

AKZO NOBEL NV  
Form 20-F  
June 21, 2007

**SECURITIES AND EXCHANGE COMMISSION  
Washington, D.C. 20549**

**FORM 20-F**

(Mark one)

- REGISTRATION STATEMENT PURSUANT TO SECTION 12 (b) OR (g) OF THE SECURITIES EXCHANGE ACT OF 1934 or
- ANNUAL REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934 For the fiscal year ended December 31, 2006 or
- TRANSITION REPORT PURSUANT TO SECTION 13 OR 15 (d) OF THE SECURITIES EXCHANGE ACT OF 1934 or
- SHELL COMPANY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934 Date of event requiring this shell company report

Commission file number 0-17444

**AKZO NOBEL N.V.**

(Exact name of registrant as specified in its charter)

**The Netherlands**

(Jurisdiction of incorporation or organization)

**76 Velperweg, 6824 BM Arnhem**

(Address of principal executive offices)

Securities registered or to be registered pursuant to Section 12 (b) of the Act:

| <u>Title of each class</u>  | <u>Name of each exchange on which registered</u> |
|---|--|
| <b>American Depositary Shares<br/>Common shares of EUR 2 each</b> | <b>NASDAQ/NMS<br/>NASDAQ/NMS*</b>                |

\* Not for trading, but only in connection with the registration of American Depositary Shares, pursuant to the requirements of the Securities and Exchange Commission

Securities registered or to be registered pursuant to Section 12 (g) of the Act: **None**

Securities for which there is a reporting obligation pursuant to Section 15 (d) of the Act: **None**

Indicate the number of outstanding shares of each of the issuer's classes of capital or common shares as of the close of the period covered by the annual report:

|   |                    |
|---|--------------------|
| <b>Common shares, par value EUR 2 per share</b>     | <b>287,268,350</b> |
| <b>Priority shares, par value EUR 400 per share</b> | <b>48</b>          |

Indicate by check mark if the registrant is a well-known seasoned issuer, as defined in Rule 405 of the Securities Act

Yes      No

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If this report is an annual or transition report, indicate by check mark if the registrant is not required to file reports pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934.

Yes      No

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, or a non-accelerated filer. See definition of accelerated filer and large accelerated filer in Rule 12b-2 of the Exchange Act (Check one):

Large accelerated filer

Accelerated filer

Non-accelerated filer

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15 (d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days.

Yes      No

Indicate by check mark which financial statement item the registrant has elected to follow.

Item 17      Item 18

If this is an annual report, indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act).

Yes      No

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**PART I****INTRODUCTION**

The consolidated financial statements of Akzo Nobel N.V. and subsidiaries appearing in this annual report are prepared in accordance with International Financial Reporting Standards ("IFRS") as adopted by the European Union, and also comply with the financial reporting requirements included in section 9 of Book 2 of the Netherlands Civil Code, as far as applicable. IFRS differ in certain respects from accounting principles generally accepted in the United States ("US GAAP"). IFRS as adopted by the EU is the same for Akzo Nobel as IFRS promulgated by the International Accounting Standards Board. The significant differences between IFRS and US GAAP affecting Akzo Nobel's net income and shareholder's equity are discussed in Note 27 of the Notes to the Consolidated Financial Statements of Akzo Nobel.

The terms "Akzo Nobel" or "the company" are sometimes used herein for convenience in contexts where reference is made to the consolidated companies of Akzo Nobel N.V. in general. Such terms are also used for convenience in referring to individual segments and subsidiaries.

In this annual report, unless otherwise specified or the context otherwise requires, references to "dollars", "U.S. dollars" and "USD" are to the United States currency. The European currency euro is sometimes referred to as EUR. For convenience only (except where noted otherwise), certain euro figures have been translated into dollars at the rate of EUR 0.759 = USD 1.00, the noon buying rate in The City of New York for cable transfers in foreign currencies as announced by the Federal Reserve Bank of New York for customs purposes (the "Noon Buying Rate") on December 31, 2006. These translations should not be construed as a representation that the euro amounts actually represent such dollar amounts or could be converted into dollars at the rate indicated. On June 12, 2007, the Noon Buying Rate was EUR 0.749= USD 1.00.

**In order to utilize the "Safe Harbor" provisions of the United States Private Securities Litigation Reform Act of 1995, Akzo Nobel is providing the following cautionary statement. This document contains certain forward-looking statements with respect to the financial condition, results of operations and business of Akzo Nobel, and certain of the plans and objectives of Akzo Nobel with respect to these items. These statements may generally, but not always, be identified by the use of words such as "anticipate", "assume", "intend", "plan", "project", "should", "expect", "estimate", "believe" or similar expressions. In particular, among other statements, certain statements in Item 4 "Information on the Company" with regard to strategy, management objectives, including return on investment targets, market trends, market standing, market share estimates based on management's estimates, benefits that may result from future restructuring programs, the product volumes, the costs and expenditures related to environmental compliance or remediation, Health, Safety and Environment targets, future research and development initiatives, the Pharma pipeline, the statements in Item 8 "Financial Information" with regard to the outcome of disputes with tax authorities, the outcome or consequences of pending or future legal or regulatory proceedings including antitrust investigations and other potential related lawsuits and their effect on the company, and those statements in Item 5 "Operating and Financial Review and Prospects" with regard to trends in results of operations, margins, overall market and macro-economic trends, risk management, exchange rates, and objectives such as return on capital are forward-looking in nature as are all statements under "Forward Looking Statement on 2007" and Item 11 "Quantitative and Qualitative Disclosures about Market Risk".**

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**By their nature, forward looking statements involve risk and uncertainty because they relate to events and depend on circumstances that will occur in the future. There are a number of factors that could cause actual results and developments to differ materially from those expressed or implied by these forward looking statements. These factors include, but are not limited to, levels of business spending in major economies (as well as other developments in the economies of the company's markets in Asia, Latin America, North America, and Europe), the development in market value of pension plan assets, governmental regulations, changes in customer needs, progress of drug development, clinical testing, and regulatory approval, the levels of marketing expenditures by Akzo Nobel and its competitors, the introduction of new products by competitors, raw material and employee costs, future foreign exchange and interest rates, changes in tax rates and product regulation, future business combinations, acquisitions or dispositions, environmental liabilities, and the outcome of tax disputes, antitrust investigations, potential product liability claims and other lawsuits, and wars and acts of terrorism or sabotage.**

Statements made in Item 4 "Information on the Company" referring to Akzo Nobel's competitive position are based on management estimates, and in some cases, the statements are also based on information from a range of sources, including analysts' reports, independent market studies and Akzo Nobel's internal assessment of market share based on publicly available information about the financial results and performance of market participants unless otherwise noted. Such references to the company's positioning refer to its market share based on revenues, unless otherwise noted.

In the analysis of the development of revenues, when compared to the previous year, the company distinguishes between the effects from changed volumes, changed selling prices, currency translation, acquisitions, and divestments. Autonomous revenues growth, which sometimes is used in the discussions in this report, is a non-GAAP measure and is defined as the change in revenues attributable to changed volumes and selling prices. Autonomous revenues growth excludes currency, acquisition, and divestment effects. As a result, autonomous growth numbers reflect comparable revenues performance, and are used and analyzed by the company's management for this purpose. Because of the comparability of revenues performance that can be analyzed by reviewing autonomous growth numbers, the company's management believes that these numbers are useful for those reviewing our financial performance. However, the autonomous growth numbers should not be viewed in isolation or as alternatives to the comparable GAAP measure of revenues and should be read in conjunction with such measure.

The company uses the term "Incidentals" in the analysis of its results. Incidentals is a non-GAAP measure and is defined as special benefits, results on divestments, restructuring and impairment charges, and charges related to major legal, antitrust, and environmental cases. Operating income excluding incidentals is one of the key figures management uses to assess the company's performance, as this figure better reflects the underlying trends in the results of the activities.

EBIT margin, formerly called return on sales, is operating income (EBIT) as percentage of revenues.

EBITDA is EBIT before depreciation and amortization.

Interest coverage is EBIT divided by the sum of financing income and expenses. EBITDA coverage is EBITDA divided by the sum of financing income and expenses.

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**Item 1. IDENTITY OF DIRECTORS, SENIOR MANAGEMENT AND ADVISORS**

Not applicable.

**Item 2. OFFER STATISTICS AND EXPECTED TIMETABLE**

Not applicable.

**Item 3. KEY INFORMATION**

**A. SELECTED CONSOLIDATED FINANCIAL DATA**

The selected financial data set forth on the following pages are derived from previously published financial information of Akzo Nobel, including the consolidated financial statements for the years ended December 31, 2006, 2005, and 2004, which appear elsewhere in this annual report. The selected financial data should be read in conjunction with, and are qualified in their entirety by reference to, such financial statements, including the notes thereto.

The audited consolidated financial statements of Akzo Nobel for the years ended December 31, 2006, 2005, and 2004, have been audited by KPMG Accountants N.V., independent registered public accounting firm, whose report thereon is included in Item 18. The consolidated balance sheets as of December 31, 2003 and 2002, and the consolidated statements of income and the consolidated statements of cash flows for the years ended December 31, 2003 and 2002, were also audited by KPMG Accountants N.V.; however, those balance sheets, statements of income, and statements of cash flows are not included in this Form 20-F.

Reference is made to Note 27 of the Notes to the Consolidated Financial Statements regarding differences between IFRS and US GAAP that affected Akzo Nobel's net income and shareholders' equity, as well as certain other lines of the Consolidated Statement of Income and the Consolidated Balance Sheet.

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| <i>In millions, except per share amounts</i>                        | <b>Selected financial data for the years ended</b> |             |             |                     |        |             |
|---|--|-------------|-------------|---------------------|--------|-------------|
|   | <b>2006</b>  | <b>2006</b> | <b>2005</b> | <b>December 31,</b> |        | <b>2002</b> |
|   | USD<br>(a)   | EUR         | EUR         | EUR                 | EUR    | EUR         |
| <b>Consolidated Income data:</b>                                    |  |             |             |                     |        |             |
| <i>Amounts in accordance with IFRS:</i>                             |  |             |             |                     |        |             |
| Revenues  | 18,099   | 13,737      | 13,000      | 12,833              |        |             |
| Operating income  | 1,926  | 1,462       | 1,486       | 1,527               |        |             |
| Net income; profit attributable to equity<br>holders of the company | 1,519  | 1,153       | 961         | 945                 |        |             |
| Basic earnings per share / ADS (b)                                  | 5.30   | 4.02        | 3.36        | 3.31                |        |             |
| <i>Amounts in accordance with US GAAP:</i>                          |  |             |             |                     |        |             |
| Revenues  | 17,984   | 13,650      | 12,916      | 12,680              | 12,931 | 13,880      |
| Operating income  | 1,574  | 1,195       | 1,089       | 1,300               | 978    | 1,446       |
| Net income  | 1,318  | 1,000       | 710         | 832                 | 559    | 860         |
| Basic earnings per share / ADS (b) (c)                              | 4.60   | 3.49        | 2.48        | 2.91                | 1.96   | 3.01        |
| Diluted earnings per share / ADS (b) (c)                            | 4.57   | 3.47        | 2.47        | 2.90                | 1.95   | 3.00        |
| <b>Consolidated Balance Sheet data:</b>                             |  |             |             |                     |        |             |
| <i>Amounts in accordance with IFRS:</i>                             |  |             |             |                     |        |             |
| Total assets  | 16,845   | 12,785      | 12,425      | 11,951              |        |             |
| Long-term borrowings  | 3,361  | 2,551       | 2,702       | 2,392               |        |             |
| Shareholders' equity  | 5,460  | 4,144       | 3,415       | 2,605               |        |             |
| <i>Amounts in accordance with US GAAP:</i>                          |  |             |             |                     |        |             |
| Total assets  | 20,833   | 15,812      | 16,149      | 15,513              | 15,066 | 16,046      |
| Long-term borrowings  | 3,295  | 2,501       | 2,636       | 2,391               | 2,652  | 2,065       |
| Shareholders' equity  | 9,436  | 7,162       | 6,701       | 6,127               | 5,651  | 5,455       |

(a)

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Amounts in this column have been translated solely for the convenience of the reader at the Noon Buying Rate on December 31, 2006, of EUR 0.759 = USD 1.00.

(b) American Depositary Shares.

(c) For the breakdown on earnings from continued and discontinued operations see Note 27 of the Notes to the Consolidated Financial Statements under (r).

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The table below sets forth the number of common shares outstanding and the amounts of interim, final and total dividends declared (and the U.S.-dollar equivalents) on the common shares in respect of the fiscal years indicated.

| Year ended<br>December<br>31, | Number of shares |               |         | Dividends per common share |       |         |       |       |
|-------------------------------|------------------|---------------|---------|----------------------------|-------|---------|-------|-------|
|                               | Average          | End of period | Interim | EUR                        |       | USD*    |       |       |
|                               |                  |               |         | Final                      | Total | Interim | Final | Total |
| 2002                          | 285,827,092      | 285,691,957   | 0.30    | 0.90                       | 1.20  | 0.32    | 0.94  | 1.26  |
| 2003                          | 285,691,957      | 285,691,957   | 0.30    | 0.90                       | 1.20  | 0.38    | 1.14  | 1.52  |
| 2004                          | 285,745,587      | 285,773,239   | 0.30    | 0.90                       | 1.20  | 0.41    | 1.23  | 1.64  |
| 2005                          | 285,773,239      | 285,773,239   | 0.30    | 0.90                       | 1.20  | 0.36    | 1.06  | 1.42  |
| 2006                          | 286,543,714      | 287,028,440   | 0.30    | 0.90                       | 1.20  | 0.40    | 1.18  | 1.58  |

\* Dividends per common share in U.S. dollars are based on the Noon Buying Rate at December 31 of each year.

The following table sets forth for the fiscal periods indicated the average exchange rates for U.S. dollars into euros per dollar based on the applicable Noon Buying Rate.

| Year ended<br>December 31, | Average* |
|----------------------------|----------|
| 2002                       | 1.06     |
| 2003                       | 0.88     |
| 2004                       | 0.80     |
| 2005                       | 0.80     |
| 2006                       | 0.80     |

\* The average of the Noon Buying Rates on the last day of each month during the period.

The following table sets forth for the months indicated the high and low rates for U.S. dollars expressed in euros per dollar.

|               | High | Low  |
|---------------|------|------|
| December 2006 | 0.77 | 0.75 |
| January 2007  | 0.77 | 0.75 |
| February 2007 | 0.77 | 0.76 |
| March 2007    | 0.76 | 0.75 |
| April 2007    | 0.75 | 0.73 |
| May 2007      | 0.74 | 0.73 |

On June 12, 2007, the noon buying Rate was EUR 0.749 = USD 1.00.

Dividends, if any, will be paid in euros, and any exchange rate fluctuations may affect the USD amounts received by holders of ADSs upon conversion by the depository of such dividends.

## B. CAPITALIZATION AND INDEBTEDNESS

Not applicable.

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### **C. REASONS FOR THE OFFER AND USE OF PROCEEDS**

Not applicable.

### **D. RISK FACTORS**

This section describes some of the risks that could affect the company's business. The factors below should be considered in connection with any forward-looking statements in the company's Annual Report on Form 20-F and the cautionary statements contained in the introduction on pages 3 and 4. Forward looking statements can be identified generally as those containing words such as "anticipate", "assume", "intend", "plan", "project", "should", "expect", "estimate", "believe", and words and terms of similar substance in connection with any discussion of future operating or financial performance.

Doing business inherently involves taking risks, and by taking measured risks we strive to be a sustainable company. Risk management is also one of the essential elements of the company's corporate governance. This calls for creating a proper balance between entrepreneurial attitude and risk levels associated with business opportunities. We foster a high awareness of business risks and internal control procedures, geared to safeguarding transparency in our operations.

Within Akzo Nobel all managers at all levels are responsible for risk management as an integral part of their day-to-day operations and decisions.

They are all required to identify enterprise risks affecting their businesses and to manage them adequately. The Akzo Nobel Risk Management function supports and develops the framework that enables managers to fulfill these responsibilities.

Risk boundaries are governed by Akzo Nobel's Company Statement, Business Principles, Internal Authority Schedules, and Corporate Directives in such areas as Finance & Control; Insurance; Health, Safety and Environment; Human Resources; Communications; and Legal and Intellectual Property.

Risk reporting covers the perceived likelihood, the assessed impact, and the effectiveness of control measures in place to deal with risks. Reporting on these elements as well as those preemptive and remedial actions is an integral part of our Business Planning & Review cycle.

The internal control system, audit procedures, and independent appraisals provide reasonable assurance of the effectiveness of our risk management approach.

Our Risk Management framework complies with the Enterprise Risk Management - Integrated Framework of COSO (the Committee of Sponsoring Organizations of the Treadway Commission). The procedures and results are reviewed by the Board of Management and discussed in the Supervisory Board.

The diversity of businesses within Akzo Nobel leads to a large number of different risk factors, each of which may result in a material impact on a particular business unit but may not materially affect the company as a whole. The diversity of the company's businesses and processes is its strength, as some of these factors may offset each other.

Under the explicit understanding that this is not an exhaustive enumeration, our major risk factors are listed below. There can be no assurance that our Risk Management function or our diversity will be able to mitigate any risks we may face. The risks below are not the only ones that Akzo Nobel faces. Some risks are not yet known to Akzo Nobel and some that Akzo Nobel does not currently believe to be material could later turn out to be material. All of these risks could materially affect Akzo Nobel's businesses, revenues,

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operating income, net income, net assets, and liquidity and capital resources. The company's risk management systems endeavor the timely discovery of such additional risks.

On March 12, 2007, the company announced its intention to divest Organon BioSciences to Schering-Plough, following their EUR 11 billion binding cash offer. The parties expect the transaction could be completed in the second half of 2007, after consultation with social partners and clearance from regulatory bodies. The risk factors set forth below should be read in the context of a likely sale of Organon BioSciences.

The factors that could affect our financial condition or our business or could cause actual results to differ materially include the following:

**External risks**

*The company may face intense competition from new products and from lower-cost generic products.*

The company's products that are under patent protection face competition from competitors' proprietary products. This competition may increase as new products enter the market. The company faces increasing competition from lower-cost generic products after patents on its products expire and from low-cost producers in other business areas. Loss of patent protection typically leads to loss of revenues in the product's markets and could affect the company's future results.

As new products enter the market, the company's products may become obsolete or competitors' products may be more effective or more effectively marketed and sold than its own products. If Akzo Nobel fails to maintain its competitive position, this could have a material adverse effect on its business and results of operations.

*Regulations which limit the prices we may charge for our pharmaceutical products can reduce the company's revenues and adversely affect its business and results of operations.*

In addition to normal price competition in the marketplace, the prices of Akzo Nobel's pharmaceutical products are restricted by price controls imposed by governments and health care providers in most countries. Price controls operate differently in different countries and can cause wide variations in prices between markets. Currency fluctuations can aggravate these differences. The existence of price controls can limit the revenues Akzo Nobel earns from its products and may have an adverse effect on its business and results of operations.

About 25% of the company's earnings were derived from the human healthcare markets in 2006. In many countries, the prices for our products are regulated. In the United States, Medicare reform could result in de facto price controls on prescription drugs. In Europe, the company's operations are also subject to price and market regulations. Many governments are introducing healthcare reforms in an attempt to curb increasing healthcare costs. In Japan, where Akzo Nobel also operates, governmental price cuts are introduced biannually. In response to rising healthcare costs, many governments and private medical care providers, such as HMOs, have instituted reimbursement schemes that favor the substitution of generic pharmaceuticals for more expensive brand-name pharmaceuticals. In the United States, generic substitution statutes have been enacted by virtually all states and permit or require the dispensing pharmacist to substitute a less expensive generic drug instead of the original brand-name drug. As a result, the company expects pressure on operating results in its pharmaceuticals business to continue.

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*Product regulation may adversely affect the company's ability to bring new products to market.*

The company and its competitors are subject to strict government controls on the development, manufacture, labeling, distribution and marketing of products. The company must obtain and maintain regulatory approval for its pharmaceutical and other products from regulatory agencies before certain products may be sold in a particular jurisdiction. The submission of an application to a regulatory authority does not guarantee that a license to market the product will be granted. Each authority may impose its own requirements and delay or refuse to grant approval, even though a product has been approved by another country. In the company's principal markets, the approval process for a new product is complex, lengthy and expensive. For pharmaceutical products, the time taken to obtain approval varies by country but generally takes from eight months to several years from the date of application. Regulatory delays, the inability to complete clinical trials successfully, claims and concerns about safety and efficacy, new discoveries, patents and products of competitors and related patent disputes and claims about adverse side effects are only a few of the factors that could adversely affect the realization of product registration. This increases the company's cost in developing new products and increases the risk that it will not succeed in selling them successfully.

*The company's business will continue to expose it to risks of environmental liabilities.*

The company uses hazardous materials, chemicals, biological and toxic compounds in its product development programs and manufacturing processes, which have exposed it, and in the future could expose it, to risks of accidental contamination and events of noncompliance with environmental laws and regulatory enforcement, and possible personal injury and property damage claims resulting therefrom. If an accident occurred or if the company were to discover contamination caused by prior operations, it could be liable for cleanup obligations, damages or fines, which could have an adverse effect on its business and results of operations.

The environmental laws of many jurisdictions impose actual and potential obligations on the company to remediate contaminated sites. These obligations may relate to sites:

- that the company currently owns or operates;
- that the company formerly owned or operated; or
- where waste from the company's operations was disposed.

These environmental remediation obligations could significantly reduce the company's operating results. In particular, the provisions and accruals for these obligations may be insufficient if the assumptions underlying the accruals prove incorrect or if the company is held responsible for additional, currently undiscovered contamination.

Stricter environmental, safety and health laws and enforcement policies could result in substantial costs and increase potential liabilities of the company, and could subject the company's handling, manufacture, use, reuse, or disposal of substances or pollutants to more rigorous scrutiny than is currently the case.

Consequently, compliance with these laws could result in significant capital expenditures as well as other costs and liabilities, thereby affecting Akzo Nobel's business and operating results.

*The company will be responsible for any liabilities arising out of non-compliance with laws and regulation e.g. antitrust litigation or the United Nations' Oil for Food Program.*

Reference is made to Note 25 of the Notes to the Consolidated Financial Statements in this report.

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*Because Organon depends on the sale of a limited number of products to generate a substantial portion of its revenues, factors adversely affecting the sale of any of these products could materially harm its revenues and results of operations.*

Organon depends on sales of a limited number of products that account for a substantial portion of its revenues. For example, in 2005, revenues from Puregon®, Remeron®, Livial®, Mercilon®, Esmeron®, and NuvaRing® in aggregate accounted for approximately 50% of Organon's revenues. Despite the anticipated launch of several new products over the next few years, including asenapine, we expect to continue to depend on a limited number of key products for the foreseeable future. As a result of this dependence, factors adversely affecting the sale of any of these products could materially adversely affect our revenues and results of operations. These factors include, but are not limited to competition from other branded pharmaceuticals that may be equivalent or superior to our own products or that the market perceives to be more attractive; competition from generic versions of branded pharmaceuticals, irrespective of the way they are marketed, once the term of patent protection and regulatory exclusivity for the original branded pharmaceuticals has expired; technological advances; the marketing strategies of our competitors; supply chain interruptions; work stoppages; changes in prescription practices; changes in the reimbursement policies of third-party payers; and other unforeseen adverse events.

*A failure to complete the sale of Organon BioSciences N.V. (OBS) could result in certain non-recoverable costs, negatively affect our ability to realize our strategic goals and negatively impact our share price or otherwise materially adversely affect our business, financial condition, or results of operations.*

On March 12, 2007, we announced that the company had received a binding cash offer for our subsidiary OBS from Schering-Plough for EUR 11 billion. There is no assurance that the conditions (consultation with social partners and clearance from regulatory bodies) to the completion of the transaction will be satisfied or waived by us. If the sale is not completed for any reason, we will continue to face the risks associated with the business of OBS. The process involved in completing the sale includes consultation with social partners and obtaining clearance from regulatory bodies, any of which could impose conditions or restrictions on such clearance.

*Our business will suffer if we are unable to obtain or defend intellectual property rights in relation to our products, if we are accused of infringing third parties' intellectual property rights or, if we are unable to gain access to, or our licensing partners terminate our rights to, the intellectual property rights of others.*

The company's ability to remain competitive and to capture additional market share depends in part on our ability to obtain and defend patents, trademarks, and other forms of intellectual property protection for our products, and on our development and manufacturing processes and our know-how. The process of obtaining patents is lengthy and expensive. We also intend to prosecute patents as appropriate. However, there can be no assurance that patents will be granted in relation to any of our currently pending or future applications or that such patents will be of sufficient scope and strength to provide us with any meaningful legal protection, any commercial advantage, or any ability to recoup our investment in product development.

It may become necessary for us to seek to enforce our patents, trademarks, licenses, and other forms of intellectual property protection and to protect our trade secrets by taking legal action or to engage in litigation in order to defend ourselves against claims of alleged infringement of someone else's intellectual property brought against us by third parties. There can be no assurance that we will be able to successfully settle or otherwise resolve claims that may be brought against us by third parties in the future. If we are unable to successfully settle future claims on terms acceptable to us, we may be required to engage in

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costly and time-consuming litigation and may be prevented from, or experience substantial delays in, marketing our existing pharmaceuticals and launching new ones. If we fail in any such dispute, in addition to paying money claims, we may lose valuable intellectual property rights. Any of these events could require us to divert substantial financial and management resources that we would otherwise be able to devote to our business.

*The outcome of tax disputes, litigation, indemnification and guarantees, and regulatory action could adversely affect the company's business and results of operations.*

Late January 2006, Akzo Nobel Nederland B.V. and the Akzo Nobel Pension Fund in the Netherlands received a summons from the Association of Retired Akzo Nobel Employees with regard to the changed financing of the company's Dutch pension plan. In January 2007, the court dismissed all claims against Akzo Nobel Nederland B.V. and the Akzo Nobel Pension Fund.

In December 2006, Akzo Nobel Nederland B.V. received a summons from certain Dutch labor unions, acting on behalf of retired Dutch Akzo Nobel employees, claiming that Akzo Nobel Nederland B.V.'s decision no longer to reimburse part of the health insurance premiums for those employees over time after a transition period is in breach of Akzo Nobel's employment contracts with these employees. The company is defending its position and based on legal advice believes that there will be no material liability to it on this matter.

A number of other claims are pending against Akzo Nobel N.V. and its subsidiaries, all of which are contested. The company is also involved in disputes with tax authorities in several jurisdictions. While the outcome of these claims and disputes cannot be predicted with certainty, the company believes, based upon legal advice and information received, that the final outcome will not materially affect the consolidated financial position of the company but could be material to the company's result of operations or cashflows in any one accounting period.

*Product liability claims could adversely affect the company's business and results of operations. The company's financial condition and results of operations could be adversely affected if the company does not successfully mitigate risks associated with insurance of pharmaceutical products.*

Given the widespread impact that brand-name drugs have on the health of patient populations, pharmaceutical and medical devices companies have historically been subject to large product-liability claims and settlements caused by the use of their products. The company also runs the risk of product liability claims from its Coatings and Chemicals products. Presently, the company is involved in a number of product liability cases claiming damages as a result of its products. It believes that any reasonably foreseeable unaccrued costs and liabilities associated with such matters will not have a material adverse effect on the company's consolidated financial position but could be materially adverse to its results of operations. There can, however, be no assurance that a future product liability claim or series of claims that are not fully covered by insurance would not have an adverse effect on the company's business or results of operations.

*Bad publicity and damage to the company's brands could adversely affect its business and results of operations.*

The reputation of the company's brands is critical to its business. The success in promoting and enhancing its brands is dependent on providing safe high-quality products, particularly in the pharma business. If it fails to successfully promote its brands, or if it receives bad publicity as a result of a product liability case or

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publicized health or other risks associated with its products, the value of the company's brands will be diminished. This could have a material and adverse effect on the business and results of operations.

*Exchange rate fluctuations can have a harmful impact on the company's financial results.*

The company has operations in more than 80 countries throughout the world. As a result, a substantial portion of its assets, liabilities, revenues and expenses are denominated in various currencies other than the euro, principally the U.S. dollar, the British pound, the Swedish krona, the Japanese yen, and Latin American and Asian currencies. Because the company's financial statements are denominated in euro, fluctuations in currency exchange rates could have a material impact on its reported results. The company has a hedging policy for certain currency exchange rate risks.

*The company's financial condition and results of operations could be adversely affected if the company does not successfully mitigate risks associated with interest rate changes.*

A portion of the company's investments, loans and borrowings bear interest on a non-fixed basis. Accordingly, changes in interest rates can affect the cost of these interest-bearing investments, loans and borrowings. The company mitigates interest risk by financing noncurrent assets and a certain portion of current assets with equity, long-term liabilities and long-term borrowings with fixed interest rates. In the event that this strategy is not successful, the business, financial condition and operating results of the company could be materially and adversely affected as a result of changes in interest rates.

*Adverse stock market developments may affect assets of pension funds, causing higher pension charges and pension premiums payable.*

The company has a number of defined benefit pension plans, covering a significant part of its employees. Plan assets principally consist of long-term interest-earning investments, quoted equity securities, and real estate. The performance of stock markets could have a material impact on the company's financial statements as some 50% of plan assets are equity securities. The poor performance of the stock markets in 2001 and 2002 had a negative influence on the investment results of Akzo Nobel's pension funds, resulting in additional pension charges, pension premiums and payments to such funds in 2002 and subsequent years.

*A downgrading by credit rating agencies could result in higher financing costs or reduced availability of credit.*

At present the company's long-term credit rating from Moody's is A3 with a short-term rating of P-2, both with a so-called "stable outlook". The current long-term credit rating from Standard & Poor's is A- and their short-term rating is A-2, both with a so-called "stable outlook".

The present rating is three notches above the so-called "high-yield zone". However, if the company's rating were to decline or approach or enter the high-yield zone, this would result in increased financing costs for the company and could also reduce availability of credit, especially at competitive rates. Such a decline could result from many reasons, including a deterioration in our business, significant and unforeseen contingent liabilities, or strategic initiatives.

A security rating is not a recommendation to buy, sell or hold securities. The rating may be subject to revision or withdrawal at any time by the rating organization. Each rating should be evaluated independently of any other rating.

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*Because the company conducts international operations, it is exposed to a variety of risks, many of them beyond its control, that could adversely affect its business.*

Akzo Nobel is a global company with operations in Europe, North America, Latin America, Asia, the Middle East, and Africa. In addition to general business risk and the risks described in this section, the company's international operations are subject to a variety of potential risks including: political and economic instability, the risk of hyperinflation in some countries, currency and interest-rate fluctuations, lack of local business experience, difficulty in enforcing property rights, local security concerns, and language and other cultural barriers. In addition, changes in the tax laws of some countries where the company does business can affect the company's net income.

*Inability to access raw materials, growth in cost and expenses for raw materials, petroleum and natural gas, and changes in product mix may adversely influence the future results of the company.*

Important raw materials or auxiliary materials for the company's production processes are salt, petroleum and petroleum derivatives, natural gas, titanium dioxide, and electricity. Some of these components are available only from a small source of suppliers. Although Akzo Nobel aims to use its purchasing power and long-term relationships with suppliers to acquire raw materials and their constant delivery at the best conditions, the company cannot assure that it will always be able to establish or maintain good relationships with such suppliers or that such suppliers will continue to exist or be able to supply ingredients in conformity with regulatory requirements or the company's requests. In addition, growth in the costs and expenses of these components resulting from a shortage or a change in Akzo Nobel's product mix may adversely influence the company's business and financial results. Akzo Nobel is sensitive to price movements in raw materials. In particular, energy prices pose a risk.

*Seasonality may adversely affect the operating results of the company's Coatings and Chemicals business.*

A portion of the company's Coatings and Chemicals business is seasonal, with revenues and earnings being relatively higher during the outdoor season and lower during the indoor season. The operating results may be harmed if bad weather delays the outdoor season in the major markets in which the company operates and the company is not able to offset during the corresponding financial year the lag in earnings resulting from such delay.

### **Strategic Decision Making Risks**

*A failure to manage expansion effectively could adversely affect the company's business.*

Management of the company's growth, as well as the commencement of commercial manufacturing and marketing of the company's forthcoming products, will require continued expansion of the company's systems and internal controls and an increase in the company's manufacturing, marketing and sales operations. In addition, the company intends to continue to add new personnel. Any failure to manage growth effectively and integrate new personnel on a timely basis could adversely affect the company's business.

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*The company may not be able to identify significant technology improvements or future acquisitions or may not be successful in integrating acquired businesses.*

The company may not be able to identify significant technology improvements or future acquisitions or may not be successful in integrating acquired businesses. The company continuously aims for sustainable growth of its business through research and development, production, and sale of new products and regularly adds new businesses through alliances, ventures, or acquisitions. We place a strong focus on integration of acquisitions as this is critical to achieve the expected results. The company does not know if it will be able to identify any future acquisitions, joint ventures, or alliances. A failure to identify future transactions may impair the company's future growth.

### **Internal Risks**

*The company's research and development efforts may not succeed or its competitors may develop more effective or successful products.*

In order to remain competitive, the company must commit substantial resources each year to research and development through its dedicated resources as well as through various collaborations with third parties. Ongoing investments in new product launches and research and development for future products could produce higher costs without a proportional increase in revenues. Especially in the Pharma businesses, the research and development process can take from six to fourteen years, from discovery to commercial product launch. This process is conducted in various stages, and during each stage there is a substantial risk that the company will not achieve its goals and accordingly may abandon a product for which it has spent substantial amounts.

Due to the inherent unpredictability and high degree of failure associated with the development of new pharmaceuticals, there can be no assurance that we will be able to successfully and timely launch new drugs and other pharmaceutical products. If we do not succeed in developing products for which regulatory approval can be sought, our ability to realize a profitable return on our investment would be diminished. Specifically, if we do not successfully complete our current Phase III registrational trial, receive regulatory approval or achieve market acceptance for asenapine, Organon's main pipeline drug in the CNS area, we may be unable to commercialize asenapine within the timeframe we planned, or at all, which could have a negative effect on our business and results of operations.

The company is looking for more partners to share the burden and success of product development in this area.

If the company fails to continue developing commercially successful products or fails to find suitable partners, this could have a material adverse effect on the company's business and results of operations. If its competitors develop more effective products or a greater number of successful new products, or if the competitive position of its European operations changes in a negative way, this could also have a material adverse effect on the company's business and results of operations.

On the other hand, there is also risk involved with the reliance on partners for the sharing of costs and generation of revenues. If these partners do not perform in accordance with our agreements with them, this could also have a material adverse effect on the company's business and results of operations.

It can also be the case that due to unwanted side effects of pharmaceutical products, in particular, which appear at a later stage after introduction of a product, the company may decide or may be forced to

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withdraw a certain product from the market. This also could have a material adverse effect on its business and results of operation.

*Risks in production processes can adversely affect the company's results of operations.*

Certain chemical production processes are hazardous, and natural disasters, operator error or other occurrences could result in explosions, fires, or equipment failure, which could result in injury or death, or damage to property or the environment, and business interruption.

It is the company's policy to try to mitigate production risks by spreading of production and an adequate inventory policy combined with contingency planning and appropriate risk transfer arrangements (e.g. insurances).

Losses and liabilities arising from such events, in so far as not covered by insurance, would significantly reduce the company's revenues or increase costs and could have a material adverse effect on its operations or financial condition.

*If the company's management of change is not adequate it may possibly lead to failure to attract the right people or the loss of key staff or knowledge or other business disruption, which could have an effect on productivity and reduced customer focus.*

The company puts emphasis on attracting, retaining, motivating, and educating staff, using Human Resources instruments and reduces uncertainty in the working environment through information and communication programs.

The company's future operating results depend in part upon its ability to attract and retain qualified management, scientific, technical, marketing, and support personnel. Competition for such personnel is intense, and there can be no assurance that the company will be able to continue to attract and retain such personnel.

#### **Item 4. INFORMATION ON THE COMPANY**

Akzo Nobel N.V. is a public limited liability company ( "Naamloze Vennootschap" ) organized under the law of the Netherlands for an indefinite period. The principal executive offices of Akzo Nobel N.V. are located at Velperweg 76, 6824 BM Arnhem, the Netherlands. Its telephone number is +31 (26) 366 4433 and its fax number is +31 (26) 366 3250.

The company's e-mail address is ACC@akzonobel.com, and the address of its website is www.akzonobel.com. Any correspondence regarding this Annual Report on Form 20-F should be directed to the Company Secretary.

The name and address of the person authorized to receive notices and communications from the U.S. Securities and Exchange Commission is:

Steven J. Miller  
Senior VP and General Counsel Akzo Nobel Inc.  
Akzo Nobel Inc.  
120 White Plains Road, Suite 300  
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At the end of July 2007, the company's principal executive offices will move to Strawinskylaan 2555, 1077 ZZ Amsterdam. The telephone number will be +31 (20) 502 7555 and its fax number will be +31 (20) 502 7666.

## **OVERVIEW**

Akzo Nobel is a Global Fortune 500 company and is listed on both the Euronext Amsterdam and NASDAQ stock exchanges. It is also included on the Dow Jones Sustainability Indexes and the FTSE4Good Index. Based in the Netherlands, we are a multicultural organization serving customers throughout the world with human and animal healthcare products, coatings, and chemicals. We employ around 62,000 people and conduct our activities in four segments—human and animal health, coatings, and chemicals—subdivided into 13 business units, with operating subsidiaries in more than 80 countries. Consolidated revenues for 2006 totaled EUR 13.7 billion, of which 19% was in human healthcare products, 8% in animal healthcare products, 45% in coatings, and 28% in chemical products.

In the pharmaceutical industry, Akzo Nobel is smaller than many of its competitors, but it has significant positions in gynecology, infertility, and selected areas of anesthesia. Akzo Nobel believes that based on revenues it is the largest coatings producer in the world; its products and markets vary widely from architectural paints in some countries to industrial coatings in others. In the chemical products industry, Akzo Nobel is a significant competitor in a number of markets, and on a global basis the company competes with a number of larger chemical companies.

Demand for Akzo Nobel's products, particularly its chemical and coatings products, is generally reflective of the overall health of economies in Western Europe, the United States, and Asia, and is, except for certain Coatings and Chemicals activities, generally not seasonal in nature.

It is Akzo Nobel's objective to develop or acquire new and defend existing leading positions in its markets, while maintaining structural long-term profitability. In addition to its core business, the company focuses on the development of new and improved products in major growth sectors that draw on the company's technological and marketing know-how. The company is pursuing expansion in Eastern Europe, SouthEast Asia, and Latin America.

## **A. HISTORY AND DEVELOPMENT OF THE COMPANY**

Akzo was created in 1969, out of the merger between AKU N.V. (AKU) and Koninklijke Zout-Organon N.V., and in 1994 it was renamed Akzo Nobel, after the merger with Nobel Industries AB (Nobel).

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AKU N.V. was founded in 1911 under the name of N.V. Nederlandsche Kunstzijdefabriek. Over the years this company grew into an international concern with interests in the field of cellulose fibers and, following the Second World War, synthetic textile and carpet fibers as well as industrial fibers. At the time of the 1969 merger, AKU's principal countries of operation were the Netherlands, Germany, the United States, the United Kingdom, Spain, and several Latin American countries, where activities were often carried out through joint ventures with local partners.

Koninklijke Zout-Organon N.V. was set up in 1967 as a holding company in connection with the merger between Koninklijke Zout-Ketjen N.V. and N.V. Koninklijke Zwanenberg-Organon. Koninklijke Zout-Ketjen N.V. had interests in companies active in salt refining, basic chemicals, specialty chemicals, and coatings. While these companies were mainly active in the Netherlands, they had built up major export positions at the time of the merger. N.V. Koninklijke Zwanenberg-Organon consisted of companies active in food/nonfood products and chemical products and of pharmaceutical companies producing brand-name drugs, nonprescription products, and raw materials for the pharmaceutical industry.

Nobel was formed in 1984 through the merger of Bofors (established in 1646) and KemaNobel, founded in 1871. At the time of the merger with Akzo in 1994, Nobel was a leading European producer of chemicals (pulp and paper chemicals and surfactants) and coatings (paints for professional and consumer markets, industrial coatings, and industrial products). Nobel had operations in more than 30 countries.

In July 1998, Akzo Nobel acquired Courtaulds plc ( Courtaulds ), an international chemical company with leading positions in high-tech industrial coatings and man-made fibers. Its best known brands, International Paints, Courtelle acrylic fibers, and Tencel , a new cellulosic fiber, were included in the acquisition. Courtaulds, which was founded in 1816 as a silk weaving company, pioneered the global man-made fiber industry at the beginning of the 20th century. In the 1960s Courtaulds acquired International Paint and Pinchin Johnson.

In November 1999, the company acquired Hoechst Roussel Vet ( HR Vet ), the veterinary business of Hoechst AG, substantially enlarging the product range of Intervet, Akzo Nobel's animal health business, and leading to its establishment as a leader in the animal health business.

After the Courtaulds acquisition, the fibers operations of Akzo Nobel and Courtaulds were combined into a separate organization, named Acordis. At December 31, 1999, Acordis was sold to a newly established company. Akzo Nobel retained a stake at present of some 20% in this company, which is gradually divesting its activities.

In 2004, the company started the restructuring of the Chemicals business by selling the Catalysts, Phosphorus Chemicals, and Coating Resins activities. Following this, a new strategic focus for Chemicals was announced in February 2005, resulting in the streamlining of the portfolio in order to competitively realign the business for sustainable growth, profitability, and leadership positions in selected markets. In this new set-up, Chemicals is organized in five growth platforms: Pulp & Paper Chemicals, Base Chemicals, Functional Chemicals, Surfactants, and Polymer Chemicals. The realignment of the Chemicals group also involved the planned divestment of several businesses with combined 2004 revenues of EUR 700 million. These businesses are among others Ink & Adhesive Resins, Oleochemicals, PVC Additives, Salt Specialties, Solar Salt Australia, and Methyl Amines/Choline Chloride. In the meantime, all of these businesses have been divested or offers have been received. Flexsys, the 50/50-joint venture with Solutia, was divested per May 1, 2007.

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After a comprehensive review of all the options for Akzo Nobel's businesses going forward, during 2006 we concluded that the most appropriate solution for all parts of the business was to separate Organon and Intervet from our Coatings and Chemicals activities. In order to prepare for this separation we incorporated our Pharma activities into a holding company: Organon BioSciences. On March 12, 2007, the company announced its intention to divest Organon BioSciences to Schering-Plough, following their EUR 11 billion binding cash offer. After careful consideration it was concluded that this cash offer represented full value to Akzo Nobel, while providing a new home for Organon BioSciences as it becomes part of Schering-Plough—one of the largest pharmaceuticals companies in the world. The parties expect that the transaction could be completed in the second half of 2007, after consultation with social partners, and clearance from regulatory bodies.

Over the years, Akzo Nobel acquired and divested numerous other activities and businesses, which all were of a much lesser size than the ones mentioned above. For recent acquisitions and divestments reference is made to Changes in Consolidated Interests of the Notes to the Consolidated Financial Statements.

For a list of the company's subsidiaries see Exhibit 8 to this Report, which is incorporated by reference herein.

## **B. BUSINESS OVERVIEW**

Operations are organized in segments on the basis of affinity between activities: Human Pharmaceuticals (Organon) and Animal Health (Intervet)—together also referred to as Pharma—Coatings and Chemicals. Within the Coatings and Chemicals segment, the activities are carried out in business units.

The Board of Management is the highest executive authority and is entrusted with the management of the company, which means, among other things, that it defines the strategic direction, establishes the policies, and manages the company's day-to-day operations. The members of the Board of Management collectively manage the company and are responsible for its performance. They are jointly and individually accountable for all decisions made by the Board of Management. At the corporate level, key tasks are coordinated in the fields of strategy; finance; control; human resources; technology; legal affairs and intellectual property; communications; health, safety, and environment; information management; and risk and insurance management.

## **STRATEGY**

Akzo Nobel is a diversified, multicultural and truly global company with activities in human and animal healthcare, coatings and chemicals. We aim to create above-average economic value over the business cycle. We strive to attract talented, ambitious people who are proud to work for our company. We seek to be respected in the societies in which we operate.

Capital allocation is focused on building sustainable leading business positions, reflected in attractive growth, returns significantly above the costs of capital, and substantial operational cash flows. We actively restructure to meet our goals and divest activities where we cannot meet the criteria.

We develop competitive advantages by combining the customer focus and entrepreneurial spirit of a decentralized business unit organization with the scale and power of a global organization which provides access to global capital markets, managerial talent, best management practices, and purchasing power.

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Our deeply ingrained Business Principles are the expression of a strong shared international culture. They guide us in the complex, ever-changing global environment in which we operate.

After a comprehensive review of all the options for Akzo Nobel's businesses going forward, we concluded that the most appropriate solution for all parts of the business was to separate Organon and Intervet (together called Organon BioSciences) from the coatings and chemicals activities of Akzo Nobel. Management believes that separation will best enhance shareholder value. We have received a binding cash offer of EUR 11 billion from Schering-Plough for Organon BioSciences. The proceeds from the sale will be used to deliver on the company's growth ambitions, to reduce pension and other liabilities, and for other general corporate purposes.

### **Coatings and Chemicals**

Our Coatings business is the world leader. It embraces most of the markets in both consumer and industrial applications for paints and coatings.

We are focusing on growth in the emerging markets of Asia, Eastern and Central Europe, and South and Central America through autonomous development and acquisitions. We will also continue to enhance our presence in the mature markets through selected acquisitions.

Our ambition is to remain the world leader in coatings and consolidate our leadership positions in all our product markets and key geographic regions. We intend to participate in the consolidation of the coatings industry, which we believe is inevitable as our supplier and customer bases strengthen globally.

Our global scale allows us to further develop our leading positions in technology. We are progressively increasing our investments in R&D towards 3.5% of revenues. Our increasing innovation efforts will allow better differentiation of our activities in the highly competitive markets in which we operate. We are also using our scale in purchasing of raw materials to secure our margins.

We have streamlined our Chemicals portfolio and are concentrating on growing profitable businesses which we have identified within selected strategic markets. We exited non-core businesses and rationalized support structures around selected platforms.

We focus on profitable growth in those market segments where we have a competitive advantage and can achieve sustainable, above-average financial returns.

We have organized our activities into five growth platforms: Pulp & Paper Chemicals, Base Chemicals, Functional Chemicals, Surfactants, and Polymer Chemicals. We almost completed the divestment of the remaining non-core activities during 2006.

Our ambition is to strengthen our leading positions in selected markets by investing in organic growth and through participating in industry consolidation.

Across our portfolio we will continuously scrutinize our activities in mature markets for opportunities to improve productivity. We also aim to improve our performance in the use of operating working capital, particularly in certain segments of our Coatings activities.

We have the following medium-term ambitions:

- outpace growth in our markets
  - realize an operational return on invested capital of above 20%.
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**Pharma**

In order to prepare for the separation we incorporated our Pharma activities into a holding company: Organon BioSciences. On March 12, 2007, the company announced its intention to divest Organon BioSciences to Schering-Plough, following their EUR 11 billion binding cash offer.

Organon BioSciences is a globally operating biopharmaceutical company which develops, manufactures and markets innovative products targeting selected therapeutic areas in human pharmaceuticals and covering a wide range of species in animal health. Our products enjoy leading positions in gynecology, fertility, selected areas of anesthesia and animal health. Organon, our human pharmaceutical business, currently has five compounds in late stage clinical development and has recently received approval from the U.S. Food and Drug Administration (the FDA) for one drug (Implanon®). Intervet, our animal health business, is the world's third-largest animal health company as measured by 2006 revenues, with an extensive product pipeline offering attractive opportunities. We believe that our leading positions in these areas, our strong pipeline—particularly in neuroscience—and our increased focus on the development of biotechnology products—including human vaccines—position us well for continued growth.

Our strategic objective so far has been to further develop the strengths of Organon and Intervet in their existing core areas. In addition, we seek to expand our capabilities in the field of biotechnology and build upon our record of innovation with respect to both new biological and chemical entities.

**Financing objectives**

To ensure the sustained growth of our businesses, and to be able to finance expansion, we want to maintain a solid balance sheet. We aim for a well-spread maturity profile of our long-term debt and a strong liquidity position.

**ACTIVITIES OF AKZO NOBEL****Industry Segment Information**

Akzo Nobel's financial reporting and industry segment information consists of results from the following segments: Organon, Intervet, Coatings, and Chemicals. The information presented below illustrates the relative importance of the individual segments.

| <i>Millions of euros</i>  | <b>Revenues</b> |               |               | <b>Operating income</b> |              |              |
|---|-----------------|---------------|---------------|-------------------------|--------------|--------------|
|   | 2006            | 2005          | 2004          | 2006                    | 2005         | 2004         |
| Organon   | 2,611           | 2,425         | 2,344         | 354                     | 415          | 275          |
| Intervet  | 1,125           | 1,094         | 1,027         | 219                     | 238          | 184          |
| Coatings  | 6,209           | 5,555         | 5,237         | 604                     | 384          | 406          |
| Chemicals   | 3,809           | 3,890         | 4,317         | 362                     | 312          | 869          |
| Miscellaneous products, intragroup deliveries, non-allocated items and eliminations | (17)            | 36            | (92)          | (77)                    | 137          | (207)        |
| <b>Total</b>  | <b>13,737</b>   | <b>13,000</b> | <b>12,833</b> | <b>1,462</b>            | <b>1,486</b> | <b>1,527</b> |

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| <i>Millions of euros</i>   | <b>Identifiable assets</b> |               |               | <b>Property, plant and equipment Expenditures</b> |            |            | <b>Depreciation</b> |            |            |
|--|----------------------------|---------------|---------------|---|------------|------------|---------------------|------------|------------|
|  | 2006                       | 2005          | 2004          | 2006  | 2005       | 2004       | 2006                | 2005       | 2004       |
| Organon  | 2,074                      | 2,262         | 2,075         | 103   | 95         | 103        | 109                 | 118        | 113        |
| Intervet   | 1,153                      | 1,082         | 968           | 55  | 54         | 54         | 42                  | 40         | 38         |
| Coatings   | 3,821                      | 3,328         | 3,094         | 135   | 112        | 122        | 126                 | 126        | 119        |
| Chemicals  | 2,549                      | 2,946         | 2,773         | 231   | 252        | 269        | 215                 | 233        | 260        |
| Miscellaneous products, nonallocated items and eliminations, including cash and cash equivalents | 3,011                      | 2,506         | 2,723         | 5   | 1          | 3          | 9                   | 11         | 10         |
|  | 12,608                     | 12,124        | 11,633        | 529   | 514        | 551        | 501                 | 528        | 540        |
| Investment in associates   | 177                        | 301           | 318           |   |            |            |                     |            |            |
| <b>Total</b>   | <b>12,785</b>              | <b>12,425</b> | <b>11,951</b> | <b>529</b>  | <b>514</b> | <b>551</b> | <b>501</b>          | <b>528</b> | <b>540</b> |

**Percent of total revenues and total operating income**

|   | <b>Revenues</b> |            |            | <b>Operating income</b> |            |            |
|---|-----------------|------------|------------|-------------------------|------------|------------|
|   | 2006            | 2005       | 2004       | 2006                    | 2005       | 2004       |
| Organon                                       | 19              | 19         | 18         | 24                      | 28         | 18         |
| Intervet                                      | 8               | 8          | 8          | 15                      | 16         | 12         |
| Coatings                                      | 45              | 43         | 41         | 41                      | 26         | 27         |
| Chemicals                                     | 28              | 30         | 34         | 25                      | 21         | 57         |
| Miscellaneous products and nonallocated items | □               | □          | (1)        | (5)                     | 9          | (14)       |
| <b>Total</b>                                  | <b>100</b>      | <b>100</b> | <b>100</b> | <b>100</b>              | <b>100</b> | <b>100</b> |

A summary of the activities of each segment is given below. For more details on Akzo Nobel's activities, reference is made to "Business Review and Developments at Business Units". See Item 5 "Operating and Financial Review and Prospects" for a discussion on factors affecting comparability between periods.

