Villeroy & Boch

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Annual Report 2006

The Group at a Glance

		2006	2005	2004	2003	2002
Sales	*Euro million*	964.2	893.2	959.9	948.6	977.5
EBITDA	*Euro million*	77.3	68.9	86.5	53.0	87.9
EBIT	*Euro million*	33.3	24.3	33.8	- 17.7	27.0
EBT	*Euro million*	23.1	16.1	23.6	- 30.8	13.6
Group results for the year	*Euro million*	17.1	13.2	16.7	- 25.4	10.3
NOPAT	*Euro million*	32.2	12.8	31.5	15.0	31.4
Balance sheet total[1)]	*Euro million*	789.4	787.1	785.1	842.7	880.3
Cash flow from operating activities	*Euro million*	22.7	56.9	63.1	52.3	71.0
Capital expenditure	*Euro million*	39.9	35.4	51.9	59.4	66.1
Depreciation	*Euro million*	44.0	44.6	52.7	70.6	60.9
Employees (annual average)	*Number*	10,211	9,521	9,633	10,812	11,010
Net operating margin	*Percent*	1.8	1.5	1.7	- 2.7	1.1
Equity ratio (incl. minority interests)[1)]	*Percent*	44.4	43.8	44.0	39.8	42.7
Return on equity (ROE)[1)]	*Percent*	4.9	3.8	4.8	- 7.6	2.7
Cash flow profitability	*Percent*	2.4	6.4	6.6	5.5	7.3
Net earnings per ordinary share	*Euro*	0.62	0.47	0.58	- 0.99	0.35
Net earnings per preference share	*Euro*	0.67	0.52	0.63	- 0.94	0.40
Dividend per ordinary share	*Euro*	0.37	0.32	0.37	0.25	0.50
Dividend per preference share	*Euro*	0.42	0.37	0.42	0.30	0.55

[1)] Prior-year values have been adjusted

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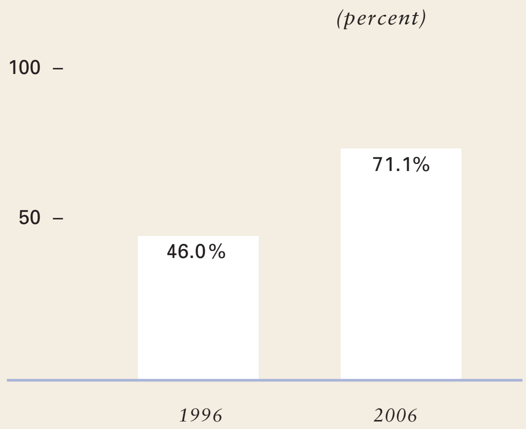
"Having restructured the Group in the last ten years, we now also aim to meet the challenges of globalisation in America and Asia using our strong brand, innovation, excellent design and good market presence."

Wendelin von Boch

EXPORT SALES TREND



An Interview with Wendelin von Boch

In the following interview Wendelin von Boch, Villeroy & Boch's Management Board Chairman, explains the process of setting a strategic course, and points out the Group's future prospects with regard to globalisation.

In the last Annual Report you commented on the strategic course set for the Group. Did you make further progress along this course in 2006?

Wendelin von Boch: Yes, probably the most important decision implemented during the 2006 business year was the sale of 51 % of V & B Fliesen GmbH to the Eczacibasi Group in March 2007. Following the problem of losses and sales decline in the tile sector, as well as selling off four tile factories, we lacked the critical assets to be able to assert ourselves in the increasingly fierce competition of the international tile sector. Together with the capacity available to Eczacibasi and this Group's low-cost production locations, a total of 40 million m^2 capacity can now be marketed globally with a good price to performance ratio. At the same time we also wanted to secure jobs at the two remaining production locations in Merzig and La Ferté Gaucher.

By doing this we have made quite considerable progress towards implementing the Group's new strategic direction. Our objective is to concentrate our attention on those Business Segments which have sufficient volume in global competition and from which a high return on net assets can be expected in the long term.

Concentration on Business Segments from which a high return on net assets can be expected in the long term.

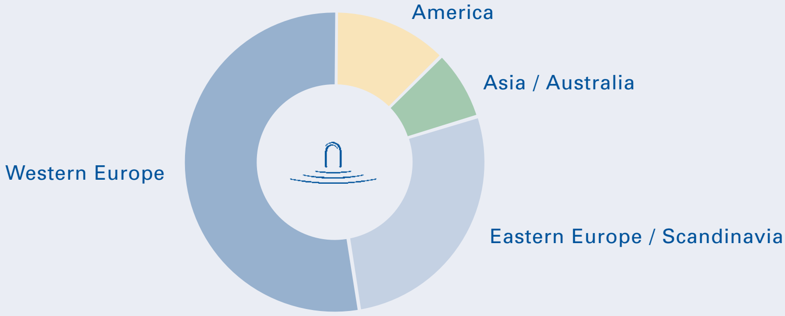
Will you continue the "House of Villeroy & Boch" full-range bathroom strategy – which is characteristic of the company as a European lifestyle supplier – after having sold the majority interest in Fliesen GmbH?

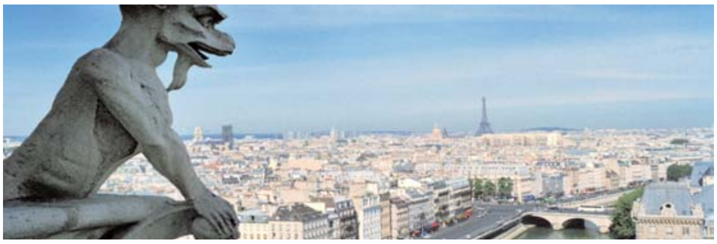
Wendelin von Boch: The "House of Villeroy & Boch" concept can't be realised without tiles. The tile is, and will remain, an integral element of this competitively superior concept. We have concluded a licensing agreement with our partners in which the criteria are determined for a joint market appearance and brand management. V & B Fliesen GmbH will remain an independent company with its registered office at the current location in Merzig. This also guarantees a close association in the marketing of full-range bathrooms. Furthermore, we shall remain interested in the success of the tile because we still hold a significant participating share there.

Shouldn't the decision to break with the tile commitment, or at least clearly reduce the risk there, have been made much earlier?

Wendelin von Boch: In the seventies, tiles still accounted for 70 % of Villeroy & Boch's total business. This percentage shrank to 62 % by 1980, to 41 % in 1990 and by 1997, *Villeroy & Boch's strategy of internationalisation is being consistently pursued. By acquiring the Mexican industrial group, "Grupo Industrial Saltillo" (GIS), the company has created an industrial platform on which its most profitable business segment – ceramic sanitary ware – can further develop this strategically important market, and also the growing markets in Central and South America. Further projects are in preparation which aim to expand global presence generally and in the area of sanitary-ware business in particular.*

FOREIGN SALES ACCORDING TO REGION





Share in %	Region	Euro million
79.8	***Europe***	*547.2*
53.0	*West*	*363.2*
26.8	*East / Scandinavia*	*184.0*
12.9	***America***	*88.6*
7.3	***Asia / Australia***	*49.7*
100.0	**Total share of foreign sales**	**685.5**

before I assumed responsibility as Management Board Chairman, tiles still accounted for 37 %. With its 2,850 employees at that time, tiles nevertheless remained the Division with the highest level of sales.

The Group's objective in the last ten years was to clearly develop and expand the profitable Divisions – namely Bathroom and Wellness, and Tableware – to reorganise the Tile Division and free us from the high dependency of this business sector. We were able to achieve these targets. The Tile Division sales share was reduced from 37 % (1997) to 15 % (2006). Compared to prior-year figures the result was reduced by Euro 10 million and thus almost reached break-even point. At the same time we successfully increased the share of total sales accounted for by the most profitable Division – Bathroom and Wellness – from 26 % to 51 %, and sales from Euro 191 million to Euro 491 million.

This restored our ability to act. Had we pulled out of tile business earlier, or radically reduced the share of our tile business, without first having successfully expanded the healthy and profitable Bathroom and Wellness Divisions, the independence and existence of our 259-year-old company would have been greatly endangered.

You have pushed ahead with Group restructuring, particularly in the face of globalisation, to prepare the company for the global market and tap new growth markets. Has this process been completed?

Wendelin von Boch: In recent years, and in particular in 2006, it was necessary to complete restructuring of the two Divisions – Bathroom and Wellness, and Tableware – and make us fit for the challenges of globalisation. This process, which in the Tableware Division alone cost Euro 10 million and led to a significant reduction in the number of employees, has been virtually completed, with the exception of the Wellness Business Segment.

Sights set on above-average growth in overseas business

Implementing globalisation, i.e. expanding our overseas presence, is at the very top of our agenda now. This can't be carried out overnight and has to be carefully prepared. Our success in the area of internationalisation can be clearly measured on the basis of our foreign-business share, which has risen from 46 % to 71 % in the last ten years. By the end of this decade we anticipate this share will total 80 %. Above-average growth should take place in the overseas-business sector.

The acquisition of three sanitary-ware factories in Mexico in 2006 enabled us to close a gap in the American market. We are also well positioned in Eastern Europe where we have a factory in the Czech Republic, one in Hungary and one in Romania. We are still lagging behind a little in Asia.

Above-average growth rates due to innovative lifestyle products.

At the General Meeting of Shareholders on June 1st 2007, shortly before your 65th birthday, you will retire from the Management Board of Villeroy & Boch AG, and then plan to change to the Supervisory Board. How will things proceed at Villeroy & Boch after this time?

Wendelin von Boch: At the end of March the Supervisory Board appointed Frank Göring CEO as my successor with effect from June 1st 2007, namely on the date of the General Meeting of Shareholders. As CEO he will be responsible for both the Bathroom and Wellness and Tableware Divisions. The operative management of both Divisions will be transferred to Executive Committees which will report directly to the CEO.

We are expecting this reorganisation to ease the workload of the Management Board, which will consequently be able to concentrate on strategic issues, in particular on globalisation. The operative business will be spread out, the Divisions bearing the responsibility for the result.

Frank Göring has the best possible qualifications to meet this responsibility and challenge. Following executive positions in the marketing departments at Procter and Gamble, Reemtsma and Hero, he joined Villeroy & Boch in 1997 as Marketing Director of the Bathroom and Kitchen Division. In January 2005 he was appointed member of the Management Board for the Bathroom and Wellness Division.

Management Board member Manfred Finger retains unchanged responsibility for the Finance and Personnel divisions, and also his position as Director of Human Resources.

We will set up a third organisation unit – Corporate Development – in the second half of the year to work together with the other organisational units with the aim of promoting the strategic development of the globalisation process.

What prospects do you see for the future?

Wendelin von Boch: Villeroy & Boch is in a much better position today than ten years ago. Seen in relation to the year 2007, profits have almost trebled. We expect all Divisions and Business Segments to be in the black in 2007 and to deliver a good return on net assets. We regard the tile problem as solved for the long term. Our industrial structure is competitive as it consists of a good mix of highly-automated production in the West, and the cost-effective production of labour-intensive products in low-wage countries.

Globalisation as an opportunity

We have to face the challenge of globalisation with our strong brand, our expertise in the area of innovation and our excellent design. Now that we have done most of our homework, we are able to conceive globalisation as an opportunity.

This presupposes that we also have local production facilities in major overseas markets and that we seize the chances to achieve growth.

Supervisory Board Annual Report

During the four rotational meetings held in the 2006 business year, the Supervisory Board dealt intensively with the company's economic and financial development, its major business transactions, its further strategic progress and its Business Segments, in particular the situation and prospects for tile business following the spin off to form a subsidiary, and also developments at the newly-acquired works in Mexico and the USA. In addition, numerous current topics of special interest were discussed. The Management Board provided the Supervisory Board Chairman with regular, prompt and detailed information, and constantly involved him in all major developments and matters awaiting decision.

CORPORATE STRATEGY AND PORTFOLIO POLICY

In January 2006, acquisition of the Mexican sanitary-ware production facilities of Vitromex, Mexico, including all shares in St. Thomas Creations, USA was approved. This acquisition further develops and strengthens company activities in the important US market.
In June 2006, the Supervisory Board also resolved acquisition of the ball-valve activities of Frese AS in Denmark. This purchase strengthens the Wellness and Fitting Business Segment's capacity in the area of technical equipment. The take-over of sales activities will result in positive effects in the important Scandinavian and Benelux markets.

CORPORATE GOVERNANCE

The Supervisory Board regularly deals with the application and further development of the company's Corporate Governance policies. In its December 2006 meeting, the Supervisory Board dealt with the modified version of the German Corporate Governance Code from June 12th 2006. In joint meetings with the Management Board, discussion took place on the subject of updating corporate policies, and a new declaration of conformity for the 2007 business year was adopted, which only differs in two points from the rules laid down in the German Corporate Governance Code. Corporate Governance is described in the Annual Report under a separate heading. The aforementioned differences are published on the Villeroy & Boch AG website under the heading "Investor Relations".

Peter Prinz Wittgenstein,
Supervisory Board Chairman

COMMITTEE MEETINGS

The Audit Committee convened twice in 2006. At its first meeting in March 2006, in the presence of the auditor, it dealt with the audit of the annual and consolidated financial statements of December 31st 2005, concentrating on their compliance with the statutory accounting requirements and internationally accepted accounting principles of the IFRS. Consultation also concentrated on awarding the audit assignment to the auditor, compliance with the Corporate Governance policies following the declaration of conformity, self-assessment of the Audit Committee's work, and organisation of the risk management system.

At its second meeting, in December 2006, the committee discussed not only the progress report from the Group's auditing department and the organisation of the risk management system, but also the criteria for self-assessment of the Audit Committee's work and the declaration of conformity for the 2007 business year.

The Staff Committee convened three times in the 2006 business year. In addition to approving the contract extension of one Management Board member, it dealt with agreements on operational targets and bonus payments to the Management Board.

During its only meeting, the Investment Committee concentrated on planning capital expenditure and operating result for 2007.

A meeting of the Conference Committee was not necessary in the 2006 business year.

APPROVAL OF ANNUAL AND CONSOLIDATED FINANCIAL STATEMENTS

KPMG has audited the Villeroy & Boch AG annual financial statements of December 31st 2006, and the 2006 Management Report, as well as the consolidated financial statements of Villeroy & Boch AG of December 31st 2006 and the consolidated management report, and issued an unqualified audit certificate. The consolidated financial statements were prepared in accordance with the International Financial Reporting Standards (IFRS). The documents named and the Management Board's proposal regarding the appropriation of retained earnings were distributed to the Supervisory Board in good time and examined by the Supervisory Board. At the Supervisory Board meeting in March 2007 the financial statements were discussed in detail in the presence of the auditor. Based on the conclusive result of the audits carried out by the Supervisory Board and Audit Committee, there are no grounds for objection. The financial statements prepared by the Management Board have been endorsed by the Supervisory Board and therefore approved.

CHANGES IN PERSONNEL

Having been a member of the Supervisory Board for six years, Ms Ina Rauls retired from her position of statutory employees' representative with effect from December 31st 2006. Mr Dietmar Langenfeld has been elected to take her place. The Supervisory Board would like to express its thanks to Ms Rauls for her many years of commitment and wish her every success for the future.

Mr Peter von der Lippe retired from his position of director on January 31st 2007. He will continue to act as Director of V & B Fliesen GmbH. The Supervisory Board would like to thank Mr Peter von der Lippe for his many years of successful work for the Management Board. Tile segment operations have been assigned to Mr Wendelin von Boch.

The Supervisory Board would furthermore like to express its thanks to all employees, statutory employees' representatives and the Management Board for the great personal commitment shown and services rendered in the 2006 business year.

Mettlach. April 2007

The Supervisory Board
Peter Prinz Wittgenstein
Chairman

Supervisory and Management Board Members

SUPERVISORY BOARD MEMBERS

KARL GUSTAF RATJEN, Königstein
Honorary member

PETER PRINZ WITTGENSTEIN, Nidda
Chairman
Management Consultant

JOSEF BALLE*, Merzig
1st Vice-Chairman
Chairman of the V & B Fliesen GmbH Works Council

LUITWIN GISBERT VON BOCH-GALHAU, Mettlach
2nd Vice-Chairman
Entrepreneur
b) Banque CIAL, Strasbourg/France (Member of the Administrative Board)
within the Group: Villeroy & Boch Magyarország Rt.,
Hódmezövásárhely/Hungary (Chairman)

HANNSGEORG EDINGER*, Bad Münder
Trade Union Secretary of the IG Bergbau, Chemie, Energie, Hanover
a) Schott AG, Mainz

DR. JÜRGEN FRIEDRICH KAMMER, Munich
Supervisory Board Chairman of Süd-Chemie AG, Munich (until 13.06.2006)
a) Lanxess AG, Leverkusen
b) Wittelsbacher Ausgleichsfonds, Munich
Augustinium gGmbH, Munich (from 16.11.2006)

CHARLES KROMBACH, Luxembourg
Director of the Landewyck Group S.à r.l., Luxembourg
Director of Heintz van Landewyck S.à r.l., Luxembourg

ULRICH KÜPPERS*, Ludwigshafen
Land District Head of the Industrial Union, Bergbau, Chemie, Energie, for the Länder Rhineland-Palatinate /Saarland, in Mainz
a) BASF AG, Ludwigshafen
STEAG Saarenergie AG, Saarbrücken (Deputy Chairman)
Technische Werke Ludwigshafen AG, Ludwigshafen (Deputy Chairman)
b) Klinikum Ludwigshafen, Ludwigshafen (Deputy Chairman)
Verkehrsbetriebe Ludwigshafen GmbH, Ludwigshafen
(Deputy Chairman) (until 31.12.2006)
Sotec GmbH, Saarbrücken (from 01.11.2006)

DIETMAR LANGENFELD*, Rehlingen-Siersburg (from 01.01.2007)
Chairman of the Villeroy & Boch AG Central Works Council
Chairman of the Mettlach Sanitary-Ware Factory Works Council

INA RAULS*, Merzig-Weiler (until 31.12.2006)
Deputy Chairwoman of the Mettlach Sanitary-Ware Factory Works Council

RALF RUNGE*, Merzig
Chairman of the Faiencerie and Cristallerie Works Council
b) Merziger Verwaltungsgesellschaft für
Wohnungswirtschaft mbH & Co. KG, Merzig
Merziger Verwaltungsgesellschaft für Wohnungswirtschaft mbH, Merzig

BERTHOLD SCHOLTES*, Merzig
Technical Director of V & B Fliesen GmbH

KILIAN VON DER TANN, Tann/Rhön
Lawyer

EMMANUEL VILLEROY DE GALHAU, Paris
Entrepreneur

MANAGEMENT BOARD MEMBERS

WENDELIN VON BOCH-GALHAU, Losheim-Britten
Chairman
Tableware Division and
Tile Division (from 01.02.2007)
a) Gerling-Konzern Allgemeine Versicherungs-AG, Cologne (until 22.06.2006)

MANFRED FINGER, Rehlingen
Finance and Personnel

FRANK GÖRING, Saarlouis
Bathroom and Wellness Division
a) within the Group:
Villeroy & Boch Magyarország Rt., Hódmezövásárhely/Hungary

PETER VON DER LIPPE, Petite-Rosselle/France (until 31.01.2007)
Tile Division

* Statutory employees' representative
a) membership in other supervisory boards to be legally formed in terms of § 125 AktG
b) membership of comparable domestic and foreign business enterprise control councils in terms of § 125 AktG

Villeroy & Boch
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PRINCIPLE OF

CORPORATE GOVERNANCE

Corporate Governance stands for sound and responsible corporate management and supervision aimed at long-term real net output. It essentially includes protection of shareholder interests, the system of the decision-making, management and supervision mechanisms, as well as transparency and openness in corporate communication.

Corporate Governance Report

From the Management and Supervisory Boards to the Villeroy & Boch Aktiengesellschaft Annual Report for the 2006 financial year.
Corporate Governance is rated highly at Villeroy & Boch Aktiengesellschaft. It forms the basis of efficient and responsible corporate management and is the foundation for the trust placed in us by our shareholders, customers, employees and the general public.
For this reason, Villeroy & Boch Aktiengesellschaft has welcomed the German Corporate Governance Codex presented by the government commission and most recently updated in June 2006 and has adopted the majority of the recommendations proposed.
In accordance with § 161 AktG (German Public Limited Company Law), on December 13th 2006 the Management and Supervisory Boards made their annual declaration of conformity, which is published on the company website. Villeroy & Boch Aktiengesellschaft has complied and continues to comply with the recommendations of the Codex with the exceptions also stated in this report.

CLOSE COOPERATION BETWEEN MANAGEMENT AND SUPERVISORY BOARDS

Efficient and value-oriented corporate management is based on intensive, ongoing discourse between the Management and Supervisory Boards.
The Management Board provides the Supervisory Board with detailed, regular updates on corporate planning and strategic development, on the trend of business and on the situation of the Group. Explanations and reasons are given for any divergences in the course of business from the proposed plans and targets.
Conditions allowing the Supervisory Board to reserve its approval of important business transactions, in particular decisions or measures which fundamentally alter the asset, financial and earnings situation of Villeroy & Boch Aktiengesellschaft, are laid down in the Management and Supervisory rules of procedure.
In addition to the statutory Conference Committee, the Supervisory Board has set up further committees from among its members to support its work. The Staff Committee decides on the conclusion, amendment and termination of employment contracts with Management Board members, on the agreement to grant loans to the group of persons named in §§ 89 and 115 of the Companies Act (AktG) and on service contracts, in particular consultancy agreements with Supervisory Board members. The Investment Board takes part in preliminary discussions with the Management Board on corporate and investment planning and paves the way for decisions on investments which require the approval of the Supervisory Board as stipulated by the Management Board rules of procedure. The tasks of the Audit Committee are to assess and prepare both Villeroy & Boch Aktiengesellschaft and consolidated accounts, risk management, the independent audit by the auditor of the annual financial statements, identification of the focal points of the audit and to commission the auditor appointed with the external audit.
Both latter committees hold meetings as and when required and prepare for the adoption of resolutions by the Supervisory Board within the scope of their duties.

PROVISION TO PREVENT CONFLICTS OF INTEREST

While discharging their management duties at Villeroy & Boch Aktiengesellschaft, Management and Supervisory Board members do not pursue any interests of their own which may oppose corporate interests.
In relation to conflicts of interest, Villeroy & Boch Aktiengesellschaft observes both the statutory provisions and those stipulated in the German Corporate Governance Codex. Consultancy agreements and any other contracts for services or work and materials concluded by a Supervisory Board member with the company require the approval of the Supervisory Board. In the 2006 financial year, there were no consultancy agreements or any other contracts for services or work and materials concluded with a Supervisory Board member, nor were there any conflicts of interest caused by Management or Supervisory Board members, for which immediate notification of the Supervisory Board Chairman was required.

DIRECTORS' DEALINGS

Villeroy & Boch Aktiengesellschaft immediately discloses on its website and, since January 20th 2007, in suitable media with circulation throughout Europe, any trading in company shares, or related financial instruments subject to registration in accordance with § 15 a WpHG (German Securities Trading Law), which was conducted by the persons specified therein, in particular by directors and by persons with whom they are closely connected. In addition, the Villeroy & Boch Aktiengesellschaft immediately conveys the relevant information and documentation to the Register of Companies or the Federal Financial Supervisory Authority.
In the year under review, several acquisition transactions subject to registration and concluded by natural and judicial persons closely connected to a Supervisory Board member in terms of § 15 a WpHG, were disclosed. All of the relevant information required by the WpHG is disclosed on the company website.
The details concerning Directors' Dealings are presented on the following page.

OWNERSHIP OF TREASURY SHARES

On December 31st 2006 Management Board members collectively held – directly or indirectly – a total of 1,936,790 ordinary and preference shares issued by the company, of which 1,920,638 individual share certificates were allotted to Wendelin von Boch-Galhau. On December 31st 2006 Supervisory Board members collectively held – directly or indirectly – 2,938,561 ordinary or preference shares, of which 2,930,795 individual share certificates were allotted to Luitwin Gisbert von Boch-Galhau.
Ownership of treasury shares by Management Board and Supervisory Board members is subject to registration and is also published on the company website within the scope of WpHG disclosures.

SUMMARY REPORT ON TRANSACTIONS CONDUCTED IN THE YEAR UNDER REVIEW BY MEMBERS OF THE MANAGEMENT IN ACCORDANCE WITH §15A WPHG

The following transactions concerning individual ordinary share certificates issued by

Villeroy & Boch Aktiengesellschaft, WKN 765720 (ISIN DE 0007657207), were registered by members of the management as well as by natural or judicial persons closely connected to them:

Transaction date	*Registrant*	*Person in management capacity*	*Relationship of registrant*	*Number of individual share certificates*	*Type of transaction*	*Price/ Currency* Euro	*Total amount* Euro
14.12.2006	Ariane von Boch-Galhau	Luitwin Gisbert von Boch-Galhau (Member of the Supervisory Board)	Daughter	214	Over-the-counter acquisition	13.29	2,844.06
14.12.2006	Brigitte Yseult von Boch-Galhau	Luitwin Gisbert von Boch-Galhau (Member of the Supervisory Board)	Spouse	214	Over-the-counter acquisition	13.29	2,844.06
27.11.2006	Brigitte Yseult von Boch-Galhau	Luitwin Gisbert von Boch-Galhau (Member of the Supervisory Board)	Spouse	1,250	Over-the-counter acquisition	12.40	15,500.00
27.11.2006	Bijoux Vermögens-verwaltungsgesell-schaft mbH	Luitwin Gisbert von Boch-Galhau (Member of the Supervisory Board)		1,000	Over-the-counter acquisition	12.40	12,400.00
27.11.2006	Ariane von Boch-Galhau	Luitwin Gisbert von Boch-Galhau (Member of the Supervisory Board)	Daughter	2,250	Over-the-counter acquisition	12.40	27,900.00
03.11.2006	Ariane von Boch-Galhau	Luitwin Gisbert von Boch-Galhau (Member of the Supervisory Board)	Daughter	485	Over-the-counter acquisition	12.18	5,907.30
03.11.2006	Bijoux Vermögens-verwaltungsgesell-schaft mbH	Luitwin Gisbert von Boch-Galhau (Member of the Supervisory Board)		485	Over-the-counter acquisition	12.18	5,907.30
03.11.2006	Brigitte Yseult von Boch-Galhau	Luitwin Gisbert von Boch-Galhau (Member of the Supervisory Board)	Spouse	245	Over-the-counter acquisition	13.29	2,984.10
17.05.2006	Ariane von Boch-Galhau	Luitwin Gisbert von Boch-Galhau (Member of the Supervisory Board)	Daughter	400	Over-the-counter acquisition	14.02	5,608.00

No transactions concerning individual preference-share certificates, WKN 765723 (ISIN: DE0007657231), were registered.

EFFICIENCY AUDIT

In 2006, as in the previous year, the Supervisory Board of Villeroy & Boch Aktiengesellschaft conducted the annual efficiency audit.
No contraventions of the Corporate Governance principles were ascertained.

RISK MANAGEMENT

Villeroy & Boch Aktiengesellschaft maintains a system for the identification and management of operating and financial risks.

The different components of the risk management system are designed in such a way as to ensure early recognition and supervision of entrepreneurial risks.
The Management Board is responsible for the internal supervision and risk management system and for the assessment of its efficacy.
Principles, guidelines, processes and responsibilities are established and defined in such a way as to ensure accurate and up-to-date accounting of all business transactions, early recognition of risks and a steady flow of reliable information for both internal and external use on the financial position of the company.

TRANSPARENCY AND FINANCIAL PUBLICATIONS

Having transparent management and monitoring mechanisms is an essential prerequisite for promoting the trust, in particular of the shareholders, in the management and monitoring of Villeroy & Boch Aktiengesellschaft. It is especially important in this respect to provide shareholders and investors in the capital market with regular up-to-date information on the company.
Private investors can obtain the latest information on developments within the Group via the internet. All investors receive equal treatment with regard to information. Our publications fulfil the requirements for transparency prescribed by the WpHG. Any transactions on the acquisition or sale of Villeroy & Boch shares through Management and Supervisory Board members are regularly disclosed. In the 2006 financial year the transactions registered by Villeroy & Boch Aktiengesellschaft have already been reported under **directors' dealings** and are also published on the internet.
Reports published by Villeroy & Boch Aktiengesellschaft over the previous 12 months are compiled in an annual document in accordance with § 10 WpPG (German Securities Prospectus Act), which is issued at the same time as this Annual Report. These can also be accessed on the company website at **http://www.villeroy-boch.com/de/de/home/unternehmen/investor-relations/jaehrliches-dokument-gemaess-10-wppg.html**

ACCOUNTING

The Consolidated Financial Statements and Interim Reports are prepared in accordance with the International Financial Reporting Standards (IFRS) and the Villeroy & Boch Aktiengesellschaft Annual Financial Statements are drawn up in accordance with the provisions laid down in the German Commercial Code (HGB).
As always, we endeavour to prepare the balance sheet within the term of 90 days recommended by the Codex. However, we are not as yet in a position to make any definite guarantees regarding Group structures and are therefore not in line with the recommendations made by the German Corporate Governance Codex on this matter.

AUDIT OF ANNUAL FINANCIAL STATEMENTS

The Supervisory Board commissioned KPMG Deutsche Treuhandgesellschaft Aktiengesellschaft Wirtschaftsprüfungsgesellschaft (KPMG), the auditor appointed by the General Meeting of Shareholders to audit the annual financial statements and consolidated financial statements for the 2006 financial year, with the task of auditing the 2006 annual financial statements.

In the course of the auditor selection process, the Audit Committee and Supervisory Board examined the professional eligibility and independence of the auditor and established that there was no conflict of interest.
For this purpose, KPMG issued a statement on the extent to which professional, financial or other relations exist between KPMG, their directors and auditing management on the one hand, and Villeroy & Boch Aktiengesellschaft, its subsidiaries and directors on the other. The statement of independence issued was duly noted by the Audit Committee. An agreement was reached with the auditor that the Chairman of the Audit Committee would be notified immediately of any grounds for disqualification due to partiality in the course of the audit, in so far as such grounds could not be eliminated quickly. It was also agreed with the auditor that any findings or events which are essential to the Supervisory Board in fulfilling its duties and which come to light in the course of the audit are to be reported immediately. Furthermore, the auditor undertook to notify the Supervisory Board, or respectively to make a relevant note in the audit report, of any facts uncovered in the course of the audit which reveal an inaccuracy in the declaration of conformity issued by the Management and Supervisory Boards in accordance with § 161 AktG.
There is no indication as a result of the examination that the independence of the auditor is not sufficiently guaranteed.

DECLARATION OF CONFORMITY WITH THE GERMAN CORPORATE GOVERNANCE CODEX

In 2006 KPMG examined the conformity of Villeroy & Boch Aktiengesellschaft to the corporate principles and issued the following statement in the meeting held by the Supervisory Board on March 29th 2007:
“Within the scope of our audit we have not ascertained any inaccuracies in the declaration of conformity to the German Corporate Governance Codex which constitute a serious violation against § 161 AktG.”
The text of the declaration of conformity can be accessed on our website at
http://www.villeroy-boch.com/fileadmin/user/ir/Entsprechenserklaerung20061213.pdf
and is also available in the annual financial statements.

Remuneration report

The following remuneration report for the Management and Supervisory Boards of Villeroy & Boch Aktiengesellschaft is an integral part of the Corporate Governance report.

APPROPRIATE REMUNERATION FOR MANAGEMENT AND SUPERVISORY BOARDS

In order to promote a corporate management which aims at long-term real net output the remuneration of Management Board members comprises two components:

- fixed remuneration
- variable performance-related bonus dependent on target achievement

In addition to the profit targets for Villeroy & Boch Aktiengesellschaft and the Divisions, every year the Supervisory Board Staff Committee sets individual targets in agreement with the individual Management Board members. These strategic targets, together with achieving the return on net operating assets aimed at on the medium term and the projected net annual profit, bear equal weighting in calculating the performance-related bonus. It makes up approximately 50 % of the total remuneration of any Management Board member and is therefore a significant motivating factor. Subsequent modification of the performance-related targets and comparative parameters is excluded.
No loans or advances were granted to Management or Supervisory Board members in the 2006 financial year.
In accordance with § 7 of the Memorandum and Articles of Association, Supervisory Board members receive a fixed remuneration with a significant performance-related component which is dependent on the shareholder's dividend.
In the 2006 financial year, the Supervisory Board members did not receive any further remuneration or benefits for personally rendered services.

ITEMISATION OF MANAGEMENT AND SUPERVISORY BOARD REMUNERATION

As regards the remuneration of Management and Supervisory Boards, Villeroy & Boch Aktiengesellschaft complied, and also complies in the 2007 financial year, with the recommendations put forward by the German Corporate Governance Codex, with the exception of an itemised report on Management Board remuneration. Owing to a resolution passed at the General Meeting of Shareholders on June 9th 2006 concerning the financial years 2006 to 2010 inclusive, the company is exempt from the legal obligation to provide an itemised report of Management Board remuneration, which came into effect on August 3rd 2005 by virtue of the law on the disclosure of Management Board remuneration (VorstOG).
Accordingly, further details given in this remuneration report will not be effected on an itemised basis for Management Board members.

