germany as well as comparable income taxes for foreign companies. As a result of changes in tax rates at individual companies, a total deferred tax expense of € 0.4 million was recorded. Taxes for exceptional items relate mainly to taxes on the gain on the sale of the Schering shares as well as to taxes related to restructuring and litigation.

The reconciliation between deferred tax assets and liabilities shown in the balance sheet and deferred taxes in the income statement is presented below:

€ million	2006	2005
Change in deferred tax assets (balance sheet)	1.0	62.5
Change in deferred tax liabilities (balance sheet)	–1.9	4.4
Deferred taxes credited/debited to equity	–7.9	–25.4
Changes in companies consolidated/Currency translation	21.8	0.5
Deferred taxes (income statement)	**13.0**	**42.0**

As of the balance sheet date, tax loss carryforwards totaled € 137.3 million (previous year: € 90.4 million). Deferred tax assets are recognized for tax loss carryforwards only if realization of the related tax benefit is probable in the foreseeable future. The vast majority of these loss carryforwards have no expiry date or can be carried forward for up to 20 years. Deferred tax assets were not recognized for losses or loss carryforwards totaling € 118.4 million (previous year: € 78.4 million) since realization of the related tax benefits is not currently expected in the planning period. In 2006, the income tax burden was reduced by € 4.4 million due to the utilization of tax loss carryforwards and tax credits (previous year: € 2.4 million). Deferred tax assets relating to tax loss carryforwards totaled € 5.9 million (previous year: € 3.7 million). Deferred tax assets of € 263.2 million (previous year: € 264.4 million) were recognized for other temporary timing differences .

Deferred tax assets and liabilities correspond to the following balance sheet items:

	Dec. 31, 2006		Dec. 31, 2005	
€ million	Assets	Liabilities	Assets	Liabilities
Intangible assets	10.4	16.0	9.7	5.7
Property, plant and equipment	3.3	64.7	2.8	54.0
Current and non-current financial assets	–	0.6	–	0.6
Inventories	53.6	0.7	53.4	8.3
Current and non-current receivables/Other assets	10.1	4.0	10.5	4.5
Provisions for pensions and other post-employment benefits	120.8	9.4	111.4	5.6
Current and non-current other provisions	131.4	3.1	118.9	5.1
Current and non-current liabilities	3.3	0.3	5.0	0.2
Tax loss carryforwards	5.9	–	3.7	–
Other	–	13.0	2.9	6.4
Netted deferred tax assets and liabilities	–69.7	–69.7	–50.2	–50.2
Total deferred taxes	**269.1**	**42.1**	**268.1**	**40.2**

The following table contains a reconciliation of the tax expense based on the theoretical tax rate for the Merck Group which would result from applying the regular tax rates of the individual German and foreign companies to the effective tax expense before exceptional items and the effective tax expense recognized in the income statement.

€ million	2006	2005
Consolidated profit before tax	1,273.5	893.4
Exceptional items	219.4	72.3
Consolidated profit before tax and exceptional items	**1,054.1**	**821.1**
Theoretical tax rate	29%	30%
Theoretical tax expense before exceptional items	–306.9	–246.7
Tax effect of companies with a negative consolidated contribution	–7.6	–13.9
Taxes for other periods	26.5	2.4
Effect of non-deductible expenses and tax-free income/Other	–1.9	23.0
Tax expense before exceptional items	**–289.9**	**–235.2**
Tax rate before exceptional items	28%	29%
Taxes for exceptional items	17.7	14.5
Tax expense according to income statement	**–272.2**	**–220.7**
Tax rate according to income statement	21%	25%

[12] Minority interest

Minority interest in net profit is primarily composed of the minority interests in Merck Marker Ltd., Pakistan, Merck Ltd., Thailand, Merck Génériques SCS, France, as well as the listed companies Merck Ltd., India and Merck Indonesia Group.

[13] Earnings per share

Basic earnings per share are calculated by dividing the net profit after minority interest by the weighted average number of theoretical shares outstanding. The use of a theoretical number of shares takes into account the fact that the general partner's capital is not represented by shares. In accordance with the division of the share capital in the amount of € 133.4 million into 51,313,889 shares (before the capital increase) the general partner's capital amounts to 139,699,997 theoretical shares. Under IAS 33, the 67,750 shares issued through the Merck stock option program in 2006 may only be included in basic earnings per share on a time proportionate basis from the date of their conversion.

	2006	2005
Earnings after minority interest (€ million)	983.1	658.9
Weighted average number of theoretical shares outstanding (in millions)	191.0	190.8
Basic earnings per share before the capital increase (€)	**5.15**	**3.45**

Diluted earnings per share are calculated by dividing the net profit after minority interest by the weighted average number of theoretical shares outstanding, plus all potentially dilutive shares. Potentially dilutive shares in the Merck Group are stock options under the Merck stock option program, provided that their exercise requirements are met at the balance sheet date. In this case, for fiscal 2006 this relates to the stock options from tranche 2002; for fiscal 2005 this relates to stock options from both tranches of Merck's stock option program. The resulting dilutive effect is not material. The diluted earnings per share before the capital increase thus correspond to the basic earnings per share before the capital increase.

The Executive Board of Merck KGaA resolved and announced on January 21, 2007 with the consent of the Supervisory Board and of E. Merck OHG as the general partner holding an equity interest, to utilize the authorized capital to increase the share capital. Within the scope of this capital increase, 13,278,927 new shares were issued. In addition, the equity interest of the general partner E. Merck OHG increased by a nominal amount of € 34 million, corresponding to 13,067,816 new shares. According to IAS 33, the basic and diluted earnings per share are to be adjusted based on the new number of shares. The adjusted weighted average number of shares to calculate the dilutive effect amounted to 194,011,560 shares (previous year: 193,918,429 shares).

	2006	2005
Earnings after minority interest (€ million)	983.1	658.9
Adjusted weighted average number of theoretical shares outstanding (in millions)	194.0	193.8
Basic earnings per share (€)	**5.07**	**3.40**

Diluted earnings per share correspond to basic earnings share also after the adjustment of the number of shares due to the capital increase.

Notes to the balance sheet

[14] Cash and cash equivalents

The item comprises:

€ million	Dec. 31, 2006	Dec. 31, 2005
Cheques, cash and bank balances	264.2	228.1
Short-term cash investments	195.9	1,093.6
	460.1	**1,321.7**

Changes in cash and cash equivalents as defined by IAS 7 are presented in the cash flow statement. The decline in cash and cash equivalents is due largely to the purchase of shares in Serono S.A. up until December 31, 2006. Cash and cash equivalents include short-term receivables due from related parties and affiliates amounting to € 24.8 million (previous year: € 2.3 million).

[15] Marketable securities and financial assets

This item comprises the following categories:

€ million	Dec. 31, 2006	Dec. 31, 2005
Held-to-maturity assets	39.6	24.3
Available-for-sale assets	60.0	129.9
Loans to third parties	20.7	–
Derivative assets	12.8	–
	133.1	**154.2**

The following amounts in respect of marketable securities and other current financial assets were recognized in equity as of the balance sheet date:

€ million	Dec. 31, 2006	Dec. 31, 2005
Fair value	60.0	129.9
Amortized acquisition cost	–52.2	–113.9
Unrealized gains/losses	**7.8**	**16.0**

No reclassifications of assets were made across the individual categories during the fiscal year.

[16] Trade accounts receivable

This item comprises:

€ million	Dec. 31, 2006	Dec. 31, 2005
Receivables from associates	–	–
Receivables from other affiliates	–	0.1
Receivables from third parties	1,252.9	1,161.2
	1,252.9	**1,161.3**

Write-downs of trade accounts receivable totaled € 21.4 million on December 31, 2006 (previous year: € 34.8 million).

[17] Inventories

This item comprises:

€ million	Dec. 31, 2006	Dec. 31 2005
Raw materials and production supplies	258.9	237.9
Work in progress, finished goods and goods purchased for resale	958.9	883.1
Advance payments	0.5	0.7
	1,218.3	**1,121.7**

Write-downs of inventories amounted to € 139.3 million as of the balance sheet date (previous year: € 116.9 million). The fair value of inventories that have been written down amounts to € 274.9 million (previous year: € 268.4 million). As of the balance sheet date, no inventories were used to secure liabilities. There were no significant contracts to be accounted for in accordance with IAS 11 (Construction Contracts) as of the balance sheet date.

[18] Other assets

This item comprises:

Other current assets

€ million	Dec. 31, 2006		Dec. 31, 2005	
Other receivables				
from associates	–		–	
from other affiliates	1.3		1.5	
from third parties	70.8	72.1	78.0	79.5
Receivables from related parties		21.7		21.0
Derivative assets		8.7		14.7
Prepaid expenses		39.9		24.0
Deferred pension payments		20.8		18.1
Other assets		8.9		18.0
		172.1		**175.3**

Other non-current assets

€ million	Dec. 31, 2006		Dec. 31, 2005	
Other receivables				
from associates	–		–	
from other affiliates	–		–	
from third parties	2.7	2.7	36.3	36.3
Prepaid expenses		26.6		3.2
Other assets		5.1		26.1
		34.4		**65.6**

Other receivables and other assets include prepayments made, interest deferrals or refund claims in connection with non-income-related taxes as well as claims in connection with duties and import fees. In addition, receivables in the form of profits resulting from co-marketing agreements with other companies for various products are recorded in this item.