**Description of Pharma's Business**

In order to prepare for the separation we incorporated our Pharma activities into a holding company: Organon BioSciences. On March 12, 2007, the company announced its intention to divest Organon BioSciences to Schering-Plough, following their EUR 11 billion binding cash offer. The parties expect that the transaction could be completed in the second half of 2007, after consultation with social partners and clearance from regulatory bodies.

Within the Pharma segment, the business is carried out in business units. The business units and their products (as at December 31, 2006) are summarized below:

## **PHARMA**

### **Organon**

- Creates, manufactures, and markets innovative prescription medicines with as core therapeutic fields: fertility, gynecology and selected areas of anesthesia. It has extensive expertise in neuroscience. Research areas also include immunology and specific areas of oncology.

### **Intervet**

- Dedicated to research, development, manufacturing, and marketing of innovative animal health products, and is providing a full range of innovative products for livestock, aquatic and companion animals. Products are grouped in two main product sectors: vaccines and pharmaceuticals.

Akzo Nobel's healthcare activities extend around the world. It engages in research, development, manufacturing, and marketing in selected areas of human pharmaceuticals and animal health. These include prescription medicines, veterinary products, as well as complex active pharmaceutical ingredients.

In recent years, our Organon human healthcare business has experienced a phase of declining revenues. As a consequence, we have adjusted the strategy and the organization and have lowered the cost base.

We believe that after the expected turning point in 2005, Organon in 2006 returned to growth again. To further strengthen the growth potential we have continued to invest heavily in R&D and pre-marketing to boost our pipeline. This temporary acceptance of a relatively low operational profit margin is in line with our medium-term value creation philosophy.

Akzo Nobel's human healthcare business, Organon, has an international reputation based on quality products and innovative R&D. Through unprecedented commitment to women's health over many years, Organon has contributed significantly to three clinical areas of great importance in gynecology: contraception, fertility and hormone therapy. In addition, significant product candidates in the areas of psychiatric disorders and anesthesiology have been produced.

Organon is among a few international companies conducting research into contraception. Sold as Desogen® in the United States, Marvelon® is one of the world's most prescribed contraceptive pills. However, sales of our oral contraceptives have been adversely affected by generic competition in the United States. NuvaRing®, our contraceptive vaginal ring, has been introduced in 32 countries and is steadily increasing sales in many markets. In late 2006, the innovative contraceptive implant Implanon® was launched onto the U.S. market. Puregon®/Follistim®, the biotech fertility product of Organon, has become one of our biggest selling products. Performance was particularly boosted by strong U.S. sales resulting from a successful launch of the Follistim Pen® and relevant product line extensions. In 2005, Puregon®/Follistim® was also introduced in Japan and China, where sales are taking off. The world welcomed the one millionth □Puregon baby□ during 2006.

Organon's main pipeline drug in the CNS area is asenapine, developed in-house and currently in phase III development. Asenapine is a novel psychopharmacologic agent that is currently being developed for the treatment of schizophrenia and acute mania in bipolar disorder. The unique profile of asenapine may help patients through control of positive and negative symptoms with a tolerability and safety profile that we believe to be superior to other products on the market. The Phase III clinical trial program for the U.S. new

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drug application (NDA) submission for the indications schizophrenia and acute mania associated with bipolar 1 disorder has been concluded. In early 2007 the efficacy and safety outcomes of the program will be shared with the FDA in a so-called pre-NDA meeting, which will lead to the determination of the submission planning. See [Risk Factors](#) for risks associated with the regulatory approval of pharmaceuticals under development.

Organon focused strongly on collaborations during 2006, with new alliances being established and some promising partnerships being prolonged.

Organon is also a leading manufacturer of complex active pharmaceutical ingredients, with production facilities in several countries. Organon provides market-driven and technology-based manufacturing of chemical and biochemical APIs as well as biotechnological compounds. Our expertise lies in complex organic chemistry and extractions for API manufacturing as well as in cell culture, fermentation, and chromatographic purification for biotechnology. We use these technologies to manufacture steroids, synthetic peptides, opiate analogues, carbohydrates, heparins, and human gonadotrophins in API manufacturing and insulin recombinant proteins as well as proprietary innovative products in biotechnology manufacturing. This expertise provides us with an improved foundation for integral product and process development regarding biotechnology. This focus on biotechnology also led to our entering into various R&D agreements with third parties during 2006.

Intervet, our animal health business, develops, manufactures, and markets a variety of innovative high-quality products intended for use in animals. Intervet's diverse portfolio of marketed products covers species in livestock, such as poultry, cattle, sheep, pigs, and fish, and companion animals, such as cats, dogs, and horses, and includes both vaccines and animal pharmaceuticals (mainly anti-parasitic, anti-infective, and specialty pharmaceuticals such as endocrine fertility products and injectors for treating mastitis and metritis). Intervet has an international reputation and works closely with leading research institutes, universities, and other companies.

In 2002, we launched the Nobilon business, to develop, license, and manufacture human vaccines, with particular emphasis on influenza. Nobilon became operational in mid-2003. We believe this is a growing market where we can benefit from our experience in vaccines and biotechnology in general. The expertise and know-how of Organon and Intervet are combined in this area, utilizing their technical, regulatory, and product development capabilities. In addition to vaccines, we also intend to continue to pursue productive areas of cooperation in the research and development function, shared compound libraries, and formulation and process development.

The products in our drug development pipeline will change over time as new compounds progress from research to development and from development to market. Owing to the nature of the drug development process, it is not unusual for some compounds, especially those in the early stages of investigation, to be terminated as they progress through development.

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The following table shows our late-stage product candidates:

| <b>Project and compound</b> | <b>Description □ main indications</b>   | <b>Clinical Development Phase</b> |
|-----------------------------|---|-----------------------------------|
| <i>Gynecology</i>           |   |                                   |
| Org 50081                   | Serotonin -2-Blocker (hot flushes)  | III                               |
| NOMAC/E <sub>2</sub>        | Oral contraceptive in-licensed from<br>Théramex (Merck KGaA)                          | III                               |
| Org 39970                   | Androgen  | II                                |
| <i>Fertility</i>            |   |                                   |
| Org 36286                   | Sustained Follicle Stimulant<br>(corifollitropin alpha)                               | III                               |
| <i>Neuroscience</i>         |   |                                   |
| asenapine                   | dopamine/serotonin antagonist   | III                               |
| Org 50081                   | Serotonin-2-Blocker (insomnia)  | III                               |
| farampator                  | AMPAkine  | II                                |
| Org 34517                   | GR antagonist   | II                                |
| Org 25935                   | GlyT1 inhibitor   | II                                |
| <i>Anesthesia</i>           |   |                                   |
| sugammadex                  | Selective muscle relaxant binding agent   | III                               |
| <i>Other</i>                |   |                                   |
| Org 42675                   | Antithrombotic dual inhibitor II/X  | II                                |
| <b>Veterinary products</b>  | Numerous new products (vaccines and pharmaceuticals) in various stages of development |                                   |

#### **Explanatory remarks**

Phase II Determination of initial evaluation of efficacy and identification of possible adverse effects, conducted in a small number of patients.

Phase III Large comparative study (compound versus placebo and/or established treatment) in patients to further evaluate dosage, efficacy, and safety.

#### **Description of Coatings' Business**

Within the Coatings segment, the business is carried out in business units. The business units and their products (as at December 31, 2006) are summarized below:

#### **COATINGS**

##### **Decorative Coatings**

- Supplies a full range of interior and exterior decoration and protection products for both the professional and do-it-yourself markets.

##### **Industrial Finishes**

- Supplies factory-applied coatings for metal, wood, and plastic products.

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## **Powder Coatings**

- Supplies powder coatings for industrial use in appliance, architectural, automotive, functional, furniture, general industry, general trade coaters, and IT.

## **Marine & Protective Coatings**

- Global market leader in marine paints and antifouling coatings, also manufactures fire retardant products for large plants and offshore installations, as well as protective coatings for structures such as bridges, aircraft and stadiums.

## **Car Refinishes**

- Supplies paints and services for the car repair, commercial vehicles and automotive plastics markets. Akzo Nobel is a leading producer of paints and finishes for industrial applications, professional painters, and of products for the do-it-yourself sector. Product areas are decorative/ architectural paint, car refinishes, liquid and powder coatings for industrial use (on wood, plastics, and metal), marine and yacht coatings, protective coatings, aerospace coatings, and industrial and consumer adhesives.

Akzo Nobel's global strategy for its coatings business is to extend leading positions in clearly defined product areas and specialist niche markets, which demand high levels of technical expertise and customer service.

The company supports the international initiative of Coatings Care®—a program for continuous improvement in Safety, Health, and the Environment—and is constantly seeking optimal ways to match the principles of eco-efficiency with those of high performance.

Decorative Coatings supplies a full range of interior and exterior decoration and protection products for both the professional and do-it-yourself markets, including paints, lacquers and varnishes. The extensive product range is marketed under brand names including Sikkens®, Astral®, Crown®, Levis®, and Flexa®. Decorative Coatings also supplies construction adhesives and floor leveling compounds, and offers services such as mixing machines, color concepts and training courses for applicators.

Industrial Finishes supplies factory-applied coatings for metal, wood, and plastic products. It is the world's largest producer of wood and coil coatings and a leading player in specialty plastic coatings and wood adhesives. Wood coatings are applied to flooring and furniture, while coil coatings (applied to coil sheet metal before being rolled, cut and pressed into shape) are used on domestic appliances and metal building products. Specialty plastics are found on items such as consumer electronics, cosmetics packaging and sporting goods.

Akzo Nobel Powder Coatings is the largest global manufacturer of powder coatings and a world leader in powder coatings technology. Powder coatings—solvent-free paints applied to metal and other conductive surfaces—are used on everything from metal furniture to window frames, radiators, pipes, and cars and even wood and plastic. Products are supplied to eight key market sectors—appliance, architectural, automotive, functional, furniture, general industry, general trade coaters, and IT—under the global brands Interpon® and Resicoat®. The business also includes Non-Stick Coatings, whose products are used on house wares and a wide range of other specialist industrial applications.

Akzo Nobel is the global market leader in marine paints and antifouling coatings used in shipbuilding, ship maintenance and repair, and by yacht and other pleasure craft owners. Marine & Protective Coatings, through the International® brand name, manufactures fire retardant products for large plants and offshore installations, as well

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as protective coatings for structures such as bridges, stadiums, and landmarks. Marine & Protective Coatings is also home to Akzo Nobel's Aerospace Coatings activities.

Car Refinishes is one of the world's leading suppliers of paints and services for the car repair, commercial vehicles, and automotive plastics markets. It sells coatings for car body refinishing, or recoating, to customers including bodyshops, distributors, fleet owners, automotive suppliers, and major bus and truck producers. Brands include Sikkens®, Lesonal®, and Dynacoat®. Operating in more than 60 countries, Car Refinishes has specialists around the world who understand local markets and can serve local needs. Its state-of-the-art customer services include offering technical and logistical support and organizing training programs.

### **Description of Chemicals' Business**

Within the Chemicals segment, the business is carried out in business units. The business units and their products (as at December 31, 2006) are summarized below:

#### **CHEMICALS**

##### **Pulp and Paper Chemicals**

- Produces bleaching chemicals used in the manufacture of paper pulp and also supplies process chemicals and performance chemicals that improve the properties of paper.

##### **Base Chemicals**

- Produces energy, salt, chlor-alkali products, and derivatives. Its products are used in the manufacture of glass, pharmaceuticals, and textiles, and in disinfectants for swimming pools.

##### **Functional Chemicals**

- Consists of a number of different businesses that manufacture and sell a variety of chemical intermediates and performance chemicals on a global scale.

##### **Surfactants**

- Produces surface-active agents used in a wide variety of applications and nearly every industry as they allow two different materials to combine or separate.

##### **Polymer Chemicals**

- Produces organic peroxides, and is also a major producer of metal alkyls and co-catalysts—chemicals used primarily in the production of plastic resins known as thermoplastics, and in processing industries that make a wide range of plastic goods.

The portfolio of Akzo Nobel Chemicals is a mix of specialty, functional, and commodity chemicals based upon leading positions in selected areas of the chemical industry.

The strategic realignment of Akzo Nobel Chemicals was successfully concluded in 2006, two years after it was initiated. This restructuring has transformed a relatively large and fragmented range of business segments into a focused, market-driven portfolio. The result is a smaller portfolio that is stronger, creates more value, and is better structured to meet our financial expectations. The Chemicals activities are now concentrated in five business units: Pulp & Paper Chemicals, Polymer Chemicals, Surfactants, Functional Chemicals, and Base Chemicals. All five Chemicals business units now have a clearly defined strategy for continued performance improvement and growth.

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Pulp & Paper Chemicals, which trades as Eka Chemicals, is the world's leading producer of bleaching chemicals used in the manufacture of paper pulp. Eka also supplies process chemicals and performance

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chemicals that improve the properties of paper, as well as systems and integrated services for the pulp and paper industry. Besides pulp and paper activities, Eka also produces specialty chemicals used in areas such as water treatment, electronics, and separation products used in the pharmaceutical industry.

Base Chemicals produces energy, salt, chlor-alkali products, and derivatives. It is Europe's largest producer of vacuum salt and a leading supplier of chlorine and caustic lye, used in the chemical, detergent, pulp and paper, and plastic industries. Its products are used in the manufacture of glass, pharmaceuticals, and textiles, and in disinfectants for swimming pools. Joint ventures operated with Dutch and Danish energy companies enable Akzo Nobel to make efficient use of combined heat and power (cogeneration) to assist in the production of chlorine and vacuum salt.

Functional Chemicals consists of a number of different businesses that manufacture and sell a variety of chemical intermediates and performance chemicals on a global scale. It is a global leading supplier of ethylene amines, monochloroacetic acid, chelates, cellulosic specialties, sulfur products, and polysulfides. It is also one of the leading producers of salt specialties in Europe. Many of these chemicals can be found in everyday items such as toothpaste, ice cream, wallpaper adhesives, camera film, bakery goods, deodorants, PVC, and cosmetics; others are used by the mining, electronics, and agricultural industries.

Surfactants is a global producer of surface-active agents used in a wide variety of applications. Its specialty surfactants and intermediate products are used by industrial as well as consumer goods producers. Surfactants are used in nearly every industry as they allow two different materials to combine or separate. Key markets include agriculture additives, household and institutional cleaning, oilfield applications, and petroleum additives. In addition, surfactants products are used in printing inks, personal care, fabric care, asphalt paving, emulsifiers, and flotation agents for the purification of minerals and mining.

Polymer Chemicals is the world's leading producer of organic peroxides, and a major producer of metal alkyls and co-catalysts—chemicals used primarily in the production of plastic resins known as thermoplastics in processing industries that make a wide range of plastic goods. The business also supplies products used in polyethylene, polypropylene, acrylics, polystyrene, and PVC, which are used for the manufacture of plastic bags, mobile phone housings, automotive parts, and shoe soles. Polymer Chemicals also manufactures high purity metal organics, which are chemicals used in consumer electronics such as LEDs (light emitting diodes) and in the lasers inside CD and DVD players.

In addition, the company has established a strong presence, both globally and regionally, through joint ventures. Joint ventures include Flexsys, Delamine, and Eka Polymer Latex. The company's stake in the Flexsys joint venture was divested per May 1, 2007.

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**GEOGRAPHIC DATA**

Below, geographic information for Akzo Nobel is presented for revenues, operating income, identifiable assets, and expenditures for property, plant and equipment.

| <i>Millions of euros</i> | <b>Revenues<br/>by region of destination</b> |               |               | <b>Revenues<br/>by region of origin</b> |               |               | <b>Operating income</b> |              |              |
|--------------------------|--|---------------|---------------|---|---------------|---------------|-------------------------|--------------|--------------|
|                          | 2006   | 2005          | 2004          | 2006                                    | 2005          | 2004          | 2006                    | 2005         | 2004         |
| The Netherlands          | 915  | 862           | 844           | 2,072                                   | 2,459         | 2,748         | 25                      | 474          | 446          |
| Germany                  | 1,209  | 1,238         | 1,165         | 1,208                                   | 1,152         | 1,050         | 87                      | 144          | 159          |
| Sweden                   | 523  | 516           | 509           | 1,284                                   | 1,237         | 1,155         | 98                      | 137          | 33           |
| United Kingdom           | 781  | 809           | 833           | 798                                     | 754           | 848           | 24                      | (59)         | (57)         |
| Other European countries | 4,245  | 4,075         | 4,122         | 3,073                                   | 3,069         | 2,921         | 579                     | 527          | 532          |
| USA and Canada           | 2,711  | 2,400         | 2,445         | 2,732                                   | 2,116         | 2,221         | 248                     | (67)         | 60           |
| Latin America            | 924  | 830           | 729           | 747                                     | 626           | 493           | 120                     | 85           | 133          |
| Asia                     | 1,755  | 1,590         | 1,536         | 1,440                                   | 1,231         | 1,087         | 241                     | 192          | 175          |
| Other regions            | 674  | 680           | 650           | 383                                     | 356           | 310           | 40                      | 53           | 46           |
| <b>Total</b>             | <b>13,737</b>                                | <b>13,000</b> | <b>12,833</b> | <b>13,737</b>                           | <b>13,000</b> | <b>12,833</b> | <b>1,462</b>            | <b>1,486</b> | <b>1,527</b> |

| <i>Millions of euros</i>                   | <b>Identifiable assets</b> |               |               | <b>Expenditures for<br/>property,<br/>plant and equipment</b> |            |            |
|--|----------------------------|---------------|---------------|---|------------|------------|
|  | 2006                       | 2005          | 2004          | 2006  | 2005       | 2004       |
| The Netherlands                            | 3,165                      | 3,061         | 2,959         | 179   | 179        | 189        |
| Germany                                    | 696                        | 750           | 828           | 24  | 25         | 23         |
| Sweden                                     | 863                        | 863           | 847           | 78  | 65         | 60         |
| United Kingdom                             | 664                        | 690           | 582           | 20  | 31         | 29         |
| Other European countries                   | 2,266                      | 2,112         | 2,163         | 85  | 81         | 81         |
| USA and Canada                             | 2,093                      | 1,959         | 1,794         | 70  | 51         | 52         |
| Latin America                              | 610                        | 619           | 454           | 23  | 42         | 61         |
| Asia                                       | 940                        | 1,017         | 834           | 43  | 32         | 47         |
| Other regions                              | 252                        | 329           | 295           | 7   | 8          | 9          |
|  | 11,549                     | 11,400        | 10,756        | 529   | 514        | 551        |
| Eliminations and cash and cash equivalents | 1,059                      | 724           | 877           |   |            |            |
| Investment in associates                   | 177                        | 301           | 318           |   |            |            |
| <b>Total</b>                               | <b>12,785</b>              | <b>12,425</b> | <b>11,951</b> | <b>529</b>  | <b>514</b> | <b>551</b> |

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See Item 5 "Operating and Financial Review and Prospects" for a discussion on factors affecting comparability between periods.

**INSURANCE**

Akzo Nobel's insurance policy is part of a general risk management philosophy emphasizing the importance of creation of risk awareness throughout the entire organization and promotion of loss control efforts. Risk finance, normally in the form of insurance, is seen as a last resort to provide financial coverage for mainly catastrophe-like events. Events of frequent nature with limited financial effect are self-insured with the use

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of 100-percent-owned captive insurance companies. The limits of insurance are based on loss scenarios as well as normal practice in Akzo Nobel's type of industry.

As of January 1, 2007 Akzo Nobel Coatings/Chemicals and Organon BioSciences (Organon, Intervet and Nobilon) have separate insurance contracts. Organon BioSciences has set up a 100% owned separate captive insurance company per January 1, 2007.

### ***Akzo Nobel Coatings/Chemicals***

For property damage/business interruption, the exposure retained in the captive insurance arrangements is limited to EUR 12 million per occurrence with an annual aggregate of EUR 30 million. When losses exceed this annual aggregate, external insurers will provide coverage from a deductible level of EUR 0.5 million. Damages from acts of terrorism are excluded from insurance coverage. The maximum amount of loss covered by external insurers for property damage/business interruption is EUR 250 million.

For general and product liability, the exposure retained in the captive insurance arrangements is limited to EUR 10 million per claim with an annual aggregate of EUR 20 million. When losses exceed this annual aggregate, external insurers will provide coverage from a deductible level of EUR 0.5 million. Liabilities as a result of acts of terrorism are excluded from insurance coverage. The maximum amount of loss covered by external insurers for general and product liability is EUR 490 Million.

### ***Organon BioSciences***

For property damage/business interruption, external insurers will provide coverage from a deductible level of EUR 2.5 million. Damages from acts of terrorism are excluded from insurance coverage. The maximum amount of loss covered by external insurers for property damage/business interruption is EUR 500 million.

For general liability for the Organon BioSciences Group the exposure retained in the captive insurance arrangement is limited to EUR 5 million per claim. For product liability in respect of animal healthcare products (Intervet) the exposure retained in the captive insurance arrangement is limited to EUR 10 million per claim. The annual aggregate for all such retained general and product liability claims is EUR 10 million. When losses exceed this annual aggregate, external insurers will provide coverage from a deductible level of EUR 0.5 million.

For product liability in respect of human healthcare products (Organon) the exposure in the captive insurance arrangement is limited to EUR 25 million per claim without an annual aggregate.

Liabilities as a result of terrorism are excluded from insurance coverage. The maximum amount of loss covered by external insurers is EUR 455 million for general liability of the Organon BioSciences Group, EUR 450 million for product liability of Intervet, and EUR 435 million for product liability of Organon plus in excess thereof USD 150 million.

## **HUMAN RESOURCES**

Akzo Nobel's decentralized organizational structure supports its ambitions and offers the company's employees broad scope and responsibility in various disciplines, permitting them to develop their talents at an early stage of their careers. Akzo Nobel provides opportunities and resources; employees can use these to develop their skills and to be ready for change even before it becomes a necessity.

The company-wide human resources (HR) initiatives we began in 2005 to enhance our policy and to strive for the creation of a "talent factory" progressed well last year.

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**Performance & Development Dialog**

We completed the introduction of our company-wide performance appraisal program, the Performance & Development Dialog (P&D Dialog). All employees can now benefit from this global program. This means more clarity on annual personal objectives, in alignment with the company's goals.

The P&D Dialog fosters more dialog and discussion between employees and managers on their performance. And that in turn creates a stronger focus on company-wide competencies in support of the business and in support of the development needs of our people. Managers everywhere are now being assessed annually on their ability to motivate employees, to stimulate their development and to create an open climate for discussion—key ingredients for continuous high performance by our company.

Creating a "talent factory" also means more focus on development, alongside employees' performance. The P&D Dialog was therefore extended further in 2006. By offering a development tool to employees and managers they are better equipped to conduct meaningful, consistent and focused development discussions. We expect to reap the benefits for the first time in 2007.

**Nurturing talent**

As one of the key ingredients for a true "talent factory", 2005 saw us start up Leadership Talent Reviews, a more structured identification of leadership talent in the company. A key leadership role is to nurture the company's future and to find and develop those who will run Akzo Nobel in the future. We made good progress in this area in 2006 and were able to take Leadership Talent Reviews deeper into business units, sub-businesses, countries and functions. The P&D Dialog serves us in this process too, since it gives the company a common language to discuss performance and competencies. With the new HR tools and HR initiatives, Akzo Nobel is well equipped for the future.

**RESEARCH AND DEVELOPMENT**

Through strong customer and market orientation, our R&D activities provide an excellent platform for sustainable business development. We are focusing on innovative approaches and technologies that ensure continuity and profitable growth. In 2006, R&D expenditures amounted to EUR 885 million, up 9% on 2005. The main driver continued to be Organon, which accounted for 55% of Akzo Nobel's total R&D expenditures. Total R&D staff at year-end 2006, was virtually unchanged at 6,600. Organon's R&D expenses were 19% of revenues, reflecting its continuous commitment to research and development. R&D expenditures as incurred by each of the groups are as follows:

|           | Millions of euros |      |      | Percent of revenues |      |      |
|-----------|-------------------|------|------|---------------------|------|------|
|           | 2006              | 2005 | 2004 | 2006                | 2005 | 2004 |
| Organon   | 484               | 433  | 395  | 19                  | 18   | 17   |
| Intervet  | 109               | 113  | 118  | 10                  | 10   | 12   |
| Coatings  | 181               | 176  | 169  | 3                   | 3    | 3    |
| Chemicals | 94                | 102  | 125  | 2                   | 3    | 3    |

**Organon**

The R&D activities of Organon are the foundation of the prospects for long-term growth of our human pharmaceuticals business and Organon is committed to maintaining a high level of investment in R&D in the future. The objective of the research organization of Organon is to develop in-house, or to obtain from

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third parties, new biological entities and new chemical entities for which proof of concept has either already been demonstrated or for which we expect proof of concept can be demonstrated and which will be suitable for full development into marketable products.

Following discovery and successful lead optimization, a compound enters pre-clinical development. During this phase, a number of toxicological and pharmaceutical evaluations is conducted to ensure that the compound is safe for human use. If these tests yield positive results, Phase I, Phase II and Phase III clinical studies are conducted to test the safety and clinical efficacy of the drug candidate. We also conduct post-marketing, Phase IV, trials to further confirm the efficacy and safety of a product.

In terms of Research & Development, Organon spent about 19% of its 2006 revenues on R&D, focusing mainly on promising compounds within phases II and III. This trend is to be expected to continue.

Consistent with the R&D strategy, the focus of the development efforts is mostly on innovative drug candidates in the main therapeutic franchises, as well as in immunology and selected areas of oncology. Currently, 39 compounds are in various stages of the development pipeline: 23 in pre-clinical development, 7 in Phase I clinical development, and 4 in Phase II clinical development, of which two are in advanced stages of Phase II development. Five products are in Phase III clinical development.

The following table shows the Phase III product candidates:

| <b><u>Franchise and Product or Compound</u></b> | <b><u>Description</u></b>               | <b><u>Main Indications</u></b> | <b><u>Clinical Development Phase</u></b> |
|---|---|--------------------------------|--|
| <i>Gynecology</i>                               |   |                                |  |
| Org 50081                                       | Serotonin-2-Blocker (hot flashes)       |                                | III                                      |
| NOMAC/E <sub>2</sub>                            | Oral contraceptive                      |                                | III                                      |
| <i>Fertility</i>                                |   |                                |  |
| Org 36286                                       | Sustained Follicle Stimulant            |                                | III                                      |
| <i>Neuroscience</i>                             |   |                                |  |
| asenapine                                       | Novel psychopharmacologic agent         |                                | III                                      |
| Org 50081                                       | Serotonin-2-Blocker (insomnia)          |                                | III                                      |
| <i>Anesthesia</i>                               |   |                                |  |
| sugammadex                                      | Selective Relaxant Binding Agent (SRBA) |                                | III                                      |

Our biotechnology program follows a two-pronged approach toward the research and development of new NBEs: the expansion of our internal discovery activities and the augmentation of the biotechnology pipeline through in-licensing and collaborations. Our biotechnology research facility in Cambridge, Massachusetts, is the center of our discovery activities for new NBEs and is charged with researching the feasibility of numerous compounds.

Organon actively pursues alliances with third parties for the development of new products, especially in the biotechnology sector. The table below provides an overview of the more important current R&D collaborations, from early research to late-stage development, as well as of licensing and manufacturing agreements to which Organon is party and which relate to existing marketed products, including a brief description of the scope of each.



**R&D Collaborations and Licensing Agreements****Partners****Scope***Research Alliances*

Entelos Inc.

Co-development of therapies for rheumatoid arthritis

Genaissance Pharmaceuticals, Inc.

Agreement for the joint identification of biomarkers in the neuroscience area

Keel Pharmaceuticals, Inc.

Collaboration agreement to discover and develop novel biotherapeutics in the autoimmune field based on approaches and targets identified by Keel

KineMed Sciences, Inc.

Agreement for the discovery of alternative applications for certain therapeutic compounds

Lexicon Genetics Incorporated

Collaboration agreement to jointly discover, develop and commercialize novel biotherapeutics

Pharmacopeia Drug Discovery Inc.

Collaboration agreements for the production of preclinical lead compounds, for research relating to human cannabinoid receptor CB-1 and for research to develop new therapeutic products in areas including neuroscience and immunology

*Compound-Oriented Development*

Cortex Pharmaceuticals, Inc.

Research and development in connection with AMPAKINE® compounds in the neuroscience area

University of Illinois

License to develop and commercialize serotonin antagonists for the treatment of sleep apnea

J. Uriach y Compañía, S.A.

Collaboration agreement to develop kinase inhibitors

*Late-Stage Development and Licenses*

Cardinal Health Inc. (formerly known as R.P. Scherer Corporation)

License of Zydis® technology used in the delivery of asenapine

Laboratoire Théramex S.A. (an affiliate of Merck KGaA based in Monaco)

In-licensing of NOMAC/E<sub>2</sub> and agreement to commence Phase III trials and co-market the final developed oral contraceptive

Washington University

License of certain patents for the use of SFS in the field of human reproductive biology (Org 36286)

*Marketed Organon Products*

Cephalon Inc. (formerly known as CIMA Labs Inc.)

Agreement for the in-licensing of the OraSolv® technology used in Remeron SolTab®

Merck Serono S.A.

In-licensing of certain patents covering recombinant FSH (Puregon®)

In June 2006, Organon entered into a collaborative research agreement with KineMed Sciences, Inc. ("KineMed") for the identification of alternative applications for certain therapeutic compounds formerly in Organon's clinical-stage pipeline through the use of certain proprietary technologies owned by KineMed. Once therapeutic utility is established for a drug candidate, we will jointly determine a development and commercialization plan. The agreement is scheduled to expire on the earlier of the date of completion of the research or the date falling one year from the agreement's effective date, but may lead to other multi-year joint development and commercialization programs.

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In 2003, Organon entered into a licensing and collaboration agreement with Pfizer Inc. under which it was agreed to collaborate on the clinical development and manufacturing of asenapine. In addition, it was agreed to co-promote the product in certain countries. In November 2006, as a part of a commercial review of its pipeline, Pfizer terminated its collaboration agreement with Organon, with effect from May 26, 2007.

### **Nobilon**

As part of an increased focus on biotechnology and following an analysis of the expertise and know-how available to us within our human and animal health businesses, Akzo Nobel concluded in 2002 that a platform suitable for entering the human vaccine market is available to us from our in-house resources. Nobilon, a new business entity became operational in mid-2003.

Nobilon's current development activities focus on vaccines against influenza and respiratory syncytial virus (RSV), two common respiratory diseases, and on vaccines for travelers. In July 2006, Nobilon entered into an agreement with The Netherlands Vaccine Institute for the co-development of a vaccine against RSV, one of the most common causes of lower respiratory tract infections in young children. In addition, Nobilon is in preclinical development of a combination vaccine against the most important bacterial pathogens that cause traveler's diarrhea, including Salmonella, Campylobacter jejuni, and enterotoxigenic E. coli.

### **Intervet**

Over the last few years the research and development activities have been focused on developing novel proprietary and generic products for both the livestock and companion animal markets. The R&D activities are closely aligned with the sales and marketing activities.

Within the vaccines area, Intervet concentrates on the identification of antigens and the development of products against specifically targeted diseases with an aim of developing a complete range of products for all the relevant species. This focus also involves specific diseases or strains that are only present in certain geographical regions, like the recently introduced poultry vaccines against certain strains of the Haemophilus bacterium (the causative agent of infectious coryza) that are typically found only in Latin America and some parts of Asia.

Intervet has 14 R&D facilities worldwide. Seven of these develop novel vaccines for the international market. As biological pathogens can vary by continent, and in some cases by country, it is important to develop new vaccines in areas where the specific diseases Intervet is targeting are manifested.

Intervet currently has approximately 60 products in pre-clinical development and approximately 140 products in clinical development.

Intervet is developing innovative products against zoonotic diseases, which are diseases that can be transmitted from animals to humans, such as avian influenza and salmonella.

A description of our most important products currently in development is as follows:

- *Revalor LA*. Revalor LA is a long-lasting next-generation ear implant for cattle which we hope to launch in 2008 in the United States as part of our Revalor range of products
  - *Cobactan® line extensions*. Intervet anticipates launching additional products in the Cobactan® range over the course of 2007 both in the United States and other countries.
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## Coatings

In the customer-driven, technology-based organization of the Coatings business units the main driver for R&D is defining customer specific solutions. The framework for the carefully balanced portfolio of both short-term and long-term innovation projects is set by three main prerequisites:

- meeting environmental regulations;
- improving the performance of products also in color aspects; and
- defining and applying novel product and process technologies.

These projects are executed by the various business units in geographically spread locations, always in the vicinity of the markets they serve. Examples of achievements or developments during 2006 are:

- Decorative Coatings introduced e.g. Rubbol XD<sup>®</sup>, the world's first decorative high solids trim paint product with an extended lifetime compared to conventional alkyd-based paints, while already meeting the stringent European VOC legislation coming into force per 2010. Other recent decorative coatings innovations include Herbol<sup>®</sup> Symbiotec, a nanosilica based exterior wall paint with extremely low dirt pick;
- Car Refinishes launched a revolutionary clearcoat, curing at high speed under UV-A light; and
- Fuel consumption focus in conjunction with many blue chip operators taking a firm environmental stance on emissions will enable a continuing focus on Marine & Protective Coatings' Intersleek<sup>®</sup> foul release biocide free systems. The launch of Intersleek<sup>®</sup> 900 targets a broader platform for sales than current technology allows. A new R&D laboratory was opened in Felling; and
- Aerospace Coatings announced a new technology around anticorrosive paint based on use of magnesium. The focus of our long-term-innovative R&D programs is gradually shifting toward new generation polymer engineering, applying new academic science, and creatively utilizing the potential of nanotechnology.

## Chemicals

For all Chemicals business units, R&D programs are customer-oriented, maintaining an adequate balance between short-term and long-term innovation goals. Continuous upgrading is a key issue in order to achieve and secure competitive market advantages. Sustainability is a major driver in the R&D efforts for both current and future operations and products. R&D resources are embedded in the individual business centers, with R&D units in place in all major markets.

Business units also cooperate on technology programs, often including university partners, this in order to ensure access to developments in the scientific world and exploit the latest technologies.

Programs include:

- reduction of energy and raw material consumption;
  - low energy routes to high quality emulsions;
  - nano technology;
  - particle technology for various applications;
  - waste and energy reduction;
  - closed loop production through process intensification;
  - more stable and safer processes by application of control room simulation; and
  - high throughput experimentation (shortening time to market and/or time to production).
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Central R&D units are focused on process & product innovation, process & product optimization, scale-up and support & consultancy. There is continued extra focus on innovations in the so called "Innovation Unit", an integrated team of business and R&D professionals. This unit exploits ideas, internal competencies and portfolio synergies. One of the R&D/innovation unit successes are in particle Technology/modified Hydrotalcite for various applications. Other successes are in process improvements at several business units as well as in improvements in energy efficiency of Akzo Nobel's processes.

## BUSINESS REVIEW AND DEVELOPMENTS AT BUSINESS UNITS

For financial details on acquisitions or divestments, reference is made to Changes in Consolidated Interests of the Notes to the Consolidated Financial Statements.

### ORGANON " Prescription Drugs

#### Business Review

Revenues 2006: EUR 2,611 million; 2005: EUR 2,425 million

Organon returned to growth in 2006. The turnaround which began in 2005 accelerated in 2006.

The consistent strategy has been to build on the strength of Organon's existing portfolio of gynecology, fertility and anesthesia products while reinforcing the neuroscience portfolio and developing initiatives in the field of biotechnology.

The existing Organon product portfolio has resulted in higher revenues, which generated improved operating income. Compared with 2005, revenues climbed 8% in 2006 to EUR 2,611 million.

Organon's main products developed as follows:

| <i>Millions of euros</i>   | <b>2006</b>     | <b>Total</b>  | <b>Autonomous</b>           |
|----------------------------|-----------------|---------------|-----------------------------|
|                            | <b>revenues</b> | <b>change</b> | <b>growth %<sup>1</sup></b> |
|                            |                 | <b>%</b>      |                             |
| Contraceptives             | 669             | 19            | 18                          |
| - of which NuvaRing®       | 213             | 68            | 67                          |
| Puregon® /Follistim®       | 384             | 8             | 8                           |
| Remeron®                   | 253             | (11)          | (11)                        |
| Anesthesia                 | 242             | 27            | 28                          |
| Livial®                    | 151             | (2)           | (2)                         |
| Pharmaceutical ingredients | 255             | 12            | 2                           |

1 Autonomous sales growth is defined as the change in revenues attributable to changed volumes and selling prices. In this case it only excludes the change in revenues attributable to currency translation effects. Acquisitions and divestments were not applicable. Reference is made to the remarks under Introduction on page 4.

Operating income before incidentals grew 34% to EUR 362 million, while the EBIT margin increased to 13.9% from 2005's 11.1%. Our operating margins have increased. We succeeded in compensating for lower Remeron® sales caused by increased competition from generics by boosting sales in other products, such as the contraceptive NuvaRing® and the fertility treatment Puregon®. Including incidentals, operating income decreased 15% to EUR 354 million. It should be noted that 2005 included the special benefit of EUR 149 million from the termination of the Risperdal® copromotion.

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By increasing efficiencies in production, we managed to decrease working capital and further improve EBIT margins. Further streamlining initiatives included the closing of activities in Scotland. All initiatives together resulted in a reduction in total headcount of 390.

Organon strives to find the right balance between improving its margin and spending the necessary amounts on R&D and marketing and sales for new products. Investment in 2006 focused on pipeline growth, which generated a significant increase in R&D spending to EUR 485 million, or 19% of revenues, from 18% the previous year.

The fertility product Puregon®/Follistim® and the innovative contraceptive NuvaRing® were the greatest contributors to Organon's advance and helped to improve the market positions of our products. NuvaRing®, which booked 67% global sales growth, topped the 1.5 million user mark worldwide, highlighting its increasing acceptance and high satisfaction rate. Demand for NuvaRing® was especially strong in the United States, where sales were supported by direct-to-customer campaigns and increased positive media attention. NuvaRing® was also approved for the Australian market, bringing to 32 the number of countries in which it has been introduced.

Puregon®/ Follistim®, the recombinant follicle-stimulating hormone which is Organon's biggest seller, saw sales rise 8%. The world welcomed its one millionth "Puregon baby" during 2006. The product has now been introduced in China, while sales in Japan took off after being launched there in late 2005.

The U.S. Food and Drug Administration (FDA) approved the innovative contraceptive implant Implanon®, after which it was launched on to the U.S. market in late 2006. Initial feedback from U.S. physicians on Implanon®, the first and only single-rod implantable contraceptive, has been positive. Sales of Implanon® increased 39% in 2006 and it is well placed to join NuvaRing® and Puregon®/Follistim® as one of Organon's leading products in 2007 and beyond.

Within our hormone therapy portfolio, sales of Livial®, which is currently being marketed in around 90 countries, were flat in 2006.

Anesthesia revenues grew 27%, boosted by muscle relaxant Esmeron® and the injectable Anzemet®, for postoperative nausea and vomiting. Anzemet®, which is licensed in by Organon from sanofi-aventis for the United States only, added to the already strong anesthesia franchise in the United States.

Neuroscience products turned in a satisfactory performance in 2006. Reinforcing this portfolio in the short and medium-term is high on our agenda. Remeron®, which represents around 10% of Organon revenues, continued its overall steady worldwide decline, but sales still increased in some countries.

Pharmaceutical ingredients sales showed a positive trend.

Royalties and services revenues were mainly attributable to royalty payments from Janssen on Risperdal® sales in selected countries and from GlaxoSmithKline on sales from Arixtra®. Service revenues were received mainly from Ligand, with whom our co-promotional collaboration on Avinza® was ended by the end of September 2006, although the royalty income from the product will remain for a number of years.

We welcome strategic alliances that can help bring new drugs to the market. While we have built up know-how and experience which enables us to largely go it alone in fertility and gynecology, our pragmatic strategy is to strike collaboration and cooperation deals if we believe this will create value. We are particularly open to alliances in neuroscience and biotechnology. We are currently working in close collaboration with more than 15 partners in research, compound-oriented development, licensing and marketing. During the course of 2006, we have entered into several new collaborative research agreements.

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Our partner Pfizer decided in November 2006 to withdraw from the asenapine development program. While unexpected, this has presented a new opportunity to Organon to pursue a go-to-market strategy which is more closely aligned with our own planning and positioning for this product candidate. Pfizer will return all product rights, intellectual property and data to us by May 2007, subject to certain conditions. We will evaluate whether we need a partner to commercialize asenapine in selected geographic areas in due course. Although we are disappointed about the withdrawal, we appreciate the positive contribution Pfizer has made to the development of asenapine.

Organon and Bayer Schering Pharma decided to halt their research collaboration into a male hormonal contraceptive after concluding that the implant-plus-injection method under consideration lacked sufficient commercial appeal.

With 19% of our revenues invested in R&D, we continue to focus heavily on our product pipeline. We have the ambition to file at least one major compound per year on average over the coming years. Organon's focused pipeline is fully aligned with our growth strategy, which is to build on the strength of our existing franchises, return to growth in neuroscience, and expand into the field of biotechnology.

The pipeline is well stocked with product candidates in various stages of development. The most advanced project in Organon's neuroscience pipeline is asenapine. The Phase III clinical trial program for the U.S. NDA submission for the indications schizophrenia and acute mania associated with bipolar 1 disorder has been concluded. In early 2007 the efficacy and safety outcomes of the program will be shared with the FDA in a so-called pre-NDA meeting, which will lead to the determination of the submission planning.

Also in an advanced stage of development (Phase III) is sugammadex, the first selective relaxant binding agent to reverse neuromuscular block. Sugammadex promises to be a perfect fit for our anesthesia portfolio. Within our fertility portfolio, we are developing a sustained follicle-stimulating hormone product to expand our range of treatments. Our contraception offering will be enhanced with NOMAC/E2, for which we expect to file a submission in 2009. Looking further ahead, we are developing Org 50081 as a treatment for insomnia.

We have a solid and long-standing expertise in biotechnology, as evidenced by Puregon®/ Follistim®, our leading recombinant follicle-stimulating hormone. Our biotech strategy is aimed at expanding our capabilities into new therapeutic areas within the human pharmaceutical area.

At the beginning of 2002, we brought together our various human and animal vaccine-related competences to create Nobilon, our human vaccine business. This new business entity became operational in mid-2003. The formation of Nobilon has allowed us to combine Intervet's expertise in fields such as host-pathogen interaction, vaccine design and vaccine manufacture with Organon's expertise in fields such as toxicology, clinical development, regulatory affairs and marketing.

More recently, we have established a new biotech research facility in Cambridge, Massachusetts, which focuses on monoclonal antibody research in immunology and certain areas of oncology. Our biotech strategy enables us to further exploit potential synergies between our human pharma and animal healthcare activities. We believe that our efforts position us well to compete in the area of biotechnology-based drug discovery and development and may assist us in enhancing the range and productivity of our R&D activities.

Nobilon's current development activities focus on vaccines against influenza and respiratory syncytial virus (RSV), two common respiratory diseases, and on vaccines for travelers. The development of flu vaccines is continuing forward. In July 2006, Nobilon entered into an agreement with The Netherlands Vaccine Institute for the co-development of a vaccine against RSV, one of the most common causes of lower respiratory tract infections in

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young children. In addition, Nobilon is in preclinical development of a combination vaccine against the most important bacterial pathogens that cause traveler's diarrhea, including Salmonella, Campylobacter jejuni and enterotoxigenic E. coli.

Organon operates in what is by definition a crowded, highly competitive and challenging market. Governments are trying to curb health spending and in many countries, fertility treatments are not fully reimbursed, though governments elsewhere have been spurred by low population growth into re-compensating such treatment.

The major challenges for 2007 and beyond – for Organon as for all pharmaceutical companies – will continue to be government-imposed price controls and competition from generic drugs. Aging populations mean increasing healthcare costs and many societies are seeking ways to limit that expense.

Successful drug discovery and development is becoming increasingly challenging. We strive to shorten time-to-market and to contain R&D costs so they make products affordable to the market. The many hurdles include the regulatory environment, ensuring safety and efficacy, the scope and duration of clinical trials, the investments needed both to develop and protect products, and the relatively short window of opportunity to earn back these massive investments between product launches and patent expiry. This is demonstrated, for example, by the fact that Livial®/Tibolone® was deemed not approvable by the FDA for admittance to the U.S. market, while certain patents on this drug have successfully been challenged in other countries.

## **INTERVET – Veterinary Products**

### **Business Review**

*Revenues 2006: EUR 1,125 million; 2005: EUR 1,094 million*

Intervet maintained its track record of steady revenues growth, attractive operating margins and new product introductions in 2006. Our robust performance is the best proof of our successful strategy of organic growth, selected acquisitions of products, components or companies, and in-licensing.

Revenues increased 3% to EUR 1,125 million. The livestock segment, which excluding feed additives represents nearly 80% of our turnover, saw revenues rise 7%. This was achieved despite consolidation among our livestock clients. Revenues in the companion animal segment grew by 7%, benefiting from increasing global prosperity: wealthier populations are more willing and able to spend money caring for their pets. Operating income before incidentals grew by 2% to EUR 213 million, equivalent to an EBIT margin of 18.9%. The latter was affected by various one-time cost effects relating to inventory write-offs and further investment in the marketing and distribution infrastructure, as well as selected restructuring measures at various sites. Operating income of EUR 219 million decreased by 8%, largely due to reduced one-off income relating to divestment activities.

Revenues in Europe—where Intervet generates 52% of its turnover—rose a healthy 5%, despite unfavorable business conditions triggered by the threat of avian influenza in early 2006. North America performed well with a 12% revenues increase, while Latin America recorded 8% growth. Overall, comparative revenues performance was influenced by the divestment of medicinal feed additives initiated in 2005. We have now divested most of our international feed additive range.

Intervet bolstered its strong presence in its core market segments of vaccines and pharmaceuticals, with both areas achieving equally strong growth.

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We have maintained a stable flow of product innovations over the years, and 2006 was no exception. PreveNile<sup>®</sup>, the equine vaccine against West Nile virus, was approved in August for use in the United States. That came just days after the European Union granted a conditional license for our Nobilis<sup>®</sup> Influenza H5N2 vaccine, which protects birds against the highly pathogenic H5N1 field strain of avian flu. Our Nobilis<sup>®</sup> Influenza vaccine range has been used successfully in Hong Kong, Mexico, Italy and Vietnam in governmental avian flu control programs. The EU's acceptance of vaccination as part of a preventative strategy against avian influenza marks an important and encouraging change in approach.

In early 2006, we announced an agreement with Bayer to acquire its Foot and Mouth Disease (FMD) vaccine factory in Cologne, Germany, strengthening our worldwide production and development capacity in that field. This is in line with the strategy to expand our presence in the FMD field, where considerable revenue was realized in 2006.

For pigs, Intervet introduced a Mycoplasma vaccine. Porcilis<sup>®</sup> M Hyo is a vaccine to protect against Mycoplasma hyo, an important cause of pneumonia in pigs. This is a major step towards completing the portfolio in pulmonary vaccines in pigs, the largest segment in the swine animal health market.

We also introduced new vaccines for companion animals. In November 2006, we began the rollout of Equilis<sup>®</sup> Prequenza, the new Equine Influenza and Tetanus vaccine, which uses an innovative adjuvant system and is proven against the most recent strains of equine flu. This new product strengthens the position of Intervet in the small yet profitable equine market. In the United States, Continuum<sup>®</sup> Feline was launched, the first U.S.-approved range of single shot vaccination providing three-year protection for cats. Sales of Vetsulin<sup>®</sup> (known in Europe as Caninsulin<sup>®</sup>)—the first insulin in the United States to treat diabetes in dogs—has taken off well following its U.S. introduction in 2005 and continues to grow strongly elsewhere in the world.

Significant for our U.S. business was the approval for Zilmax<sup>®</sup>, a product designed to improve production performance in beef cattle. Commercialization will begin in 2007 following completion of additional studies to define optimal usage recommendations under the unique U.S. cattle feeding and marketing conditions.

The business around our proprietary molecule cefquinome was further extended by the European launches of Cobactan<sup>®</sup> IV 4.5% for horses and Cobactan<sup>®</sup> Long Acting 7.5% for cattle — two more additions to the fourth-generation cephalosporin family.

In fertility management, we strengthened our position with the EU launch of the equine fertility product Regumate<sup>®</sup> and the launch of Cyclix<sup>®</sup> Porcine and Cyclix<sup>®</sup> Bovine. Our recently introduced Chronogest<sup>®</sup> CR for fertility management in sheep was well received by the market.

Intervet's investment in R&D has led to the launch of, on average, eight to ten new products each year in the past few years.

The animal health industry has consolidated in the last ten years, with the top ten companies now representing around 75% of the market. Further consolidation is anticipated.

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## COATINGS

### **Business Review**

Akzo Nobel Coatings came back on track in 2006. We consolidated our position as the world's leading coatings company, and our increasing reach and strength enabled us to even better serve our customers, and to harness global economic expansion to accelerate our profitable growth.

We returned to our strategic path of financial improvement, pushing return on investment (ROI) back up to 21.1% . Including incidentals, ROI was 24.6% . Revenues rose 12% to EUR 6.2 billion, with operating income before incidentals up 22% to EUR 518 million. Including incidentals, operating income was up 57%, due to sizeable gains on divestments in 2006, predominantly of the site near Barcelona, Spain.

A key driver of our growth was our strength in Asian markets such as China, Korea and Vietnam, which were ebullient in 2006. We opened two new plants in China, for powder and decorative coatings. Another crucial factor was our customer-driven corporate culture, which allows us to anticipate and react quickly to customer demands. Akzo Nobel Coatings delivered further on its long-held strategy of growing organically while solidifying its world-leading position through selective acquisitions. Akzo Nobel became the number one decorative coatings player in Canada through the acquisition of coatings company Sico Inc., and we established ourselves as a top-three player in the U.S. woodcare market with the purchase of the Flood Group. The company also strengthened its presence in emerging markets—where more than a third of our Coatings revenues are generated—by acquiring leading Czech coatings company Balakom and the Ukraine's Khimrezerv.

European industrial markets were unexpectedly vibrant. Our wood, coil, powder and protective coatings businesses all grew well in Western Europe. However, European retail markets were disappointing, and our Decorative Coatings Europe business delivered unsatisfactory results, especially in mature markets, where consumer spending was weaker and competition intense.

As of January 1, 2007, we have merged Decorative Coatings Europe and Decorative Coatings International into one integrated global business unit with regional sub-units. This will allow us to better co-ordinate key strategies for branding, product range and geographical expansion, whilst keeping local customer focus. It will also allow us to better leverage our scale in R&D, purchasing and production.