MANAGEMENT AND SUPERVISORY BOARD EMOLUMENTS

According to the Memorandum and Articles of Association of Villeroy & Boch Aktiengesellschaft, Supervisory Board members are entitled to claim reimbursement of the expenses they have incurred as a result of their work. In addition to this, they receive a fixed basic remuneration and a variable share of remuneration.
Until July 9th 2006 inclusive, the basic remuneration amounted to Euro 7,500 per year. With effect from July 10th 2006 the fixed remuneration was increased to Euro 12,000 per year, in accordance with a resolution passed at the General Meeting of Shareholders on June 9th 2006. Until July 9th 2006 the Chairman received double and the Deputy-Chairman one-and-a-half times the amount of remuneration received by a simple member, in addition to the basic remuneration. Since July 10th 2006, the Chairman receives Euro 28,000 and the Deputy Chairman Euro 8,000.
The additional, variable remuneration amounts to Euro 195.00 per Supervisory Board member for every Euro cent per share of shareholder's dividend which exceeds the amount of 10.5 Euro cents. (average of the dividend paid on a preference share and an ordinary share).

The preceding remunerations are paid together with any statutory value-added tax which may be incurred. A claim to remuneration exists only pro rata temporis for the term of appointment.
Until July 9th 2006 a committee chairman received an additional Euro 1,875 (25 % of the fixed annual remuneration for Supervisory Board members), each committee member an additional Euro 1,500 (20% of the fixed annual remuneration for Supervisory Board members) per year. Since July 10th 2006 the Chairmen of the Investment Committee and Audit Committee (Peter Prinz Wittgenstein and Kilian von der Tann) each receive Euro 4,000, and the members (Luitwin Gisbert von Boch and Ralf Runge, as well as Ina Rauls and Peter Prinz Wittgenstein) each receive Euro 2,500 per year in addition to their basic remuneration. A total of Euro 0.172 million inclusive of the variable remuneration components expected for 2006 on the balance-sheet date was shown in the consolidated result for the 2006 financial year as an expense (previous year: Euro 0.229 million). The reversal with effect on the operating result of the provision for the variable remuneration components for 2005 to the amount of Euro 0.045 million (previous year: 0.004 million) was taken into account in this case. In the financial year, a total of Euro 0.227 million (previous year: Euro 0.197 million) was paid out in professional fees. As in the previous year, Supervisory Board members of Villeroy & Boch Aktiengesellschaft received remuneration for participating in supervisory bodies of the subsidiaries – in terms of § 125 AktG – to the amount of Euro 0.002 million. The following overview shows the remuneration paid to Supervisory Board members in the 2006 financial year.

	Supervisory Board Remuneration		
Euro '000	*Fixed remuneration*	*Variable share for 2006*	*Total 2006*
Peter Prinz Wittgenstein	31	9	40
Luitwin Gisbert von Boch-Galhau	19	7	26
Josef Balle	15	7	22
Emmanuel Villeroy de Galhau	9	5	14
Kilian von der Tann	12	5	17
Hannsgeorg Edinger	10	1	11
Ulrich Küppers	10	5	15
Ina Rauls (until 31.12.2006)	12	5	17
Charles Krombach	10	5	15
Dr. Jürgen Friedrich Kammer	10	5	15
Berthold Scholtes	10	5	15
Ralf Runge	12	5	17
Gisela Hannack (until 30.09.2005)	-	3	3
	160	**67**	**227**

The emoluments received by Management Board members totalling Euro 2.208 million (previous year: Euro 2.274 million) were composed of Euro 1.227 million (previous year: Euro 1.264 million) fixed and Euro 0.981million (previous year: Euro 1.010 million) variable remuneration components. §314 subsection 2 sentence 2 HGB in connection with §286 subsection 5 HGB was applied with respect to the disclosure of individual Management Board emoluments.
The pension rights of the Management Board members to the amount of Euro 1.760 million (previous year: Euro 2.154 million) are included in provisions for pensions. Provisions for pensions for former Management Board members amount to Euro 11.842 million (previous year: Euro 11.669 million), with emoluments in the financial year totalling Euro 1.057 million (previous year: Euro 1.053 million).

An essential factor for our success is the implementation of result-orientated solutions which we have worked out together. To achieve this goal our executive staff undergoes regular training.

TREND AND NUMBER OF EMPLOYEES IN THE GROUP AS OF 31.12.

Divisions	2006	2005	Change 05/06
Tiles	1,017	1,021	- 4
Bathroom and Wellness	5,868	4,739	1,129
Tableware	2,890	3,213	- 323
Other	385	485	- 100
Group as a whole	**10,160**	**9,458**	**702**

Countries	2006	2005	Change 05/06
Germany	3,572	3,724	- 152
Western Europe	2,896	3,113	- 217
Eastern Europe	2,094	1,921	173
Other	1,598	700	898
Group as a whole	**10,160**	**9,458**	**702**

Employees

CORPORATE PERFORMANCE MANAGEMENT

The job evaluation system devised together with a renowned partner and originally introduced in Germany has now also been applied internationally. Starting with the corporate headquarters of Villeroy & Boch AG, the leading European locations, namely France, Sweden, Romania, Hungary and Luxembourg, have been incorporated into the evaluation system. The Netherlands and further countries will follow in 2007. Based on a description and evaluation of management and technical executive positions, the international comparison of compensation policies has expanded into personnel work. Using the relevant market data it has become a standardised process to benchmark allowances for usual regional company benefits, such as the eligibility for a company car.
In-depth talks/discussions with employees have brought clarity and transparency to respective tasks and a resulting evaluation of management and executive assignments. As a result it has been possible to complete the job evaluation system and the associated human resource policies, making them comprehensible for all employees.

CORPORATE HR DEVELOPMENT

Training schemes extended to include works management

In 2003 we began implementing modular management training schemes for all levels. In 2006 management training was also initiated in all Divisions for works management (assistant foremen/foremen). Roughly 110 executives from the areas of production and logistics are currently taking part in this training scheme, where they are given the instruments for everyday management in the production and logistic sectors, graded to suit their particular needs and within the framework of our management principles. A special interview guide was therefore developed and implemented for performance reviews. As with the other levels of the hierarchy, superiors, department managers and directors actively accompany these measures and are regularly present at the evening events (fireside-chat evenings). New launches in 2006 were the Junior Management Programme and the Junior Professional Programme. Both of these programmes are intended to point out to junior members not only the skills and capabilities for professional project management, but also the first steps towards assuming management responsibility. Further specialised measures are defined with the superiors and pursued and monitored during performance reviews.
Autumn 2006 saw the start of the international training programme for young engineers in the Bathroom and Wellness Division. During the course of one year, fifteen young engineers from the various production locations in Europe will complete an intensive programme of training, under the guidance of mentors. The programme involves a combination of technical content (ceramics expertise) and methodical and social competence. In 2007 all those taking part will attend a development centre for evaluation. The aim is to create a pool of international engineers, which will enable us to react flexibly to the future challenges of globalisation.

Villeroy & Boch Global Academy: a unique promotional programme

CORPORATE HR SERVICES AND INFORMATION SYSTEMS

Following the successful introduction of the SAP organisation management system, which stipulates a clear allocation of employees to superiors, it was possible to simplify and streamline processes which were previously time and labour intensive. The process of authorising holidays is, therefore, paper-free, as are all other authorisation processes. In this way, it has been possible to structure appropriate reporting systems in a manner which is clearly more reliable and up-to-date.

Employees and executives can obtain information more directly and clearly via ESS (Employee Self Service) and MSS (Management Self Service) on the newly-installed Villeroy & Boch portal. Following the successful introduction of this portal in Germany, it is now planned to extend its use to foreign subsidiaries of Villeroy & Boch AG.

TRAINEES

Internal exchange programme for trainees

In contrast to the trend experienced with regard to the general numbers of persons employed, a total of 39 young people were again employed in 2006 for the purpose of receiving training in commercial and industrial occupations. In so doing Villeroy & Boch AG has again fulfilled its social commitment by training more persons than necessary for its own requirements. During the year 2006 as a whole a total of 138 trainees were occupied in 13 different jobs requiring training. An international trainee exchange programme held in 2006 made it possible to successfully carry out the first-ever practical training courses for German trainees at AB Gustavsberg, our Swedish subsidiary.

The extremely positive response to this exchange has strengthened our resolve to increase programmes of this kind in future. The significance of the experience gained by our employees while training abroad is becoming increasingly important in terms of Villeroy & Boch's internationalisation strategy.

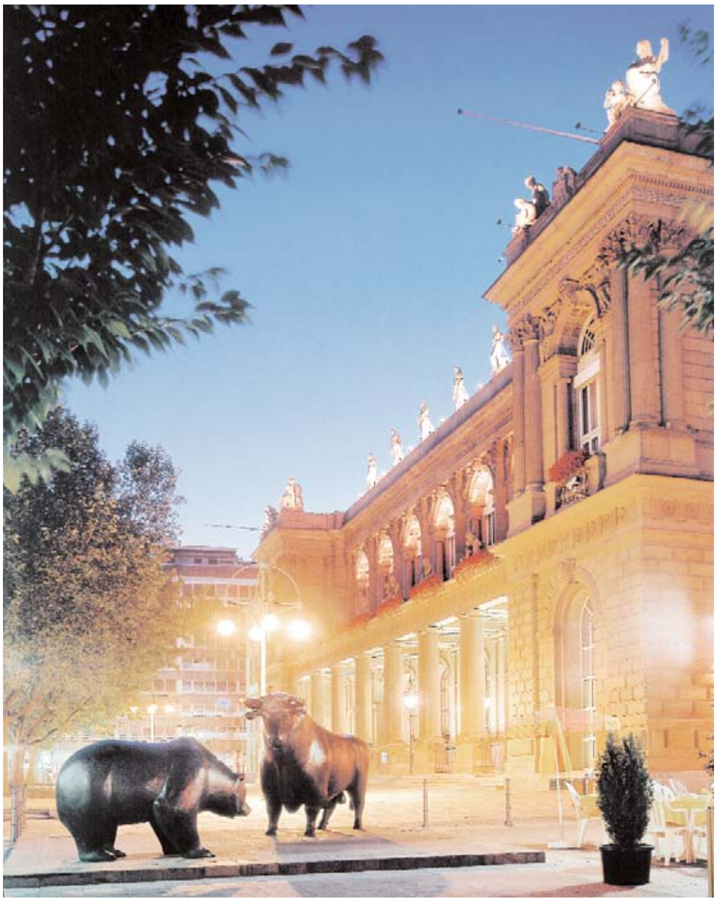
EMPLOYEE REPRESENTATION

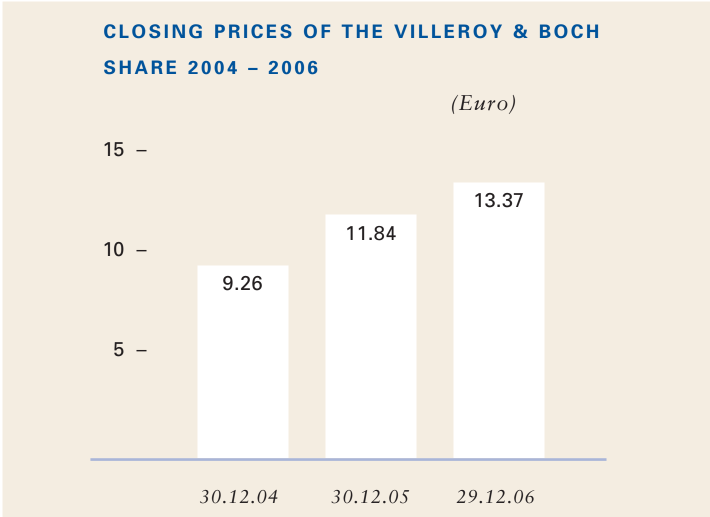
The year 2006 saw a number of changes within the company, some of which led to redundancies in Germany and other countries. Socially-acceptable solutions were found together with the respective codetermination bodies. During discussions the employees' representatives proved themselves to be mutually responsible, constructive partners. As in previous years, cooperation was characterised by a trusting attitude and open communication.

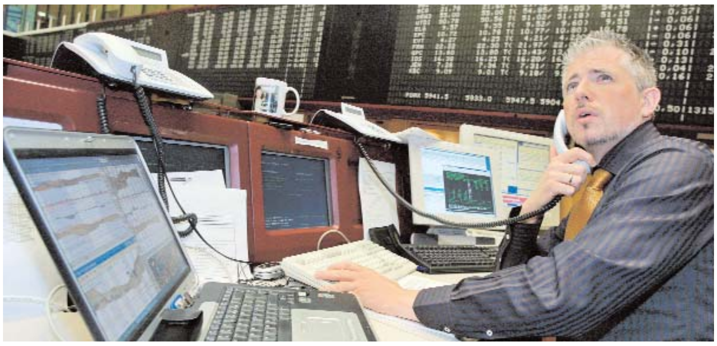
At a European level, the statutory employees' representatives met with Management at the 15th Euroforum in Mettlach.

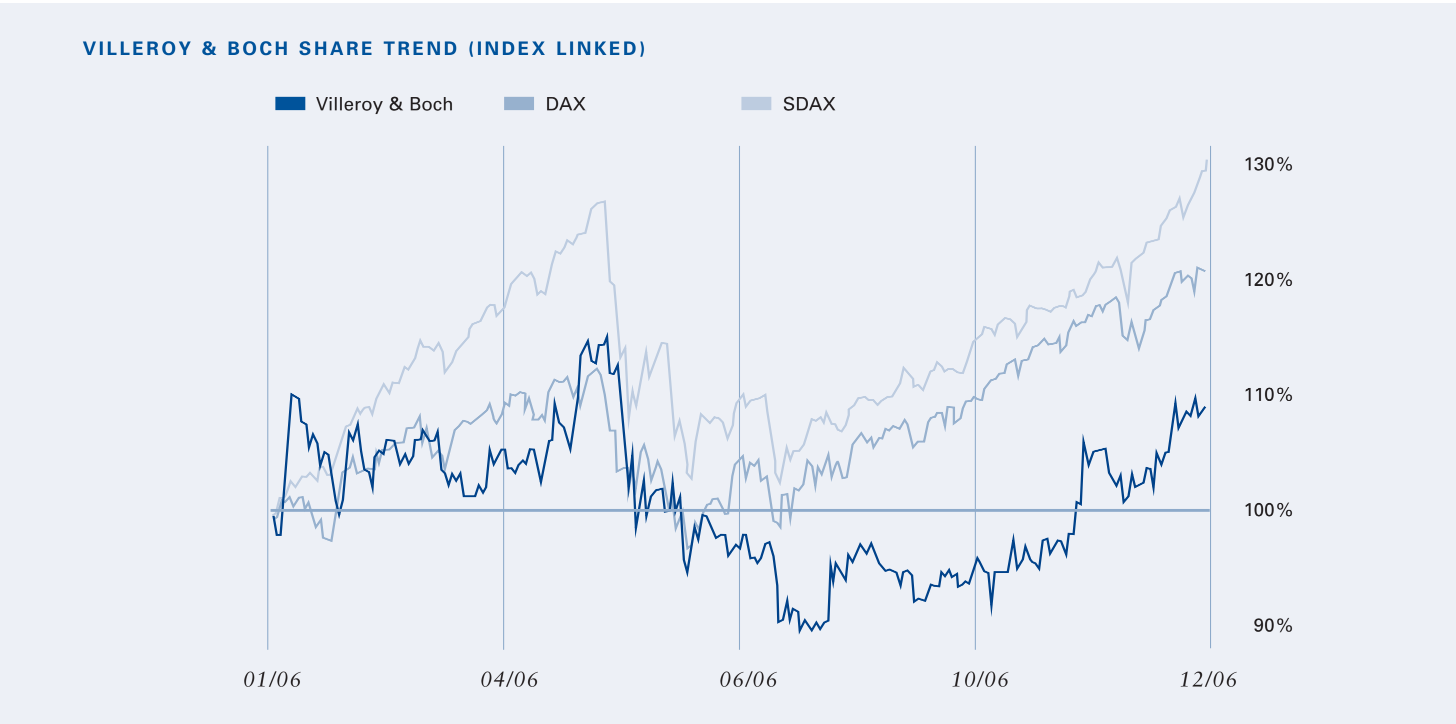
The fact that the Villeroy & Boch Group was able to maintain its market hold, despite a difficult economic environment, is due particularly to the efforts of the entire workforce, which has contributed to the company's success with a high degree of motivation and great commitment. The Management Board thanks all employees for this dedication.

Villeroy & Boch Share









Share

ISIN	DE0007657231
Class	no-par-value bearer preference shares
Shareholder structure	88.0% Free Float
Quotation	official trading Frankfurt/Main (Prime Standard), XETRA and unofficial dealing in Berlin-Bremen, Düsseldorf, Hamburg, Munich and Stuttgart
Designated Sponsor	Landesbank Hessen-Thüringen
Yearly high/low	Euro 14.00 /10.99
Closing price on 29.12.2006	Euro 13.37 (XETRA)
Market capitalisation as of 29.12.2006	Euro 165.3 million (free float of preference share)
Profit per share	Euro 0.65
PER H/L	21.5/16.9

2006 – A SUCCESSFUL STOCK-MARKET YEAR

Rising quotations in Germany in 2006 gave investors reason to be pleased for the fourth time in succession. The share indexes achieved rates of increase of between 22% and 31%. German shares therefore performed better than the major European reference indexes, which rose between 10% and 17%. The US stock market also lagged behind the movement in Germany, reporting similar rates of increase, while the Japanese stock market posted accretion of 7%.
Performance in 2006 was divided into two parts. Prices rose clearly from January to May, after which a sluggish phase began. The price decline lasted until mid July, from which time the stock markets started to pick up again. At the end of the year, share prices were clearly above the highest values posted in May.
The sluggish period from May caused a great number of Germans to sell shares. Roughly five billion Euro were removed from shares and equity funds in 2006.

PRICE MOVEMENT OF VILLEROY & BOCH SHARE CONFIRMED

Share price with positive trend

The Villeroy & Boch share started the year at a price of Euro 12.20 and performed better than the German share indexes in January, while movement in February was comparable. By May the price had risen to Euro 14.00, which was also the yearly high. The lowest price of the year, Euro 10.99, was reached in July. After this time the price recovered through till the end of the year, closing at Euro 13.37. A rise of 12.9% was therefore recorded during the course of the year.
Although the price rise was lower than that of the SDAX Index, the positive movement of the Villeroy & Boch share price was confirmed in 2006, after price rises of 24.3% in 2004 and 29.7% in 2005.

Manfred Finger,
Villeroy & Boch Management Board member,
on Villeroy & Boch share performance

"A sound investment."

In 2006 the Villeroy & Boch share was not quite able to keep pace with the general trend in the German Stock Market. How do you explain this?
Manfred Finger: It is true that, at the beginning of 2006, the Villeroy & Boch share price was affected by the poor result in 2005. In the course of the year, the considerable financial burden arising from job cuts, particularly in Luxembourg, added to the negative effect on the result and price movement. Many potential investors initially adopted a wait-and-see policy. Not until the fourth quarter of 2006 could the share again record a positive movement. This trend continued to improve in the first quarter of 2007, the Villeroy & Boch share gaining roughly 10 % in the first three months of 2007, while the DAX rose only 3 % in the same period.
The above-average increase in sales and favourable press reports at the beginning of 2007 renewed a strong interest in the Villeroy & Boch share.

What price movement do you foresee in the coming months? Is this positive trend going to continue?
Manfred Finger: Following the disposal of 51 % of the tile business, relevant sales will cease to exist on final consolidation of the tile share arising from the Group. However, key figures for profitability – such as the EBIT margin – will clearly improve. The concentration on the Tableware and Bathroom and Wellness Divisions, both of which have been enjoying international success for years, should increase the earning power of the company in the long term. In effect, this is also decisive for the share-price movement.

How has the structure of shareholders of the preference share changed in the 17 years since the initial listing on the stock market?
Manfred Finger: In the last few years, our share has been attracting an increasing number of international shareholders. The internationalisation strategy introduced in 1998 has raised company awareness worldwide and, in so doing, has also captured the attention and interest of investors, fund managers and analysts. Over 60 % of the preference shares are currently held by institutional investors, roughly 50 % of whom are made up jointly of English and American investors. The majority of institutional investors perceive our share as a sound, long-term commitment because they believe in our corporate strategy and foresee a positive trend at Villeroy & Boch.

SDAX

Due to the Villeroy & Boch share's relatively low level of stock market turnover, the Management Board of the German Stock Market removed the share from the SDAX Index on September 18th 2006. This was due to a recommendation from the share index working party. In the time which followed, the share price continued to perform positively, with the effect that there are no recognisable negative consequences of the removal.

INVESTOR RELATIONS

At the press conference on financial statements and a conference for financial analysts, the Management Board reported in detail on the business trend of the Villeroy & Boch Group. In addition there was regular contact with financial analysts and the business press. Individual contact was also made with financial investors and investment fund managers in connection with the increased commitment of investors and investment funds from Germany, the USA and Great Britain.

TREASURY SHARES / SHARE PURCHASE WARRANTS

Executive share option programme

Based on decisions made at several General Meetings of Shareholders from the year 2000, treasury shares were purchased in the years up to 2005. As in the previous year, no treasury shares were purchased in the 2006 financial year, with the result that the total number of 1,683,029 treasury shares (roughly 6% of issued capital) held by Villeroy & Boch AG on December 31st 2006 remained unchanged. The authorisation to purchase treasury shares expired in December 2006.
In the year 2000 Villeroy & Boch AG introduced an executive share option programme. Share purchase warrants were issued on a yearly basis from 2000 to 2003. It was not possible to exercise share purchase warrants during the first three years as the premises to do so remained unfulfilled. The requirements to exercise the last tranche from 2003 were fulfilled in 2006. The price of Euro 13.1555 during the reference period was more than 20% above the exercise price of Euro 7.4030 and the threshold value of Euro 12.00.
In the Supervisory Board meeting on June 9th 2006, cash settlement was resolved. The payments were covered by a provision set up for this purpose in the balance sheet on 31.12.2005. The share option scheme has therefore been terminated.

DIVIDEND HIGHER THAN IN PREVIOUS YEAR

Owing to the improved earnings situation, the Supervisory Board and Management Board will propose to the General Meeting of Shareholders that a higher dividend be paid for the 2006 financial year – namely Euro 0.42 per individual preference share – than for the previous year.

- consolidated sales rise roughly 8 % (adjusted, 4.6 %)
- consolidated operating result (EBIT) of Euro 33.3 million (prior year: Euro 24.3 million) shows clear improvement
- strong improvement in Villeroy & Boch AG operating result
- prior-year dividends increase Euro 0.05 to Euro 0.37 / Euro 0.42
- Villeroy & Boch AG tile business transferred to V & B Fliesen GmbH on 01.01.2006
- moderate but stable global economic development expected for 2007
- improved sales and result planned in all Divisions in 2007

Management Report

UNDERLYING ECONOMIC CONDITIONS

Global economy still shining with strong growth

Despite the progressive increase in energy prices in 2006, which was curbed slightly in the fourth quarter, the global economy continued to expand strongly. This can be seen in the renewed increase in global economic growth from 3.5 % in 2005 to 3.9 % in 2006. The trend is even more remarkable considering it was achieved despite new increases in the price of raw materials and raised levels of interest. However, this trend was subject to strong regional shifts.

China and the USA continue to be the motors of worldwide economic activity, accounting for 10.7 % and 3.3 % respectively. It must be stated here that in contrast to the USA, China continued to gain momentum and produced real growth in double figures. Positive developments were reported during the reporting period in the Euro region. In contrast, development in Japan (2.2 %) slowed down considerably after a strong start to the year, and failed to meet expectations.

Global economic activity peaks in Euro region

Having lagged behind the global economy in recent periods, the Euro region is now also able to reflect the outstanding global economic trend – due not least to the favourable trend in Germany. The revival first seen in exports and investments has now reached the labour market. It is expected that this will also give a strong boost to domestic demand in the short term.

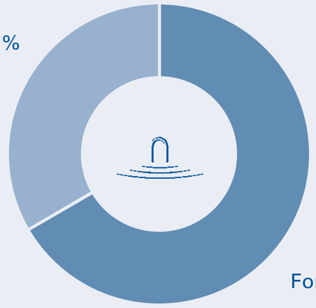
Given a real change in gross domestic product of 2.7 %, the company is expecting the best result in years.

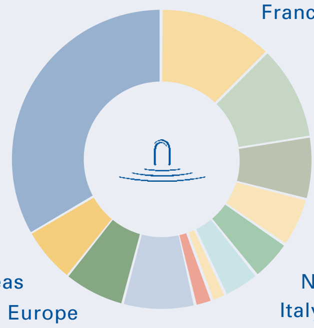
Positive course of economic activity in Germany

Germany in particular played a major role in the Euro region's positive economic development. This is apparent from the regular upward correction of gross domestic product forecasts. GDP grew more strongly in 2006 than at any time since the turn of the millennium, rising from the prior year value of 0.9 %, to 2.5 %. The driving forces behind the clearly improved underlying economic conditions were again exports – which rose 12 % – and increased investments. Securing 3.6 % growth, the construction sector, for example, recorded its best year since 1994. A positive trend was also seen again in the area of private consumption, where growth reached 0.6 %. This trend was doubtlessly supported by the increase in VAT in 2007, which gave rise in particular to advanced purchases of cars and consumer durables owing to the planned increase in value-added tax. However, the increase in private consumption is still lagging a little behind the overall economic trend as the wage ratio has not yet caught up.

The "Ifo economic-climate index" is regarded as the barometer of German economic activity (IfO = Institute for Economic Research). At the start of the year this index still showed the historically-high reading of 112.8 points.

VILLEROY & BOCH GROUP SALES ACCORDING TO COUNTRY





Share in %	*Country*	*Euro million*
28.9	**Germany**	**278.7**
11.4	France	109.6
10.8	Scandinavia	104.7
6.8	USA	65.1
5.3	Great Britain	50.8
4.5	Netherlands	43.2
4.2	Italy	40.2
1.9	Austria	18.7
2.0	Switzerland	19.3
8.4	Rest of Western Europe	81.4
8.2	Eastern Europe	79.3
7.6	Overseas	73.2
71.1	**Total foreign sales**	**685.5**

SALES AND RESULT

(Adjusted) consolidated sales rise 4.6 %

Compared with prior-year figures, all Divisions of the Villeroy & Boch Group were able to secure sales increases. This resulted in a pleasing integral change of 4.6 %. Including acquisitions consolidated for the first time, absolute sales of Euro 964.2 million were 7.9 % above the prior-year value of Euro 893.2 million.

2006 Sales Trend

Difference to previous year (absolute)	+ 7.9%
- adjustment for acquisitions	- 3.6%
integral change following acquisition	+ 4.3%
+ adjustment for effects of exchange rate	+ 0.3%
integral change (overall)	+ 4.6%

Domestic sales within the Villeroy & Boch Group rose 1.6 % to a total of Euro 278.7 million. In contrast, foreign sales of Euro 685.5 million recorded an increase of 10.8 %. A rise of 5.4 % results after adjustments.
The Group was able to record pleasing sales growth in several regions. Sales were clearly above prior-year levels in Scandinavia (+5.7 %), Eastern Europe (+5.6 %), Western Europe (+6.3 %) and Australia (+12.4 %).
The foreign share of sales rose from 69.3 % to 71.1 %.

Rise in Villeroy & Boch AG (adjusted) sales

Owing to the transfer of tile business to V & B Fliesen GmbH, Villeroy & Boch AG sales can no longer be compared with the relevant prior-year figures. Sales of Euro 452.7 million in the year under review contrast with sales of Euro 555.7 million in the previous year. If prior-year sales are adjusted to exclude the tile share of Euro 125.5 million, sales are seen to increase 5.2 %, from Euro 430.2 million to Euro 452.7 million. A 73 %-share of this sales increase is allocated to the Bathroom and Wellness Division and 27 % to the Tableware Division.

Prior-year consolidated operating result clearly improved

Villeroy & Boch consolidated operating result (EBIT) rose to Euro 33.3 million during the 2006 financial year, and constitutes a rise of 37 %. This pleasing development is also reflected in the Euro 23.1 million result from ordinary activities (EBT), which is Euro 7.0 million higher than in the previous year (Euro 16.1 million). Both sales growth and the cost-cutting measures initiated in all Divisions during prior years contributed towards this positive trend.
Besides high accounting profit of roughly Euro 12.7 million resulting from the sale of property in France and Denmark, the financial year also includes special expenses of Euro18.6 million incurred in connection with restructuring measures. The latter are due,

STRUCTURE OF THE CONSOLIDATED INCOME STATEMENT (IFRS)

(Euro million)

	2006	% of sales	2005	% of sales
Sales	964.2	100.0%	893.2	100.0%
Costs of sales	- 594.1	- 61.6%	- 547.1	- 61.3%
Gross Profit	370.1	38.4%	346.1	38.7%
Selling, marketing and development costs	- 279.3	- 29.0%	- 281.8	- 31.5%
General and administrative expenses	- 52.7	- 5.5%	- 48.7	- 5.5%
Remaining expenses/income	- 4.8	- 0.5%	8.7	1.0%
EBIT	33.3	3.4%	24.3	2.7%
Financial results	- 10.2	- 1.0%	- 8.2	- 0.9%
Result from ordinary activities /EBT	23.1	2.4%	16.1	1.8%
Income taxes	- 6.0	- 0.6%	- 2.9	- 0.3%
Results for the year	17.1	1.8%	13.2	1.5%

above all, to a reduction in the number of persons employed in production and logistics in Luxembourg, as well as to further measures implemented in the Netherlands, Germany and France.

The Group's financial results total Euro -10.2 million (prior year: Euro -8.2 million). These figures were positively influenced in the previous year by the sale of securities totalling roughly Euro 1.8 million. After adjustment to exclude this special effect, the financial results still maintained a constant level during the 2006 financial year.

As in the previous year, the financial results include the share of interest for pensions – totalling Euro 9.8 million (prior year: Euro 9.6 million) – as a considerable item.

The consolidated tax ratio rose from 17.9 % in the prior year to 25.8 % in the year under review.

Rise in Villeroy & Boch AG operating result

Although Villeroy & Boch AG net income for the year increased Euro 7.2 million to Euro 22.3 million in the year under review (prior year: Euro 15.1 million), EBIT is actually Euro 25.0 million above prior-year figures (Euro 17.7 million in 2006 compared with Euro -7.3 million in the previous year) when viewed prior to absorbing the result from subsidiary participations.

An essential factor here is that prior-year figures included a negative result from tile business which was transferred to V & B Fliesen GmbH. In addition, a pleasing trend was recorded in the operating result of both the Bathroom and Wellness Division and the Tableware Division.

The net income for the year does not reflect the total scale of the aforementioned grounds, as the result from subsidiary participations absorbed in the prior year was Euro 17.8 million higher than in 2006. In addition, the year under review includes Euro -4.5 million depreciation of a subsidiary in Belgium.

The Villeroy & Boch AG net income for the year includes a Euro 1.8 million tax expense resulting from the improved result situation. In the prior year, income of Euro 0.5 million was reported which ensued from income tax refunds for previous years.

Dividend proposal

The Supervisory Board and Management Board will propose to the General Meeting of Shareholders on June 1st 2007 that net profit, in the amount of Euro 29.4 million, be used to distribute a dividend of

Euro 0.42	per individual preference-share certificate and
Euro 0.37	per individual ordinary-share certificate.

The distribution volume, therefore, totals Euro 11.1 million. The amount named will change by the share of the dividend apportioned to the company's own holding of individual preference-share certificates at the time dividends are distributed. A total of Euro 18.3 million is, therefore, to be carried forward to a new account at Villeroy & Boch AG.