[19] Tax receivables

Tax receivables amounted to € 77.5 million (previous year: € 97.4 million) and results from tax refund claims for tax prepayments that exceed the actual amount of tax payable for the past and prior fiscal years, and from refund claims for prior years owing to tax audits as well as withholding tax credits.

[20] Intangible assets

€ million	Patents, licenses and similar rights, as well as brands, trademarks/Other – Finite useful life	Patents, licenses and similar rights, as well as brands, trademarks/Other – Indefinite useful life	Goodwill	Software	Advance payments	Total
Acquisition cost January 1, 2005	**242.5**	**–**	**1,347.7**	**82.0**	**5.9**	**1,678.1**
Adjustment for accumulated amortization of goodwill in accordance with IFRS 3	–	–	–507.6	–	–	–507.6
Currency translation	0.9	–	–0.7	3.0	0.1	3.3
Changes in companies consolidated	45.2	–	–0.5	–0.7	–0.2	43.8
Additions	19.7	–	0.3	5.2	6.7	31.9
Disposals	–11.0	–	–	–9.0	–0.8	–20.8
Transfers	–2.2	–	–	8.2	–4.3	1.7
December 31, 2005	**295.1**	**–**	**839.2**	**88.7**	**7.4**	**1,230.4**
Accumulated amortization and impairment losses January 1, 2005	**–163.0**	**–**	**–507.6**	**–58.5**	**–**	**–729.1**
Adjustment for accumulated amortization of goodwill in accordance with IFRS 3	–	–	507.6	–	–	507.6
Currency translation	–1.2	–	–	–2.4	–	–3.6
Changes in companies consolidated	0.1	–	–	0.6	–	0.7
Amortization and impairment losses	–25.9	–	–0.3	–12.6	–	–38.8
Disposals	10.7	–	–	9.0	–	19.7
Transfers	3.2	–	–	–3.7	–	–0.5
Write-ups	–	–	–	–	–	–
December 31, 2005	**–176.1**	**–**	**–0.3**	**–67.6**	**–**	**–244.0**
Net carrying amount as of December 31, 2005	**119.0**	**–**	**838.9**	**21.1**	**7.4**	**986.4**
Acquisition cost January 1, 2006	**295.1**	**–**	**839.2**	**88.7**	**7.4**	**1,230.4**
Currency translation	–1.1	–	0.7	–2.8	–	–3.2
Changes in companies consolidated	38.8	14.9	14.1	–	–	67.8
Additions	10.1	27.4	–	6.9	12.2	56.6
Disposals	–6.1	–	–	–11.7	–0.7	–18.5
Transfers	5.6	–	–	4.7	–9.5	0.8
December 31, 2006	**342.4**	**42.3**	**854.0**	**85.8**	**9.4**	**1,333.9**
Accumulated amortization and impairment losses January 1, 2006	**–176.1**	**–**	**–0.3**	**–67.6**	**–**	**–244.0**
Currency translation	1.1	–	–	2.1	–	3.2
Changes in companies consolidated	1.3	–	–	–	–	1.3
Amortization and impairment losses	–34.7	–	–0.1	–12.4	–	–47.2
Disposals	5.2	–	–	11.3	–	16.5
Transfers	1.0	–	–	–1.2	–	–0.2
Write-ups	–	–	–	–	–	–
December 31, 2006	**–202.2**	**–**	**–0.4**	**–67.8**	**–**	**–270.4**
Net carrying amount as of December 31, 2006	**140.2**	**42.3**	**853.6**	**18.0**	**9.4**	**1,063.5**

In 2006, the changes in the composition of the Group relate exclusively to company acquisitions. The major transactions were as follows: The acquisition of the minority interests in our subsidiary Merck Hoei Ltd. and simultaneously renaming of the company to Merck Seiyaku Ltd., led to goodwill of € 10.8 million. The acquisition of an additional interest in our subsidiary Société de Participation Pharmaceutique S.A.S. also generated goodwill (€ 2.8 million). Within the scope of the acquisitions of Prasfarma, Spain, and Agribiotics Holdings Inc., Canada, we purchased intangible assets with a total value of € 42.2 million and mainly consisting of patents, rights and licenses. Within the scope of the acquisition of Survac, Denmark, we acquired technology, rights and patents with a total value € 14.9 million. These intangible assets with infinite useful lives will not be amortized until the marked launch of the related products occurs.

Due to amended sales expectations, an impairment loss of € 11.7 million was taken on intangible assets (marketing rights in connection with Niaspan® marketing). A discount rate of 7.8 % was used to calculate the value in use. The resulting expense is disclosed under other operating expenses of the Ethicals division.

Since goodwill and intangible assets with indefinite useful lives are not amortized, these are subjected to an annual impairment test. In 2006, this did not lead to any material impairment losses.

Goodwill can be allocated to the divisions as follows:

€ million	Dec. 31, 2006	Dec. 31, 2005
Ethicals	255.4	255.8
Generics	357.4	343.6
Consumer Health Care	148.0	147.9
Performance & Life Science Chemicals	88.7	87.5
Liquid Crystals	4.1	4.1
Total	**853.6**	**838.9**

[21] Property, plant and equipment

€ million	Land, land rights and buildings, including buildings on third-party land	Plant and machinery	Other facilities, operating and office equipment	Construction in progress and advance payments to vendors and contractors	Total
Acquisition cost January 1, 2005	**1,205.5**	**1,998.0**	**657.8**	**109.6**	**3,970.9**
Currency translation	45.4	54.0	17.3	2.4	119.1
Changes in companies consolidated	–43.7	–43.8	–14.8	–1.9	–104.2
Additions	18.2	55.1	37.0	157.3	267.6
Disposals	–10.4	–77.2	–25.2	–1.4	–114.2
Transfers	20.3	50.7	13.8	–86.5	–1.7
December 31, 2005	**1,235.3**	**2,036.8**	**685.9**	**179.5**	**4,137.5**
Accumulated depreciation and impairment losses January 1, 2005	**–461.1**	**–1,200.9**	**–441.3**	**–11.3**	**–2,114.6**
Currency translation	–13.5	–34.9	–11.6	–0.2	–60.2
Changes in companies consolidated	7.7	24.9	10.9	–	43.5
Depreciation and impairment losses	–48.3	–140.1	–61.7	–	–250.1
Disposals	5.0	73.5	22.9	–	101.4
Transfers	–1.4	1.0	–0.3	1.2	0.5
Write-ups	–	–	–	–	–
December 31, 2005	**–511.6**	**–1,276.5**	**–481.1**	**–10.3**	**–2,279.5**
Net carrying amount as of December 31, 2005	**723.7**	**760.3**	**204.8**	**169.2**	**1,858.0**
Acquisition cost January 1, 2006	**1,235.3**	**2,036.8**	**685.9**	**179.5**	**4,137.5**
Currency translation	–33.2	–41.2	–12.5	–5.4	–92.3
Changes in companies consolidated	1.9	1.0	0.1	–	3.0
Additions	17.3	53.2	45.1	137.6	253.2
Disposals	–47.8	–92.4	–32.2	–2.6	–175.0
Transfers	43.0	85.4	32.5	–161.7	–0.8
December 31, 2006	**1,216.5**	**2,042.8**	**718.9**	**147.4**	**4,125.6**
Accumulated depreciation and impairment losses January 1, 2006	**–511.6**	**–1,276.5**	**–481.1**	**–10.3**	**–2,279.5**
Currency translation	9.9	29.0	8.9	–	47.8
Changes in companies consolidated	–	–	–	–	–
Depreciation and impairment losses	–43.2	–151.4	–59.0	–0.7	–254.3
Disposals	33.9	75.1	29.9	0.2	139.1
Transfers	–0.2	8.1	–7.7	–	0.2
Write-ups	0.6	0.3	–	–	0.9
December 31, 2006	**–510.6**	**–1,315.4**	**–509.0**	**–10.8**	**–2,345.8**
Net carrying amount as of December 31, 2006	**705.9**	**727.4**	**209.9**	**136.6**	**1,779.8**

In 2006, impairment losses of € 34.3 million were recognized on property, plant and equipment. The major transactions were as follows: Impairment losses of € 29.6 million were recognized in connection with the strategic realignment of the Pigments business. The impairment is based on the calculation of values in use and net realizable values. A discount rate of 7.8 % was used to calculate the value in use. The related expense is disclosed under exceptional items of the Performance & Life Science Chemicals division. The Performance & Life Science Chemicals division likewise includes write-downs resulting from amended sales forecasts at Merck in Brazil. The adjustment for the value in use amounting to € 1.6 million is disclosed under other operating expenses and is based on a discount factor of 10.8 %.