A significant development during 2006 was the successful turnaround of Car Refinishes, which demonstrated our ability to overhaul underperforming businesses. Our Specialty Plastics operation was a dynamic growth engine with its coatings for Apple's sought-after products and mobile phones from Nokia, Motorola and Sony Ericsson. We continued our flow of innovative product launches, including the next generation of our marine coating Intersleek®, the Duraflex® non-stick powder coating for cookware, and an ultra-fast drying automotive topcoat from Sikkens® called Autoclear® UV.

In June, we launched the first ever Global Coatings Report, cementing our position as a knowledge leader in the industry. However, the year was not without its challenges. Although less severe than in 2005, increases in raw material prices once again created pressure on margins. We addressed this partly by passing on some of the price rises to customers, and partly by changing the formulation of certain products to reduce their use of costly raw materials. We became more assertive with suppliers and shifted some of our supplier base to emerging markets.

Steps were taken to start reducing our operating working capital, which remains too high. We will continue our efforts over the coming years to cut operating working capital as a percentage of sales to the level of our best-

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performing peers. We should continue to benefit from expected high growth in emerging countries, adding capacity in these areas, and we will critically assess our cost base, especially in mature markets.

### **Developments in the Coatings Business Units**

#### **Decorative Coatings**

*Revenues 2006: EUR 2,287 million; 2005: EUR 2,038 million*

Akzo Nobel's Decorative Coatings unit is made up of the Decorative Coatings Europe and Decorative Coatings International businesses. In January 2007 these two units were merged into one global business unit.

#### **Decorative Coatings Europe**

Decorative Coatings Europe experienced challenging business conditions in 2006 due to fierce competition and high raw material prices. However, despite these difficulties we were able to increase volume by 3%, while revenues were up 5%.

Sales to professional painters were strong, particularly in the fourth quarter. This indicated an improvement in the general business climate in this segment. Revenues performance improved in most key European countries, specifically the United Kingdom. Our joinery business, window frames, and other pre-painted activities also grew well, supported by recovering construction activities in Germany.

On the retail side—sales to consumer outlets—we faced stiff competition. Good volume growth could not be translated into a similar growth in revenues, as market demand favored cheaper commodity products. However, the business still managed to improve in this segment, notably in the fourth quarter, when conditions began to improve in many markets.

We were very successful in Eastern Europe, boosted by Akzo Nobel's acquisition of Balakom a.s., one of the leading coatings companies in the Czech Republic and South-East Europe. The business also expanded its research and development facility in Poland and we announced details of the relocation of our Spanish manufacturing facilities situated in greater Barcelona.

Many of our products are household names in their respective countries and our strategy has been to grow our business by capitalizing on the quality and reputation of our many strong brands, such as Sikkens®, Crown®, and Levis®. We continued to meet consumer needs and introduced new innovations by rolling out 25 new products during the year.

We also worked closely with IKEA to promote color usage and successfully launched new color concepts—such as "Fashion for Walls®" and "Extreme Colors"—as well as an innovative easy-to-pour packaging concept in a number of European countries. The relaunch of our Crown® brand in the UK received a particularly positive response from our customers.

Stringent environmental legislation regarding the reduction of volatile organic compounds (VOC) is being introduced throughout the European Union in two phases—in 2007 and in 2010. Our ambition is to maintain—or even improve—high aesthetic quality, ease of use and durability while introducing more environmentally-friendly ingredients. We intend to build on our strong technology base in water-based coatings to realize this ambition.

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**Decorative Coatings International**

Decorative Coatings International made good progress in 2006 with volumes and revenues substantially up. The business grew both organically and through acquisitions. We seized new opportunities in emerging markets and posted modest gains in mature markets.

One of our key strategies during the year was to focus on acquiring market share in countries that offered the biggest potential for future growth—primarily in the Asia-Pacific region, but also in Eastern Europe.

China contributed strongly to the business—overall volume growth following our acquisition of the coatings activities of Guangzhou Toide Manufacturing Co. We also completed an acquisition in the Ukraine by securing a controlling stake in Khimrezerv, one of the Ukraine's top five decorative coatings manufacturers. Both transactions helped to realize solid growth in the emerging markets.

Two major deals were also concluded in North America during the year. Akzo Nobel acquired both Sico Inc.—Canada's leading coatings company—and The Flood Company, the biggest independent woodcare business in the United States. We enjoyed vibrant growth in the woodcare sector during 2006 in the United States and Argentina. Once their integration is complete, both companies will support our North American revenues in 2007.

On a regional level, Turkey faced challenging market conditions, which impacted our margins. We successfully addressed this issue with aggressive marketing, subsequently resulting in robust volume growth. In Morocco, we have restructured and taken cost-cutting actions and we now expect to reap the benefits in the course of 2007/early 2008.

Strong brands are crucial for our global growth and by focusing on our leading brands in key markets we boosted our performance. All of our operations worked hard to maintain customer loyalty by maintaining their emphasis on quality and value for money. However, high raw material prices continued to create pressure on margins.

During 2006, we continued to maintain the highest safety standards throughout the organization while meeting ever-tighter environmental regulations. Our water-based paints in particular took a big step towards securing greater market share in China—where customers are displaying an increasing preference for environmentally-friendly coatings.

**Industrial Activities**

*Revenues 2006: EUR 1,959 million; 2005: EUR 1,740 million*

Akzo Nobel's industrial activities are made up of the Industrial Finishes and Powder Coatings businesses.

**Industrial Finishes**

Industrial Finishes generated substantial organic growth in 2006 as a result of strategic investments, value-added product offerings and the efforts of its dedicated workforce.

Double-digit revenues growth was posted in the key emerging markets of China, Vietnam, India, Russia, and Eastern Europe, while the predominantly West European-based businesses recovered well due to stronger demand in the industrial markets.

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Volatility in the cost and supply of petrochemical derivatives created relentless pressure on our operating performance throughout the year. However, the suppression of margins in 2006 was more than offset by volume growth in frontier markets and prudent cost management in mature markets.

It was an encouraging year in terms of financial performance, with all units in all regions delivering improved results compared with 2005. This was achieved through balanced growth, value enhancement and cost management.

Our customers remain the key focus of attention. We maintain a value-added partnership with our customers by providing leading design capability, custom engineered products, and extensive end process service. Our customers include multinational corporations who market products with some of the most recognizable and respected brands in their industry.

We operate a deliberate strategy of bottom-up thinking and work right next to our customers at their own place of business, an approach which has resulted in the forging of many long-term relationships which we are proud of.

Our overall strategy remains to migrate, change, and innovate with our customers faster than the competition. Our forward investments in rapidly-growing emerging markets enable us to be there with local service and production when our customers need us. By combining our intense customer focus, global reach, and expansive technology base, Industrial Finishes remains uniquely competitive in the markets we serve.

We stay ahead of market trends in color and fashion by working with leading design and fashion consultants globally and continually investing in environmentally-friendly, energy efficient, and renewable technologies.

Looking forward, our strategy is aimed at matching capacity with demand in both mature and emerging markets. We plan to grow our operations in the mature markets of Europe and North America and have targeted rapid growth in China.

The business is also making inroads into markets in Eastern Europe, Russia, Vietnam, and India.

### ***Powder Coatings***

Powder Coatings posted double-digit growth in revenues and operating income in 2006—far exceeding market growth—which was delivered despite cost hikes in raw materials. This was achieved by expanding capacity to meet growing demand in emerging markets, improving production efficiencies, boosting technological innovation, and aligning core business functions. In China—where we enjoy first mover advantage and clear market leadership—we expanded the capacity of our four factories in line with strong market growth, as well as taking initial steps towards establishing a fifth facility.

Eastern Europe is rapidly emerging as a significant powder market and during 2006 the business also completed the construction of its first factory in Russia, while expansion work began on our newly acquired factory in the Czech Republic. In addition, we doubled our capacity in Turkey—one of the fastest growing markets in the world.

In Western Europe, we centralized operations into a single virtual plant coordinating supply from five factories to 17 countries. This will enable us to streamline the production process and achieve higher efficiencies of scale with individual plants focusing, for example, on powder for refrigerators or washing machines. We expect to reap the benefits from this significant improvement in production efficiency during the years to come.

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A major turnaround was achieved in the United States, where higher revenues were posted in 2006, as we consolidated operations into our Nashville facility.

Our Functional Coatings activity continues to go from strength to strength, delivering record sales and income for the second year in a row. We also made major in-roads into the pipe coatings market and extended production into Asia and the Americas.

The environment is a major factor in the growth of powder coatings with environmental regulations in many markets driving customers from liquid to powder coatings in order to reduce emissions. Powder coatings which contain no solvents are often the best choice to enable compliance.

We are committed to technology and product innovation as a fundamental building block for the future growth of sales and earnings and currently have 485 individual patents. In 2006, we developed new innovations in powder coatings for temperature sensitive substrates—MDF and plastic—including ultra violet curing technology. We invested significantly in creating new special effects and colors and also concentrated on developing specific performance attributes, such as anti-corrosion, antibacterial, and anti-fingermarking properties. These products found markets in coatings for furniture, shop fittings, automotive plastic components, personal computers, and in insulating products for wind turbines and hybrid car engines.

A more integrated organizational structure was introduced in 2006 designed to capitalize on the strength of our global position. The organization is now structured more along functional lines at country, regional and global levels.

This provides a high degree of alignment throughout the business and allows us to leverage our global strengths. One example is the purchase of raw materials, where the new structure allows us to implement a coordinated global approach focusing on global and regional preferred suppliers, thereby enhancing control of quality and prices. Another example is in R&D, which we have organized into a series of Centers of Expertise located in different countries around the world. This not only brings product development closer to the world of our customers, but also allows new developments to be deployed on a global scale. For example, in the United States and Germany, we have centers dedicated to automotive coatings; in Italy and China the focus is on domestic appliances; while France and Australia concentrate on fashion and design. These centers focus on local customers initially, but the products they develop are then rolled-out globally.

With regards to the future, our focus is on strong revenues growth in North America and Europe, and double-digit growth for Eastern Europe and Asia Pacific as more companies shift from liquid to powder and from mature to emerging markets.

### **Marine & Protective Coatings**

*Revenues 2006: EUR 1,129 million; 2005: EUR 975 million*

Marine & Protective Coatings enjoyed sustained revenues growth in 2006 as double-digit volume increases and internal cost savings more than offset high raw material prices and adverse currency effects. Revenues were up 16%, exceeding EUR 1 billion for the first time.

Our financial performance—which vindicated our strategy of growth through leadership—was strong despite unprecedented price rises in key raw materials such as copper and zinc, which squeezed Marine Coatings' margins in particular. Margins were also under pressure from higher oil prices. We reduced costs by improving supply chain efficiency, especially in manufacturing and delivery. Productivity was boosted at almost all our plants, both through centrally-driven and local initiatives.

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Each of our activities—Marine Coatings, Protective Coatings, Yacht Paints, and Aerospace Coatings—increased sales volumes in emerging markets, where we have invested significantly and generate an ever greater proportion of our business. We also grew in mature markets, where we implemented the bulk of our productivity improvements.

Creating and marketing added-value products that offer our customers clear operational and financial benefits is a key driver of our strategy. An additional objective is to ensure that our product range causes as little harm to the environment as possible. During the year, we launched a host of innovative and groundbreaking products in each of our activities.

In Marine, with the International® brand name, we launched the second generation of Intersleek®—our premium biocide-free antifouling product—for a wide range of vessels, including liquid natural gas tankers and container fleets. The new Intersleek® 900 series reduces fuel consumption, saving costs for customers and enhancing our margin. Intersleek® and ballast tank coating Intershield® grew sales further in 2006. Our performance in the marine new-building market in Korea and China was particularly strong.

In Protective Coatings, we launched Intertherm® 751, which offers excellent corrosion protection in high temperature environments, including oil and gas installations, chemical plants, and power stations. We also launched Intercure® 99, a cost-effective, single-coat product which helps to increase throughput at paint shops. In addition, we expanded our range of fire protection products with Chartek® 1709—a strong competitor to concrete which offers thinner and better steel coating.

Yacht Paints performed well, benefiting in particular from a vibrant superyacht sector. The Awlgrip® range—a powerful brand which sets the industry standard for topsides—was revitalized and performed especially well. As did the International® range of market-leading underwater antifouling products.

We introduced several new and innovative products to an aerospace market which continues to grow briskly. High quality coatings are crucial for aircraft. They must be able to withstand temperatures ranging from minus 55°C in the air to plus 55°C on the ground. They also have to cope with ultra-violet irradiation at 30,000 feet.

Aeroflex® HS is a special, lower weight wing coating which retains high flexibility throughout its service life. ECLG 854—a two-component aerosol for touching up aircraft exteriors—made an instant market impact on its launch in 2006 and was swiftly adopted by major logistics companies and airlines. Finally, we signed a commercial licensing agreement with the North Dakota State University Research Foundation which made us the first to develop aerospace products containing breakthrough chromate-free technology. This patented technology has the same anticorrosive properties as toxic chromate, but is safer to use.

Looking ahead, we expect the recent strength in the oil and gas market to continue and with it major investment in exploration and production. That should benefit Protective Coatings, along with the continued strong investment in installations such as power stations and waste water treatment facilities. Marine Coatings should benefit from increased activity in liquid natural gas tankers.

Our best response to challenges such as raw material prices and currency volatility is the strength of our industry-leading, high-value products. Innovative new products such as those launched in 2006 should ensure that we maintain the leadership positions we have established in the years to come.

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**Car Refinishes***Revenues 2006: EUR 922 million; 2005: EUR 886 million*

Car Refinishes continued the turnaround which began in 2005 by producing strong results in all business segments and regions in 2006. We improved our financial performance with increased restructuring to cut costs, along with further technology improvements, especially in Asia. The restructuring initiatives and cost improvement measures that we launched several years ago are clearly paying off.

Revenues rose 4% to EUR 922 million, with all business lines contributing. Our automotive plastics business is experiencing growth in sales and profitability as the automotive industry in general is continually expanding its range of plastic components, including door handles, bumpers and interiors. A challenge in 2006, however, was static production by auto-makers in Europe and North America. We compensated by boosting our sales to higher-growth auto-makers in Asia, South America and Mexico.

The traditional aftermarket for Car Refinishes, made up of repairers, will continue to feel pressure from over-capacity in North America and Europe. However, gains are being made due to strong marketing programs such as e-benchmarking and a focus on our reputation for best-in-class color technology.

In Asia—where we opened a new color development lab in India—revenues were strong and outpaced market growth. Europe, the Middle East, and Africa booked significant improvements, attributable to cost reductions and increased customer focus. In the Americas, Car Refinishes demonstrated a major improvement over 2005. We achieved this through continued production efficiencies, reduced cost structures, and increased focus on meeting local customer requirements.

Product introductions in 2006 included a high speed undercoat, and Autoclear® UV — a new UV-curable topcoat which outperforms all other clearcoats on the market for drying time, thus allowing for a substantial increase in bodyshop productivity. We also developed new car interior paints, with a focus on styling and special effect coatings. These “soft feel” coatings — which mimic leather — are used heavily in the interior components of many vehicles.

Everything we do is driven by our clear, customer-focused strategy. Fostering and developing strong relationships with our customers is fundamental to our business operations. Collision repair shops require the very best colors, at the best price. Producing coatings that are highly efficient to apply, with minimal waste, saves our customers money, as well as reducing emissions. By producing innovative new products that dry quicker, we enable our customers to paint more cars thus improving their customer service levels and profitability.

Another development during 2006 was our introduction of new brand and distributor strategies. These plans will drive volume and follow the requirements of the many markets in which we operate. We adapt our distribution to meet local needs, whether selling directly to importers or independent distributors. In Japan, one of our more mature markets, we rejuvenated our sales by creating new sales teams and using newly-developed marketing tools. In Europe, the Middle East, and Africa, we realigned our distribution networks to better meet local needs. We also offset some of the pressure from raw material costs by implementing new arrangements with our suppliers.

Our research and development investments yielded profitable technologies. Approval was received from General Motors to use the more environmentally-friendly Autowave® water-borne technology for warranty repairs on their new vehicles. We developed this technology in Europe, and effective technology transfer allowed us to capitalize on this in the United States. The commitment is strong to remain ahead of environmental regulations through advanced R&D efforts, and by taking a leadership position with the regulatory agencies around the globe.

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We now operate color development laboratories that work closely with car manufacturers across the world. These can be found in countries such as Mexico, the Netherlands, Indonesia and India. By working together with these manufacturers—including Toyota, General Motors, Volkswagen, Hyundai, and Renault—we are able to obtain advance information about color styling trends.

Our aspiration is to increase revenues growth in the years ahead, even as we continue to focus on our cost base to complete the turnaround. We intend to invest heavily in color development, marketing tools and training, as this is vital to the car refinishes business.

## **CHEMICALS**

### **Business Review**

The strategic realignment of Akzo Nobel Chemicals was successfully concluded in 2006, two years after it was initiated. This restructuring has transformed a relatively large and fragmented range of business segments into a focused, market-driven portfolio. All five Chemicals business units now have a clearly defined strategy for continued performance improvement and growth.

Akzo Nobel Chemicals has achieved a significant financial turnaround in recent years. The divestment of 14 businesses between 2004 and 2006 took a modest toll on revenues. Yet the strategic logic of divesting those businesses showed in our ROI, which rose from 12% in 2003 to 17% in 2006. Revenues excluding divestments grew by 5% from 2005 to 2006, with operating income before incidentals of EUR 351 million, on a par with 2005. Including incidentals, operating income grew 16% to EUR 362 million.

The new clarity of direction is important for our employees, customers, and investors. Creating five strong and focused growth platforms resulted in a new sense of confidence about the position of Chemicals within Akzo Nobel. For the near future, we see four growth drivers for Chemicals. First, to grow in close cooperation with our customers. Second, to invest in emerging markets in China, South America and Eastern Europe. Third, to focus on innovative and more environmentally-friendly products and applications. And finally, to step up our selective acquisitions, a process which has already begun.

China will play a pivotal role in our strategic development in Asia during the coming years. We already operate six chemical plants in China and plan to expand this rapidly. In November 2006, Pulp & Paper Chemicals opened a second Chinese facility—in Guangzhou—to further service the booming Chinese paper industry. Demand for Polymer Chemicals is also high, and we are investigating the possibility of opening a third Polymer Chemicals site in China. Surfactants signed a marketing alliance with Feixiang Chemicals Ltd., while Functional Chemicals is expected to open a new Chinese plant in June 2007 for producing polysulfides, which is used in the aerospace and glass industries.

As part of our growth strategy, on April 26, 2007, we announced that we will spend EUR 250 million on building two chemicals plants in China, the first confirmed investments in a new multi-site being established by the company in Ningbo. As announced last October, a 50 hectare plot has been reserved within the Ningbo Chemical Industry Zone (NCIZ) and the two new facilities—for the manufacture of ethylene amines and chelating agents—will be the first to be constructed on what will be one of the biggest sites for the company's activities in the world. Work will begin once the relevant approvals have been obtained from the Chinese authorities.

Brazil is another dynamic market which has our attention. Our Pulp & Paper Chemicals business—the global market leader in bleaching—invested EUR 70 million in a second bleaching plant in Bahia. In paper chemicals, we

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are a strong player in traditional markets such as Europe and North America, and we are expanding rapidly in emerging economies.

Our Base Chemicals business was boosted by significant investments amounting to EUR 120 million in the production of chlorine at our Dutch sites in Delfzijl and Rotterdam. Akzo Nobel's efficient and unique production chain in energy, salt and chlorine ensures Base Chemicals' market leadership in North Western Europe.

Two important internal initiatives were also launched during the year, both of which have been introduced at all five businesses. The first is designed to further improve safety performance at all sites around the world, while the second is focused on improving margins.

### **Developments in the Chemicals Business Units**

#### **Pulp & Paper Chemicals**

*Revenues 2006: EUR 966 million; 2005: EUR 893 million*

Pulp & Paper Chemicals performed well in 2006 as increased turnover, higher volumes, contained costs, and an enhanced product mix drove our improved financial performance. Although we experienced steep increases in energy prices—mainly in Europe—by capitalizing on strong demand and our product portfolio, revenues grew by 8% to EUR 966 million.

Demand for our pulp bleaching products was particularly robust. Revenues increased substantially in the fast-developing markets of Asia and South America, and there was also growth in North America.

We doubled our Asia capacity with the opening of a second paper chemicals plant in China. This facility—in Guangzhou, Southern China—will give us production capacity closer to our customers in that region, in line with our strategy of building a strong presence in the expanding markets and remaining the preferred supplier of bleaching and performance chemicals to the worldwide pulp and paper industry.

The steady flow of innovative product launches continued and we maintained our tempo of patent applications. A key launch during 2006 was Purate®, a novel concept to the paper industry which uses chlorine dioxide as a biocide to prevent microorganism and bacteria generation in paper mills.

Following the success in North America of our Compozil® retention chemicals system in the wood-containing paper sector, we increased sales by successfully marketing the concept in other parts of the world. Our specialty products—including Kromasil® separation products, Expancel® microspheres and the Permascand® activities—are making good progress.

Our divestments of recent years are paying off in the shape of a more streamlined business with increased room for growth. We are constantly improving our own cost efficiency, applying cost reductions in the supply chain, along with improved inventory management.

We plan to pursue our growth drive—particularly in Asia and South America—while continuing to contain costs in mature markets. Our sights are set on organic growth, though we do not rule out acquisitions that would create synergies. We will also strive to work even more closely with customers to carve out a greater role in the chemical supply chain. In this regard, operating plants on site at our customers' premises—a highly successful model which is becoming increasingly popular—will play an important role.

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To gain market share, we plan to launch innovative new products and technologies, which in turn will help to make our customers more cost efficient. That means investing time, resources and competence. In order to better help customers to optimize their systems and reduce their own costs, we will also accelerate the introduction of new industrial IT tools.

### **Base Chemicals**

*Revenues 2006: EUR 767 million; 2005: EUR 787 million*

Overall, 2006 was a challenging but successful year for Base Chemicals. Although energy prices continued to rise, we achieved similar results to 2005. Our strong financial performance was supported by the implementation of a comprehensive internal restructuring and efficiency program, which significantly offset higher energy costs. After a period of reorganization, we are now well placed to further strengthen our market leadership positions.

The opening in September of a new state-of-the-art chlorine plant at Delfzijl in the Netherlands—inaugurated together with Functional Chemicals—new MCA facility—was an important step in balancing the production and consumption of chlorine. Nearly 90% of Akzo Nobel's chlorine production is now based on modern membrane electrolysis technology, which is yielding substantial energy savings.

In the chlor-alkali segment, we completed our asset restructuring and modernization program in 2006. We have reduced the number of chlorine plants from seven to five. Following the plant closures in 2005 at Bohus, Sweden, and Delfzijl, the Netherlands, the Dutch chlorine plant in Hengelo was also shut down last June.

This effectively ended Akzo Nobel's regular chlorine transports by rail in the Netherlands.

Also in 2006, Gasunie and Nuon began construction work on an underground gas storage facility in the north of the Netherlands. Base Chemicals is facilitating this investment by constructing a special type of salt cavern suitable for this application.

Energy is the lifeline for the Base Chemicals business, which since 2005 has consisted of four activities—Energy, Salt, Chlor-Alkali and Ecosystems. The last two years have seen an unprecedented rise in the price of gas, our main fuel. In an effort to reduce our dependency on gas, we have taken steps to create a more balanced fuel mix. At our Salt plant in Mariager, Denmark, a new steam boiler is under construction which will run on biomass (wood chips) instead of gas. At other locations, we are exploring options to use steam supply from local waste incineration units. As well as cutting our energy bills, these projects will be more beneficial for the environment.

Steep gas prices have also led to high electricity costs, particularly in the Netherlands, where the dependency on gas for power generation is much higher than in the surrounding countries. We are participating in a Dutch consortium for the purchase of electricity which is generated by using cheaper solutions. The consortium, which is made up of Akzo Nobel and several other energy-intensive companies, is pursuing discussions with power suppliers and the Dutch government.

At two of our Dutch plants—Delfzijl and Rotterdam—we outsourced technical services during 2006 to Stork. Most of the employees were transferred to the new owner. At the Delfzijl chemical park, the operations of MA/CC and Methanor, a minority shareholding, were closed. For redundant staff, a social plan was agreed with unions. We are pleased that the divestments and plant closures could take place without collective forced lay-offs. In the meantime, the former Methanor business resumed production of methanol under new ownership with the aim of converting feedstock away from natural gas.

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Increasing safety in the production process topped the Base Chemicals agenda in 2006 and our ambition is to have zero incidents in operations.

Looking ahead, Base Chemicals will continue to build on the integrated product chain of Energy, Salt, Chlor-Alkali and Chlorine Derivatives. Our goal is to further develop our alliances with key customers, who are growing faster than their market competitors.

### **Functional Chemicals**

*Revenues 2006: EUR 740 million; 2005: EUR 703 million*

For Functional Chemicals, 2006 was a year of mixed results. Continued strong global demand led to solid growth and substantially higher revenues. However, temporary setbacks in production and planned maintenance costs negatively affected our financial performance. Nevertheless, we look to the future with confidence. Our strong businesses have leading market positions, with a clear intention to grow and a very solid structural return on investment.

Revenues increased in 2006 by 5%, from EUR 703 million in 2005 to EUR 740 million. But margins were depressed by operational start-up costs in the Netherlands—where we opened a new MCA plant in Delfzijl—and planned maintenance stops in Sweden, where we further expanded the capacity of our Ethylene Amines and Cellulosic Specialties plants to meet global demand.

Another challenge was the significant further increase in raw material and energy costs, and passing these costs on to our customers is gradually being reflected in higher product prices.

Looking at some of the business— individual activities, in MCA (an intermediate used in the manufacture of various products), our global number one position improved further in 2006, with a double-digit increase in revenues. During the relocation from Hengelo to Delfzijl, our global production network proved essential in maintaining supply to our customers.

In Chelates (chemical products that bind metal ions), where we lead both in product range and in geographical spread, our financial performance improved significantly. This was attributable to strong sales developments and the positive impact of the group-wide margin management program. Ferrazone®—our iron compound used to fortify foods and beverages in order to reduce iron deficiency—is enjoying more widespread recognition and use, and is a highly sustainable solution for this global issue. We also strengthened our leading position in chelated micronutrients for agricultural use.

Although production of Ethylene Amines in Sweden temporarily slowed in the latter part of 2006 due to the major maintenance and capacity expansion stop, annual revenues showed substantial growth. The expansion of production capacity to 75 kilotons at our Swedish Stenungsund plant further reinforced our worldwide number two position.

Our Sulfur Products business also performed well, thanks to strong volume demand in the United States for all product lines. Polysulfides volumes grew, but financial performance declined slightly, albeit at a high level. We expect our strong global number one position in polysulfides to be enhanced by the completion of the new grassroots polysulfides plant in Taixing, China. This facility started up in the second quarter of 2007.

Although Cellulosic Specialties came under pressure from high raw material costs and fierce competition in most of its markets, revenues further increased in 2006. We are increasing production capacity for Bermocol®

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a rheology modifier used in paint and building products at the Örnsköldsvik plant in Sweden, which will be completed by mid-2007.

In October, Salt Specialties became part of Functional Chemicals and a roadmap is being developed aimed at improving the business performance. Restructuring and a strong focus on margin management are key elements in this plan.

Overall, the strong technology and market positions of our individual businesses continue to make Akzo Nobel Functional Chemicals a strong growth platform for the future. Growth, margin management and operational excellence continue to be our main priorities. Our strategic focus is on profitable growth and to that effect, we are exploring and pursuing investments in emerging markets, primarily China, which will improve our ability to meet the increasing local demand. Another priority is margin management, which is aimed at securing good profitability for our products at a time when raw material and energy prices remain at a high level.

We will also maintain vigilance on health and safety, where we are proud of our progress in recent years. The LeMoyne site in Alabama in the United States last year celebrated ten years of applying the behavior-based safety program, which is now being rolled out across all of the company's Chemicals plants. In 12 years, LeMoyne has not had a single lost time injury.

### **Surfactants**

*Revenues 2006: EUR 523 million; 2005: EUR 511 million*

Surfactants completed a year of renewal in 2006, growing revenues by 2% to EUR 523 million (2005: EUR 511 million). The year's escalating raw material and energy costs were largely offset by price increases. Meanwhile the business has grown to become the largest global supplier of specialty surfactants. In August, we strengthened our position in the Chinese market by signing an alliance agreement with the local market leader, Feixiang Chemicals Company Ltd, in Zhangjiagang.

This joint venture will market both companies' products in China, where the surfactants industry is enjoying double-digit growth rates. Akzo Nobel will be the exclusive distributor for Feixiang's surfactants outside of China.

In South America, our local manufacturing presence in Brazil is enabling us to create new business opportunities, while in Eastern Europe and Russia we are making inroads into the asphalt and agro-chemical segments via distributors and direct sales.

We also continued to optimize our operations during the year—the final phase of a restructuring plan which began in 2003. Two plants in the United States were expanded in order to consolidate operations from the McCook facility near Chicago, which will shut down in 2007. This will result in further reductions in our fixed cost structure. By mid-2007, the business will have reduced its manufacturing headcount by more than a third over a three-year period. General and administrative staff numbers have also fallen by around 25%.

Akzo Nobel's Surfactants business sells more than 1,500 surface-active agents and intermediate products to more than 2,500 customers. We have reduced complexity over the past few years and renewed our product range. Low-margin products have been pruned to reduce the total number by 20%, while the business has been simplified by transferring some smaller customers to our distributors, where they can be better served.

We are one of the industry leaders when it comes to introducing "greener" chemical products that are less toxic to the environment in applications such as offshore oilfield drilling and hard surface household cleaners. These products can be used in aqueous solutions or are more biodegradable. The European Union's REACH directive

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on product registration, which comes into effect in 2007, is another challenge for the industry. We have therefore been testing our products and have led various industry association consortia to use this regulation to our competitive advantage.

In 2006, we also conducted a worldwide Customer Satisfaction Survey among 400 of our customers in 50 countries. This resulted in positive feedback, which cited product quality, delivery reliability, and the relationship with our sales and technical service people as motives for buying our products.

With a keen eye on selected growth opportunities, we are now focused on expanding our higher value-added specialty products. Sales of new surfactants have grown to account for nearly a quarter of our total revenues.

We continue to see room for accelerated expansion in both the consumer and industrial sectors, based on innovations in our core technologies. For example, in 2006 we introduced new biodegradable hard surface cleaners, adjuvants and dispersants for agro-chemical formulations and viscoelastic surfactants for oilfield stimulation.

Although we hold leadership positions in all our regions, the EUR 4 billion specialty surfactants market still provides sufficient room to grow. Indeed, over the coming years, demand in specialty surfactants is expected to exceed gross domestic product growth in emerging markets such as China, India, South America and Eastern Europe.

Looking ahead, in 2007 we will shift our focus from restructuring toward growth by partnering with our customers that are market leaders. Awareness of what they need and expect from us provides a basis for growing with our partners in the years ahead. Our strategy here is to work closely with industrial leaders and provide technical assistance to solve their problems or enhance their products.

### **Polymer Chemicals**

*Revenues 2006: EUR 516 million; 2005: EUR 471 million*

For Polymer Chemicals, 2006 was a greatly improved year. Recent large-scale restructuring is now paying off, bringing our cost structure more in line with market reality. Our annual revenues rose steeply from EUR 471 million in 2005 to EUR 516 million in 2006, an increase of more than 10%. With profits showing a strong improvement compared with the previous two years, 2006 was a turnaround year for Polymer Chemicals.

Our results were enhanced by increasing demand in the global plastics market—especially in emerging economies—and by our ability to offset increases in raw material costs. In fact, the main driver of our growth has been the ongoing worldwide expansion of the plastics industry, which has been outpacing global economic growth for more than 30 years. In many industrial sectors, materials such as wood and metal continue to be replaced by plastics, while demand is growing in the emerging economies of China and India, in the Americas and the Middle East.

During 2006, we also took steps to combat the relentless rise in raw material prices—which has been impacting us for the last three years—by undertaking an internal project to help improve our margins. This strategy worked well, particularly in North America, where we concluded the divestment of our U.S. facility in New Jersey. Other important factors that contributed to our strong 2006 results included further enhancing relationships with customers and implementing ongoing internal efficiency programs.

Following the restructuring and reorganization of recent years, in 2006 we shifted our focus to growth and we expect to remain a major growth pillar in the years ahead. So it was encouraging to see all three of our activities

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Organometallic Specialties (OMS), High Polymer Specialties (HPS) and Cross-linking and Thermoset peroxides, and Polymer Additives (XTP) performed better than in 2005.

Our antifouling and suspending agents which are used in the PVC industry and had been underperforming for a number of years also achieved a positive turnaround in 2006.

Our customers appreciate our various services and our consistent reliability. They especially appreciate the service provided with respect to the safe handling and use of our products, which is an essential part of our business strategy.

We have also been busy implementing the group-wide behavior-based safety program, which is designed to further improve site safety among employees.

Looking at the future, our main products organic peroxides and metal alkyls have a strong position in emerging economies and we are looking at expansion opportunities and the development of these products for non-polymer applications. All these factors make us confident that Polymer Chemicals will remain a major growth driver in the years ahead.

## **SERVICE BUSINESSES**

### **Technology & Engineering**

Akzo Nobel Technology & Engineering (T&E) was created in April 2006 through the integration of service units mainly originating from the Chemicals group and Akzo Nobel Engineering. With a wide range of service products and support, T&E quickly fulfilled an evident need in the market, both inside and outside of Akzo Nobel.

By combining know-how and experience in engineering, inspection, technology, safety, health, environment, regulatory affairs, toxicology and sustainable development, we have raised the quality, efficiency and effectiveness of the total T&E organization to an even higher level.

Akzo Nobel T&E achieved a very successful first financial year. In 2006, our activities continued to thrive worldwide, mainly in the areas of chemicals, pharmaceuticals and the fiber industry. Our results are testament to the value we add for our customers both inside and outside Akzo Nobel. We are proud that work was never interrupted during the formation of T&E; clients were neither refused nor subjected to delays.

With offices in the United States, China, Sweden and the Netherlands, Akzo Nobel T&E employs around 260 permanent staff and 70 temporary employees.

## **SOURCES AND AVAILABILITY OF RAW MATERIALS**

Raw materials essential to our business are purchased in the normal course of business from numerous suppliers worldwide. Important raw materials or auxiliary materials for the company's production processes are salt, petroleum and petroleum derivatives, natural gas, titanium dioxide, and electricity. In principal, these materials are widely available from multiple sources. No serious shortages or delays were encountered in 2006 and although we expect to be able to meet our requirements from our strategic reserves in the foreseeable future, increases to the volume of production of any product may be impeded by the limited availability of certain raw materials.

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Although Akzo Nobel aims to use its purchasing power and long-term relationships with suppliers to acquire raw materials and their constant delivery at the best conditions, the company cannot assure that it will always be able to establish or maintain good relationships with such suppliers or that such suppliers will continue to exist or be able to supply ingredients in conformity with regulatory requirements or the company's requests.

## **MARKETING AND DISTRIBUTION**

The company sells its products in more than 130 countries. The sales, marketing and distribution functions are decentralized within the company. Each business unit has its own sales, marketing and distribution network for its products. The organization of these functions varies from business unit to business unit.

For the geographical distribution of sales, see Item 5 [Operating and Financial Review and Prospects].

### **Organon and Intervet**

The company sells its human-healthcare prescription medicines primarily through sales representatives to wholesale drug distributors, independent and chain pharmacies, hospitals, government entities and other institutions. The products are dispensed to the public through prescriptions written by physicians. Similar procedures generally apply for the animal-healthcare products, whereby representatives of the company visit veterinarians or farmers.

The company deploys sales forces of representatives and supporting medical staff to visit medical prescribers and healthcare purchasers or veterinarians to promote the company's (prescription) products.

However, the traditional relationship between the company and its ultimate customers is changing as a result of the Internet. Patients are better informed and want to have more of a say in their treatment. The Internet is a unique tool for establishing contacts between the company, the prescribers of its products, and the end users.

### **Coatings**

Coatings are sold through a range of distribution channels. The operations in the Decorative sector are serving the Retail (Do-it-yourself), Trade (Professionals) and Specialties markets. Due to concentration of retailers, their purchasing power is increasing. The products of the other coatings activities are mainly sold through a direct sales force, but often also commercial distribution channels are used.

### **Chemicals**

Chemical products are sold in a wide range of industries. These products are either marketed directly or through independent merchants, wholesalers, and distributors who resell them to smaller users. Commodity products are sold through a direct sales force or through distributors primarily to other operators in the chemical industry.

## **INTELLECTUAL PROPERTY**

The company's intellectual property portfolio includes numerous patents, trademarks, domain names, works of authorship, databases, and trade secrets. Where appropriate, the company seeks to obtain intellectual property rights in relevant regional markets by filing patent and trademark applications and by taking protective measures, such as confidentiality agreements with employees, customers, and suppliers. The company monitors new products, processes, trademarks, and works of competitors and enforces its

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intellectual property rights whenever and wherever advisable. The company challenges third party intellectual property rights and claims, whenever appropriate.

## **GOVERNMENT REGULATION**

Akzo Nobel's businesses are subject to the normal regulatory framework applicable to a pharmaceutical and chemical company, notably various health, safety and environmental rules both at national and local levels. The company also voluntarily conforms to a number of international and national codes of best practice appropriate to its business.

Besides the normal regulatory framework for chemical companies, the company is subject to more extensive regulations for the veterinary and human pharmaceutical industry<sup>1</sup>. The international pharmaceutical industry is highly regulated. National and supranational regulatory authorities administer numerous laws and regulations regarding the testing, approval, manufacturing, import, labeling, and marketing of drugs, and also review the safety and effectiveness of pharmaceutical and biological products. Further regulations exist on the non-clinical and clinical development of pharmaceutical and biological products in particular. These regulatory requirements are a major factor in determining whether a substance can be developed into a marketable product and the amount of time and expense associated with such development.

The introduction of new pharmaceutical products generally entails a lengthy regulatory approval process. Of particular importance is the requirement in all major countries that products be authorized or registered by governmental regulatory authorities prior to marketing and that such authorization or registration is maintained subsequently. The regulatory process requires increased testing and documentation for clearance of new drugs and vaccines, and a corresponding increase in the expense of product development. To register such a product, a registration file containing evidence regarding the quality, safety and efficacy of the product must be submitted to regulatory authorities. The registration process may take one to several years, depending on the jurisdiction, the quality of the data submitted, the efficiency of the registration authority's procedures, and the nature of the product.

In the United States, applications for drug registration are submitted to and reviewed by the United States Food and Drug Administration (FDA). Registrations of veterinary vaccines are reviewed by the US Department of Agriculture (USDA) in a slightly different procedure. The FDA regulates the testing, approval, manufacturing, labeling, and marketing of pharmaceutical products intended for commercialization in the United States, as well as the monitoring of all pharmaceutical products currently on the U.S. market. The pharmaceutical development and registration process is intensive, lengthy, and rigorous. A new drug application is filed with the FDA if the data demonstrate sufficient quality, safety, and efficacy. The new drug application must contain all the specific information that has been gathered and also covers all subjects tested in clinical trials. Very similar requirements apply to field trials for veterinary drugs and to vaccine registrations with the USDA.

If the FDA or the USDA, as the case may be, approves a new drug application, the new drug becomes available for physicians or veterinarians to prescribe.

Thereafter for human drugs, the drug license owner must submit periodic update reports to the FDA, including any cases of adverse reactions. For some drugs, the FDA requires additional studies to evaluate long-term effects or to gather information on the use of the product under special conditions. The FDA also requires compliance with standards relating to laboratory, clinical, and manufacturing practices.

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<sup>1</sup> In this section, the term "pharmaceutical industry" encompasses both human and animal healthcare, unless specifically indicated.



In the European Union (EU), there are two types of marketing authorization, namely the Community Authorisation (Community responsibility) and the National Authorisation (responsibility of the competent authorities of the Member States). A Community Authorisation is obtained via the Centralized Procedure (CP). In the CP, applications are made to the European Medicines Agency (EMA) for review and a scientific opinion by its Committees. The EMA's opinion is forwarded to the European Commission for authorization, which is valid across all EU member-states. The CP is mandatory for biotechnology products, orphan medicinal products, and for products containing a new active substance developed for some specifically defined indications (e.g. AIDS, cancer). It is optional for products containing new active substances, products which constitute a significant therapeutic, scientific or technical innovation or products for which a Community authorization would be in the interest of patient health at community level.

When a National Authorisation is needed in more than one member state the Mutual Recognition Procedure (MRP) or the Decentralised Procedure (DP) needs to be followed. In the MRP, a first authorization is granted by a single EU member-state. Subsequently, mutual recognition of this first authorization can be sought from the remaining EU member-states. In the DP, a Reference Member State prepares an assessment report based on its own assessment and contributions from the Concerned Member States. Potentially serious public health concerns that cannot be resolved during the DP or MRP will be referred to a Co-ordination Group followed by a referral procedure (and a binding Commission decision) if no consensus is reached. EU member-states also run their own pharmacovigilance systems to which post-marketing adverse events are reported. The EMA coordinates the pharmacovigilance activities within the EU. In the EU, pharmaceutical companies have to comply with GLP, GMP, and GCP regulations in order to develop, produce, and test pharmaceutical and biological products.

In Japan, applications for marketing authorization are made to the Pharmaceutical and Medical Devices Organization (PMDA). After a check on GLP and GCP compliance and a reliability review of the data, the PMDA performs a scientific review of the NDA application and prepares a review report. This review report is forwarded to the Ministry of Health, Labor and Welfare (MHLW). The review report of the PMDA is also forwarded to the Pharmaceutical Affairs Food & Sanitation Council (PAFSC), a consultative body to the MHLW. After advice from the PAFSC, only the Minister of MHLW is authorized to issue a license. For veterinary products, a similar procedure applies whereby the Ministry of Agriculture, Forestry and Fisheries is authorized to issue licenses.

## PRICE CONTROLS

In addition to the forms of regulation already referred to, in many countries the prices of human pharmaceutical products are controlled by law and are subject to drug reimbursement programs with varying price control mechanisms. Governments may also influence the prices of pharmaceutical products through their control of national healthcare organizations, which may bear a large part of the cost of supplying such products to consumers. Generic substitution becomes an increasingly important issue worldwide, and it is actively supported by governmental and healthcare policies in several countries.

In the United States, debate over the reform of the healthcare system has resulted in an increased focus on pricing. Although there are currently no government price controls over private sector purchases in the United States, federal legislation requires pharmaceutical manufacturers to pay prescribed rebates on certain drugs to enable them to be eligible for reimbursement under certain healthcare programs. In the absence of new government regulation, managed care has become a potent force in the market place that increases downward pressure on the prices of the pharmaceutical products. In addition, the current national debate over Medicare costs could increase pricing pressures. As of January 1, 2006, Medicare pays for

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outpatient pharmaceutical coverage for beneficiaries and the U.S. government could use its enormous purchasing power to demand discounts from pharmaceutical companies thereby creating de facto price controls on prescription drugs. On the other hand, Medicare coverage of outpatient pharmaceuticals may increase the volume of pharmaceutical drug purchases, offsetting, at least in part, potential price discounts. As a result, we expect that pressure on pricing and operating results will continue.

In the EU, governments influence the price of human pharmaceutical and biological products through their control of national healthcare systems that fund a large part of the cost of such products to consumers. The downward pressure on healthcare systems in general, particularly prescription drugs, has become very intense. As a result, increasingly high barriers are being erected to the entry of new products, as exemplified by the National Institute for Clinical Excellence in the United Kingdom, which evaluates the data supporting new medicines and passes reimbursement recommendations to the government. In addition, in some countries cross-border imports from low-priced markets (parallel imports) exert a commercial pressure on pricing within a country.

In Japan, the National Health Ministry biannually reviews the pharmaceutical prices of individual human products. In the past, these reviews have resulted in price reductions. It is expected that the Japanese government will perform a healthcare reform and that the pharmaceutical pricing system will be one of the issues closely looked at. Key issues are the evaluation of innovative products and the pricing of long-listed products, including the biannual reduction of reimbursement prices adjusted for actual discounts given.

## **C. ORGANIZATIONAL STRUCTURE**

For a description of the organization of the company see B. Business Overview.

Reference is made to Exhibit 8 for a list of the company's subsidiaries.

## **D. PROPERTY, PLANT AND EQUIPMENT**

A substantial portion of Akzo Nobel's principal production plants and research facilities are located in Europe and North America. Akzo Nobel's principal production plants and research facilities are located in the Netherlands, Germany, United Kingdom, Sweden, France, Italy, the United States, Brazil, and China. In total, Akzo Nobel has over 300 production plants throughout the world.

The most important production sites for Pharma are in Oss and Boxmeer, the Netherlands; Swords, Ireland; Durham, North Carolina; and DeSoto, Kansas.

The major Coatings sites are based in Montataire, France; Sassenheim and Groot Ammers, the Netherlands; Cologne, Stuttgart, and Osterwick, Germany; Barcelona, Spain; Como, Italy; Malmö, Sweden; Felling and Darwen, United Kingdom; Wloclawek, Poland; Tiszaujváros, Hungary; Elefsis, Greece; Gebze, Turkey; Casablanca, Morocco; Longueuil, Canada; Columbus, Ohio, High Point, North Carolina, and Houston, Texas, United States; São Paulo, Brazil; Donguan, Shanghai, Ningbo, and Shenzhen, China.

For Chemicals, the major production sites are located in Delfzijl, Hengelo, and Rotterdam, the Netherlands; Bohus and Stenungsund, Sweden; Pasadena, Texas; and Bahia, Brazil.

Akzo Nobel's policy is generally to own its facilities. The net book value of its property, plant equipment was EUR 3.3 billion at December 31, 2006. The book value of property, plant and equipment financed by

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installment buying and leasing was EUR 54 million at December 31, 2006. Akzo Nobel has rented certain offices and warehouses by means of operational leases.

Akzo Nobel believes that its production plants and research facilities are well maintained and generally adequate to meet its needs for the foreseeable future.

Further discussions on relevant developments in property, plant and equipment are included in Item 4.B under B  [Business Review and Developments at Business Units](#).

For environmental issues affecting the company's properties, reference is made to Legal Proceedings in Item 8  [Financial Information](#).

#### **Item 4.A UNRESOLVED STAFF COMMENTS**

None.

#### **Item 5. OPERATING AND FINANCIAL REVIEW AND PROSPECTS**

The following discussion is based on the consolidated financial statements of Akzo Nobel included in this annual report under Item 18 and should be read in conjunction with those statements and the other financial information included herein, including the industry segment information and information by geographical area.

The consolidated financial statements of Akzo Nobel appearing in this annual report are prepared in accordance with IFRS, which differ in certain respects from US GAAP. The significant differences between IFRS and US GAAP affecting Akzo Nobel's net income and shareholders' equity are described in Note 27 of the Notes to the Consolidated Financial Statements of Akzo Nobel.

Any trends, uncertainties, demands, commitments, or events that are reasonably likely to have a material effect on the company's revenues, income from operations, profitability, liquidity or capital resources, or that would cause the reported financial information not necessarily to be indicative of future operating results or financial condition, if any, are discussed in the relevant chapters below. For developments in the first quarter of 2007 reference is made the Report for the 1<sup>st</sup> Quarter of 2007, which has been furnished on Form 6-K to the Commission on April 24, 2007, which is incorporated by reference into this Annual Report.

On March 12, 2007, the company announced its intention to divest Organon BioSciences to Schering-Plough following their EUR 11 billion binding cash offer. The parties expect the transaction could be completed in the second half of 2007, after consultation with social parties and clearance from regulatory bodies.

#### **2006 COMPARED TO 2005**

##### **Revenues, Cost, and Income**

Net income (attributable to equity holders of the company) was up EUR 192 million or 20% from EUR 961 million to EUR 1,153 million, which is EUR 4.02 per share (2005: EUR 3.36) . Excluding incidentals, net income amounted to EUR 872 million, up 19% on 2005, when it was EUR 735 million.

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| <i>Millions of euros; for the year-ended December 31</i> | <b>Statement of income</b> |            |
|--|----------------------------|------------|
|  | 2006                       | 2005       |
| Revenues   | 13,737                     | 13,000     |
| Cost of sales  | (7,394)                    | (7,070)    |
| Gross profit   | 6,343                      | 5,930      |
| Selling expenses   | (3,436)                    | (3,214)    |
| Research and development expenses                        | (885)                      | (810)      |
| General and administrative expenses                      | (749)                      | (680)      |
| Other operating income                                   | 189                        | 260        |
| Operating income   | 1,462                      | 1,486      |
| Financing income   | 126                        | 125        |
| Financing expenses                                       | (237)                      | (281)      |
| Operating income less financing income and expenses      | 1,351                      | 1,330      |
| Share in profit of associates                            | 89                         | 6          |
| Profit before tax  | 1,440                      | 1,336      |
| Income taxes   | (258)                      | (338)      |
| Profit for the period                                    | 1,182                      | 998        |
| Attributable to:   |                            |            |
| Equity holders of the company (net income)               | 1,153                      | 961        |
| Minority interest  | 29                         | 37         |
| Profit for the period                                    | <b>1,182</b>               | <b>998</b> |

**Revenues**

Revenues amounted to EUR 13.7 billion, up 6% on last year. This was mainly attributable to autonomous (especially volume) growth across all segments. Coatings showed a strong growth of 12%, of which 4% was obtained from recent acquisitions. Revenues of the ongoing operations of Chemicals achieved a robust growth of 5%, mostly from higher selling prices. Organon realized revenues growth of 8%, driven by strong sales of NuvaRing® and fertility products. Intervet performed well across all regions and product ranges, delivering 6% autonomous growth. On balance, currency translation had no impact on revenues for the full year.

Akzo Nobel's total revenues developed as follows:

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**Currency Divestments/**

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| <i>In %</i>       | <b>Total</b> | <b>Volume</b> | <b>Price</b> | <b>translation</b> | <b>acquisitions</b> |
|-------------------|--------------|---------------|--------------|--------------------|---------------------|
| Organon           | 8            | 8             | □            | □                  | □                   |
| Intervet          | 3            | 6             | □            | □                  | (3)                 |
| Coatings          | 12           | 6             | 2            | □                  | 4                   |
| Chemicals         | (2)          | 1             | 4            | □                  | (7)                 |
| <b>Akzo Nobel</b> | <b>6</b>     | <b>4</b>      | <b>2</b>     | □                  | □                   |

**Operating Income**

Operating income before incidentals was EUR 1,310 million, up EUR 158 million or 14% compared with 2005. EBIT margin was 9.5% (2005: 8.9%) . Organon, up EUR 92 million or 34%; and Coatings, with an increase of EUR 95 million or 22%, led the way. Intervet's operating income was up EUR 4 million or 2%, while Chemicals maintained its results at the same level, in spite of divestments. Including incidentals, operating income for the year decreased 2% from EUR 1,486 million to EUR 1,462 million, with an EBIT margin of 10.6% (2005: 11.4%).