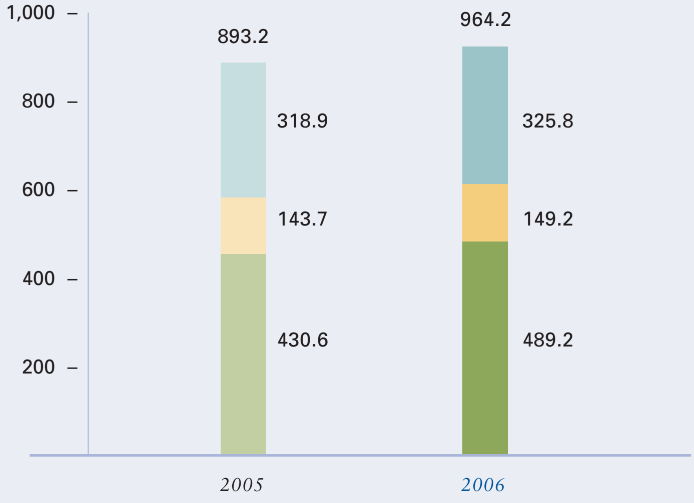
SALES AND RESULT IN THE DIVISIONS (GROUP)

Sales trend in the Divisions

In 2006, the **Bathroom and Wellness** Division was able to increase its prior-year sales by 13.6 %. Integral growth excluding the acquisitions in Mexico and the USA was 5.9 %, whereby the percentage rise was almost equally high in both the domestic and the export markets.
The year was extremely successful for the **Ceramic Sanitary Ware, Kitchen and Furniture Business Segment** (excluding acquisition) which was able to secure sales of Euro 323.8 million and increase prior-year sales by 7.1 %. This increase was secured not only in Germany (+4.6 %), but in virtually all export markets, and accordingly raised foreign share from 70 % to 71 %.
Taking into account the company acquired in June of the year under review, sales in 2006 increased Euro 33.0 million to a total of Euro 356.8 million. When regarded together with the acquisition, the Business Segment improved its prior-year sales by roughly 18 % and the foreign share rose to roughly 74 %.
The **Wellness and Fittings Business Segment** was also able to fulfil expectations in 2006. Sales of Euro 132.4 million exceeded prior-year figures by 3.3 %. A particularly pleasing trend was seen in the domestic market (+11.5 %), though foreign markets were also able to increase their 2005 sales figures by a total of 2 %. The drop in sales recorded in some Western European markets was more than compensated in particular by the positive trend experienced not only in the Scandinavian core market (+9.8 %), but also in Eastern Europe (+9.1 %) and overseas (+11.6 %).
The **Tile Division** secured sales of Euro 149.2 million in the financial year, thus improving its prior-year sales by 3.8 %. Domestic growth of 9.6 % accounted for the largest contribution to this increase in the persistently difficult economic environment. In contrast, foreign sales fell 3.7 % as compared with the previous period, whereby different trends were seen in the individual sales regions. While clear increases were achieved in markets such as France (+9.5 %), the Netherlands (+7.1 %) and Scandinavia (+15.2 %), a decline of almost 47 % was recorded in Eastern Europe, which is to be explained essentially by the termination of unprofitable sales of the "Mondial" brand in Romania.

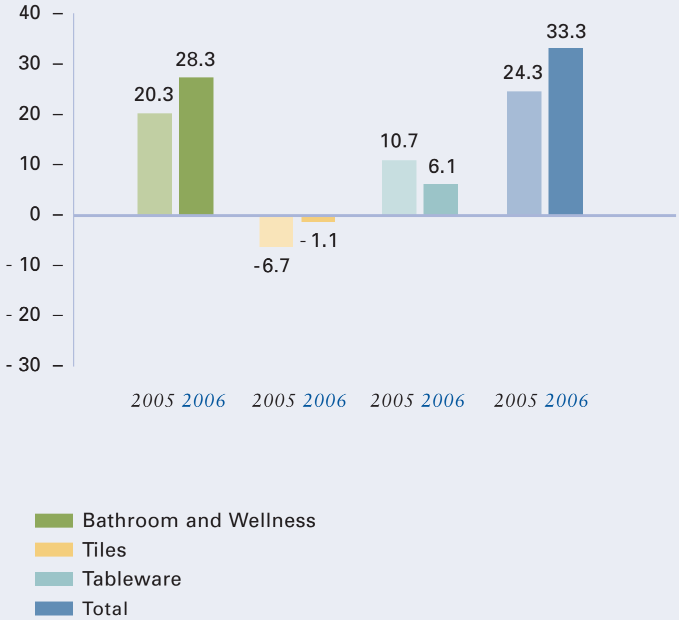
CONSOLIDATED SALES

Distribution according to Division (in Euro million)



GROUP EBIT

(in Euro million)



Tableware Division sales of Euro 325.8 million were 2.2 % higher than in the previous year. Strong foreign sales (+7.1 %) more than compensated for the continuing difficult situation in the German market (-11.0 %). As a result, the export share of total Division sales rose to roughly 76 %. In addition to the positive effects created by developing our own retail sector, further contributions were made towards this pleasing trend by considerable business in the area of advertising-media, and other special business, which was concentrated mainly in Spain (+82.6 %) and Switzerland (+34.7 %).

Result trend in the Divisions

In the year under review the **Bathroom and Wellness Division** was able to clearly increase its operating result (EBIT) from Euro 20.3 million in the previous year to Euro 28.3 million in 2006, a rise of 39.4 %. The EBIT margin therefore improved from 4.7 % to 5.8 % – a trend which can be recognised in both Business Segments.

In the **Ceramic Sanitary Ware, Kitchen and Furniture Business Segment**, the good prior-year result was increased yet again even without taking the acquisition in Mexico into account. Securing its own result of Euro 1.5 million, the new Mexican acquisition made a pleasing contribution to the result of this Business Segment. The Business Segment's good performance can be mainly attributed to the increase in revenue.

The **Wellness and Fittings Business Segment** was able to halt the declining trend and halve the negative result in the year under review. In addition to the positive effects exerted on the result by the increased sales figures, the Business Segment was also able to achieve the high effects expected from the cost-cutting programmes initiated in the previous year. This reduction of costs stemmed from measures implemented in connection with reorientating production, from the use of uniform technical platforms and further optimising the supply chain. In this way, costs incurred in the previous year were reduced, for example as a result of centralising purchasing operations. The opposite effect was created by restructuring costs of Euro 3.6 million, incurred predominantly in the Netherlands, and the generally increased costs of raw materials.

The **Tile Division** improved its EBIT and was able to cut its prior-year loss 83.6 % from Euro -6.7 million in 2005 to Euro -1.1 million in the year under review. This clearly better result arises firstly from the improved sales situation and secondly from higher-than-expected cost reductions made in connection with better process sequences in the area of production and logistics.

The **Tableware Division** operating result (EBIT) of Euro 6.1 million was clearly lower in the 2006 financial year than that of Euro 10.7 million in 2005.

The increase in revenue is unfortunately not reflected in the operating result, as lower margins were attained from transactions in the area of advertising-media and other special business. In addition, it must also be considered that the non-recurring effects of restructuring measures, in the amount of roughly Euro 9.1 million (prior-year: Euro 2.6 million) are included in 2006.

CAPITAL EXPENDITURE

Increased volume of Group capital expenditure

In the 2006 financial year the Villeroy & Boch Group invested a total of Euro 39.9 million (prior year: Euro 35.4 million) in property, plant and equipment and intangible assets.

CAPITAL EXPENDITURE ON PROPERTY, PLANT AND EQUIPMENT AND INTANGIBLE ASSETS

(in Euro million)

When compared with the previous year, this constitutes a Euro 4.5 million increase in the volume of capital expenditure. This does not take into account the asset additions in the amount of Euro 19.1 million, acquired with the sanitary-ware activities of the Mexican GIS Group.
A 35.8 % share of total capital expenditure was allocated to domestic locations. Depreciation in the year 2006 totalled Euro 44.0 million, as compared with Euro 44.6 million in the previous financial year.
Roughly 73 % of investing activities (prior year: 61 %) were concentrated in the **Bathroom and Wellness Division**, where capital expenditure rose from Euro 21.6 million to Euro 29.1 million. These figures do not take account of the acquisition in Mexico.
Totalling Euro 19.2 million, capital expenditure in the **Ceramic Sanitary Ware, Kitchen and Furniture Business Segment** was Euro 3.9 million above the prior-year value of Euro 15.3 million. Disregarding the acquisition in Mexico, the majority of investing activity – 67.3 % (prior year: 67.4 %) – was carried out abroad in the year under review, where it concentrated on measures to modernise production in Hungary and Austria. In Germany, capital expenditure was made mainly in optimising die-casting technology and in further environmental protection measures.
A total of Euro 9.9 million was invested in the **Wellness and Fittings Business Segment** as compared with Euro 6.3 million in the previous year. Wellness capital expenditure concentrated in the Czech Republic, where a total of Euro 2 million related to production expansion measures and reinvestment. In addition ca. Euro 1.1 million were allotted to acquiring the remaining minority interests in the Vagnerplast subsidiary. Capital expenditure in the Fittings sector was made mainly in acquiring the product range and sales activities of a Danish ball-bearing manufacturer.
Roughly 52.7 % of capital expenditure in the **Tableware Division** was made in Germany and 47.3 % abroad. Capital expenditure totalled Euro 6.8 million (prior year: Euro 8.5 million) and concentrated primarily on measures to optimise the central warehouse in Merzig and develop sales locations in foreign markets.
A total of Euro 4.0 million was invested in the **Tile Division**, as compared with Euro 5.3 million in the previous year, almost all of which was invested in Germany (prior year: 72.8 %). An essential measure to be mentioned here was the acquisition of a rectification plant at the factory in Merzig.

Volume of Villeroy & Boch AG capital expenditure slightly below prior-year level

Villeroy & Boch AG invested a total of Euro 11.8 million (prior year: Euro 12.4 million), 57 % of which was allocated to the Bathroom and Wellness sectors (prior year: 41 %), 3 % to the Tiles (prior year: 30 %) and 40 % to Tableware (prior year: 29 %).

FINANCING

Cash flow from operating activities (Group) falls 60.0 %; Group liquidity falls as a result of increased investing activities

When compared with the previous financial year, cash flow from operating activities in 2006 decreased Euro 34.2 million to Euro 22.7 million. This resulted mainly from the build up of trade receivables, the balanced receivables from the sale of property in France and Denmark, and from a lower run-down of inventories in 2006.

Compared with prior-year figures, the cash flow from investing activities almost doubled. This effect was caused fundamentally by investments in the Mexican sanitary-ware business, from which a funds flow in the amount of roughly Euro 31 million resulted.
Dividend payments are essentially reflected in the cash flow from financing activities.

Investment in Mexico business has strong effect on Villeroy & Boch AG cash flow

In spite of the rise in net income for the year of roughly Euro 7 million, and taking into account depreciation of Euro 4.5 million on a Belgian subsidiary, the Villeroy & Boch AG cash flow from operating activities fell from Euro 29 million to roughly Euro -11.6 million. The main factor for this was the rise in receivables from affiliated companies. This was caused firstly by incorporating tile activities of roughly Euro 21 million into V & B Fliesen GmbH. The remaining rise of this item by a further Euro 27 million resulted from an amount of roughly Euro 5.4 million from the Mexico acquisition, as well as from generally increased receivables from various Group companies.
Furthermore, the cash flow from operating activities was roughly Euro 12 million lower than in the previous year due to the build up of notes receivable.
This effect is strengthened by the reduction of other liabilities.
The cash flow from investing activities shows a funds flow which is Euro 27.4 million higher, and which essentially originates from a non-current credit granted to finance acquisitions made in 2006.

VILLEROY & BOCH GROUP – ABRIDGED CASH FLOW STATEMENT

(Euro million)

	2006	2005
Profit after tax	17.1	13.2
Depreciation of fixed assets incl. write-up	44.2	44.0
Change in non-current provisions	- 11.6	- 13.6
Profit from disposal of fixed assets	- 12.3	- 2.6
Changes in inventories, accounts receivable, liabilities and current provisions, as well as other assets and liabilities	- 25.6	6.3
Other non-cash income /expenses	10.9	9.6
Cash flow from operating activities	22.7	56.9
Cash flow from investing activities	- 60.7	- 32.8
Cash flow from financing activities	- 9.3	- 16.4
Change in cash balance	- 47.3	7.7
Changes due to exchange rate	0.1	- 0.5
Net increase in cash and cash equivalents	- 47.2	7.2
Balance of cash and cash equivalents as of 01.01.	58.5	51.3
Changes in consolidated companies	0.3	-
Balance of cash and cash equivalents as of 31.12.	11.6	58.5

FALL IN NET SOLVENCY DUE TO INVESTMENT

Cash in the Villeroy & Boch Group decreased Euro 46.9 million from Euro 58.5 million to Euro 11.6 million by the end of the year.
This was attributable above all to the acquisitions made in Mexico, Denmark and Portugal during the financial year. As in the previous year, financial liabilities in the Group were not shown. Again in 2006, no influence was exerted on liquidity, as no treasury shares were repurchased.
The decrease in Group net solvency was reflected mainly at Villeroy & Boch AG, where there was a change of Euro -60.7 million, for the same reasons as in the Group. Net solvency totalled Euro 19.6 million (prior year: Euro 80.4 million). This perspective combines the cash balance, the current securities, stocks and bonds and the current financial liabilities.

BALANCE SHEET STRUCTURE IN 2006

Total assets of Euro 789.4 million on December 31st 2006 were only Euro 2.3 million higher than in the previous financial year. Return on equity increased from 43.8 % in 2005 to 44.4 % in the year under review.
Changes have been made to the prior-year values arising from the balance-sheet adjustment of discounted bills of exchange shown in the prior-year contingent liabilities.
When compared with prior-year figures, non-current assets as a whole saw very little change. There was a slight Euro 0.4 million increase in the fixed asset share of non-current assets in the 2006 financial year, bringing the total to Euro 305.8 million. Taking into account depreciation from the year under review, the positive change resulting from additions both to property, plant and equipment and also intangible assets, is contrasted by a reduction in other assets, which results essentially from the reclassification of a promissory note bond (Euro 10.1 million) in current assets. The 38.7 % share of fixed assets in total assets remained at prior-year level. Current assets (incl. cash) were equally stable, rising as a whole only Euro 2.5 million to a total of Euro 431.4 million. However, strong shifts were experienced in the composition of current assets, caused not least by the acquisition in Mexico. The strong reduction in cash was compensated by the increase in trade receivables, the increase in other financial assets and also in other current assets. The latter were increased fundamentally by the purchase-price receivables from the disposal of property in France and Denmark. As in the previous year, non-current assets are almost completely covered by equity.
The **Villeroy & Boch AG balance-sheet structure** is characterised firstly by the incorporation of tile activities into V & B Fliesen GmbH. Secondly, circumstances such as relocation of the warehouse from Luxembourg to Merzig and the related organisational changes, as well as the acquisition in Mexico have given rise to structural changes. This is reflected above all on the asset side of the balance sheet. In contrast, total assets only fell Euro 3.8 million.
Compared with prior-year figures, fixed assets increased by a total of Euro 32.3 million. A Euro 16.0 million-reduction in property, plant and equipment – Euro 11.7 million of which was caused by the tile spin-off – was contrasted by a Euro 48.4 million increase in financial assets. This resulted essentially from capitalising V & B Fliesen GmbH (Euro 24.0 million) and financing the acquisition in the sanitary-ware segment (Euro 31.1 million).

GROUP BALANCE SHEET STRUCTURE

(in Euro million)

Assets	*2005*	*2006*	*Liabilities*	*2005*	*2006*
Non-current assets	358.1	358.0	Equity	344.4	350.4
Current assets	370.5	419.8	Non-current liabilities	223.3	218.9
Cash	58.5	11.6	Current liabilities	219.4	220.1
Total assets	**787.1**	**789.4**	**Total assets**	**787.1**	**789.4**

Current assets fell Euro 36.1 million from Euro 341.5 million to Euro 305.4 million. Taking account of the tile transaction at the start of the year, the Euro 55.6 million cash decrease was contrasted by an increase in receivables within the Group, as well as by other assets.
The change in total assets on the liabilities side is caused essentially by the fact that provisions of roughly Euro 10 million were transferred to V & B Fliesen GmbH and an additional reduction of special accounts with reserve characteristics, provisions and liabilities were not completely compensated by the net income for the year. Due to the results for the year in 2006, return on equity rose from 49.2 % to 51.4 %.

EMPLOYEES

The average number of persons employed in the Villeroy & Boch Group increased 7.2 % in the year under review, from 9,521 to 10,211. Taking into account the acquisition in Mexico there was a 3.1 % reduction in the number of persons employed.
Compared with prior-year figures, changes in the number of persons employed in the **Bathroom and Wellness Division** were due solely to acquisitions. In the 2006 financial year the average number of persons employed totalled 5,789 as compared with prior-year figures of 4,801.
The number of **Tableware Division** employees decreased by 192, from 3,203 to 3,011.
A decline was also recorded in the number of **Tile Division** employees, where the prior-year total of 1,044 was reduced to 976.
Of the entire average number of persons employed, 6,625 are occupied abroad and 3,586 in Germany. Compared with the previous year, therefore, the number of persons employed abroad increased by 914, and those in Germany fell by 224.
Villeroy & Boch trained an average of 118 employees during the course of the year under review. This level of training is clearly higher than the company actually needs. By providing this training, the company aims to fulfil the social demands made on prominent employers.
Compared with prior-year figures, personnel expenses in the Villeroy & Boch Group rose 3.9 % from Euro 324.7 million to Euro 337.5 million. Taking into account restructuring expenses of roughly Euro 15.8 million (prior-year: 6.7 million) included in the personnel expenses, a rise of 1.2 % results. In the year under review the personnel expenses ratio (personnel expenses to sales) was 35.0 % (prior year: 36.3 %), and 33.4 % (prior year: 35.6 %) after adjustments to exclude the effects of restructuring expenses.
The number of persons employed by Villeroy & Boch AG fell from 3,559 to 2,623 employees in the 2006 financial year. Taking into account the 773 employees who were relocated to V & B Fliesen GmbH, the number of persons employed declined 5.8 %.

Essential features of the remuneration system

The remuneration system for Management Board members is made up of two components:
- a fixed remuneration and
- a variable, performance-related incentive payment for goal achievement.

In addition to the target results for Villeroy & Boch AG and the Divisions, the Supervisory Board Staff Committee agrees particular targets with the individual Management

Board members. Equal weighting is given to these strategic goals, and achievement of the medium-term net operating assets return assumption and the planned results for the year. It accounts for roughly 50 % of a Management Board member's total remuneration and therefore represents a considerable motivation factor. Subsequent change may not be made to the performance objectives or comparative parameters.
The Supervisory Board members receive remuneration as stipulated in § 7 of the Articles of Association and which includes a significant performance-related component measured on the basis of the shareholders' dividend.

PROCUREMENT

The purchase price for energy, raw materials and consumables used rose more than 5 % in the 2006 financial year. This situation had also been forecast for the annual planning.
The price increases were caused almost completely by the rapid rise in the price for crude oil on the world market. As a result, more than 3/4 of the price-related cost increase come from the rise in gas prices, which had a delayed link to the trend in oil prices. The other price increases recorded in the area of raw materials and packaging were also indirectly caused by the increase in oil prices. These increases affected in particular freight costs for raw materials, and the costs of plastic and paper for packaging. As a result of appropriate hedging measures Villeroy & Boch was not affected by the generally strong increases in the price of electricity in 2006.

RESEARCH AND DEVELOPMENT

The Euro 12.1 million spent on research and development in the Villeroy & Boch Group in 2006, was slightly lower than the prior-year amount of Euro 12.4 million. The largest share of research and development costs – roughly 62.5 % – was expended in the Bathroom and Wellness Division, while 23.9 % of the remaining costs were expended in the Tableware Division and 13.6 % in the Tile Division.
In addition to continuous research and development activity searching for possible areas of application for innovative production technology and developing new Villeroy & Boch products which conform with market trends, attention in 2006 focussed, for example, on consolidating the use of die-casting technology and in successively increasing productivity with the aim of cutting costs.
For several years, research activity has therefore been intensified in the area of process-integrated environmental protection. Applied research is being boosted predominantly in the central development department in Germany. The search for low-firing-temperature raw materials and their components not only emphasises Villeroy & Boch's commitment to modern environmental protection, but also makes it possible to increase the productivity of raw materials, which in turn contributes towards reducing costs.

FINANCIAL MANAGEMENT

The central treasury department of Villeroy & Boch AG carries out financial management of the Villeroy & Boch Group. This involves ensuring that the anticipated financial requirements are always covered adequately and cost-effectively for all Group companies, both for

operational business and for capital expenditure. In this connection Villeroy & Boch AG assumes the role of an in-house bank.
Its functions also include arranging and guaranteeing loans, as well as granting financial aid in the form of guarantees and letters of comfort for Group companies.
The following principles apply throughout the Group for all financial activities:

Financial unity:

The Villeroy & Boch Group acts externally as a financial unit towards third parties. In this way it is possible to optimise the terms and conditions which are to be negotiated on the financial markets. In so doing the interests of the Group always have priority over those of individual Group companies.

Operational scope in financial matters:

The Group's operational scope is protected in all financial decisions made in relation to banks and other business partners. In so doing definite limits are determined for business partners in such a way that it is always possible for the Group to replace one financial partner with another.

Financial partners:

The creditworthiness of financial partners is permanently examined and continuously monitored by the central treasury department. Business relations are entered into following authorisation by the Management Board. As Villeroy & Boch AG acts as an in-house bank, Group companies usually conclude financial transactions with Villeroy & Boch AG. If this is not possible because of foreign exchange, tax or formal reasons, these transactions are allocated to external banks.

Audit requirements:

The dual-control principle always applies in the Villeroy & Boch Group, whereby the requirement for separate operations is satisfied. In particular, as treasury-department organisation is structured similarly to a bank, there is a strict separation between trading on the one hand, and controlling, processing, reporting and accounting on the other. The guidelines applicable throughout the Group define processes and responsibilities.

Central risk management:

Financial transactions in the Villeroy & Boch Group are only concluded in connection with hedged items. The total portfolio is monitored by Villeroy & Boch AG.

RISK REPORT

Risk management system in the Villeroy & Boch Group

The varied risks connected with the company's business activities are minimised and, wherever possible, eliminated in accordance with the Villeroy & Boch Group's understanding of risks. Risks are only consciously taken if they can be calculated and the probability of their occurrence is minimal.

Risks from the economic and industrial environment

Risks which can arise from the general economic environment or from the industry are expounded in the economic outlook.

Risks from the procurement and sales market

Although the oil-price situation has clearly eased in 2007, with the effect that we do not expect any further increases in the price of gas, the majority of production locations are confronted with drastically increased electricity prices owing to the expiry of their older power-supply agreements. In order to compensate for at least part of the increased energy costs, we have launched a Group-wide project to reduce energy consumption.
Purchase prices as a whole are again expected to rise more than 5 % in 2007. Villeroy & Boch is continuing to counter this rise by constantly improving processes and benefiting from the cost-saving effects which result.
Considerable influences are being exerted on sales and employment in the European ceramics industry as a result of growing imports from low-wage countries. Villeroy & Boch is countering this influential factor by consistently stepping up specialisation and automation.

Financial Risks

The central treasury department of Villeroy & Boch AG controls the financial risks of the Villeroy & Boch Group. These are in particular:

- credit-standing risks
- liquidity risks
- risks from fluctuations in payment flow, and
- interest and currency risks

Credit-standing risks

Credit-standing risks can arise if contracting parties completely or partially default within the scope of financial investments, in the case of derivative financial instruments with positive market values, or by way of insolvency. In order to minimise and monitor these credit-standing risks, and also to secure business operations with banks throughout the Group, Villeroy & Boch has, therefore, not only fixed minimum credit-standing requirements for these business partners, but also arranged specific maximum limits for the assumed obligation (limits) which are founded on predefined categories. The basis is a limit scheme stipulated in the guidelines laid down for the treasury department, and which essentially takes into consideration the ratings of international ratings agencies, or internal examinations of debtors' financial standing. The treasury system continuously checks that these limits are observed, and adjusts them, wherever necessary, to the underlying conditions. At present, financial investments are essentially placed only with contracting parties who have an investment grade classification, i.e. a good to very good credit standing. On the whole Villeroy & Boch is only exposed to credit-standing risks to a minor degree.

Liquidity risks

Provision of liquidity is ensured at all times by a liquidity outlook with 12-month planning horizon, complemented by additional, short-term financial planning, unused lines of credit

and adequate liquidity reserves. Villeroy & Boch employs money-market products, such as time deposits and call money and also bilateral credit, as financial instruments. As an in-house bank Villeroy & Boch AG guarantees the Villeroy & Boch Group companies the correct amount of adequate cover at the lowest possible cost, to finance business operations and on-the-spot capital expenditure.
The concentration of liquidity which results from employing international cash-pooling systems throughout the Villeroy & Boch Group improves balance-sheet structure, reduces the volume of external financing and optimises financial investments with positive effects on the financial results. At the same time greater transparency of the liquidity situation is created. Furthermore, the surplus cash resources of individual Group companies are used to internally finance the cash requirements of other Group companies.

Risks from fluctuations in payment flow

The Group counteracts risks from fluctuations in payment flow with a margin of solvency and adequate lines of credit. Changes in the future level of interest, however, can mean fluctuations in the payment flow of asset and liability items with variable interest rates. Villeroy & Boch has, therefore, secured part of the liability items with variable interest rates by using derivative financial instruments.

Interest and currency risks

During the course of business operations the Villeroy & Boch Group is exposed to the risks of changes in interest and currency rates. The corporate policy is to limit or exclude these risks by concluding hedging transactions. This is carried out using original and derivative financial instruments. The central treasury department implements and coordinates all the necessary hedging measures. Guidelines exist which stipulate that no speculative business dealings may be negotiated. Every interest or currency transaction must be based on a hedged item, so that the company's risk position is not heightened by transactions of this kind. Hedging transactions are concluded solely with first-class national and international banks. Interest risks arise as a result of possible fluctuations in the value of a financial instrument owing to changes in market interest rates, in particular in the case of medium-term and non-current receivables and liabilities. One possibility of restricting these interest risks, depending on market conditions, is to use interest-rate swaps. Intercompany financing is usually structured using matching maturities for replacement financing.
Currency risks arise firstly from purchasing goods internationally and owing to cost, and secondly, as a result of invoicing customers in a currency other than that of the relevant country.
The exchange risks arising from surplus or inadequate cover following a Group-wide process of netting (natural hedging) the foreign currencies are limited by financial hedge instruments, essentially forward exchange operations. Again in 2006, Villeroy & Boch pursued the exchange hedging policy of initially hedging only 70 % of the excess amounts or inadequate cover remaining after a Group-wide process of netting. On December 31st 2006, however, the positions in the various foreign currencies were virtually closed as a result of further exchange hedging measures implemented during the course of the financial year. These were carried out essentially on the following foreign currencies: USD, GBP, SEK, HUF and DKK. All in all these currencies account for roughly 80 % of the foreign currency denominated sales from payment flows.

Overall estimation of the risk situation

When regarded in relation to the previous year, no essential changes have occurred in the Villeroy & Boch risk situation. There are no recognisable risks which could be a threat to company existence, either individually or as regards total risk, or which appear capable of jeopardising the company's financial position or financial performance.

OCCURRENCES OF PARTICULAR SIGNIFICANCE AFTER CONCLUDING THE 2006 FINANCIAL YEAR (VILLEROY & BOCH GROUP)

There are currently no events of essential importance which occurred after the end of the 2006 financial year.

OCCURRENCES OF PARTICULAR SIGNIFICANCE AFTER CONCLUDING THE 2006 FINANCIAL YEAR (VILLEROY & BOCH AG)

No special occurrences exist.

OUTLOOK

Future economic forecasts remain confident

A clear deceleration of global economic growth is expected for the year 2007. Even if global economic production still increases slightly, it is nevertheless to be anticipated that the utilisation of macroeconomic capacity will clearly recede, above all in the USA. This will be linked to a decline in private consumption.

The revival in the Euro region has probably reached its peak. As a result of the slow-down in global economic activity, a slightly lower rate of increase is anticipated in 2007 than in the prior year.

It is expected that Germany will make a fast recovery from the effect of the VAT increase and that all in all, growth of roughly 2 % can be reckoned with. Even if the "Ifo economic-climate index" of the Institute for Economic Research in Munich fell from 107.9 to 107.0 during the month of February 2007, it nevertheless remains on a high level. According to expert statements, this does not represent a threat to the revival.

The 3.6 % growth in the construction industry should increase even more in keeping with expectations. As a result of the strong economic situation the branch is even complaining about shortages in building materials and machinery. Seen in relation to the tile sector, however, the situation has not eased in the slightest anywhere in Europe. In fact, there has been a further increase in aggressive pricing owing to the high pressure of stocks in major producing countries, and growing imports from low-wage countries.

SALES, RESULT AND CAPITAL EXPENDITURE IN THE GROUP

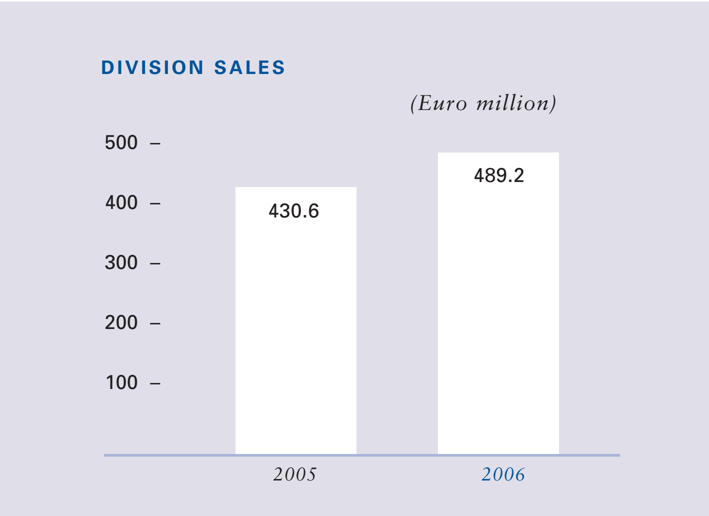
Like other European competitors, Villeroy & Boch is confronting an ever growing proportion of cheap imports from the Far East with a strategy of consistent automation at its production locations in the West, and an increase in production at its more cost-effective locations in the East.

Generally speaking further sales growth is expected in all Divisions, provided there is a continued positive trend in economic activity. A contribution will already be made to this growth from the start of the new financial year by the Bathroom and Wellness Division's boosting acquisition made in Mexico in 2006.
The effects of the cost-cutting measures taken in the last two years were already noticeable in 2006. As these effects will continue to exert an influence throughout the whole of 2007, we not only expect further integral growth but a linked rise in result (EBIT) in all Divisions. This trend is reinforced by the fact that no extraordinary effects on result are currently foreseen. A further result improvement is anticipated in the Tile Division in particular.
The Euro 39 million investment volume planned for the 2007 financial year is virtually on prior-year level. Investment measures are allocated to the Divisions with a share of 64 % to Bathroom and Wellness, 24 % to Tableware and 12 % to Tiles. Investment in the Bathroom and Wellness Division concentrate on creating a uniform standard of automation where the use of die-cast technology is concerned, and in reorienting production processes using uniform technical platforms.
In the Tableware Division it is planned to continue expanding the company's own retailing sector and in so doing strengthen market presence and gain appropriate market shares.

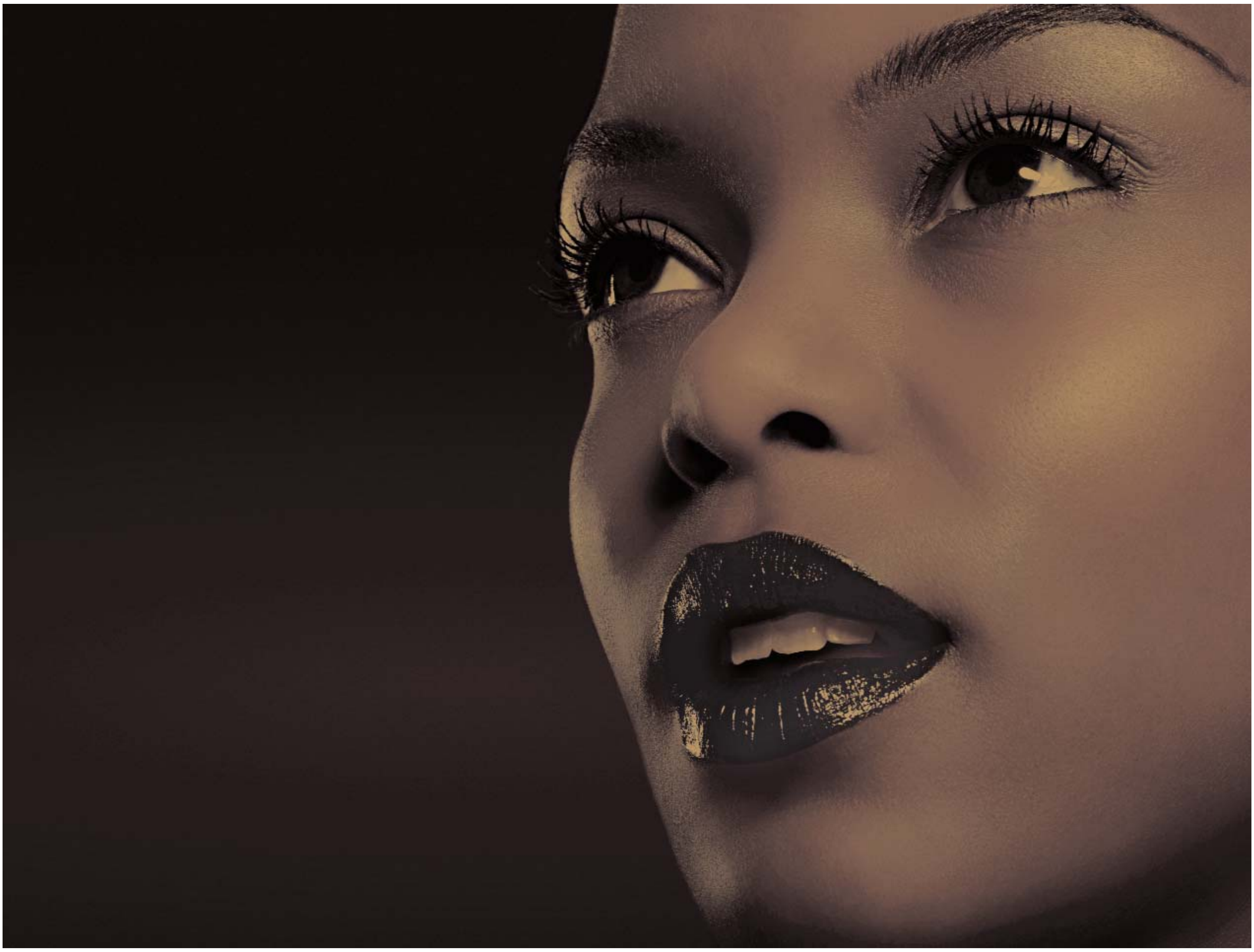
SALES AND RESULT IN THE AG

Stabilisation of the situation regarding income and sales arising from operations at Villeroy & Boch AG is expected.