Changes in companies consolidated exclusively comprise additions resulting from the acquisitions of Prasfarma, Spain, as well as Agribiotics Holdings Inc., Canada.

Property, plant and equipment amounting to € 8.5 million serve as collateral (previous year: € 9.0 million). Total government grants and subsidies during the fiscal year amounted to € 7.0 million (previous year: € 4.0 million).

Property, plant and equipment also includes assets that are rented or leased. The total value of capitalized leased assets amounts to € 1.3 million and the corresponding obligations amount to € 1.1 million (please see Note [23] "Financial liabilities").

Capitalized leased assets are as follows:

€ million	Dec. 31, 2006	Dec. 31, 2005
Capitalized leased land	0.3	2.2
Capitalized leased buildings	–	5.1
Capitalized leased facilities	0.5	0.9
Capitalized leased vehicles	–	0.1
Capitalized leased other property, plant and equipment	0.5	–
	1.3	**8.3**

[22] Non-current financial assets and investments at equity

	Investments in			Securities		Loans		
€ million	associates	companies classified as "available-for-sale"	other affiliates	classified as "available-for-sale"	classified as "held-to-maturity"		Total	Investments at equity
Acquisition cost January 1, 2005	**3.7**	**50.0**	**4.5**	**6.0**	**0.8**	**28.1**	**93.1**	**46.3**
Currency translation	–	–	–	–	–	0.2	0.2	0.6
Changes in companies consolidated	–	–	0.3	–	–	–	0.3	–44.3
Additions	–	2.2	43.7	0.1	10.0	3.7	59.7	0.3
Disposals	–3.7	–23.4	–30.9	–0.2	–0.3	–2.5	–61.0	–1.0
Transfers	–	–	–	–	–	–	–	–
December 31, 2005	**–**	**28.8**	**17.6**	**5.9**	**10.5**	**29.5**	**92.3**	**1.9**
Accumulated depreciation and impairment losses January 1, 2005	**–3.7**	**–5.6**	**–0.1**	**–4.3**	**–**	**–0.4**	**–14.1**	**–4.9**
Currency translation	–	–	–	–	–	–	–	–0.1
Changes in companies consolidated	–	–	–	–	–	–	–	4.6
Depreciation and impairment losses	–	–0.6	–	–	–	–	–0.6	–
Disposals	3.4	–10.8	–	–	–	–	–7.4	–
Fair value adjustments of long-term investments taken directly to equity	–	–0.9	–	–	–	–	–0.9	–
Write-ups	0.3	–	–	–	–	–	0.3	–
Transfers	–	–	–	–	–	–	–	–
December 31, 2005	**–**	**–17.9**	**–0.1**	**–4.3**	**–**	**–0.4**	**–22.7**	**–0.4**
Net carrying amount as December 31, 2005	**–**	**10.9**	**17.5**	**1.6**	**10.5**	**29.1**	**69.6**	**1.5**
Acquisition cost January 1, 2006	**–**	**28.8**	**17.6**	**5.9**	**10.5**	**29.5**	**92.3**	**1.9**
Currency translation	–	–	–	–	–	–0.2	–0.2	–0.3
Changes in companies consolidated	–	–	–75.7	–	–	–	–75.7	–
Additions	–	1,578.7	82.5	–	3.2	4.1	1,668.5	0.1
Disposals	–	–1.3	–	–0.1	–13.3	–2.8	–17.5	–
Transfers	–	–	–	–	–	–	–	–
December 31, 2006	**–**	**1,606.2**	**24.4**	**5.8**	**0.4**	**30.6**	**1,667.4**	**1.7**
Accumulated depreciation and impairment losses January 1, 2006	**–**	**–17.9**	**–0.1**	**–4.3**	**–**	**–0.4**	**–22.7**	**–0.4**
Currency translation	–	–	–	–	–	–	–	–
Changes in companies consolidated	–	–	–	–	–	–	–	–
Depreciation and impairment losses	–	–1.5	–	–	–	–	–1.5	–
Disposals	–	0.6	–	0.1	–	–	0.7	–
Fair value adjustments of long-term investments taken directly to equity	–	–3.5	–	–	–	–	–3.5	–
Write-ups	–	–	–	–	–	–	–	–
Transfers	–	–	–	–	–	–	–	–
December 31, 2006	**–**	**–22.3**	**–0.1**	**–4.2**	**–**	**–0.4**	**–27.0**	**–0.4**
Net carrying amount as of December 31, 2006	**–**	**1,583.9**	**24.3**	**1.6**	**0.4**	**30.2**	**1,640.4**	**1.3**

Additions to “available-for-sale” investments result mainly from the acquisition of shares in Serono S.A., Switzerland, (€ 1,575.4 million). As of December 31, 2006, non-current financial investments classified as available for sale with a book value of € 2.1 million were carried at cost since a fair value could not be determined.

No non-current financial assets were reclassified between the individual categories of financial instruments during the fiscal year. The following amounts arising from non-current financial assets classified as “available-for-sale” were recognized in equity as of the balance sheet date:

€ million	Available-for-sale investments	Available-for-sale securities	Total Dec. 31, 2006	Available-for-sale investments	Available-for-sale securities	Total Dec. 31, 2005
Fair values/ Book values	1,583.9	1.6	1,585.5	10.9	1.6	12.4
Amortized acquisition cost	–1,585.2	–1.6	–1,586.8	–8.7	–1.6	–10.2
Unrealized gains/losses	–1.3	–	–1.3	2.2	–	2.2

A statement of the Merck Group's equity interests is filed with the Commercial Register of the Darmstadt Local Court under the number HRB 6164. Major companies of the Merck Group as of December 31, 2006 are presented in the following table:

Major companies of the Merck Group by region	Direct equity interest in %	Sales[1] € million	Profit after tax[1] € million	Net equity[1] € million	Employees
Germany/Europe					
Merck KGaA, Darmstadt, Germany	Parent company	1,900.0	128.8	3,372.9	8,625
Merck Santé S.A.S., Lyon, France	100.00	372.3	57.1	435.0	1,189
Merck Lipha Santé S.A.S., Lyon, France	100.00	347.0	21.6	65.9	446
Merck Génériques S.A.S., Lyon, France	100.00	338.3	45.2	71.5	329
Merck Pharma GmbH, Darmstadt, Germany	100.00	205.2	12.6	25.0	399
Merck Farma y Quimica S.A., Mollet del Vallès, Spain	100.00	195.8	23.7	80.8	773
McDermott Laboratories Ltd. (Gerard), Dublin, Ireland	100.00	118.5	2.7	31.4	355
Generics (UK) Ltd., Potters Bar, United Kingdom	100.00	115.6	–36.3	37.3	400
Laboratoire Théramex S.A.M., Monaco	99.90	100.4	10.1	48.2	392
Seven Seas Group, Hull, United Kingdom	100.00	98.8	7.3	18.3	385
Merck CHC France Group, Lyon, France	100.00	97.0	8.1	35.8	210
Merck N.V.-S.A., Overijse, Belgium	100.00	78.6	6.9	13.6	190
Merck UK, West Drayton, United Kingdom	100.00	68.8	3.0	–1.2	235
Merck Austria Group, Vienna, Austria	100.00	58.0	6.0	10.9	99
Merck dura GmbH, Darmstadt, Germany	100.00	57.7	–2.8	–0.1	167
Merck Chimie S.A.S., Fontenay s/Bois, France	100.00	51.1	4.2	40.5	61
Merck & Cie KG, Altdorf, Switzerland	98.87	50.0	28.9	116.9	90
Merck AG, Zug, Switzerland and Darmstadt, Germany	100.00	0.0	91.0	1,217.7	0
North America					
Dey, Inc., Napa, CA United States	100.00	477.9	82.8	68.5	871
EMD Chemicals, Inc., Hawthorne, NY United States	100.00	222.9	4.5	248.2	699
Genpharm, Inc., Etobicoke, Canada	100.00	158.3	4.2	55.7	593
EMD Biosciences, Inc., San Diego, CA United States	100.00	53.4	27.8	54.2	256
EMD Pharmaceuticals, Inc., Durham, NC United States	100.00	0.0	–46.5	0.4	95
Latin America					
Merck, S.A. de C.V., Mexico City, Mexico	100.00	172.3	28.7	71.5	933
Merck S.A., Rio de Janeiro, Brazil	100.00	145.1	8.2	49.7	1,047
Merck S.A., Bogota, Colombia	100.00	44.1	2.8	23.9	495
Asia, Africa, Australasia					
Merck Ltd., Tokyo, Japan	100.00	516.4	45.7	98.5	475
Korean companies, South Korea	100.00	369.6	37.4	88.4	266
Alphapharm Pty. Ltd., Sydney, Australia	100.00	288.6	23.3	81.5	691
Merck Seiyaku Ltd., Tokyo, Japan	100.00	113.0	7.8	40.3	330
Merck Ltd., Mumbai, India	51.00	58.0	23.0	74.2	860
Merck Indonesia Group, Jakarta, Indonesia	73.99	42.2	7.6	19.9	644
Merck South Africa Group, Modderfontein, South Africa	100.00	40.6	3.4	13.8	219
Pacific Pharmaceuticals Ltd., Auckland, New Zealand	100.00	39.8	1.4	10.2	198
Merck Marker (Pvt.) Ltd., Karachi, Pakistan	75.00	38.1	6.5	18.4	783