**Incidentals**

Incidentals, on balance, contributed EUR 152 million, which was EUR 182 million lower than the previous year. Special benefits of EUR 55 million were mainly attributable to a change in the U.S. post retirement healthcare plan and the transition to a defined contribution scheme for certain U.S. pension plans. The results on divestments of EUR 213 million were derived from the sale of a Coatings plant near Barcelona and the Chemicals divestment plan. The restructuring and impairment charges of EUR 112 million related to various restructuring activities at Coatings and Chemicals. Changes in the provisions for antitrust and environmental cases resulted, on balance, in a charge of EUR 4 million. In 2005, incidentals resulted in a gain of EUR 334 million, mainly due to the settlement of certain Organon cases, changes in the Dutch pension and other postretirement plans, and restructuring and impairment charges.

**R&D Expenses**

Akzo Nobel's R&D expenses were EUR 885 million, which is equivalent to 6.4% of revenues. For 2005, this was EUR 810 million and 6.2%, respectively. In 2006, Organon spent 19% of its revenues on R&D. The Intervet ratio amounted to 10%, while for Coatings and Chemicals this ratio remained unchanged at around 3%.

**Net Financing Charges**

Financing income and expenses decreased from EUR 156 million in 2005 to EUR 111 million in 2006, due to lower interest charges for discounted provisions. Interest on net interest-bearing borrowings was also lower due to decreased net liabilities (2006: EUR 95 million; 2005: EUR 115 million). Interest coverage improved from 9.5 to 13.2. EBITDA coverage was 18.1 (2005: 13.2) .

**Share in profit of associates**

Share in profit of associates was EUR 89 million, up EUR 83 million compared with 2005. Operational earnings of the associates increased to EUR 50 million (2005: EUR 43 million). In 2006, earnings included incidental gains of EUR 39 million, mainly related to Acordis, while in 2005 net incidental losses of EUR 37 million were recognized, primarily due to the impairment of Methanor.

**Income Taxes**

Income taxes included a one-time benefit of around EUR 125 million. This benefit was attributable to an agreement with tax authorities in several countries on transfer pricing issues related to the company's corporate income tax filings covering a period of almost ten years. Excluding this benefit, the tax rate of 2006 amounted to 28%, which was higher than the previous year (2005: 25%).

**Restructuring of Activities**

Provisions for restructuring of activities comprise accruals for certain employee termination benefits and for costs which are directly associated with plans to exit specific activities, primarily related to costs associated with closing down facilities.

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| <i>Millions of euros</i>  | <b>Termination<br/>benefits</b> | <b>Exit<br/>costs</b> | <b>Total<br/>provision</b> |
|---|---------------------------------|-----------------------|----------------------------|
| Balance at December 31, 2004  | <b>168</b>                      | <b>73</b>             | <b>241</b>                 |
| Changes in exchange rates   | □                               | 2                     | 2                          |
| Additions charged to income as restructuring charge under incidentals | 48                              |                       | 48                         |
| Other additions charged to income                                     | 3                               | 14                    | 17                         |
| Utilization   | (71)                            | (38)                  | (109)                      |
| Amounts reversed during the year                                      | (9)                             | (2)                   | (11)                       |
| Unwind of discount  | 8                               | 3                     | 11                         |
|   | <hr/>                           | <hr/>                 | <hr/>                      |
| Balance at December 31, 2005  | <b>147</b>                      | <b>52</b>             | <b>199</b>                 |
| Changes in exchange rates   | (1)                             | □                     | (1)                        |
| Additions charged to income as restructuring charge under incidentals | 74                              | 27                    | 101                        |
| Other additions charged to income                                     | 5                               | 3                     | 8                          |
| Utilization   | (90)                            | (29)                  | (119)                      |
| Amounts reversed during the year (mainly as incidental)               | (23)                            | (6)                   | (29)                       |
| Unwind of discount  | 3                               | □                     | 3                          |
| Divestiture   | (1)                             | □                     | (1)                        |
|   | <hr/>                           | <hr/>                 | <hr/>                      |
| Balance at December 31, 2006  | <b>114</b>                      | <b>47</b>             | <b>161</b>                 |

*2006 movements*

For the additions charged to income mainly relate to various restructurings at Coatings and Chemicals. At Coatings it predominantly concerns sites in the mature markets and in Morocco. Chemicals' additions include the restructuring programs at the Hengelo and Delfzijl sites in the Netherlands. The additions to termination benefits involve approximately 1,160 jobs at various sites all over the world.

During 2006, the total amount paid and charged against the related liability amounted to EUR 90 million for termination benefits and EUR 29 million for exit costs. These payments and charges all concerned the execution of plans decided upon during 2006 and prior years.

The company has a sizeable number of restructuring programs involving personnel reductions at numerous sites all over the world, none of which are individually significant to the consolidated financial statements of the company.

*2005 movements*

For the additions charged to income reference is made to the disclosure under restructuring and impairment charges in 2005 compared to 2004. The additions to termination benefits involve approximately 645 jobs at various sites all over the world.

During 2005, the total amount paid and charged against the related liability amounted to EUR 71 million for termination benefits and EUR 38 million for exit costs. These payments and charges all concerned the execution of plans decided upon during 2005 and prior years.

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The company has a sizeable number of restructuring programs involving personnel reductions at numerous sites all over the world, none of which are individually significant to the consolidated financial statements of the company.

### **Number of employees**

The number of employees developed as follows:

| <i>Number of employees</i> | <b>December 31, 2006</b> | <b>Restructurings</b> | <b>Acquisitions/divestments</b> | <b>Other changes</b> | <b>December 31, 2005</b> |
|----------------------------|--------------------------|-----------------------|---------------------------------|----------------------|--------------------------|
| Organon                    | 13,710                   | (200)                 | (260)                           | 70                   | 14,100                   |
| Intervet                   | 5,370                    | (40)                  | □                               | 150                  | 5,260                    |
| Coatings                   | 31,660                   | (620)                 | 1,970                           | 1,110                | 29,200                   |
| Chemicals                  | 9,680                    | (300)                 | (1,230)                         | (220)                | 11,430                   |
| Others                     | 1,460                    |                       |                                 | 110                  | 1,350                    |
| <b>Akzo Nobel</b>          | <b>61,880</b>            | <b>(1,160)</b>        | <b>480</b>                      | <b>1,220</b>         | <b>61,340</b>            |

At the end of 2006, the company had 61,880 employees, compared with 61,340 at year-end 2005. Growth of our business in emerging markets resulted in a workforce expansion of 1,220, while restructuring programs in Coatings, Chemicals, and Organon in the mature markets resulted in a decrease of 1,160. Acquisitions (2,000) and divestments (1,520) on balance added 480.

### **Revenues and Operating Income by Activities**

Earnings development per group was as follows.

| <i>Millions of euros</i>  | <b>Revenues</b> |               | <b>Operating income</b> |              |
|---|-----------------|---------------|-------------------------|--------------|
|   | 2006            | 2005          | 2006                    | 2005         |
| Organon   | 2,611           | 2,425         | 354                     | 415          |
| Intervet  | 1,125           | 1,094         | 219                     | 238          |
| Coatings  | 6,209           | 5,555         | 604                     | 384          |
| Chemicals   | 3,809           | 3,890         | 362                     | 312          |
| Miscellaneous products, intragroup deliveries, and eliminations | (17)            | 36            | (77)                    | 137          |
| <b>Total</b>  | <b>13,737</b>   | <b>13,000</b> | <b>1,462</b>            | <b>1,486</b> |

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**Organon**

| Country of origin        | Percentage<br>of revenues<br>2006 |
|--------------------------|-----------------------------------|
| The Netherlands          | 15                                |
| Germany                  | 5                                 |
| United Kingdom           | 5                                 |
| France                   | 8                                 |
| Other European countries | 22                                |
| USA and Canada           | 26                                |
| Latin America            | 8                                 |
| Asia                     | 9                                 |
| Other regions            | 2                                 |

Organon returned to growth in 2006. The turnaround which began in 2005 accelerated in 2006. The consistent strategy has been to build on the strength of Organon's existing portfolio of gynecology, fertility and anesthesia products while reinforcing the neuroscience portfolio and developing initiatives in the field of biotechnology.

The existing Organon product portfolio has resulted in higher revenues, which generated improved operating income. Compared with 2005, revenues climbed 8% in 2006 to EUR 2,611 million. Sales of Organon's key products developed as follows:

| <i>Millions of euros or %</i> | 2006<br>revenues | Total<br>change<br>% | Autonomous<br>growth % <sup>1</sup> |
|-------------------------------|------------------|----------------------|-------------------------------------|
| Contraceptives                | <b>669</b>       | 19                   | 18                                  |
| – of which NuvaRing®          | <b>213</b>       | 68                   | 67                                  |
| Puregon® /Follistim®          | <b>384</b>       | 8                    | 8                                   |
| Remeron®                      | <b>253</b>       | (11)                 | (11)                                |
| Anesthesia                    | <b>242</b>       | 27                   | 28                                  |
| Livial®                       | <b>151</b>       | (2)                  | (2)                                 |
| Pharmaceutical ingredients    | <b>255</b>       | 12                   | 2                                   |

1 Autonomous sales growth is defined as the change in sales attributable to changed volumes and selling prices. In this case it only excludes the change in sales attributable to currency translation effects. Acquisitions and divestments were not applicable. Reference is made to the remarks under Introduction on page 4.

Operating income before incidentals grew 34% to EUR 362 million, while the EBIT margin increased to 13.9% from 2005's 11.1%. Our operating margins have increased. We succeeded in compensating for lower Remeron® sales caused by increased competition from generics by boosting sales in other products, such as the contraceptive NuvaRing® and the fertility treatment Puregon®. Including incidentals, operating income decreased 15% to EUR 354 million. It should be noted that 2005 included the special benefit of EUR 149 million from the termination of the Risperdal® copromotion.

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By increasing efficiencies in production, we managed to decrease working capital and further improve EBIT margins. Further streamlining initiatives included the closing of activities in Scotland. All initiatives together resulted in a reduction in total headcount of 390.

Organon strives to find the right balance between improving its margin and spending the necessary amounts on R&D and marketing and sales for new products. Maintaining a well-filled pipeline of promising products is key to our growth strategy. Investment in 2006 focused on pipeline growth, which generated a significant increase in R&D spending to EUR 485 million, or 19% of revenues, from 18% the previous year.

The fertility product Puregon®/Follistim® and the innovative contraceptive NuvaRing® were the greatest contributors to Organon's advance and helped to improve the market positions of our products. NuvaRing®, which booked 67% global sales growth, topped the 1.5 million user mark worldwide, highlighting its increasing acceptance and high satisfaction rate. Demand for NuvaRing® was especially strong in the United States, where sales were supported by direct-to-customer campaigns and increased positive media attention. NuvaRing® was also approved for the Australian market, bringing to 32 the number of countries in which it has been introduced.

Puregon®/ Follistim®, the recombinant follicle-stimulating hormone which is Organon's biggest seller, saw sales rise 8%. The world welcomed its one millionth "Puregon baby" during 2006. The product has now been introduced in China, while sales in Japan took off after being launched there in late 2005.

The U.S. Food and Drug Administration (FDA) approved the innovative contraceptive implant Implanon®, after which it was launched on to the U.S. market in late 2006. Initial feedback from U.S. physicians on Implanon®, the first and only single-rod implantable contraceptive, has been positive. Sales of Implanon® increased 39% in 2006 and it is well placed to join NuvaRing® and Puregon®/Follistim® as one of Organon's leading products in 2007 and beyond.

Within our hormone therapy portfolio, sales of Livial®, which is currently being marketed in around 90 countries, were flat in 2006.

Anesthesia revenues grew 27%, boosted by muscle relaxant Esmeron® and the injectable Anzemet®, for postoperative nausea and vomiting. Anzemet®, which is licensed in by Organon from sanofi-aventis for the United States only, added to the already strong anesthesia franchise in the United States.

Neuroscience products turned in a satisfactory performance in 2006. Reinforcing this portfolio in the short and medium-term is high on our agenda. Remeron®, which represents around 10% of Organon revenues, continued its overall steady worldwide decline, but sales still increased in some countries.

Pharmaceutical ingredients sales showed a positive trend.

Royalties and services revenues were mainly attributable to royalty payments from Janssen on Risperdal® sales in selected countries and from GlaxoSmithKline on sales from Arixtra®. Service revenues were received mainly from Ligand, with whom our co-promotional collaboration on Avinza® was ended by the end of September 2006, although the royalty income from the product will remain for a number of years.

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**Intervet**


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| <b>Country of origin</b> | <b>Percentage<br/>of revenues<br/>2006</b> |
|--------------------------|--|
| The Netherlands          | 32   |
| Germany                  | 10   |
| United Kingdom           | 4  |
| France                   | 5  |
| Other European countries | 16   |
| USA and Canada           | 16   |
| Latin America            | 9  |
| Asia                     | 4  |
| Other regions            | 4  |

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Intervet maintained its track record of steady revenues growth, attractive operating margins and new product introductions in 2006. Our continued revenues growth is the best proof of our successful strategy of organic growth, selected acquisitions of products, components or companies, and in-licensing.

Revenues increased 3% to EUR 1,125 million. The livestock segment, which excluding feed additives represents nearly 80% of our turnover, saw revenues rise 7%. This was achieved despite consolidation among our livestock clients. Revenues in the companion animal segment grew by 7%, benefiting from increasing global prosperity: wealthier populations are more willing and able to spend money caring for their pets. Operating income before incidentals grew by 2% to EUR 213 million, equivalent to an EBIT margin of 18.9%. The latter was affected by various one-time cost effects relating to inventory write-offs and further investment in the marketing and distribution infrastructure, as well as selected restructuring measures at various sites. Operating income of EUR 219 million decreased by 8%, largely due to reduced one-off income relating to divestment activities.

Revenues in Europe—where Intervet generates 52% of its turnover—rose a healthy 5%, despite unfavorable business conditions triggered by the threat of avian influenza in early 2006. North America performed well with a 12% revenues increase, while Latin America recorded 8% growth. Overall, comparative revenues performance was influenced by the divestment of medicinal feed additives initiated in 2005. We have now divested most of our international feed additive range.

Intervet bolstered its strong presence in its core market segments of vaccines and pharmaceuticals, with both areas achieving equally strong growth.

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**Coatings**

| <b>Business unit</b>             | <b>Percentage<br/>of<br/>revenues<br/>2006</b> | <b>Country of origin</b> | <b>Percentage<br/>of<br/>revenues<br/>2006</b> |
|----------------------------------|--|--------------------------|--|
| Decorative Coatings              | 36   | The Netherlands          | 6  |
| Industrial Coatings and Finishes | 31   | Germany                  | 10   |
| Marine & Protective Coatings     | 18   | Sweden                   | 7  |
| Car Refinishes                   | 15   | United Kingdom           | 9  |
|                                  |  | France                   | 7  |
|                                  |  | Other European countries | 21   |
|                                  |  | USA and Canada           | 17   |
|                                  |  | Latin America            | 4  |
|                                  |  | Asia                     | 15   |
|                                  |  | Other regions            | 4  |

Akzo Nobel Coatings came back on track in 2006. We consolidated our position as the world's leading coatings company, and our increasing reach and strength enabled us to even better serve our customers, and to harness global economic expansion to accelerate our profitable growth.

We returned to our strategic path of continuous financial improvement, pushing return on investment (ROI) back up to 21.1% . Including incidentals, ROI was 24.6% . Revenues rose 12% to EUR 6.2 billion, with operating income before incidentals up 22% to EUR 518 million. Including incidentals, operating income was up 57%, due to sizeable gains on divestments in 2006, predominantly of the site near Barcelona, Spain.

A key driver of our growth was our strength in Asian markets such as China, Korea and Vietnam, which were ebullient in 2006. We opened two new plants in China, for powder and decorative coatings. Another crucial factor was our customer-driven corporate culture, which allows us to anticipate and react quickly to customer demands. Akzo Nobel Coatings delivered further on its long-held strategy of growing organically while solidifying its world-leading position through selective acquisitions. Akzo Nobel became the number one decorative coatings player in Canada through the acquisition of coatings company Sico Inc., and we established ourselves as a top-three player in the U.S. woodcare market with the purchase of the Flood Group. The company also strengthened its presence in emerging markets—where more than a third of our Coatings revenues are generated—by acquiring leading Czech coatings company Balakom and the Ukraine's Khimrezerv.

European industrial markets were unexpectedly vibrant. Our wood, coil, powder and protective coatings businesses all grew well in Western Europe. However, European retail markets were disappointing, and our Decorative Coatings Europe business delivered unsatisfactory results, especially in mature markets, where consumer spending was weaker and competition intense.

As of January 1, 2007, we have merged Decorative Coatings Europe and Decorative Coatings International into one integrated global business unit with regional sub-units. This will allow us to better co-ordinate key strategies for branding, product range and geographical expansion, whilst keeping local customer focus. It will also allow us to better leverage our scale in R&D, purchasing and production.

A significant development during 2006 was the successful turnaround of Car Refinishes, which demonstrated our ability to overhaul underperforming businesses. Our Specialty Plastics operation was a dynamic growth engine

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with its coatings for Apple's sought-after products and mobile phones from Nokia, Motorola and Sony Ericsson. We continued our flow of innovative product launches, including the next generation of our marine coating Intersleek®, the Duraflex® non-stick powder coating for cookware, and an ultra-fast drying automotive topcoat from Sikkens® called Autoclear® UV. In June, we launched the first ever Global Coatings Report, cementing our position as a knowledge leader in the industry. However, the year was not without its challenges. Although less severe than in 2005, increases in raw material prices once again created pressure on margins. We addressed this partly by passing on some of the price rises to customers, and partly by changing the formulation of certain products to reduce their use of costly raw materials. We became more assertive with suppliers and shifted some of our supplier base to emerging markets.

Steps were taken to start reducing our operating working capital, which remains too high. We will continue our efforts over the coming years to cut operating working capital as a percentage of sales to the level of our best-performing peers. We should continue to benefit from expected high growth in emerging countries, adding capacity in these areas, and we will critically assess our cost base, especially in mature markets. Opportunities to improve our financial performance will be exploited and we expect further growth in revenues. Akzo Nobel Coatings is in good shape, but we still intend to seize every opportunity to further improve our performance and remain optimistic about the future.

### Chemicals

| Business unit  | Percentage  | Country of origin        | Percentage  |
|--|-------------|--------------------------|-------------|
|  | of revenues |                          | of revenues |
|  | 2006        |                          | 2006        |
| Pulp and Paper Chemicals                                   | 25          | The Netherlands          | 24          |
| Base Chemicals   | 20          | Germany                  | 10          |
| Functional Chemicals                                       | 19          | Sweden                   | 21          |
| Surfactants  | 14          | UK                       | 1           |
| Polymer Chemicals  | 14          | Other European countries | 10          |
| Activities to be divested / classified<br>as held for sale | 8           | USA and Canada           | 23          |
|  |             | Latin America            | 4           |
|  |             | Asia                     | 6           |
|  |             | Other regions            | 1           |

The strategic realignment of Akzo Nobel Chemicals was successfully concluded in 2006, two years after it was initiated. This restructuring has transformed a relatively large and fragmented range of business segments into a focused, market-driven portfolio. All five Chemicals business units now have a clearly defined strategy for continued performance improvement and growth.

Akzo Nobel Chemicals has achieved a significant financial turnaround in recent years. The divestment of 14 businesses between 2004 and 2006 took a modest toll on revenues. Yet the strategic logic of divesting those businesses showed in our ROI, which rose from 12% in 2003 to 17% in 2006. Revenues excluding divestments grew by 5% from 2005 to 2006, with operating income before incidentals of EUR 351 million, on a par with 2005. Including incidentals, operating income grew 16% to EUR 362 million.

The new clarity of direction is important for our employees, customers, and investors. Creating five strong and focused growth platforms resulted in a new sense of confidence about the position of Chemicals within Akzo Nobel. For the near future, we see four growth drivers for Chemicals. First, to grow in close cooperation with our

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customers. Second, to invest in emerging markets in China, South America and Eastern Europe. Third, to focus on innovative and more environmentally-friendly products and applications. And finally, to step up our selective acquisitions, a process which has already begun.

China will play a pivotal role in our strategic development in Asia during the coming years. We already operate six chemical plants in China and plan to expand this rapidly. In November 2006, Pulp & Paper Chemicals opened a second Chinese facility in Guangzhou to further service the booming Chinese paper industry. Demand for Polymer Chemicals is also high, and we are investigating the possibility of opening a third Polymer Chemicals site in China. Surfactants signed a marketing alliance with Feixiang Chemicals Ltd., while Functional Chemicals will open a new Chinese plant in June 2007 for producing polysulfides, which is used in the aerospace and glass industries.

Brazil is another dynamic market which has our attention. Our Pulp & Paper Chemicals business the global market leader in bleaching invested EUR 70 million in a second bleaching plant in Bahia. In paper chemicals, we are a strong player in traditional markets such as Europe and North America, and we are expanding rapidly in emerging economies.

Our Base Chemicals business was boosted by significant investments amounting to EUR 120 million in the production of chlorine at our Dutch sites in Delfzijl and Rotterdam. Akzo Nobel's efficient and unique production chain in energy, salt and chlorine ensures Base Chemicals market leadership in North Western Europe.

Two important internal initiatives were also launched during the year, both of which have been introduced at all five businesses. The first is designed to further improve safety performance at all sites around the world, while the second is focused on improving margins.

Our internal realignment has clearly worked and all market indicators tell us we have chosen the right path. Akzo Nobel Chemicals is well set for growth.

## Geographic Developments

| <i>Millions of euros</i>  | <b>Revenues,<br/>by destination</b> |               | <b>Revenues,<br/>by origin</b> |               | <b>Operating<br/>income</b> |              | <b>Identifiable<br/>assets</b> |               |
|---|-------------------------------------|---------------|--------------------------------|---------------|-----------------------------|--------------|--------------------------------|---------------|
|   | 2006                                | 2005          | 2006                           | 2005          | 2006                        | 2005         | 2006                           | 2005          |
| The Netherlands   | 915                                 | 862           | 2,072                          | 2,459         | 25                          | 474          | 3,165                          | 3,061         |
| Germany   | 1,209                               | 1,238         | 1,208                          | 1,152         | 87                          | 144          | 696                            | 750           |
| Sweden  | 523                                 | 516           | 1,284                          | 1,237         | 98                          | 137          | 863                            | 863           |
| United Kingdom  | 781                                 | 809           | 798                            | 754           | 24                          | (59)         | 664                            | 690           |
| Other European countries  | 4,245                               | 4,075         | 3,073                          | 3,069         | 579                         | 527          | 2,266                          | 2,112         |
| USA and Canada  | 2,711                               | 2,400         | 2,732                          | 2,116         | 248                         | (67)         | 2,093                          | 1,959         |
| Latin America   | 924                                 | 830           | 747                            | 626           | 120                         | 85           | 610                            | 619           |
| Asia  | 1,755                               | 1,590         | 1,440                          | 1,231         | 241                         | 192          | 940                            | 1,017         |
| Other regions   | 674                                 | 680           | 383                            | 356           | 40                          | 53           | 252                            | 329           |
| Eliminations, cash and cash equivalents, and investment in associates |                                     |               |                                |               |                             |              | 1,236                          | 1,025         |
| <b>Total</b>  | <b>13,737</b>                       | <b>13,000</b> | <b>13,737</b>                  | <b>13,000</b> | <b>1,462</b>                | <b>1,486</b> | <b>12,785</b>                  | <b>12,425</b> |

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Revenues and earnings in 2006 were only slightly affected by changes in key foreign currencies relative to the euro.

Revenues by country of destination in the Netherlands mainly increased at Organon due to the agreement with the tax authorities, while the other segments were at or slightly below last year's level. In Germany, Coatings revenues grew while Chemicals' sales decreased due to the divestments. The increase of revenues by destination in the other European countries and in North America mainly increased as a result of the Sico acquisition at Coatings. Revenues of Organon in the United States were substantially up due to a strong growth of NuvaRing®, as a consequence of the direct-to-customer advertising campaign since November 2005. Revenues in Latin America increased at all segments. Growth in Asia also continued, especially at Coatings.

In 2006, operating income in the Netherlands decreased considerably compared to 2005, in which year sizeable benefits were realized from the change in pension and other postretirement benefit arrangements (EUR 283 million). Pensions accounting was also the cause of the changes in operating income in Germany and the United Kingdom. The decline in operating income Sweden was attributable to the Chemicals divestments made. The increase in US operating income related to a strong performance of NuvaRing®, pensions, and impairment charges recognized in 2005 at several units. Latin America and Asia operating income increased at all segments.

#### **2005 COMPARED TO 2004**

Net income (attributable to equity holders of the company) was up 2% compared with 2004 and amounted to EUR 961 million, which is EUR 3.36 per share (2004: EUR 3.31) . Organon earnings were up due to increased revenues and to income derived from deals with other pharma companies. Premarketing costs and R&D expenses were higher as a consequence of our investments in future growth. Intervet's EBIT was up substantially. Coatings revenues showed satisfactory growth of 6% but margins were under pressure from increased raw material prices and weaker European economies, especially in the first half of the year. In the second half, performance of the industrial coatings activities improved. Chemicals present operations achieved robust growth in revenues and EBIT, despite higher energy and raw material prices.

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**Revenues, Cost, and Income**

| <i>Millions of euros; for the year-ended December 31</i> | <b>Statement of income</b> |            |
|--|----------------------------|------------|
|  | 2005                       | 2004       |
| Revenues   | 13,000                     | 12,833     |
| Cost of sales  | (7,070)                    | (6,988)    |
| Gross margin   | 5,930                      | 5,845      |
| Selling expenses   | (3,214)                    | (3,288)    |
| Research and development expenses                        | (810)                      | (826)      |
| General and administrative expenses                      | (680)                      | (684)      |
| Other operating income                                   | 260                        | 480        |
| Operating income   | 1,486                      | 1,527      |
| Financing income   | 125                        | 109        |
| Financing charges, net                                   | (281)                      | (253)      |
| Operating income less financing income and expenses      | 1,330                      | 1,383      |
| Share in profit of associates                            | 6                          | 14         |
| Profit before tax  | 1,336                      | 1,397      |
| Income taxes   | (338)                      | (416)      |
| Profit for the period                                    | <b>998</b>                 | <b>981</b> |
| Attributable to:   |                            |            |
| Equity holders of the company (net income)               | 961                        | 945        |
| Minority interest  | 37                         | 36         |
| Profit for the period                                    | <b>998</b>                 | <b>981</b> |

**Revenues**

Revenues from our present operations amounted to EUR 13.0 billion, up 6% on last year. This was mainly attributable to autonomous growth across all segments. Organon's revenues decline in recent years was reversed with growth of 3%. Intervet performed well, delivering 7% growth. Coatings and Chemicals realized healthy autonomous growth of 4%. On balance, currency translation had a slight positive effect during the year.

Akzo Nobel's total revenues developed as follows:

| <i>In %</i>                   | <b>Total</b> | <b>Volume</b> | <b>Price</b> | <b>Currency translation</b> | <b>Divestments/ acquisitions</b> |
|-------------------------------|--------------|---------------|--------------|-----------------------------|----------------------------------|
| Organon                       | 3            | 2             | □            | 1                           | □                                |
| Intervet                      | 7            | 5             | 1            | 2                           | (1)                              |
| Coatings                      | 6            | (1)           | 5            | 1                           | 1                                |
| Chemicals, present operations | 4            | 1             | 3            | □                           | □                                |

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|                   |          |          |          |          |                        |
|-------------------|----------|----------|----------|----------|------------------------|
| <b>Akzo Nobel</b> | <b>1</b> | <b>1</b> | <b>3</b> | <b>1</b> | <b>(4)<sup>1</sup></b> |
|-------------------|----------|----------|----------|----------|------------------------|

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1 Includes the effect of the Chemicals businesses divested in 2004.

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**Operating Income**

Operating income excluding incidentals from present operations was EUR 1,152 million, on balance down 6% compared with 2004. EBIT margin was 8.9% (2004: 10.0%) . Total operating income for the year decreased by 3% from EUR 1,527 million to EUR 1,486 million with an EBIT margin of 11.4% (2004: 11.9%) .

Organon's earnings were up on the previous year due to revenues growth of 3% and the special benefits derived from deals with other pharma companies. NuvaRing® and Puregon® were the main drivers of revenues growth. The decline of Remeron® sales was less than expected. Sales of Livial® were slightly down. Intervet earnings were boosted by strong autonomous growth of 6% and improved supply chain management. In the first half year, Coatings earnings were impacted by significantly increased raw material prices and weaker European economies, while in the second half, the industrial coatings activities delivered a strong performance. Earnings from the present Chemicals operations were up 18%, despite higher energy and raw material prices.

The special benefits are attributable to the termination of the Risperdal® copromotion contract (EUR 149 million) and the settlement with Duramed/Barr on their infringement of Organon's rights to the Mircette® patent (EUR 109 million). In addition, the new Dutch defined contribution pension plan and the termination of the postretirement healthcare scheme resulted in a release of provisions of EUR 283 million. The divestment of Intervet's feed additives business and the company's stake in Svensk Ethanolkemie resulted in a profit of EUR 44 million. The restructuring and impairment charges of EUR 169 million were due to programs at Organon's active pharmaceutical ingredients business and several Coatings and Chemicals projects. The settlement of the last Remeron® court case cost EUR 64 million, while a charge of EUR 39 million was recorded for additions to the provision for antitrust cases.

**Incidentals**

Incidentals are special benefits, results on divestments, restructuring and impairment charges, and charges related to major legal, antitrust, and environmental cases.

**Special Benefits**

In 2005, the special benefits mainly relate to the termination of the Risperdal® copromotion (EUR 149 million), the settlement with Duramed/Barr on Mircette (EUR 109 million), the release of provisions due to termination of the postretirement healthcare plan in the Netherlands, and the change to a defined contribution plan in the Netherlands (EUR 283 million). In 2004, the special benefits mainly related to the full transfer of Arixtra® to Sanofi-Synthélabo (EUR 54 million), the early entrance fee for a marketing license for Remeron® in Germany, and the settlement of insurance claims for the West Orange site.

**Results on divestments**

Results on divestments in 2005 mainly concern the divestment of Intervet's feed additives business and the divestment of the company's interest in Svensk Ethanolkemie AB. In 2004, the gain on the divestments is mainly related to the divestment of Catalysts, Phosphorus Chemicals, and Coating Resins.

**Legal, antitrust, and environmental cases**

Charges related to major legal, antitrust, and environmental cases for 2005 include EUR 64 million for the settlement of the last Remeron® case, EUR 39 million for antitrust cases, and EUR 9 million for environmental risks at derelict sites of companies acquired in the past. In 2004, these charges related to antitrust (EUR 102 million), Remeron® cases (EUR 89 million), and environmental cases (EUR 11 million).

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**Restructuring and Impairment Charges**

The restructuring and impairment charges in 2005 consist of the following elements:

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*Millions of euros*

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|                      |              |
|----------------------|--------------|
| Asset impairments at |              |
| □ Organon            | (67)         |
| □ Coatings           | (5)          |
| □ Chemicals          | (49)         |
| Restructurings at    |              |
| □ Organon            | (3)          |
| □ Coatings           | (31)         |
| □ Chemicals          | (14)         |
| <b>Total</b>         | <b>(169)</b> |

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In 2005, the asset impairments mainly relate to Organon's active pharmaceutical ingredients activities and the Chemicals McCook plant in the United States. Organon's active pharmaceutical ingredients activities are under pressure from difficult market circumstances, leading to a pre-tax impairment charge of EUR 67 million. The impairment of the McCook plant was the result of restructuring of the production capacity in order to address the more competitive environment in which the Surfactants business operates. In addition, several smaller impairments at Chemicals and Coatings were recognized. Restructuring charges relate to several relatively smaller plans within the company and comprise accruals for employee benefits and for costs directly associated with plans to exit specific activities and to close down facilities. For all restructurings a detailed formal plan exists, and the implementation of the plan has started or the plan has been announced.

**R&D Expenses**

Akzo Nobel's R&D expenses were EUR 810 million, which is equivalent to 6.2% of revenues. For 2004, this was EUR 826 million and 6.4%, respectively. In 2005, Organon spent 18% of its revenues on R&D. The Intervet ratio amounted to 10%, while for Coatings and Chemicals this ratio remained unchanged at around 3%.

**Net Financing Charges**

Financing charges increased from EUR 144 million in 2004 to EUR 156 million in 2005 due to higher interest charges on discounted provisions (2005: EUR 41 million; 2004: EUR 21 million). However, interest on net interest-bearing borrowings was lower due to decreased net liabilities (2005: EUR 115 million; 2004: EUR 123 million). Interest coverage decreased from 10.6 to 9.5. EBITDA coverage was 13.2 (2004: 14.5).

**Share in profit of associates**

The share in profit of associates was EUR 6 million, down EUR 8 million compared to 2004. The overall operational performance of the associates on balance improved slightly, as higher results for Flexsys and most of the other Chemicals joint ventures more than offset the earnings decline at Methanor and the loss of earnings from the divested Catalysts joint ventures. 2005 earnings include net incidental losses of EUR 37 million (2004: EUR 29 million). These concerned an impairment charge for Methanor and charges related to guarantees for environmental costs at Acordis.

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**Income Taxes**

The tax charge decreased from 30% in 2004 to 25% in 2005. This is attributable to the geographical mix of the company's results and favorable settlements of certain tax disputes.

**Number of employees**

The number of employees developed as follows:

| <i>Number of employees</i> | <b>December 31, 2005</b> | <b>Restructurings</b> | <b>Other changes</b> | <b>December 31, 2004</b> |
|----------------------------|--------------------------|-----------------------|----------------------|--------------------------|
| Organon                    | 14,100                   | □                     | 10                   | 14,090                   |
| Intervet                   | 5,260                    | □                     | (10)                 | 5,270                    |
| Coatings                   | 29,200                   | (500)                 | 840                  | 28,860                   |
| Chemicals                  | 11,430                   | (390)                 | (70)                 | 11,890                   |
| Others                     | 1,350                    | (30)                  | 40                   | 1,340                    |
| <b>Akzo Nobel</b>          | <b>61,340</b>            | <b>(920)</b>          | <b>810</b>           | <b>61,450</b>            |

At the end of 2005, the company had 61,340 employees, virtually unchanged from year-end 2004. Growth of our business in emerging markets and acquisitions resulted in a workforce expansion of 810, while restructuring programs in Coatings and Chemicals in the mature markets resulted in a decrease of 920.

**Revenues and Operating Income by Activities**

Earnings development per group was as follows.

| <i>Millions of euros</i>  | <b>Revenues</b> |               | <b>Operating income</b> |              |
|---|-----------------|---------------|-------------------------|--------------|
|   | 2005            | 2004          | 2005                    | 2004         |
| Organon   | 2,425           | 2,344         | 415                     | 275          |
| Intervet  | 1,094           | 1,027         | 238                     | 184          |
| Coatings  | 5,555           | 5,237         | 384                     | 406          |
| Chemicals   | 3,890           | 4,317         | 312                     | 869          |
| Miscellaneous products, intragroup deliveries, and eliminations | 36              | (92)          | 137                     | (207)        |
| <b>Total</b>  | <b>13,000</b>   | <b>12,833</b> | <b>1,486</b>            | <b>1,527</b> |

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**Organon**

| <b>Country of origin</b> | <b>Percentage<br/>of revenues<br/>2005</b> |
|--------------------------|--|
| The Netherlands          | 31   |
| Germany                  | 2  |
| United Kingdom           | 2  |
| France                   | 4  |
| Other European countries | 34   |
| USA and Canada           | 12   |
| Latin America            | 5  |
| Asia                     | 8  |
| Other regions            | 2  |

2005 was a turning point for Organon, as the organization established a solid base for future growth. Organon's revenues in 2005 (EUR 2,425 million, up 3%) started growing again following several years of declining sales since Remeron® lost its market exclusivity in the United States. The strong performances of Puregon® and NuvaRing® were instrumental in contributing to this return to growth in 2005.

Sales of Organon's key products developed as follows:

| <i>Millions of euros or %</i> | <b>2005<br/>revenues</b> | <b>Total<br/>change<br/>%</b> | <b>Autonomous<br/>growth %<sup>1</sup></b> |
|-------------------------------|--------------------------|-------------------------------|--|
| Contraceptives                | <b>564</b>               | 8                             | 7  |
| - of which NuvaRing®          | <b>127</b>               | 57                            | 58   |
| Puregon® /Follistim®          | <b>355</b>               | 20                            | 24   |
| Remeron®                      | <b>283</b>               | (22)                          | (22)                                       |
| Livial®                       | <b>154</b>               | (4)                           | (6)  |
| Pharmaceutical ingredients    | <b>228</b>               | 8                             | 8  |

1 Autonomous sales growth is defined as the change in sales attributable to changed volumes and selling prices. In this case it only excludes the change in sales attributable to currency translation effects. Acquisitions and divestments were not applicable. Reference is made to the remarks under Introduction on page 4.

Operating income showed strong growth compared to the previous year (EUR 415 million, up 51%) despite rising R&D expenses, the settlement of the last lawsuit for Remeron® in the United States, and an impairment charge of EUR 67 million in the pharmaceutical ingredients unit. Organon received significant cash amounts from Johnson & Johnson for terminating the copromotion contract for Risperdal® and from Duramed/Barr for the patent litigation settlement involving our oral contraceptive Mircette®.

Organon's contraceptive vaginal ring, NuvaRing®, which has now been introduced in more than 25 countries, is also continuing to enjoy steadily increasing sales in many markets. After a successful pilot in three states, a direct-to-consumer advertising campaign was launched in November to promote NuvaRing® throughout the United States, mainly consisting of television commercials.

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Puregon/Follistim®, Organon's biotech fertility product, has become one of our biggest selling products. Performance was particularly boosted by strong U.S. sales resulting from a successful launch of the Follistim Pen and product line extensions. In 2005, Puregon®/Follistim® was also introduced in Japan and China.

For Livial® in the United States, additional data was submitted to the FDA in December 2005. In June 2006, however, the FDA determined that the NDA submitted for this product was not approvable.

### **Nobilon**

The development of human influenza vaccines by Nobilon, in cooperation with Organon and Intervet, is progressing according to schedule.

Nobilon is in the process of upscaling its influenza antigen production based on cell culture technology.

### **Intervet**

| <b>Country of origin</b> | <b>Percentage<br/>of revenues<br/>2005</b> |
|--------------------------|--|
| The Netherlands          | 34   |
| Germany                  | 13   |
| United Kingdom           | 5  |
| France                   | 5  |
| Other European countries | 12   |
| USA and Canada           | 15   |
| Latin America            | 9  |
| Asia                     | 3  |
| Other regions            | 4  |

Intervet produced consistently strong results during 2005, as the strategic initiatives introduced in recent years began to pay off. Revenues increased by 7% to EUR 1,094 million, with volume growth being the main contributor. These increased volumes and the resulting boost in earnings were favorably impacted by efficiency improvements in manufacturing, supply chain, and marketing, and the result on the divestment of the feed additives business. Intervet was therefore able to deliver an operating income of EUR 238 million, up 29% from 2004 and equivalent to an EBIT margin of 21.8% .

We further expanded our strong market position in Europe where the business generates more than 50% of its revenues and our development in North America was characterized by growth in key areas, while sales in Latin America were boosted by substantial growth in Brazil and Chile. This strong growth was achieved even though a number of disposals took place, with Intervet divesting interests in noncore areas such as the diagnostic and feed additive activities.

Intervet will continue to sharpen its focus on major food and companion animal markets, and we expect to see similarly positive trends beyond 2005, when new products resulting from our extensive research and development programs should enhance our existing portfolio.

Looking at 2005 in more detail, market gains in Europe were largely attributable to improved supplies and the strong sales growth of Cobactan®, our innovative range of anti-infective formulations based on the

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proprietary molecule cefquinome. In North America, sales were buoyed by new product introductions in the companion animal sector, including Vetsulin® (the first insulin to treat diabetes in dogs) and Continuum® (a combination vaccine with long-lasting immunity). The recently launched cattle bioline Vista® also received a very positive response. Latin American performance was boosted by major growth in Brazil (in various markets) and in Chile, where the main driver was increased sales of fish vaccines. In Asia, where large areas have been severely affected by outbreaks of avian influenza, business is growing.

The acquisition of AgVax Developments Ltd enables Intervet to benefit from AgVax's close collaboration with its former parent company, AgResearch, New Zealand's largest Crown Research Institute.

During 2005, we divested large parts of our feed additive business. These activities no longer fitted into our core business operations and had become distanced from Intervet's strategic focus.

### Coatings

| Business unit                    | Percentage<br>of<br>revenues<br>2005 | Country of origin        | Percentage<br>of<br>revenues<br>2005 |
|----------------------------------|--------------------------------------|--------------------------|--------------------------------------|
| Decorative Coatings              | 36                                   | The Netherlands          | 7                                    |
| Industrial Coatings and Finishes | 31                                   | Germany                  | 10                                   |
| Marine & Protective Coatings     | 17                                   | Sweden                   | 7                                    |
| Car Refinishes                   | 16                                   | United Kingdom           | 10                                   |
|                                  |                                      | France                   | 8                                    |
|                                  |                                      | Other European countries | 21                                   |
|                                  |                                      | USA and Canada           | 15                                   |
|                                  |                                      | Latin America            | 4                                    |
|                                  |                                      | Asia                     | 13                                   |
|                                  |                                      | Other regions            | 5                                    |

Coatings experienced a tough year due to steeply rising raw material prices and difficult economic conditions in mature markets, especially in Western Europe. Our businesses addressed these issues by focusing on tight cost control and by pushing through price increases. Coatings managed to keep profits at an acceptable level, although the ROI excluding incidentals slipped to just below 20%. Including incidentals, ROI was 17.8% .

Revenues grew autonomously by 4%, mainly fueled by growth in the emerging markets of Asia Pacific, Eastern Europe, and the Middle East. During the year, we opened two new Powder Coatings facilities and two Decorative Coatings plants in China and Vietnam. We also announced the acquisition of the Chinese decorative coatings company Guangzhou Toide Paint Manufacturing Co. (which was completed in the first quarter of 2006), established a Powder Coatings joint venture in Egypt, and invested in the construction of a new Powder Coatings plant in Russia. At the end of 2005, emerging markets represented 34% of our worldwide sales.

The industrial activities put in a strong performance especially in the second half of 2005. Successful marketing initiatives expanded the business base and the average pricing in all markets improved. Marine & Protective Coatings had another good year. Higher sales of added-value products are offering clear operational and financial benefits to our customers, while the growth in target developing markets continues. Car Refinishes results remained under pressure and restructuring programs are being carried

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out to address this situation. The performance of Decorative Coatings showed a mixed picture. In some of the large western European countries results were under pressure, while in the emerging markets earnings improved.

In mature markets, we continued to improve our portfolio through selective acquisitions. During 2005, we acquired Swiss Lack, the leading supplier of decorative coatings in Switzerland; ICI's German industrial wood finishes business Zweihorn GmbH; and BASF's joinery business Glasurit®. In addition, we continued to further expand the commercial distribution network of our European Decorative Coatings business by acquiring a number of wholesalers in Germany, the largest market for architectural paints in Europe.

### Chemicals

| Business unit                          | Percentage of revenues |  | Country of origin        | Percentage of revenues |    |
|--|------------------------|--|--------------------------|------------------------|----|
|  | 2005                   |  |                          | 2005                   |    |
| Pulp and Paper Chemicals               | 22                     |  | The Netherlands          |                        | 24 |
| Base Chemicals                         | 19                     |  | Germany                  |                        | 9  |
| Functional Chemicals                   | 17                     |  | Sweden                   |                        | 21 |
| Surfactants                            | 13                     |  | UK                       |                        | 1  |
| Polymer Chemicals                      | 12                     |  | Other European countries |                        | 10 |
| Activities to be divested / classified |                        |  | USA and Canada           |                        | 21 |
| as held for sale                       | 17                     |  | Latin America            |                        | 5  |
|  |                        |  | Asia                     |                        | 7  |
|  |                        |  | Other regions            |                        | 2  |

Akzo Nobel Chemicals made good progress in 2005, as it successfully implemented a strategy to streamline its portfolio in order to competitively realign the business for sustainable growth, profitability, and leadership positions in selected markets.

Revenues and operating income improved compared to 2004. The record ROI excluding incidentals of more than 16% underlines the progress which has been made toward our medium term target of 17.5% . The overall performance improved across the board against a backdrop of raw material price increases and rising energy costs. Including incidentals, ROI was 14.4% .

Now organized in five growth platforms—Base Chemicals, Functional Chemicals, Polymer Chemicals, Pulp & Paper Chemicals, and Surfactants—the Chemicals group is starting to reap the benefits of an improved structure and a more focused approach as a result of the strategic revision which began in 2004.

Despite significantly higher energy costs, Base Chemicals turned in an excellent performance in 2005, driven by higher volumes and continuing cost reduction and restructuring programs. Functional Chemicals performed robustly as market demand remained high, while results of Polymer Chemicals were slightly down compared to 2004. Pulp & Paper Chemicals had a mixed year due to margin pressure, experiencing particularly adverse conditions in Europe, but profitable growth in South America and Asia. Profits improved at the newly formed Surfactants business on the back of its revised focus and efficiency measures.

The realignment of the Chemicals group also involved the planned divestment of a number of businesses with combined 2004 revenues of EUR 700 million. These businesses are among others Ink & Adhesive

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Resins, Oleochemicals, PVC Additives, Salt Specialties, Solar Salt Australia, and Methyl Amines/Choline Chloride. In the meantime, several of these businesses have been divested or offers have been received. The company completed all remaining divestments resulting from the strategic realignment of its Chemicals portfolio during the first half year of 2007. Recently, it was decided to withdraw Salt Specialties from its list of Chemicals businesses to be divested, as it became clear that a satisfactory deal based on the company's original divestment offer would not be forthcoming. Flexsys, the 50/50-joint venture with Solutia, was divested per May 1, 2007.

With the five growth platforms now firmly established, our streamlined businesses are ready to fully implement the strategic plans for the future and expand both operations and profitability.

### Geographic Developments

| <i>Millions of euros</i>   | <b>Revenues,<br/>by destination</b> |               | <b>Revenues,<br/>by origin</b> |               | <b>Operating income</b> |              | <b>Identifiable<br/>assets</b> |               |
|--|-------------------------------------|---------------|--------------------------------|---------------|-------------------------|--------------|--------------------------------|---------------|
|  | 2005                                | 2004          | 2005                           | 2004          | 2005                    | 2004         | 2005                           | 2004          |
| The Netherlands  | 862                                 | 844           | 2,459                          | 2,748         | 474                     | 446          | 3,061                          | 2,959         |
| Germany  | 1,238                               | 1,165         | 1,152                          | 1,050         | 144                     | 159          | 750                            | 828           |
| Sweden   | 516                                 | 509           | 1,237                          | 1,155         | 137                     | 33           | 863                            | 847           |
| United Kingdom   | 809                                 | 833           | 754                            | 848           | (59)                    | (57)         | 690                            | 582           |
| Other European<br>countries  | 4,075                               | 4,122         | 3,069                          | 2,921         | 527                     | 532          | 2,112                          | 2,163         |
| USA and Canada   | 2,400                               | 2,445         | 2,116                          | 2,221         | (67)                    | 60           | 1,959                          | 1,794         |
| Latin America  | 830                                 | 729           | 626                            | 493           | 85                      | 133          | 619                            | 454           |
| Asia   | 1,590                               | 1,536         | 1,231                          | 1,087         | 192                     | 175          | 1,017                          | 834           |
| Other regions  | 680                                 | 650           | 356                            | 310           | 53                      | 46           | 329                            | 295           |
| Eliminations, cash and<br>cash equivalents, and<br>associates, net |                                     |               |                                |               |                         |              | 1,025                          | 1,195         |
| <b>Total</b>   | <b>13,000</b>                       | <b>12,833</b> | <b>13,000</b>                  | <b>12,833</b> | <b>1,486</b>            | <b>1,527</b> | <b>12,425</b>                  | <b>11,951</b> |

Revenues and earnings in 2005 were only slightly affected by changes in key foreign currencies relative to the euro.

Revenues (by destination) in the Netherlands mainly increased in the Coatings area, while the other segments were at or slightly below last year's level. In Germany, both Coatings and Chemicals increased revenues. Revenues for Pharma in the United States were strong, particularly boosted by Puregon®/Follistim®, due to the successful launch of the Follistim Pen™ and product line extensions. Also NuvaRing® grew strongly in the United States, aided by a direct-to-customer advertising campaign in place since November. Coatings revenues in the United States also increased on last year. Lower revenues in the United States for Chemicals were caused by the impact of the Chemicals divestments. Revenues in Latin America increased for all segments. Growth in Asia also continued, especially for Coatings.

In 2005, operating income in Sweden increased considerably compared to 2004, for a large part due to better performance of Coatings and Chemicals. Furthermore, lower restructuring charges contributed to the improved Swedish operating income. The decline in U.S. operating income related to the settlement of the Remeron® court cases and restructuring and impairment charges for several units. Lower 2005 operating income in Latin America is mainly attributable to the divestment results included in 2004 operating income.

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**LIQUIDITY AND CAPITAL RESOURCES**

To Akzo Nobel's knowledge, and other than as disclosed herein, there are no trends or any demands, commitments, events or uncertainties that will result in or that are reasonably likely to result in a material change in Akzo Nobel's liquidity. As of the date of this Annual Report, Akzo Nobel has no material commitments for capital expenditures other than arising from the normal course of business, and other than as disclosed herein, and, to the knowledge of Akzo Nobel, there are no material trends, favorable or unfavorable, in Akzo Nobel's capital resources. Akzo Nobel believes that its capital resources and funds generated by operations will be sufficient to satisfy present and future capital expenditures and other commitments in connection with its ongoing business. Akzo Nobel may, however, utilize other sources of funding, from time to time, as and when appropriate.

On March 12, 2007, the company announced its intention to divest Organon BioSciences to Schering-Plough following their EUR 11 billion binding cash offer. The parties expect the transaction could be completed in the second half of 2007, after consultation with social parties and clearance from regulatory bodies.

**Condensed Statement of Cash Flows**

| <i>Millions of euros</i>   | <b>2006</b>  | <b>2005<sup>1</sup></b> | <b>2004<sup>1</sup></b> |
|--|--------------|-------------------------|-------------------------|
| Cashflow from operations   | 1,279        | 1,549                   | 1,120                   |
| Changes in working capital   | 90           | (248)                   | (32)                    |
| Changes in provisions  | (262)        | (598)                   | (63)                    |
| <b><i>Net cash from operating activities</i></b>                                     | <b>1,107</b> | <b>703</b>              | <b>1,025</b>            |
| Capital expenditures   | (529)        | (514)                   | (551)                   |
| Investments in intangible assets   | (12)         | (67)                    | (28)                    |
| Net cash effect of acquisitions  | (326)        | (55)                    | (80)                    |
| Proceeds from divestments/redemptions  | 371          | 91                      | 1,047                   |
| Loan to APF  | 19           | (150)                   |                         |
| Other  | 169          | 181                     | 214                     |
| <b><i>Net cash from investing activities</i></b>                                     | <b>(308)</b> | <b>(514)</b>            | <b>602</b>              |
| Cash dividends paid  | (369)        | (366)                   | (366)                   |
| Issue of shares  | 40           |                         |                         |
| Changes in borrowings  | (58)         | (188)                   | (169)                   |
| <b><i>Net cash used for financing activities</i></b>                                 | <b>(387)</b> | <b>(554)</b>            | <b>(535)</b>            |
| Effect of exchange rate changes on cash and cash equivalents and impact of IAS 32/39 | (27)         | 40                      | (8)                     |
| <b>Change in cash and cash equivalents</b>   | <b>385</b>   | <b>(325)</b>            | <b>1,084</b>            |

<sup>1</sup> Reclassified for comparative reasons.