Bathroom and Wellness



"Smart Bench": This closable WC bench, with all the functions of a toilet, opens up new dimensions of the bathroom as a space in which to live.



The extensive product range not only offers a wide array of designs and functions, but also special bathroom concepts which absorb relevant social and demographic trends. In this way, the innovative bathroom series offer solutions which consider the growing 50-plus target group, just as much as singles. Polished product systems are the answer to the international trend towards wellness, recreation and good health. The range of products in the commercial sector has been clearly expanded, given the continuing construction boom experienced particularly in Russia, Asia and the Emirates.

Frank Göring, member of the Villeroy & Boch Management Board, on growth and globalisation

"We are continuously building up our overseas presence."

You have planned high levels of growth in the coming years. How and where do you intend to achieve them?

Frank Göring: There is high growth potential in Russia, the Middle East, the Far East, the USA and Mexico, but also in several Western European countries, such as Italy and Spain. Given the sustained construction boom which has contributed to the importance of the Asian and Arabian markets, we aim to achieve our growth by expanding our commercial business in these countries. For this purpose we shall systematically approach decision makers such as planners and architects, and also strengthen the marketing organisations, both quantitatively and qualitatively. At the same time we aim to be clearly involved not only in the semi-luxury professional sector, but also in the high-volume business sectors in these regions.

How do you serve and supply these markets?

Frank Göring: Our platforms for production and distribution in Western and Eastern Europe and their modern logistic services put us in a good position to supply all major European countries from here. We supply the growth markets in North and Central America via our factories in Mexico. In order to build up our position in the overseas markets around Asia, we shall offer a product range which has been specially adapted to the requirements of these countries, and establish local production facilities. This will directly facilitate distribution within these markets.

What relevance does the brand have in the growth markets? Do your lifestyle products correspond with the tastes of these cultural groups?

Frank Göring: As a European lifestyle supplier we take advantage of the opportunity which is connected with our renowned European brand on the overseas markets. Groups of well-situated, brand-conscious buyers have developed, not only in countries such as China, India and the Emirates, but also in Russia, and they are absolutely fascinated by lifestyle products and brands from the West. However, in order to ensure that our products fulfil the specific technical, functional and aesthetic requirements of these countries and cultures, we are also developing completely new ranges.

Bathroom and Wellness Division

BATHROOM AND WELLNESS DIVISION KEY DATA

		2006	2005
Sales	*Euro million*	489.2	430.6
EBIT	*Euro million*	28.3	20.3
Net operating margin	*Percent*	5.8	4.7
Capital expenditure	*Euro million*	29.1	21.6
Depreciation	*Euro million*	22.0	21.5
Employees (annual average)	*Number*	5,789	4,801

In 2006 the Bathroom and Wellness Division was able to increase its sales 13.6 %. A major contribution was made to this clear increase by the foreign markets in which Villeroy & Boch again successfully built up its position. The Division also recorded a slight plus on the domestic market, where the construction industry began showing signs of recovery. The rate of growth achieved in the Bathroom and Wellness Division, however, was much higher than the rates of economic growth.
The broad acceptance of new products introduced during the last two years was only one decisive factor for the profitable growth. Their high degree of technical innovation and their sophisticated appearance convinced both market partners and consumers. In addition, measures were implemented to extend distribution and strengthen the sales team in growth markets, and also to achieve greater automation and flexibility in the production processes.

Expansion of distribution activities

CERAMIC SANITARY WARE, KITCHENS AND FURNITURE BUSINESS SEGMENT

The Ceramic Sanitary Ware, Kitchens and Furniture Business Segment was able to achieve strong rates of growth in Germany and almost all European markets. A considerable contribution was made to the positive result by consistent market development specific to the particular country, and an intentionally individual approach to market partners in the major European markets: Italy, the Netherlands, Belgium, Switzerland, Great Britain and the Baltic States. As a result of expanding distribution and strengthening the sales team in Russia, the Business Segment was able to achieve double-figured sales growth with the Villeroy & Boch brand. The premium series “Bellevue” and “Subway” in particular satisfy the taste of discerning, wealthy Russian consumers.
In 2006 the Business Segment was able to further expand its activities in the US market, which was already a major foreign market for Villeroy & Boch before acquisition of the three sanitary-ware factories in Mexico. Cooperation with the most important customers in the USA was strengthened by improving the supply chain, and the product range was extended. Sanitary-ware products which have been specially developed for the American market will be presented at the important “KBIS” trade fair in Las Vegas in May 2007.

The "Memento" edition is characterised by formal reduction and a material combination which is disceringly modern. Its surfaces are of Amazaque real-wood veneer combined with black glass.

Further progressive, high-potential markets, located primarily in the Middle and Far East, were successfully developed within the scope of the company's globalisation strategy. A particularly satisfying development was seen in the Chinese market, where there is a new class of solvent, brand-oriented consumers. One factor which contributed to this development was the sales branch which was opened in 2005 and expanded in 2006.
The positive response on the international market can be attributed, above all, to a product-range strategy focussing on comprehensive concepts rather than individual products. The broad, cleverly-thought-out collections offer a variety of problem-solving concepts which are also of particular interest to the renovation sector. Among the sanitary-ware products offered, the premium series "Pure Stone", "Bellevue" and "Memento" and the mainstream collections "Sunberry" and "Sentique" are outstanding.
The new "Omnia architectura" series was successfully launched in the professional segment, which is important for overall performance. This versatile commercial collection gives architects and planners a modular system with which they can creatively develop and implement highly individual concepts, right down to the last detail.
An important contribution was made to the positive performance by automation and flexibility, which were promoted at the production facilities in this Business Segment by further investments. Priority was given to the very latest die-casting techniques and automating the flow of materials.
Despite competition from stainless-steel sinks, the kitchen-sink sector has developed extremely well in Germany. This is due above all to the unique selling proposition of the metallic colours on ceramic, and the new product introductions "NewWave" and "Subway". These new sinks represent the successful transfer of winning Villeroy & Boch designs from the bathroom ("Subway") and tableware ("NewWave") sectors, to the kitchen-sink sector.
Further success was achieved in the area of bathroom furniture with new product introductions, above all in the "Modern Classic" lifestyle category. An outstanding example is the premium, timelessly-elegant series "Sentique" which was developed for the sanitary-ware range of the same name.

WELLNESS AND FITTINGS BUSINESS SEGMENT

Full range concept for the "50-plus" target group

Despite clear increases in the price of raw materials, above all in the fittings sector, the Wellness and Fittings Business Segment was able to halt the previous year's negative sales trend. An improved cost structure was achieved by reorienting production, using uniform technical standards and continuously optimising the supply chain. The product range and sales activities of Frese, the Danish manufacturer, were taken over to strengthen capacity in the area of technical equipment. Positive effects were achieved above all as a result of amalgamating Bathroom and Wellness sales activities. This was seen particularly in the key markets Germany and the Benelux countries.
The term wellness, incorporating recreation, fitness, relaxation and body care, has become a key word with growing interest in every consumer category. This is particularly so in the 50-plus group, whose role is becoming ever stronger due to the demographic development, in particular in Western Europe. Villeroy & Boch is also supporting the concept of wide ranges in the specific Wellness sector in order to tap the full potential of this market segment in the bathroom sector.

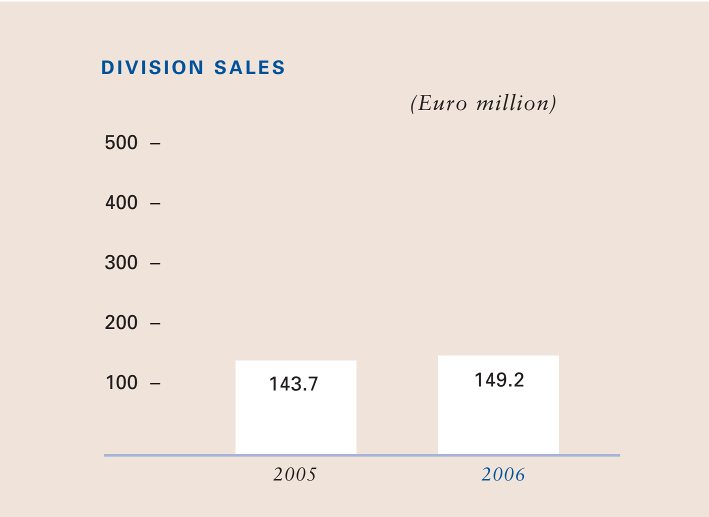
The range of stylish steam showers and whirlpools in the middle and upper price category has therefore been extended to include highly-competitive products in the low-level price segment, which is clearly gaining market relevance. "Just Relax", the new low-price whirlpool system, and "Steam Cube", the cleverly-thought-out steam shower, enable market partners to round off their product range and reach new target groups.
Particularly strong approval was reaped by "Squaro", the shower series which was expanded into a comprehensive product family and combines refined aesthetic appeal with ergonomic comfort. At the centre of this concept is a column element with "walk-in" system. This enables comfortable entry without a step and at the same time emphasises the transparency and lightness of a modern bathroom. Villeroy & Boch was presented with the coveted IF Design Award for its "Squaro Walk-In" and "Squaro Superflat" shower trays. A positive trend was also seen in the fittings segment. There has been successful development of the existing cooperation with "Dornbracht" – the reputable fittings manufacturer – in the area of marketing Villeroy & Boch brand fittings. In addition, strong sales growth was recorded by the Gustavsberg brand, which is marketed predominantly in Scandinavia. The amalgamation of sales teams also constituted a considerable success factor here.

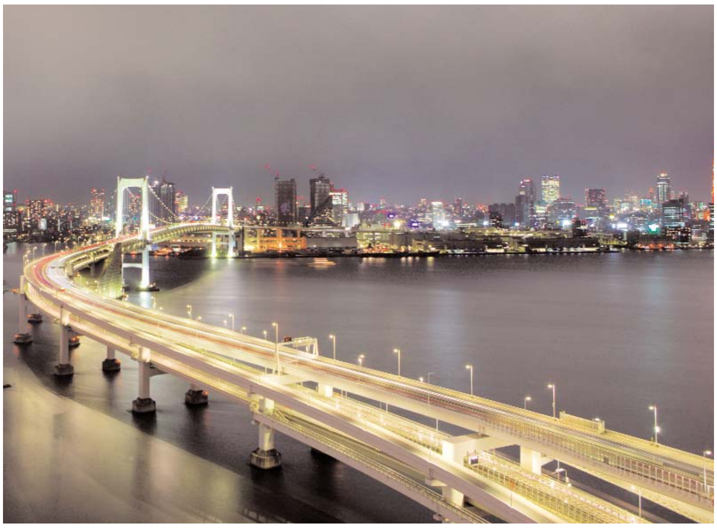
OUTLOOK

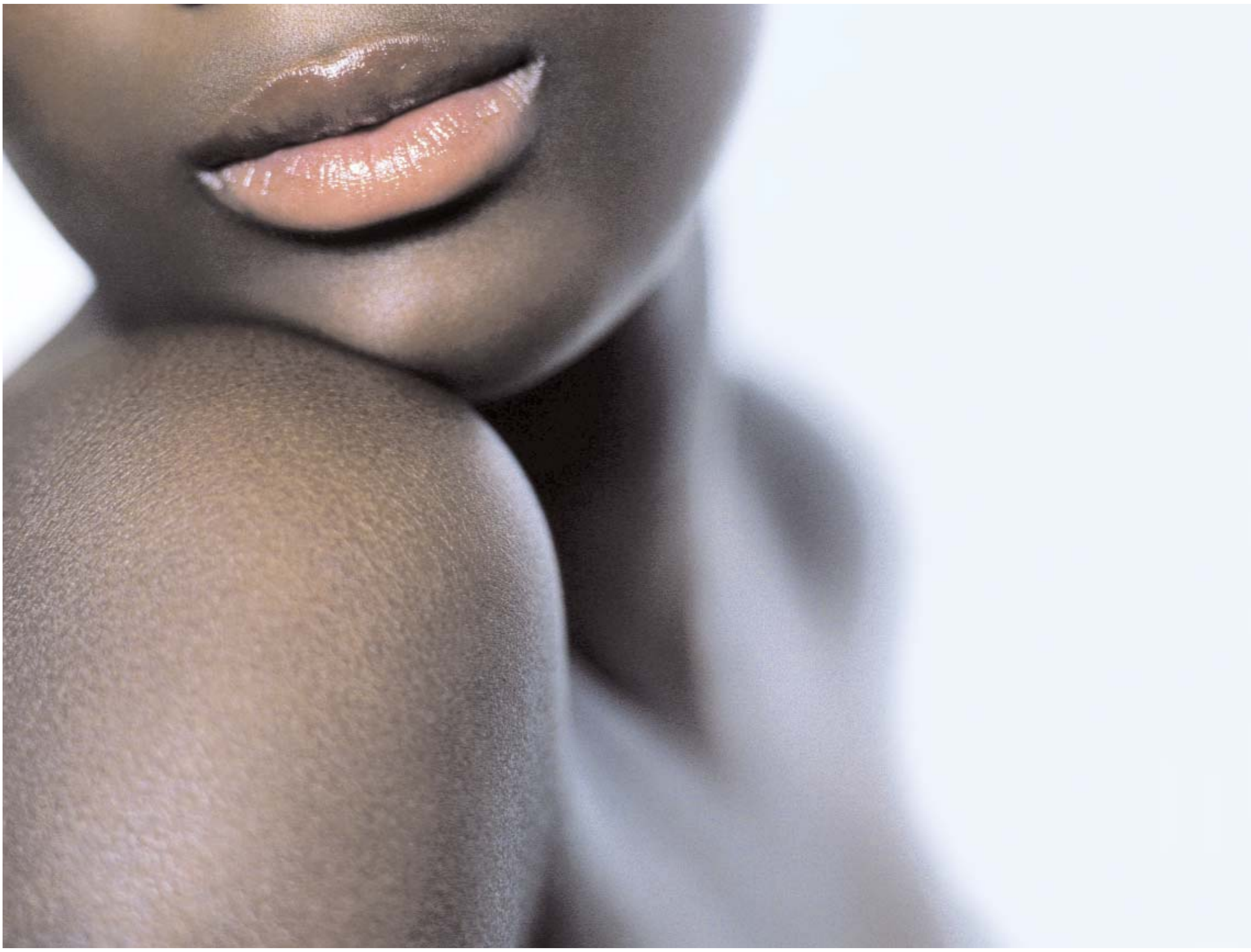
Progressive expansion of overseas presence

The coming years will also be strongly influenced by internationalisation and globalisation. Our position in North and Central America, and in the growth regions Middle East, Far East and Russia, will be strengthened as a result of expanding our sales activities. China will play a dominant role, offering tremendous potential in the commercial and hotel sector due to the sustained construction boom brought about by the Olympics and the Expo. We shall continue to take part in this boom by promoting our commercial business and further increase awareness of the Villeroy & Boch brand by strengthening the presence of our products. Furthermore, we shall launch new product lines in these regions which will be adapted to the requirements of individual countries.
In addition to this global market orientation Villeroy & Boch will also continue systematically developing markets in Central and Eastern Europe, for example using special range extensions and distribution synergies. It is our aim to gain market share, even in markets which are partly saturated. A contribution will be made to this goal by further intensifying our cooperation with planners and architects.
We shall present cleverly-thought-out new products, range extensions, product concepts and revolutionary innovations at the international trade fairs. One of the highlights at "ISH", the important trade fair for the heating, sanitation and air-conditioning sector, was the "Smart Bench" (see photo on page 48). This WC contains all toilet functions – including a brush and toilet-roll holder – inside a bench which can be closed by a wooden element. With this product, which allows the entire sanitary function to vanish in a flash, Villeroy & Boch is opening up new planning alternatives for the bathroom as a space for living and wellness, and in so doing, opening up a new category of bathrooms. The "Lifetime" collection has been created to meet the special requirements of customers in the 50-plus generation. The concept is based on the "comfort using ergonomics" formula and is equipped with countless functional features for making time spent in the bathroom even more pleasurable. For our partners in the manual sector we shall introduce a number of innovations which can be easily installed, and also save time and money.

Innovative bathroom collection: a clever combination of all elements turns the bathroom into a space for living and regeneration. With its pillar element, the new “Squaro” series walk-in shower solution emphasises the bathroom’s modernity and transparency.


DIVISION SALES
(Euro million)
500
400
300
200
100
143.7
149.2
2005
2006





The consistent orientation towards international focus markets has led to above-average sales increases. We shall continue to consolidate our position in the European market in 2007 by purposefully developing distribution. In addition, we offer a uniquely positioned product mix, achieved using not only trend strengths, but also aesthetic and technical differentiation with regard to furnishing preferences of the international markets.

Peter von der Lippe, Villeroy & Boch on the subject of Turnaround und Stability.

"Demonstrating Presence in Future Markets."

Following a very promising start to V & B Fliesen GmbH, what do you now consider the main areas of focus for further financial restructuring of Villeroy & Boch's tile business?

Peter von der Lippe: It's correct that we have made good progress in the important areas of cost reduction, product-range development, process improvement and market development. We've also been able to strengthen motivation once again among employees and customers. It's also correct, however, that we still have to take the final step this year to complete the turnaround and achieve stability. We shall continue to concentrate our attention on the same areas as in 2006, though again there will be additional focussing on markets.

Can you expand on this?

Peter von der Lippe: Our intention was to stop the sales decline in Germany and France, our two major markets, and start growing again. We were extremely successful in these areas in 2006, and managed to secure an increased share in both markets. Further growth is also planned for 2007. Considerable strengthening measures will also be implemented in international markets and in the area of large-scale projects. We are currently developing appropriate ranges to support this undertaking.

In this context, what significance do you attach to the planned joint venture with the Turkish group Eczacibasi Karo Seramic?

Peter von der Lippe: Irrespective of the planned operational independence of V & B Fliesen GmbH and separate management of the Villeroy & Boch tile brand, there are considerable opportunities for product-range development using interrelated international production, as well as the possibility of complementary distribution in international markets as regarded from the market aspect. The exchange of know-how in the areas of technical processes and ceramics will strengthen innovative power and lead to systematic investments.

Tile Division

TILE DIVISION KEY DATA

		2006	2005
Sales	*Euro million*	149.2	143.7
EBIT	*Euro million*	- 1.1	- 6.7
Net operating margin	*Percent*	- 0.7	- 4.7
Capital expenditure	*Euro million*	4.0	5.3
Depreciation	*Euro million*	5.6	6.7
Employees (annual average)	*Number*	976	1,044

POSITIVE SALES DEVELOPMENT DESPITE DECLINE IN BRANCH TREND

Clear rise in sales and revenue in the core range of the Villeroy & Boch brand

The tasks and goals set when the Tile Division was spun off to form V & B Fliesen GmbH were successfully implemented and achieved in 2006. The programmes drawn up in 2005 to cut costs and improve structures were realised according to schedule. They were impaired, however, by dramatic price increases in the area of energy and raw materials. Processes and sequences were constantly revised and more efficiently structured. The progress made has clearly improved motivation among employees and their identification with the company.

In the same way, the Division was able to strengthen confidence in the market and among customers. Customers responded particularly positively to product-range planning and design, to the administrative and logistic services and the speed of development and marketing.

The situation for the tile industry in the European building sector – above all in such an important sales market as Germany – again showed no signs of easing during the year 2006. Increases in aggressive pricing methods continued. This was caused by the high pressure of stocks in major producer countries, and in addition, by the increasing quantities of imports from low-wage countries such as China and Brazil. Despite this difficult environment, and having suffered years of decline, V & B Fliesen GmbH was able to clearly improve its sales. Clear increases in sales and revenue were secured above all by the core range of the Villeroy & Boch brand.

Despite a slight upturn in the 4th quarter of 2006, tile consumption in Germany – the Division's largest sales market – again experienced a quantitative decline of 5 %, while values remained stagnant. Villeroy & Boch was able to secure a 7 % sales increase here too, and in so doing, clearly gained market share. A considerable contribution was made to this achievement by prior-year investments. These were made predominantly in the Merzig factory to improve processes and quality, acquire machinery and systems to manufacture trend-compatible formats and also to develop distribution and logistic services. A positive effect was also achieved by reorganising the shift system in Merzig.

Above all, the Division was able to strengthen its international position. As a result of the consistent strategic orientation of V & B Fliesen GmbH to certain target markets, above-average sales increases were secured and the market position in the relevant countries clearly improved. Sales in France – the Division's second largest market – rose 10.8 %, in Benelux 18 %, in Scandinavia 17 % and in South-Eastern Europe 36 %. These increases were able to more than compensate for the considerable sales loss incurred as a result of giving up sales and distribution of tiles under the Mondial brand name in Romania.

HIGH LEVEL OF ACCEPTANCE FOR DYNAMIC INNOVATION STRATEGY

Above-average sales increase in target markets

The above-average sales trend in 2006 essentially also results from a highly dynamic development of innovative products which recorded a positive response in all markets. In addition, the prompt selection, provision and supply of samples in January 2006 was a decisive success factor which enabled us to secure a considerable time advantage over the competition.

The tone for tile design in 2006 was set by highly-nuanced natural stone looks, colour and a variety of formats. With our finger on the pulse of time we took up the latest trends and realised them in cooperation with renowned international designers. Innovative series such as "Fire & Ice" or "Scenario" strike new paths in the areas of colour, material effect and decoration. While colour was previously considered the trend-setting element, today it is structures and material character which are playing an increasingly dominant role. In addition to bold fashion colours, Villeroy & Boch has, therefore, also chosen unusual surface structures, relief effects and haptic qualities for its tile collections, with the effect that ceramic acquires a new emotionality and value as a material. "Scope", the innovative fine stoneware concept, stood out as a result of its effective combination of simplicity and high-tech, and the wealth of its modern, purist design alternatives. A "Country" lifestyle highlight is seen in the natural-stone look of the new "Ravera" series. It is a perfect interpretation of Sardinian sandstone and is characterised by highly-functional advantages.

One of the outstanding designs at "Cersaie 2006" – the major international tile trade fair – was the "Fire & Ice" series. Its distinctive character reveals new iridescent colour in the softly shimmering metal effect of the surfaces, depending on the light. Large formats, such as 30 x 60 cm, intensify the effect.

Having already enjoyed success for many years, the "Pro Architectura" series – a versatile commercial collection suitable for totally differing areas of application – again received a strong positive response from planners and architects. The comprehensive modular system of formats, colours and moulded accessories provides a wealth of alternatives with which to creatively develop and realise highly individual solutions, right down to the very last detail.

In autumn we presented our new tile introductions to our trading partners in Germany during the course of a "Tile Forum" held at four selected locations. Free from exhibition stress and time pressure we were able to perform on-the-spot presentations of our new-product collection during one-to-one talks in Berlin, Oberhausen, Mettlach and Munich. The provision and supply of samples was therefore ensured at the start of January 2007, even before the German construction trade fair in Munich.

Bathroom design using the "Scenario" wall tile in different formats and expressive bright colours. A characteristic feature is the unusual material mix of fully-patterned glass tiles in a shiny petrol blue and three dimensional effects.

Bathroom arrangement using the "Melrose" wall tile in soft, pastel shades. The vertical border, presented in the floral, sand-blasted pattern "Ayurveda", is a response to the trend towards nature and authenticity, and harmonises well with the fine-stoneware floor tile, "Bernina".

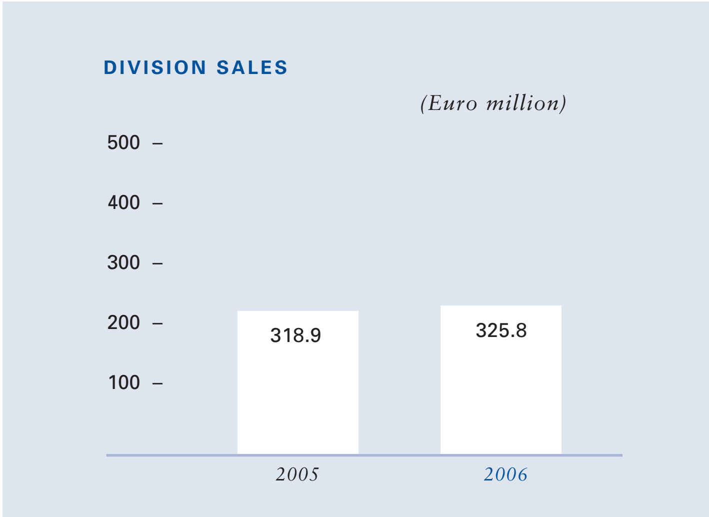
The products launched in 2005 and 2006 once again successfully raised the new-product share of sales in 2006 to more than 30 %. In 2007 there will again be an extensive range of new product introductions, not only in summer, but also on the occasion of the "Cersaie" trade fair in Bologna in autumn.
In addition to their strong design qualities, these new developments and product-range extensions satisfy the needs of special target groups, particularly those in the area of large-scale projects, and at the same time meet the varying requirements of the different international markets. The range's extensive renewal has been accompanied by a clear increase in average revenue.
We shall continue to promote this development by positioning prices in the middle and upper price segment in line with market trends, and in so doing also accommodate our trade partners' wishes for profitable product ranges.

OUTLOOK

Following the clear progress made both in the area of costs and markets, our declared goal is now to secure a profit. Essential elements of our strategy will continue to be the tight management of costs and processes, as well as the dynamic development of our product range to conform with market trends. By strengthening our position in the domestic market and developing international distribution to include filtered target markets, further support will be achieved for sales growth at V & B Fliesen GmbH.

Global distribution campaign

In Eastern Europe, we shall again prioritise the potential of the Polish and Russian markets. Following a long break in our attendance, we shall once again participate in "Mosbuild", the construction trade fair in Moscow, in 2007. V & B Fliesen GmbH will also start a comparable distribution campaign in the USA by taking part in "Coverings" in Chicago. It is likewise planned to reinforce our distribution network in the markets of the Middle and Far East, where the emphasis on tapping potential in China is becoming a priority.


DIVISION SALES
(Euro million)
500
400
300
200
100
318.9
325.8
2005
2006

Using our keen sense of international trends and lifestyle segmentation, we develop and market products which comply exactly with the taste of discerning customers in the global market. Design-conscious consumers in the major growth markets Asia and America appreciate European design and renowned European brands.

Wendelin von Boch, Management Board Chairman of Villeroy & Boch, on the international significance of design and quality

"Simply Good Design."

How do you account for the development lead Villeroy & Boch tableware has over the competition?
Wendelin von Boch: In the three-and-a-half decades in which I have managed Villeroy & Boch tableware business, our sales have risen from Euro 20 million to Euro 326 million, which has secured our current ranking of third in the world. In fact, the Villeroy & Boch brand itself ranks top.

I think that our above-average development can be attributed primarily to the better feeling we have for the right product. We have recognised trend changes more quickly and presented the right design at the right time. This was made possible as a result of our deep involvement with the needs of end consumers. Such a positive development over such a long period of time would have been inconceivable without the constant innovation of concepts, products and technologies and a high level of consumer closeness.

It's alleged that as a rule, two out of every three innovations are flops.
Wendelin von Boch: Our flop rate is just the opposite. Only one innovation in three flops. Our selection procedure is carried out with extreme care. The chances of a successful product launch are increased by our extensive knowledge of the market, target-group analysis and customer closeness on the one hand, and professional product managers and outstanding designers on the other.

In earlier years, 70 % of sales were made in the domestic market and only 30 % in export markets. Today the export share has grown to 76 %. Is it not more difficult to develop a commercial design which can be marketed internationally?
Wendelin von Boch: In principle it is more difficult and results in much more complexity within the range. Great differences can often be seen in drinking and eating habits from one region or continent to another.

However, it is possible to note that the tastes in the "global village" we live in are becoming increasingly similar. This can be attributed mostly to growing tourism and the internationalisation of the media.

The result is that the same patterns and tableware styles not only top the charts in Asia, but also in Europe and America. Only twenty years ago, however, patterns which were successful in Germany simply couldn't be sold in the USA or France, and vice-versa. We believe the latest trend offers a great opportunity for global presence.

Tableware Division

TABLEWARE DIVISION KEY DATA

		2006	2005
Sales	*Euro million*	325.8	318.9
EBIT	*Euro million*	6.1	10.7
Net operating margin	*Percent*	1.9	3.4
Capital expenditure	*Euro million*	6.8	8.5
Depreciation	*Euro million*	16.4	16.4
Employees (annual average)	*Number*	3,011	3,203

MODERATE GROWTH DESPITE INTERNATIONALLY INTENSIFIED COMPETITION

Sales and profit on a broader basis by using different channels of distribution

Despite the persistently fierce competition from China the Tableware Division was able to assert itself well in the year 2006. However, the raised level of buyer confidence in Germany has had little effect on sales growth, which can be attributed in part to structural changes in dealings within the specialised retailing sector. This was more than compensated by the strong growth in export business, which as a whole was 7 % higher than in the previous year. This development raised the export share to 76 %.

Particular success was experienced in Europe in the Spanish, Swiss, Polish, Belgian/Dutch, Italian and British markets. The markets in the Middle and Far East, as well as overseas markets, including Australia, were also able to secure strong gains. In contrast, slight declines developed in the USA and France. Sales losses there can also be attributed to structural adjustments in the retail environment.

Sales in the Tableware Division were above the prior-year level. A particular contribution was made to these figures by successfully opening several new outlets in our own retailing sector, and also by securing large-scale advertising media business and special orders which were more than able to compensate for declines in the traditional specialised retailing sector. Also in 2006 Villeroy & Boch put sales and profit on a broader basis by using different channels of distribution.

Profit in the year 2006 was strongly affected by large-scale restructuring measures, particularly at the business location in Luxembourg, due to which our operating result profit was lower than planned. We expect to cut expenses by ca. Euro 6 million in future as a result of implementing these measures to centralise all logistic and decoration business.

TABLEWARE AND ACCESSORIES BUSINESS SEGMENT

The global marketing strategy which was launched in 2005 and focuses on asymmetrical tableware, continued to enjoy success in the year 2006. Current products in the asymmet-

Decorated with soft applications of gold, the "Golden Garden" tableware series combines opulence and lightness. Made from the finest bone china, this series complies with the latest trend towards luxury and romanticism.

rical range saw sales growth of around 17 %, and it was also possible to improve prior-year gross margins.
Villeroy & Boch was extremely successful with a number of new product introductions in the "Classic", "Country" and "Metropolitan" lifestyles. Four of these series stand out in particular: "Country Heritage" and "Cascara" from the modern, country-cottage-style sector, the "Metropolitan" tableware series "Flow" with its remarkable stylistic elements, and "Aureus", which was launched in response to the latest mega-trend "Luxury". These new product introductions are also not marketed as individual products, but instead as concept series with appealing solutions both for the trade and the consumer.

GLASS AND CUTLERY BUSINESS SEGMENT

The Glass and Cutlery Business Segment was able to develop positively again this year in a highly competitive environment and in so doing, made a considerable contribution to increasing sales and stabilising profit within the Division. Significant special orders for cutlery also played a part here. Special mention is to be given to the successful launch of "Cascara" – the glass series matching tableware of the same name – and "Marchesi" – the gourmet cutlery series which was developed by the Italian celebrity chef of the same name.

HOTEL BUSINESS SEGMENT

Efficiency in providing solutions for the retail and commercial sectors

The Hotel Business Segment was able to improve its prior-year figures despite the fiercely contested market conditions. The competitive situation became even more intensive in 2006 due to the massive rise in imports from low-wage countries. Villeroy & Boch was able to expand its activities in this specific business as a result of consistently implementing the Hotel Business Segment's strategy, which is based on innovation, quality and service. In this way we were able to win a number of new customers in the international market, not only from the traditional catering sector, but also those requiring large-scale projects. In this respect, special mention is made of the order to equip the VIP catering sector with roughly 1 million pieces of tableware for the Confederation Cup and the World Cup.