[1] Figures for the entire company unconsolidated, irrespective of the equity interest

[23] Financial liabilities

This item comprises:

Current financial liabilities

€ million	Dec. 31, 2006	Dec. 31, 2005
Bank loans and overdrafts	51.6	59.8
Commercial paper obligations	293.6	5.8
Liabilities from finance lease obligations	0.5	0.6
Loans from third parties	36.1	16.8
Liabilities to related parties	–	196.1
Liabilities from derivatives	107.3	–
Other financial liabilities	9.3	12.2
	498.4	**291.3**

Non-current financial liabilities

€ million	Dec. 31, 2006	Dec. 31, 2005
Bonds	477.5	495.5
Bank loans and overdrafts	74.4	74.1
Liabilities from finance lease obligations	0.6	0.5
Loans from third parties	61.0	83.9
Liabilities to related parties	–	–
Other financial liabilities	0.1	–
	613.6	**654.0**

Bank financing commitments to the Merck Group are comprised as follows:

€ million	Financing commitments from banks	Utilization as of Dec. 31, 2006	Interest	Due
Syndicated loan 2006	11,500.0	–	variable	2011
Bilateral credit facilities with banks	100.0	–	variable	2010
Bilateral credit facilities with banks	4.8	4.8	fixed/variable	2009
Bilateral credit facilities with banks	70.0	69.6	fixed/variable	2008
Various credit facilities	417.7	51.6	fixed/variable	< 1 year
	12,592.6	**126.0**		

To finance the acquisition of Serono S.A., Merck KGaA concluded an € 11.5 billion syndicated multi-currency term loan and revolving credit facilities agreement in which a total of 49 banks participated. The loan consists of the following four facilities: Tranche A for € 2.5 billion with a maturity of one year, tranche B for € 3 billion with a maturity of three years, tranche C for € 4 billion with a maturity of five years as well as a revolving credit line of € 2 billion to be used for business purposes with a maturity of five years.

The current and non-current liabilities of the Merck Group to banks are denominated in the following currencies:

	Dec. 31, 2006	Dec. 31, 2005
Euros	78.3%	68.0%
U.S. dollars	0.4%	0.3%
Pounds sterling	0.0%	1.6%
Swiss francs	0.2%	0.0%
Yen	1.0%	5.2%
Other currencies	20.1%	24.9%
	100.0%	**100.0%**

In 2005, Merck KGaA launched its first euro Benchmark Bond in the European debt capital market via Merck Finanz AG, Luxembourg. The size of the issue was € 500 million with a maturity of seven years. The bond pays a coupon of 3.75% and was issued at a price of 99.716%. The interest expense of the bond has been made variable through interest rate swaps based on six-month EURIBOR. The carrying value reflects a disagio, transaction costs and a mark-to-market measurement.

In order to meet short-term capital requirements, Merck KGaA issued a commercial paper program with a volume of € 500 million, € 290.0 million of which had been utilized as of the balance sheet date with maturities of up to one month and interest rates between 3.6% and 3.8%. Merck companies in Taiwan issued commercial paper for an equivalent of € 3.6 million as of the balance sheet date.

Liabilities from finance lease obligations represent the discounted amount of future payments arising from finance leases. This item primarily relates to liabilities from finance leases for land, buildings and vehicles.

Information on liabilities due to related parties can be found in Note [44].

[24] Trade accounts payable

Trade accounts payable consist of the following:

€ million	Dec. 31, 2006	Dec. 31, 2005
Liabilities due to associates	–	–
Liabilities due to other affiliates	0.4	0.3
Liabilities due to third parties	607.6	607.7
	608.0	**608.0**

Trade accounts payable include accrued amounts of € 222.6 million (previous year: € 212.5 million) for outstanding invoices and accrued reductions in sales revenues.

[25] Other liabilities

This item comprises:

Other current liabilities

€ million	Dec. 31, 2006		Dec. 31, 2005	
Other liabilities				
to associates	–		–	
to other affiliates	1.6		1.8	
to third parties	66.2	67.8	99.7	101.5
Advance payments received from customers		6.3		7.1
Payroll liabilities		51.5		65.0
Liabilities to related parties		224.5		171.1
Liabilities from derivatives		1.1		11.3
Deferred income		1.9		2.7
Accruals for personnel expenses		198.8		187.5
Liabilities from profit distributions		0.4		0.6
		552.3		**546.8**

Other non-current liabilities

€ million	Dec. 31, 2006		Dec. 31, 2005	
Other liabilities				
to associates	–		–	
to other affiliates	–		–	
to third parties	2.5	2.5	4.5	4.5
Advance payments received from customers		–		–
Payroll liabilities		0.9		0.6
Deferred income		3.9		3.9
		7.3		**9.0**

Other liabilities due to other companies include liabilities in connection with non-income-related taxes as well as obligations in connection with duties and import fees. Liabilities due to insurance companies as well as contractually agreed payment obligations vis-à-vis other companies are also disclosed here.

The deviation in liabilities due to related parties results compared with 2005 is mainly the result of an increase in the profit transfers to E. Merck OHG.

[26] Tax liabilities

Tax liabilities amount to € 205.5 million (previous year: € 172.2 million). This item also includes provisions for tax liabilities amounting to € 131.8 million (previous year: € 107.5 million).

[27] Provisions

Provisions developed as follows:

€ million	Restructuring	Personnel	Litigation	Other	Total
January 1, 2006	**33.3**	**121.2**	**122.1**	**124.0**	**400.6**
Exchange rate differences	–0.6	–2.1	–7.5	–3.1	–13.3
Utilizations	–30.7	–42.7	–28.9	–42.2	–144.5
Additions	43.7	53.3	88.5	81.9	267.4
Release	–0.6	–5.7	–5.8	–12.4	–24.5
Changes in companies consolidated/Other	1.1	2.8	0.2	–4.2	–0.1
December 31, 2006	**46.2**	**126.8**	**168.6**	**144.0**	**485.6**
thereof current	35.6	50.1	33.3	82.0	201.0
thereof non-current	10.6	76.7	135.3	62.0	284.6

Provisions for restructuring: This item mainly includes provisions for project-related severance payments for employees, contractually agreed severance obligations and contingent liabilities. The relevant provisions are recognized in accordance with IAS 37 when detailed restructuring plans have been prepared and communicated.

Provisions for personnel: Personnel provisions mainly include the expenses of obligations for the partial early retirement program, severance pay and anniversary bonuses.

Provisions for litigation: Provisions for litigation risks in connection with pending claims against our U.S. subsidiary Dey Inc. concerning the allegedly false reporting of pricing information amounted to € 124.4 million on the balance sheet date. A total of € 79.6 million was added to provisions for litigation in connection with this legal risk in 2006.

The remaining litigation provisions relate to risks from claims for damages and other ongoing litigation as well as legal fees incurred by various subsidiaries of the Merck Group.

Other provisions: This item includes provisions for uncertain commitments in the context of environmental protection measures as well as contributions, duties and fees.

[28] Provisions for pensions and other post-employment benefits

The calculation of obligations as well as the relevant plan assets is based on the following actuarial parameters:

	2006	2005
Discount rate	4.6%	4.6%
Future salary increases	3.2%	3.2%
Future pension increases	2.2%	2.2%
Staff turnover	2.1%	2.2%
Expected return on plan assets	6.0%	6.4%
Future increases in health care benefits	10.0%	12.0%

These are average values weighted by the present value of the respective benefit obligation. The average expected return on plan assets is weighted by the fair value of the respective plan assets. Plan assets for funded benefit obligations primarily comprise equities, fixed-income securities and real estate. They do not include financial instruments issued by Merck Group companies or real estate used by Group companies.

The balance sheet item "Provisions for pensions and other post-employment benefits" can be broken down as follows:

€ million	Dec. 31, 2006	Dec. 31, 2005
Present value of benefit obligations funded by provisions	1,206.0	1,147.3
Present value of funded benefit obligations	401.2	344.1
Present value of all benefit obligations	**1,607.2**	**1,491.4**
Fair value of plan assets of all funds	–346.2	–276.5
Funded status	**1,261.0**	**1,214.9**
Other changes	0.5	–3.4
Net liability recognized in the balance sheet	**1,261.5**	**1,211.5**
Deferred pension payments	20.8	18.1
Provisions for pensions and other post-employment benefits	**1,282.3**	**1,229.6**

In 2006, the following items were recognized in income:

€ million	2006	2005
Current service cost	47.5	40.7
Past service costs	0.5	0.6
Interest cost on pension obligations	67.9	65.1
Expected return on plan assets	–18.3	–15.3
Other effects	–3.5	–2.6
Total amount recognized in income	**94.1**	**88.5**

The actual return on plan assets amounted to € 31.7 million (previous year: € 32.0 million). Apart from the interest component stemming from provisions for financial obligations, which is disclosed in the financial result, the relevant expense of defined benefit and defined contribution plans is distributed across the individual functional areas.