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In 2006, cash increased EUR 0.4 billion, compared with a reduction of EUR 0.3 billion in 2005, and an increase of EUR 1.1 billion in 2004. The 2006 increase was generated by improved cash generated from operating activities, which was up EUR 0.4 billion to EUR 1.1 billion. 2004 included sizeable proceeds from divestments at Chemicals.

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Net cash from operating activities amounted to EUR 1.1 billion in 2006, compared to EUR 0.7 billion in 2005 (2004: EUR 1.0 billion). The cashflow from operations was EUR 0.4 billion above last year, mainly due to lower working capital requirements. Changes in provisions were also lower as 2005 included the one-time contributions to the company's Pension Fund in the Netherlands due to the changes in the pension plan.

Net cash from investing activities was an outflow of EUR 0.3 billion compared to an outflow of EUR 0.5 billion last year and an inflow of EUR 0.6 billion in 2004. This decline is mainly attributable to lower proceeds from divestments and lower dividends received from associates.

Capital expenditures amounted to EUR 529 million (2005: EUR 514 million; 2004: EUR 551 million). Capital expenditures were 106% of depreciation. Targeted investments were in the emerging markets, particularly China and Central and Eastern Europe, where growth continued at high rates and where we opened several new factories. Chemicals investments included projects in the Netherlands and Sweden.

Investments in intangible assets in 2005 were mainly due to the new R&D collaboration contracts with Lexicon Genetics and Merck KGaA affiliate Laboratoire Théramex.

2006 acquisition expenditures predominantly concerned Sico, Flood, and Balakom at Coatings.

Proceeds from divestments in 2006 principally related to the sale of various activities under the Chemicals divestment program, which included the Ink & Adhesive Resins and the Solar Salt activities. 2004 proceeds principally stemmed from the divestment of Catalysts, Phosphorus Chemicals and Resins.

Net cash used for financing activities was with EUR 0.4 billion somewhat lower than in the two prior years. Dividends paid were at a similar level in all years. The main changes in borrowings in 2005 were the redemption of the NLG 500 million 1995-2005 bond (EUR 227 million), partially offset by the termination of a currency swap, which generated EUR 78 million<sup>1</sup>.

Akzo Nobel has a U.S. commercial paper program of USD 1.0 billion and a euro commercial paper program of EUR 1.5 billion. At December 31, 2006, these commercial paper programs were not used.

At December 31, 2006, the total amount of long-term credit facilities arranged by Akzo Nobel amounted to EUR 1.5 billion. This facility can be used for general corporate financing purpose and supports our commercial paper programs in the euro-market and in the United States. During 2006, none of the facilities were used.

At present, the company's long-term credit rating from Moody's is A3 with a short-term rating of P-2, both with a so-called "stable outlook". The current long-term credit rating from Standard & Poor's is A<sup>+</sup> and their short-term rating is A-2, both with a so-called "stable outlook".

The present rating is 3 notches above the so-called "high-yield zone". However, if the company's rating, due to whatever circumstances would decline or would approach or enter the high-yield zone, this will not only result in increased financing cost for the company, but could also reduce availability of credit, especially at commercially acceptable rates.

1 In January 2005, the company terminated a currency swap contract whereby EUR 250 million floating-rate EURIBOR-related liabilities were swapped into USD 223 million LIBOR-related liabilities, generating EUR 78 million in cash proceeds. This swap was part of an interest rate currency swap whereby euro-denominated fixed rate liabilities were swapped into floating rate U.S. dollar- denominated liabilities.

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It should be noted, however, that the company's present loan documentation does not include any rating covenants.

A security rating is not a recommendation to buy, sell or hold securities. The rating may be subject to revision or withdrawal at any time by the rating organization. Each rating should be valued independently of any other rating.

At December 31, 2006, the company had a cash and cash equivalents position of EUR 1.9 billion, which was freely available. The cash position was up EUR 0.4 billion on last year, mainly due to the improved funds from operations. Net interest-bearing borrowings<sup>1</sup> were down EUR 0.5 billion to EUR 1.1 billion.

For additional information on the type of financial instruments used by the company, the maturity profile of the company's debt, and the currency and interest rate structure of such debt, see Item 11 "Quantitative and Qualitative Disclosures about Market Risk" under Foreign Currency Exchange Risk Management and Interest Rate Risk Management.

Equity increased EUR 0.7 billion as a result of retained income.

Year-end gearing<sup>2</sup> improved from 0.44 at December 31, 2005, to 0.26 at December 31, 2006.

### Contractual obligations

The following table summarizes our principal contractual obligations at December 31, 2006.

| Contractual obligations<br><i>Millions of euros</i> | Payments due by period |                     |              |              |                  |
|---|------------------------|---------------------|--------------|--------------|------------------|
|   | Total                  | Less than<br>1 year | 1-3<br>years | 4-5<br>years | After 5<br>years |
| Long-term debt and capital lease obligations*       | 2,709                  | 158                 | 1,604        | 800          | 147              |
| Commitments for interest**                          | 387                    | 130                 | 189          | 63           | 5                |
| Provisions  | 2,703                  | 571                 | 345          | 254          | 1,533            |
| Deferred income                                     | 7                      | 7                   |              |              |                  |
| Deferred tax liabilities                            | 174                    | 24                  | 7            | 9            | 134              |
| Operating leases and other long-term commitments    | 776                    | 225                 | 277          | 139          | 135              |
| Commitments for raw materials and services          | 1,354                  | 779                 | 460          | 84           | 31               |
| Commitments for capital expenditures                | 96                     | 86                  | 10           |              |                  |
| <b>Total Contractual Obligations</b>                | <b>8,206</b>           | <b>1,980</b>        | <b>2,892</b> | <b>1,349</b> | <b>1,985</b>     |

\* Of which capital leases total EUR 36 million, reasonably spread over future years.

\*\* Interest commitments based on fixed interest rates. For some loans interest rate swaps were concluded, whereby the fixed rate is changed in a floating LIBOR or floating EURIBOR rate. Reference is made to Note 24 of the Notes to the Consolidated Financial Statements.

All purchase commitments for raw materials and services are in the ordinary course of business.

Guarantees related to associates totaled EUR 5 million (at December 31, 2005: EUR 3 million). As general partners in several partnerships, Akzo Nobel companies are liable for obligations incurred by these partnerships. At December 31, 2006, the risk ensuing from known liabilities associated with these partnerships was EUR 93 million (at December 31, 2005: EUR 113 million).

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- 1 Defined as Long-Term Borrowings plus Short-Term Borrowings less Cash and Cash Equivalents.
  - 2 Net Interest-Borrowings divided by Equity.
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**Certain Trading Activities**

Although the company hedges certain foreign currency, interest, and raw material pricing exposures, it does not actively trade in derivative financial instruments. Furthermore, the company does not hold any derivative financial instruments where fair values are determined other than on an active trading market.

**Off-Balance Sheet Transactions**

Other than the activities in nonconsolidated joint ventures with other (industrial) partners and operational leases of certain assets, the company does not utilize special-purpose entities or engage in other off-balance sheet activities.

Reference is made to Note 9 of the Notes to the Consolidated Financial Statements.

Guarantees related to associates totaled EUR 5 million (at December 31, 2005: EUR 3 million). As general partners in several partnerships, Akzo Nobel companies are liable for obligations incurred by these partnerships. At December 31, 2006, the risk ensuing from known liabilities associated with these partnerships was EUR 93 million (at December 31, 2005: EUR 113 million).

**RESEARCH AND DEVELOPMENT, PATENTS AND LICENSES**

Research and development spending amounted to EUR 826 million in 2004, EUR 810 million in 2005, and EUR 885 million in 2006. The company's research and development policies are specific to each of its three groups. For additional information regarding the company's research and development policies for the last three years, see Item 4 "Information on the company" under B. Business Overview.

**CRITICAL ACCOUNTING POLICIES**

The preparation of the financial statements in conformity with IFRS requires management to make judgments, estimates, and assumptions that affect amounts reported in the consolidated financial statements. The estimates and assumptions are based on experience and various other factors that are believed to be reasonable under the circumstances and are used to judge the carrying values of assets and liabilities that are not readily apparent from other sources. Actual results may differ from those estimates. The estimates and underlying assumptions are reviewed on an ongoing basis.

Revisions to accounting estimates are recognized in the period in which the estimate is revised, or in the revision and future periods if the changed estimates affect both current and future periods.

The most critical accounting policies involving a higher degree of judgment and complexity in applying principles of valuation are described below.

**Impairment of intangible assets and property, plant and equipment**

The company reviews noncurrent assets for impairment when events or circumstances indicate carrying values may not be recoverable. Assets subject to this review include property, plant and equipment and intangible assets. In determining property, plant and equipment and intangible assets, management must make significant judgments and estimates to determine if the future cash flows expected to be generated by those assets are

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less than their carrying value. Determining cash flows requires the use of judgments and estimates that have been included in the company's strategic plans and long-term planning forecasts. The data necessary for the execution of the impairment tests are based on management estimates of future cash flows, which require estimating revenue growth rates and profit margins. Assets are written down to their recoverable value. This recoverable value of impaired assets is determined by taking into account these estimated cash flows and using a net present value technique based on discounting these cash flows with business-specific discount rates.

Changes in assumptions and estimates included in the impairment reviews could result in significantly different earnings than those recorded in the financial statements.

**Accounting for income taxes**

As part of the process of preparing consolidated financial statements, the company is required to estimate income taxes in each of the jurisdictions in which the company operates. This process involves estimating actual current tax expenses and temporary differences between tax and financial reporting. Temporary differences result in deferred tax assets and liabilities, which are included in the consolidated balance sheet. The company must then assess the likelihood that deferred tax assets will be recovered from future taxable income. In the event actual results differ from these estimates in future periods, and depending on the tax strategies that the company may be able to implement, changes to the deferred tax assets could be required, which could impact the financial position and results from operations.

**Provisions**

By their nature, provisions for contingent liabilities are dependent upon estimates and assessments whether the criteria for recognition have been met, including estimates as to the outcome and the amount of the potential cost of resolution. Contingent liabilities are recognized by a charge against income when it is probable that a liability has been incurred and the amount of such liability can be reasonably estimated.

Contingent liabilities and provisions for environmental matters, antitrust cases, other litigation, and tax disputes are discussed in Note 25 – Contingent liabilities and commitments. Estimates related to provisions for environmental matters are based on the nature and seriousness of the contamination as well as on the technology required for cleanup. The provision for antitrust cases is based on an estimate of the costs, fines, and civil damages, taking into account legal advice and the current facts and circumstances. Provisions for other litigation are also based on an estimate of the costs, taking into account legal advice and information currently available.

If the actual outcome differs from the assumptions and estimates, revisions to the estimated provisions would be required. This could impact our financial position and results from operations.

Provisions for termination benefits and exit costs also involve management's judgment in estimating the expected cash outflows for severance payments and site closure or other exit costs. Should the actual cash outflows differ from the assumptions and estimates, additional charges would be required, which could impact our financial position and results from operations.

**Accounting for pensions and other postretirement benefits**

Retirement benefits represent obligations that will be settled in the future and require assumptions to project benefit obligations and fair values of plan assets. Retirement benefit accounting is intended to reflect the recognition of future benefit costs over the employee's approximate service period, based on the terms of the plans and the investment and funding decisions made by the company. The accounting requires management to make assumptions regarding variables such as discount rate, rate of compensation increase, return on assets, mortality rates, and future healthcare costs. Periodically, management consults with external actuaries

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regarding these assumptions. Changes in these key assumptions can have a significant impact on the projected benefit obligations, funding requirements and periodic costs incurred. For details on key assumptions and policies, see note 19.

It should be noted that when discount rates decline or rates of compensation increase — due to e.g. increased inflation — pension and postretirement benefit obligations will increase. Net periodic pension and postretirement costs might also increase, but that depends on the actual relation between the unrecognized loss and the so-called corridor (10% of the greater of benefit obligations and plan assets) as well as on the relative change of the discount rate versus the change of the benefit obligation.

## **NEW ACCOUNTING PRONOUNCEMENTS**

### **IFRS**

In 2005 and 2006 several new accounting pronouncements were issued, of which the company assessed that the following have an impact on the company's consolidated financial statements.

IFRS 7 Financial Instruments: Disclosures and the Amendment to IAS 1 Presentation of Financial Statements: Capital Disclosures requires disclosures about the significance of financial instruments for an entity's financial position and performance, and qualitative and quantitative disclosures on the risks arising from financial instruments. The standard becomes effective from 2007 onwards. The effect on the company's disclosures is expected to be limited.

IAS 19 (Amendment), Employee Benefits, is mandatory for accounting periods beginning on or after January 1, 2006. It introduces the option of an alternative recognition approach for actuarial gains and losses. It may impose additional recognition requirements for multi-employer plans where insufficient information is available to apply defined benefit accounting. It also adds new disclosure requirements. As the company does not intend to change the accounting policy adopted for recognition of actuarial gains and losses and does not participate in any multi-employer plans, adoption of this amendment only impacts the format and extent of disclosures presented in the consolidated financial statements.

IAS 39 and IFRS 4 (Amendment), Financial Guarantee Contracts, applies to annual periods beginning on or after January 1, 2006. Under this standard, a financial guarantee contract is initially recognized at fair value and is subsequently measured at the higher of (a) the amount determined in accordance with IAS 37 and (b) the amount initially recognized less, when appropriate, cumulative amortization recognized in accordance with IAS 18. Different requirements apply for the subsequent measurement of financial guarantee contracts that prevent derecognition of financial assets or result in continuing involvement. Financial guarantee contracts held are not within the scope of the standard.

IFRIC 4, Determining whether an Arrangement contains a Lease, applies to annual periods beginning on or after January 1, 2006. This Interpretation provides guidance for determining whether an arrangement, comprising a transaction that does not take the legal form of a lease but conveys a right to use an asset should be accounted for in accordance with IAS 17. The standard did not impact the consolidated financial statements.

IFRIC 9 Reassessment of Embedded Derivatives requires that only when there are changes to the contract a reassessment should be made of whether embedded derivatives should be separated from the underlying host contract. IFRIC 9 becomes effective for the 2007 financial statements and is not expected to have any impact on the consolidated financial statements.

IFRIC 10 Interim Financial Reporting and Impairments prohibits the reversal of an impairment loss recognized in a previous interim period in respect of goodwill, an investment in an equity instrument or a financial asset carried

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at cost. IFRIC 10 is effective from 2007. It will apply prospectively from the date that IFRS was first implemented and does not impact the consolidated financial statements.

#### **US GAAP**

The Financial Accounting Standards Board (FASB) issued several pronouncements with an effective date on or after January 1, 2007, of which the following are applicable to the company.

In June 2006, the FASB issued FIN No. 48 'Accounting for Uncertainty in Income Taxes, an interpretation of FASB Statement No. 109. This FASB interpretation clarifies the accounting for uncertainty in income taxes recognized in an enterprise's financial statements and prescribes a recognition threshold and measurement attribute for the financial statement recognition and measurement of a tax position taken or expected to be taken in a tax return. FIN 48 is effective for fiscal years beginning after December 15, 2006. Akzo Nobel will adopt FIN 48 effective January 1, 2007. The cumulative effect will be reported as an adjustment to the opening balance of retained earnings as of the date of adoption. Akzo Nobel is still in the process of determining the potential effects of FIN 48 on its consolidated financial position and results of operations.

In September 2006, the FASB issued FASB Statement No. 157, 'Fair Value Measurement' (SFAS 157). SFAS 157 defines fair value, establishes a framework for the measurement of fair value, and enhances disclosures about fair value measurements. The Statement does not require any new fair value measures. The Statement is effective for fair value measures already required or permitted by other standards for fiscal years beginning after November 15, 2007. The Company is required to adopt Statement 157 beginning on January 1, 2008. Statement 157 is required to be applied prospectively, except for certain financial instruments. Any transition adjustment will be recognized as an adjustment to opening retained earnings in the year of adoption. The Company is still in the process of evaluating the impact of adopting SFAS 157 on its results of operations and financial position.

In September 2006, the FASB issued FASB Staff Position No. AUG AIR-1, 'Accounting for Planned Major Maintenance Activities'. This guidance prohibits the use of the accrue-in-advance method of accounting for planned major activities because an obligation has not occurred and therefore a liability should not be recognized. The provisions of this guidance will be effective for reporting periods beginning after December 15, 2006. The provisions of the Staff Position are consistent with the Company's current policies and the Company does not anticipate that the adoption of the provisions of this guidance will have a material impact on its results of operation and financial presentation.

#### **FORWARD LOOKING STATEMENT ON 2007**

Akzo Nobel is well positioned for profitable growth, supported by favorable signs about the world economy. Provided that no major discontinuities occur, Akzo Nobel believes that it is well placed to outgrow its markets and further improve the financial returns in Coatings and Chemicals. Finally, Akzo Nobel is confident that the proposed separation of its pharmaceutical business will create further value for shareholders.

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**Item 6. DIRECTORS, SENIOR MANAGEMENT AND EMPLOYEES****A. DIRECTORS AND SENIOR MANAGEMENT****Corporate Governance**

Akzo Nobel N.V. is a public limited liability company (‘‘Naamloze Vennootschap’’) established under the laws of the Netherlands. Its common shares are listed on Euronext Amsterdam and quoted on NASDAQ in the form of American Depositary Shares.

Akzo Nobel’s management and supervision structure is organized in a so-called two-tier system, comprising a Board of Management, solely composed of executive directors, and a Supervisory Board, solely composed of nonexecutive directors. The two Boards are independent of each other and are accountable to the General Meeting of Shareholders for the performance of their functions.

Akzo Nobel’s corporate governance structure is based on the requirements of the Dutch Civil Code, the company’s Articles of Association, and the rules and regulations applicable to companies listed on Euronext Amsterdam and NASDAQ, complemented by several internal procedures. These procedures include a risk management and control system, as well as a system of assurance of compliance with laws and regulations.

Over the last decade, Akzo Nobel has been enhancing and improving its corporate governance standards in accordance with applicable laws and regulations. Most notable are the Dutch Corporate Governance Code adopted in 2003 (‘‘the Code’’) and the U.S. Sarbanes-Oxley Act of 2002 (‘‘SOX’’) and its implementation rules by the SEC and NASDAQ.

The Code contains principles and best practices for Dutch companies with listed shares. Akzo Nobel agrees both with the general approach and with the vast majority of its principles and best practice provisions. Corporate governance at Akzo Nobel was placed on the agenda of the 2004 and 2005 General Meeting of Shareholders as a separate item for discussion. This specifically included a number of aspects where Akzo Nobel’s corporate governance deviates from the Code, as explained in the 2004 Annual Report. The Board of Management and the Supervisory Board have taken these discussions into account in formulating a position on the company’s corporate governance. One of the results was an amendment of the Articles of Association that has been approved by the Annual General Meeting of Shareholders in 2005.

In this chapter, Akzo Nobel’s corporate governance is addressed and deviations from the Code are explained, in accordance with the Code’s ‘‘apply or explain’’ principle.

The Board of Management and the Supervisory Board believe that the company’s corporate governance structure as described here is the most appropriate for Akzo Nobel at this point in time. Except for those aspects of the company’s governance structure which can only be amended with the approval of the General Meeting of Shareholders, the Board of Management and the Supervisory Board may make adjustments to the way the Code is applied as described below, to the extent this is considered to be in the interest of the company and its affiliated enterprises in the manner described below. If such adjustments are made, they will be published and reported in the annual report for the relevant year.

**Supervisory Board**

The overall responsibility of the Supervisory Board is to exercise supervision over the policies adopted by the Board of Management and over the general conduct of the business of the company and its subsidiaries. This

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specifically includes supervision of the achievement of the company's operational and financial objectives, the corporate strategy designed to achieve the objectives, and the main financial parameters and risk factors. The Supervisory Board also provides the Board of Management with advice. In fulfilling its duties, the Supervisory Board and its members are guided by the interests of the company and its affiliated enterprises.

### ***Appointment, Independence, and Composition***

The nomination procedures outlined on page 94 and 95 for the members of the Supervisory Board and the Board of Management apply. As a general rule, based on the rotation schedule, a Supervisory Board member's tenure is four years. In principle, members are eligible for reelection twice. However, in deviation of the Code (provision III.3.5), a member can be nominated for reelection more often if in a specific case this is considered to be in the company's interest. Accordingly, in 2005, Abraham Cohen was appointed for a fourth term.

The composition of the Supervisory Board is such that the members are able to act with due objectivity and independently of one another and of the Board of Management.

All Supervisory Board members meet the independence requirements as stated in Code provisions III.2.1, III.2.2 and III.2.3, except for Cees van Lede and Dolf van den Brink. In this respect, it should be noted that Mr. van Lede is a former member of the Board of Management of Akzo Nobel, who retired from this position in 2003. As a long-standing policy, Akzo Nobel welcomes the recent knowledge and expertise of the affairs and business of the company in one member of the Supervisory Board. Mr. van den Brink was a member of the Managing Board of ABN AMRO, one of the company's principal banks. He retired from this position in 2002. Mr. van den Brink is still a consultant on macroeconomic policies to this bank, but in this capacity he is not involved in its management. Although this is formally not in compliance with Code provision III.2.3, the company's conclusion is that Mr. van den Brink should be considered as an independent Supervisory Board member.

No member of the Supervisory Board holds more than five supervisory board memberships in Dutch listed companies.

The Supervisory Board is governed by its Rules of Procedure, which include detailed provisions on how to deal with conflicts of interest and potential conflicts of interest between members of the Supervisory Board and the company. The Rules of Procedure, encompassing the Profile and the Charters of the Committees, reflect the tasks and responsibilities of the Supervisory Board and are available on Akzo Nobel's corporate website.

The Chairman of the Supervisory Board determines the agenda and chairs the meetings of the Supervisory Board, monitors the proper functioning of the Supervisory Board and its Committees, arranges for the adequate provision of information to the members of the Supervisory Board, and acts on behalf of the Supervisory Board as the main contact for the Board of Management. He also initiates the evaluation of the functioning of the Supervisory Board and the Board of Management, and chairs the General Meeting of Shareholders. Until April 2006, the Supervisory Board was chaired by Aarnout Loudon, a former chairman of the Board of Management who retired from this position in 1994. This was a temporary deviation from the Code (provision III.4.2). The company believed that in view of the experience and expertise of Mr. Loudon as Chairman of the Supervisory Board, it was in the best interest of the company that Mr. Loudon remained Chairman until his present term expired at the end of April 2006. The Annual General Meeting of Shareholders in 2004 confirmed this by reappointing Mr. Loudon accordingly. After his resignation from the Supervisory Board, this temporary deviation no longer exists.

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During 2006, the Supervisory Board consisted of the following persons:

| <b>Supervisory Board</b>   | <b>Principal Occupation</b>   | <b>Member since</b>                      |
|--|---|--|
| Maarten van den Bergh <sup>1,2</sup><br>(1942, Dutch)<br><i>Chairman</i> | Former President of Royal Dutch Petroleum Company; Former Vice-Chairman Committee of Managing Directors of Royal Dutch/Shell Group plc; Former Chairman of the Board of Lloyds TSB Group plc; Nonexecutive Director of Royal Dutch Shell plc; British Airways plc; and BT Group plc   | 2005<br><i>Current term</i><br>2005-2009 |
| Karel Vuursteen <sup>3,7</sup><br>(1941, Dutch)                          | Former CEO of Heineken; Deputy Chairman and Member of the Board of Directors of Heineken Holding; Member of the Supervisory Board of ING Group; Member of the Supervisory Board of Henkel; and Member of the Advisory Board of CVC Capital Partners Nederland   | 2002<br><i>Current term</i><br>2006-2010 |
| Virginia Bottomley <sup>2,3</sup><br>(1948, British)                     | Former Secretary of State for Health and Member of the British Cabinet; Member of the House of Lords; Former Secretary of State for National Heritage; Governor of the London School of Economics; Governor of the Ditchley Foundation; Executive Director of Odgers Ray & Berndtson; and Trustee of the Economist newspaper  | 2000<br><i>Current term</i><br>2004-2008 |
| Dolf van den Brink <sup>4</sup><br>(1948, Dutch)                         | Professor Financial Institution University of Amsterdam; Economic Advisor to the Managing Board of ABN AMRO Bank; Former Member of the Managing Board of ABN AMRO Bank; Chairman of the Supervisory Boards of Van der Moolen Holding and Nyenrode University; and Member of the Supervisory Board of Samas Groep  | 2004<br><i>Current term</i><br>2004-2008 |
| Uwe-Ernst Bufe <sup>5</sup><br>(1944, German)                            | Former CEO of Degussa AG; Vice-Chairman Investment Banking and Deputy Chairman of the Supervisory Board of UBS Deutschland AG; Member of the Supervisory Board of Altana; and Member of the Supervisory Boards of Solvay and Umicore SA   | 2003<br><i>Current term</i><br>2003-2007 |
| Antony Burgmans<br>(1947, Dutch)   | Chairman of Unilever NV and Unilever plc; Member of the International Advisory Board of Allianz AG; Nonexecutive Director of BP plc; and Member of the Advisory Board of CVC Capital Partners Nederland   | 2006<br><i>Current term</i><br>2006-2010 |
| Abraham Cohen <sup>5</sup><br>(1936, American)                           | Former Senior Vice-President of Merck & Co.; Former President of Merck Sharp & Dohme International; Chairman of the Board of Directors of Vasomedical and of Neurobiological Technologies; Nonexecutive Director of Teva Pharmaceutical Industries, and of Chugai Pharmaceuticals   | 1992<br><i>Current term</i><br>2005-2009 |
| Louis Hughes <sup>6</sup><br>(1949, American)                            | Chairman and CEO of GBS Laboratories LLC; Former President and COO of Lockheed Martin; Former Executive Vice-President of General Motors; Nonexecutive Chairman of Maxager Technology Inc.; Member of the Supervisory Board of MTU Aero Engines Holding AG; Member of the Board of Directors of AB Electrolux, Sulzer AG and ABB AG; and Executive Advisor of Wind Point Partners | 2006<br><i>Current term</i><br>2006-2010 |
| Cees van Lede<br>(1942, Dutch)   | Former Chairman of the Board of Management of Akzo Nobel; Chairman of the Supervisory Board of Heineken; Member of the Supervisory Board of Philips Electronics and Stork <sup>8</sup> ;  | 2003<br><i>Current term</i><br>2003-2007 |

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|   |   |  |
|---|---|--|
| Alain Mérieux<br>(1938, French)   | Nonexecutive Director of Air Liquide, Reed Elsevier, Sara Lee Corp. and Air France/KLM; Chairman of the Board of Directors of INSEAD; and Senior Advisor for Europe of JP Morgan Chase plc<br>Chairman of bioMérieux; Director of Eurazeo and Compagnie Plastic Omnium SA | 2002<br><i>Current term</i><br>2006-2010 |
| Aarnout Loudon<br>(1936, Dutch),  | Retired as Chairman as of May 1 , 2006  |  |
| 1 Chairman of the Nomination Committee as of May 1, 2006<br>2 Member of the Remuneration Committee<br>3 Member of the Nomination Committee<br>4 Chairman of the Audit Committee as of January 1, 2006 | 5 Member of the Audit Committee<br>6 Member of the Audit Committee as of June 1, 2006<br>7 Chairman of the Remuneration Committee as of May 1, 2006<br>8 Temporary appointment by the enterprise chamber of the Amsterdam District Court                                  |  |

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The Supervisory Board is assisted by the Secretary. All members of the Supervisory Board have access to the advice and service of the Secretary, who is responsible for ensuring that the Supervisory Board procedures are followed and that the Supervisory Board acts in accordance with its statutory obligations under the Articles of Association.

### ***Changes in the Supervisory Board***

Effective May 1, 2006, the Chairman of the Supervisory Board Mr. Loudon stepped down, having reached the age limit. The Supervisory Board and the Board of Management acknowledged a debt of gratitude to Mr. Loudon, who with his expertise and broad business experience has rendered outstanding service to the company over the past 37 years. During that time, he served for 29 years as respectively member of the Board of Management, Chairman of the Board of Management and Chairman of the Supervisory Board.

Also effective May 1, 2006, Mr. van den Bergh, former Chairman of Lloyds TSB Group plc and non-executive director of Royal Dutch Shell plc, was appointed Chairman of the Supervisory Board for a four-year term. Mr. Vuursteen was appointed Deputy Chairman as of the same date.

Having reached the age of 70, Mr. Cohen will resign from the Supervisory Board after the 2007 General Meeting of Shareholders. At the same time, Mr. Mérieux has informed the Supervisory Board and the Board of Management that, for personal reasons, he will resign from the Supervisory Board immediately after the 2007 General Meeting of Shareholders. The Supervisory Board acknowledges a debt of gratitude to both Mr. Cohen and Mr. Mérieux, who with their pharmaceutical expertise and broad business experience have rendered outstanding services to the company.

By May 1, 2007, the term of Mr. van Lede will have expired. Mr. van Lede holds supervisory and advisory positions at a number of multinational companies, and has, in addition, recently been appointed as a supervisory board member at Stork NV by the district court of Amsterdam. Mr. van Lede has therefore decided that he will not be available for reappointment. The Supervisory Board acknowledge a debt of gratitude to Mr. van Lede who, with his expertise and broad business experience, has rendered outstanding services to the company over the past 16 years, of which nine as Chairman of the Board of Management and four as member of the Supervisory Board.

At the 2006 General Meeting of Shareholders, Mr. Burgmans, Chairman of Unilever NV/plc and former Vice-Chairman of Unilever plc and Mr. Hughes, Chief Executive Officer of GBS Laboratories, and former Executive Vice-President of General Motors Corp. (USA); were appointed to the Supervisory Board for a four-year term.

The 2007 General Meeting of Shareholders appointed Mrs. Bruzelius, former CEO of ASEA Brown Boveri AB and Former Executive Vice- President of Skandinaviska Enskilda Banken, to the Supervisory Board for a four-year term. Furthermore, by May 1, 2007, the term of office of Mr. Bufe will have expired. Mr. Bufe was reappointed.

At the same time, 2007 General Meeting of Shareholders approved a reduction in the number of Supervisory Board members from ten members to eight members. The Supervisory Board and the Board of Management considered a reduction in the number of Board members a logical consequence of the separation of Akzo Nobel and Organon BioSciences into two separate companies as approved by the shareholders at the Extraordinary General Meeting of Shareholders on September 7, 2006.

All nominations were made in accordance with the membership profile, which can be found on Akzo Nobel's corporate website.

### ***Remuneration***

Supervisory Board members receive a fixed annual remuneration which is determined by the General Meeting of Shareholders. In accordance with the Articles of Association, the Supervisory Board has determined

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additional remuneration for its Chairman and the members of its Committees. More information on the Remuneration of the Supervisory Board members can be found under B – Compensation.

Supervisory Board members are subject to the Akzo Nobel Rules on Inside Information and report all transactions in Akzo Nobel shares to the applicable authorities. The company has chosen not to follow provision III.7.3 of the Code that requires notification by members of the Supervisory Board of all changes in their holdings of shares in Dutch listed companies, as this is governed by the company's own internal code. The same considerations apply as stated in this respect for members of the Board of Management.

### **Committees**

The Supervisory Board has established three Committees: the Audit Committee, the Nomination Committee, and the Remuneration Committee. Each Committee has a charter describing its role and responsibility and the manner in which it discharges its duties and reports to the full Supervisory Board. These charters are included in the Rules of Procedure, published on the company's corporate website. The Committees report on their deliberations and findings to the full Supervisory Board.

The Audit Committee assists the Supervisory Board in overseeing the quality and integrity of the accounting, auditing, reporting, and risk management practices of the company, as well as on a number of other subjects, as included in its charter. Mr. van den Brink is Chairman of the Audit Committee. The Supervisory Board has determined that Mr. van den Brink meets the financial expert requirements pursuant to SOX and the Code and is "independent" under the meaning of Rule 10A-3 of the US Securities and Exchange Act of 1934, as amended.

One area of particular focus in corporate governance is the independence of the auditors. The Audit Committee has been delegated direct responsibility for the compensation and the oversight of the auditors and the services they provide to the company. The auditors are prohibited from providing certain nonaudit services to the company. In order to anchor this in the company's procedures, the Supervisory Board adopted the "Akzo Nobel Auditors Independence Policy" and the related "Akzo Nobel Audit Committee Preapproval Policy on Audit, Audit-Related, and Nonaudit Services." All the aforementioned documents and policies are available on Akzo Nobel's corporate website.

The Nomination Committee focuses on drawing up selection criteria and appointment procedures for Supervisory Board and Board of Management members, assessing the size and composition of both Boards, assessing the functioning of the individual members, making proposals for appointments and reappointments, and supervising the Board of Management on the selection of senior management.

The Remuneration Committee is responsible for drafting proposals to the Supervisory Board on the remuneration policy for the Board of Management, for overseeing the remuneration of individual members of the Board of Management and the remuneration schemes for Akzo Nobel executives involving Akzo Nobel shares. The Committee also prepares Supervisory Board proposals to the General Meeting of Shareholders concerning the remuneration of the members of the Supervisory Board. The Remuneration Committee was chaired by Mr. Vuursteen.

The Nomination Committee and the Remuneration Committee, consist of the same members.

### **Supervisory Board Activities**

The full Supervisory Board met seven times during the course of 2006, which included one meeting fully dedicated to the company's strategy. All meetings were plenary sessions with the full Board of Management and were well attended by all Supervisory Board members.

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The Supervisory Board held a separate meeting, which was attended in part by the CEO, during which the Supervisory Board conducted a self-assessment and appraised its committees, working methods, procedures, and performance, as well as evaluating the functioning of the Board of Management and its individual members. The Supervisory Board also assessed its relationship with the Board of Management and discussed the composition of the Supervisory Board and its committees.

The Chairman of the Supervisory Board prepares the meetings with the assistance of the CEO. The Supervisory Board discussed such issues as company strategy, corporate governance, risk management, and the approval of major investments, acquisitions, and divestments. Regular agenda items included financial and operational performance, share price development, operational planning, course of business, and the annual financing and investment plan.

In 2006, the Supervisory Board again devoted considerable time to discussions on the company's strategy. The Supervisory Board reviewed and discussed in-depth with the Board of Management the overall company strategy and strategic options, including objectives, associated risks, and the mechanisms for controlling financial risks. During regular meetings, the company's strategic direction was a major point of discussion.

On September 7, 2006 an Extraordinary General Meeting of Shareholders (EGM) was held at which it was decided to separate the pharmaceutical activities from the rest of Akzo Nobel. For these purposes, a new company, Organon BioSciences NV, was incorporated. Throughout 2006, the Supervisory Board was given an update at each meeting on preparations for the separation of the pharmaceutical business and later Organon BioSciences. The Supervisory Board approved the decision to separate Organon BioSciences through a listing of a minority stake on Euronext Amsterdam on February 28, 2007. Later this listing was superseded by the binding offer received from Schering-Plough on March 12, 2007.

Other discussion topics included:

- the acquisition of Sico Inc., Canada;
- SOX 404 implementation; and
- risk Management.

The Board of Management keeps the Supervisory Board regularly informed of intended organizational changes and appointments of senior managers.

#### *Audit Committee*

The Audit Committee consists of four members and is chaired by Mr. van den Brink. Mr. Hughes was appointed by the Supervisory Board as a fourth member of the Audit Committee in June 2006.

The Audit Committee had seven regular meetings in 2006. In principle, the CEO, the CFO, the director of financial reporting, the internal auditor, and the lead partner of the external auditor, KPMG, attend all regular meetings. In addition, the Audit Committee met once without management being present to conduct self-evaluation and appraise performance. A meeting with only the internal auditor, and one with only the external auditor present, was also held.

The Audit Committee discussed Financial Statements, the Annual Report on Form 20-F for SEC filing, internal and external control procedures, the implementation of SOx 404, risk management, Internal Auditing reports, planning, tax strategy, and the external auditor's performance and independence. Before each announcement of quarterly results, the Audit Committee was informed of the figures and consulted on the reports and press releases to be published.

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The Audit Committee further discussed such items as:

- KPMG’s management letter and the Board of Management’s follow up;
- SOX 404 implementation;
- KPMG’s engagement letter, fee and audit plan;
- legal and environmental provisions; and
- tax provisions and policy.

Issues discussed in Audit Committee meetings are reported back to the full Supervisory Board in subsequent meetings of this Board.

#### *Remuneration Committee*

The Remuneration Committee consists of four members and is chaired by Mr. Vuursteen. The Committee met four times in 2006, with three of the meetings being combined sessions with the Nomination Committee.

In 2006, The Remuneration Committee made recommendations on the remuneration and remuneration policy for the members of the Board of Management, including personal targets, and made recommendations on the remuneration of the Supervisory Board, which were approved by the Supervisory Board and adopted by the 2006 General Meeting of Shareholders.

More information on the remuneration of the Board of Management and the proposed revised remuneration of the Supervisory Board can be found under B – Compensation.

#### *Nomination Committee*

The Nomination Committee consists of four members and is chaired by Mr. van den Bergh. The Committee met four times in 2006, with three of the meetings being combined sessions with the Remuneration Committee. The Nomination Committee made proposals as described above for the appointment of Mrs. Bruzelius in 2007 in the Supervisory Board and for the reduction of the number of Supervisory Board members by two.

### **Board of Management**

#### ***General***

The Board of Management is entrusted with the management of the company, which means, among other things, that it defines the strategic direction, establishes the policies, and manages the company’s day-to-day operations. The members of the Board of Management collectively manage the company and are responsible for its performance. They are jointly and individually accountable for all decisions made by the Board of Management. In performing its duties, the Board of Management is guided by the interest of the company and its affiliated enterprises.

The Chief Executive Officer (CEO) leads the Board of Management in its overall management of the company to achieve its performance goals and ambitions. He is the main point of liaison with the Supervisory Board. The Chief Financial Officer (CFO) is specifically responsible for the company’s financial affairs. The Board of Management has members with specific responsibilities for the company’s main segments: Organon, Intervet, Coatings, and Chemicals.

Within the segments, business is carried out in business units. The General Managers thereof are responsible for the performance of their business units and report to the individual member of the Board of Management who is responsible for the segment to which the business unit belongs. To safeguard consistency and coherence for the total organization, Corporate Directives have been established by the Board of Management.

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To steer effectively the strategy and operations of the business units, the Board of Management has delegated certain authorities to Board Committees for Organon and Intervet, Coatings, and Chemicals. Furthermore, a Pensions Board Committee oversees the general pension policies to be implemented in the various pension plans of the company. Board Committees consist of at least two Board members. Delegation of authorities to Board Committees and individual Board members is laid down in an internal authority schedule.

Representative authority, including the signing of documents, is vested in at least two members of the Board of Management jointly. The Board of Management may appoint corporate agents, whose powers of attorney will be determined by the Board of Management upon their appointment.

The Board of Management appoints its own secretary, who may be and at this moment is the same person as the Secretary of the Supervisory Board. This is Mr. G.R. Wladimiroff, G.R. (1967, Dutch), serving in this capacity since 2006.

During 2006, the Board of Management consisted of the following persons:

| <b>Board of Management</b>                    | <b>Position with company</b> | <b>Served in such or similar capacity since</b> |
|---|------------------------------|---|
| Hans Wijers<br>(1951, Dutch)                  | Chairman and CEO<br>Coatings | 2002  |
| Rob Frohn<br>(1960, Dutch)                    | CFO                          | 2004  |
| Toon Wilderbeek <sup>1</sup><br>(1950, Dutch) | Pharma                       | 2002  |
| Leif Darner<br>(1952, Swedish)                | Chemicals                    | 2004  |

<sup>1</sup> Resigned effective February 28, 2007.

In connection with the separation of Akzo Nobel, Mr. Wilderbeek resigned from the Board of Management of Akzo Nobel effective February 28, 2007. The Supervisory Board proposed a reduction in the total number of members of the Board of Management by one, which was approved at the 2007 General Meeting of Shareholders. A Board of Management of three is seen as a logical consequence of the separation of Organon BioSciences.

### ***Appointment, Conflicts of Interest***

The General Meeting of Shareholders appoints the members of the Board of Management. The Meeting of Holders of Priority Shares is entitled to make binding nominations for such appointments. As a rule, the members of the Board of Management step down at the Annual General Meeting in the year in which they reach the age of 62. Members of the Board of Management can be removed from office by the General Meeting of Shareholders.

Starting with the appointments made in 2004, members of the Board of Management are appointed for four-year terms, with the possibility of reappointment. This is in line with the Code's provision II.1.1. However, the contracts of the members of the Board of Management appointed before 2004 were not renegotiated, as this was not felt to be in the interest of the company.

The Meeting of Holders of Priority Shares has the right to make binding nominations for the appointment of members of the Board of Management and the Supervisory Board. The priority shares are held by the

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Foundation Akzo Nobel. The Board of the Foundation Akzo Nobel consists of the members of the Supervisory Board who are not members of the Audit Committee.

According to the Code's recommendation (provision IV.1.1), the General Meeting of Shareholders should be able to pass a resolution to cancel the binding nature of a nomination for the appointment of the Supervisory Board or the Board of Management. The Articles of Association provide that the holders of priority shares have the power to draw up binding nominations for appointments as aforesaid, which cannot be canceled by the General Meeting of Shareholders.

The company subscribes to the Code's principle in general and therefore—as described at the 2004 Annual Report and discussed at the General Meeting of Shareholders in 2005—it has been decided that in normal circumstances, the members of the Supervisory Board and the Board of Management will be appointed on the basis of a nonbinding nomination by the Supervisory Board. The Board of the Foundation Akzo Nobel has confirmed its intention to use its binding nomination rights only in the case of exceptional circumstances, such as in the event of a (threatened) hostile takeover (reference is made to the description of antitakeover provisions and control below). In both of the aforesaid situations, resolutions to appoint a person as a member of the Supervisory Board or the Board of Management require a simple majority. Of course shareholders, meeting the requirements laid down in the Articles of Association, are also entitled to nominate members of the Supervisory Board or the Board of Management. According to the Articles of Association, such appointments will require a two-thirds majority representing at least 50% of the outstanding share capital.

Although a deviation from provision IV.I.I. of the Code, the Supervisory Board and the Board of Management believe these provisions will enhance the continuity of the company's management and policies.

Members of the Board of Management are allowed to hold a maximum of two supervisory board memberships in other listed companies. This is in line with the Code (provision II.1.7) . The exception to this rule is that in the year prior to their retirement, Board of Management members are allowed to hold more than two supervisory board memberships in order to allow them to prepare for postretirement, as long as this does not interfere with the performance of their tasks as members of the Board of Management. Acceptance of external supervisory board memberships is subject to approval by the Supervisory Board, which power has been delegated to the Chairman of the Supervisory Board.

The handling of (potential) conflicts of interest between the company and members of the Board of Management is governed by the Rules of Procedure for the Board of Management. Decisions to enter into transactions under which Board of Management members would have conflicts of interests that are of material significance to the company, and/or to the relevant Board of Management member, require the approval of the Supervisory Board and will be mentioned in the Annual Report.

### **Antitakeover Provisions and Control**

According to provision IV.3.9 of the Code, the company is required to provide an overview of its actual or potential antitakeover measures and of the circumstances in which they may be used.

The priority shares may be considered to constitute a form of antitakeover measure. In the context of the nomination rights of the Meeting of Holders of Priority Shares the following can be noted. As stated above in connection with the nomination procedure for members of the Supervisory Board and of the Board of Management, the Foundation Akzo Nobel has confirmed that it intends to make use of its binding nomination rights in the event of exceptional circumstances only. These circumstances include situations where in the opinion of the Board of the Foundation the continuity of the company's management and policies is at stake.

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This may be the case if a public bid for the common shares of the company has been announced or has been made, or the justified expectation exists that such bid will be made without any agreement having been reached in relation to such a bid with the company. The same shall apply if one shareholder, or more shareholders acting in a concerted way, are holding a substantial percentage of the issued common shares of the company without making an offer, or if, in the opinion of the Board of the Foundation Akzo Nobel, the exercise of the voting rights by one shareholder or more shareholders, acting in a concerted way, is materially in conflict with the interests of the company and its enterprise. In such cases the Supervisory Board and the Board of Management, in accordance with their statutory responsibility, will evaluate all available options with a view to serving the best interests of the company, its enterprise, and its shareholders and other stakeholders. In order to allow for sufficient time to conduct such an evaluation, the Board of the Foundation Akzo Nobel reserves the right to make use of its binding nomination rights for the appointment of members of the Supervisory Board and of the Board of Management in such circumstances.

In the event of a hostile takeover bid, in general the Supervisory Board and the Board of Management reserve the right to use all powers available to them in the interest of the company and its enterprise.

## **B. COMPENSATION**

### **Remuneration in 2006**

Pursuant to the Dutch [Disclosure of Remuneration of Board Members Act], total remuneration and shares held by members of the Supervisory Board and the Board of Management are specified below.

In 2006, the aggregate remuneration of the Supervisory Board and Board of Management was EUR 6.8 million. The aggregate amount set aside or accrued by the company in 2006 to provide pension, retirement or similar benefits for those individuals was EUR 1.1 million, while the aggregate amount of other compensations was EUR 0.2 million.

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**Supervisory Board**

In respect of their functions the members of the Supervisory Board received the following total remuneration:

| <i>In euros</i>                               |              |                        |                   | <b>2006<br/>Total<br/>remuneration</b> | <b>2005</b> |
|---|--------------|------------------------|-------------------|--|-------------|
|   | Remuneration | Committee<br>allowance | Attendance<br>fee |  |             |
| Maarten van den Bergh, Chairman <sup>1)</sup> | 63,700       | 12,300                 | 16,000            | 92,000                                 | 32,000      |
| Aarnout Loudon <sup>2)</sup>                  | 17,300       | 2,300                  |                   | 19,600                                 | 59,000      |
| Karel Vuursteen <sup>3)</sup>                 | 53,700       | 12,300                 |                   | 66,000                                 | 48,000      |
| Virginia Bottomley <sup>4)</sup>              | 47,000       | 9,000                  | 11,000            | 67,000                                 | 48,000      |
| Dolf van den Brink <sup>5)</sup>              | 47,000       | 15,700                 | 1,000             | 63,700                                 | 52,000      |
| Uwe-Ernst Bufe <sup>5)</sup>                  | 47,000       | 12,300                 | 24,000            | 83,300                                 | 53,000      |
| Antony Burgmans <sup>6)</sup>                 | 33,300       |                        |                   | 33,300                                 |             |
| Abraham Cohen <sup>5)</sup>                   | 47,000       | 12,300                 | 13,000            | 72,300                                 | 54,000      |
| Louis R. Hughes <sup>7)</sup>                 | 33,300       | 10,000                 | 25,000            | 68,300                                 |             |
| Cees van Lede                                 | 47,000       |                        |                   | 47,000                                 | 41,000      |
| Alain Mérieux                                 | 47,000       |                        | 8,500             | 55,500                                 | 41,000      |

1) From May 1, 2006, Chairman and member of the Remuneration Committee and member of the Nomination Committee.

2) Until May 1, 2006, Chairman and member of the Remuneration Committee and member of the Nomination Committee.

3) From May 1, 2006, Deputy Chairman and member of the Remuneration Committee and member of the Nomination Committee.

4) Member of the Remuneration Committee and member of the Nomination Committee.

5) Member of the Audit Committee.

6) From May 1, 2006, member of the Supervisory Board.

7) From May 1, 2006, member of the Supervisory Board Member and from June 1, 2006 member of the Audit Committee.

In accordance with the articles of association and good corporate governance practice, the remuneration of Supervisory Board members is not dependent on the results of the company. As from May 1, 2006, the remuneration of the members of the Supervisory Board has been changed. Fixed remuneration has been changed into EUR 75,000 (2005: EUR 52,000) for the Chairman, EUR 60,000 (2005: EUR 41,000) for the Deputy Chairman and EUR 50,000 (2005: EUR 41,000) for the other members. Members of committees receive an extra compensation. Attendance fees have been increased with respect to members living outside Europe and in Europe but outside the Netherlands. Members living in the Netherlands do not receive an attendance fee.

The company does not grant stock options and/or shares to its Supervisory Board members and does not provide loans to them.

Travel expenses and facilities for members of the Supervisory Board are borne by the company and reviewed by the Audit Committee.

Former members of the Supervisory Board did not receive any remuneration.

**Board of Management***General*

The remuneration policy and the individual service contracts of the members of the Board of Management are determined by the Supervisory Board within the framework of the remuneration policy as adopted by the General Meeting of Shareholders. The Supervisory Board's Remuneration Committee prepares all relevant information and provides advice to the Supervisory Board on all matters relating to the remuneration and other conditions of employment of the Board of Management.





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The objective of the company's remuneration policy is to provide remuneration in a form that will attract, retain, and motivate the members of the Board of Management as top managers of a major international company. In the determination and differentiation of the remuneration levels of the CEO, the CFO, and the other members, due allowance is made for the individual's specific responsibilities. Remuneration is differentiated on a basis comparable to that in other large Dutch multinational companies. To ensure that remuneration is linked to performance, a significant proportion of the remuneration package is variable and dependent on short- and long-term performance of the individual Board member and the company.

#### *Remuneration Policy*

The company's remuneration policy, including all structures and policies related to the remuneration and employment contracts of the Board of Management, is in line with the Dutch Corporate Governance Code.

The total remuneration package of the members of the Board of Management consists of:

- base salary;
- performance-related short-term incentive;
- performance-related stock options;
- performance-related shares;
- pension provisions; and
- other benefits.

To ensure overall competitiveness of the remuneration provided, the remuneration levels of the Board of Management are assessed against a peer group. The Remuneration Committee consults professional independent remuneration experts to ensure an appropriate comparison.

This remuneration package is based on a remuneration policy as adopted by the General Meeting of Shareholders in April 2005. It is the company's policy to move gradually toward overall remuneration levels that are at the median level of the external benchmark of the following peer group of companies:

- |   |   |
|---|---|
| <input type="checkbox"/> Aegon                    | <input type="checkbox"/> Royal Ahold    |
| <input type="checkbox"/> Ciba Specialty Chemicals | <input type="checkbox"/> Royal DSM      |
| <input type="checkbox"/> Clariant                 | <input type="checkbox"/> Royal KPN      |
| <input type="checkbox"/> Heineken                 | <input type="checkbox"/> Royal Numico   |
| <input type="checkbox"/> ICI                      | <input type="checkbox"/> Solvay         |
| <input type="checkbox"/> Reed Elsevier            | <input type="checkbox"/> TNT            |
| <input type="checkbox"/> Rhodia                   | <input type="checkbox"/> Wolters Kluwer |

Royal Ahold and Royal KPN and Wolters Kluwer are not included in the peer group for the CEO. The peer group included five direct competitors of Akzo Nobel. The Supervisory Board is of the opinion that it is relevant to incorporate compensation data from direct competitors to ensure that information relating to the specific industry pay levels and policies is available. In line with the company's remuneration policy, variable performance-related remuneration is an important part of total compensation.

#### *Base salary*

The objective of the base salary is to enable recruitment and retention of top managers of a major international company.