DISTRIBUTION / DISTRIBUTION CHANNELS

Existing points of sale were modernised and new shops opened in the company's own retailing sector. In contrast, some "House of Villeroy & Boch" stores which no longer achieved the stipulated profitability targets, or whose business location had become less attractive, were closed, and others in the same category will follow in future. The specialised retailing sector remains problematic. As a result, an increasing number of shops in Europe are closing down due either to a lack of successor regulations or to the change in consumer behaviour. Despite this background, Villeroy & Boch was still able to win new specialised retailers again in 2006. Also in 2006, Villeroy & Boch offered the specialised retailing sector numerous sales promotion measures which backed sales in spring, autumn and during the Christmas business period.

e-commerce: rapid rise in the USA

The e-commerce channel of distribution launched in 2005 experienced rapid development. As a result, sales in 2006 were more than double those in the prior year, a situation promoted mainly by the tremendous rise in use in the United States market, and also by

opening this same distribution channel in every EU country. Further markets will be developed in the year 2007.
Further support for the multi-channel strategy is achieved by implementing an extensive CRM project (Customer Relation Management) called the "House of Customers". This project places customers at the centre of processes and trade. It is therefore concerned not only with the Division's ability to attend to customer needs more intensively using the respective existing distribution channel, but also with internally aligning the value chain even more strongly to meet this target. In October 2006 the company was able to successfully apply the first phase of computer support.

OUTLOOK

Further new product concepts will be launched in the various lifestyles in 2007: "New-Wave Caffè Africa" and an ethnic-trend "NewWave" ("Metropolitan"), "Marlene" and "Viviane" ("Classic") and "My Garden" ("Country"). Attention will be focussed particularly on articles from the accessory sector, and on the seasonal gift articles related to Easter and Christmas. POS appeal will be further increased by a balanced product range covering items from the completely-laid table to extensive gift concepts.
Our distribution strategy will focus on further internationalisation and concentrate in particular on the Indian and Chinese markets. Numerous new POS will be opened with our partners in these future markets.
There will be further development of the company's own retailing sector. In 2007 we shall implement several selective advertising and marketing campaigns together with the traditional retailing sector. From as early as spring, the "rosy times" campaign is being offered as a sales promotion measure, and has already met with a high degree of acceptance.

Response to "VIVO | Villeroy & Boch" brand exceeds all expectations

The main area of concentration in 2007 will be the launch of the new "VIVO | Villeroy & Boch" brand, which was presented for the first time at "Ambiente", the spring trade fair in Frankfurt. With this brand Villeroy & Boch is serving the growing target group of young, mobile, unconventional and price-conscious consumers, which the premium brand has previously been unable to reach. "VIVO | Villeroy & Boch" is therefore positioned clearly below the premium brand's price level, and its cheeky, trendy designs, its multifunctionality and convenience are geared specifically towards the needs and tastes of the target group.
Although expectations were high at "Ambiente", they were even exceeded by the enthusiastic response among market partners. A large volume of orders was already received at the trade fair alone. The character of this young brand is to be underlined by an independent presentation in the retail sector. A completely new, mobile display system has been developed in a cool design which is totally in keeping with the "VIVO | Villeroy & Boch" style. The primary aim of this system is to effectively distinguish the new brand from the rest of the range and also to convey it to consumers.
The product concept consists of a compact, clearly-structured range with versatile items from the tableware, glass, cutlery and kitchen-aid areas. Offering well-thought-out functionality, user friendliness and a fresh appearance on a mix&match basis, it accommodates the modern "oven-to-table" principle, with the effect that it complies with the target group's ideas at all levels.

The new VIVO | Villeroy & Boch brand for a mobile, unconventional lifestyle offers a compact range with tableware, accessories and cutlery. The characteristic design is based on the shape of a four-leaf clover.

vivo
VILLEROY & BOCH

Consolidated Financial Statements of Villeroy & Boch AG

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Consolidated Income Statement

Euro '000	*Notes*	*2006*	*2005*
REVENUE	*23*	**964,180**	**893,241**
Costs of sales	*24*	- 594,081	- 547,088
GROSS PROFIT		**370,099**	**346,153**
Selling, marketing and development costs	*25*	- 279,343	- 281,809
General and administrative expenses	*26*	- 52,653	- 48,671
Other operating income/expenses	*27*	- 5,246	8,419
Result from investments in associates	*28*	425	243
OPERATING RESULT (EBIT)		**33,282**	**24,335**
Financial income	*29*	5,506	6,789
Financial expenses	*29*	- 15,737	- 15,073
FINANCIAL RESULTS		**- 10,231**	**- 8,284**
RESULT BEFORE TAX		**23,051**	**16,051**
Income taxes	*30*	- 5,939	- 2,873
RESULT AFTER TAX		**17,112**	**13,178**
of which attributable to minority interests	*31*	- 75	- 103
OF WHICH GROUP EQUITY HOLDERS ARE ENTITLED TO (CONSOLIDATED RESULT)		**17,037**	**13,075**
Net earnings per ordinary share in Euros	*32*	0.62	0.47
Net earnings per preference share in Euros	*32*	0.67	0.52

Assets

Euro '000	*Notes*	*31.12.2006*	*31.12.2005*
NON-CURRENT ASSETS			
Intangible assets	*1*	47,681	42,235
Property, plant and equipment	*2*	253,190	245,737
Investment properties	*3*	1,360	1,303
Investment accounted for at equity	*4*	1,058	633
Other financial assets	*5*	2,528	15,502
		305,817	**305,410**
Other non-current assets	*10*	240	482
Deferred tax assets	*6*	51,926	52,242
		357,983	**358,134**
CURRENT ASSETS			
Inventories	*7*	205,759	205,644
Trade receivables	*8*	163,486	136,273 [1)]
Financial assets	*9*	10,348	78
Other current assets	*10*	24,184	13,891
Tax claims	*11*	16,017	14,551
Cash and cash equivalents	*12*	11,596	58,490
		431,390	**428,927**
TOTAL ASSETS		**789,373**	**787,061**

[1)] Prior-year figures adjusted due to the change in the accounting of a discounted bill of exchange

Liabilities and Shareholders' Equity

Euro '000	*Notes*	*31.12.2006*	*31.12.2005*
EQUITY ATTRIBUTABLE TO VILLEROY & BOCH AG SHAREHOLDERS			
Issued capital	13	71,909	71,909
Capital surplus	14	193,587	193,587
Retained earnings	15	67,556	62,214
Consolidated result		17,037	13,075
		350,089	**340,785**
EQUITY ATTRIBUTABLE TO MINORITY INTERESTS	16	**310**	**3,642**
TOTAL EQUITY		**350,399**	**344,427**
NON-CURRENT LIABILITIES			
Provisions for pensions and similar obligations	17	187,045	189,127
Other non-current provisions	18	9,253	7,671
Non-current financial liabilities	19	0	0
Other non-current liabilities	20	3,606	5,068
Deferred tax liabilities	6	19,017	21,425
		218,921	**223,291**
CURRENT LIABILITIES			
Other current provisions	18	31,660	33,212 [2]
Current financial liabilities	19	0	0
Other current liabilities	20	89,641	81,883 [2]
Trade payables	21	82,391	86,059 [1]
Tax liabilities	22	16,361	18,189
		220,053	**219,343**
TOTAL LIABILITIES		**438,974**	**442,634**
TOTAL EQUITY AND LIABILITIES		**789,373**	**787,061**

[1] Prior-year figures adjusted due to the change in the accounting of a discounted bill of exchange
[2] Prior-year figure adjusted due to the reclassification in the previous year from current liabilities to current provisions

Cash Flow Statement

Euro '000	*2006*	*2005*
Profit after tax	17,112	13,178
Depreciation of non-current assets	44,188	44,560
Write-ups on non-current assets	0	- 599
Change in non-current provisions	- 11,569	- 13,563
Profit from disposal of fixed assets	- 12,341	- 2,631
Change in inventories, accounts receivable and other assets	- 14,205	20,358
Change in liabilities, current provisions and other liabilities	- 4,227	- 13,155
Taxes paid/received in financial year	- 5,698	- 1,538
Interest paid in financial year	- 4,535	- 3,593
Interest received in financial year	3,065	4,271
Other non-cash income/expenses	10,934	9,572
CASH FLOW FROM OPERATING ACTIVITIES	**22,724**	**56,860**
Purchase of intangible assets, property, plant and equipment	- 38,804	- 35,438
Investment in non-current financial assets and cash payments for the acquisition of consolidated companies	- 37,010	- 13,636
Cash receipts from disposals of fixed assets	15,157	16,290
CASH FLOW FROM INVESTING ACTIVITIES	**- 60,657**	**- 32,784**
Change in financial liabilities/other	- 247	- 6,000
Dividend payments	- 9,068	- 10,388
CASH FLOW FROM FINANCING ACTIVITIES	**- 9,315**	**- 16,388**
SUM OF CASH FLOWS	**- 47,248**	**7,688**
Changes due to exchange rates	80	- 532
NET INCREASE IN CASH AND CASH EQUIVALENTS	**- 47,168**	**7,156**
Balance of cash and cash equivalents as of 01.01.	58,490	51,334
Change in consolidated companies	274	0
Net increase in cash and cash equivalents	- 47,168	7,156
BALANCE OF CASH AND CASH EQUIVALENTS AS OF 31.12.	**11,596**	**58,490**

The balance of cash and cash equivalents consists of the items 'Cash at banks' and 'Cheques and cash on hand'.

See note 37 to the consolidated financial statements of Villeroy & Boch AG for additional information.

Statement of Equity

Euro '000	*Issued capital*	*Capital surplus*	*Retained earnings*	*Consolidated result*	*Equity attributable to Villeroy&Boch AG share-holders*	*Equity attributable to minority interests*	*Total equity*
As of 01.01.2005	**71,909**	**193,587**	**60,356**	**15,995**	**341,847**	**3,458**	**345,305**
Dividend				- 10,388	- 10,388	- 62	- 10,450
Reclassification of prior-year consolidated result			5,607	- 5,607	0		0
Consolidated result				13,075	13,075	103	13,178
Subsequent valuation IAS 39			557		557		557
Currency adjustment			- 4,702		- 4,702	146	- 4,556
Acquisition of minority interests					0	- 3	- 3
Other changes in equity			396		396		396
As of 31.12.2005	**71,909**	**193,587**	**62,214**	**13,075**	**340,785**	**3,642**	**344,427**
As of 01.01.2006	**71,909**	**193,587**	**62,214**	**13,075**	**340,785**	**3,642**	**344,427**
Dividend				- 9,068	- 9,068	- 66	- 9,134
Reclassification of prior-year consolidated result			4,007	- 4,007	0		0
Consolidated result				17,037	17,037	75	17,112
Subsequent valuation IAS 39			- 447		- 447		- 447
Acquisition of minority interests					0	- 3,338	- 3,338
Currency adjustment			1,962		1,962	- 3	1,959
Other changes in equity			- 180		- 180		- 180
As of 31.12.2006	**71,909**	**193,587**	**67,556**	**17,037**	**350,089**	**310**	**350,399**

See notes 13-16 to the consolidated financial statements of Villeroy & Boch AG for additional information.

Group Segment Reporting

SEGMENT REPORTING ACCORDING TO DIVISION – PRIMARY SEGMENTS

	Bathroom and Wellness			Tiles		
Euro million	*2006*	*2005*	*Difference*	*2006*	*2005*	*Difference*
External revenue (net)	489.2	430.6	58.6	149.2	143.7	5.5
Segment-spanning internal revenue	1.4	1.7	- 0.3	0.0	0.1	- 0.1
Revenue (net)	490.6	432.3	58.3	149.2	143.8	5.4
EBITDA	50.3	41.8	8.5	4.5	0.0	4.5
Depreciation (intangible/tangible assets)	22.0	21.5	0.5	5.6	6.7	- 1.1
- thereof impairment	0.0	0.0	0.0	0.0	0.0	0.0
Depreciation of financial assets	-	-	-	-	-	-
EBIT	28.3	20.3	8.0	- 1.1	- 6.7	5.6
Financial results	-	-	-	-	-	-
Capital expenditure	29.1	21.6	7.5	4.0	5.3	- 1.3
Capital expenditure arising from change in consolidated companies	19.1	0.0	19.1	0,0	0.0	0.0
Operating assets	377.4	316.1	61.3	112.2	114.3	- 2.1
Operating liabilities	128.4	106.6	21.8	38.8	38.2	0.6
Net operating assets	249.0	209.5	39.5	73.4	76.1	- 2.7
Other non-cash expenses	0.0	0,0	0.0	0.0	0.0	0.0
Result from associates	0.0	0,0	0.0	0.4	0.2	0.2
Number of employees (annual average)	5,789	4,801	988	976	1,044	- 68

See note 38 to the consolidated financial statements of Villeroy & Boch AG for additional information.

SEGMENT REPORTING ACCORDING TO REGION – SECONDARY SEGMENTS

	Germany			France			Rest of Western Europe		
Euro million	*2006*	*2005*	*Difference*	*2006*	*2005*	*Difference*	*2006*	*2005*	*Difference*
External revenue (net)	278.7	274.3	4.4	109.6	111.2	- 1.6	358.4	329.5	28.9
Segment-spannin internal revenue	1.4	1.7	- 0.3	0.0	0.0	0.0	0.1	0.2	- 0.1
Revenue (net)	280.1	276.0	4.1	109.6	111.2	- 1.6	358.5	329.7	28.8
Capital expenditure	14.3	13.1	1.2	2.4	3.8	- 1.4	13.1	11.5	1.6
Capital expenditure arising from change in consolidated companies	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Operating assets	328.3	304.3	24.0	23.4	36.6	- 13.2	176.7	189.9	- 13.2
Operating liabilities	117.0	101.9	15.1	16.3	18.7	- 2.4	58.2	57.3	0.9
Net operating assets	211.3	202.4	8.9	7.1	17.9	- 10.8	118.5	132.6	- 14.1
Number of employees (annual average)	3,586	3,810	- 224	820	854	- 34	2,196	2,290	-94

See note 38 to the consolidated financial statements of Villeroy & Boch AG for additional information.

Tableware			Consolidation			Villeroy & Boch Group		
2006	*2005*	*Difference*	*2006*	*2005*	*Difference*	*2006*	*2005*	*Difference*
325.8	318.9	6.9	0.0	0.0	0.0	964.2	893.2	71.0
0.1	0.1	0.0	- 1.5	- 1.9	0.4	0.0	0.0	0.0
325.9	319.0	6.9	- 1.5	- 1.9	0.4	964.2	893.2	71.0
22.5	27.1	- 4.6	-	-	-	77.3	68.9	8.4
16.4	16.4	0.0	-	-	-	44.0	44.6	- 0.6
0.0	0.0	0.0	-	-	-	0.0	0.0	0.0
-	-	-	0.2	0.0	0.2	0.2	0.0	0.2
6.1	10.7	- 4.6	-	-	-	33.3	24.3	9.0
-	-	-	- 10.2	- 8.2	- 2.0	- 10.2	- 8.2	- 2.0
6.8	8.5	- 1.7	-	-	-	39.9	35.4	4.5
0.0	0,0	0.0	-	-	-	19.1	0.0	19.1
186.0	198.5	- 12.5	113.8	158.2	- 44.4	789.4	787.1	2.3
50.8	47.1	3.7	221.0	250.8	- 29.8	439.0	442.7	- 3.7
135.2	151.4	- 16.2	- 107.2	- 92.6	- 14.6	350.4	344.4	6.0
0.0	0.0	0.0	- 13.8	- 17.9	4.1	- 13.8	- 17.9	4.1
0.0	0.0	0.0	-	-	-	0.4	0.2	0.2
3,011	3,203	- 192	435	473	-38	10,211	9,521	690

Eastern Europe			Rest of the World			Consolidation			Villeroy & Boch Group		
2006	*2005*	*Difference*	*2006*	*2005*	*Difference*	*2006*	*2005*	*Difference*	*2006*	*2005*	*Difference*
79.3	75.0	4.3	138.2	103.2	35.0	0.0	0.0	0.0	964.2	893.2	71.0
0.0	0.0	0.0	0.0	0.0	0.0	- 1.5	- 1.9	0.4	0.0	0.0	0.0
79.3	75.0	4.3	138.2	103.2	35.0	- 1.5	- 1.9	0.4	964.2	893.2	71.0
8.5	6.3	2.2	1.6	0.7	0.9	-	-	-	39.9	35.4	4.5
0.0	0.0	0.0	19.1	0.0	19.1	-	-	-	19.1	0.0	19.1
75.4	70.6	4.8	71.8	27.5	44.3	113.8	158.2	-44.4	789.4	787.1	2.3
8.9	9.6	- 0.7	17.6	4.4	13.2	221.0	250.8	-29.8	439.0	442.7	- 3.7
66.5	61.0	5.5	54.2	23.1	31.1	- 107.2	- 92.6	-14.6	350.4	344.4	6.0
2,011	1,895	116	1,598	672	926	-	-	-	10,211	9,521	690

GENERAL INFORMATION

Villeroy & Boch AG headquarters are situated in Saaruferstrasse, Mettlach. As a public limited company under German law it is quoted on the German stock market and acts as parent company to the Villeroy & Boch Group. The Villeroy & Boch Group is an internationally established network of companies which focuses its activities as leading lifestyle provider on the Tile, Bathroom and Wellness, and Tableware Divisions. Villeroy & Boch AG trades on the Prime Standard of the German stock market, Deutsche Börse AG. The consolidated financial statements as of 31 December 2006 have been drawn up in consideration of 315a HGB [German Commercial Code] in accordance with the current provisions of the International Accounting Standards Board (IASB) and the applicable interpretations of the International Financial Reporting Interpretations Committee (IFRIC). In so doing, all IFRS accounting principles have been considered which have been adopted by the European Commission and the application of which is compulsory for the financial year commencing January 1st 2006. The consolidated financial statements have been supplemented by additional explanatory notes in accordance with §315a HGB.
The following explanatory notes give detailed information and comments on the balance sheet with regard to maturity, on the income statement in accordance with the cost-of-sales method, on the statement of changes in equity, on the segmenting and on the cash flow statement.
The consolidated financial statements were prepared in Euros. The reporting currency is the Euro. Unless otherwise specified, all amounts are given in thousands of Euros (Euro ’000).
The valuation and accounting principles of the IFRS regulatory system, as applied by Villeroy & Boch in accordance with the regulations, are described below.

VALUATION AND ACCOUNTING PRINCIPLES

Intangible assets
Nongratuitously acquired intangible assets are included in the assets at cost. The cost is composed of the original price less reductions in the original price plus ancillary expenses necessary for the asset to become operational. The cost of financing is reported with effect on the operating result in accordance with the benchmark method as stipulated by IAS 23. Research costs are shown as current expenditure of the respective financial year. Self-generated intangible assets are only included under assets in the year of their accrual if the requirements stipulated by IAS 38 have been fulfilled.
Intangible assets consist of values with finite and indefinite periods of useful life. Values for a finite useful life are reduced in accordance with their course of useful life by scheduled amortisation using the straight-line method. Useful life is mainly between three and six years. Amortisation is predominantly included in the general and administrative expenses.
The amortisation of assets with an indefinite useful life, for example goodwill, is only carried out if a reduction in value has been ascertained. In order to determine the value the historical cost is compared with the recoverable amount. The recoverable amount is defined as the higher of the two amounts arising from the net realisable value and the value in use of the same asset.
The net realisable value corresponds to the revenue that could be achieved with an independent business partner after deduction of the total accrued cost of sale.
The current three-year plan drawn up by the management forms the basis on which the value in use is determined. The planning principles are brought in line with the respective current facts and circumstances. In so doing, assumptions on macroeconomic trends and historical developments are taken into account. A perpetual annuity is taken into account for the planning projection aligned with the three-year planning period. The value in use is calculated by discounting the extrapolated cash flow with an appropriate long-term interest rate before income taxes in accordance with the discounted cash flow method. The interest rate applied is 6 %. The rates of increase in sales and in the result are taken into account in the planning projections. The annual impairment test for capitalised goodwill is conducted on a Division level.
In the event that reductions in value are ascertained, these are included with effect on the operating result. Should the grounds for impairment amortisation with effect on the operating result cease to exist, a corresponding write-up will be undertaken. A write-up is not permitted in the case of capitalised goodwill.
Payments on intangible assets are shown at their cost. The assets concerned are not written down until they are operational.

Emission allowances
The certificates issued gratuitously by the German emissions trading authority, Deutsche Emissionshandelsstelle, or by a comparable authority in other countries are assessed at the market prices on the date of the credit transfer or at the cost in the case of nongratuitous acquisition. A value adjustment is undertaken if the market values are lower.

Property, plant and equipment
Property, plant and equipment are reported in the balance sheet at cost or production cost minus scheduled amortisation dependent on the useful life. The cost is composed of the original price minus reductions in the original price plus ancillary expenses necessary for the asset to become operational. The cost of production is assessed on the basis of the directly allocable unit costs together with prorata factory overheads including write-downs. The cost of repair of property, plant and equipment and the cost of financing are fundamentally reported with effect on the operating result.
In the event that an asset is made up of several components, the useful life of which differs considerably from one to another, scheduled amortisation of the individual elements is undertaken in accordance with their individual performance potential. All the components of an asset are shown in the same item.
The straight-line method is used to depreciate property, plant and equipment in accordance with their period of useful life. The following periods of useful life are taken as a basis throughout the group:

Class of asset	*Useful life in years*
Buildings (predominantly 20 years)	20 – 50
Plant facilities	10 – 20
Kilns	5 – 10
Technical equipment and machinery	6 – 12
Vehicles	4 – 8
EDP systems	3 – 6
Other fixtures, fittings and equipment	3 – 10

The estimated commercial useful life is reviewed regularly and, if necessary, the future instalments for amortisation are adjusted.
In addition to the scheduled amortisation, the value of property, plant and equipment is depreciated if the value in use or net realisable value of the asset concerned has fallen below the historical cost or cost of production. Should reasons for depreciation of the value cease to exist, an appropriate write-up is undertaken. Low-value items are written off completely in the year of acquisition.
Facilities under construction and payments made on account are reported in the balance sheet at cost. They are not written down until the assets concerned are available and operational.

Leasing
If fixed assets are rented or leased, and if beneficial ownership is held by the respective consolidated company, the aforementioned values are allocated to the lessee (finance lease). Capitalisation takes place at their fair value or the lower present value of the leasing instalments. Depreciation is carried out on the basis of the appropriate useful life or, if shorter, the term of the leasing agreement. The appropriate financial obligations arising from the future leasing instalments are set up as a liability.
If the lessee bears all the basic risks and prospects connected to the property (operating lease), the leasing instalments or rental expenses respectively are included directly in the Income Statement as an expense.

Government grants
Public grants and subsidies received for the acquisition or construction of tangible and intangible assets reduce the cost and cost of production, in so far as they can be allocated to the individual assets. If this is not the case, they are accrued and then appropriated with a subsequent reversal dependent on the degree of performance.

Non-current assets held for sale
Non-current assets are to be classified in accordance with IFRS 5 as 'held for sale' if the carrying amount of the object can be achieved mainly through its sale and not through its current use. This presupposes that the asset concerned is available for immediate sale in its current condition and that a sale is to be expected. The valuation is calculated on the basis of the lower of the two amounts arising from the carrying amount and the fair value less the cost of sale. These values are no longer depreciated according to schedule.

Investment property
In accordance with IAS 40, real estate and buildings kept to earn regular rentals (investment properties) are to be shown separately from assets used in business operations. A multi-purpose real-estate property is classified prorata as a financial investment if the portion of the building let on lease could be sold separately. If the criterion of individual disposability is not fulfilled, the property is considered to be an investment property if the owner-occupied portion is insignificant (less than 30 %). Investment Properties are shown in the balance sheet at historical cost. The period of depreciation corresponds to that of the property, plant and equipment used for business operations. The official land benchmark cards form the basis of the valuation of the current market value. These are drawn up at regular intervals by committees of experts of the competent cadastral office on the basis of the real-estate transactions effected in the respective administrative district.

Investment accounted for at equity
Investments in associates are shown in the balance sheet in accordance with the equity method. In this case, the cost accrued at the time of acquisition is adjusted to reflect the investor's future share of the net profit.

Other financial assets
Participating interests and securities held on a long-term basis are classified in accordance with IAS 39 as 'held-to-maturity assets' or 'available-for-sale' financial assets. The value of financial assets is to be reviewed regularly.
In so far as a market price can be determined for a participating interest or a security held on a long-term basis, an expense of the depreciation of the value exists if it can be ascertained that the value in the balance sheet is expected to be higher in the long term than the market value. If there is no listed market price available for a financial asset, it is shown on the balance sheet at historical cost. If there are objective and substantive indications for a reduction in value, the recoverable amount is written down.
If a reduction in value is ascertained, it is reported with effect on the operating result. Should the reasons for impairment depreciation required in the previous year cease to exist, a corresponding write-up with effect on the operating result is undertaken. In this case, the write-up will not exceed the reduction in value ascertained in the previous year.
Borrowings are shown in the balance sheet at historical cost.

Financial instruments
The initial valuation of financial instruments is undertaken at cost. The cost comprises the market price plus transaction cost. In this case, the cost of financing and the general and administrative costs are not taken into account. IAS 39 divides financial assets into the following classifications:
- Held-for-trading financial assets or liabilities, which are shown at fair value;
- Held-to-maturity financial investments, which are included at historical cost;
- 'Other' borrowings and receivables or liabilities respectively, which are also evaluated at historical cost;
- Available-for-sale financial assets, which do not fall under the first three classifications and which are also reported at fair value. In this classification, the change in fair value between balance-sheet dates is shown in equity without effect on the operating result.

There was no reclassification between the individual valuations in the year under review.

Hedge accounting
Forward exchange operations and interest rate swaps in particular are used within the Villeroy & Boch Group to secure balance sheet items and against the risk of future in-payments and out-payments.

In the case of cash flow hedges to secure against the risk of future in-payments and out-payments, the hedge transaction is valued at market value. Changes in the valuation are initially without effect on the operating result within the retained earnings and only included with effect on the operating result on realisation of the in-payments and out-payments.
In the case of fair value hedges to secure against the risk of a change in value, both hedge transaction and the proportional risk secured against in the mainstay business are likewise shown in the balance sheet at market value. Fluctuations in the market value of hedge and mainstay transactions are shown with effect on the operating result.

Related financial instruments
Other financial instruments or other contractual agreements may contain derivative components (embedded derivatives). These related instruments form a valuation unit if the prospects and risks arising from both component parts are closely linked and the hedged item would be shown in the balance sheet at fair value. In all other cases the embedded derivative of the basic component is treated separately and as an independent instrument of the classification 'held-for-trading financial assets or liabilities, which are shown at fair value'.

Other accounts receivable and financial assets
Other accounts receivable and financial assets are shown on the balance sheet at historical cost. Any necessary adjustments to value, which are guided by actual risk of default, are taken into account. A separate disclosure is made in line with the remaining term.

Deferred tax
Deferred tax is formed to cover temporary differences between the values reported in the consolidated balance sheet and the tax balance sheet and additionally for claims to a tax decrease, which result from the anticipated future application of accumulated losses. If there is not sufficient certainty that this will be realised, the values are adjusted accordingly.
Deferred tax is ascertained on the basis of the anticipated tax rates applicable on the adjustment date of the different valuation rates between the tax balance sheet and the commercial balance sheet. Generally, the changes to deferred tax are reported with effect on the operating result with the exception of the initial entries to be made without effect on the operating result in equity. As stipulated in IAS 1, the balance-sheet item 'deferred tax' is generally deemed to be long term.

Distinction between current and non-current
In accordance with IAS 1, current and non-current assets and current and non-current liabilities are to be shown in separate classifications on the balance sheet. A balance-sheet item is to be classified as short term if it fulfils at least one of the following criteria:
a. Its realisation/settlement is expected within the regular course of business;
b. It is kept primarily for trading purposes;
c. Its realisation/repayment is expected within twelve months of the balance-sheet date or
d. In the case of an asset, it concerns cash; or, in the case of a liability, the Villeroy & Boch Group does not have the absolute right to defer the discharge of its obligation by at least twelve months after the balance-sheet date.

All other assets are classified as non-current.

Inventories
Inventories are valued at cost or cost of production unless the net realisable value is lower. The cost and cost of production include the directly allocable unit costs (direct material and labour) and the overheads which are to be allocated to the production process. The cost of financing is not taken into account. Write-downs are undertaken to an appropriate and adequate extent for inventory risks ensuing from the period of storage and/or diminished usability.
Net realisable value is calculated as the sale proceeds which are expected to be recovered, minus any costs incurred up to the time of sale.
If the net realisable value increased in inventories which had previously been adjusted, the resulting original value is included as a reduction in the initial cost of the sales.

Construction contracts
Provided the result of a construction contract can be anticipated reliably, construction contracts are reported on the balance sheet in accordance with the percentage-of-completion method. An external auditor with the necessary expertise is appointed to determine the stage of production to be appropriated. Payments for modifications to the contract specifications and secure premiums are included in the agreed scope. If the accumulated payments exceed the payments on account, the construction contract is shown on the assets side of the balance sheet under accounts receivable. If the balance is negative after deduction of the payments on account, the entry is made on the liabilities side of the balance sheet under obligations. Any anticipated risk of losses arising from construction according to customer specification is covered by the creation of a provision.

Other assets
The other accounts receivable, loans to associates and other assets are shown on the balance sheet at historical cost. Value adjustments are undertaken to take the potential risk of default into account.

Cash and cash equivalents
Cash and cash equivalents include cash on hand, demand deposits and fixed-term deposits with an original term of up to three months. Cash and cash equivalents are shown in the balance sheet at nominal value.

Provisions for pensions
The provisions for pensions are reported on the basis of actuarial appraisals using the projected unit credit method. In addition to the pensions identified on the balance-sheet date and acquired expectancies, this method also takes anticipated future increases in salaries and pensions into account. Actuarial profit and loss outside a ten-percent margin of the scope of the obligation is distributed over the average remaining period of service. The expense for the period of service is recorded in the personnel expenses. The proportionate interest expense arising from the allocation to provisions is shown in the financial results.

Other provisions
Provisions are set up for legal or constructive obligations to third parties, which arise from past developments, whereby the outflow of funds for settling the existing commitment must be probable and reliably estimable. Valuation is carried out at the future settlement amount. Discounting is undertaken where necessary. The terms are organised according to the type of provision.

Liabilities
Non-current liabilities are reported at historical cost. Liabilities arising from finance leases are entered on the liabilities side of the balance sheet at the present value of the leasing instalment. Current liabilities are appropriated with their redemption amount.

Contingent liabilities
Contingent liabilities are potential or existing obligations which are based on past developments and for which an outflow of resources is unlikely. Contingent liabilities are not shown on the balance sheet; see note no. 39. The obligations itemised correspond to the volume of liability existing on the balance-sheet date.
In the reporting period there was a shift in the balance-sheet structure of bills of exchange sent to a financial institution for discounting.
In the balance sheet as of December 31st 2005 this change affected the balance-sheet items concerned as follows:

Euro '000	*Balance-sheet amount before change*	*Effect of change*	*Balance-sheet amount after change*
Assets			
Trade receivables (note 8)	119,292	16,981	136,273
Equity and liabilities			
Trade payables (note 21)	69,078	16,981	86,059

Realisation of income and expense
Revenue, interest and provisions as well as other operating income is reported when the goods and services owed by the debtor have been provided and the price risk has been transferred to the customer. Revenue arising from the disposal of assets is not realised until they have definitively left the Group. Contract revenue and contract costs for construction contracts are reported as soon as a reliable valuation on the result of the contract is available and the contract has a substantial revenue volume.

Research and development costs
Research costs are incurred as a result of a systematic, independent search for the latest scientific and technological findings. In accordance with IAS 38, they are recorded on accrual with immediate effect on expenditure. Development costs include expenditure for the purpose of converting available theoretical knowledge into technological and commercial practice. The development phase ends when commercial production or use begins. Costs accruing in this period are capitalised if the criteria to record them as an intangible asset are fulfilled. Due to the risks involved until product placement, these criteria are, as a rule, not fully met. For this reason, the accrual is recorded with effect on expenditure.

Earnings per share
Earnings per share relate to a ratio determined in accordance with IAS 33. They are accrued by dividing the consolidated results for the year after income taxes by a weighted average number of shares issued in the course of the business year. Diluted net earnings per share are calculated on the assumption that all potential share certificates and stock options have been converted or exercised respectively. The ratio is to be given for each class of share

Cash flow statement
The cash flow statement gives the origin and use of flows of payment. Depending on their origin, they are to be allocated to the divisions of current operating activities, or investing and financing activities. Any effects due to changes in consolidated companies are to be excluded from the respective items. Incoming and outgoing payments of cash and cash equivalents which are based on fluctuations in exchange rates are shown separately.

Valuations and assessments made by the Management
It is necessary to make assumptions or valuations respectively to a certain degree in the process of drawing up the Consolidated Financial Statements.
These have affected, for example, the value assessment of capitalised assets, the ascertainment of the periods of economic useful life to be applied throughout the Group, the date of payment of accounts receivable, the valuation of the use of accumulated tax losses and the itemisation of provisions. The assumptions and valuations taken as a basis are founded on the level of information currently available at the time the Consolidated Financial Statements are drawn up. In individual cases, the real values may differ from the projected estimates.