During 2006, the present value of all defined obligations changed as follows:

€ million	2006	2005
Present value of all defined benefit obligations on January 1	1,491.4	1,301.3
Currency translation differences	–2.8	14.4
Current service cost	47.5	40.7
Interest cost on pension obligations	67.9	65.1
Other effects recognized in income	–3.1	–2.4
Actuarial gains/losses	37.7	130.7
Pension payments in the reporting period	–67.5	–58.9
Transfers/Changes in companies consolidated/Other changes	36.1	0.5
Present value of all defined benefit obligations on December 31	**1,607.2**	**1,491.4**

The fair value of the plan assets changed as follows in the reporting period:

€ million	2006	2005
Fair value of the plan assets on January 1	276.5	234.9
Currency translation differences	–0.7	7.2
Expected return on the plan assets	18.3	15.3
Other effects recognized in income	0.2	0.2
Actuarial gains/losses	12.9	16.1
Employer contributions	21.4	14.0
Employee contributions	2.1	0.5
Pension payments in the reporting period	–18.0	–12.7
Transfers/Changes in companies consolidated/Other changes	33.5	1.0
Fair value of the plan assets on December 31	**346.2**	**276.5**

In 2006, actuarial losses and the effects of limiting accrued pension payments in accordance with IAS 19.58 amounting to € 37.7 million (previous year: € 130.7 million) were taken to equity as well as actuarial gains of € 12.9 million (previous year: € 16.1 million).

As of December 31, cumulative actuarial gains and losses as well as the effects of limiting accrued pension payments in accordance with IAS 19.58 amounting to € 267.2 million (previous year: € 242.4 million) were taken to equity.

The fair value of the plan assets can be allocated to the individual asset categories as follows. Weighted average values are used here:

	Dec. 31, 2006	Dec. 31, 2005
Equity instruments	53.3 %	56.4 %
Debt instruments	37.4 %	35.7 %
Real estate	2.1 %	3.5 %
Other assets	7.2 %	4.5 %

On average, the expected rate of return on equity instruments is 7.9%, on debt instruments 4.0% and real estate 4.7%. The respective rates of return take into account country-specific conditions and are based, among other things, on interest and dividend income expected over the long term as well increases in the value of the investment portfolio after the deduction of directly allocable taxes and expenses.

Over the past five years, the funded status, composed of the present value of the defined benefit obligations and the fair value of the plan assets, has changed as follows:

€ million as of Dec. 31	2006	2005	2004	2003	2002
Present value of the defined benefit obligations	1,607.2	1,491.4	1,301.3	1,355.0	1,235.2
Fair value of the plan assets	–346.2	–276.5	–234.9	–308.8	–250.4
Funded status	1,261.0	1,214.9	1,066.4	1,046.2	984.8

It is expected that the payments to beneficiaries from unfunded pension plans will amount to around € 54 million in 2007 while payments to fund-financed pension plans will probably amount to around € 20 million in 2007.

The cost of ongoing contributions in 2006 for defined contribution plans that are financed exclusively by external funds and for which the companies of the Merck Group are only obliged to pay the contributions, amounted to € 13.2 million in 2006. In addition, employer contributions of € 42.3 million were transferred to the German statutory pension insurance system and of € 7.1 million to statutory pension insurance systems abroad.

[29] Net equity

The subscribed capital of Merck KGaA is composed of 51,313,889 no-par value shares with equivalent rights on December 31, 2006. Owing to the issue of new shares within the scope of the stock option program of Merck KGaA, the number of shares increased by 67,750 in the fiscal year. E. Merck OHG, the general partner of Merck KGaA, did not exercise its right to conduct a capital increase in the same proportion. The amount resulting from the issue of shares by Merck KGaA exceeding the nominal amount is recognized in the capital reserves. The reserves contain the retained earnings and the net retained profit of the consolidated subsidiaries as well as the effects of consolidation measures and income and expenses taken directly to equity. The currency translation difference includes the differences from currency translation by subsidiaries not recognized in income and the difference between the translation of expenses and income at weighted average annual rates/translation of the net retained profit at the closing rate. Currency translation differences decreased equity in 2006 by € 128.6 million (previous year: increased by € 155.3 million). Accordingly, as of December 31, 2006 currency translation differences in equity amounted to a loss of € 317.4 million.

The disclosure of minority interest is based on the stated equity of the subsidiaries concerned after any adjustment required to ensure compliance with the accounting policies of the Merck Group, as well as pro rata consolidation entries. The interests of other shareholders in net equity mainly relates to the minority interests in Merck Ltd. India, the Merck Indonesia Group and Merck Marker Ltd., Pakistan.

In addition to the dividend payments to the shareholders of Merck KGaA and to minority shareholders in subsidiary companies of the Merck Group, the appropriation of profits includes the transfer of profits from Merck & Cie KG to E. Merck OHG in accordance with the company agreements and the reciprocal transfer of profits between E. Merck OHG and Merck KGaA, also in accordance with the Articles of Association. In accordance with the capital ratios, E. Merck OHG has a 73.1% interest in the result of Merck KGaA while Merck KGaA has an interest of 26.9% in the result of E. Merck OHG. Merck KGaA's profit from ordinary activities less trade income tax, on which the appropriation of its profits is based, amounts to € 548.2 million. In 2006, Merck & Cie KG transferred € 28.3 million (previous year: € 29.9 million) and Merck KGaA transferred € 400.9 million (previous year: € 150.5 million) to E. Merck OHG. E. Merck OHG transferred € 203.8 million (previous year: € 3.2 million) to the net retained profit and retained earnings of Merck KGaA. In 2005, E. Merck OHG reported a loss of € 13.3 million, which was carried forward as provided for by the Articles of Association and was not used for the allocation of net profit/loss to Merck KGaA. Subsequent to an amendment to the Articles of Association, net losses are now also used for reciprocal profit/loss transfers. In 2006, E. Merck OHG reported a net loss of € 1.7 million. Added to the loss from 2005, a total loss of € 14.8 million results. This amount will be used for the distribution of profit/loss. Consequently, Merck KGaA will take over a loss of € 4.0 million.

For 2006, a dividend of € 0.90 per share plus a bonus of € 0.15 per share will be proposed. This corresponds to a total dividend payment of € 53.9 million to the limited liability shareholders.

The following table shows the development of changes taken directly to equity as a result of recognizing financial instruments at fair value in accordance with IAS 39.

€ million	Current and non-current financial assets classified as "available-for-sale"	Derivative financial instruments	Total
Balance as of January 1, 2006	**18.2**	**2.0**	**20.2**
Fair value adjustments	247.9	–70.0	177.9
Reclassification to income statement	–259.6	–10.1	–269.7
Subsequent measurement in fiscal year	**–11.7**	**–80.1**	**–91.8**
Deferred taxes recognized in equity	–0.5	0.1	–0.4
Currency translation difference	0.0	0.1	0.1
Balance as of December 31, 2006	**6.0**	**–77.9**	**–71.9**

As part of the stock option program for senior executives resolved by the Merck KGaA Annual General Meeting 2000, the creation of € 5,720,000 contingent capital for issuing stock rights was approved. As a result, a maximum of 2,200,000 stock options may be issued from the approved contingent capital. To date, 2,153,500 options have been granted in two tranches. Each option entitles the bearer to acquire one share of Merck KGaA, provided that the exercise requirements are met. The term of the program for both tranches is six years. Both tranches had a minimum vesting period of 25 months. Stock options may only be exercised after the minimum vesting period if the stock price on the day before exercise is at least 30% higher than the option exercise price. The exercise price is the mean value of Merck's shares in the Frankfurt XETRA trading system, commencing 30 days before the date of issue of the stock rights. In addition, the rights are subject to a lockup period that begins two calendar weeks before the date of publication of the Q1 and Q3 reports and eight calendar weeks before the date of publication of the H1 and Annual Reports. When granted, the first tranche included 766,500 options. As of October 2002, options from the first tranche may be exercised at the exercise price of € 37.41, provided that Merck's share price is not below € 48.63. When granted, the second tranche included 1,387,000 options. These stock options may be exercised as of May 2004, at an exercise price of € 34.35, provided that Merck's share price is not below € 44.66. Upon exercising the options, the shares carry dividend rights for the current and following fiscal years.

The development of all options on shares of Merck KGaA is presented in the following table:

	2006		2005	
	Tranche 1	Tranche 2	Tranche 1	Tranche 2
Outstanding options as of January 1	**29,300**	**96,310**	**351,900**	**436,970**
Options exercised during the period	16,750	51,000	322,600	340,660
Options forfeited during the period	12,550	5,000	–	–
Outstanding options as of December 31	**0**	**40,310**	**29,300**	**96,310**
thereof exercisable as of December 31	0	40,310	29,300	96,310
Recognized capital increase (in € million)	0.6	1.8	12.1	11.7

The weighted average price of Merck KGaA's shares in XETRA trading at the time of exercise of the stock options was € 83.67 in 2006.