While the focus on variable performance-related compensation elements will continue, the base salaries need to become more aligned with the market median in order to remain competitive. The Supervisory Board considers each

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year whether the circumstances allow a reconsideration of the base salaries.

#### *Short-term incentive (annual bonus)*

The target short-term incentive (annual bonus) is at 100% of the base salary for the CEO and at 65% for the other members of the Board of Management.

The objectives of the short-term incentive are to reward economic value creation (EVA) for our shareholders and other stakeholders, to measure individual and collective performance and to encourage progress in the achievement of long-term strategic objectives.

The bonus opportunity is linked to EVA for 70%; the remaining 30% is based on qualitative individual and collective targets. On the outcome of these elements, the Remuneration Committee applies an overall rating based on the principles of the Performance and Development Dialog, an appraisal system that has been implemented throughout Akzo Nobel in 2005. For the Board of Management, the rating includes a reasonableness test, in which the Supervisory Board critically assesses the actual ambition level of the performance targets in light of the assumptions made at the beginning of the year. It also includes an assessment of the progress made in achieving long-term strategic objectives.

This method for bonus determination is also the basis of the compensation framework for executives in the company as introduced in January 2005.

The performance measure EVA is used in order to encourage the Board of Management to create long-term value for the company's shareholders and other stakeholders. EVA is calculated by deducting from net operating profit after taxes (NOPAT) a capital charge representing the cost of capital calculated on the basis of an average return investors expect. The elements of the EVA calculation cannot be derived directly from the data given in the financial statements, as it takes into account certain adjustments such as addition of non-recurring items and special treatment of strategic investments, acquisitions and divestments.

Targets are set in the context of the medium-term objectives of the company and qualify as commercially sensitive information. The company will not disclose the targets. The Supervisory Board ensures that targets are realistic and sufficiently stretching. The target EVA for the bonus will be determined annually by the Supervisory Board and will be derived from budget. The EVA-related part of the bonus has a performance threshold level of 80% and a maximum performance level of 120% of the targeted EVA. The company's auditors have ascertained that the actual EVA calculation is in line with the guidelines and rules as established.

#### *Long-term incentives*

The objectives of the Akzo Nobel long-term incentive plan are to encourage long-term economic and shareholder value creation, both absolute and relative to our competitors, to align the interests of the Board of Management with those of shareholders and to ensure retention of the members of the Board of Management.

The long-term incentive plan consists of performance stock options and performance shares.

Under the stock option plan, stock options will be conditionally granted on performance upon vesting. The number of stock options that will be granted to the Board of Management is determined by the Supervisory Board. Market levels, as well as company-specific circumstances, will be taken into account in determining the appropriate conditional number of options to be granted. The actual number of options which the Board of Management receives depends on the company's performance during a three-year vesting period. The total option term is seven years.

The performance measure used to determine the number of options that vest is set by the average of the results of

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the comparison between planned and realized EVA on Invested Capital (EOI) or economic value created in relation to invested capital during the period of three consecutive years. This measure is used to encourage EVA performance over a longer period of time. The EOI targets are set annually by the Supervisory Board. Stock options will not vest below 80% of the targeted EOI. The number of granted options is also the maximum number of options that vest upon achieving the targeted performance. If targeted performance is exceeded, there will be no increase in the number of options that vest. The specific targets will not be disclosed as they qualify as commercially sensitive information.

The expected value of performance stock options for the Board of Management is based on the Binomial Option Pricing Model, which is in line with international accounting regulations.

As a policy, the exercise price of the stock options is the Euronext Amsterdam opening price on the first day after the General Meeting of Shareholders that the Akzo Nobel share is quoted ex-dividend.

The aim of the performance share plan is to align the interests of the Board of Management and the shareholders in order to improve the performance of the company. Under the plan, shares will be granted to the members of the Board of Management provided that certain performance targets are achieved and the contract of employment is continued. These targets are determined by the Supervisory Board in the first quarter of the year of issue on the basis of the weighted average of the price of the Akzo Nobel share increased by the dividend paid over a period of three years (Total Shareholder Return).

Due to a merger or takeovers of three companies of the peer group (Degussa, Schering and Serono) these companies are replaced by two new companies (Rohm & Haas and Sherwin Williams).

The TSR will be compared with the following peer group:

- |   |   |
|---|---|
| <input type="checkbox"/> Bayer                    | <input type="checkbox"/> PPG Industries   |
| <input type="checkbox"/> CIBA Specialty Chemicals | <input type="checkbox"/> Rohm & Haas      |
| <input type="checkbox"/> Clariant                 | <input type="checkbox"/> Royal DSM        |
| <input type="checkbox"/> Dow Chemical Company     | <input type="checkbox"/> Sherwin Williams |
| <input type="checkbox"/> DuPont de Nemours        | <input type="checkbox"/> Solvay           |
| <input type="checkbox"/> ICI                      | <input type="checkbox"/> UCB              |
| <input type="checkbox"/> Merck KGaA               | <input type="checkbox"/> Valspar          |
| <input type="checkbox"/> Novo Nordisk             |   |

Based on this peer group, Akzo Nobel will be ranked for its total return to shareholders. Independent external specialists will conduct this analysis to determine the number of shares that will vest over a three-year period. The determination of the final ranking (and thus the vesting of shares) will be reviewed by the company's auditors at the end of the performance period.

Given the company's historical performance, market expectations, and strategy, the following performance incentive zone will apply. There will be no shares that vest for a position below the tenth position of the 15 peer companies. For the fifth position, all shares conditionally granted will vest. The maximum number of shares will vest only for the first position within the peer group. This is 150% of the target value of the number of shares conditionally granted.

The expected value of the performance share plan is based on probability analyses. In valuating its incentive plans, the company is assisted by independent external advisers.

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**Pensions**

The pension plan for all the members of the Board of Management is based on an income- and age-related defined contribution plan and in line with the pension legislation as from January 1, 2006. The available premium is invested with a pension fund. The pension payment at pension age depends on the premiums received and the investment results during the period. The premium percentages to be paid for the Board member concerned are fixed by the Supervisory Board taking into account pension build up (internally or externally) in the period preceding the appointment as Board member and the rules applicable in the country of origin. External reference data can be used in determining market competitive levels of pension arrangements. If applicable, pension rights built up in the period preceding Board membership will be adjusted in conformity with the relevant rules and regulations. Members of the Board of Management pay a personal contribution.

Members of the Board of Management normally retire in the year that they reach the age of 62.

**Employment agreements**

Employment agreements for members of the Board of Management appointed in 2004 and subsequent years are concluded for a period of four years in conformity with the Dutch Corporate Governance Code. After this initial term, reappointments may take place for consecutive periods of four years each or so much shorter as will follow from the application of the date of retirement. If reappointment does not take place and the employment agreement between the Board member concerned and Akzo Nobel NV is not continued, the Board member will be entitled to a severance payment, established in accordance with the Dutch Corporate Governance Code. The amount of this severance payment shall in principle not exceed the equivalent of one year of base salary, or in case of termination upon the first term of four years, two years of base salary. The employment agreements for the members of the Board of Management appointed before 2004 have not been adjusted in this respect. However, the Supervisory Board has the intention to take the provisions of the Code as guidance for establishing severance payments. The employment contracts allow the Supervisory Board to request a Board member to resign between the age of 60 and the regular retirement age for effective succession planning within the Board. In such an exceptional situation, the Board member concerned will be entitled to fixed salary payments until the date of retirement.

The notice period by the Board member is subject to a term of three months; notice by the company shall be subject to a six months term.

**Remuneration in 2006***General*

The remuneration decisions made in 2006 are in line with the remuneration policy as adopted by the General Meeting of Shareholders. The Supervisory Board considered the median market development of the peer group. The remuneration policy stresses the importance of the variable remuneration components. In 2006, the value of fixed and variable components at target levels breaks down as follows:

|          | <b>CEO</b> | <b>Other Board members</b> | <b>Average</b> |
|----------|------------|----------------------------|----------------|
| Fixed    | 36.3%      | 42.7%                      | 40.9%          |
| Variable | 63.7%      | 57.3%                      | 59.1%          |

This breakdown is in line with the policy to provide a highly performance-related remuneration package. The variable components are related to stretching performance targets. Therefore, the reward related to these components may be lower than indicated. Only in case actual performance exceeds targeted performance a reward may be granted that is higher than indicated.

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*Base salary 2006*

The salaries of the members of the Board of Management were increased by 3% on January 1, 2006. The base salary was fixed at EUR 685,000 on a yearly basis for the CEO and EUR 489,300 for the other members.

In spite of the salary adjustment in 2006, the base salary level of the CEO remains approximately 24% below the median level of the peer group of companies used in the external comparison. For the other members, the percentage amounts to approximately 12% below the median level.

*Short-term incentive (annual bonus) 2006*

Bonuses, to be paid out over 2006 to the members of the Board of Management, are based on achieved target performance and a score of the P&D Dialog which exceeded 100%. The increase of the bonus for the chairman is reflecting the increase of the at-target bonus from 80% to 100% (as decided by the shareholder meeting in 2006) and the strong company performance.

*Long-term incentives 2006*

Under the option plan applicable as from the year 2004, 19,800 conditional options were granted to the CEO and 13,000 to the other members of the Board of Management. The number of performance-related shares granted to the members of the Board of Management in 2006 amounted to 23,000 for the CEO and 15,100 for the other Board members.

With respect to the performance shares granted in 2004, calculation of the TSR performance has been made for the companies of the peer group. In order to adjust for changes in exchange rates, all native currencies are converted into euros. Based on the EOI performance over the period 2004-2006, all stock options (conditionally) granted to the members of the Board of Management became unconditional.

Akzo Nobel's performance over the period January 1, 2004 to December 31, 2006, resulted in a ninth position within the ranking of the peer group companies. Consequently, the final vesting percentage of the 2004 grant equals 40%, resulting in a definitive grant of shares (including the compounded dividend yield till December 31, 2006) of 14,596 shares for the CEO and 9,731 shares for the other members of the Board of Management.

Akzo Nobel's Total Shareholder Return, compared with the adjusted peer group over a three-year period, determines the following position with regard to the performances shares, granted in 2005 and 2006:

- for the two-year period ending 2006: Akzo Nobel's position is 6 (2005: 7); and
  - for the one-year period ending 2006: Akzo Nobel's position is 6.
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**Overview of Remuneration 2006**

The members of the Board of Management received the following salaries, performance-related bonuses, emoluments and other compensations.

| <i>In euros</i>              | <b>2006</b> | <b>2005</b> |
|------------------------------|-------------|-------------|
| <b>Hans Wijers, Chairman</b> |             |             |
| Salary                       | 685,000     | 665,000     |
| Bonus                        | 1,020,500   | 790,000     |
| Other emoluments             | 3,600       | 6,600       |
| <b>Leif Darner</b>           |             |             |
| Salary                       | 489,300     | 475,000     |
| Bonus                        | 474,500     | 460,000     |
| Other emoluments             | 3,600       | 4,800       |
| <b>Rob Frohn</b>             |             |             |
| Salary                       | 489,300     | 475,000     |
| Bonus                        | 474,500     | 460,000     |
| Other emoluments             | 5,900       | 7,100       |
| <b>Toon Wilderbeek</b>       |             |             |
| Salary                       | 489,300     | 475,000     |
| Bonus                        | 474,500     | 460,000     |
| Other emoluments             | 3,600       | 3,200       |

Other emoluments concern employer's charges (social contributions and healthcare contributions).

**Other Compensations**

Other compensations for members of the Board of Management borne by the company amounted to EUR 123,400 for Mr. Darner, related to compensation for living expenses and contributions to an international school. The compensation fee for Mr. Frohn relating to his move to the Netherlands amounted to EUR 34,600.

**Pension Charges**

After deduction of any contributions made by members of the Board of Management, pension expenses borne by the company were as follows:

| <i>In euros</i>       | <b>2006</b> | <b>2005</b> |
|-----------------------|-------------|-------------|
| Hans Wijers, Chairman | 421,300     | 354,600     |
| Leif Darner           | 218,800     | 167,900     |
| Rob Frohn             | 144,900     | 111,900     |
| Toon Wilderbeek       | 263,500     | 261,400     |

**Incentives**

In 2006, conditional and performance-related stock options and shares were granted to the members of the Board

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of Management.

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The aggregate number of options held by the members of the Board of Management at December 31, 2006, is as follows:

| <i>Number of options</i>          | <b>Year of issue</b> | <b>Exercise price in EUR</b> | <b>Outstanding at December 31, 2005</b> | <b>Granted in 2006</b> | <b>Exercised in 2006</b> | <b>Outstanding at December 31, 2006</b> | <b>Expiry date</b> |
|-----------------------------------|----------------------|------------------------------|---|------------------------|--------------------------|---|--------------------|
| Hans Wijers                       | 2002                 | 46.53                        | 14,850                                  |                        |                          | 14,850                                  | April 25, 2012     |
|                                   | 2003                 | 19.51                        | 29,700                                  |                        |                          | 29,700                                  | April 22, 2010     |
|                                   | 2004                 | 31.45                        | 23,000                                  |                        |                          | 23,000                                  | April 25, 2011     |
|                                   | 2005                 | 31.98                        | 23,000                                  |                        |                          | 23,000                                  | April 24, 2012     |
|                                   | 2006                 | 46.46                        |   | 19,800                 |                          | 19,800                                  | April 27, 2013     |
| Value outstanding options, in EUR |                      |                              |   |                        |                          | 1,723,800                               |                    |
| Leif Darner                       | 2001                 | 46.75                        | 4,950                                   |                        | (4,950)                  |   | April 25, 2009     |
|                                   | 2002                 | 46.53                        | 4,950                                   |                        |                          | 4,950                                   | April 22, 2010     |
|                                   | 2003                 | 19.51                        | 4,950                                   |                        |                          | 4,950                                   | April 25, 2011     |
|                                   | 2004                 | 31.45                        | 15,000                                  |                        |                          | 15,000                                  | April 24, 2012     |
|                                   | 2005                 | 31.98                        | 15,000                                  |                        |                          | 15,000                                  | April 27, 2013     |
|                                   | 2006                 | 46.46                        |   | 13,000                 |                          | 13,000                                  |                    |
| Value outstanding options, in EUR |                      |                              |   |                        |                          | 701,500                                 |                    |
| Rob Frohn                         | 2001                 | 46.75                        | 4,950                                   |                        | (4,950)                  |   | April 25, 2009     |
|                                   | 2002                 | 46.53                        | 4,950                                   |                        |                          | 4,950                                   | April 22, 2010     |
|                                   | 2003                 | 19.51                        | 4,950                                   |                        |                          | 4,950                                   | April 25, 2011     |
|                                   | 2004                 | 31.45                        | 15,000                                  |                        |                          | 15,000                                  | April 24, 2012     |
|                                   | 2005                 | 31.98                        | 15,000                                  |                        |                          | 15,000                                  | April 27, 2013     |
|                                   | 2006                 | 46.46                        |   | 13,000                 |                          | 13,000                                  |                    |
| Value outstanding options, in EUR |                      |                              |   |                        |                          | 701,500                                 |                    |

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|                                   |      |       |        |         |           |                |
|-----------------------------------|------|-------|--------|---------|-----------|----------------|
| Toon Wilderbeek                   | 2001 | 46.75 | 6,600  | (6,600) |           |                |
|                                   | 2002 | 46.53 | 3,300  |         | 3,300     | April 25, 2009 |
|                                   | 2002 | 46.53 | 13,200 |         | 13,200    | April 25, 2012 |
|                                   | 2003 | 19.51 | 26,400 |         | 26,400    | April 22, 2010 |
|                                   | 2004 | 31.45 | 15,000 |         | 15,000    | April 25, 2011 |
|                                   | 2005 | 31.98 | 15,000 |         | 15,000    | April 24, 2012 |
|                                   | 2006 | 46.46 |        | 13,000  | 13,000    | April 27, 2013 |
| Value outstanding options, in EUR |      |       |        |         | 1,346,800 |                |

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For the performance-related shares granted to the members of the Board of Management in 2004, a calculation of the TSR performance of the peer group companies, based on their home/primary listing were made by independent external specialists. The TSR was calculated over the period from January 1, 2004 through December 31, 2006. Akzo Nobels' TSR performance over this period resulted in a no. 9 ranking. In conformity with the Akzo Nobel Performance Share Plan as approved by the General Meeting of Shareholders, the final vesting percentage of the 2004 grant equals 40%.

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| Number of performance-related shares | Series    | Outstanding at December 31, 2005 | Granted in 2006 | Accumulated dividend till December 31, 2006 <sup>1</sup> | Forfeited | Vested on January 1, 2007 | Outstanding at December 31, 2006 |
|--------------------------------------|-----------|----------------------------------|-----------------|--|-----------|---------------------------|----------------------------------|
| Hans Wijers                          | 2004-2006 | 33,000                           |                 | 1,396  | (19,800)  | 14,596                    |                                  |
|                                      | 2005-2007 | 33,000                           |                 | 2,112  |           |                           | 35,112                           |
|                                      | 2006-2008 |                                  | 23,000          | 607  |           |                           | 23,607                           |
| Leif Darner                          | 2004-2006 | 22,000                           |                 | 931  | (13,200)  | 9,731                     |                                  |
|                                      | 2005-2007 | 22,000                           |                 | 1,408  |           |                           | 23,408                           |
|                                      | 2006-2008 |                                  | 15,100          | 399  |           |                           | 15,499                           |
| Rob Frohn                            | 2004-2006 | 22,000                           |                 | 931  | (13,200)  | 9,731                     |                                  |
|                                      | 2005-2007 | 22,000                           |                 | 1,408  |           |                           | 23,408                           |
|                                      | 2006-2008 |                                  | 15,100          | 399  |           |                           | 15,499                           |
| Toon Wilderbeek                      | 2004-2006 | 22,000                           |                 | 931  | (13,200)  | 9,731                     |                                  |
|                                      | 2005-2007 | 22,000                           |                 | 1,408  |           |                           | 23,408                           |
|                                      | 2006-2008 |                                  | 15,100          | 399  |           |                           | 15,499                           |

<sup>1</sup>. Equivalent in shares to accumulated dividend.

The shares granted under the Performance Share Plan will be conditional to a performance period of three years. The shares will be retained for a period of five years by the members of the Board of Management.

The share price of a common share Akzo Nobel NV used in the calculations as at December 29, 2006 was EUR 46.21 (2005: EUR 39.15)

## C. BOARD PRACTICES

### Rules of Procedure, Codes of Conduct, Complaints Procedures

The Supervisory Board has adopted Rules of Procedure that address internal procedural issues for the Board of Management. The members of the Board of Management are subject to the Akzo Nobel Rules on Inside Information, which limits their opportunities to trade in Akzo Nobel and in certain circumstances other company shares. Transactions in Akzo Nobel shares executed by the Board of Management are notified to the Dutch Authority for the Financial Markets in accordance with Dutch law and, if necessary, to other relevant authorities.

The Akzo Nobel Rules on Inside Information provide that making use of inside information by executing transactions in Akzo Nobel securities, as well as securities other than Akzo Nobel securities, is prohibited if the person concerned has inside information regarding such securities. The rules also provide that the Compliance Officer may determine that transactions in securities other than Akzo Nobel securities are prohibited, irrespective of whether he or she has inside information and has notified the relevant designated persons thereof. Akzo Nobel has chosen not to follow the provisions of the Code (provision II.2.6) requiring notification by members of the Board of Management of all changes in holdings of shares in Dutch listed companies, as it believes that in addition to the cited restrictions, this will create an unnecessary administrative burden.

A comprehensive code of conduct followed by officers and employees committed to individual and corporate integrity is one of the critical foundations of good corporate governance. Akzo Nobel's Company Statement and

Business Principles set out the company's position. They guide all our employees in their daily work. The company has established several procedures to arrange for company-wide dissemination of the Business Principles and training. It has also established procedures to monitor compliance with the Business Principles

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in general, and certain of its provisions in particular, and to provide for enforcement of the Business Principles. The Business Principles are available on the company's corporate website.

The Board of Management has adopted a Code of Ethics for senior financial officers. The designated persons, including the CEO and the CFO, have to confirm annually in writing that they have adhered to this Code. The Code of Ethics can be found on the company's corporate website.

A complaints procedure enables employees to file complaints concerning practices that violate the Business Principles, Policy statements on Human Resources, HSE and Security, and Corporate Directives. This procedure ensures that employees have the opportunity to report alleged irregularities without jeopardizing their legal position. Furthermore, there is a procedure for complaints regarding accounting, internal control, and auditing matters. Pursuant to SOX, the Audit Committee is directly responsible for receiving and handling complaints based on this financial complaints procedure and for providing confidentiality for whistleblowers on such matters. These procedures are posted on the company's corporate website.

### **Summary of Significant Differences between Dutch Corporate Governance Practices and the NASDAQ Corporate Governance Standards**

In accordance with NASDAQ Rule 4350(a)(1), Akzo Nobel N.V. as a foreign private issuer may follow its home country practice in lieu of certain requirements of Rule 4350, provided it discloses in its annual reports filed with the SEC each requirement of Rule 4350 that it does not follow and describes the home country practice followed in lieu of such requirements.

Akzo Nobel N.V. does not follow the requirements of Rule 4350(b)(1)(A) and Rule 4350(g). Rule 4350(b)(1)(A) states that each issuer shall distribute to shareholders copies of an annual report containing audited financial statements of the company and its subsidiaries. The report shall be distributed to shareholders a reasonable period of time prior to the company's annual meeting of shareholders and shall be filed with NASDAQ at the time it is distributed to shareholders. Rule 4350(g) states that each issuer shall solicit proxies and provide proxy statements for all meetings of shareholders and shall provide copies of such proxy solicitation to NASDAQ. It is not common practice in the Netherlands nor is it required by Dutch law for listed companies to voluntarily distribute to shareholders copies of the annual report containing audited financial statements of the company and its subsidiaries. The same can be said for soliciting proxies and providing proxy statements for meetings of shareholders.

Because shares in Dutch listed companies usually are bearer shares (as are Akzo Nobel N.V.'s common shares), and because these shares are held by securities intermediaries, Dutch listed companies generally do not know who their shareholders are. This prevents the distribution of materials to shareholders. To solve this problem, Akzo Nobel N.V. was one of the key companies in the establishment of the Shareholders' Communication Channel, a project of Euronext Amsterdam, banks in the Netherlands, and several major Dutch companies to enable communication between a company and its shareholders and amongst shareholders themselves. Through the Shareholders' Communication Channel, Akzo Nobel N.V. can communicate with shareholders who hold their shares through an associated bank and have actively indicated that they want to participate in this system. In practice, this means that mainly Dutch retail investors are reached through the Shareholders' Communication Channel.

Akzo Nobel N.V. uses the Shareholders' Communication Channel to distribute the notice of the General Meeting of Shareholders and a voting instruction form, thereby giving shareholders the possibility to have their votes executed by a civil law notary at the General Meeting of Shareholders. As for ADR holders, they are also sent the notice of the General Meeting of Shareholders and a voting instruction form via the sponsor of the

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ADR Program, Deutsche Bank. For all the relevant information about the General Meeting of Shareholders, shareholders participating in the Shareholders' Communication Channel and ADR holders are referred to the company's corporate website, on which all relevant information, including the annual report containing audited financial statements, are published. Neither these documents nor a proxy statement are distributed. This is not required by Dutch law. Article 2:394 of the Dutch Civil Code requires public limited liability companies to publish the annual accounts, the annual report and the other documents as referred to in article 2:392 of the Dutch Civil Code by depositing copies of these documents at the commercial registry kept by the Chamber of Commerce and Industry. In addition, it is common practice that listed companies publish these documents on their company website. Akzo Nobel N.V. follows this practice and also posts its Form 20-F on the company's corporate website. As the Form 20-F is filed with the SEC via the Electronic Data Gathering, Analysis, and Retrieval (EDGAR) system, it is also publicly available via the website of the SEC. Finally, if a shareholder or ADR holder so requests, he is provided with a copy of these documents free of charge.

The practice described above is in line with the best practice provisions of the Dutch Corporate Governance code of December 9, 2003, that is applicable to all Dutch listed companies.

#### D. EMPLOYEES

The tables below set forth the distribution of the number of employees per group and geographical area for the last three fiscal years.

|              | <b>Number of employees per segment, December 31</b> |               |               |
|--------------|---|---------------|---------------|
|              | 2006  | 2005          | 2004          |
| Organon      | 13,710  | 14,100        | 14,090        |
| Intervet     | 5,370   | 5,260         | 5,270         |
| Coatings     | 31,660  | 29,200        | 28,860        |
| Chemicals    | 9,680   | 11,430        | 11,890        |
| Other        | 1,460   | 1,350         | 1,340         |
| <b>Total</b> | <b>61,880</b>                                       | <b>61,340</b> | <b>61,450</b> |

|                          | <b>Number of employees by country or region, December 31,</b> |        |        |
|--------------------------|---|--------|--------|
|                          | 2006  | 2005   | 2004   |
| The Netherlands          | 11,130  | 11,580 | 11,320 |
| Germany                  | 4,020   | 4,120  | 4,140  |
| Sweden                   | 3,890   | 3,950  | 4,000  |
| United Kingdom           | 3,880   | 4,100  | 4,250  |
| Other European countries | 13,350  | 12,850 | 13,460 |
| USA and Canada           | 8,840   | 8,210  | 8,380  |
| Latin America            | 4,360   | 4,390  | 4,420  |
| Asia                     | 10,320  | 9,810  | 9,190  |
| Other regions            | 2,090   | 2,330  | 2,290  |

|       |               |               |               |
|-------|---------------|---------------|---------------|
| Total | <b>61,880</b> | <b>61,340</b> | <b>61,450</b> |
|-------|---------------|---------------|---------------|

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At the end of 2006, the company had 61,880 employees, compared with 61,340 at year-end 2005. Growth of our business in emerging markets resulted in a workforce expansion of 1,220, while restructuring programs in Coatings, Chemicals, and Organon in the mature markets resulted in a decrease of 1,160. Acquisitions (2,000) and divestments (1,520) on balance added 480.

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The company generally has good relationships with the labor unions.

## **E. SHARE OWNERSHIP**

### ***Shares of Akzo Nobel N.V. held by the Members of the Supervisory Board and the Board of Management***

At May 31, 2007, the members of Supervisory Board held 900 Akzo Nobel N.V. common shares and did not hold any other Akzo Nobel N.V. securities.

The ownership of Akzo Nobel N.V. common shares breaks down as follows:

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#### *Number of shares*

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|                    |     |
|--------------------|-----|
| Virginia Bottomley | 500 |
| Karel Vuursteen    | 400 |

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At May 31, 2007, the members of the Board of Management held 41,922 Akzo Nobel N.V. common shares, which do not include the conditional entitlements on performance-related shares, for which reference is made to Item 6.B. The ownership breaks down as follows:

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#### *Number of shares*

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|             |        |
|-------------|--------|
| Hans Wijers | 20,530 |
| Leif Darner | 8,661  |
| Rob Frohn   | 12,731 |

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Members of the Board of Management held no options other than the stock options disclosed in Item 6.B.

No member of the Supervisory Board or the Board of Management beneficially owns more than 1 percent of Akzo Nobel N.V. common shares.

## **Item 7. MAJOR SHAREHOLDERS AND RELATED PARTY TRANSACTIONS**

### **A. MAJOR SHAREHOLDERS**

As required by the Disclosure of major Holdings in Listed Companies Act 1996, the Netherlands Authority for the Financial Markets announced in July 2002 that ING had acquired a position of 5 percent in Akzo Nobel common shares. At May 31, 2007, ING held 14,984,723 common shares, representing 5.3 percent of Akzo Nobel common shares outstanding. ING does not have any different voting rights from the rights of other common shareholders.

At year-end 2006, Akzo Nobel estimates that there were approximately 50% of its shares (including ADRs) held in the United States, 20% in the Netherlands, 11% in the United Kingdom, and 19% in other countries. About 10% of the total number of shares were owned by private investors and 90% by institutional investors.

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In February 1989, Akzo Nobel established a sponsored American Depositary Receipt facility with Morgan Guaranty Trust Company of New York, as depositary, pursuant to which American Depositary Receipts (["ADRs"]) representing American Depositary Shares (["ADSs"]) are issued. In October 1999, Akzo Nobel terminated its depositary arrangements with Morgan Guaranty Trust Company and appointed Citibank, N.A., as depositary for its ADR facility. In October 2004, Akzo Nobel terminated its depositary arrangements with Citibank, N.A. and appointed Deutsche Bank Trust Company Americas, as depositary for its ADR facility. In connection with the four-for-one stock split, which took effect on July 1, 1998, the ADSs were redenominated so that one ADS represents one Akzo Nobel common share (until July 1, 1998 each ADS represented one-half of a common share of Akzo Nobel). Akzo Nobel has been informed by the depositary that in the United States as of May 31, 2007, there were 22,835,045 sponsored ADSs (representing 8 percent of the outstanding common shares) which were held by 1,755 record holders.

### **Relations with Shareholders and Other Investors**

Akzo Nobel has three classes of shares: common shares, cumulative preferred shares, and priority shares. Common shares are traded on the Euronext Amsterdam stock exchange and in the form of American Depositary Shares on NASDAQ in the United States. No preferred shares have been issued to date. It has been communicated that the preferred shares merely have a financing function, which means that, if necessary, they will be issued at or near to the prevailing quoted price for common shares. The priority shares are held by the Foundation Akzo Nobel. The Foundation's Board consists of members of Akzo Nobel's Supervisory Board who are not members of the Audit Committee.

General Meetings of Shareholders are held at least once a year. The General Meeting of Shareholders is convened by public notice. The agenda and the notes to the agenda are published in advance and posted on the company's corporate website. The notes to the agenda contain all relevant information with respect to the proposed resolutions. All resolutions are made on the basis of the "one share, one vote" principle. The General Meeting of Shareholders reviews the Annual Report and decides on adoption of the Financial Statements and the dividend proposal, as well as on the discharge of the members of the Supervisory Board and the Board of Management. Holders of common shares in aggregate representing at least 1% of the total issued capital may submit proposals in writing for the agenda of the General Meeting at the company's office, at least six weeks in advance. Such requests shall be granted unless the Supervisory Board and the Board of Management are of the opinion that this is evidently not in the best interest of the company. The General Meeting of Shareholders will be provided with all requested information, unless the Supervisory Board and the Board of Management are of the motivated opinion that this is contrary to an overriding interest of the company.

The company attaches great value to shareholder relations. Akzo Nobel uses the Shareholders' Communication Channel to distribute the agenda of the Annual General Meeting and to allow shareholders who hold their shares through an associated bank, participation in the proxy voting at said meeting. Holders of American Depositary Shares are also given the opportunity to vote by proxy.

In conformity with relevant laws and regulations, the company provides all shareholders and other parties in the financial markets with equal and simultaneous information about matters that may influence the share price, thereby taking into account possible exceptions permitted by those laws and regulations.

Akzo Nobel actively communicates its strategy and the developments of its businesses to the financial markets. Members of the Board of Management and business managers regularly attend analysts meetings in Europe and the United States. The quarterly results, press conferences, and the analysts' conference calls, as well as the presentations at analysts meetings organized by the company, are all announced in advance, and are available as webcasts and accessible online. Presentations to (institutional) investors are held at regular intervals and, in principle, are announced on the company's website or by press releases. Other meetings with

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analysts or investors are not normally announced in advance, nor can they be followed by webcast or any other means. Discussions in such meetings are limited to information that is already in the public domain. This is in line with the requirement to ensure that all shareholders and other parties in the financial market have equal and simultaneous access to information that may influence the share price. In this respect, the company complies with applicable laws and regulations. In principle, analyst meetings, presentations to (institutional) investors, and direct meetings with investors are not held shortly before publication of the quarterly and annual results.

## **B. RELATED PARTY TRANSACTIONS**

The associates of Akzo Nobel N.V. are shown in Exhibit 8, to which reference is made. Certain associates sell goods and provide services to consolidated Akzo Nobel companies. In addition, consolidated Akzo Nobel companies sell goods and provide services to certain associates. Such transactions were not significant on an individual or aggregate basis. These transactions were conducted at arm's length with terms comparable to transactions with third parties.

In the ordinary course of business the company has transactions with various organizations with which certain of its members of the Supervisory Board or Board of Management are associated but no material transactions responsive to this item have been entered into in the period commencing January 1, 2004 to the date of this report. Likewise there have been no transactions with members of the Supervisory Board or Board of Management, any other senior management personnel or any family member of such persons. Also no loans have been extended to members of the Supervisory Board or Board of Management, any other senior management personnel or any family member of such persons.

## **C. INTEREST OF EXPERTS AND COUNSEL**

Not applicable.

## **Item 8. FINANCIAL INFORMATION**

### **A. CONSOLIDATED STATEMENTS AND OTHER FINANCIAL INFORMATION.**

See Item 18 "Financial Statements" for the Consolidated Financial Statements of the company. The consolidated financial statements of Akzo Nobel have been prepared in accordance with International Financial Reporting Standards (IFRS) and its interpretations adopted by the EU. IFRS as adopted by the EU is the same for Akzo Nobel as IFRS promulgated by the International Accounting Standards Board.

### **Legal Proceedings**

See Note 25 of the Notes to the Consolidated Financial Statements in this report.

### **Dividend Policy**

It is Akzo Nobel's current intention to pay a dividend of 35 - 40 percent of net income excluding restructuring and impairment charges and results on divestments, but this is subject to earnings, management's views on the business and allocation of capital, as well as the impact of acquisitions and divestments, and so could change at any time.

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**B. SIGNIFICANT CHANGES****Report for the First Quarter of 2007**

The report for the first quarter of 2007 was published on April 24, 2007 and a Form 6-K was furnished with the SEC on the same date. The report is incorporated by reference in this Annual Report.

**Binding cash offer for Organon BioSciences from Schering-Plough**

After a comprehensive review of all the options for Akzo Nobel's businesses going forward, during 2006 management concluded that the most appropriate solution for all parts of the business was to separate Organon and Intervet from our Coatings and Chemicals activities. In order to prepare for this separation we incorporated our Pharma activities into a holding company: Organon BioSciences. On March 12, 2007, the company announced its intention to divest Organon BioSciences to Schering-Plough, following their EUR 11 billion binding cash offer. After careful consideration it was concluded that this cash offer represented full value to Akzo Nobel, while providing a new home for Organon BioSciences as it becomes part of Schering-Plough—one of the largest pharmaceutical companies in the world. The parties expect that the transaction could be completed in the second half of 2007, after consultation with social partners and clearance from regulatory bodies. At December 31, 2006, the company had not made a decision to sell Organon BioSciences, but was in the process of preparing for an IPO, while still retaining a majority control of Organon BioSciences. Therefore, it was not a discontinued operation at December 31, 2006.

**EUR 1.6 billion share buyback program**

On April 24, 2007, the company announced that it would commence a EUR 1.6 billion open market share buyback program on May 3, 2007. At the current share price, this represents approximately 10% of the common shares outstanding. Following shareholder approval on April 25, 2007, the repurchased shares will be cancelled. The open market repurchase program is expected to be completed by the end of 2007. The repurchase price will be based on the daily VWAP (Volume Weighted Average Price) and the program will be in full compliance with the Safe Harbor trading and volume restrictions of the Market Abuse Directive. Akzo Nobel provides weekly progress updates to the market. Up to June 8, 2007, 6,430,000 common shares have been purchased for a total amount of EUR 383.1 million.

**Flexsys divestment**

The company's 50%-stake in Flexsys was divested per May 1, 2007.

**Court case in the Netherlands on pensions**

Late January 2006, Akzo Nobel Nederland B.V. and the Akzo Nobel Pension Fund in the Netherlands received a summons from the Association of Retired Akzo Nobel Employees with regard to the changed financing of the company's Dutch pension plan. In January 2007, the court dismissed all claims against Akzo Nobel Nederland BV and the Akzo Nobel Pension Fund. The Association of retired Akzo Nobel Employees has instituted an appeal against the judgment of the court.

**Item 9. THE OFFER AND LISTING****A. OFFER AND LISTING DETAILS**

The tables below sets forth the high and low sales prices for Akzo Nobel common shares on the EURONEXT stock exchange in Amsterdam during the periods indicated and for the ADSs on NASDAQ/NMS. One ADS represents one Akzo Nobel common share.

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|                              | <b>Amsterdam</b>                  |       | <b>NASDAQ/NMS</b>                      |       |
|------------------------------|-----------------------------------|-------|--|-------|
|                              | High<br><i>In euros per share</i> | Low   | High<br><i>In U.S. dollars per ADS</i> | Low   |
| 2002                         | 54.50                             | 27.25 | 47.30                                  | 27.56 |
| 2003                         | 32.44                             | 16.00 | 38.67                                  | 18.12 |
| 2004                         | 33.79                             | 24.87 | 43.75                                  | 30.88 |
| 2005                         | 40.18                             | 30.82 | 47.16                                  | 38.96 |
| 2006                         | 49.41                             | 38.30 | 62.19                                  | 46.46 |
| 2005 1 <sup>st</sup> quarter | 35.54                             | 30.96 | 46.16                                  | 39.56 |
| 2 <sup>nd</sup> quarter      | 36.28                             | 30.82 | 46.84                                  | 38.96 |
| 3 <sup>rd</sup> quarter      | 36.40                             | 32.23 | 43.84                                  | 39.33 |
| 4 <sup>th</sup> quarter      | 40.18                             | 34.65 | 47.16                                  | 42.25 |
| 2006 1 <sup>st</sup> quarter | 45.60                             | 38.30 | 54.72                                  | 46.46 |
| 2 <sup>nd</sup> quarter      | 49.41                             | 39.14 | 59.90                                  | 49.42 |
| 3 <sup>rd</sup> quarter      | 48.78                             | 40.15 | 61.75                                  | 50.27 |
| 4 <sup>th</sup> quarter      | 48.80                             | 41.75 | 62.19                                  | 53.63 |
| December 2006                | 46.30                             | 42.90 | 61.02                                  | 57.23 |
| January 2007                 | 49.75                             | 46.25 | 63.83                                  | 61.15 |
| February 2007                | 48.85                             | 44.55 | 63.65                                  | 60.11 |
| March 2007                   | 57.61                             | 44.41 | 76.47                                  | 58.24 |
| April 2007                   | 60.38                             | 56.18 | 81.09                                  | 76.00 |
| May 2007                     | 61.32                             | 57.99 | 82.00                                  | 78.51 |

**B. PLAN OF DISTRIBUTION**

Not applicable.

**C. MARKETS**

As of May 31, 2007, the Akzo Nobel common shares were listed on the following stock exchanges:

The Netherlands: Euronext Amsterdam  
United States of America: NASDAQ/NMS, as American Depositary Shares  
The Euronext stock exchange in Amsterdam is the principal trading market for Akzo Nobel common shares.

**D. SELLING SHAREHOLDERS**

Not applicable.

**E. DILUTION**

Not applicable.

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**F. EXPENSES OF THE ISSUE**

Not applicable.

**Item 10. ADDITIONAL INFORMATION****A. SHARE CAPITAL**

Not applicable.

**B. MEMORANDUM AND ARTICLES OF ASSOCIATION**

The following description sets out certain information concerning the company's common shares and summarizes certain provisions of the company's Articles of Association (the "Articles of Association" or the "Articles") and the Dutch Civil Code<sup>1</sup>. This summary does not purport to be complete and is qualified in its entirety by reference to the company's Articles of Association and the Dutch Civil Code.

The Articles of Association were amended by resolution of the General Meeting of Shareholders on April 21, 2005. The amended Articles of Association came into effect on July 1, 2005. The amended Articles were furnished on Form 6-K on July 12, 2005.

The company's authorized capital is EUR 1,600,019,200, which is divided into 48 priority shares of EUR 400 each, 600,000,000 common shares of EUR 2 each, and 200,000,000 cumulative preferred shares of EUR 2 each, divided into fifty series numbered 1 through 50 of 4,000,000 shares each. As of December 31, 2006, 48 priority shares and 287,268,350 common shares were issued and fully paid up.

**Principal Objects**

Article 3 of the company's Articles of Association provides that its objects include participation directly or indirectly in partnerships, companies and other legal entities, and to do all such things necessary to manage and finance such entities, including the holding and administering of patents and other intellectual property rights.

**General**

All of the issued and outstanding common shares are fully paid and nonassessable. Common shares are registered shares or bearer shares, at the option of the shareholder concerned. Registered shares may be Model I shares (no share certificate issued) or Model II shares (share certificate issued without a dividend sheet). A shareholder may also elect to replace Model I shares with Model II shares, and vice versa, subject to any minimum number of shares established by the Board of Management. Model I registered shares may be transferred by delivery to the company of a signed deed of transfer in the form made available by the company. Model II registered shares may be transferred by delivery of the certificate for such shares, if the form on its reverse, of a similar instrument accompanying the certificate, has been signed by the transferor.

<sup>1</sup> All references to the Articles of Association and the Dutch Civil Code are based upon English translations of such documents and are qualified by the original Dutch provisions.

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## **Voting Rights**

At shareholders' meetings each cumulative preferred share and each common share is entitled to one vote. Each priority share is entitled to two hundred votes. Attendance, whether by person or by proxy, for purposes of having the right to vote at a general meeting is decided upon by the chairman of the general meeting in accordance with the Articles of Association. Unless the Articles of Association or the Dutch Civil Code stipulate otherwise, all resolutions of the General Meeting of Shareholders must be approved by a majority of the votes cast. The chairman of the meeting shall decide the manner of voting, including the possibility of voting by acclamation.

The number of members of both the Supervisory Board and the Board of Management is determined by the General Meeting of Shareholders on the proposal of the Supervisory Board. The members of both Boards are appointed and removed from office by the General Meeting of Shareholders. Appointment shall be made from a binding list of at least two nominees for each vacancy to be filled, such list to be drawn up by the meeting of holders of priority shares within three months of the date that the Board of Management shall by registered letter have invited the holders of priority shares to do so. If the binding list of nominees has not been drawn up in time, the General Meeting of Shareholders shall be free to nominate and appoint candidates of its own choice. Nominees for any one vacancy may not at the same meeting be nominated to fill any other vacancy. The priority shares are held by the Foundation Akzo Nobel. The Board of the Foundation consists of the members of the Supervisory Board who are not member of the Audit Committee. Due to a grandfathering provision of the legislator at the time, these nominations cannot be cancelled by the General Meeting of Shareholders. The Board of the Foundation has confirmed its intention to use its binding nomination rights only in case of exceptional circumstances, such as in the event of a (threatened) hostile takeover. This is confirmed in the Articles of Association of the Foundation.

In the event the meeting of holders of priority shares has not drawn up a binding list as referred to above, the Supervisory Board may make a nonbinding nomination consisting of one person. In the event the meeting of holders of priority shares has not drawn up a binding list as referred to above, a resolution to appoint a member of the Board of Management, not nominated by the Supervisory Board, shall be adopted by at least a two-thirds majority of the votes cast, if such majority represents more than half the issued share capital.

Unless the General Meeting of Shareholders resolves otherwise at the proposal of the Supervisory Board:

- a. a member of the Supervisory Board shall be appointed for a term that shall lapse in the fourth year after the year of his appointment, on the last day of the month in which the annual General Meeting is held; and
- b. a person may serve on the Supervisory Board for a maximum of twelve years, provided however that exceeding this term pursuant to a resignation at the annual General Meeting of Shareholders in the final year of his term is allowed.

A member of the Supervisory Board may be reappointed with due observance of the provisions mentioned above.

A member of the Board of Management shall be appointed for a maximum period of four years, provided however that unless such member of the Board of Management has resigned at an earlier date, his term of office shall lapse on the day, in the fourth year after the year of his appointment, on the last day of the month in which the annual General Meeting is held. A member may be reappointed with due observance of the preceding sentence. By resolution of the General Meeting of Shareholders, the maximum period of four years may be deviated from.

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The General Meeting of Shareholders can only adopt a resolution to remove a member of the Supervisory Board or a member of the Board of Management from office by a two-thirds majority of the votes cast, in the event that less than half of the issued capital is represented, unless the Supervisory Board itself proposes the removal.

The General Meeting of Shareholders determines the remuneration of the members of the Supervisory Board, which shall consist of a fixed amount per annum and which may include a variable remuneration.

The General Meeting of Shareholders adopts the remuneration policy for the Board of Management, upon a proposal of the Supervisory Board. The remuneration of members of the Board of Management will, with due observance of this policy, be determined by the Supervisory Board. A proposal regarding the arrangements for the remuneration of the Board of Management in the form of shares or rights to acquire shares shall need the approval of the General Meeting of Shareholders.

Resolutions of the Board of Management with regard to an important change in the identity or character of the company or the enterprise shall be subject to the approval of the General Meeting of Shareholders.

A proposal to dissolve the company requires the prior approval of the Supervisory Board. A resolution to dissolve the company may be adopted only by a majority of at least two-thirds of the votes cast in a General Meeting of Shareholders at which at least two-thirds of the outstanding capital is represented. If the required proportion of outstanding capital is not represented at such a meeting, a second meeting may be convened for a date within four weeks of the date of the first meeting. At such second meeting a resolution to dissolve the company may be adopted by a majority of at least two-thirds of the votes cast, regardless of the capital represented. In the notice convening such a meeting it shall be stated that and why a resolution may be adopted regardless of the part of the capital represented at such meeting.

#### **Amendment of the Articles of Association**

A proposal to amend the Articles of Association requires approval of the Meeting of the Holders of Priority Shares. The General Meeting of Shareholders may only resolve upon an amendment of these Articles which changes the special rights enjoyed by holders of priority shares if such change has been approved by a meeting of holders of priority shares. A resolution to give such approval must be adopted by a majority of at least three-fourths of the outstanding priority shares. Amendment of the Articles of Association to the effect that the special rights accorded holders of any series of preferred shares are changed, shall require the prior approval of the meeting of holders of that series of preferred shares. The General Meeting of Shareholders may only resolve upon an amendment of these Articles which changes the special rights enjoyed by holders of priority shares if such change has been approved by a meeting of holders of priority shares. A resolution to give such approval must be adopted by a majority of at least three-fourths of the outstanding priority shares.

#### **General Meeting of Shareholders**

The Articles use "persons entitled to attend shareholders meetings" to mean:

- (a) the company's shareholders;
  - (b) holders of depositary receipts for shares issued with the company's sponsorship; and
  - (c) pledgees or usufructuaries of shares in the company's capital, excepting pledgees or usufructuaries of shares whereof the voting rights are vested in the shareholder and whereof the rights that the law confers on holders of depositary receipts for shares issued with the company's sponsorship were withheld when the pledge or usufruct was created or transferred.
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The Articles use "persons entitled to attend shareholders meetings and to vote thereat" to mean:

- (a) company shareholders having the right to vote;
  - (b) usufructuaries or pledgees having the right to vote for the shares to which the usufruct or pledge relates.
- With due observance of the mandatory rules of law and of the provisions of the Articles, the Board of Management may issue further instructions concerning the manner in which shareholders and other persons entitled to attend shareholders' meetings may exercise their rights.

Notice of a General Meeting of Shareholders shall be given by the Board of Management or by the Supervisory Board through advertisements inserted in one or more national daily newspapers and in the Official List of Euronext Amsterdam N.V. (the Amsterdam stock exchange). The period intervening between the date on which notice of a meeting is given and the date fixed for such meeting, not counting either of these dates, shall be at least twenty-one days.

One or more persons entitled to attend shareholders' meetings and vote thereat who alone or jointly represent at least one-hundredth part of the total issued capital may submit proposals for consideration at the General Meeting of Shareholders, provided that such proposals be submitted in writing to the company's office at least six weeks in advance of the meeting. However, the Board of Management reserves the right not to place proposals from persons mentioned above in this paragraph on the agenda if it judges them to be evidently not in the interest of the company.

Article 110 of Book 2 of the Dutch Civil Code provides that one or more shareholders, who jointly represent at least one-tenth of the issued capital may, on their application, be authorized by the President of the Court to convene a General Meeting of Shareholders. The President of the Court shall disallow the application if it does not appear to him that the applicants have previously requested the Board of Management and the Supervisory Board in writing, stating the exact matters to be considered, to convene a General Meeting of Shareholders and neither the Board of Management nor the Supervisory Board, which in this case have equal powers, have taken the necessary steps so that the General Meeting of shareholders could be held within six weeks after the request. For the application of this article, holders of depositary receipts issued for shares with cooperation of the company have the same rights as shareholders.

Without prejudice to the other provisions of article 47 of the Articles, the members of the Supervisory Board and the Board of Management and the persons entitled to attend shareholders' meetings shall have the right to attend the General Meeting of Shareholders.

Every person entitled to attend shareholders' meetings and vote thereat shall have the right to attend the General Meeting of Shareholders, either in person or by proxy duly authorized in writing, to address the meeting, and to vote thereat:

- (a) provided that he has declared his intention to do so not later than on the day named in the convening notice, which day cannot be earlier than seven and not later than five clear days before the day of the meeting (not counting either the day that he declared his intention or the day of the meeting), at the venue specified in that notice; and
  - (b) in the case of a holder of bearer shares, a usufructuary with the right to vote, or a pledgee with the right to vote, provided that he has deposited the document evidencing his right not later than on the day named in the convening notice, which day cannot be earlier than seven and not later than five clear days before the day of the meeting (not counting the day that the share certificates were deposited or the day of the meeting), at the venue specified in that notice, against a receipt. This receipt shall also serve as ticket of admission to the meeting.
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Every person entitled to attend shareholders' meetings shall have the right to attend the General Meeting of Shareholders, either in person or by proxy duly authorized in writing, and to address the meeting. The provisions of the preceding paragraph apply mutatis mutandis.

The Board of Management may decide that those persons shall be considered as entitled to attend meetings or attend meetings and vote thereat that, at a record date then to be set, have these rights and had their names recorded in a register designated by the Board of Management for that purpose, regardless of who would have been entitled, at the time of the General Meeting of Shareholders, to attend the meeting, or attend the meeting and vote thereat, if a record date as contemplated in this paragraph had not been set. The convening notice for the meeting shall both state the record date and the manner in which the persons entitled to attend the meeting, or attend the meeting and vote thereat, may have their names registered and exercise their rights. These provisions shall apply notwithstanding the provisions of the second and third paragraphs of this article.

The person entitled to attend shareholders' meetings who wishes to be represented at the General Meeting of Shareholders by a proxy duly authorized in writing shall present the proxy statement, or cause it to be presented, at the place specified in the convening notice not later than on the date named therein.

Any disputes on the question whether a person entitled to attend shareholders' meetings or a proxy has furnished sufficient proof of his identity to be allowed to attend the General Meeting of Shareholders and exercise the right to vote, and on all other issues connected with the correct procedure at the meeting, shall be decided by the chairman of that meeting. The chairman shall decide on admission to the meeting of persons other than those entitled under article 47 of the Articles.

For the purpose of article 47 of the Articles, the company has the right to go by the account of the keepers of registers as referred to in this article or in the convening notice or notices, and by the account of agencies or banks involved in ascertaining who is entitled to attend the meeting or attend the meeting and vote thereat.

General Meetings of Shareholders are presided over by the Chairman of the Supervisory Board or, in his absence, by one of the Deputy Chairmen or, if all Deputy Chairmen are absent, by one of the other members of the Supervisory Board. If no member of the Supervisory Board is present, the meeting shall choose a chairman.