Future modifications due to approved accounting regulations
There are currently no new IFRS or IFRIC provisions adopted which require the Villeroy & Boch Group to make changes to its accounting. Note 48 gives information on new developments in the IASC regulatory system.

CONSOLIDATED COMPANIES

In addition to Villeroy & Boch AG, the Consolidated Financial Statements include 19 (previous year: 17) domestic and 51 (previous year: 49) foreign subsidiaries, in which – directly or indirectly – majority voting rights are held.
The changes in the consolidated companies compared to the previous year are due to:

Villeroy & Boch AG and fully consolidated companies	*Germany*	*Abroad*	*Total*
As of 01.01.2006	18	49	67
Additions due to newly established companies	2	3	5
Share purchases	-	2	2
Reductions due to amalgamations	-	- 3	- 3
liquidations	-	-	-
As of 31.12.2006	20	51	71

Companies accounted for at equity	*Germany*	*Abroad*	*Total*
As of 31.12.2006 – unchanged	1	-	1

Following are the newly established companies:
- Vilbomex S.A. de C.V., Saltillo (Mexiko)
- International Materials LLC., Delaware (USA)
- Villeroy & Boch Trading (Shanghai) Co. Ltd., Shanghai (China)
- Keraco GmbH, Wadgassen
- Gästehaus Schloß Saareck Betreibergesellschaft mbH, Mettlach

The newly established company Vilbomex S.A. de C.V., in Saltillo, Mexico, has adopted the production technology available from the acquisition of the sanitary-ware business belonging to the industrial group Grupo Industrial Saltillo (GIS). The company International Materials LLC. was founded in the USA in order to optimise the tax situation. It holds a participatory interest in the acquired American trading company St. Thomas Creation Inc. Villeroy & Boch Trading (Shanghai) Co. Ltd. was established in order to be able to manage the business in China more effectively.
The acquisition of the sanitary-ware business of the GIS Group involved the takeover of two companies. A description of the company acquisitions concluded is given in the section ‘acquisitions/disinvestments/activities to be discontinued’.

Additionally, in the course of the improvements made in 2006 to corporate structure within the Villeroy & Boch Group, in Austria the company Villeroy & Boch Badmöbel GmbH was merged to form Villeroy & Boch Austria Handelsgesellschaft mbH, while in the Netherlands the companies Ucosan International B.V. and Intercore Holding B.V. were merged to form Villeroy & Boch Wellness B.V.
All subsidiaries are included in the Consolidated Financial Statements of Villeroy & Boch AG.
As in the previous year, the balance sheet of a company registered in Germany is drawn up in accordance with the equity method. The company has a 50 % share of the voting rights. The annual financial statements of the associated companies drawn up in accordance with commercial law show the following values in total:

Euro '000	*2006*	*2005*
Income statement		
Revenue	13,299	12,114
Gross profit	3,863	3,363
Operating result (EBIT)	965	577
Result before tax	858	459
Result after tax	706	374
Villeroy & Boch – share of result after tax	353	187
Balance sheet		
Non-current assets	613	723
thereof property, plant and equipment	582	693
Current assets	4,118	3,027
thereof cash and cash equivalents	48	0
Total assets	**4,731**	**3,750**
Equity	780	780
Non-current liabilities	0	0
thereof financial liabilities	0	0
Current liabilities	3,951	2,970
thereof financial liabilities	57	175
Total equity and liabilities	**4,731**	**3,750**
Villeroy & Boch – share of equity	390	390

The share of the interest is recorded separately and publicised in the electronic Federal Bulletin.

Exemption provisions for German companies
The right to waive disclosure in accordance with § 264 subsection 3 HGB for the audit and publication of financial statements was exercised.

ACQUISITIONS / DISINVESTMENTS / ACTIVITIES TO BE DISCONTINUED

Acquisitions were recorded using the purchase method in accordance with IFRS 3. Accordingly, the results of the companies acquired were included in the Consolidated Financial Statements from the date of their respective acquisition. The costs of the foreign companies acquired were converted on the date of their acquisition in the respective currency to Euros.
On 30 January 2006 a purchase agreement was concluded for the takeover of the sanitary-ware activities of the Mexican industrial group Grupo Industrial Saltillo (GIS). The acquisition comprised three factories for sanitary ware with a capacity of 2.1 million units as well as an independent marketing office in the USA.
The GIS Group assigned these activities to the Building Products Segment. In addition to sanitary-ware products this segment produces wall and floor tiles as well as continuous-flow water heaters. Having sold the three sanitary-ware factories, the GIS Group is now giving up its activities in the sanitary-ware business.
All the assets and liabilities acquired were evaluated at their current market value. On the date of acquisition these were represented as follows:

Assets and liabilities acquired *Euro '000*	*Evaluated at acquisition*
Other intangible assets	1
Property, plant and equipment	19,053
Inventories	7,322
Other non-current and current assets	13,115
Cash and cash equivalents	274
Assets assumed	**39,765**
Pensions and similar obligations	406
Other non-current provisions	947
Other current provisions	1,840
Financial liabilities	0
Other liabilities	2,704
Liabilities assumed	**5,897**
Current market value of net assets	33,868
Goodwill arising from company acquisition	0
Purchase price	33,868
incl. incidental acquisition cost	907

As the GIS group prepared its annual financial statements in accordance with Mexican commercial law, an IFRS opening balance sheet was not drawn up until the takeover date. Representation of assets and liabilities as required by IFRS before takeover is therefore impossible.
The purchase price of 43.446 million US Dollars (Euro 32.961 million) and the incidental ancillary cost of 1.195 million US Dollars (Euro 0.907 million) were settled in cash. The final instalment due on January 4th 2007 to the amount of Euro 1.939 million (Euro 1.471 million) was included on the balance-sheet date in other liabilities and was paid within the specified time. In 2006 the outflow of funds amounted to 32.123 million, inclusive of the Mexican sales tax paid and the cash assumed.
Within the scope of the acquisition GIS took over the high-quality sanitary-ware brand St. Thomas Creations, which was launched in the USA. The right to utilise this brand is restricted to 2021.

In the year of purchase, the acquisition was reflected in the income statement and balance sheet of the Villeroy & Boch Group as follows:

Acquisition in the year under review	*2006 Euro '000*	*%*
Income statement		
Revenue	32,981	100
Gross profit	6,725	19
Operating result (EBIT)	1,545	4
Result before tax	1,552	4
Profit after tax	827	2
	31.12.2006 Euro '000	*%*
Balance sheet		
Non-current assets	19,849	37
thereof property, plant and equipment	19,828	37
Current assets	33,391	63
thereof cash and cash equivalents	6,050	11
Total assets	53,240	100
Non-current liabilities	1,730	3
thereof financial liabilities	0	0
Current liabilities	50,344	95
thereof financial liabilities	0	0
Residual amount (equity)	1,166	2
Total equity and liabilities	53,240	100
Disclosure		
Contingent liabilities and other financial liabilities	0	-

Further to this significant acquisition, the Villeroy & Boch Group made the following additional purchases:
On June 14th 2006 the Villeroy & Boch Group acquired the remaining shares in the companies of the Vagnerplast Group. The purchase price of 123 million Czech Crowns (koruna) (Euro 4.3 million) was settled in part in cash, otherwise set off against an existing loan. This transaction created goodwill to the value of 1.1 million Euros. As a result, The Villeroy & Boch Group holds the entire company share in the Vagnerplast Group on the balance-sheet date, thus reducing the minority interests shown in the consolidated equity.
On August 1st 2006 the Spanish group company Villeroy & Boch Hogar S.L. acquired four specialist retail stores in Lisbon, which are to be continued as dependent businesses. The fair value of the net assets acquired amounted to Euro 0.321 million in inventories and Euro 0.387 million in so-called key money. The amount of Euro 0.708 million was agreed for the takeover of the specialist retailers, Euro 0.633 million of which was paid in cash. The final instalment is reflected in other liabilities and is to be paid by December 31st 2009. Reorganisation measures were not required.

With a view to reinforcing the Bathroom and Wellness Division, on August 11th 2006 the Swedish group company AB Gustavsberg took over the range of products and marketing activities of Frese A/S, a Danish sanitary ball bearings manufacturer. The net assets assumed at fair value, essentially inventories, amounted to Euro 0.350 million. Utilization of the brand name FRESE in connection with the ball-bearing activities adopted is restricted to 2016. The cash payment created goodwill to the total value of Euro 4.6 million. This is principally due to a stronger market position and the benefit of additional synergy effects. The final instalment to the amount of Euro 1.0 million, which is due in 2007, is shown as a liability. Provisions for reorganisation measures were not required at the time of acquisition.

Planned acquisitions

In addition to the information on business combinations in the 2006 financial year, IFRS 3 also requires information on business combinations completed between the balance-sheet date and the release of the annual financial statements for publication. This situation did not arise up to the release of the annual financial statements.

Disinvestment

No disinvestment measures were undertaken in the 2006 financial year.

Discontinued activities

An activity which is abandoned and to be permanently discontinued applies solely to those company components of the Villeroy & Boch Group which are disposed of in their entirety, as a group or by component on the basis of a single unitary plan or which are discontinued through abandonment in accordance with a unitary plan.
This situation did not arise up to the balance-sheet date.
On December 12th 2006 a press release was issued to the effect that negotiations had commenced with a Turkish ceramic manufacturer on cooperation with V & B Fliesen GmbH, which was spun off as a separate company in 2006. The aim was to cooperate in the manufacture and marketing of ceramic wall and floor tiles in order to improve the earning power of the company. The negotiations are ongoing.
Labour and material resources allocated to the company are reflected in the segment reporting of the Tile Segment.

CONSOLIDATION PRINCIPLES

The annual financial statements of the companies included in the Villeroy & Boch Group Consolidated Financial Statements are consolidated in accordance with the accounting policies stipulated under IAS 27, which are applied throughout the Group. In so doing, the consolidation focuses on the last audited annual financial statements of the respective company. The balance-sheet date of the consolidated companies corresponds to that of the parent company.
The Consolidated Financial Statements include the business transactions of the respective companies in which the Villeroy & Boch Group indirectly or directly holds the majority of the voting rights of the subsidiaries or, on the strength of economic power of disposal, in which the Group is also in a position to draw the majority of the economic benefit or is compelled to bear the risks arising from the activities of the company concerned. As a rule, part ownership exceeds 50 per cent. Inclusion begins on the date on which control becomes possible and ends when control is no longer feasible.
Capital consolidation for the companies included is carried out in accordance with IFRS 3. In this respect, the investment book values of the subsidiary companies at the time of their acquisition are offset against the newly evaluated equity ratio allotted to them. The resulting variations are recognised as goodwill.
Once revealed, the hidden reserves and burdens are carried forward in the following consolidation in accordance with the assets and liabilities.
With respect to the consolidation of debts, the reconciled accounts receivable and liabilities of the companies included in the consolidation are offset against each other.

Sales, expenses and income between the companies included are eliminated. Intercompany results in fixed assets and also inventories are eliminated.
Deferred taxation in accordance with IAS 12 is carried out on consolidation measures affecting net income provided the varying tax expense is expected to balance itself in later financial years.
If an associated company is included for the first time, the differential amounts arising from the initial consolidation are treated in accordance with the principles of full consolidation. The intercompany profit or loss of these companies was insignificant in the years under review.
The consolidation principles and accounting policies applied in the previous year have been maintained.

CURRENCY TRANSLATION

Taking individual company financial statements as a basis, all business transacted in foreign currency is valuated at the rate applicable at the time of its initial entry. Valuation on the respective balance-sheet date is carried out at the current rate.
The individual company balance sheets of the consolidated companies are prepared in foreign currency and subsequently translated to Euro following the concept of functional currency. With respect to the foreign Group companies, the functional currency is the respective national currency as these companies transact business independently as regards finance, commerce and organisation.
The assets and liabilities are translated to the spot rate on the balance-sheet date and all items of the Income Statement to average monthly rates. Differences arising as a result of translating the financial statements of foreign subsidiary companies are treated as not affecting operating result and reported under a separate item in equity. The effects of currency exchange which are based on equity-type net investment in a foreign consolidated company are also recorded as not affecting operating result. If companies which were formerly consolidated leave the circle of consolidated companies, the translation differences which have been treated as not affecting operating result, are then reversed with an effect on result.
The exchange rates of the most important currencies in relation to the Euro changed as follows:

Currency (1 Euro =)		*Balance-sheet date exchange rate 2006*	*2005*	*Average exchange rate 2006*	*2005*
Mexican peso	MXN	14.32000	12.61000	13.7062	12.9421
Pound Sterling	GBP	0.6714	0.6870	0.6825	0.6840
New Rumanian lei	RON	3.3817	3.6771	3.5298	3.6252
Swedish crown	SEK	9.0430	9.3930	9.2778	9.2795
US Dollar	USD	1.3181	1.1834	1.2532	1.2451
Hungarian forint	HUF	251.6750	252.6650	264.9765	248.0626

The following changes in the exchange rates are recorded in the Income Statement:

Euro '000	*2006*	*2005*
Exchange profit	2,177	1,870
Exchange loss	- 1,549	- 1,473
	628	**397**

RELEASE FOR PUBLICATION

The Villeroy & Boch Management Board released the Consolidated Financial Statements on March 6th 2007 for transmittal to the Supervisory Board. It is the duty of the Supervisory Board to audit the Consolidated Financial Statements and to issue a declaration as to whether it approves the Consolidated Financial Statements.

NOTES TO BALANCE SHEET

Non-Current Assets

As stipulated by the IFRS, non-current assets are made up of fixed assets, deferred tax assets and other non-current assets.

Fixed Assets

Movement of fixed assets in the financial year was as follows:

Euro '00 Notes	*Intangible assets* *1*	*Property, plant and equipment* *2*	*Investment properties* *3*	*Investment accounted for at equity* *4*	*Other financial assets* *5*	*Total*
Accumulated costs						
As of 01.01.2006	54,050	902,501	1,303	633	15,794	974,281
Currency adjustment	- 29	1,490	0	0	0	1,461
Adjustment of financial assets to market values, without affecting operating result	0	0	0	0	0	0
Change in consolidated companies	1	19.053	0	0	80	19,134
Additions	7,469	32,396	57	425	308	40,655
Disposals	- 911	- 36,944	0	0	- 3,306	- 41,161
Transfers	- 68	- 66	0	0	- 10,137	- 10,271
As of 31.12.2006	**60,512**	**918,430**	**1,360**	**1,058**	**2,739**	**984,099**
Accumulated depreciation						
As of 01.01.2005	11,815	656,764	0	0	292	668,871
Currency adjustment	5	680	0	0	0	685
Change in consolidated companies	0	0	0	0	0	0
Scheduled amortisation	1,432	42,577	0	0	179	44,188
Disposals	- 421	- 34,781	0	0	- 260	- 35,462
Write-ups	0	0	0	0	0	0
Transfers	0	0	0	0	0	0
As of 31.12.2006	**12,831**	**656,764**	**0**	**0**	**211**	**678,282**
Net book values						
As of 31.12.2006	**47,681**	**253,190**	**1,360**	**1,058**	**2,528**	**305,817**
As of 31.12.2005	42,235	245,737	1,303	633	15,502	305,410

1. Intangible Assets

Movement of intangible assets in the financial year was as follows:

Euro '000	*Concessions patents, licences and similar rights*	*Goodwill*	*Advances paid on intangible assets*	*Total*
Accumulated costs				
As of 01.01.2005	**17,543**	**35,343**	**90**	**52,976**
Currency adjustment	- 9	0	0	- 9
Change in consolidated companies	0	0	0	0
Additions	1,398	0	0	1,398
Disposals	- 330	0	0	- 330
Transfers	105	0	- 90	15
As of 01.01.2006	**18,707**	**35,343**	**0**	**54,050**
Currency adjustment	- 37	8	0	- 29
Change in consolidated companies	1	0	0	1
Additions	1,707	5,759	3	7,469
Disposals	- 911	0	0	- 911
Transfers	- 68	0	0	- 68
As of 31.12.2006	**19,399**	**41,110**	**3**	**60,512**
Accumulated depreciation				
As of 01.01.2005	**11,283**	**0**	**0**	**11,283**
Currency adjustment	- 16	0	0	- 16
Change in consolidated companies	0	0	0	0
Accumulated depreciation	1,335	0	0	1,335
Disposals	- 188	0	0	- 188
Write-ups	- 599	0	0	- 599
Transfers	0	0	0	0
As of 01.01.2006	**11,815**	**0**	**0**	**11,815**
Currency adjustment	5	0	0	5
Change in consolidated companies	0	0	0	0
Scheduled amortisation	1,432	0	0	1,432
Disposals	- 421	0	0	- 421
Write-ups	0	0	0	0
Transfers	0	0	0	0
As of 31.12.2006	**12,831**	**0**	**0**	**12,831**
Net book values				
As of 31.12.2006	**6,568**	**41,110**	**3**	**47,681**
As of 31.12.2005	6,892	35,343	0	42,235

The increase in capital due to the GIS acquisition is included in the item ‘change in consolidated companies’. A description of the company acquisitions concluded in the reporting period is provided in the section ‘acquisitions/disinvestments/activities to be discontinued’.

In the asset group ‘concessions, patents, licences and similar rights’ self-generated intangible assets are capitalised at a carrying amount of Euro 0.000 million (previous year: Euro 0.034 million). This applies exclusively to an internally produced software interface. Euro 0.034 million (previous year: Euro 0.052 million) were written down with effect on the operating result in the financial year.

In the previous year, the situation regarding the reduction in value of the asset group ‘concessions, patents, licences and similar rights’ for the Tableware Segment was no longer applicable. No further occurrences in this connection were identified during the last financial year.

The acquisition activities undertaken by the Villeroy & Boch Group resulted in an increase in recognised goodwill in the year under review of Euro 5.759 million. The capitalised goodwill was tested for impairment as stipulated by IFRS 3. This test involved comparing the net book value of the individual cash-generating units with their respective recoverable amount. In every case, the recoverable amount (value in use) exceeded the historical cost, thus excluding impairment. The capitalised goodwill of the Villeroy & Boch Group is allotted to the Bathroom and Wellness Division as a cash-generating unit.

A more detailed description of the procedure for the impairment test is provided in the section ‘valuation and accounting principles’.

Since January 1st 2005 capitalised goodwill is no longer depreciated according to schedule over a useful life of 15 years. Theoretically, if scheduled depreciation had been continued, the depreciation accrued in the 2006 financial year would have totalled Euro 3.633 million.

As in the previous financial year, no restraints exist on ownership or disposal of intangible assets. Intangible assets were not pledged as security for liabilities.

No intangible assets classified by IFRS 5 as being held for sale were kept in the financial year. No intangible asset was permanently closed down. An economic value is to be expected in the future on all capitalised values.

As in the previous year, no borrowing costs were capitalised in specified intangible assets.

2. Property, Plant and Equipment

Movement of property, plant and equipment used in business operations in the current reporting periods was as follows:

Euro '000	*Land and buildings*	*Technical equipment, plant and machinery*	*Other equipment, fixtures fittings and equipment*	*Advance payments and plant and machinery in process of construction*	*Total*
Accumulated costs					
As of 01.01.2005	**315,349**	**433,037**	**130,736**	**21,345**	**900,467**
Currency adjustment	- 620	- 2,333	1,786	- 46	- 1,213
Change in consolidated companies	0	0	0	0	0
Additions	2,534	17,580	8,159	5,117	33,390
Disposals	- 2,751	- 15,177	- 12,048	- 59	- 30,035
Transfers	- 3,721	19,368	3,486	- 19,241	- 108
As of 01.01.2006	**310,791**	**452,475**	**132,119**	**7,116**	**902,501**
Currency adjustment	779	1,949	- 1,244	6	1,490
Change in consolidated companies	11,659	7,324	70	0	19,053
Additions	3,688	13,147	7,441	8,120	32,396
Disposals	- 2,228	- 22,723	- 11,641	- 352	- 36,944
Transfers	314	2,918	939	- 4,237	- 66
As of 31.12.2006	**325,003**	**455,090**	**127,684**	**10,653**	**918,430**
Accumulated depreciation					
As of 01.01.2005	**198,551**	**337,460**	**105,624**	**0**	**641,635**
Currency adjustment	- 191	- 1,866	1,468	0	- 589
Change in consolidated companies	0	0	0	0	0
Scheduled depreciation	6,691	26,074	10,451	0	43,216
Disposals	- 2,548	- 13,385	- 11,565	0	- 27,498
Write-ups	0	0	0	0	0
Transfers	- 5,724	3,087	2,637	0	0
As of 01.01.2006	**196,779**	**351,370**	**108,615**	**0**	**656,764**
Currency adjustment	208	1,540	- 1,068	0	680
Change in consolidated companies	0	0	0	0	0
Scheduled depreciation	6,954	26,403	9,220	0	42,577
Disposals	- 1,406	- 22,168	- 11,207	0	- 34,781
Write-ups	0	0	0	0	0
Transfers	- 209	0	209	0	0
As of 31.12.2006	**202,326**	**357,145**	**105,769**	**0**	**665,240**
Net book values					
As of 31.12.2006	**122,677**	**97,945**	**21,915**	**10,653**	**253,190**
As of 31.12.2005	114,012	101,105	23,504	7,116	245,737

The addition to assets arising from the GIS acquisition is reflected in the position 'change in consolidated companies'. A description of the company acquisitions concluded in the reporting period is provided in the section 'acquisitions/disinvestments/activities to be discontinued'.
There are no restraints on rights of disposal for property, plant and equipment. The carrying amount of tangible fixed assets pledged as security for liabilities on the balance-sheet date amounted to Euro 0 million. In the Villeroy & Boch Group the carrying amounts of property, plant and equipment which are only partially or no longer used are insignificant.
In the year under review Euro 1.863 million (previous year: Euro 1.902 million) from the government grants received was deducted at cost as an asset; Euro 1.364 million (previous year: Euro 1.446 million) is included as a liability in deferred income. Euro 0.082 million (previous year: Euro 0.215 million) was released from the deduction on the liability side with effect on the operating result. All requirements with respect to the awarding of these grants have been fulfilled, and there is currently no risk of failure in performance.
In the financial year no tangible assets were held which were classified in accordance with IFRS 5 as held for sale. No property, plant or equipment was closed down permanently. A plant which had not as yet been integrated into the production process was derecognised in accordance with IAS 16.67b. Future economic utility is anticipated from all capitalised values. No amounts of compensation were received from third parties for items of property, plant or equipment that were impaired, lost or given up.
As in the previous year, no borrowing costs were capitalised in specified assets.
Contractual obligations existing on the balance-sheet date for the acquisition of property, plant or equipment are described in note 40 under 'other financial obligations'.

Leasing

In the 2006 financial year, the leasing expense arising from operating lease agreements amounted to Euro 34.689 million (previous year: Euro 34.445 million). The Group rents or leases salesrooms, warehouses, office premises and other facilities or tangible assets. The increase in rental or leasing expense compared to the previous year is due to the changes in the consolidated companies. The agreements are based on a rental or leasing term of between 6 months and 32 years. None of the agreements contains an option to purchase the object leased. Most of the agreements are implicitly renewed under the existing terms and conditions. Neither price adjustment provisions nor any other restrictions were agreed.
In order to improve the Group cash flow, unused rented or leased property is offered to interested parties against payment. In the financial year this resulted in additional income amounting to Euro 0.184 million (previous year: Euro 0.034 million). Accrued incidental expenses and other obligations are assumed by our tenant. The increase in income is a result of the resolute measures to sublease properties in Germany and abroad.
Obligations arising from operating lease relationships are due for payment in the subsequent years as follows:

Euro '000	*Up to 1 year*	*1 to 5 years*	*More than 5 years*
Operating lease			
Future lease payments	13,986	33,312	6,997
Future income arising from subleasing	165	385	259

In order to develop foreign markets further the company-owned retail trade network was again expanded and optimised in the year under review. This essentially concerned the leasing of new branches in Australia, New Zealand, Portugal and France, which results in a medium-term increase in future obligations from operating leases.
As in the previous year, no agreements which meet the requirements for capitalisation as a finance lease agreement have been concluded within the Group.

3. Investment Properties

Within the scope of follow-up development programmes properties that are not necessary for business will constantly be improved with a view to letting them, thus allowing currently unused space to contribute to improving the Group cash flow in the medium to long term. There is no multi-purpose property.
Several properties in Germany are currently being improved, and their capitalised carrying amounts are shown in the table below. These carrying amounts contrast with a current market value of Euro 8.1 million (previous year: Euro 8.1 million). The increase in the carrying amounts of Euro 0.057 million (previous year: Euro 0.650 million) is due to the capitalisation of subsequent cost. The current market values shown have been determined by using official maps of estimated land values (base year: 2001) and taking account of surcharges and deductions relevant for the property in question. Committees of experts at the competent cadastral office regularly calculate the values shown in the maps for estimated land values on the basis of prices obtained from land sales in the respective area. Expert opinions drawn up by third parties are not obtained for reasons of cost.
As in the previous year, the carrying amount of the investment properties is Euro 0.021 million. Straight-line depreciation of these properties is suspended while follow-up development is in progress.

Euro '000	*Land and equivalent rights*	*Buildings*	*Investment properties*
Accumulated costs			
As of 01.01.2006	**1,282**	**21**	**1,303**
Additions	57	0	57
Disposals	0	0	0
As of 31.12.2006	**1,339**	**21**	**1,360**
Accumulated depreciation			
As of 01.01.2006	**0**	**0**	**0**
Scheduled depreciation	0	0	0
Disposals	0	0	0
As of 31.12.2006	**0**	**0**	**0**
Net book values			
As of 31.12.2006	**1,339**	**21**	**1,360**
As of 31.12.2005	1,282	21	1,303

Rent totalling Euro 0.209 million (previous year: Euro 0.209 million) is currently being earned from letting the properties to be improved to affiliated companies. This was correspondingly eliminated from the Consolidated Financial Statements in accordance with the consolidation principles. In the financial year the maintenance and management expenses accrued amounted to Euro 0.085 million (previous year: Euro 0.073 million).

Financial Assets

Movement in financial assets in the reporting period was as follows:

Euro '000	Investment accounted for at equity	Other investments	Security investments	Borrowings	Total
Note	4	5	5	5	
Accumulated costs					
As of 01.01.2005	**390**	**30**	**8,519**	**2,016**	**10,955**
Currency adjustment	0	0	0	0	0
Adjustment of financial assets to market values, without affecting operating result	0	0	1,256	0	1,256
Change in consolidated companies	0	0	0	0	0
Additions	243	0	2,962	10,431	13,636
Disposals	0	0	- 9,168	-224	- 9,392
Transfers	0	0	0	- 28	- 28
As of 01.01.2006	**633**	**30**	**3,569**	**12,195**	**16,427**
Currency adjustment	0	0	0	0	0
Adjustment of financial assets to market values, without affecting operating result	0	0	0	0	0
Change in consolidated companies	0	0	0	80	80
Additions	425	0	0	308	733
Disposals	0	0	- 3,169	- 137	- 3,306
Transfers	0	0	0	- 10,137	- 10,137
As of 31.12.2006	**1,058**	**30**	**400**	**2,309**	**3,797**
Accumulated depreciation					
As of 01.01.2005	**0**	**0**	**288**	**65**	**353**
Currency adjustment	0	0	0	0	0
Change in consolidated companies	0	0	0	0	0
Scheduled depreciation	0	0	1	8	9
Impairment	0	0	0	0	0
Disposals	0	0	0	- 70	- 70
Write-ups	0	0	0	0	0
Transfers	0	0	0	0	0
As of 01.01.2006	**0**	**0**	**289**	**3**	**292**
Currency adjustment	0	0	0	0	0
Change in consolidated companies	0	0	0	0	0
Scheduled depreciation	0	0	9	170	179
Impairment	0	0	0	0	0
Disposals	0	0	- 257	- 3	- 260
Write-ups	0	0	0	0	0
Transfers	0	0	0	0	0
As of 31.12.2006	**0**	**0**	**41**	**170**	**211**
Net book values					
As of 31.12.2006	**1,058**	**30**	**359**	**2,139**	**3,586**
As of 31.12.2005	633	30	3,280	12,192	16,135

There are no restraints on ownership or rights of disposal for financial assets. No financial assets were pledged as security for liabilities.

4. Investment Accounted for at Equity

Investments in an associate are shown in the balance sheet in accordance with the equity method. In this case, the company concerned maintains its own valuation principles. Revaluation is dispensed with owing to the insignificant influence of revaluation measures. The company is included on the basis of the current, commercial financial statement as of December 31st 2006. The carrying amount of the investment allocable to the Tile Segment amounts to Euro 1.058 million (previous year: Euro 0.633 million).
The investment shown in the balance sheet as an associate is not listed on the stock market.

5. Other Financial Assets

Other financial assets are made up of the securities held on a long-term basis, the other investments and the borrowings.

Available-for-sale financial assets
Included in this category are fixed-interest securities and interests in a separate fund amounting to Euro 0.359 million (previous year: Euro 0.400 million) used to cover the severance pay provisions of the Austrian subsidiaries as stipulated in § 14 of the Austrian Income Tax Law. Following a reform in the law it was possible to reduce the separate fund in the financial year. In accordance with the statutory provisions, these assets were disposed of in full in the first quarter of 2007.
In the year under review the interest in an insurance company listed on the stock market was sold prematurely. This transaction generated income amounting to Euro 0.757 million.
As in the previous year, there was no value adjustment arising from impairment in the year under review.

Held-to-maturity financial assets
In the previous year the borrowings category reported a promissory note bond with a maturity period of 18 months, issued at 2.1 % at a cost of Euro 9.884 million. In the year under review this promissory note bond was reclassified to current assets. A description is provided in note 9.

Other Non-Current Assets

In accordance with IFRS, non-current assets also include deferred tax and other non-current assets which serve the Villeroy & Boch Group for more than one year. The other non-current assets are explained in note 10.

6. Deferred Tax

Deferred tax is reported in the balance sheet in the following positions:

Euro '000	*31.12.2006*	*31.12.2005*
Deferred tax assets arising from temporary differences	29,408	30,084
Deferred tax assets arising from accumulated losses	22,518	22,158
Deferred tax assets	51,926	52,242
Deferred tax liabilities	19,017	21,425

The deferred taxes arising from temporary differences are a result of different valuations between the consolidated balance sheet and the tax balance sheet in the following positions:

		Deferred tax assets		*Deferred tax liabilities*	
Euro '000	*note*	*31.12.2006*	*31.12.2005*	*31.12.2006*	*31.12.2005*
Intangible assets	*1*	261	266	743	583
Property, plant and equipment	*2*	5,428	4,195	5,222	7,118
Financial assets	*5*	361	397	27	549
Inventories	*7*	7,495	8,396	285	788
Other assets	*10*	345	207	1,437	1,463
Special tax items		0	0	10,802	10,805
Provisions for pensions	*17*	11,742	13,182	0	43
Other provisions	*18*	1,248	1,993	33	20
Liabilities	*20*	2,528	1,448	468	56
Deferred tax arising from temporary differences		**29,408**	**30,084**	**19,017**	**21,425**

The individual balance-sheet items are described in the notes under the number given.

The deferred tax assets arising from accumulated losses comprise:

Euro '000	*31.12.2006*	*31.12.2005*
Deferred tax on accumulated domestic deficits	14,729	16,766
thereof corporate income tax and reunification charge	10,306	11,732
thereof trade tax	4,423	5,034
Deferred tax on accumulated foreign deficits	18,912	17,161
Total of accumulated domestic and foreign deficits	**33,641**	**33,927**
Valuation reserves	-11,123	-11,769
Deferred tax on accumulated losses	**22,518**	**22,158**

While the accumulated domestic deficits can be carried forward without limitation with regard to minimum taxation, time limitations specific to the respective country apply to accumulated foreign deficits.
No deferred tax assets were created from the accumulated tax deficits amounting to Euro 11.123 million (previous year: Euro 11.769 million) under the assumption that it would probably not be possible to utilise them within the scope of the medium-term tax plan.

Utilisation of the existing deferred tax assets on accumulated losses is planned as follows:

Euro '000	*31.12.2006*	*31.12.2005*
Within one year	6,312	6,204
Within two years	7,433	7,312
Within three years	6,935	6,869
Within four years	1,115	1,108
Within five years or more	723	665
	22,518	**22,158**

Deferred tax amounting to Euro -0.222 million (previous year: Euro 0.339 million) was offset against equity without effect on the operating result.

In consideration of the trend in the result over the last two financial years, tax deferral can be classified as follows:

	Temporary differences		*Tax on accumulated losses*	
Euro '000	*Assets*	*Liabilities*	*Gross*	*Net*
Companies with a				
profit trend	13,555	12,928	20,566	15,885
permanent positive trend	13,163	4,748	148	148
loss trend	1,853	957	3,785	3,117
permanent loss trend	837	385	9,142	3,368
Total	**29,408**	**19,018**	**33,641**	**22,518**

Income tax expense is explained in note 30.