Moreover, options that have not been exercised or converted into cash are neither recorded in the balance sheet nor recognized in income in these financial statements.

Notes to the segment reporting

The classification of asset and income figures as well as of other key figures by business sector or by region in accordance with IAS 14 is presented in "Segment Reporting". Segmentation was performed in accordance with the internal reporting of the Merck Group. The operating segments are described in detail in the business sector sections in the Annual Report.

With the sale of our Electronic Chemicals business in April 2005, the remaining contract manufacture business as well as the previous year's figures reported under this segment were reclassified to the segment "Corporate and Other".

Transfer prices for intragroup sales are determined on an arm's-length basis. There were no significant intercompany relations between the business segments. In the Segment Reporting, the United States and Canada are combined to form a single region "North America", as the two countries are managed as a single territory in the Merck Group's internal reporting.

Operating assets included in "Segment Reporting" were as follows:

€ million	Dec. 31, 2006	Dec. 31, 2005
Total assets of the Merck Group	8,102.5	7,280.8
Monetary assets (cash and cash equivalents, loans, securities)	–625.2	–1,516.9
Non-operating receivables from related companies and parties, tax receivables and deferred taxes as well as non-operating receivables	–373.4	–386.6
Trade accounts payable	–608.0	–608.0
Other operating liabilities	–331.5	–384.1
Net operating assets	**6,164.4**	**4,385.2**

Notes to the cash flow statement

[30] Net cash flows from operating activities

Tax payments in 2006 totaled € 215.5 million (previous year: € 238.9 million). Interest expense totaled € 29.4 million (previous year: € 20.5 million) and interest income totaled € 42.7 million (previous year: € 27.6 million).

[31] Net cash flows from investing activities

In 2006, the acquisition of Prasfarma, Spain, was completed. This involved a payment of € 9.3 million, which together with the € 8.9 million paid in the previous year results in a total net cash outflow of € 18.2 million. The acquisition of Survac ApS, Denmark, and the acquisition of the minority interests in Merck Seiyaku Ltd., Japan, involved payments of € 10.8 million and € 13.8 million, respectively. The acquisition of Agribiotics, Canada, involved a purchase price payment of € 21.9 million. An amount of € 9.1 million was spent to increase our interest in Société de Participation Pharmaceutique.

In the third and fourth quarters of 2006, 2,308,865 shares of Serono S.A., Switzerland, were purchased on the capital market for € 1,575.4 million.

€ million	Prasfarma	Merck Seiyaku Ltd.	Survac ApS	Agribiotics	Société de Part. Pharmaceutique	Serono S.A.
Purchase price	11.1	13.8	10.8	21.9	9.1	1,575.4
Cash and cash equivalents acquired	–1.8	–	–	–	–	–
Net cash outflows	**9.3**	**13.8**	**10.8**	**21.9**	**9.1**	**1,575.4**

The changes in other financial assets include the gains on the sale of the Schering shares amounting to € 441.2 million.

[32] Net cash flow from financing activities

Disclosed dividend payments and transfers of profits in accordance with the Articles of Association were broken down as follows in the fiscal year:

€ million	2006		2005	
Total dividend payments				
Dividends to shareholders	–43.6		–51.0	
Dividends to minority shareholders	–6.1	**–49.7**	–6.8	**–57.8**
Net profits transferred by Merck KGaA to E. Merck OHG				
Profit transfer in accordance with the Articles of Association from E. Merck OHG to Merck KGaA	–4.0		–	
Profit transfer in accordance with the Articles of Association from Merck KGaA to E. Merck OHG	–400.9		–150.5	
Appropriation by E. Merck OHG to reserves/ profit carried forward of Merck KGaA	203.8	**–201.1**	3.2	**–147.3**
Profit transfer from Merck & Cie KG to E. Merck OHG		**–28.3**		**–29.9**
Total dividend payments and profit transfers		**–279.1**		**–235.0**

This resulted in free cash flow for the year after dividends and profit transfers of € –1,352.5 million (previous year: € 422.0 million).

[33] Cash and cash equivalents

The composition of cash and cash equivalents is presented under “Notes to the Balance Sheet”.

[34] Free cash flow

Free cash flow is an indicator that we use internally to measure the contribution of our divisions to liquidity. Free cash flow includes all net cash flows from operating activities as well as investing activities performed in connection with operating business. We do not include in free cash flow pure financial investments and similar monetary deposits of more than three months, which are also to be reported as net cash flows from investing activities under IFRS.

Other disclosures

[35] Financial instruments

We use derivative financial instruments exclusively to hedge currency and interest rate positions, and thereby minimize currency risks and financing costs caused by exchange rate or interest rate fluctuations. The instruments used are marketable forward exchange and currency option contracts, interest rate swaps as well as interest/currency swaps. The strategy to hedge the transaction risk arising from currency fluctuations is set by a Group interest rate and currency committee, which meets on a regular basis. A review period of 12 months normally serves as the basis. Every hedge must relate to an underlying transaction that either already exists or is definitely expected to take place (ban on speculation). Currency risks from financial assets or loans denominated in foreign currencies are generally hedged. The use of such derivatives contracts is governed by internal regulations, and derivative transactions are subject to continuous risk management procedures. Trading, settlement and control functions are strictly separated, and this separation is monitored by our internal audit department. Derivatives contracts are only entered into with prime-rated banks and are restricted to the hedging of our business operations and related financing transactions.

The following derivative financial positions were held as of the balance sheet date:

	Nominal volume		Fair value	
€ million	Dec. 31, 2006	Dec. 31, 2005	Dec. 31, 2006	Dec. 31, 2005
Forward exchange contracts	8,410.4	1,501.1	–65.8	3.4
Interest rate swaps	500.0	521.6	–22.0	–1.8
Cross-currency swaps	–	51.1	–	–0.6
Currency options	16.0	–	0.9	–
	8,926.4	**2,073.8**	**–86.9**	**1.0**

The nominal volume is the aggregate of all buy and sell amounts relating to derivatives contracts. The fair values result from the valuation of open positions at market prices, ignoring any opposite movements in the value of the underlyings. They correspond to the income or expenses which would result if the derivatives contracts were closed out as of balance sheet date. The fair values are calculated on the basis of quoted prices or current market data provided by a recognized information service.

The fair values of the derivative financial instruments are reported in the balance sheet under other current receivables and other assets or under other liabilites. Gains and losses on the fair value of derivatives and underlyings are usually recognized directly in the income statement. If cash flows are being hedged and the requirements for hedge accounting in accordance with IAS 39.88 are met, the effective portions of the gains and losses from the fair value measurement of derivatives are recognized in equity until the underlying transaction occurs. These amounts are only reclassified from equity and carried to the income statement after accounting for the underlying transactions. Amounts reclassified to the income statement are either recognized in the operating result, or in the financial result if liabilities have been hedged.

The maturity structure of the hedging transactions (nominal volume) is as follows as of the balance sheet date:

€ million	Remaining maturity less than 1 year	Remaining maturity more than 1 year	Total Dec. 31, 2006	Remaining maturity less than 1 year	Remaining maturity more than 1 year	Total Dec. 31, 2005
Forward exchange contracts	8,410.4	–	8,410.4	1,501.1	–	1,501.1
Interest rate swaps	–	500.0	500.0	7.2	514.4	521.6
Cross-currency swaps	–	–	–	51.1	–	51.1
Currency options	16.0	–	16.0	–	–	–
	8,426.4	**500.0**	**8,926.4**	**1,559.4**	**514.4**	**2,073.8**

The forward exchange contracts that are entered into to reduce the exchange rate risk with a total nominal volume of € 8,410.4 million primarily serve to hedge the Serono S. A. purchase price. For this purpose, CHF hedge contracts amounting to € 7,085.0 million had been entered into as of December 31, 2006. In addition, to a large extent loans granted to companies of the Merck Group or those assumed on behalf of Group companies were also hedged. These primarily served to hedge fluctuations in the exchange rates of the USD (€ 577.9 million), the JPY (€ 352.2 million) and the CAD (€ 102.0 million) against the euro.

Forecast transactions are only hedged if the occurrence can be assumed to be highly probable. The nominal volume of hedged future transactions amounted to € 7,288.5 million as of the balance sheet date. The occurrence of hedged items is expected within the next 12 months. During the fiscal year, losses of € 70.0 million from the fair value measurement of derivatives were recognized in equity. € 10.1 million was transferred from equity to income. Apart from hedging the purchase price of Serono S.A. in CHF, this relates mainly to hedging of future sales in JPY and USD.