The annual General Meeting of Shareholders shall be held each year not later than June 30. The agenda for this meeting shall at least comprise the following items:

- (a) consideration of the written annual report of the Board of Management on the company's business and the Board's conduct thereof;
- (b) adoption of the annual financial statements;
- (c) for discussion purposes any changes to the policy of the company on additions to reserves and on dividends;
- (d) with due observance of article 43 of the Articles the allocation of profits; and
- (e) if applicable, the proposal to pay a dividend.

These items need not be included in the agenda if an extension has been granted of the term for the preparation of the annual financial statements and the submission of the annual report, or if a proposal for such an extension is part of the agenda.

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**Dividends**

With the approval of the Supervisory Board, with due observance of the relevant provisions of the Dutch Civil Code, and without prejudice to the provisions of paragraph 6 of article 43 of the Articles of Association, the Board of Management may declare an interim dividend to be debited to the profit for the current fiscal year, the additional paid-in capital, or any other reserve not being statutory reserves. An interim dividend of this kind may be paid wholly or partly in shares and may be restricted to one class of shares or one or more series of a particular class.

From the profits as shown by the approved statement of income a dividend shall first of all be paid to the preferred shares in the manner described in Article 43 of the Articles of Association. The Board of Management shall be authorized to determine, with the approval of the Supervisory Board, what share of profit remaining shall be carried to the reserves. The remaining profit shall be placed at the disposal of the General Meeting of Shareholders, with due observance of the following sentence, it being provided that no further dividend shall be paid on the preferred share. From the remaining profit, distributions shall, to the extent possible, be made to the priority shares and then equally to the common shares, all in conformity with Article 43 of the Articles of Association. Article 105 of Book 2 of the Dutch Civil Code provides that distribution of profits to shareholders may be made only to the extent that shareholders' equity exceeds the sum of the amount of the paid and the called up part of the capital and the reserves which must be maintained under the law or Articles of Association. Under Dutch law, a company may make interim distributions if it demonstrates that it has fulfilled the above requirement by providing an interim statement of assets and liabilities on a date no earlier than the first day of the third month preceding the month in which the resolution to make a distribution is published.

Cash dividends by virtue of paragraph 4 of article 20, article 42, or article 43 of the Articles of Association that have not been collected within five years of the commencement of the second day on which they became due and payable shall revert to the Company.

**Liquidation Rights**

The assets remaining after payment of all debts and of the liquidation costs shall be distributed as follows:

- (a) first of all, every holder of preferred shares shall, as much as possible, receive:
    - (i) the par value of his shares plus the excess over par value paid at the time of issue;
    - (ii) an amount equaling any shortfall in the distribution on preferred shares as referred to in article 43 of the Articles of Association;
    - (iii) an amount equaling the percentage referred to in paragraph 1 of article 43 of the Articles of Association (as adjusted, if necessary, by virtue of the pertinent provision of paragraph 3 of that article) of the aggregate par value after addition of the excess paid on the shares at the time of issue, calculated over the period beginning on the first day of the last full fiscal year preceding dissolution, and ending on the day of payment of the distribution on preferred shares referred to in this article, it being understood that all dividends paid on preferred shares in that period shall be deducted from the distribution by virtue of this clause (beginning at iii). If said assets should be insufficient to make the abovementioned distributions, the shortfall in funds shall be deducted from the amounts payable to the holders of preferred shares in proportion to the amounts to which they are entitled;
  - (b) next, the holders of priority shares shall as much as possible receive the aggregate par value of their shares;
  - (c) next, the holders of common shares shall as much as possible receive the aggregate par value of their shares;
  - (d) the balance then remaining shall be used to pay any arrears in dividends on the priority shares; and
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(e) any residue left after this payment shall be distributed among the holders of common shares, in proportion to their individual holdings.

### **Preemptive Rights**

The company may only issue authorized shares in accordance with a proposal of the Board of Management and only after the General Meeting of Shareholders has adopted a resolution to issue such shares or granted to the Board of Management a general empowerment of a duration not greater than five years to issue such shares. Such a resolution or empowerment is valid only if it has been approved by every group of holders of shares of the same class whose rights the issue will adversely affect. The company may not issue shares without the approval of the Supervisory Board. Generally, subject to certain limitations and qualifications, Article 96 (a) of Book 2 of the Dutch Civil Code provides each shareholder a preemptive right to acquire any issue of shares pro rata to the aggregate amount of his shares. Under the Dutch Civil Code and Article 5 of the Articles of Association, such preemptive rights may be restricted or excluded by a resolution of the General Meeting of Shareholders.

### **Capital Reduction**

The General Meeting of Shareholders may, upon the proposal of the Board of Management which has been duly approved by the Supervisory Board, resolve to reduce the issued capital of the company by canceling shares or by reducing the par value of shares by means of amendment of the Articles of Association. Partial repayment may be made for all shares or exclusively for common shares, preferred shares or any series of preferred shares.

### **Treasury Shares**

With due observance of Dutch statutory law, the company may acquire for a consideration fully paid-up shares in the company's capital, as well as depositary receipts for such shares. For any such acquisition the Board of Management shall require the authorization of the General Meeting of Shareholders and the approval of the Supervisory Board. There is no obligation for neither the company nor for any shareholder to engage in such a transaction.

### **Indemnification of Members of the Board of Management and the Supervisory Board**

Unless Dutch law provides otherwise, the following shall be reimbursed to current and former members of the Board of Management and Supervisory Board:

- (i) the reasonable costs of conducting a defense against claims based on acts or failures to act in the exercise of their duties or any other duties currently or previously performed by them at the company's request;
- (ii) any damages or fines payable by them as a result of an act or failure to act as referred to under (i);
- (iii) the reasonable costs of appearing in other legal proceedings in which they are involved as current or former members of the Board of Management or Supervisory Board, with the exception of proceedings primarily aimed at pursuing a claim on their own behalf.

There shall be no entitlement to reimbursement as referred to above if and to the extent that (i) a Dutch court has established in a final and conclusive decision that the act or failure to act of the person concerned may be characterized as willful ("opzettelijk"), intentionally reckless ("bewust roekeloos"), or seriously culpable ("ernstig verwijtbaar") conduct, unless Dutch law provides otherwise or this would, in view of the circumstances of the case, be unacceptable according to standards of reasonableness and fairness, or (ii) the costs or financial loss of the person concerned are covered by an insurance and the insurer has paid out the costs or financial loss.

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The company may take out liability insurance for the benefit of the persons concerned. The Supervisory Board may give further implementation to the above with respect to members of the Board of Management. The Board of Management may give further implementation to the above with respect to members of the Supervisory Board.

### **Conflict of Interest**

Paragraph 3 of article 30 of the Articles of Association provides that when a member of the Supervisory Board has a conflict of interest with respect to a matter to be resolved on by the Supervisory Board, he shall not be entitled to vote on that matter. This principle is elaborated on in the regulations of the Supervisory Board as referred to in paragraph 3 of article 31 of the Articles of Association. In accordance with paragraph 5 of article 35 of the Articles of Association, the Board of Management has drawn up a set of regulations, including provisions in respect of, amongst other things, a conflict of interest between the Company and a member of the Board of Management.

The provisions in the regulations of the Supervisory Board and the regulations of the Board of Management with respect to conflicts of interest are in line with the best practice provisions of the Dutch Corporate Governance Code.

### **C. MATERIAL CONTRACTS**

The company has not entered into other material contracts (other than those entered into in the ordinary course of business) in the past three years. For a description of significant acquisitions and divestments in 2006, 2005, and 2004 reference is made to Changes in Consolidated Interests of the Notes to the Consolidated Financial Statements in Item 18 Financial Statements.

### **D. EXCHANGE CONTROLS**

There are no legislative or other legal provisions currently in force in the Netherlands or arising under the Articles of Association restricting remittance to holders of securities of the company not resident in the Netherlands. Cash dividends payable in euros on the securities of the company may be officially transferred from the Netherlands and converted into any other convertible currency.

There are no limitations, either by the laws of the Netherlands or in the Articles of Association, which affect the rights of non-resident or foreign owners to hold or vote Akzo Nobel common shares.

### **E. TAXATION**

#### **Netherlands Taxation**

The statements below only represent a broad overview of the present Netherlands tax laws and the present United States/Netherlands Tax Convention (the Tax Treaty) applicable to holding and disposing shares of Akzo Nobel, which are both subject to change, and are not to be read as extending by implication to matters not specifically referred to herein.

**As to individual tax consequences, each investor in the common shares should consult his own tax advisor.**

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**Withholding Tax**

In general, a dividend distributed by a company resident in the Netherlands (such as Akzo Nobel) is subject to a withholding tax imposed by the Netherlands at a rate of 15%. This percentage of 15% is valid as of 2007; before 2007 the rate was 25%. Stock dividends paid out of the company's additional paid-in capital recognized for Netherlands tax purposes are not subject to the above withholding tax.

Pursuant to the provisions of the Tax Treaty, dividends paid as of 2007 by the company to a shareholder that is a resident of the United States (as defined in the Tax Treaty), are not eligible for a reduction in the above mentioned rate (15%) of Netherlands withholding tax. However, dividends paid before 2007 (tax withheld at 25%) by the company to a shareholder that is a resident of the United States (as defined in the Tax Treaty), are generally eligible for a reduction in the rate of Netherlands withholding tax to 15% unless (I) the beneficial owner of the dividends carries on business in the Netherlands through a permanent establishment, or performs independent personal services in the Netherlands from a fixed base, and the common shares form part of the business property of such permanent establishment or pertain to such fixed base, or (II) the beneficial owner of the dividends is not entitled to the benefits of the Tax Treaty under the "treaty-shopping" provisions thereof. Dividends paid to qualifying exempt US pension trusts and certain qualifying exempt US organizations are exempt from Netherlands withholding tax under the Tax Treaty.

**Capital Gains**

Capital gains realized upon the sale or exchange of common shares by a non-resident of the Netherlands (either an individual or corporation) are exempt from Netherlands tax, unless (I) such gains are effectively connected with a permanent establishment in the Netherlands of the shareholder's trade or business or (II) are derived from a direct, indirect or deemed substantial holding of common shares of such company (such substantial holding not being a business asset).

In general, an individual has a substantial holding if he holds either directly or indirectly and either independently or jointly with his spouse, at least 5% of the nominal paid-up capital of any class of shares in a company.

Under the Tax Treaty, however, the Netherlands may tax a capital gain derived from a substantial holding only if the alienator has been a resident of the Netherlands at any time during the five-year period preceding the alienation and at the time of the alienation owns, either alone or together with family-related individuals, at least 25% of any class of shares of such company.

**Estate and Gift Taxes**

No estate, inheritance or gift taxes are imposed by the Netherlands on the transfer of common shares if, at the time of the death of the shareholder or the transfer of the common shares (as the case may be), such shareholder or transferor is not a resident of the Netherlands, unless such common shares are attributable to a permanent establishment or permanent representative of the shareholder in the Netherlands.

Inheritance or gift taxes (as the case may be) are due, however, if such shareholder or transferor:

- (a) has Netherlands nationality and has been a resident of the Netherlands at any time during the ten years preceding the time of the death or transfer, or
  - (b) has no Netherlands nationality but has been a resident of the Netherlands at any time during the twelve months preceding the time of transfer (for Netherlands gift taxes only).
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## **United States Taxation**

This section describes the material United States federal income tax consequences to a U.S. holder (as defined below) of owning shares or ADSs. It applies to you only if you hold your shares or ADSs as capital assets for tax purposes. This section does not apply to you in all respects if you are a member of a special class of holders subject to special rules, including:

- a dealer in securities,
- a trader in securities that elects to use a mark-to-market method of accounting for your securities holdings,
- a tax-exempt organization,
- a life insurance company,
- a person liable for the alternative minimum tax,
- a person that actually or constructively owns 10 percent or more of the voting stock of Akzo Nobel,
- a person that holds shares or ADSs as part of a straddle or a hedging or conversion transaction, or
- a person whose functional currency is not the U.S. dollar.

This section is based on the Internal Revenue Code of 1986, as amended, its legislative history, existing and proposed regulations, published rulings and court decisions, and the laws of the Netherlands, all as currently in effect, as well as the Tax Treaty. These laws are subject to change, possibly on a retroactive basis. In addition, this section is based in part upon the representations of the Depositary and the assumption that each obligation in the Deposit Agreement and any related agreement will be performed in accordance with its terms.

You are a U.S. holder if you are a beneficial owner of shares or ADSs, and you are:

- a citizen or resident of the United States,
- a United States domestic corporation,
- an estate whose income is subject to United States federal income tax regardless of its source, or
- a trust if a United States court can exercise primary supervision over the trust's administration and one or more United States persons are authorized to control all substantial decisions of the trust.

### **You should consult your own tax advisor regarding the United States federal, state and local, Dutch and other tax consequences of owning and disposing of shares and ADSs in your particular circumstances.**

In general, and taking into account the earlier assumptions, for United States federal income tax purposes, if you hold ADRs evidencing ADSs, you will be treated as the owner of the shares represented by those ADRs. Exchanges of shares for ADRs, and ADRs for shares generally will not be subject to United States federal income tax.

### ***Taxation of Dividends***

Under the United States federal income tax laws, if you are a U.S. holder, you must include in your gross income the gross amount of any dividend paid by Akzo Nobel out of its current or accumulated earnings and profits (as determined for United States federal income tax purposes). You must include any Netherlands tax withheld from the dividend payment in this gross amount even though you do not in fact receive it. The dividend is taxable income that you must include in income when you, in the case of shares, or the Depositary, in the case of ADSs, receive the dividend, actually or constructively. If you are a noncorporate U.S. holder, dividends paid to you in taxable years beginning before January 1, 2011 that constitute qualified dividend income will be taxable to you at a maximum rate of 15% provided that you hold the shares or ADSs for more than 60 days during the 121-day period beginning 60 days before the ex-dividend date and meet other holding period requirements. Dividends paid by Akzo Nobel with respect to the shares or ADSs generally will be qualified dividend income. The dividend will not be eligible for the dividends-received deduction generally allowed to

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United States corporations in respect of dividends received from other United States corporations. The amount of the dividend distribution that you must include in your income as a U.S. holder will be the U.S. dollar value of the euro payments made, determined at the spot euro/ U.S. dollar rate on the date the dividend distribution is includible in your income, regardless of whether the payment is in fact converted into U.S. dollars. Generally, any gain or loss resulting from currency exchange fluctuations during the period from the date you include the dividend payment in income to the date you convert the payment into U.S. dollars will be treated as ordinary income or loss and will not be eligible for the special tax rate applicable to qualified dividend income. The gain or loss generally will be income or loss from sources within the United States for foreign tax credit limitation purposes. Distributions in excess of current and accumulated earnings and profits, as determined for United States federal income tax purposes, will be treated as a non-taxable return of capital to the extent of your basis in the shares or ADSs and thereafter as capital gain.

Subject to certain limitations, the Netherlands tax withheld in accordance with the Tax Treaty and paid over to the Netherlands will be creditable or deductible against your United States federal income tax liability. Under a provision of the Netherlands dividend tax act, Akzo Nobel will apply a credit against the amount of the dividend tax withheld before remittance to the Netherlands tax authorities. This credit is the lesser of:

- 3% of the part of the gross dividend from which dividend tax is withheld, and
- 3% of the gross amount of dividends received from qualifying non-Netherlands subsidiaries.

Because of this credit, the US tax authorities may take the view that the Netherlands withholding tax eligible for credit against United States Federal income taxes should be limited accordingly.

Special rules apply in determining the foreign tax credit limitation with respect to dividends that are subject to the maximum 15% rate.

Dividends will be income from sources outside the United States, and dividends paid in taxable years beginning before January 1, 2007, generally will be "passive income" or "financial services income", while dividends paid in taxable years beginning after December 31, 2006, generally will be "passive" or "general" income which, in either case, is treated separately from other types of income for purposes of computing the foreign tax credit allowable to you.

### **Taxation of Capital Gains**

If you are a U.S. holder and you sell or otherwise dispose of your shares or ADSs, you will recognize capital gain or loss for United States federal income tax purposes equal to the difference between the U.S. dollar value of the amount that you realize and your tax basis, determined in U.S. dollars, in your shares or ADSs. Capital gain of a noncorporate U.S. holder that is recognized in taxable years beginning before January 1, 2011, is generally taxed at a maximum rate of 15% where the holder has a holding period greater than one year. The gain or loss will generally be income or loss from sources within the United States for foreign tax credit limitation purposes.

### **F. DIVIDENDS AND PAYING AGENTS**

Not applicable.

### **G. STATEMENT BY EXPERTS**

Not applicable.

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**H. DOCUMENTS ON DISPLAY**

The documents that are exhibits to or incorporated by reference in this Annual Report can be read at the U.S. Securities and Exchange Commission's public reference facilities at room 1024, 450 Fifth Street, NW, Washington, D.C. 20549. Please call the SEC at 1-800-SEC-0330 for further information on the public reference rooms and their copy charges. The company's filings since November 4, 2002, are also publicly available through the SEC's website located at <http://www.sec.gov>.

**Item 11. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK****Foreign Currency Exchange Risk Management**

Akzo Nobel has operations in more than 80 countries and, as a result, is exposed to changes in foreign currency exchange rates. The company manages most of these exposures on a consolidated basis, which allows netting certain exposures to take advantage of any natural offsets. To the extent the company enters into forward exchange contracts to hedge transaction exposures, these principally arise with respect to assets and liabilities or firm commitments related to sales and purchases. The purpose of Akzo Nobel's foreign currency hedging activities is to protect the company from the risk that the eventual functional currency net cash flows resulting from trade transactions would be adversely affected by changes in exchange rates.

At December 31, 2006, the following contracts to buy and sell currencies were outstanding, all having maturities within one year:

| Currency                 | Buy<br>contracts | Sell<br>contracts | Mark to<br>market<br>value<br>buy<br>contracts* | Mark to<br>market<br>value<br>sell<br>contracts* |
|--------------------------|------------------|-------------------|---|--|
| <i>Millions of euros</i> |                  |                   |   |  |
| U.S. dollar              | 168              | 376               | (3)   | (2)  |
| Canadian dollar          | 8                | 12                | □   | □  |
| Pound sterling           | 257              | 18                | 3   | □  |
| Swedish krona            | 192              | 130               | 3   | (3)  |
| Japanese yen             | 2                | 81                | □   | 2  |
| Swiss franc              | 5                | 1                 | □   | □  |
| Australian dollar        | 14               | 5                 | □   | □  |
| Norwegian krone          | 76               | 73                | (2)   | 1  |
| Danish krone             | 2                | □                 | □   | □  |
| Singapore dollar         | 4                | 17                | □   | □  |
| Mexican pesos            | 3                | 33                | □   | □  |
| Other                    | 44               | 67                | (1)   | (1)  |
| <b>Total</b>             | <b>775</b>       | <b>813</b>        | <b>□</b>  | <b>(3)</b>                                       |

\* Asset/(liability)

The table below summarizes information on instruments and transactions that are sensitive to foreign currency exchange rates. For debt obligations, the table presents principal cash flows and related weighted average interest rates by expected maturity dates.



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**Financial Instruments (Balance Sheet)**

| <i>Millions of euros</i>   | Expected maturity date |      |      |      |      |            | Total | Fair value |
|----------------------------|------------------------|------|------|------|------|------------|-------|------------|
|                            | 2007                   | 2008 | 2009 | 2010 | 2011 | Thereafter |       |            |
| Long-term borrowings (USD) |                        |      | 14   |      |      | 107        | 121   | 124        |
| Average interest rate %    |                        |      | 6.28 |      |      | 6.54       | 6.51  |            |

The company does not use financial instruments to hedge the translation risk related to equity and earnings of foreign subsidiaries and associates.

**Interest Rate Risk Management**

In principle, the company manages interest risk by matching the duration of assets and liabilities. As a consequence, noncurrent assets and a certain portion of current assets are financed with equity, provisions, and long-term borrowings with fixed interest rates. The remainder of current assets is financed with short-term debt, including floating rate short-term borrowings. In order to achieve an appropriate mix of fixed and floating rate exposure within the company's policy, a number of swap contracts and forward rate agreements have been entered into.

For information about the company's financial instruments that are sensitive to changes in interest rates see Note 24 of the Notes to the Consolidated Financial Statements.

**Commodities**

In order to hedge the price risk of natural gas, the company has entered into swap contracts for the underlying fuels, with an average volume per month of 36,500 ton for the period of January through December 2007, whereby the price is fixed. The company also concluded futures contracts for the purchase of 1,966 million m<sup>3</sup> of gas, reasonably spread over the period 2007 - 2009.

Furthermore, the company entered into future contracts for electricity in order to hedge the price risk for the expected use of electricity by certain subsidiaries over the period 2007-2010, spread in tranches of three months. For these contracts cash flow hedge accounting is applied.

The fair value of such contracts is as follows:

| <i>Millions of euros; asset / liability</i> | Fair value |
|---|------------|
| Electricity futures                         | 2          |
| Petroleum swaps                             | (16)       |
| Gas futures                                 | (1)        |

**Item 12. DESCRIPTION OF SECURITIES OTHER THAN EQUITY SECURITIES**

Not applicable.

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## **PART II**

### **Item 13. DEFAULTS, DIVIDEND ARREAGES AND DELINQUENCIES**

None.

### **Item 14. MATERIAL MODIFICATIONS TO THE RIGHTS OF SECURITY HOLDERS AND USE OF PROCEEDS**

None.

### **Item 15. CONTROLS AND PROCEDURES**

#### **A. DISCLOSURE CONTROLS AND PROCEDURES**

Akzo Nobel has a Disclosure Committee which monitors procedures established by the company and advises the Board of Management to ensure adequate and timely disclosure of financial and nonfinancial information.

Under the supervision and with the participation of the company's management, including the company's Chief Executive Officer and Chief Financial Officer, the company has evaluated the effectiveness of the design and operation of its disclosure controls and procedures (as defined in Rules 13a-15(e) and 15d-15(e) under the Securities and Exchange Act of 1934) as of the end of the period covered by this Annual Report. Based on that evaluation, the Chief Executive Officer and Chief Financial Officer have concluded that these disclosure controls and procedures are effective at the reasonable assurance level.

In designing and evaluating our disclosure controls and procedures, our management, including the Chief Executive Officer and Chief Financial Officer, recognized that any controls and procedures, no matter how well designed and operated, can provide only reasonable assurance of achieving the desired control objectives, and the Board of Management necessarily was required to apply its judgment in evaluating the cost-benefit relationship of possible controls and procedures. Because of the inherent limitations in all control systems, no evaluation of controls can provide absolute assurance that all control issues and instances of fraud, if any, within the company have been detected.

#### **B. MANAGEMENT'S ANNUAL REPORT ON INTERNAL CONTROL OVER FINANCIAL REPORTING**

The Board of Management is responsible for establishing and maintaining adequate internal control over financial reporting for the company (as defined in Rule 13a-15(f) under the US Securities Exchange Act). Akzo Nobel's internal control over financial reporting is a process designed under the supervision of the principal executive and principal financial officers to provide reasonable assurance regarding the reliability of our financial reporting and the preparation of Akzo Nobel's financial statements for external reporting purposes in accordance with IFRS, and the required reconciliation to US GAAP.

As of the end of the 2006 fiscal year, the Board of Management conducted an assessment of the effectiveness of our internal control over financial reporting based on the framework in *Internal Control - Integrated Framework* issued by the Committee of Sponsoring Organizations of the Treadway Commission. Based on this assessment, the Board of Management concluded that the company's internal control over financial reporting was effective as of December 31, 2006.

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The company's internal control over financial reporting includes policies and procedures that pertain to the maintenance of records that, in reasonable detail, accurately and fairly reflect transactions and dispositions of assets; provide reasonable assurances that transactions are recorded as necessary to permit preparation of financial statements in accordance with IFRS and the required reconciliation to US GAAP, and that receipts and expenditures are being made only in accordance with authorizations of management and the directors of Akzo Nobel; and provide reasonable assurance regarding prevention or timely detection of unauthorized acquisition, use or disposition of Akzo Nobel's assets that could have a material effect on our financial statements. Because of its inherent limitations, internal control over financial reporting is not intended to provide absolute assurance that a misstatement of our financial statements would be prevented or detected.

Management's assessment of the effectiveness of the Company's internal control over financial reporting as of December 31, 2006, excluded the companies acquired after January 1, 2006. The total assets of these acquisitions represented 1.7% (EUR 221 million) of consolidated total assets in accordance with IFRS and revenues represented 1.5% (EUR 202 million) of consolidated total revenues of the Company in accordance with IFRS as of and for the year ended December 31, 2006. If adequately disclosed, companies are allowed to exclude acquisitions from their assessment of internal control over financial reporting during the first year of an acquisition while integrating the acquired company under guidelines established by the US Securities and Exchange Commission.

KPMG Accountants NV, an independent registered public accounting firm, has audited management's assessment of the effectiveness of our internal control over financial reporting as of December 31, 2006, as stated in their report included in Item 15.C.

### **C. ATTESTATION REPORT OF THE REGISTERED PUBLIC ACCOUNTING FIRM**

To the Board of Management of Akzo Nobel N.V. and Supervisory Board:

We have audited management's assessment, included in the accompanying Management's Annual Report on Internal Control over Financial Reporting, that Akzo Nobel N.V. and subsidiaries maintained effective internal control over financial reporting as of December 31, 2006, based on criteria established in *Internal Control-Integrated Framework* issued by the Committee of Sponsoring Organizations of the Treadway Commission (COSO). Akzo Nobel N.V. and subsidiaries' management is responsible for maintaining effective internal control over financial reporting and for its assessment of the effectiveness of internal control over financial reporting. Our responsibility is to express an opinion on management's assessment and an opinion on the effectiveness of the Company's internal control over financial reporting based on our audit.

We conducted our audit in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether effective internal control over financial reporting was maintained in all material respects. Our audit included obtaining an understanding of internal control over financial reporting, evaluating management's assessment, testing and evaluating the design and operating effectiveness of internal control, and performing such other procedures as we considered necessary in the circumstances. We believe that our audit provides a reasonable basis for our opinion.

A company's internal control over financial reporting is a process designed to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles. A company's internal control over financial reporting includes those policies and procedures that (1) pertain to the maintenance of records that, in reasonable detail, accurately and fairly reflect the transactions and dispositions of the assets of the company;

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(2) provide reasonable assurance that transactions are recorded as necessary to permit preparation of financial statements in accordance with generally accepted accounting principles, and that receipts and expenditures of the company are being made only in accordance with authorizations of management and directors of the company; and (3) provide reasonable assurance regarding prevention or timely detection of unauthorized acquisition, use, or disposition of the company's assets that could have a material effect on the financial statements.

Because of its inherent limitations, internal control over financial reporting may not prevent or detect misstatements. Also, projections of any evaluation of effectiveness to future periods are subject to the risk that controls may become inadequate because of changes in conditions, or that the degree of compliance with the policies or procedures may deteriorate.

Akzo Nobel N.V. acquired various companies during 2006 (together The Acquired Companies), and management excluded from its assessment of the effectiveness of Akzo Nobel N.V. internal control over financial reporting as of December 31, 2006, The Acquired Companies internal control over financial reporting associated with assets representing 1.7% (EUR 221 million) of consolidated assets in accordance with IFRS of Akzo Nobel N.V. and revenues representing 1.5% (EUR 202 million) of consolidated revenues in accordance with IFRS of Akzo Nobel N.V. as of and for the year ended December 31, 2006. Our audit of internal control over financial reporting of Akzo Nobel N.V. also excluded an evaluation of the internal control over financial reporting of The Acquired Companies.

In our opinion, management's assessment that Akzo Nobel N.V. and subsidiaries maintained effective internal control over financial reporting as of December 31, 2006, is fairly stated, in all material respects, based on criteria established in *Internal Control—Integrated Framework* issued by the Committee of Sponsoring Organizations of the Treadway Commission (COSO). Also, in our opinion, Akzo Nobel N.V. and subsidiaries maintained, in all material respects, effective internal control over financial reporting as of December 31, 2006, based on criteria established in *Internal Control—Integrated Framework* issued by the Committee of Sponsoring Organizations of the Treadway Commission (COSO).

We also have audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States), the consolidated balance sheets of Akzo Nobel N.V. and subsidiaries as of December 31, 2006 and 2005, and the related consolidated statements of income, changes in equity, and cash flows for each of the years in the three-year period ended December 31, 2006, and our report dated June 13, 2007, expressed an unqualified opinion on those consolidated financial statements.

Arnhem, the Netherlands  
June 13, 2007

KPMG Accountants N.V.

#### **Item 16A. AUDIT COMMITTEE FINANCIAL EXPERT**

The Supervisory Board has determined, that its member Dolf van den Brink meets the requirements of an Audit Committee Financial Expert as defined in Item 16A of Form 20-F. Mr. van den Brink is independent for purposes of the NASDAQ listing requirements.

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**Item 16B. CODE OF ETHICS**

The company recognizes that its businesses have responsibilities within the communities in which they operate. The company has a Financial Code of Ethics which applies to the Chief Executive Officer, the Chief Financial Officer, the Senior Vice President Finance, the Director Corporate Control, the Director Corporate Tax, the Director Corporate Internal Audit, the Group Controllers, the Business Unit Controllers, the country controllers, and certain other senior financial officers specifically designated for the purpose.

The company has published its Financial Code of Ethics on its website ([www.akzonobel.com](http://www.akzonobel.com)).

No changes have been made to the Financial Code of Ethics since its adoption and no waivers have been granted therefrom to the officers mentioned above.

Akzo Nobel is subject to the Corporate Governance Code 2004 of The Netherlands and the Corporate Governance Rules of NASDAQ, both of which require that the company has a code of conduct. The company's Business Principles, which apply to all employees including the members of the Board of Management, complies with the Corporate Governance Code of the Netherlands and serves as the code of conduct for the purpose of the Corporate Governance Rules of NASDAQ. The company has established several procedures to arrange for dissemination of the Business Principles and training company-wide. It also has established procedures to monitor compliance with the Business Principles in general and certain of its provisions in particular and to provide for enforcement of the Business Principles.

**Item 16C. PRINCIPAL ACCOUNTANT FEE AND SERVICES**

The external auditor is appointed by the General Meeting of Shareholders on the proposal of the Supervisory Board. The appointment is for an indefinite period of time with a review every three years by the Audit Committee. The Audit Committee advises the Supervisory Board, which will communicate the results of this assessment to the General Meeting of Shareholders. The lead auditor in charge of the Akzo Nobel account will be changed every five years.

The Audit Committee has been granted direct responsibility for compensation and oversight of the auditors and the services they provide to the company. The Committee formally evaluates the independence of the external auditor and preapproves the fees for all audit, audit-related, and permitted nonaudit services rendered by the external auditor. The external auditors are prohibited from providing certain non-audit services to the company. In order to anchor this in the procedures of the company, the Audit Committee adopted the "Akzo Nobel Auditors Independence Policy" and the related "Akzo Nobel Audit Committee Preapproval Policy on Audit, Audit-Related, and Nonaudit Services." The Audit Committee has adopted a policy on auditor independence which governs the external auditor's appointment, rotation, responsibilities, services rendered, compensation, and oversight. These policies can be found on the company's website ([www.akzonobel.com](http://www.akzonobel.com)).

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The aggregate fees billed by KPMG for professional services rendered for the years 2006 and 2005 were as follows:

| <i>Millions of euros</i> | <b>2006</b> | <b>2005</b> |
|--------------------------|-------------|-------------|
| Audit fees               | 15.5        | 8.8         |
| Audit-related fees       | 7.4         | 2.9         |
| Tax fees                 | 1.0         | 1.0         |
| Other fees               | 0.3         | 0.1         |
| <b>Total</b>             | <b>24.2</b> | <b>12.8</b> |

Audit fees consist of fees for the examination and audit of both the consolidated financial statements and statutory financial statements of certain subsidiaries of Akzo Nobel N.V., as well as the audit of Internal Control Over Financial Reporting for 2006. Audit-related fees primarily consist of fees in connection with audits of acquisitions and divestments, audits in connection with the preparation for the separation of Organon BioSciences, and accounting consultations. Tax fees mainly relate to tax compliance and expatriate tax services.

All services rendered by KPMG have been approved by the Audit Committee.

**Item 16D. EXEMPTIONS FROM THE LISTING STANDARDS FOR AUDIT COMMITTEES**

None. Our Supervisory Board has determined that all members of the Audit Committee satisfy the independence requirements of Rule 10A-3 of the U.S. Securities and Exchange Act of 1934, as amended.

**Item 16E. PURCHASES OF EQUITY SECURITIES BY THE ISSUER AND AFFILIATED PURCHASERS**

During 2006, no Akzo Nobel N.V. common shares were repurchased.

**PART III**

**Item 17. FINANCIAL STATEMENTS**

Akzo Nobel has responded to Item 18.

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**Item 18. FINANCIAL STATEMENTS**

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FINANCIAL STATEMENT SCHEDULE<sup>1</sup>

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*1 Schedules other than the one listed under this heading are omitted for the reason that they are not required or are not applicable.*

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**REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM**

To the Board of Management of Akzo Nobel N.V. and Supervisory Board:

We have audited the consolidated financial statements of Akzo Nobel N.V. and subsidiaries as listed in the accompanying index. In connection with our audits of the consolidated financial statements, we have also audited the financial statement schedule as listed in the accompanying index. These consolidated financial statements and the financial statement schedule are the responsibility of the company's management. Our responsibility is to express an opinion on these consolidated financial statements and the financial statement schedule based on our audits.

We conducted our audits in accordance with the standards of the Public Company Accounting Oversight Board (United States of America). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the financial position of Akzo Nobel N.V. and subsidiaries at December 31, 2006 and 2005, and the results of their operations and their cash flows for each of the years in the three-year period ended December 31, 2006, in conformity with International Financial Reporting Standards as adopted by the EU. Also in our opinion, the related financial statement schedule, when considered in relation to the basic consolidated financial statements taken as a whole, presents fairly, in all material respects, the information set forth therein.

International Financial Reporting Standards as adopted by the EU vary in certain significant respects from US generally accepted accounting principles. Information relating to the nature and effect of such differences is presented in Note 27 to the consolidated financial statements.

We have also audited, in accordance with the standards of the PCAOB (United States), the effectiveness of Akzo Nobel's internal control over financial reporting as of December 31, 2006, based on criteria established in Internal Control Integrated Framework issued by the Committee of Sponsoring Organizations of the Treadway Commission (COSO), and our report dated June 13, 2007, expressed an unqualified opinion on management's assessment of, and the effective operation of internal control over financial reporting.

Arnhem, the Netherlands  
June 13, 2007

KPMG Accountants N.V.

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**SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES USED IN PREPARING THE CONSOLIDATED FINANCIAL STATEMENTS**

Akzo Nobel NV is a company domiciled in the Netherlands. The address of the company's registered office is Velperweg 76, Arnhem.

The consolidated financial statements of Akzo Nobel NV have been prepared in accordance with International Financial Reporting Standards (IFRS) as adopted by the European Union, and also comply with the financial reporting requirements included in section 9 of Book 2 of the Netherlands Civil Code, as far as applicable.

The financial statements as prepared by the Board of Management and as presented in this report are subject to approval by the General Meeting of Shareholders.

For comparison purposes the presentation of the financial statements 2005 and 2004 has been changed to conform with the presentation in 2006.

**Consolidation**

The consolidated financial statements include the accounts of Akzo Nobel NV and its subsidiaries. Subsidiaries are companies over which Akzo Nobel NV has directly and/or indirectly the power to control the financial and operating policies so as to obtain benefits. In assessing control, potential voting rights that are presently exercisable or convertible are taken into account. The financial statements of subsidiaries are included in the consolidated financial statements from the date that control commences until the date that control ceases. Minority interest in equity and earnings is shown separately. Transactions between consolidated companies and intercompany balances are eliminated. Accounting policies, as set out below, have been applied consistently for all periods presented in these consolidated financial statements and by all subsidiaries. Certain comparative amounts have been reclassified to conform with current year's presentation.

**Valuation**

The principles of valuation and determination of income used in the consolidated financial statements are based on historical costs, unless stated otherwise in the principles of valuation of assets and liabilities. Exceptions on the historical cost basis include derivative financial instruments and share-based compensation, which are based on fair value, and pensions, for which actuarial present value calculations are used.

**Translation of foreign currencies**

Transactions in foreign currencies are translated into the functional currency of entities using the foreign exchange rate at transaction date. The functional currency of foreign entities generally is the local currency. Assets and liabilities denominated in foreign currencies are translated using the exchange rates at the balance sheet date. Resulting foreign currency differences are included in the statement of income.

The financial statements of foreign entities are translated into euros. The balance sheet is translated into euros using the exchange rates at the balance sheet date. The statements of income of foreign entities are translated into euros using the foreign exchange rates at transaction date, approximating the average exchange rates. Foreign exchange differences resulting from translation into euros of shareholders' equities and of intercompany loans of a permanent nature with respect to subsidiaries outside the euro region are recorded as a separate component (cumulative translation reserve) within shareholders' equity. Upon disposal or liquidation of a foreign entity these cumulative translation adjustments are recognized in the statement of income.

Before being consolidated, the financial statements of subsidiaries established in hyperinflationary countries are adjusted for the effects of changing prices of the local currency.

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**Exchange rates of key currencies**

The principal exchange rates against the euro used in preparing the balance sheet and the statement of income are:

|     | Balance sheet |       |       | Statement of income |       |       |
|-----|---------------|-------|-------|---------------------|-------|-------|
|     | 2006          | 2005  | 2004  | 2006                | 2005  | 2004  |
| USD | <b>1.317</b>  | 1.186 | 1.364 | <b>1.256</b>        | 1.245 | 1.243 |
| GBP | <b>0.671</b>  | 0.687 | 0.708 | <b>0.682</b>        | 0.684 | 0.680 |
| SEK | <b>9.047</b>  | 9.428 | 9.017 | <b>9.247</b>        | 9.302 | 9.123 |

**Principles of valuation of assets and liabilities****Property, plant and equipment**

Property, plant and equipment are valued at cost less accumulated depreciation and impairment charges.

Costs include expenditures that are directly attributable to the acquisition of the asset, including financing income and expenses of capital investment projects under construction.

Government grants to compensate for the cost of an asset are deducted from the cost of the related asset.

Depreciation is calculated by the straight-line method, based on the estimated useful life. In the majority of cases the useful life of plant equipment and machinery is 10 years, and for buildings ranges from 20 to 30 years. Land is not depreciated. In the majority of cases residual value is assumed to be insignificant. Depreciation methods, useful lives and residual values are reassessed annually.

If there is an indication that an asset may be impaired the recoverable amount of the asset is estimated; see Impairments. If the carrying value exceeds the recoverable amount an impairment charge is recognized in the statement of income.

Gains and losses on the sale of property, plant and equipment are included in the statement of income.

Parts of property, plant and equipment that have different useful lives are accounted for as separate items of property, plant and equipment. Cost of major maintenance activities are capitalized as a separate component of property, plant and equipment, and depreciated over the estimated useful life. Maintenance costs which cannot be separately defined as a component of property, plant and equipment are expensed in the period in which they occur.

**Leases**

Lease contracts whereby the company has substantially all the risks and rewards of ownership are classified as finance leases. At inception these are recognized in the balance sheet at the lower of the assets' fair value and the present value of the minimum lease payments. Subsequently, these are amortized on a straight-line basis over the shorter of the lease term or the useful life of the asset. If the carrying value exceeds the recoverable amount of the assets an impairment charge is recognized.

Operational leases are not capitalized. Costs related to these contracts are expensed as incurred, which is normally on a straight-line bases over the term of the lease.

**Asset retirement obligations**

The company has identified conditional asset retirement obligations at a number of its facilities that are mainly related to plant decommissioning. The company recognizes these conditional asset retirement obligations in the periods in which sufficient information becomes available to reasonably estimate their fair values.

**Intangible assets**

Intangible assets with a finite life, such as licenses, know-how, brand names, customer relationships, and intellectual property rights, are capitalized at historic cost and amortized on a straight-line basis over the estimated useful life, which in the majority of cases ranges from 10 to 40 years.

Development costs are capitalized if costs can be measured reliably, the product or process is technically and commercially feasible and sufficient future economic benefits will be generated, and the company has sufficient resources to complete the development. Capitalized development costs are amortized on a straight-line basis over the estimated useful life, which in the majority of cases is 5 years. If there is an indication that an intangible asset may be impaired the recoverable amount of the asset is estimated; see Impairments. If the carrying value exceeds the recoverable amount an impairment charge is recognized in the statement of income.

Intangible assets with an indefinite life, which presently only include purchased goodwill, are not amortized, but tested for impairment annually. In cases where the carrying value of the intangibles exceeds the recoverable amount an impairment charge is recognized in the statement of income. Goodwill is determined as the difference between the fair value of the consideration paid for a business combination and the fair value of the acquired identifiable assets, liabilities and recognized contingent liabilities. Goodwill related to an investment in associates is included in the carrying value of that investment.

**Business combinations**

In accounting for the acquisition of subsidiaries the purchase accounting method is used. The cost of an acquisition is measured as the fair value of the assets given, equity instruments issued, and liabilities incurred or assumed at the date of exchange, plus costs directly attributable to the acquisition. Identifiable assets acquired and liabilities and contingent liabilities assumed in a business combination are initially measured at fair value at the acquisition date. The excess of the cost of acquisition over the fair value of Akzo Nobel's share of the identifiable net assets acquired is recorded as goodwill. If the cost of acquisition is less than the fair value of the net assets of the subsidiary acquired, the difference is recognized directly in the statement of income.

The assets and liabilities from business combinations arising from transfers of interests in entities that are under the control of the company are accounted for at the carrying amounts recognized previously.

If written put options on minority shares are acquired as part of a business combination, these are accounted for under IFRS 3 as if the additional interests were already acquired from the initial date of acquisition. This results in the recognition of a liability instead of a minority share, and an increase of goodwill for the fair value of the written put option.

**Associated companies and joint ventures**

Investments over which Akzo Nobel has significant influence but no control over the financial and operational policies, are classified as associated companies and are accounted for using the equity method from the date that significant influence commences until the date that significant influence ceases. The consolidated financial statements include the company's share of the income and expenses of the equity-accounted investments, whereby calculation is based as much as possible on the Akzo Nobel principles of valuation. When the share of losses exceeds the interest in the company, the carrying amount is reduced to nil and recognition of further losses is discontinued, unless Akzo Nobel has incurred legal or constructive obligations on behalf of the company.

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Jointly controlled companies are equity accounted for under associated companies and joint ventures. Joint control is established by contractual agreement and requires unanimous consent for strategic, financial, and operational decisions.

Unrealized gains arising from transactions with equity accounted associates and joint ventures are eliminated to the extent of Akzo Nobel's interest in the company and are eliminated against the investment. Unrealized losses are eliminated in the same way as unrealized gains, but only to the extent that there is no evidence of impairment.

Loans to associates and joint ventures are carried at amortized cost, less impairment losses.

### **Other financial noncurrent assets**

#### ***Held to maturity investments***

Other financial noncurrent assets are classified as held to maturity if the company has the positive intent and ability to hold these assets to maturity. These assets are measured at amortized costs using the effective interest method, less any impairment losses.

#### ***Other financial noncurrent assets available for sale***

Other financial noncurrent assets classified as available for sale are measured at fair value, and changes in the fair value, other than impairment losses and foreign exchange gains and losses, are recognized directly in equity. Upon derecognition, the cumulative gain or loss in equity is transferred to the statement of income.

### **Inventories**

Inventories are measured at the lower of cost or net realizable value. Costs of inventories comprise all costs of purchase, costs of conversion, and other costs incurred in bringing the inventories to the present location and condition. The costs of conversion of inventories include direct labor and fixed and variable production overheads, and takes into account the stage of completion. The costs of inventories is determined using the weighted average cost formula. Net realizable value is the estimated selling price in the ordinary course of business, less the estimated costs of completion and selling expenses.

### **Receivables**

Trade and other receivables are measured at amortized cost, using the effective interest method, less impairment losses. Long-term receivables are discounted to their net present value.

### **Cash and cash equivalents**

Cash and cash equivalents include all cash balances and short-term highly liquid investments that are directly convertible into cash.

### **Assets and liabilities classified as held for sale**

Assets and liabilities are classified as held for sale if it is highly probable that the carrying value will be recovered through a sale transaction rather than through continuing use. When reclassifying assets as held for sale, the assets are recognized at the lower of the carrying value or fair value less selling costs. Assets held for sale are not depreciated but tested for impairment. Impairment losses on assets and liabilities held for sale are recognized in the statement of income.

### **Shareholders' equity**

The consideration paid for repurchased shares, including directly attributable cost, is deducted from equity.

Dividends are recognized as a liability in the period in which they are declared.

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**Provisions**

Provisions are recognized when a present legal or constructive obligation as a result of a past event exists, and it is probable that an outflow of economic benefits is required to settle the obligation. Provisions are measured at net present value, taking the timing of cash outflows into account. The expected future cash outflows are discounted at appropriate pretax interest rates, reflecting current market assessments of the time value of money and, if applicable, the risks specific to the liability. The increase of provisions as a result of the passage of time is recognized in the statement of income under financing income and expenses.

Provisions for restructuring are recognized when a detailed and formal restructuring plan has been approved, and the restructuring has either commenced or has been announced publicly. Future operating costs are not provided for.

**Pensions and other postretirement benefits*****Defined contribution plans***

Obligations for contributions to defined contribution plans are recognized in the statement of income as incurred.

***Defined benefit plans***

Most of the company's defined benefit pension plans are funded with plan assets that have been segregated in a trust or foundation. For plans which are not separately funded, the company recognizes a provision. Valuations of both funded and unfunded plans are carried out by independent actuaries based on the projected unit credit method. Pension costs primarily represent the increase in the actuarial present value of the obligation for projected pension benefits based on employee service during the year and the interest on this obligation in respect of employee service in previous years, net of the expected return on plan assets. The discount rate used in determining the present value of the obligations is the yield at reporting date of risk-free credit-rated bonds that have maturity dates approximating the terms of the company's obligations.

In certain countries the company also provides postretirement benefits other than pensions to its employees. These plans are generally not funded. Valuations of the obligations under these plans are carried out by independent actuaries based on the projected unit credit method. The costs relating to such plans primarily consist of the present value of the benefits attributed on an equal basis to each year of service and the interest on this obligation in respect of employee service in previous years.

Actuarial gains and losses that arise after January 1, 2004, in calculating the company's obligation in respect of a plan, are recognized to the extent that any cumulative unrecognized actuarial gain or loss exceeds ten percent of the greater of the present value of the defined benefit obligation and the fair value of plan assets. That portion is recognized in the statement of income over the expected average remaining working lives of the employees participating in the plan.

When the benefits of a plan are improved, the portion of the increased benefit relating to past service by employees is recognized as an expense in the statement of income on a straight-line basis over the average period until the benefits become vested. To the extent that the benefits vest immediately, the expense is recognized immediately in the statement of income.

**Other long-term employee benefits**

Other long-term employee benefits include long-service or sabbatical leave, jubilee or other long-service benefits and other employee benefits payable more than 12 months after the related service rendered. These provisions are measured at present value, using actuarial assumptions. The discount rate is the yield at reporting date of risk-free credit-rated bonds that have maturity dates approximating the terms of the company's obligations.

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**Short-term employee benefits**

Short-term employee benefits are measured on an undiscounted basis and are expensed as the related service is provided. A provision is recognized for the amounts expected to be paid under short-term bonus or profit sharing plans if a present legal or constructive obligation as a result of past services provided exists, and the obligation can be estimated reliably.

**Deferred taxes**

Deferred tax assets and liabilities are based on temporary differences between the valuation of assets and liabilities for accounting purposes and the valuation for tax purposes. Measurement of deferred tax assets and liabilities is based upon the enacted or substantially enacted tax rates expected to apply to taxable income in the years in which those temporary differences are expected to be reversed. Deferred taxes are not discounted. The tax effect on the elimination of intercompany profit in inventories is based on the tax rate of the country of the company receiving the goods.

Deferred tax assets, including assets arising from losses carried forward, are recognized if it is probable that the asset will be realized. Nonrefundable dividend taxes are taken into account in the determination of provisions for deferred taxes to the extent of earnings expected to be distributed by subsidiaries. If separate tax rates exist for distributed and undistributed profits, the current and deferred taxes are measured at the tax rate applicable to undistributed profits. The income tax consequences of dividends are recognized when a liability to pay the dividend is recognized. Deferred taxes are not provided for the following temporary differences: the initial recognition of goodwill, the initial recognition of assets or liabilities that affect neither accounting nor taxable profit, and differences relating to investments in subsidiaries to the extent that they will probably not reverse in the foreseeable future.

**Current taxes**

Current tax includes the expected tax payable on the taxable income for the year, using tax rates enacted or substantially enacted at reporting date, as well as any adjustments to tax payable in respect of previous years.

**Share-based compensation**

The stock option plan allows certain employees of the company to acquire Akzo Nobel NV common shares. These options generally vest if the employee stays with the company during an uninterrupted three-year period. The company also has a Performance Share Plan, under which shares are conditionally granted to certain employees. The actual number of shares which the employees will receive, depends on the employee having stayed with the company during an uninterrupted three-year period and the company's Total Shareholder Return (TSR) performance over a three-year period, compared with the TSR performance of a specified peer group.

The fair value of the options or performance shares granted is recognized as an employee expense with a corresponding increase in shareholders' equity. The fair value is measured at grant date and amortized over the period during which the employees become unconditionally entitled to the options or performance shares. The fair value of the options granted is measured using a binomial model, taking into account the terms and conditions upon which the options and performance shares were granted. For the performance shares the fair value is measured using the Monte Carlo simulation model. This model also includes the market conditions expected to impact the company's TSR performance in relation to the selected peers. The amount recognized as an expense is adjusted to reflect the actual number of options or performance shares that vest, except where forfeiture or extra vesting of performance shares is only due to the actual TSR performance differing from the performance anticipated at the grant of the performance shares.

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**Long-term borrowings and short-term debt**

Long-term borrowings are measured at amortized cost, applying the effective interest rate method unless fair value interest rate hedging is applied. In that case the carrying amount is adjusted for the fair value changes caused by the hedged risk. Short-term debt is measured at amortized cost, using the effective interest method, less any impairment losses.

**Trade and other payables**

Trade and other payables are measured at amortized cost, using the effective interest method.

**Derivative financial instruments**

Derivative financial instruments include forward exchange rate contracts, interest rate derivatives and commodity contracts, as well as embedded derivatives included in normal business contracts.

Forward exchange and commodity contracts are measured at fair value on the balance sheet, with changes in the fair value recognized in other operating income, unless cash flow hedge accounting is applied. In that case, the fair value changes are recognized on the related specific lines in the statement of income. Fair values are derived from market prices and quotes from dealers and brokers, or estimated by calculation, and are recognized on the balance sheet under trade and other receivables, or under trade and other payables.

Changes in fair value of highly effective derivatives qualifying as a cash flow hedge are deferred in shareholders' equity until the hedged transactions have been reflected in the accounts. At termination of the hedge, the deferred fair value changes are recognized in the statement of income. When a derivative qualifying as a cash flow hedge is not highly effective or has ceased to be highly effective, the changes in fair value related to the ineffective part are recognized immediately in the statement of income.

The changes in fair value of interest derivatives are recognized in the statement of income, where the effective part is offset by the fair value changes of the underlying fixed rate bond, in case fair value hedge accounting is applied. Such amounts are included in financing income and expenses. The fair value of the derivatives is recognized in the balance sheet under other financial noncurrent assets.