Current Assets

7. Inventories

On the balance-sheet date inventories comprised:

Euro '000	*31.12.2006*	*31.12.2005*
Raw materials and supplies	35,046	30,839
Work in progress	30,966	30,058
Finished goods	138,523	144,703
Advance payments	923	44
Emission allowances	301	-
	205,759	**205,644**

Inventories are divided between the individual Divisions as follows:

Euro '000	31.12.2006	31.12.2005
Tiles	52,619	56,420
Bathroom and Wellness	86,344	76,916
Tableware	66,796	72,308
	205,759	**205,644**

Valuation reserves for inventories were reduced in the financial year on balance by Euro 0.649 million from Euro 33.182 million to Euro 32.533.
No restraints exist on ownership or disposal of intangible assets. No inventories were pledged as security for liabilities.

8. Trade Receivables

Movement in accounts receivable from trading in the financial year was as follows:

Euro '000	31.12.2006	Remaining term more then 1 year	31.12.2005	Remaining term more then 1 year
Trade receivables	**163,486**	88	**136,273**	120

Accounts receivable from trading are balanced at par value. Where default or transfer risks exist, liabilities are calculated at the lower realisable amount. This is reflected in the form of implemented individual valuation reserves. In the financial year, valuation reserves were formed to the amount of Euro 1.669 million (previous year: Euro 2.050 million) with effect on the operating result.
There is no significant concentration of default risks in the Group as they are distributed over a large number of contractual partners and customers. As in the previous financial year, no restraints exist on ownership or disposal.
Due to the change in the accounting of the discounted bill of exchange shown in the previous year in contingent liabilities, the value of the previous year was adjusted in an extension of the balance sheet to Euro 16.981 million.

9. Current Financial Assets

The current financial assets include investments, the settlement of which is expected within 12 months of the balance-sheet date and derivatives without hedging instruments.

Euro '000	31.12.2006	31.12.2005
Held-to-maturity financial assets	10,192	0
Financial assets held accounted for at fair value	156	78
Current financial assets	**10,348**	**78**

Held-to-maturity financial assets

In the year under review a promissory note bond issued in the previous year at 2.1 %, at a cost of Euro 9.884 million (base value Euro 10 million), was reclassified to current financial assets.

This process did not affect valuation. As in the previous year, the asset is shown in the valuation category 'held-to-maturity' financial assets.
The borrower of this loan, which has a maturity period of 18 months, is an international credit institution with first-class financial standing. In addition, a deficit guarantee has been issued via the German deposit safety fund. The valuation is undertaken using the effective interest method. In the financial year this resulted in income arising from interest amounting to Euro 0.218 million (previous year: Euro 0.09 million).
On February 5th 2007 the promissory note bond was duly repaid in full by the borrower. This resulted in an income in interest of Euro 0.326 million over the entire term of the loan.
This financial instrument incorporates a derivative which had already been shown in the previous year under current financial assets in the category 'financial assets held, accounted for at fair value'.

Financial assets held, accounted for at fair value
This valuation category consists of a derivative which is embedded in a guaranteed promissory note bond. It creates opportunities for an additional index-oriented return on interest. These opportunities do not carry any risks as the capital employed to the amount of Euro 0.116 million is to be repaid on maturity by an international credit institution with first-class financial standing. A valuation income to the amount of Euro 0.078 million (previous year: Euro -0.038 million) was recorded. The valuation is based on a monthly report from the issuer.
Due to the developments affecting the agreed share basket in 2007 Villeroy & Boch AG was denied additional income on interest. On 05 February 2007 the derivative was redeemed together with the promissory note bond, giving Villeroy & Boch AG a total profit of Euro 0.210 million.

10. Other Non-Current and Current Assets

Other assets include accounts due from associates, the remaining other assets and the deferrals.

Euro '000	*Carrying amount 31.12.2006*	*Remaining term*		*Carrying amount 31.12.2005*	*Remaining term*	
		up to 1 year	*more than 1 year*		*up to 1 year*	*more than 1 year*
Accounts due from associates	**666**	666	0	**792**	792	0
Remaining other assets	**21,353**	21,133	220	**11,606**	11,187	419
Prepaid expenses	**2,405**	2,385	20	**1,975**	1,912	63
	24,424	**24,184**	**240**	**14,373**	**13,891**	**482**

The accounts due from associates as well as the other assets and prepaid expenses on the assets side are balanced at par value. Appropriate valuation reserves cover any default or other risks. There is no significant concentration of default risks in the Group as they are distributed over a large number of contractual partners and customers.
The item 'remaining other assets' is a significant entry in that it includes receivables due from the disposal of property in France and Denmark. It also includes advances, creditors with debit balances, rent deposits, receivables arising from initial equipment and fittings for franchisers, receivables due from the workforce, receivables from the market valuation of derivatives, receivables from bonuses, advances for the motor-vehicle fleet and other security payments, and also a multitude of smaller individual items. This position shows a total of Euro 1.327 million (previous year Euro 0.854 million) which can be characterised as advance payment.
The usual deferrals, such as rent and insurance premiums, are included in the prepaid expenses item.

11. Tax Claims

Movement in the claims due to tax refunds in the financial year was as follows:

Euro '000	Carrying amount 31.12.2006	Remaining term up to 1 year	Remaining term more than 1 year	Carrying amount 31.12.2005	Remaining term up to 1 year	Remaining term more than 1 year
Claims on income tax	**4,883**	4,883	0	**7,944**	7,944	0
Other tax claims	**11,134**	11,134	0	**6,607**	6,607	0
	16,017	**16,017**	**0**	**14,551**	**14,551**	**0**

A total of Euro 2.565 million of the tax claims as of December 31st 2006 has been allotted to German companies and the amount of Euro 13.452 million to foreign companies of the Villeroy & Boch Group.
In this respect, claims on income tax are essentially made up of claims on current corporate income tax assets. Other tax claims, which are predominantly shown in foreign companies, include purchase tax credit to the amount of Euro 7.683 million.

12. Cash and Cash Equivalents

On the balance-sheet date cash and cash equivalents comprise:

Euro '000	31.12.2006	31.12.2005
Cheques and cash on hand	1,044	723
Cash in banks	10,552	57,767
	11,596	**58,490**

Cash on hand and in banks is balanced at par value.
No cash equivalents are held in the Villeroy & Boch Group as of the balance-sheet date. Accounts receivable due from banks and liabilities due to banks are reported as having been netted out to the amount of Euro 11.220 million (previous year: Euro 16.097 million), for which there are offsetting terms and the intention of net settlement (IAS 32.80).
There is minimal default risk on liquid assets as they are held by banks certified by international rating agencies as having a high credit standing.

Equity

Consolidated equity includes:
- issued capital, Villeroy & Boch AG capital reserves and retained earnings
- retained earnings of consolidated companies, provided since belonging to the Group
- reduction of equity by Villeroy & Boch AG treasury shares
- effects of consolidation measures and
- equity attributable to minority interests

Movement in equity is shown separately in the equity transition.

13. Issued Capital

Share capital is divided into 14,044,800 individual ordinary-share certificates and 14,044,800 nonvoting individual preference-share certificates, each having a calculated share in the share capital of Euro 2.56. The share capital is divided into equal numbers of ordinary shares and preference shares respectively.
The company's share capital amounts to Euro 71,909,376 (previous year: Euro 71,909,376).

14. Capital Surplus

Capital surplus amounting to Euro 193.587 million include the premium arising from the initial listing on the stock market in 1990 and have remained unchanged since then.

15. Retained Earnings

Other consolidated retained earnings amounting to Euro 67.556 million (previous year: Euro 62.214 million) include those of Villeroy & Boch AG and the proportional profits – produced since belonging to the Group – of the consolidated subsidiaries. In addition, this item includes consolidation measures and currency influences.
For the first time, longer-term loans to foreign consolidated companies were classified in accordance with IAS 21 as net investments in a foreign business operation. The valuation results arising from the currency translation of these business activities to the amount of Euro -1.028 million are shown in currency fluctuations.
Retained earnings were reduced by treasury shares held by the consolidated companies. The resolution passed at the General Meeting of Shareholders on 03 June 2005 authorised the Management Board of Villeroy & Boch AG to acquire treasury shares by December 2006 equivalent to a maximum of Euro 7,190,937 million of the share capital. Villeroy & Boch AG is entitled to hold up to 10 % of the share capital in no-par individual preference-share certificates (2,808,960 shares). Transactions require the approval of the Supervisory Board. Utilisation of the shares held is restricted by the resolutions passed. The treasury shares held do not entitle the holder to a dividend.
Movement of the shares held by Villeroy & Boch AG was as follows:

	Number of shares		*Equivalent in Euro '000*	
	2006	*2005*	*2006*	*2005*
As of 01.01.	1,683,029	1,683,029	4,309	4,309
Purchase	0	0	0	0
Sale	0	0	0	0
As of 31.12.	**1,683,029**	**1,683,029**	**4,309**	**4,309**

All transactions were conducted through the stock market. No equity was sold to affiliated companies or individuals in the reporting period. The accumulated historical costs to the amount of Euro 14.999 million were offset in the retained earnings.

16. Equity Attributable to Minority Interests

Company shares in the equity of consolidated subsidiary companies are shown under the item 'equity attributable to minority interests'. On the balance-sheet date they totalled Euro 0.310 million (previous year: Euro 3.642 million). In the financial year the Villeroy & Boch Group acquired the remaining company shares in the Vagnerplast Group. Further information on this acquisition is provided in the section 'acquisitions/disinvestments/activities to be discontinued'. The remaining minority interests shown originate from minor third-party shares in three consolidated companies in Romania, Hungary and France. Minority interests are calculated on the basis of the equity reported in the balance sheets of the companies concerned on the balance-sheet date.

Stock Option Plan

Within the scope of the 2000-2003 stock option plan the members of the Management Board received nine share warrants for the purchase of one share from the Villeroy & Boch portfolio while other management staff received eight. These shares are not to be sold for the entire term of the option. The 2003 stock options were exercised on 16 June 2006 as the share price had risen by a minimum of 20 % since the time of issue and was valued above the minimum exercise price of Euro 12.00. In accordance with the resolution passed at the General Meeting of Shareholders on June 9th 2006 the option holders received a cash option at the option price of Euro 12.68. After disbursements totalling Euro 481,487.26 the remaining provisions to the amount of Euro 43,512.74 could be reversed.

In this way, the authorisation to purchase treasury shares expired. The portfolio on the balance-sheet date of 31 December 2006 totalled 1,683,029 shares, the equivalent of a prorata share capital of Euro 4.308.555 million.

Movement in the guaranteed claims arising from stock options is shown in the following chart:

	2006		2005	
	Shares	*Options*	*Shares*	*Options*
As of 01.01.	4,852	38,816	21,662	173,296
Guaranteed	-	-	-	-
Exercised	- 4,852	- 38,816	-	-
Forfeited	-	-	- 16,810	- 134,480
As of 31.12.	**0**	**0**	**4,852**	**38,816**

Non-Current and Current Liabilities

17. Provisions for Pensions and Similar Obligations

The provisions for pensions and similar obligations include old-age protection for Villeroy & Boch Group employees, the overwhelming majority of whom are resident in the European Economic Area.
The following items are included in the balance sheet:

Euro '000	*31.12.2006*	*31.12.2005*
Provisions for pensions	171,643	173,466
Provisions for similar obligations	15,402	15,661
	187,045	**189,127**

The provisions for pensions and similar obligations have changed as follows:

	Provisions for			
Euro '000	*Pension obligations*	*Anniversary bonuses*	*Semi-retirement*	*Total*
As of 01.01.2005	**176,833**	**6,762**	**7,721**	**191,316**
Currency	- 44	0	0	- 44
Utilisation	- 12,496	- 560	- 2,072	- 15,128
Reversal	-229	0	0	-229
Allocation	9,402	1,033	2,777	13,212
Change in consolidated companies	0	0	0	0
As of 01.01.2006	**173,466**	**7,235**	**8,426**	**189,127**
Currency	54	- 16	0	38
Utilisation	- 13,695	- 656	- 2,642	- 16,993
Reversal	0	- 1,605	0	- 1,605
Allocation	11,703	152	4,217	16,072
Change in consolidated companies	115	291	0	406
As of 31.12.2006	**171,643**	**5,401**	**10,001**	**187,045**

Due to the acquisition of the Mexican sanitary-ware factory Villeroy & Boch assumed provisions for pensions to the amount of Euro 0.115 million and for anniversary bonuses to the amount of Euro 0.291 million which had been guaranteed by the vendor. This accrual is shown on the basis of the takeover report in the item 'change in consolidated companies'.
The various old-age protection systems are based, as a rule, on the employee's length of employment and remuneration. The schemes concerned are predominantly performance-oriented pension organisations.
In Germany Villeroy & Boch AG pays contributions for the national pension insurance scheme to the amount of Euro 11.247 million (previous year: Euro 11.647 million). In addition, a voluntary contributory pension scheme is offered through the Chemical Industry Pension Fund. In the current financial year a contribution amounting to Euro 0.115 million (previous year: Euro 0.082 million) was paid. A total of Euro 0.359 million (previous year: Euro 0.244 million) has been transferred since the introduction of this voluntary contributory pension scheme.
In Austria every employee receives severance pay on termination of employment. A new severance-pay system was introduced on the basis of the statutory provisions for employee pension funds. In the new severance-pay system the employer does not make a payment to the employee but pays contributions to the employee pension fund. On termination of employment the employee pension fund pays the severance. In the 2006 financial year a total of Euro 0.016 million (previous year: Euro 0.006 million) was paid into the employee pension fund. Employees who commenced their employment before January 1st 2003 remain in the old system. The old system is explained in note 18.
In the provisions for similar obligations the Villeroy & Boch Group makes provisions in consideration of the legal, tax and economic situation of the respective country. Due to an agreement negotiated by the employer and the works council in one of the German consolidated companies Euro 1.605 million could be released with effect on the operating result for anniversary bonuses. A provision to the amount of Euro 0.291 million for anniversary bonuses arising from the takeover of the Mexican company and its employees is shown for the first time. Since it joined the Group, this obligation has increased by Euro 0.033 million, by Euro 0.017 million after currency adjustment.
Valuation of pension obligations is carried out using an interest rate for accounting purposes to the amount of 4.5 % and a long-term wage and salary trend of 1.0 %, 2.0 %, 2.5 % and 3.5 %. In the case of employee pension-scheme settlements, calculations are carried out on the basis of a long-term retirement pension trend of 1.0 %, 1.5 % and 6.67 % and the employee turnover specific to the company. Valuation is carried out on the basis of mortality tables which are specific to the country. The actuarial profits/losses are entered using the 10 % corridor rule. An expected return of 4.25 % and 5.0 % (previous year: 4.5 %) was assumed when determining the plan assets. The expected return is based on the portfolio structure of the plan assets. (See page 109.)

In the financial year under review, pension expenses were made up as follows:

Euro '000	*31.12.2006*	*31.12.2005*
Expense for period of service	1,919	1,286
Return on plan assets	- 801	- 632
Interest expense	9,517	9,957
Depreciated loss arising from corridor rule	962	0
	11,597	**10,611**

The pension schemes shown are included in the cost of sales, selling expenses and general and administrative expenses – the proportionate interest expense is appropriately shown in the financial results.

Provisions for pensions within the Villeroy & Boch Group are secured by assets under third-party administration, by the so-called plan assets, or internally through the allocation of provisions for pensions.

	31.12.2006			31.12.2005		
Euro '000	*External*	*Internal*	*Total*	*External*	*Internal*	*Total*
Pension-right present values	22,626	168,423	**191,049**	21,074	169,509	**190,583**
Plan assets	- 19,406	-	**- 19,406**	- 17,117	-	**- 17,117**
Pension obligation	**3,220**	**168,423**	**171,643**	**3,957**	**169,509**	**173,466**

There are no unsecured pension obligations within the Villeroy & Boch Group.

The movement and structure of the pension-right present values and also of the plan assets are as follows:

Euro '000	*31.12.2006*	*31.12.2005*
Present value of pension rights		
As of 01.01.	190,583	191,693
Change in consolidated companies	330	0
Currency fluctuations	54	- 44
Interest expense	9,517	9,957
Expense for period of service	1,919	1,286
Annuity payments	- 12,316	- 12,076
Actuarial losses/profits	962	- 233
As of 31.12.	**191,049**	**190,583**
Change in plan assets		
As of 01.01.	17,117	14,860
Change in consolidated companies	215	0
Currency fluctuations	5	0
Return on plan assets	801	632
Annuity payments	- 245	0
Employer contributions	1,513	1,625
As of 31.12.	**19,406**	**17,117**
Financing situation		
As of 31.12.	199,565	210,410
Actuarial losses not yet taken into account	- 27,922	- 36,944
Provision as of 31.12.	**171,643**	**173,466**

The plan assets show the following portfolio structure:

	31.12.2006		31.12.2005	
	Euro '000	*%*	*Euro '000*	*%*
Shares (share fund)	2,484	13	1,836	11
Annuities (annuity fund)	7,267	37	4,788	28
Loans and promissory note bond	7,516	39	8,399	49
Cash and cash equivalents	824	5	1,030	6
Other assets	1,315	6	1,064	6
Plan assets	**19,406**	**100**	**17,117**	**100**

Actuarial profit not yet taken into account to the amount of Euro 0.401 million (previous year: Euro 0.533 million) was accrued in the plan assets.

Movement in the provisions for pensions is represented in the following 5-year overview:

Euro '000	*2002*	*2003*	*2004*	*2005*	*2006*
Pension-right present values of pension rights – internally secured	175,448	175,245	173,190	169,509	168,423
Pension-right present values of pension rights – externally secured	19,431	14,895	16,656	21,074	22,626
Present values of pension rights	**194,879**	**190,140**	**189,846**	**190,583**	**191,049**
Plan assets	- 11,231	- 11,311	- 13,295	- 17,117	- 19,406
Provision obligation	**183,648**	**178,829**	**176,551**	**173,466**	**171,643**

18. Other Non-Current and Current Provisions

Movement in the other non-current and current provisions in the reporting period was as follows:

Euro '000	Non-current provisions	Current provisions for: Personnel sector	Guarantee obligations	Restructuring	Other	Total	Aggregate sum
As of 01.01.2005	**9,089**	**7,375**	**17,574**	**10,681**	**14,482**	**50,112**	**59,201**
Currency adjustment	- 34	85	- 107	- 24	433	387	353
Utilisation	- 155	- 7,374	- 2,944	- 5,887	- 5,267	- 21,472	- 21,627
Reversal	- 2,062	- 47	- 6,950	- 709	- 5,750	- 13,456	- 15,518
Allocation	833	7,757	1,510	4,407	3,833	17,507	18,340
Transfer	0	318	0	0	- 184	134	134
Change in consolidated companies	0	0	0	0	0	0	0
As of 01.01.2006	**7,671**	**8,114**	**9,083**	**8,468**	**7,547**	**33,212**	**40,883**
Currency adjustment	47	- 77	46	- 29	- 56	- 116	- 69
Utilisation	- 586	- 7,686	- 1,635	- 5,646	- 4,270	- 19,237	- 19,823
Reversal	0	- 161	- 556	0	- 730	- 1,447	- 1,447
Allocation	1,174	9,143	1,650	2,890	3,768	17,451	18,625
Transfer	0	0	0	0	- 43	- 43	- 43
Change in consolidated companies	947	0	585	0	1,255	1,840	2,787
As of 31.12.2006	**9,253**	**9,333**	**9,173**	**5,683**	**7,471**	**31,660**	**40,913**

The non-current provisions are made up of precautionary measures related to environmental protection and recultivation projects as well as provisions for severance pay for personnel from Austria (old severance-pay system), Mexico, Italy and Australia.

The provision for measures related to environmental protection to the amount of Euro 5.321 million (previous year: Euro 4.788 million) covers expected financial burdens arising from the recultivation of landfill sites, the elimination of environmental impact on existing production facilities, the certified carbon dioxide emission and for similar measures. In the reporting period a total of Euro 4.761 million (previous year: Euro 4.395 million) was set aside for future recultivation projects.

The severance-pay system was reformed in Austria and supplemented with a contribution-oriented variation. This new variation is to be shown in the pensions and similar obligations. A description of the new severance-pay system is provided in note 17. Employees who commenced employment before January 1st 2003 remain in the old severance-pay system.

Provisions for the personnel sector show provisions for outstanding management bonuses and severance payments owing to personnel layoffs. The guarantee provision takes liabilities for the usual product guarantees into account and also continues to cover the risks from guarantees connected to the as yet incomplete divestment measures in the Tile Division.

Other provisions essentially include provisions for commission, auditing costs, the risks of lost lawsuits, licence fees, and also a multitude of individual items.

Changes arising from company acquisitions concluded in the year under review are represented in the item 'change in consolidated companies'.

19. Non-Current and Current Financial Liabilities

As in the previous year, the Villeroy & Boch Group does not show any non-current or current financial liabilities. Receivables and borrowings with respect to credit institutions were balanced at Euro 11.220 million (previous year: Euro 16.097 million). Offsetting conditions and the intention to settle on a net basis are present. By taking out bank loans the Villeroy & Boch Group is running the risk of an interest rate change. Borrowings with agreed fixed interest rates place the fair value at risk, while variable interest rates involve a risk at the time of the payment flows. In order to secure against risks, the loan agreements are concluded on a short-term basis.

20. Other Non-Current and Current Liabilities

Other non-current and current liabilities are made up of other liabilities as well as deferred income.

	Carrying	*Remaining term*		*Carrying*	*Remaining term*	
	amount	*up to*	*more than*	*amount*	*up to*	*more than*
Euro ’000	*31.12.2006*	*1 year*	*1 year*	*31.12.2005*	*1 year*	*1 year*
Advances received on purchase orders	1,055	1,055	0	1,671	1,671	0
Payroll accounting	28,785	28,785	0	30,420	30,420	0
Bonuses and rebates	45,574	45,574	0	39,579	39,579	0
Other liabilities	15,233	13,166	2,067	12,195	9,111	3,084
Deferred income	2,600	1,061	1,539	3,086	1,102	1,984
	93,247	**89,641**	**3,606**	**86,951**	**81,883**	**5,068**

Other liabilities essentially include market value changes arising from the evaluation of hedge transactions, customers with credit balances, the purchase price liability arising from the GIS acquisition, as well as a multitude of individual items.
Deferred income essentially includes subsidies in Romania, Italy and Germany.

21. Trade Payables

The trade payables are made up of outstanding obligations arising from trade transactions.

	Carrying	*Remaining term*		*Carrying*	*Remaining term*	
	amount	*up to*	*more than*	*amount*	*up to*	*more than*
Euro ’000	*31.12.2006*	*1 year*	*1 year*	*31.12.2005*	*1 year*	*1 year*
Trade payables	**82,391**	**82,391**	**0**	**86,059**	**86,059**	**0**

Due to the change in the accounting of the discounted bill of exchange shown in the previous year in contingent liabilities, the value of the previous year was adjusted in an extension of the balance sheet to Euro 16.981 million.
The fair values correspond to the itemised carrying amounts.

22. Non-Current and Current Tax Liabilities

Non-current and current tax liabilities are made up of tax liabilities and tax provisions.

Euro '000	Carrying amount 31.12.2006	Remaining term up to 1 year	Remaining term more than 1 year	Carrying amount 31.12.2005	Remaining term up to 1 year	Remaining term more than 1 year
Income tax liabilities	787	787	0	417	417	0
Liabilities from other taxes	9,872	9,872	0	12,621	12,621	0
Tax liabilities	**10,659**	**10,659**	**0**	**13,038**	**13,038**	**0**
Income tax provisions	4,541	4,541	0	4,008	4,008	0
Provisions for other taxes	1,161	1,161	0	1,143	1,143	0
Tax provisions	**5,702**	**5,702**	**0**	**5,151**	**5,151**	**0**
Total tax liabilities	**16,361**	**16,361**	**0**	**18,189**	**18,189**	**0**

Euro 3.794 million of the tax liabilities is allotted to German companies and Euro 6.865 to foreign companies. The tax liabilities of the German companies are essentially made up of payroll and church tax, while those of the foreign companies essentially comprise payroll, trade and purchase tax liabilities.

The item 'tax provisions' changed in the years under review as follows:

Euro '000	2006	2005
As of 01.01.	**5,151**	**4,060**
Currency adjustment	6	15
Utilisation	- 2,931	- 661
Reversal	0	- 1
Allocation	3,476	1,564
Transfer	0	174
Change in consolidated companies	0	0
As of 31.12.	**5,702**	**5,151**

Tax provisions are predominantly allotted to Villeroy & Boch AG. They include income taxes as yet to be paid arising from taxation of the profit of the current year, as well as subsequent assessment risks.

NOTES TO CONSOLIDATED INCOME STATEMENT

23. Revenue

Revenue is entered when deliveries or services that are due have been performed and the price risk has been passed to the purchaser. The entry of contract revenue and also of contract costs in the case of construction contracts is carried out as soon as a reliable estimate of the contract result exists. The Villeroy & Boch Group predominantly generates revenue through the delivery of goods.

Sales (net) are made up as follows:

Euro '000	*2006 Domestic*	*2006 Foreign*	*2006 Total*
Tiles	88,785	60,417	149,202
Bathroom and Wellness	112,825	376,334	489,159
Tableware	77,056	248,763	325,819
	278,666	**685,514**	**964,180**

Euro '000	*2005 Domestic*	*2005 Foreign*	*2005 Total*
Tiles	81,006	62,758	143,764
Bathroom and Wellness	106,719	323,877	430,596
Tableware	86,593	232,288	318,881
	274,318	**618,923**	**893,241**

The movement in regional sales is presented within the scope of segment reporting.

24. Costs of Sales

Costs of sales include the costs of products sold, as well as the costs of merchandise sold. In accordance with IAS 2, not only directly allocable costs such as material, personnel and energy costs are taken into account in this connection, but also overheads and allocable depreciation on production plants.

25. Selling, Marketing and Development Costs

This item includes the costs of marketing and distribution, of the field sales force, advertising and logistic costs, license expenses and the costs of research and development.
Expenses amounting to Euro 12.145 million (previous year: Euro 12.444 million) are included for research and development. The latter are divided as follows between the individual Divisions:

Euro '000	*2006*	*2005*
Tiles	1,656	1,997
Bathroom and Wellness	7,592	7,145
Tableware	2,897	3,302
	12,145	**12,444**

26. General and Administrative Expenses

General and administrative expenses include the labour costs and cost of materials incurred in the management and administrative offices.

27. Other Operating Income/Expenses

Other operating income and expenses are made up as follows:

Euro '000	*2006*	*2005*
Other operating income arising from		
Exchange profits[1]	16,555	9,911
Accounting profit from disposal of fixed assets	11,759	2,868
Reversal of valuation reserves to receivables	1,179	1,840
Reversal of provisions no longer required	1,071	14,637
Other measures	10,372	9,063
Total	**40,936**	**38,319**
Other operating expenses arising from		
Reversal of provisions for the cost of restructuring	16,587	5,804
Exchange losses[1]	15,585	9,260
Expenses from the allocation of valuation reserves to receivables	1,982	2,659
Other measures	12,028	12,177
Total	**46,182**	**29,900**
Other operating income/expenses	- 5,246	**8,419**

[1] *predominantly from cash flow hedges*

Other operating income and other operating expenses are presented netted out in this item. Included in the other operating income are essentially exchange profits, income from the disposal of fixed assets, income from the reversal of valuation reserves, income from the reversal of provisions no longer required, recovery of damages, rental revenue and income from licences.

Included in the other operating expenses are essentially the reversal of provisions for the cost of restructuring, expenses for exchange losses, expenses ensuing from the allocation of valuation reserves to receivables, expenses from the disposal of fixed assets and expenses from insurance premiums.

28. Result from Investment in Associates

The result from subsidiary participations in the Villeroy & Boch Group includes income from participation in an associate to the amount of Euro 0.425 million (previous year: Euro 0.243 million).

29. Financial Results

Euro '000	*2006*	*2005*
Other interest and similar income	4,195	4,426
Interest and similar expenses	- 5,355	- 4,743
Interest share in the change in provisions for pensions and similar obligations	- 9,755	- 9,638
Total of net interest income	**- 10,915**	**- 9,955**
Remaining financial results	684	1,671
	- 10,231	**- 8,284**

Included in the interest expense is Euro 0.000 million (previous year: Euro 0.017 million) as a proportionate interest share of the leasing instalments arising from the finance lease agreements, entered in accordance with IAS 17.

30. Income Taxes

Taxes on income and earnings which are paid and due in the individual countries, as well as deferred taxation, are shown as income taxes. German companies in the Villeroy & Boch Group are subject to an average municipal trade tax on income, amounting to roughly 15 % of the trading profit, which is deductible when determining corporate income tax. The rate of corporate income tax is 25 %, plus a reunification charge of 5.5 % on corporate income tax.
The determination of deferred taxes is based on tax rates expected in the individual countries at the time of realisation. These tax rates are always based on the legal regulations applying or passed on the balance-sheet date.
Foreign income taxes are calculated on the basis of valid laws and orders in the individual countries.
The applied income-tax rates for foreign companies vary from 16.0 % to 42.9 %.

Euro '000	*2006*	*2005*
Taxes paid or due in Germany	- 1,716	495
Taxes paid or due abroad	- 6,092	- 5,554
	- 7,808	**- 5,059**
Deferred taxes	1,869	2,186
Taxes on income	**- 5,939**	**- 2,873**

The effective rate of tax is 25.76 % (previous year: 17.90 %). The transition to the German rate of income tax, which remained unchanged at 37.7 % in the year 2006, is as follows:

Euro '000	*2006*	*2005*
Result before income tax	23,051	16,051
Expected income tax (EBT x tax rate of 37.7 %)	- 8,690	- 6,051
Differences arising from foreign tax rates	- 2,016	4,343
Tax effects arising from:		
- expenses disallowable against tax	- 1,971	- 2,231
- other variances	6,739	1,066
Actual expense of income taxes	**- 5,939**	**- 2,873**
Actual tax rate in %	**25.76**	**17.90**

The transition of deferred tax assets and liabilities in the balance sheet to the deferred taxes shown in the Income Statement is presented as follows:

Euro '000	*2006*	*2005*
Change in deferred tax assets	- 316	9,347
Change in deferred tax liabilities	2,407	- 7,499
Change in deferred tax assets and liabilities formed without affecting operating result	- 222	338
Deferred taxes in accordance with Income Statement	**1,869**	**2,186**

31. Result after Tax Attributable to Minority Interests

Minority shares in the result amount to Euro - 0.075 million (previous year: Euro - 0.103 million). The decrease is due to the acquisition of the remaining company shares in the Vagnerplast Group.

32. Earnings per Share

Net earnings per share result from dividing the consolidated results for the year by a weighted number of issued shares, and must be stated for each class of share.

Ordinary shares	*2006*	*2005*
Number of individual share certificates issued	14,044,800	14,044,800
Proportionate consolidated results for the year (Euro '000)	8,733	6,625
Net earnings per share (Euro)	0.62	0.47

Preference shares	*2006*	*2005*
Number of individual share certificates issued	12,361,771	12,361,771
Proportionate consolidated results for the year (Euro '000)	8,304	6,450
Net earnings per share (Euro)	0.67	0.52

A share dilution effect did not exist either in the year under review or in the previous year. For the ordinary shares a weighted number of 14,044,800 shares was taken as a basis for the calculation. The weighted treasury stock portfolio was not taken into consideration in the case of preference shares.

33. Depreciation and Amortisation

Depreciation and amortisation in the financial year was made up as follows:

Euro '000	*2006*	*2005*
Scheduled depreciation of property, plant, equipment and amortisation of intangible assets	44,009	44,551
Depreciation of financial assets	179	9
	44,188	**44,560**

34. Cost of Materials

The following costs of materials are included in the costs of sales:

Euro '000	*2006*	*2005*
Cost of raw materials and supplies (including primary products)	152,311	146,897
Cost of purchased goods	125,878	101,766
	278,189	**248,663**
Cost of purchased services	47,359	43,912
	325,548	**292,575**

35. Personnel Expenses

Personnel expenses are made up as follows:

Euro '000	*2006*	*2005*
Wages and salaries	270,881	259,387
Social security, pension and other benefit costs	66,661	65,335
thereof for pensions	(5,664)	(4,461)
	337,542	**324,722**

Average number of persons employed:

Number of employees	*2006*	*2005*
Wage earners	6,174	5,498
Salaried employees	4,037	4,023
	10,211	**9,521**

Of the entire workforce, 3,586 persons (previous year: 3,810) are employed in Germany and 6,625 (previous year: 5,711) abroad. The acquisition of the sanitary-ware factory alone increased the number of employees by 988 in comparision with the previous year.

Employees according to Division:	*2006*	*2005*
Tiles	976	1,044
Bathroom and Wellness	5,789	4,801
Tableware	3,011	3,203
Other	435	473
	10,211	**9,521**

36. Other Taxes

Other taxes total Euro 6.389 million (previous year: Euro 5.597 million). These are essentially taxes dependent on assets.