	Nominal volume		Fair value	
€ million	Dec. 31, 2006	Dec. 31, 2005	Dec. 31, 2006	Dec. 31, 2005
Hedging of future transactions	7,288.5	486.4	–76.4	3.4
Hedging of recognized transactions	1,121.9	1,014.7	10.6	–
Total forward exchange contracts	**8,410.4**	**1,501.1**	**–65.8**	**3.4**

The interest expense of the euro benchmark bond, which was issued in 2005 with a volume of € 500.0 million, was made variable through interests rate swaps from a fixed rate of 3.75% to six-month EURIBOR. Overall, the interest rate structure of the Merck Group's assets and liabilities is presented in the following table:

€ million	Fixed rate	Floating rate	Non-interest bearing	Total Dec. 31, 2006	Fixed rate	Floating rate	Non-interest bearing	Total Dec. 31, 2005
Loans granted	30.3	–	–	30.3	29.1	–	–	29.1
Cash and cash equivalents, marketable securities and financial assets	101.7	424.8	66.7	593.2	392.5	1,045.5	38.0	1,475.9
Other assets/Tax receivables	4.2	12.1	267.7	284.0	5.7	57.9	274.7	338.3
Financial liabilities	121.5	876.6	113.9	1,112.0	146.3	792.3	6.7	945.3
Other liabilities/Tax liabilities	1.5	4.1	759.5	765.1	7.0	23.3	697.7	728.0

The trade accounts receivable and payable not included in the table are for the most part non-interest-bearing.

A theoretical credit risk for the existing derivative instruments only applies to the amount of the positive fair values. As of the balance sheet date, these amount to € 21.5 million (previous year: € 14.7 million) and result from forward exchange contracts and currency options. As the underlying contracts are only concluded with prime-rated banks, we do not believe that these financial instruments involve any actual credit risk. For financial instruments originated by the company, the fair values correspond to the carrying values unless stated otherwise in the notes to the individual balance sheet items. Specific write-downs are charged to cover possible credit risks for financial instruments originated by the company. In addition, the broad-based business structure of the Merck Group means that there is no particular concentration of credit risks as regards either customers or specific countries.

[36] Contingent liabilities

€ million	Dec. 31, 2006	thereof subsidiaries	Dec. 31, 2005	thereof subsidiaries
Bills endorsed and in circulation	0.1	–	–	–
Guarantees	37.1	2.4	115.8	2.7
Warranties	0.1	–	5.2	–
Other contingent liabilities	16.6	–	18.4	–

Merck sold its interest in Bracco, Italy, in 2000. It was agreed that a portion of the purchase price would be paid in installments. These outstanding payments have been secured by way of a bank guarantee in favor of Merck. In 2002, Merck KGaA sold the residual claim from Bracco amounting to € 322.1 million to a bank. In this connection, Merck KGaA assumed a guarantee to secure the respective residual claim, which amounted to € 26.7 million (previous year: € 108.0 million) on December 31, 2006 and is presented under guarantees.

[37] Other financial obligations

Other financial obligations comprise the following:

€ million	Dec. 31, 2006	thereof subsidiaries	Dec. 31, 2005	thereof subsidiaries
Orders for capital expenditure on property, plant and equipment	25.2	–	39.6	–
Future rental payments	64.8	–	75.3	–
Future operating lease payments	48.3	–	48.5	–
Long-term purchase commitments	0.3	–	0.8	–
Other financial obligations	13.0	–	32.1	–
	151.6	–	**196.3**	–

Other financial obligations are carried at nominal value. Liabilities from lease agreements are composed as follows:

€ million	Remaining maturity less than 1 year	Remaining maturity 1 to 5 years	Remaining maturity more than 5 years	Total Dec. 31, 2006
Present value of future payments from finance leases	0.5	0.6	–	1.1
Interest component of finance leases	–	–	–	–
Future finance lease payments	0.5	0.6	–	**1.1**
Future operating lease payments	18.5	28.9	0.9	**48.3**

[38] Secured liabilities

On the balance sheet date, liabilities were secured as follows:

	secured by real property liens		secured by other liens	
€ million	Dec. 31, 2006	Dec. 31, 2005	Dec. 31, 2006	Dec. 31, 2005
Bank loans and overdrafts	–	4.7	–	–
Other liabilities	0.3	0.5	0.2	0.1
	0.3	**5.2**	**0.2**	**0.1**

[39] Personnel expenses/Headcount

Personnel expenses comprise the following:

€ million	2006	2005
Wages and salaries	1,382.4	1,284.3
Compulsory social security contributions and special financial assistance	219.2	208.8
Pension expenses	96.7	87.9
	1,698.3	**1,581.0**

As of December 31, 2006, the companies of the Merck Group had 29,999 employees (previous year: 29,133). The average number of employees during the year was 29,774 (previous year: 28,927).

[40] Material costs

Material costs amounted to € 1,633 million in 2006 (previous year: € 1,599 million).

[41] Auditors' fees

The costs of the auditors of the financial statements of the Merck Group (KPMG) can be broken down as follows:

	2006		2005	
Cost in € million for	Merck Group	thereof Germany	Merck-Group	thereof Germany
Audits of financial statements	3.9	0.8	3.8	0.7
Other audit-related services	0.3	0.1	0.6	0.3
Tax consultancy services	0.4	0.1	0.8	0.1
Other services	1.1	0.7	0.5	0.3
	5.7	**1.7**	**5.7**	**1.4**

[42] Corporate Governance

The Statement of Compliance in accordance with Section 161 of the German Stock Corporation Act (Aktiengesetz) was published in the Corporate Governance section of our Web site (www.corporategovernance.merck.de) in February 2006 and thus made permanently available.

As of December 31, 2006, the Members of the Executive Board and the Supervisory Board held 28,375 shares. Their total ownership represents less than 1% of the issued shares of Merck KGaA.

In accordance with Section 15a of the German Securities Trading Act (Wertpapierhandelsgesetz), reportable purchases and sales of non-par-value shares of Merck KGaA (ISIN: DE 000 659 990 5) by Board Members in 2006 can be inferred from the Corporate Governance Report.

[43] Companies opting for exemption under to Section 264 (4) of the German Commercial Code

The following companies, which have been consolidated in these financial statements, have exercised the option under Section 264 (4) of the German Commercial Code not to prepare notes and a management report:

Merck Pharma GmbH, Darmstadt
Merck dura GmbH, Darmstadt
Chemische Fabrik Lehrte Dr. Andreas Kossel GmbH, Lehrte
Merck Selbstmedikation GmbH, Darmstadt

[44] Related-party disclosures

Related parties in respect of the Merck Group are E. Merck OHG as well as the companies Emanuel Merck Vermögens KG and E. Merck Beteiligungen OHG. In principle, direct or indirect subsidiaries of Merck KGaA, associates and joint ventures of the Merck Group as well as pension funds that are classified as funded defined benefit plans in accordance with IAS 19, are also related parties within the meaning of IAS. Members of the Executive Board and the Supervisory Board of Merck KGaA, the Board of Management and the Board of Partners of E. Merck OHG as well as close members of their families are also related parties.

As of December 31, 2006, there were liabilities by Merck KGaA and Merck & Cie KG, Altdorf, to Merck OHG in the amount of € 224.5 million (previous year: € 367.2 million). In addition, Merck KGaA was owed receivables in the amount of € 37.6 million (previous year: € 11.6 million) by E. Merck OHG as of December 31, 2006. The balances result mainly from the profit transfers by Merck & Cie to E. Merck OHG, the reciprocal profit transfers between Merck KGaA and E. Merck OHG, as well as the extension of loans by Merck KGaA to E. Merck OHG as well as the extension of loans by E. Merck OHG to Merck KGaA. These financial receivables of € 22.6 million (previous year: payables of € 196.1 million) are subject to standard market interest rates. In 2006, Merck KGaA performed services for E. Merck OHG with a value of € 0.9 million (previous year: € 0.7 million). In exchange, E. Merck OHG performed services for Merck KGaA with a value of € 0.5 million (previous year: € 0.5 million). As of December 31, 2006, Merck KGaA had receivables from E. Merck Beteiligungen OHG in the amount of € 6.7 million (previous year: € 9.4 million). In 2006, Merck KGaA performed services for E. Merck Beteiligungen OHG with a value of € 0.5 million (previous year: € 0.4 million). In addition, Merck KGaA performed services for Emanuel Merck Vermögens KG with a value of € 0.1 million (previous year: € 0.1 million).

Business transactions with major subsidiaries have been eliminated during consolidation and are not disclosed further in the Notes. Information on pension funds that are classified as funded defined-benefit plans in accordance with IAS 19 can be found in Note [28]. There were no further material transactions with these pension funds.

During the fiscal year, companies of the Merck Group supplied goods with a value of € 4.3 million (previous year: € 4.3 million) to associates. There were no further material transactions with associates in 2006.

The remuneration of the Executive Board of Merck KGaA is paid by the general partner, E. Merck OHG, and recorded as an expense in its income statement. For 2006, fixed salaries of € 3.0 million (previous year: € 2.8 million) and variable compensation of € 10.5 million (previous year: € 8.7 million) were recorded for Members of the Executive Board of Merck KGaA. Variable compensation is based on the three-year rolling average of profit after tax of the E. Merck Group. Furthermore, additions to pension provisions of E. Merck OHG include current service costs of € 0.9 million (previous year: € 1.1 million) and past service costs of € 8.0 million (previous year: € 8.1 million) for members of the Executive Board of Merck KGaA.

Subject to the approval of the Annual General Meeting on the proposed distribution of a € 0.90 dividend per share plus a bonus of € 0.15 per share, the remuneration of the Supervisory Board amounting to € 350 thousand (previous year: € 293 thousand) consists of a fixed portion of € 95 thousand (previous year: € 95 thousand) and a variable portion of € 255 thousand (previous year: € 198 thousand).

Further material transactions, for example the provision of services or the extension of loans, between the companies of the Merck Group and members of the Executive Board and the Supervisory Board of Merck KGaA, the Board of Management and the Board of Partners of E. Merck OHG or close members of their families did not take place in 2006.

[45] Post-balance sheet events

Merck KGaA and its wholly-owned subsidiary, Merck Vierte Allgemeine Beteiligungsgesellschaft mbH, which acted as purchaser, and members of the Bertarelli family, as sellers, concluded a purchase agreement on September 21, 2006 pertaining to the acquisition of a majority shareholding in Serono S.A., Coinsins, Switzerland, (now known as "Merck Serono S.A."). The shares of the Bertarelli family were largely held by the holding company Bertarelli Biotech S.A. (now known as SeroMer Biotech S.A.). The shares of Bertarelli Biotech S.A. were part of the share purchase agreement. The share purchase agreement was closed on January 5, 2007. On the basis of the share purchase agreement Merck acquired the majority of shares and voting rights. Pursuant to Art. 32 of the Swiss Federal Law on Stock Exchange and Securities Trading (Bundesgesetz über den Börsen- und Effektenhandel, BEHG), on January 9, 2007 Merck submitted a public tender offer in Switzerland. The offer price amounts to CHF 1,100 per bearer share. In addition, more shares were purchased in the market. The acquisition of Serono is expected to strengthen the former Ethicals division. Together they form the new Merck Serono division within the Pharmaceuticals business sector.

All told, as of the expiration of the main public tender offer on February 5, 2007, Merck holds 97 % of Serono's capital and 98 % of the voting rights. This involved cash payments of € 9,857 million.

Assuming the acquisition of 100 % of the shares in Serono S.A., the purchase price will likely total € 10,266 million. In addition, the net assets of the holding company Bertarelli Biotech S.A. were acquired from the Bertarelli family for € 570 million. The holding company has liquid assets in the same amount, moreover it holds the majority of the acquired interest in Serono S.A. The allocation of the purchase price of the interest in Serono S.A. to the acquired assets and liabilities has not yet been completed.

The following allocation is therefore provisional and is still subject to change, the same holds true for the pre-acquisition book values:

€ million	Pre-acquisition book-values[1]	Adjustment	Fair value
Cash and cash equivalents, marketable securities, financial assets	1,496	–	1,496
Inventories	192	734	926
Other current assets	568	–	568
Goodwill	60	1,089	1,149
Other intangible assets	213	6,932	7,145
Property, plant and equipment	648	95	743
Other non-current assets	605	–	605
Current financial obligations	–595	–	–595
Other current liabilities	–576	–	–576
Non-current financial liabilities	–13	–	–13
Provisions for pensions and other post-employment benefits	-39	27	–12
Other non-current liabilities	–270	–900	–1,170
Net assets	**2,289**	**7,977**	**10,266**

[1] Most recently published financial statements dated September 30, 2006. In addition, cash inflows of around € 106 million are expected from the exercise of Serono S.A. stock options.

The goodwill remaining pursuant to this provisional allocation is also attributable to in-process research & development activities in early stages of development. The uncertainty associated with the early stage makes it impossible to reliably estimate future cash flows and thus to meet the prerequisites for capitalization.

To finance the acquisition of Serono, Merck KGaA concluded an € 11.5 billion syndicated multi-currency term loan and revolving credit facilities agreement with the lead banks Bear Stearns International Limited, Dresdner Bank AG and Société Générale S. A. on September 23, 2006. Various tranches of the loan agreement were drawn upon for the first time in January 2007. Subsequent to the partial repayment using the proceeds from the capital increase, around € 7.2 billion is still outstanding. Owing to the marked increase in outside financing, the financial result and the debt figures will change considerably in comparison with the previous year.

In addition, the Executive Board of Merck KGaA resolved on January 21, 2007 with the consent of the Supervisory Board and of E. Merck OHG as the general partner holding an equity interest, to utilize the authorized capital to increase the share capital of currently € 133,416,111.40 by € 34,525,210.20 to € 167,941,321.60. The capital increase is part of the refinancing of the acquisition of Serono S.A.

The transaction consisted of a rights offering to the limited liability shareholders and an allocation of rights to E. Merck OHG as the general partner holding an equity interest in Merck KGaA. The total of 13,278,927 new shares was subscribed for by the members of an underwriting syndicate at a subscription price of € 78.00 per share in accordance with market practice. The new shares have been included in the quotation of the shares of Merck KGaA on the Frankfurt Stock Exchange since February 7, 2007 and are entitled to full dividends for 2006.

E. Merck OHG has increased its equity interest by a nominal amount of approximately € 34 million (with a premium of approximately € 1,019 million).

Merck KGaA generated proceeds amounting to approximately € 2,055 million from the capital increase by issuing the 13,278,927 new shares and from the intended increase of the equity interest of the general partner holding an equity interest, E. Merck OHG. Subsequent to the capital increase, the equity interest of the limited shareholders will amount to around 30% and to around 70% for E. Merck OHG.

On January 5, 2007, the Executive Board of Merck KGaA announced that the divestiture of the Generics business (Generics division) is being evaluated as one strategic option.

The Executive Board of Merck KGaA
Darmstadt, February 19, 2007

Michael Römer

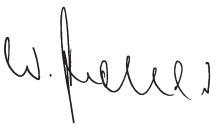
Karl-Ludwig Kley

Michael Becker

Bernd Reckmann

Elmar Schnee

Jan Sombroek



Walter W. Zywottek

Auditor's Report

"We have audited the consolidated financial statements prepared by Merck Kommanditgesellschaft auf Aktien, Darmstadt, comprising the balance sheet, the income statement, presentation of comprehensive income, the cash flow statement and the notes to the consolidated financial statements together with the group management report, for the Merck Group for the business year from January 1 to December 31, 2006. The preparation of the consolidated financial statements and the group management report in accordance with International Financial Reporting Standards (IFRS) as adopted by the EU, and the additional requirements of German commercial law pursuant to § 315a Abs. 1 HGB are the responsibility of the parent company's management. Our responsibility is to express an opinion on the consolidated financial statements and the group management report based on our audit.

We conducted our audit of the consolidated financial statements in accordance with § 317 of the German Commercial Code (HGB) and German generally accepted standards for the audit of financial statements promulgated by the Institut der Wirtschaftsprüfer (IDW) and in supplementary compliance with International Standards on Auditing (ISA). Those standards require that we plan and perform the audit such that misstatements materially affecting the presentation of the net assets, financial position and results of operations in the consolidated financial statements in accordance with the applicable financial reporting framework and in the group management report are detected with reasonable assurance. Knowledge of the business activities and the economic and legal environment of the Group and expectations as to possible misstatements are taken into account in the determination of audit procedures. The effectiveness of the accounting-related internal control system and the evidence supporting the disclosures in the consolidated financial statements and the group management report are examined primarily on a test basis within the framework of the audit. The audit includes assessing the annual financial statements of those entities included in consolidation, the determination of entities to be included in consolidation, the accounting and consolidation principles used and significant estimates made by management, 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 led to any reservations.

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

Mannheim, February 20, 2007

KPMG Deutsche Treuhand-Gesellschaft
Aktiengesellschaft
Wirtschaftsprüfungsgesellschaft

Walter
Wirtschaftsprüfer

Heublein
Wirtschaftsprüfer

Financial calendar for 2007

Annual press conference
Thursday, March 1

Interim Report 1st quarter
Wednesday, April 25

Annual General Meeting
Friday, April 27

Interim Report 2nd quarter
Wednesday, July 25

Autumn press conference
Interim Report 3rd quarter
Wednesday, October 24

More information

The Merck Annual Report for 2006 is available in German and English. Both reports are available as online versions on the Web at www.financialreports.merck.de. An abridged version is also available in German and English.

More information about Merck can be found on the Web at www.merck.de and in the following publications, which you may read or order (in German and English) online at www.publications.merck.de.

Responsibility for Employees, the Environment and the Community — 2005 Report

Merck transparent — (also available in French and Spanish)

"Was der Mensch thun kann ..." — History of Merck – The World's Oldest Pharmaceutical and Chemical Company

TopTopics Oncology — Merck Breaks New Ground in Cancer Therapy

TopTopics CardioMetabolic Care — Integrated Management of Cardiovascular and Metabolic Diseases

Chemistry with a Future — A Glimpse of Research at Merck

Top Topics Liquid Crystals — Merck Makes Bits and Bytes Visible

The History of the Future — 100 Years of Liquid Crystals at Merck

A Strong Site — A Global Player Rooted in Darmstadt

You can order these publications from Corporate Communications, Merck KGaA, 64271 Darmstadt, Germany, or via the following e-mail address: corpcom@merck.de.

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