NOTES TO CASH FLOW STATEMENT

37. Notes to Cash Flow Statement

In accordance with IAS 7 the Cash Flow Statement shows changes in the financial resources of the Villeroy & Boch Group in the course of the year under review. In so doing, the effects of company acquisitions and sales have been eliminated from operating activities.

A difference is made between cash flow from operating activities, cash flow from investing activities and cash flow from financing activities. The balance of financial resources includes the cash.

Cash flow from operating activities fell by Euro 34.2 million in 2006 compared with the previous year. This was largely attributable to the fact that, due to a stock optimisation programme, the reduction in inventories in the previous year was Euro 10 million higher than in the year under review. Further contributing factors were the approximately Euro 11 million higher reduction in trade receivables, originating predominantly from the Bathroom and Wellness Division, in part from the operating activities of the new Mexican company, and the reduction of receivables included in other assets from the disposal of property in France and Denmark (Euro 11.7 million).

Cash flow from investing activities is marked by the purchase price paid for the acquisition in the sanitary-ware sector. It shows a funds flow of Euro 60.7 million in the financial year (previous year: Euro 32.8 million), Euro 30.8 million of which is attributable to the acquisition of the Mexican activities.

In the year under review, the cash flow from financing activities shows a funds flow amounting to Euro 9.3 million (previous year: Euro 16.4 million). The reduction in bank borrowings affected this position in the previous year, with the result that no financial liabilities were represented in either 2005 or in this financial year.

NOTES TO GROUP SEGMENT REPORTING

38. Notes to Segment Reporting

Segment Reporting provides specific information as required by IAS 14. The reportable segments are organised to conform to internal management and internal reporting structures in the Group. Consequently, the primary segment is reported according to Division and the secondary according to geographical region.

The various structures of the primary segments and the activities of the Divisions and Business Segments listed are briefly described in the following chart:

Division / Business Segment	*Activities*
Tiles	Non-vitreous and glazed/unglazed vitreous wall and floor tiles; tiles and natural stone purchased from external companies; turnkey solutions for industrial suppliers
Bathroom and Wellness	
Ceramic sanitary-ware, kitchen and furniture	Ceramic sanitary ware, ceramic kitchen sinks, other ceramic products, fittings and accessories purchased from external companies; bathroom furniture, bathroom furniture purchased from external companies
Wellness and fittings	Baths, shower trays, whirlpools, shower partitions, shower cubicles and steam cubicles, fittings/kitchen fittings and technical accessories, kitchen fittings and technical accessories purchased from external companies
Tableware	Tableware services made of faience, vitreous porcelain, fine Vilbo china and bone china, gift articles made of ceramic and glass; tableware, cutlery and silverware, gift articles made of ceramic and glass, lead-crystal drinking glasses, table linen, accessories for the well-laid table and home furniture purchased from external companies

Relations between the Divisions are eliminated in the ‘transition/consolidation’ column. Assets and liabilities as well as expenses and revenue which are not directly allocable to a particular segment are added to the operating segments by means of appropriate keys.
Secondary segment reporting is arranged in order of the strongest sales markets.

Segment information is organised in the following manner:

External revenue represents segment sales with companies outside the Group.

Segment-spanning **internal revenue** comprises sales with other Divisions. Segment-spanning transactions are insignificant and are treated in the same way as independent transactions (arm’s length method).

The **EBITDA** of the segments is expressed in terms of the result before interest, depreciation and of income taxes

Depreciation concerns assets allocated to the individual segments. A distinction is made in the chart between depreciation of intangible assets and property, plant and equipment as well as financial assets.

The **EBIT** (operating result) of the segments is defined as earnings before interest and income taxes.

The **financial results** are not directly allocated to the segments, as the financial management of the Group is undertaken by Villeroy & Boch AG. The scope of the financial results is described in note 29.

Capital expenditure relates to intangible fixed assets and property, plant and equipment.

Operating assets comprise intangible fixed assets and property, plant and equipment, investments in associates, inventories, trade receivables, accounts due from associates, discounted bills of exchange, other assets (excluding income tax assets) as well as accrued income. Items included in the transition from operating assets to the balance-sheet total are those which are to be allocated to financial, tax and other non-operating sectors. These essentially concern financial assets without investments in associates, securities, cash and deferred taxes.

Operating liabilities comprise other provisions, trade payables, accounts due to associates, other liabilities (without liabilities for income taxes) and deferred income.
Items included in the transition from operating liabilities to borrowed capital are those which are to be allocated to the financial, tax and other non-operative sectors. These are essentially tax provisions, bank borrowings, notes payable, pension provisions and the part of other provisions not allocated to the segments.

Details of **employees** are based on an annual average.

Segments according to region
External revenue is allocated according to the registered seat of the client.
Capital expenditure, net operating assets and the number of employees are allocated according to the respective location of the company. Capital expenditure is made up of additions in intangible assets (inclusive of acquired goodwill) and property, plant and equipment.

OTHER NOTES

39. Contingent Liabilities and Commitments

Euro '000	*31.12.2006*	*31.12.2005*
Guarantee and endorsement obligations	0	25
Trustee obligations	326	427

There are no obligations due to associates.

40. Other Financial Obligations

Euro '000	*31.12.2006*	*31.12.2005*
Obligations arising from orders placed for capital expenditure	1,034	2,110

Rental and leasing obligations are presented in detail in note 2.

41. Financial Instruments

Financial instruments are contract-based commercial operations which include a claim to cash. In accordance with IAS 32 these cover self-generated financial instruments, such as trade receivables and trade payables or financial claims and liabilities, yet they also include derivative financial instruments which are used as covering transactions to secure against risks arising from exchange rates and interest rates.

Risk management and controlling

From the view of risk management, performance of these derivative transactions is subject to a strict functional division with regard to business, processing, control and the accounting treatment. Observance of principles stipulated by a uniform guideline and the processing of accounting events are also continuously monitored.

Original financial instruments

These include the individual items that can be seen directly from the balance sheet. Please refer to explanations of the relevant items for their accounting and evaluation. Unless further details are reported, carrying amounts correspond to fair values.

Derivative financial instruments

We employ derivative financial instruments to secure currency and interest items in order to minimise or eliminate the exchange risks and financing costs caused as a result of fluctuations in exchange and interest rates. For this purpose we use marketable forward exchange operations and interest rate swaps.

Transactions are only concluded with banks that have a perfect credit standing. They are employed according to uniform guidelines, and their use is subject to strict monitoring and limited to covering operational transactions as well as the financial operations connected with such.

'Usual' purchases and sales of financial assets in accordance with IAS 39 are reported in the balance sheet according to the method of accounting on the due date.

The derivative financial instruments are valuated at fair value, in accordance with IAS 39. They are disclosed in other assets and other liabilities.

Cash flow hedges are used to secure against the risks of cash payments and receipts from an existing assets or liabilities item, a contractually agreed obligation and planned transactions, i.e. payments which fluctuate in the future.

Forward exchange operations are concluded to provide security against the exchange risks (essentially USD, GBP, SEK, HUF, DKK) arising from future sales and purchase volumes in the individual divisions. Recognised valuation methods are used to calculate the fair values of the forward exchange operations on a monthly basis. In this respect, valuation is based on spot rates.

The fair values of interest rate swaps, used to minimise the risks of interest rate changes in existing liabilities due to banks, are determined by means of the market valuation provided by a bank.

The market value changes of forward exchange operations included in a cash flow hedge are reported in equity. The valuation of the derivative financial instruments contained in equity is transferred to the operating result when the mainstay business secured against is realised. Market value changes in derivative interest-rate tools, which have been concluded to secure against floating interest payments, are likewise recorded in equity without effect on the operating result. In so far as the derivative financial instruments are not providing security, valuation is carried out with effect on result.

In the year under review, Euro - 1.167 million (previous year: Euro - 0.197 million) from the market valuation of the derivative financial instruments was recorded in equity, without affecting operating result, and Euro - 0.084 million (previous year: Euro - 0.059 million) was recorded with effect on the operating result.

On the balance-sheet date, the following derivative financial instruments were employed to minimise risks:

Euro '000	*Nominal volume*	*Fair Value*	
		Financial assets	*Financial obligations*
Interest rate swaps	26,219	-	1,623 [1]
Forward exchange operations	80,520	435	1,342

[1] *incl. accrued interest*

The interest-hedging business concluded to secure against interest rate risks, amounting to Euro 0.779 million (previous year: Euro 1.880 million) has a remaining term of one to five years. As in the previous year, no interest rate is secured for a remaining term of over 5 years. The forward exchange operations concluded to guard against exchange risks fundamentally have a remaining term of up to one year. In the year under review, Euro 0.080 million was taken over from the valuation reserve of the forward exchange operations in equity and incorporated in the result for the period (previous year: Euro 0.940 million).

The forward exchange transactions were presented as follows:

	Nominal amounts	
	Euro '000	*%*
Forward exchange transactions due		
within the following three months	2,861	3
in three to six months	46,551	58
in six to twelve months	31,108	39
after twelve months	0	0
	80,520	**100**

Credit or loss risks

The executed, categorically derivative financial contracts are only concluded with banks that have a perfect credit standing, meaning that there is only a very slight risk of loss. In addition, the maximum risk of loss can be regarded as the sum of the positive market values of the derivative financial instruments from which there are claims vis-à-vis contractual partners. A limit is thus set for contracts with the individual contractual partners in order to minimise these risks.

42. Supervisory Board and Management Board Remuneration

According to the Memorandum and Articles of Association of Villeroy & Boch AG, Supervisory Board members are entitled to claim reimbursement of the expenses they have incurred as a result of their work. In addition to this, they receive a fixed basic remuneration and a variable share of remuneration.

Until July 9th 2006 inclusive, the basic remuneration amounted to Euro 7,500 per year. With effect from July 10th 2006 the fixed remuneration was increased to Euro 12,000 per year, in accordance with a resolution passed by the General Meeting of Shareholders on June 9th 2006. Until July 9th 2006 inclusive, the Chairman received double, the Deputy Chairman one-and-a-half times the remuneration paid to a simple member, in addition to the basic remuneration. As of July 10th 2006, the Chairman receives Euro 28,000 and the Deputy Chairman Euro 8,000.

The additional variable remuneration amounts to Euro 195.00 per Supervisory Board member for every Euro cent per share of shareholders' dividend which exceeds the amount of 10.5 Euro cents. (average of the dividend paid on a preference and an ordinary share).

The preceding remunerations are paid together with any statutory value-added tax which may be incurred. A claim to remuneration exists only pro rata temporis for the term of appointment.

Until July 9th 2006 a committee chairman received an additional Euro 1,875 (25 % of the fixed annual remuneration for Supervisory Board members), each committee member an additional Euro 1,500 (20 % of the fixed annual remuneration for Supervisory Board members) per year. Since July 10th 2006 the Chairmen of the Investment Committee and Audit Committee (Peter Prinz Wittgenstein and Kilian von der Tann) each receive Euro 4,000, and the members (Luitwin Gisbert von Boch and Ralf Runge, as well as Ina Rauls and Peter Prinz Wittgenstein) each receive Euro 2,500 per year in addition to their basic remuneration.

A total of Euro 0.172 million inclusive of the variable remuneration components expected for 2006 on the balance-sheet date was shown in the consolidated result for the 2006 financial year as an expense (previous year: Euro 0.229 million). The reversal with effect on the operating result of the provision for the variable remuneration components for 2005 to the amount of Euro 0.045 million (previous year: 0.004 million) was taken into account in this case. In the financial year, a total of Euro 0.227 million (previous year: Euro 0.197 million) was paid out in professional fees.

As in the previous year, Supervisory Board members of Villeroy & Boch Aktiengesellschaft received remuneration for participating in supervisory bodies of the subsidiaries – in terms of § 125 AktG – to the amount of Euro 0.002 million.

The emoluments received by Management Board members totalling Euro 2.208 million (previous year: Euro 2.274 million) were composed of Euro 1.227 million (previous year: Euro 1.264 million) fixed and Euro 0.981 million (previous year: Euro 1.010 million) variable remuneration components.

The pension rights of the Management Board members to the amount of Euro 1.760 million (previous year: Euro 2.154 million) are included in provisions for pensions. Provisions for pensions for former Management Board members amount to Euro 11.842 million (previous year: Euro 11.669 million), with emoluments in the financial year totalling Euro 1.057 million (previous year: Euro 1.053 million).

§ 314 subsection 2 sentence 2 HGB in connection with § 286 subsection 5 HGB was applied with respect to the disclosure of individual Management Board emoluments.

43. Related Party Disclosures

In the course of our operating activities we procure materials, inventories and services from a great number of business associates worldwide. These include companies in which the Villeroy & Boch Group has a share and companies which are in some way connected to Supervisory Board and Management Board members of Villeroy & Boch AG. In principle, all the transactions are conducted according to customary business terms and conditions. The corresponding sales are insignificant from the perspective of the Villeroy & Boch Group.

Closely associated persons or family members employed within the Villeroy & Boch Group receive remuneration according to their position or duties, which is paid irrespective of the individual holding the position.
The transactions between Villeroy & Boch AG and subsidiary companies as well as between the subsidiary companies themselves were eliminated in accordance with the consolidation principles. An overview of the principal consolidated companies is found on page 128 of the Annual Report.

44. Events Subsequent to the Balance-Sheet Date

There are no significant events to report.
The Consolidated Financial Statements were released for publication by the Villeroy & Boch AG Management Board on March 6th 2007.

45. Proposed Appropriation of Villeroy & Boch AG Retained Earnings

Supervisory Board and Management Board propose using the retained earnings of Euro 29,405,347.91 to distribute a dividend of Euro 0.37 per individual ordinary-share certificate and Euro 0.42 per individual preference-share certificate. The proposed appropriation of retained earnings corresponds with a dividend of

	Euro
for ordinary share capital	5,196,576.00
for preference share capital	5,898,816.00
	11,095,392.00

The remaining amount of retained earnings to the amount of Euro 18,309,955.91 will be carried forward to new account.
If treasury stock is still in the possession of the company at the time of the resolution on the appropriation of retained earnings, the dividend payment for preference share capital is reduced by the sum allotted to the treasury stock. Retained earnings brought forward increase accordingly for the year 2007.

46. Corporate Governance Codex

In application of the Corporate Governance Codex, the corporate principles were updated in 2005. The new declaration of conformity as prescribed by § 161 AktG [German Public Limited Company Law] was made by the Management and Supervisory Boards for the 2006 financial year. A summarised presentation of the Corporate Governance principles can be found in the Annual Report as well as on the internet, where the shareholders' Declaration of Conformity can also be accessed permanently (www.villeroy-boch.de, Investor Relations).

47. Auditor's Fees

The auditor's fees are made up as follows:

	Euro '000
Annual audit	276
Other certification or valuation services	8
Tax consultancy services	40
Other services	30

48. Developments in the IASC Regulatory System

The regulatory system of the International Accounting Standard Committee Foundation (abbreviated to 'IASC Foundation') comprises the basic concept, individual standards and interpretations. IASB publishes all the standards in the name of IASC, while IFRIC publications serve to explain and interpret already existing standards. Both institutions have published official announcements on standards, the adoption of which is not as yet obligatory for annual financial statements as of December 31st 2006. The following overview lists the as yet non-obligatory regulations which have not been adopted by the Villeroy & Boch Group up to the present time:

IFRS	7	Financial Instruments: Disclosures
IFRS	8	Operating Segments*
IFRIC	7	Applying the Restatement Approach under IAS 29 Financial Reporting in Hyperinflationary Economies
IFRIC	8	Scope of IFRS 2*
IFRIC	9	Reassessment of Embedded Derivatives
IFRIC	10	Interim Financial Reporting and Impairment*
IFRIC	11	IFRS 2 Group and Treasury Share Transactions*
IFRIC	12	Service Concession Arrangements*

The above standards and interpretations will be applied when they become effective within the European Union. The standards and amendments which have not as yet been adopted by the European Union have been marked with an asterisk. Current information indicates that the Villeroy & Boch Group is only marginally affected by these changes.

Mettlach. March 6th 2007

Wendelin von Boch-Galhau Manfred Finger Frank Göring

AUDITOR'S REPORT

We have audited the consolidated financial statements prepared by the Villeroy & Boch Aktiengesellschaft, Mettlach, comprising the balance sheet, the income statement, statement of changes in equity, cash flow statement and the notes to the consolidated financial statements, together with the combined management report of the Company and the Group for the business year from 1 January to 31 December 2006. The preparation of the consolidated financial statements and the group management report in accordance with IFRSs, 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 on the group management report based on our audit.
We conducted our audit of the consolidated financial statements in accordance with § 317 HGB [Handelsgesetzbuch „German Commercial Code"] and German generally accepted standards for the audit of financial statements promulgated by the Institut der Wirtschaftsprüfer (IDW). Those standards require that we plan and perform the audit such that misstatements materially affecting the presentation of the net assets, financial position and results of operations in the consolidated financial statements in accordance with the applicable financial reporting framework and in the 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, and 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.

Cologne. March 6th 2007

KPMG Deutsche Treuhand-Gesellschaft
Aktiengesellschaft
Wirtschaftsprüfungsgesellschaft

(Kohns)
Qualified auditor

(Braun)
Qualified auditor

Major Group Companies

Affiliated Companies:

Bathroom and Wellness Division	Belgium	Villeroy & Boch Wellness N.V., Roeselare
	France	Villeroy & Boch S.A.S., Paris
	Italy	Villeroy & Boch Wellness Italia S.r.l., Castelraimondo
	Netherlands	Villeroy & Boch (Nederland) B.V., Amsterdam
		Villeroy & Boch Wellness Holding B.V., Roden
	Romania	S.C. Mondial S.A., Lugoj
	Sweden	AB Gustavsberg, Gustavsberg/Värmdö
		Villeroy & Boch Wellness AB, Växjö
	Slovak Republic	Vagnerplast Slovensko s. r.o., Partizánske
	Czech Republic	Vagnerplast spol. s r.o., Velké Prítocno - Unhost
	Hungary	Villeroy & Boch Magyarország Rt., Hódmezövásárhely
	Mexico	Vilbomex S.A. de C.V., Saltillo
Tableware Division	Denmark	Villeroy & Boch Denmark A/S, Roedovre
	Germany	Villeroy & Boch Creation GmbH, Mettlach
	Luxembourg	Villeroy & Boch S.à r.l., Faiencerie de Septfontaines-lez-Luxembourg, Luxembourg
	France	Villeroy & Boch Arts de la Table S.A.S., Paris
	Italy	Villeroy & Boch Arti della Tavola S.r.l, Milan
	Switzerland	Villeroy & Boch Creatable AG, Lenzburg
	Sweden	Villeroy & Boch Nordic AB, Stockholm
	Norway	Villeroy & Boch Norge AS, Oslo
	Netherlands	Villeroy & Boch Tableware B.V., Oosterhout NB
	Canada	Villeroy & Boch Tableware Ltd., Aurora
	Australia	Villeroy & Boch Australia Pty. Ltd., Frenchs Forest
	Hong Kong	Villeroy & Boch Tableware (Far East) Ltd., Hong Kong
	Japan	Villeroy & Boch Tableware (Japan) K.K., Tokyo
Tile Division	Germany	Fliesenhandel an der Cristallerie GmbH, Wadgassen
		Fliesenhandel Merzig GmbH, Merzig
		V & B Fliesen GmbH, Merzig
Division-Spanning Companies	France	S.D.P.C. S.A., Paris
	England	Villeroy & Boch (U.K.) Ltd., London
	Spain	Villeroy & Boch Hogar S.L., Barcelona
	Austria	Villeroy & Boch Austria G.m.b.H., Hallwang
	Belgium	Villeroy & Boch Belgium S.A., Brussels
	Hungary	V&B Holding Ungarn Korlátolt Felelösségü Társaságnak, Budapest
	USA	Villeroy & Boch USA Inc., Princeton

Share Capital		*Villeroy & Boch AG Participation*		
Currency	*Million*	*Direct* %	*Indirect* %	*Total* %
EUR	7.56	100.00	-	100.00
EUR	9.27	100.00	-	100.00
EUR	8.00	-	100.00	100.00
EUR	0.05	100.00	-	100.00
EUR	1.62	100.00	-	100.00
RON	17.0	99.56	-	99.56
SEK	20.00	100.00	-	100.00
SEK	1.00	-	100.00	100.00
SKK	0.20	-	100.00	100.00
CZK	92.93	-	100.00	100.00
HUF	2,289.30		99.62	99.62
MXN	55.05	-	100.00	100.00
DKK	1.50	33.33	66.67	100.00
EUR	0.05	100.00	-	100.00
EUR	15.00	100.00	-	100.00
EUR	3.14	-	100.00	100.00
EUR	0.03	0.20	99.80	100.00
CHF	0.50	-	100.00	100.00
SEK	2.00	-	100.00	100.00
NOK	0.10	-	100.00	100.00
EUR	0.10	100.00	-	100.00
CAD	2.20	-	100.00	100.00
AUD	0.52	-	100.00	100.00
HKD	7.00	-	100.00	100.00
JPY	97.50	-	100.00	100.00
EUR	0.26	100.00	-	100.00
EUR	0.36	100.00	-	100.00
EUR	8.00	100.00	-	100.00
EUR	2.13	97.15	2.85	100.00
GBP	1.10	-	100.00	100.00
EUR	0.27	44.44	55.56	100.00
EUR	1.24	100.00	-	100.00
EUR	0.06	99.90	0.10	100.00
HUF	3.00	100.00	0	100.00
USD	1.10	-	100.00	100.00

ASSET DEPRECIATION RATIO
Ratio of accumulated depreciation on property, plant and equipment to historical cost of property, plant and equipment

ASSETS STRUCTURE
Relationship between non-current assets and current assets.

CASH FLOW
The internal financing potential of the company, resulting from the inflow of funds, adjusted to take account of expenses and income not affecting liquid assets

CASH FLOW FROM FINANCING ACTIVITIES
Cash balance resulting from a change in financial liabilities, deposits from sales, payments for acquiring treasury stock, withholding tax paid and dividend payments.

CASH FLOW FROM INVESTING ACTIVITIES
Cash balance that the company has invested in acquiring financial assets and property, plant and equipment or has realised from selling financial assets and property, plant and equipment.

CASH FLOW FROM OPERATING ACTIVITIES (OPERATING CASH FLOW)
Cash surplus obtained from operative business.

CASH FLOW STATEMENT
Examination of the liquidity trend, taking into consideration the effects of the sources and application of funds within a business year.

CORPORATE GOVERNANCE
Good, responsible corporate management and monitoring aimed at long-term real net output.

CURRENT ANALYTIC LIABILITIES
The current analytic liabilities of current deferred income for calculating liquidity ratios consist of the trade payables plus the current tax liabilities and other current remaining liabilities with the exception of current deferred charges.

DEFERRED CHARGES AND PREPAID EXPENSES
Payments during the period under review, the effects of which refer to a period after the balance sheet date as far as the result is concerned

DEFERRED TAXES

Differences, limited in time, between taxes calculated on results reported according to commercial and tax balance sheets, the aim being to report tax expenditure in accordance with the commercial result.

DISTRIBUTION QUOTA

Share of net income distributed to the shareholders in the form of dividend payments

EBIT

Earnings Before Interest and Tax

EBITDA

Earnings Before Interest, Tax, Depreciation and Amortisation

EBIT MARGIN

Ratio of EBIT to sales

EBITDA MARGIN

Ratio of EBITDA to sales

EBT

Earnings Before Tax

EQUITY GEARING

Relationship between shareholders' equity and liabilities.

EQUITY RATIO

Ratio of shareholders' equity to total capital

FIXED ASSETS

Fixed assets comprise assets that are destined to serve business operations on a permanent basis. They consist of intangible assets, property, plant and equipment, investment properties, investment accounted for at equity, and other financial assets.

FREE CASH FLOW

Sum of the cash flows from investing activities and operating activities. Free cash flow describes the free funds at the company's disposal.

FREE CASH FLOW MARGIN
Ratio of free cash flow to sales

GOODWILL
The difference by which the purchase price paid to take over a company exceeds the value of the individual corporate assets minus the debts at the time of takeover.

GROSS INVESTMENT POSITION
The gross investment position results from the carrying amount of fixed assets plus accumulated depreciation (each excluding goodwill), plus other non-current assets and current assets

IFRS (IAS)
International Financial Reporting Standards. Internationally recognised and applied statutory accounting requirements, developed by the International Accounting Standards Board (IASB) with the aim of harmonising accounting worldwide.

LIABILITIES
Sum of the liability items “non-current and current liabilities” shown in the balance sheet. These consist of the provisions for pensions and similar obligations, other provisions, liabilities and deferred charges.

MARGINS
Division of the ratio under examination by the sales figure

NOPAT (NET OPERATING PROFIT AFTER TAX)
Balance from gross profit, the selling, marketing and development costs, the general and administrative expenses and the income taxes

OTHER NON-CURRENT ASSETS
The other non-current assets consist of deferred taxes on the assets side and the remaining non-current assets which will serve the Villeroy & Boch Group for longer than one year. Fixed assets are recorded separately.

RETURN ON CAPITAL EMPLOYED (ROCE)
See also “Return on total capital employed”.

RETURN ON EQUITY (ROE)
Yield on the funds made available by the owners of the company, as well as on the company’s openly retained earnings.

RETURN ON INVESTMENT (ROI)
Ratio of profit to average total capital.

RETURN ON TOTAL CAPITAL EMPLOYED
Yield on the average total capital altogether available.

SALES PROFITABILITY
The ratio of net income/loss to sales.

SDAX®
SDAX® is the Selection Index of the Deutsche Börse AG for smaller companies from traditional branches, the so-called “small caps”. It embraces 50 values which are listed in the “Prime Standard” of the Official Market, or in the Regulated Market.

SHAREHOLDERS’ EQUITY
Funds which the company has permanently at its disposal, these coming from deposits or capital contributions made by the owners (including minority shareholders) and from retained earnings.

STOCK OPTIONS
Stock options used as a means of compensation for selected management-level employees in the company.

WORKING CAPITAL
Difference between current assets and current liabilities.

Explanation of Ratios

BALANCE SHEET RATIOS (IN %)

Cash flow profitability	cash flow : total capital x 100
Equity ratio	shareholders' equity : total capital x 100
Net operating margin	profit : sales x 100

ASSET SITUATION RATIOS (IN %)

Asset depreciation ratio	accumulated depreciation on property, plant and equipment : historical cost of property, plant and equipment x 100
Intensity of investments	fixed assets : total assets x 100
Assets structure	non-current assets : current assets x 100

FINANCIAL SITUATION RATIOS

Cash ratio (in %)	cash : current analytic liabilities x 100
Quick ratio (in %)	cash + trade receivables : current analytic liabilities x 100
Current ratio (in %)	cash + trade receivables + inventories : current analytic liabilities x 100
Equity gearing (in %)	liabilities : shareholders' equity x 100
Working capital (in Euro million)	current assets – current analytic liabilities

EARNINGS SITUATION RATIOS (IN %)

Cash Flow ROI (CFROI)	gross cash flow : gross investment position x 100
EBIT margin	EBIT : sales x 100
EBITDA margin	EBITDA : sales x 100
EBT margin	EBT : sales x 100
Free cash flow margin	free cash flow : sales x 100
Operating cash flow margin	operating cash flow : sales x 100
Return on Investment (ROI)	sales profitability x turnover rate = (profit : sales) x (sales : total capital) x 100

SHARE RATIOS

Dividend yield (in %)	dividend : average market price x 100
Price-cash flow ratio	market price per share : cash flow per share
Price-earnings ratio (PER)	market price per share : profit per share
Operating cash flow per share	operating cash flow : number of shares in circulation

YIELD RATIOS (IN %)

Return on Equity (ROE)	profit : total equity x 100
Return on Capital Employed (ROCE)	EBIT : (property, plant and equipment + investment property + working capital) x 100

Company Calendar

General Meeting of Shareholders

June 1st 2007
3 p.m.
Stadthalle Merzig

Villeroy & Boch will report on
the first three months of the year
with the quarterly report on

April 26th 2007,

on the first six months of the current financial year
with the semi-annual financial statements on

July 26th 2007

and on
the first nine months of the year on

October 30th 2007.

Dear shareholders,

If you are interested in further information, or in the German version of the Annual Report for the year 2006, please contact:

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Concept and design: Klötzner Company Werbeagentur GmbH, Hamburg

Multi-Year Comparison of Ratios

Asset situation ratios		2006	2005	2004	2003	2002
Fixed assets	*Euro million*	305.8	305.4	311.7	350.2	363.2
Change in comparison with previous year	*Percent*	0.1	- 2.0	- 11.0	- 3.6	- 7.1
Other non-current assets	*Euro million*	52.2	52.7	43.1	55.9	43.0
Change in comparison with previous year	*Percent*	- 1.1	22.2	- 22.9	30.1	15.3
Current assets[2]	*Euro million*	431.4	429.0	430.3	436.6	474.1
Change in comparison with previous year[2]	*Percent*	0.6	- 0.3	- 1.4	- 7.9	4.7
Intensity of investments[2]	*Percent*	38.7	38.8	39.7	41.6	41.3
Assets structure[2]	*Percent*	83.0	83.5	82.5	93.0	85.7
Asset depreciation ratio	*Percent*	72.4	72.8	71.3	70.1	69.4
Balance sheet total[2]	*Euro million*	789.4	787.1	785.1	842.7	880.3
Change in comparison with previous year[2]	*Percent*	0.3	0.3	- 6.8	- 4.3	- 0.1

Financial situation ratios		2006	2005	2004	2003	2002
Equity (incl. that attributable to minority interests)[2]	*Euro million*	350.4	344.4	345.6	335.0	376.2
Liabilities[2]	*Euro million*	439.0	442.7	439.5	507.7	504.1
Equity gearing[2]	*Percent*	125.3	128.5	127.2	151.5	134.0
Cash ratio[2]	*Percent*	6.4	32.5	31.9	20.5	30.7
Quick ratio[2]	*Percent*	122.2	108.3	102.8	88.8	106.0
Current ratio[2]	*Percent*	235.5	222.6	266.3	241.9	270.7
Working capital[2]	*Euro million*	249.8	249.1	269.6	255.6	299.4

Earnings situation ratios		2006	2005	2004	2003	2002
EBITDA margin						
after special expense	*Percent*	8.0	7.7	9.0	5.6	9.0
before special expense	*Percent*	8.0	7.7	9.0	8.3	9.7
EBIT margin						
after special expense	*Percent*	3.5	2.7	3.5	- 1.9	2.8
before special expense	*Percent*	3.5	2.7	3.5	2.2	3.5
EBT margin	*Percent*	2.4	1.8	2.5	- 3.2	1.4
Operating cash flow margin	*Percent*	2.4	6.4	6.6	5.5	7.3
Free cash flow margin	*Percent*	- 3.9	2.7	5.6	- 0.6	3.9
Return On Investment (ROI)[2]	*Percent*	2.2	1.7	2.1	- 3.0	1.2
Cash flow ROI (CFROI)[2]	*Percent*	5.2	4.9	5.9	4.1	5.8

Share ratios

Share ratios		2006	2005	2004	2003	2002
Annual closing price (Xetra)	*Euro*	13.37	11.84	9.26	7.35	6.80
Annual high (Xetra)	*Euro*	14.00	15.50	9.90	8.45	11.50
Annual low (Xetra)	*Euro*	10.99	8.90	7.25	6.46	6.50
Net earnings per ordinary share	*Euro*	0.62	0.47	0.58	- 0.99	0.35
Net earnings per preference share	*Euro*	0.67	0.52	0.63	- 0.94	0.40
Operating cash flow per share	*Euro*	0.86	2.15	2.39	1.95	2.62
Dividend per ordinary share	*Euro*	0.37	0.32	0.37	0.25	0.50
Dividend per preference share	*Euro*	0.42	0.37	0.42	0.30	0.55
Changes compared with previous year (ordinary share)	*Percent*	15.6	- 13.5	48.0	- 50.0	0
Changes compared with previous year (preference share)	*Percent*	13.5	- 11.9	40.0	- 45.5	0
Dividend yield per ordinary share	*Percent*	2.96	2.62	4.31	3.35	5.56
Dividend yield per preference share	*Percent*	3.36	3.03	4.90	4.02	6.11
Price-cash flow ratio (KCV)[1]	*Factor*	14.52	5.67	3.59	3.82	3.43
Price-earnings ratio (PER) per ordinary share[1]	*Factor*	20.2	26.0	14.8	- 7.5	25.7
Price-earnings ratio (PER) per preference share[1]	*Factor*	18.6	23.5	13.6	- 7.9	22.5

Yield ratios

Yield ratios		2006	2005	2004	2003	2002
Return on Equity (ROE)[2]	*Percent*	4.9	3.8	4.8	- 7.6	2.7
Return on Capital Employed (ROCE)[2]	*Percent*	6.6	4.9	6.4	- 3.2	4.6

[1] Calculations are based on the average market price, which results as the average from the annual high and the annual low.
[2] Prior-year values have been adjusted

Villeroy & Boch

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