Both at the hedge inception and at each reporting date, the company assesses whether the derivatives used are highly effective in offsetting changes in fair values or cash flows of hedged items. When a derivative is not highly effective as a hedge, hedge accounting is discontinued prospectively, whereby changes in fair value are recognized in the statement of income.

**Principles of determination of income**

The determination of income is closely associated with the valuation of assets and liabilities. In addition, the following principles are observed in the preparation of the statement of income:

**Revenues**

Revenues are defined as the revenue from the sale and delivery of goods and services and royalty income, net of rebates, discounts and similar allowances, and net of sales tax. Revenue is recognized when the significant risks and rewards have been transferred to a third party, recovery of the consideration is probable, the associated costs and possible return of goods can be estimated reliably, and there is no continuing management involvement with the goods. For revenue from sales of goods these conditions are generally met at the time the product is shipped and delivered to the customer, depending on the delivery conditions. Service revenues are generally recognized as services are rendered.

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### **Costs of sales**

Costs of sales comprise the manufacturing costs of the goods sold and delivered, and any inventory write-downs to lower net realizable value. Manufacturing costs include such items as:

- the costs of raw materials and supplies, energy, and other materials;
- depreciation and the costs of maintenance of the assets used in production;
- salaries, wages, and social charges for the personnel involved in manufacturing.

The costs of services and royalties are generally included in the functional cost lines, as applicable: selling expenses, research and development expenses, or general and administrative expenses.

### **Research costs and preparation and start-up expenses**

Research costs and preparation and start-up expenses are charged to income as incurred.

### **Government grants**

Government grants related to cost are recognized in the statement of income in the same periods as the related cost to be compensated and are deducted from the relevant cost. For government grants related to assets, see the accounting policy for property, plant and equipment.

### **Financing income and expenses**

Financing income and expenses comprise:

- the interest payable on borrowings, calculated using the effective interest method;
- the interest expense component of finance lease payments;
- the increase of provisions as a result of the passage of time;
- entries related to interest rate derivatives;
- interest income, recognized using the effective interest method; and
- the fair value changes of interest derivatives.

### **Income taxes**

Income taxes comprise both current and deferred taxes, including effects of changes in tax rates. Income tax is recognized in the statement of income, unless it relates to items recognized directly in equity or deferred tax recognized in a purchase price allocation.

### **Share in profit of associates**

Income from investment in associates consists of Akzo Nobel's share in earnings of these companies and interest on loans granted to them, with an allowance being made for taxes relating to these items.

### **Impairments**

The carrying value of assets other than inventories and deferred tax assets are reviewed when events or changes in circumstances indicate that the carrying amount of an asset may not be recoverable. If such indication exists, the recoverable amount of the asset is estimated. For goodwill and other intangible assets with an indefinite useful life the recoverable amount is estimated at each balance sheet date. The recoverable amount of an asset or its cash generating unit is the greater of the net selling price and the value in use, whereby estimated future cash flows are discounted to their present value. The discount rate used reflects current market assessments of the time value of money and, if appropriate, the risks specific to the assets.

An impairment loss is recognized whenever the carrying value of an asset or its cash generating unit exceeds its recoverable value. Impairment losses are recognized in the statement of income. The review for impairment is performed at the lowest level of assets generating largely independent cash inflows. Within a cash generating unit, impairment losses are allocated by first writing down the goodwill allocated to the cash generating unit and then



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pro rata writing down the other assets of the cash generating unit, whereby no asset is written down below its recoverable value.

Except for goodwill, impairment losses are reversed if and to the extent there has been a change in estimates used to determine the recoverable amount, but only to the extent that the carrying value of the asset does not exceed the carrying value that would have been determined, net of depreciation or amortization, if no impairment loss had been recognized. Reversals of impairment are recognized in the statement of income.

**Emission rights**

Emission rights granted by the government are recognized at cost, which is generally nil. A provision is recorded if the actual emission of pollutants is higher than the emission rights granted.

**Earnings per share**

The company presents basic and diluted earnings per share data for its ordinary shares. Basic earnings per share is calculated by dividing the profit or loss attributable to ordinary shareholders of the company by the weighted average number of ordinary shares outstanding during the period. Diluted earnings per share is calculated by dividing the profit or loss attributable to ordinary shareholders by the weighted average number of ordinary shares outstanding including the effects for all dilutive potential ordinary shares, which comprise share options granted to employees.

**Use of estimates**

The preparation of the financial statements in conformity with IFRS requires management to make judgments, estimates, and assumptions that affect amounts reported in the consolidated financial statements. The estimates and assumptions are based on experience and various other factors that are believed to be reasonable under the circumstances and are used to judge the carrying values of assets and liabilities that are not readily apparent from other sources. Actual results may differ from those estimates. The estimates and underlying assumptions are reviewed on an ongoing basis.

Revisions to accounting estimates are recognized in the period in which the estimate is revised, or in the revision and future periods if the changed estimates affect both current and future periods.

The most critical accounting policies involving a higher degree of judgment and complexity in applying principles of valuation are described below.

**Impairment of intangible assets and property, plant and equipment**

The company reviews noncurrent assets for impairment when events or circumstances indicate carrying values may not be recoverable. Assets subject to this review include property, plant and equipment and intangible assets. In determining property, plant and equipment and intangible assets, management must make significant judgments and estimates to determine if the future cash flows expected to be generated by those assets are less than their carrying value. Determining cash flows requires the use of judgments and estimates that have been included in the company's strategic plans and long-term planning forecasts. The data necessary for the execution of the impairment tests are based on management estimates of future cash flows, which require estimating revenue growth rates and profit margins. Assets are written down to their recoverable value. This recoverable value of impaired assets is determined by taking into account these estimated cash flows and using a net present value technique based on discounting these cash flows with business-specific discount rates.

Changes in assumptions and estimates included in the impairment reviews could result in significantly different earnings than those recorded in the financial statements.

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**Accounting for income taxes**

As part of the process of preparing consolidated financial statements, the company is required to estimate income taxes in each of the jurisdictions in which the company operates. This process involves estimating actual current tax expenses and temporary differences between tax and financial reporting. Temporary differences result in deferred tax assets and liabilities, which are included in the consolidated balance sheet. The company must then assess the likelihood that deferred tax assets will be recovered from future taxable income. In the event actual results differ from these estimates in future periods, and depending on the tax strategies that the company may be able to implement, changes to the deferred tax assets could be required, which could impact the financial position and results from operations.

**Provisions**

By their nature, provisions for contingent liabilities are dependent upon estimates and assessments whether the criteria for recognition have been met, including estimates as to the outcome and the amount of the potential cost of resolution. Contingent liabilities are recognized by a charge against income when it is probable that a liability has been incurred and the amount of such liability can be reasonably estimated.

Contingent liabilities and provisions for environmental matters, antitrust cases, other litigation, and tax disputes are discussed in Note 25 – Contingent liabilities and commitments. Estimates related to provisions for environmental matters are based on the nature and seriousness of the contamination as well as on the technology required for cleanup. The provision for antitrust cases is based on an estimate of the costs, fines, and civil damages, taking into account legal advice and the current facts and circumstances. Provisions for other litigation are also based on an estimate of the costs, taking into account legal advice and information currently available.

If the actual outcome differs from the assumptions and estimates, revisions to the estimated provisions would be required. This could impact our financial position and results from operations.

Provisions for termination benefits and exit costs also involve management's judgment in estimating the expected cash outflows for severance payments and site closure or other exit costs. Should the actual cash outflows differ from the assumptions and estimates, additional charges would be required, which could impact our financial position and results from operations.

**Accounting for pensions and other postretirement benefits**

Retirement benefits represent obligations that will be settled in the future and require assumptions to project benefit obligations and fair values of plan assets. Retirement benefit accounting is intended to reflect the recognition of future benefit costs over the employee's approximate service period, based on the terms of the plans and the investment and funding decisions made by the company. The accounting requires management to make assumptions regarding variables such as discount rate, rate of compensation increase, return on assets, mortality rates, and future healthcare costs. Periodically, management consults with external actuaries regarding these assumptions. Changes in these key assumptions can have a significant impact on the projected benefit obligations, funding requirements and periodic costs incurred. For details on key assumptions and policies, see note 19. It should be noted that when discount rates decline or rates of compensation increase – due to e.g. increased inflation – pension and postretirement benefit obligations will increase. Net periodic pension and postretirement costs might also increase, but that depends on the actual relation between the unrecognized loss and the so-called corridor (10% of the greater of benefit obligations and plan assets) as well as on the relative change of the discount rate versus the change of the benefit obligation.

**Segment reporting**

The primary segment reporting is based on the business segments of the company, whereby the business segments are engaged in providing products or services which are subject to risks and rewards which differ from

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the risks and rewards of the other segments. In determining whether products and services are related, aspects such as the nature of the products or services, the nature of the production processes, and the type or class of customers for the products or services are taken into consideration. Segments reported are Organon, Intervet, Coatings, and Chemicals, which also reflects the management structure of the company. The secondary segment reporting is based on the geographical areas in which the company operates, whereby economic environments with comparable risks and returns are grouped together. Intersegment pricing is determined on an arm's length basis.

### **New IFRS accounting standards**

In 2005 and 2006 several new accounting pronouncements were issued, of which the company assessed that the following have an impact on the company's consolidated financial statements.

IFRS 7 Financial Instruments: Disclosures and the Amendment to IAS 1 Presentation of Financial Statements: Capital Disclosures requires disclosures about the significance of financial instruments for an entity's financial position and performance, and qualitative and quantitative disclosures on the risks arising from financial instruments. The standard becomes effective from 2007 onwards. The effect on the company's disclosures is expected to be limited.

IAS 19 (Amendment), Employee Benefits, is mandatory for accounting periods beginning on or after January 1, 2006. It introduces the option of an alternative recognition approach for actuarial gains and losses. It may impose additional recognition requirements for multi-employer plans where insufficient information is available to apply defined benefit accounting. It also adds new disclosure requirements. As the company does not intend to change the accounting policy adopted for recognition of actuarial gains and losses and does not participate in any multi-employer plans, adoption of this amendment only impacts the format and extent of disclosures presented in the consolidated financial statements.

IAS 39 and IFRS 4 (Amendment), Financial Guarantee Contracts, applies to annual periods beginning on or after January 1, 2006. Under this standard, a financial guarantee contract is initially recognized at fair value and is subsequently measured at the higher of (a) the amount determined in accordance with IAS 37 and (b) the amount initially recognized less, when appropriate, cumulative amortization recognized in accordance with IAS 18. Different requirements apply for the subsequent measurement of financial guarantee contracts that prevent derecognition of financial assets or result in continuing involvement. Financial guarantee contracts held are not within the scope of the standard.

IFRIC 4, Determining whether an Arrangement contains a Lease, applies to annual periods beginning on or after January 1, 2006. This Interpretation provides guidance for determining whether an arrangement, comprising a transaction that does not take the legal form of a lease but conveys a right to use an asset should be accounted for in accordance with IAS 17. The standard did not impact the consolidated financial statements.

IFRIC 9 Reassessment of Embedded Derivatives requires that only when there are changes to the contract a reassessment should be made of whether embedded derivatives should be separated from the underlying host contract. IFRIC 9 becomes effective for the 2007 financial statements and is not expected to have any impact on the consolidated financial statements.

IFRIC 10 Interim Financial Reporting and Impairments prohibits the reversal of an impairment loss recognized in a previous interim period in respect of goodwill, an investment in an equity instrument or a financial asset carried at cost. IFRIC 10 is effective from 2007. It will apply prospectively from the date that IFRS was first implemented and does not impact the consolidated financial statements.

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**CONSOLIDATED STATEMENT OF INCOME**

| <i>Millions of euros, except per share amounts</i>  | Note | <b>For the years ended<br/>December 31,</b> |                         |                         |
|---|------|---|-------------------------|-------------------------|
|   |      | <b>2006</b>                                 | <b>2005<sup>1</sup></b> | <b>2004<sup>1</sup></b> |
| Revenues  |      | 13,737                                      | 13,000                  | 12,833                  |
| Cost of sales                                       |      | (7,394)                                     | (7,070)                 | (6,988)                 |
| Gross margin  |      | 6,343                                       | 5,930                   | 5,845                   |
| Selling expenses                                    |      | (3,436)                                     | (3,214)                 | (3,288)                 |
| Research and development expenses                   |      | (885)                                       | (810)                   | (826)                   |
| General and administrative expenses                 |      | (749)                                       | (680)                   | (684)                   |
| Other operating income                              | 2    | 189   | 260                     | 480                     |
| Operating income                                    |      | 1,462                                       | 1,486                   | 1,527                   |
| Financing income                                    | 3    | 126   | 125                     | 109                     |
| Financing expenses                                  | 3    | (237)                                       | (281)                   | (253)                   |
| Operating income less financing income and expenses |      | 1,351                                       | 1,330                   | 1,383                   |
| Share in profit of associates                       | 4    | 89  | 6                       | 14                      |
| Profit before tax                                   |      | 1,440                                       | 1,336                   | 1,397                   |
| Income taxes  | 5    | (258)                                       | (338)                   | (416)                   |
| Profit for the period                               |      | 1,182                                       | 998                     | 981                     |
| Attributable to:                                    |      |   |                         |                         |
| Equity holders of the company (net income)          |      | 1,153                                       | 961                     | 945                     |
| Minority interest                                   |      | 29  | 37                      | 36                      |
| Profit for the period                               |      | <b>1,182</b>                                | <b>998</b>              | <b>981</b>              |
| In EUR:   |      |   |                         |                         |
| Basic earnings per share                            | 18   | <b>4.02</b>                                 | <b>3.36</b>             | <b>3.31</b>             |
| Diluted earnings per share                          | 18   | <b>4.00</b>                                 | <b>3.35</b>             | <b>3.30</b>             |

See accounting policies and accompanying notes to consolidated financial statements.

<sup>1</sup> Reclassified for comparative reasons.

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**CONSOLIDATED BALANCE SHEETS**

| Before allocation of profit<br><i>Millions of euros</i> | <b>December 31,</b> |               |               |
|---|---------------------|---------------|---------------|
|   | Note                | 2006          | 2005          |
| <b>Assets</b>   |                     |               |               |
| Property, plant and equipment                           | 7                   | 3,346         | 3,432         |
| Intangible assets                                       | 8                   | 682           | 488           |
| Deferred tax assets                                     | 10                  | 953           | 895           |
| Investment in associates                                | 11                  | 177           | 301           |
| Other financial noncurrent assets                       | 9                   | 576           | 604           |
|   |                     | <hr/>         | <hr/>         |
| <b>Total noncurrent assets</b>                          |                     | 5,734         | 5,720         |
| Inventories   | 12                  | 2,042         | 1,987         |
| Income tax receivable                                   | 13                  | 109           | 137           |
| Trade and other receivables                             | 14                  | 2,810         | 2,773         |
| Cash and cash equivalents                               | 15                  | 1,871         | 1,486         |
| Assets held for sale                                    | 16                  | 219           | 322           |
|   |                     | <hr/>         | <hr/>         |
| <b>Total current assets</b>                             |                     | 7,051         | 6,705         |
|   |                     | <hr/>         | <hr/>         |
| <b>Total assets</b>                                     |                     | <b>12,785</b> | <b>12,425</b> |
|   |                     | <hr/>         | <hr/>         |
| <b>Equity</b>   |                     |               |               |
|   | 17                  |               |               |
| Issued Capital  |                     | 574           | 572           |
| Share Premium   |                     | 1,841         | 1,803         |
| Other reserves  |                     | 1,729         | 1,040         |
|   |                     | <hr/>         | <hr/>         |
| <b>Akzo Nobel N.V. shareholders' equity</b>             |                     | 4,144         | 3,415         |
| <b>Minority interest</b>                                |                     | 119           | 161           |
|   |                     | <hr/>         | <hr/>         |
| <b>Total equity</b>                                     |                     | 4,263         | 3,576         |
| <b>Liabilities</b>                                      |                     |               |               |
| Provisions  | 19                  | 2,132         | 2,210         |
| Deferred income   | 20                  | 7             | 27            |
| Deferred tax liabilities                                | 10                  | 174           | 156           |
| Long-term borrowings                                    | 21                  | 2,551         | 2,702         |
|   |                     | <hr/>         | <hr/>         |
| <b>Total noncurrent liabilities</b>                     |                     | 4,864         | 5,095         |
| Short-term borrowings                                   | 22                  | 410           | 357           |
| Income tax payable                                      | 13                  | 321           | 380           |
| Trade and other payables                                | 23                  | 2,331         | 2,191         |
| Current portion of provisions                           | 19                  | 571           | 766           |

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|                                    |    |                      |                      |
|------------------------------------|----|----------------------|----------------------|
| Liabilities held for sale          | 16 | <u>25</u>            | <u>60</u>            |
| <b>Total current liabilities</b>   |    | <u>3,658</u>         | <u>3,754</u>         |
| <b>Total equity an liabilities</b> |    | <u><b>12,785</b></u> | <u><b>12,425</b></u> |

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See accounting policies and accompanying notes to consolidated financial statements.

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**CONSOLIDATED STATEMENT OF CASH FLOWS**

| <i>Millions of euros</i>  | <b>2006</b>       | <b>20051</b>      | <b>20041</b>      |                   |
|---|-------------------|-------------------|-------------------|-------------------|
| Profit for the period   | 1,182             | 998               | 981               |                   |
| <i>Adjustments to reconcile earnings to cash generated from operating activities:</i> |                   |                   |                   |                   |
| Depreciation and amortization   | 552               | 569               | 565               |                   |
| Impairment losses   | 29                | 132               | 74                |                   |
| Financing income and expenses   | 111               | 156               | 144               |                   |
| Share in profit of associates   | (79)              | (17)              | (52)              |                   |
| Income taxes  | 258               | 338               | 415               |                   |
|   | <u>          </u> | <u>          </u> | <u>          </u> |                   |
| <i>Operating profit before changes in working capital and provisions</i>              |                   | 2,053             | 2,176             | 2,127             |
| Changes in trade and other receivables  | 22                | (169)             | (163)             |                   |
| Changes in inventories  | (54)              | 38                | (23)              |                   |
| Changes in trade and other payables   | 122               | (117)             | 154               |                   |
| Changes in provisions   | (262)             | (598)             | (63)              |                   |
| Other   | 18                | 28                | (4)               |                   |
|   | <u>          </u> | <u>          </u> | <u>          </u> |                   |
|   |                   | (154)             | (818)             | (99)              |
|   | <u>          </u> | <u>          </u> | <u>          </u> | <u>          </u> |
| <b>Cash generated from operating activities</b>                                       |                   | 1,899             | 1,358             | 2,028             |
| Interest paid   | (213)             | (220)             | (207)             |                   |
| Income taxes paid   | (366)             | (391)             | (217)             |                   |
| Pretax gain on divestments  | (213)             | (44)              | (579)             |                   |
|   | <u>          </u> | <u>          </u> | <u>          </u> |                   |
|   |                   | (792)             | (655)             | (1,003)           |
|   | <u>          </u> | <u>          </u> | <u>          </u> | <u>          </u> |
| <b>Net cash from operating activities</b>   |                   | 1,107             | 703               | 1,025             |
| Capital expenditures  | (529)             | (514)             | (551)             |                   |
| Investments in intangible assets  | (12)              | (67)              | (28)              |                   |
| Interest received   | 112               | 109               | 89                |                   |
| Repayments from associates  | –                 | 27                | 11                |                   |
| Dividends from associates   | 37                | 19                | 123               |                   |
| Acquisition of consolidated companies <sup>2</sup>                                    | (326)             | (55)              | (80)              |                   |
| Proceeds from sale of interests <sup>2</sup>  | 371               | 64                | 1,036             |                   |
| Loan to APF <sup>3</sup>  | 19                | (150)             |                   |                   |
| Other changes in noncurrent assets  | 20                | 53                | 2                 |                   |
|   | <u>          </u> | <u>          </u> | <u>          </u> |                   |
| <b>Net cash from investing activities</b>   |                   | (308)             | (514)             | 602               |
| New long-term borrowings  | 4                 | 3                 | 22                |                   |
| Repayment of borrowings   | (83)              | (269)             | (191)             |                   |
| Issue of shares   | 40                |                   |                   |                   |



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|  |                   |                   |                   |
|--|-------------------|-------------------|-------------------|
| Termination of currency swap   | 21                | 78                |                   |
| Dividends  | (369)             | (366)             | (366)             |
|  | <u>          </u> | <u>          </u> | <u>          </u> |
| <b>Net cash from financing activities</b>  | (387)             | (554)             | (535)             |
|  | <u>          </u> | <u>          </u> | <u>          </u> |
| <i>Net change in cash and cash equivalents</i>                                       | 412               | (365)             | 1,092             |
| Cash and cash equivalents at January 1   | 1,486             | 1,811             | 727               |
| Effect of exchange rate changes on cash and cash equivalents and impact of IAS 32/39 | (27)              | 40                | (8)               |
|  | <u>          </u> | <u>          </u> | <u>          </u> |
| Cash and cash equivalents at December 31   | 1,871             | 1,486             | 1,811             |
|  | <u>          </u> | <u>          </u> | <u>          </u> |

See accounting policies and accompanying notes to consolidated financial statements.

<sup>1</sup> Reclassified for comparative reasons.

<sup>2</sup> Net of cash acquired or disposed of.

<sup>3</sup> Akzo Nobel Pension Fund in the Netherlands.



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**CONSOLIDATED STATEMENT OF CHANGES IN EQUITY**

| <i>Millions of euros</i>                                   | <b>Attributable to equity holders of the parent</b> |                                   |  |  |   |                            |                          | <b>Total equity</b> |
|--|---|-----------------------------------|--|--|---|----------------------------|--------------------------|---------------------|
|  | <b>Subscribed share capital</b>                     | <b>Additional paid-in capital</b> | <b>Change in fair value of derivatives</b> | <b>Cumulative translation reserves</b> | <b>Other (statutory) reserves and undistributed profits</b> | <b>Shareholders equity</b> | <b>Minority interest</b> |                     |
| <i>Balance at January 1, 2004</i>                          | 572   | 1,803                             |  |  | (350)   | 2,025                      | 140                      | 2,165               |
| Changes in exchange rates in respect of foreign operations |   |                                   |  | (20)                                   |   | (20)                       | (4)                      | (24)                |
| Income/(expense) directly recognized in equity             |   |                                   |  | (20)                                   |   | (20)                       | (4)                      | (24)                |
| Profit for the period                                      |   |                                   |  |  | 945   | 945                        | 36                       | 981                 |
| <i>Total income/(expenses)</i>                             |   |                                   |  | (20)                                   | 945   | 925                        | 32                       | 957                 |
| Dividend paid  |   |                                   |  |  | (343)   | (343)                      | (23)                     | (366)               |
| Equity-settled transactions                                |   |                                   |  |  | (2)   | (2)                        |                          | (2)                 |
| Changes in minority interests in subsidiaries              |   |                                   |  |  |   |                            | (9)                      | (9)                 |
| <i>Balance at December 31, 2004</i>                        | 572   | 1,803                             |  | (20)                                   | 250   | 2,605                      | 140                      | 2,745               |
| Implementation IAS 32 and 39                               |   |                                   | 11   |  | (20)  | (9)                        |                          | (9)                 |
| Changes in fair value of derivatives                       |   |                                   | 11   |  |   | 11                         |                          | 11                  |
| Changes in exchange rates in respect of foreign operations |   |                                   |  | 162                                    |   | 162                        | 16                       | 178                 |
| Income/(expense) directly recognized in equity             |   |                                   | 22   | 162                                    | (20)  | 164                        | 16                       | 180                 |
| Profit for the period                                      |   |                                   |  |  | 961   | 961                        | 37                       | 998                 |
|  |   |                                   | 22   | 162                                    | 941   | 1,125                      | 53                       | 1,178               |

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|  |     |       |      |       |       |       |      |       |
|--|-----|-------|------|-------|-------|-------|------|-------|
| <i>Total income/(expenses)</i>                             |     |       |      |       |       |       |      |       |
| Dividend paid  |     |       |      |       | (343) | (343) | (23) | (366) |
| Equity-settled transactions                                |     |       |      |       | 28    | 28    |      | 28    |
| Changes in minority interests in subsidiaries              |     |       |      |       |       |       | (9)  | (9)   |
| <i>Balance at December 31, 2005</i>                        | 572 | 1,803 | 22   | 142   | 876   | 3,415 | 161  | 3,576 |
| Changes in fair value of derivatives                       |     |       | (24) | (2)   |       | (26)  |      | (26)  |
| Changes in exchange rates in respect of foreign operations |     |       |      | (110) |       | (110) | (10) | (120) |
| Income/(expenses) directly recognized in equity            |     |       | (24) | (112) |       | (136) | (10) | (146) |
| Profit for the period                                      |     |       |      |       | 1,153 | 1,153 | 29   | 1,182 |
| <i>Total income/(expenses)</i>                             |     |       | (24) | (112) | 1,153 | 1,017 | 19   | 1,036 |
| Dividend paid  |     |       |      |       | (344) | (344) | (25) | (369) |
| Equity-settled transactions                                |     |       |      |       | 16    | 16    |      | 16    |
| Issue of common shares                                     | 2   | 38    |      |       |       | 40    |      | 40    |
| Changes in minority interests in subsidiaries              |     |       |      |       |       |       | (36) | (36)  |
| <i>Balance at December 31, 2006</i>                        | 574 | 1,841 | (2)  | 30    | 1,701 | 4,144 | 119  | 4,263 |

See accounting policies and accompanying notes to consolidated financial statements.

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**NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS OF AKZO NOBEL**

Unless stated otherwise, all amounts are rounded in millions of euros.

**Subsidiaries and associated companies**

A list of subsidiaries and associated companies, drawn up in conformity with sections 379 and 414 of Book 2 of the Netherlands Civil Code, has been filed with the Trade Registry of Arnhem.

**Changes in consolidated interests**

In August 2006 Akzo Nobel acquired the Flood Company to strengthen its position in the North American wood coatings market. The purchase price amounted to EUR 31 million and included EUR 11 million for goodwill.

In June 2006 Akzo Nobel acquired Sico Inc., active in the architectural coatings market, for an amount of EUR 210 million, including EUR 118 million for goodwill.

In February 2005, Akzo Nobel announced it would focus its Chemicals portfolio on five strategic areas with clear prospects for profitable leadership. As a consequence of the strategic review, businesses with total 2004 revenues of around EUR 700 million will be divested. The processes to realize these divestments are near to completion. The divestment process for a number of these activities is at such a stage that the assets and liabilities thereof qualify as held for sale. See note 16. Given their relatively limited size, none of these divestments meet the criteria for discontinued operations.

During 2006 and 2005, Akzo Nobel acquired several other businesses in strategic markets and geographic areas. Also a number of other activities were divested in 2006 and 2005. None of these were significant to the consolidated financial statements.

All acquisitions were accounted for on the basis of the purchase accounting method.

The acquisitions in 2006 contributed EUR 202 million to revenues. If all acquisitions had occurred on January 1, 2006 additional revenues would have been EUR 132 million. The acquisitions in 2006 only had a marginal contribution to net income, even if all acquisitions had occurred on January 1, 2006.

The acquisitions in 2006 (at acquisition date) had the following effect on Akzo Nobel's assets and liabilities:

| <i>Millions of euros</i>                | Recognized values |
|---|-------------------|
| Property, plant and equipment           | 63                |
| Intangible assets                       | 102               |
| Other fixed assets                      | 12                |
| Cash acquired                           | 4                 |
| Inventories                             | 68                |
| Trade and other receivables             | 74                |
| Provisions                              | (65)              |
| Long-term borrowings                    | (58)              |
| Trade and other payables                | (44)              |
|   | 156               |
| Net identifiable assets and liabilities | 156               |
| Goodwill on acquisitions                | 174               |

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|                    |       |     |
|--------------------|-------|-----|
|                    | <hr/> |     |
| Consideration paid |       | 330 |
| Cash acquired      |       | (4) |
|                    | <hr/> |     |
| Net cash outflow   |       | 326 |
|                    | <hr/> |     |

**NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS OF AKZO NOBEL****Segment information**

Segment information is presented in respect of the company's business and geographical segments. The primary segment reporting is based on the business segments, which also forms the basis for the company's management and internal reporting structure. The secondary segment reporting is based on the geographical areas in which the company operates, whereby segment revenue is based on the geographical location of customers and segment assets are based on the geographical location of the assets.

Segment results, assets and liabilities include items directly attributable to a segment as well as those that can be allocated on a reasonable basis.

| <i>Millions of euros</i> | <b>Revenues to third parties</b> |             |             | <b>Group revenues</b> |                |                 | <b>Operating income</b> |             |             |
|--------------------------|----------------------------------|-------------|-------------|-----------------------|----------------|-----------------|-------------------------|-------------|-------------|
|                          | <b>2006</b>                      | <b>2005</b> | <b>2004</b> | <b>2006</b>           | <b>2005</b>    | <b>2004</b>     | <b>2006</b>             | <b>2005</b> | <b>2004</b> |
| Organon                  | 2,589                            | 2,404       | 2,323       | 2,611                 | 2,425          | 2,344           | 354                     | 415         | 275         |
| Intervet                 | 1,125                            | 1,094       | 1,027       | 1,125                 | 1,094          | 1,027           | 219                     | 238         | 184         |
| Coatings                 | 6,203                            | 5,541       | 5,225       | 6,209                 | 5,555          | 5,237           | 604                     | 384         | 406         |
| Chemicals                | 3,791                            | 3,867       | 4,202       | 3,809                 | 3,890          | 4,317           | 362                     | 312         | 869         |
| Other                    | 29                               | 94          | 56          | 63                    | 117            | 59              | (77)                    | 137         | (207)       |
| Intersegment revenues    | 13,737                           | 13,000      | 12,833      | 13,817<br>(80)        | 13,081<br>(81) | 12,984<br>(151) | 1,462                   | 1,486       | 1,527       |
|                          |                                  |             |             | <b>13,737</b>         | <b>13,000</b>  | <b>12,833</b>   |                         |             |             |

| <i>Millions of euros</i> | <b>Share in profit of associates</b> |             |             | <b>Depreciation and amortization</b> |             |             |
|--------------------------|--------------------------------------|-------------|-------------|--------------------------------------|-------------|-------------|
|                          | <b>2006</b>                          | <b>2005</b> | <b>2004</b> | <b>2006</b>                          | <b>2005</b> | <b>2004</b> |
| Organon                  | 2                                    | 2           | 1           | 121                                  | 126         | 118         |
| Intervet                 |                                      |             |             | 59                                   | 54          | 46          |
| Coatings                 | (1)                                  | (1)         | 2           | 140                                  | 135         | 123         |
| Chemicals                | 41                                   | 23          | 15          | 221                                  | 241         | 272         |
| Other                    | 47                                   | (18)        | (4)         | 11                                   | 13          | 6           |
|                          | <b>89</b>                            | <b>6</b>    | <b>14</b>   | <b>552</b>                           | <b>569</b>  | <b>565</b>  |

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**NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS OF AKZO NOBEL**

| <i>Millions of euros</i>  | <b>Total assets</b> |               | <b>Total liabilities</b> |              |              | <b>Investment in associates</b> |             |             |             |
|---|---------------------|---------------|--------------------------|--------------|--------------|---------------------------------|-------------|-------------|-------------|
|   | <b>2006</b>         | <b>2005</b>   | <b>2004</b>              | <b>2006</b>  | <b>2005</b>  | <b>2004</b>                     | <b>2006</b> | <b>2005</b> | <b>2004</b> |
| Organon   | 2,074               | 2,262         | 2,075                    | 644          | 677          | 587                             | 6           | 5           | 3           |
| Intervet  | 1,153               | 1,082         | 968                      | 270          | 245          | 210                             |             |             |             |
| Coatings  | 3,821               | 3,328         | 3,094                    | 1,524        | 1,360        | 1,331                           | 6           | 11          | 10          |
| Chemicals   | 2,549               | 2,946         | 2,773                    | 895          | 1,003        | 1,098                           | 128         | 263         | 256         |
| Miscellaneous and eliminations, incl. cash and cash equivalents, and borrowings | 3,011               | 2,506         | 2,723                    | 5,189        | 5,564        | 5,980                           | 37          | 22          | 49          |
| Investment in associates  | 177                 | 301           | 318                      |              |              |                                 |             |             |             |
|   | <b>12,785</b>       | <b>12,425</b> | <b>11,951</b>            | <b>8,522</b> | <b>8,849</b> | <b>9,206</b>                    | <b>177</b>  | <b>301</b>  | <b>318</b>  |

| <i>Millions of euros</i> | <b>Capital expenditures</b> |             |             | <b>Impairment losses</b> |             |             |
|--------------------------|-----------------------------|-------------|-------------|--------------------------|-------------|-------------|
|                          | <b>2006</b>                 | <b>2005</b> | <b>2004</b> | <b>2006</b>              | <b>2005</b> | <b>2004</b> |
| Organon                  | 103                         | 95          | 103         |                          | 73          | 31          |
| Intervet                 | 55                          | 54          | 54          |                          |             |             |
| Coatings                 | 135                         | 112         | 122         | 5                        | 10          | 16          |
| Chemicals                | 231                         | 252         | 269         | 24                       | 49          | 27          |
| Miscellaneous            | 5                           | 1           | 3           |                          |             |             |
|                          | <b>529</b>                  | <b>514</b>  | <b>551</b>  | <b>29</b>                | <b>132</b>  | <b>74</b>   |

| <i>Millions of euros</i> | <b>Revenues by region of destination</b> |             |             | <b>Revenues by region of origin</b> |             |             | <b>Operating income</b> |             |             |
|--------------------------|--|-------------|-------------|-------------------------------------|-------------|-------------|-------------------------|-------------|-------------|
|                          | <b>2006</b>                              | <b>2005</b> | <b>2004</b> | <b>2006</b>                         | <b>2005</b> | <b>2004</b> | <b>2006</b>             | <b>2005</b> | <b>2004</b> |
| The Netherlands          | 915                                      | 862         | 844         | 2,072                               | 2,459       | 2,748       | 25                      | 474         | 446         |
| Germany                  | 1,209                                    | 1,238       | 1,165       | 1,208                               | 1,152       | 1,050       | 87                      | 144         | 159         |
| Sweden                   | 523                                      | 516         | 509         | 1,284                               | 1,237       | 1,155       | 98                      | 137         | 33          |
| United Kingdom           | 781                                      | 809         | 833         | 798                                 | 754         | 848         | 24                      | (59)        | (57)        |
| Other                    |  |             |             |                                     |             |             |                         |             |             |
| European countries       | 4,245                                    | 4,075       | 4,122       | 3,073                               | 3,069       | 2,921       | 579                     | 527         | 532         |
| USA and Canada           | 2,711                                    | 2,400       | 2,445       | 2,732                               | 2,116       | 2,221       | 248                     | (67)        | 60          |
| Latin America            | 924                                      | 830         | 729         | 747                                 | 626         | 493         | 120                     | 85          | 133         |
| Asia                     | 1,755                                    | 1,590       | 1,536       | 1,440                               | 1,231       | 1,087       | 241                     | 192         | 175         |



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|               |               |               |               |               |               |               |              |              |              |
|---------------|---------------|---------------|---------------|---------------|---------------|---------------|--------------|--------------|--------------|
| Other regions | 674           | 680           | 650           | 383           | 356           | 310           | 40           | 53           | 46           |
| <b>Total</b>  | <b>13,737</b> | <b>13,000</b> | <b>12,833</b> | <b>13,737</b> | <b>13,000</b> | <b>12,833</b> | <b>1,462</b> | <b>1,486</b> | <b>1,527</b> |



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**NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS OF AKZO NOBEL**

| <i>Millions of euros</i>                   | <b>Total assets</b> |               |               | <b>Capital expenditures</b> |             |             |
|--|---------------------|---------------|---------------|-----------------------------|-------------|-------------|
|  | <b>2006</b>         | <b>2005</b>   | <b>2004</b>   | <b>2006</b>                 | <b>2005</b> | <b>2004</b> |
| The Netherlands                            | 3,165               | 3,061         | 2,959         | 179                         | 179         | 189         |
| Germany                                    | 696                 | 750           | 828           | 24                          | 25          | 23          |
| Sweden                                     | 863                 | 863           | 847           | 78                          | 65          | 60          |
| United Kingdom                             | 664                 | 690           | 582           | 20                          | 31          | 29          |
| Other European countries                   | 2,266               | 2,112         | 2,163         | 85                          | 81          | 81          |
| USA and Canada                             | 2,093               | 1,959         | 1,794         | 70                          | 51          | 52          |
| Latin America                              | 610                 | 619           | 454           | 23                          | 42          | 61          |
| Asia                                       | 940                 | 1,017         | 834           | 43                          | 32          | 47          |
| Other regions                              | 252                 | 329           | 295           | 7                           | 8           | 9           |
|  | <b>11,549</b>       | <b>11,400</b> | <b>10,756</b> | <b>529</b>                  | <b>514</b>  | <b>551</b>  |
| Eliminations and cash and cash equivalents | 1,059               | 724           | 877           |                             |             |             |
| Investment in associates                   | 177                 | 301           | 318           |                             |             |             |
|  | <b>12,785</b>       | <b>12,425</b> | <b>11,951</b> |                             |             |             |

**Note 1 □ Incidentals**

Incidentals are special benefits, results on divestments, restructuring and impairment charges, and charges related to major legal, antitrust, and environmental cases.

Incidentals included in the statement of income are as follows:

| <i>Millions of euros</i>   | <b>2006</b> | <b>2005</b> | <b>2004</b> |
|--|-------------|-------------|-------------|
| Special benefits   | 55          | 571         | 84          |
| Results on divestments   | 213         | 44          | 579         |
| Restructuring and impairment charges                               | (112)       | (169)       | (197)       |
| Charges related to major legal, antitrust, and environmental cases | (4)         | (112)       | (202)       |
|  | <b>152</b>  | <b>334</b>  | <b>264</b>  |

The incidentals are included in the following cost lines:

| <i>Millions of euros</i>            | <b>2006</b> | <b>2005</b> | <b>2004</b> |
|-------------------------------------|-------------|-------------|-------------|
| Cost of sales                       | (39)        | (15)        | (163)       |
| Selling expenses                    | (2)         | 83          | (34)        |
| Research and development expenses   |             | 24          | (10)        |
| General and administrative expenses |             | 24          | (10)        |

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|                                   |            |            |            |
|-----------------------------------|------------|------------|------------|
| Other operating income (expenses) | 193        | 218        | 481        |
|                                   | <b>152</b> | <b>334</b> | <b>264</b> |

In 2006, the special benefits of EUR 55 million were mainly attributable to the transition to a defined contribution scheme for certain U.S. pension plans and a change of the U.S. postretirement healthcare plan.

In 2005, the special benefits mainly related to the termination of the Risperdal® copromotion (EUR 149 million), the settlement with Duramed/Barr on Mircette (EUR 109 million), the release of provisions due to termination of

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**NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS OF AKZO NOBEL**

the postretirement healthcare plan in the Netherlands and the change to a defined contribution plan in the Netherlands (EUR 283 million).

In 2004, the special benefits mainly related to the full transfer of Arixtra® to Sanofi-Synthelabo (EUR 54 million), the early entrance fee for a marketing license for Remeron® in Germany, and the settlement of insurance claims for the West Orange site.

Results on divestments of EUR 213 million in 2006 were derived mainly from the sale of a Coatings plant near Barcelona and the profits from the Chemicals divestment plan.

Results on divestments in 2005 mainly concerned the divestment of Intervet's feed additives business BioVet and the divestment of the company's interest in Svensk Ethanolkemie AB.

In 2004, the gain on the divestments was mainly related to the divestment of Catalysts, Phosphorus Chemicals, and Coating Resins.

The following restructuring and impairment charges were recognized:

| <i>Millions of euros</i> | <b>2006</b>  | <b>2005</b>  | <b>2004</b>  |
|--------------------------|--------------|--------------|--------------|
| Asset impairments at     |              |              |              |
| – Organon                |              | (67)         | (31)         |
| – Coatings               | (5)          | (5)          | (16)         |
| – Chemicals              | (24)         | (49)         | (30)         |
| Restructurings at:       |              |              |              |
| – Organon                | (8)          | (3)          | (19)         |
| – Coatings               | (34)         | (31)         | (38)         |
| – Chemicals              | (40)         | (14)         | (61)         |
| – Others                 | (1)          |              | (2)          |
| <b>Total</b>             | <b>(112)</b> | <b>(169)</b> | <b>(197)</b> |

In 2006, the asset impairments mainly related to some smaller impairments at Chemicals and Coatings. Of the total impairment charges of EUR 29 million, EUR 1 million relates to goodwill, EUR 19 million to property, plant and equipment, while EUR 9 million of impairments relate to other assets, which after impairment were included under assets held for sale.

In 2005, the asset impairments mainly related to Organon's active pharmaceutical ingredients activities and the McCook plant of Chemicals in the United States. Organon's active pharmaceutical ingredients activities were under pressure from difficult market circumstances, leading to a pretax impairment charge of EUR 67 million. The impairment of the McCook plant was the result of restructuring of the production capacity in order to address the more competitive environment in which the Surfactants business operates. In addition, some smaller impairments at Chemicals and Coatings were recognized.

In 2004, the asset impairments mainly related to some smaller impairments at Organon, Chemicals and Coatings.

In 2006, 2005 and 2004, restructuring charges relate to several relatively smaller plans within the company and comprise accruals for employee benefits and for costs directly associated with plans to exit specific activities

**NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS OF AKZO NOBEL**

and to close down facilities. For all restructurings a detailed formal plan exists, and the implementation of the plan has started or the plan has been announced.

Charges related to major legal, antitrust and environmental cases for 2006 amounted to EUR 21 million for antitrust cases and a reversal of EUR 17 million for environmental risks at derelict sites of companies acquired in the past. In 2005, these charges related to antitrust (EUR 39 million), Remeron® cases (EUR 64 million) and environmental cases (EUR 9 million). In 2004, these charges related to antitrust (EUR 102 million), Remeron® cases (EUR 89 million) and environmental cases (EUR 11 million).

**Note 2 □ Other operating income**

| <i>Millions of euros</i>            | <b>2006</b> | <b>2005</b> | <b>2004</b> |
|-------------------------------------|-------------|-------------|-------------|
| Incidentals                         | 193         | 218         | 482         |
| IAS 39 fair value adjustments       | (17)        | 26          | (1)         |
| Results on sale of redundant assets | 9           | 5           | 5           |
| Currency exchange differences       | 3           | 5           | (4)         |
| Other items                         | 1           | 6           | (2)         |
|                                     | <b>189</b>  | <b>260</b>  | <b>480</b>  |

**Note 3 □ Financing income and expenses**

| <i>Millions of euros</i>  | <b>2006</b>  | <b>2005</b>  | <b>2004</b>  |
|---|--------------|--------------|--------------|
| Interest income   | 126          | 125          | 109          |
| Interest expense  | (221)        | (240)        | (232)        |
| Interest on discounting of provisions and other long-term receivables | (16)         | (41)         | (21)         |
|   | <b>(111)</b> | <b>(156)</b> | <b>(144)</b> |

Included in the interest expenses was a reduction of EUR 4 million (2005: EUR 3 million; 2004: EUR 4 million) due to the capitalization of financing expenses of capital investment projects under construction. The average interest rate used for capitalization of borrowing cost was 4%.

**Note 4 □ Share in profit of associates**

The 2006 share in profit of associates amounted to EUR 85 million net of a tax charge of EUR 4 million (2005: EUR 4 million net of a tax charge of EUR 2 million; 2004: EUR 10 million net of a tax charge of EUR 4 million). The operational performance of associates in 2006 improved, mainly due to improved results for Flexsys. The 2006 earnings include net incidental profits of EUR 39 million, mainly related to Acordis. In 2005, the net incidental losses of EUR 37 million mainly related to the closure of Methanor and guarantees for environmental costs at Acordis. In 2004, the net incidental loss of EUR 29 million related to antitrust charges recognized at Flexsys and guarantees for pension charges granted to Acordis at the time of its divestment.

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**NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS OF AKZO NOBEL****Note 5 □ Income Taxes**

Pretax income (including the share in profit of associates) amounted to EUR 1,440 million (2005: EUR 1,336 million, 2004: EUR 1,397 million). Tax(charges)/benefits are included in the statement of income as follows:

| <i>Millions of euros</i>                                   | <b>2006</b>  | <b>2005</b>  | <b>2004</b>  |
|--|--------------|--------------|--------------|
| Tax on operating income less financing income and expenses | (254)        | (336)        | (412)        |
| Tax on share in profit of associates                       | (4)          | (2)          | (4)          |
|  | <b>(258)</b> | <b>(338)</b> | <b>(416)</b> |

The classification of current and deferred taxes is as follows:

| <i>Millions of euros</i>                            | <b>2006</b>  | <b>2005</b>  | <b>2004</b>  |
|---|--------------|--------------|--------------|
| Current tax:  |              |              |              |
| – for the year                                      | (487)        | (418)        | (412)        |
| – adjustments for prior years                       | 141          | 31           | (15)         |
|   | <u>(346)</u> | <u>(387)</u> | <u>(427)</u> |
| Deferred tax for:                                   |              |              |              |
| – origination and reversal of temporary differences | 109          | 60           | 27           |
| – changes in tax rates                              | (15)         | (9)          | (12)         |
| – tax losses recognized                             | (6)          | (2)          | (4)          |
|   | <u>88</u>    | <u>49</u>    | <u>11</u>    |
|   | <b>(258)</b> | <b>(338)</b> | <b>(416)</b> |

The reconciliation of the corporation tax rate in the Netherlands to the effective consolidated tax rate is as follows:

|   | <b>2006</b> | <b>2005</b> | <b>2004</b> |
|---|-------------|-------------|-------------|
| Corporate tax rate in the Netherlands           | 30          | 32          | 35          |
| Effect of lower tax rates in certain countries  | (2)         | (6)         |             |
| Tax-exempt income/nondeductible expenses        | (1)         | 2           | (5)         |
| Nontaxable income from investment in associates | (1)         | (1)         | (2)         |
| Changes in enacted tax rates                    | 1           | □           |             |
| Effect of tax losses utilized                   |             |             | 1           |
| Under/(over) provided in prior years            | (9)         | (2)         | 1           |

**18**

**25**

**30**

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**NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS OF AKZO NOBEL**

In 2006, the effective consolidated tax rate is affected by a change in the geographical mix of taxable income and by a one-time benefit of around EUR 125 million. The benefit is attributable to an agreement with tax authorities in several countries on transfer pricing issues related to the company's corporate income tax filings, covering a period of almost ten years. Also the enacted tax rates in several jurisdictions decreased. The main changes include the decrease of the tax rate in the Netherlands from 29.6% (2006) to 25.5% (2007), and a decrease of the tax rate in Spain from 35% to 32.5% (2007) and to 30% (2008).

In 2006, the aggregate amount of current and deferred taxes relating to items directly recognized in equity is a credit of EUR 46 million and relates to cashflow hedge accounting, sharebased payments, and intercompany loans of a permanent nature. In 2005, this was a charge of EUR 51 million. In 2004, this was a credit of EUR 18 million.

**Note 6 – Salaries, wages and social charges**

| <i>Millions of euros</i>              | <b>2006</b>  | <b>2005</b>  | <b>2004</b>  |
|---------------------------------------|--------------|--------------|--------------|
| Salaries and wages                    | 2,543        | 2,402        | 2,382        |
| Pension and other postretirement cost | 316          | 304          | 345          |
| Other social charges                  | 499          | 515          | 489          |
|                                       | <b>3,358</b> | <b>3,221</b> | <b>3,216</b> |

Pension and other postretirement cost exclude the special benefits of EUR 55 million, mainly related to the changes in the pension and postretirement plans in the United States (2005: EUR 283 million related to changes in the pension and postretirement plans in the Netherlands). Charges recognized in the statement of income for share-based compensation are included in salaries and wages (2006: EUR 16 million; 2005: EUR 12 million; 2004: EUR 5 million). For more details on share-based compensation see Note 17.

**Employees**

| <i>Average number of employees</i> | <b>2006</b>   | <b>2005</b>   | <b>2004</b>   |
|------------------------------------|---------------|---------------|---------------|
| Organon                            | 14,000        | 14,200        | 14,700        |
| Intervet                           | 5,300         | 5,300         | 5,300         |
| Coatings                           | 30,700        | 29,000        | 28,700        |
| Chemicals                          | 10,500        | 11,600        | 13,600        |
| Other units                        | 1,400         | 1,300         | 1,300         |
|                                    | <b>61,900</b> | <b>61,400</b> | <b>63,600</b> |

Number of employees at December 31 **61,900** **61,300** **61,400**  
The average number of employees working outside the Netherlands was 50,500 (2005: 50,000; 2004: 51,600).

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**NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS OF AKZO NOBEL****Note 7 □ Property, Plant and Equipment**

| <i>Millions of euros</i>                    | <b>Total</b> | <b>Buildings<br/>and land</b> | <b>Plant<br/>equipment<br/>and<br/>machinery</b> | <b>Other<br/>equipment</b> | <b>Construction<br/>in progress<br/>and<br/>prepayments<br/>on projects</b> | <b>Assets not<br/>used in<br/>the<br/>production<br/>process</b> |
|---|--------------|-------------------------------|--|----------------------------|---|--|
| <b>Balance at December 31, 2004</b>         |              |                               |  |                            |   |  |
| Cost of acquisition                         | 9,141        | 2,576                         | 5,186  | 830                        | 382   | 167  |
| Depreciation/impairment                     | (5,606)      | (1,109)                       | (3,753)  | (626)                      |   | (118)  |
| Carrying value                              | <u>3,535</u> | <u>1,467</u>                  | <u>1,433</u>                                     | <u>204</u>                 | <u>382</u>  | <u>49</u>  |
| <b>Changes in carrying value:</b>           |              |                               |  |                            |   |  |
| Acquisition through business combinations   | 18           | 6                             | 10   | 2                          |   |  |
| Divestitures                                | (1)          |                               | (1)  |                            |   |  |
| Capital expenditures                        | 514          | 96                            | 365  | 84                         | (33)  | 2  |
| Transfer between categories                 |              | (38)                          | 31   | 62                         | (54)  | (1)  |
| Disinvestments                              | (13)         | (8)                           | (2)  | (1)                        |   | (2)  |
| Depreciation                                | (528)        | (105)                         | (339)  | (81)                       |   | (3)  |
| Impairment                                  | (97)         | (35)                          | (57)   | (3)                        |   | (2)  |
| Transfer to noncurrent assets held for sale | (164)        | (41)                          | (74)   | (43)                       | (6)   |  |
| Changes in exchange rates                   | 168          | 72                            | 77   | 8                          | 9   | 2  |
| Total changes                               | <u>(103)</u> | <u>(53)</u>                   | <u>10</u>  | <u>28</u>                  | <u>(84)</u>   | <u>(4)</u>   |
| <b>Balance at December 31, 2005</b>         |              |                               |  |                            |   |  |
| Cost of acquisition                         | 9,419        | 2,665                         | 5,386  | 890                        | 298   | 180  |
| Depreciation/impairment                     | (5,987)      | (1,251)                       | (3,943)  | (658)                      |   | (135)  |
| Carrying value                              | <u>3,432</u> | <u>1,414</u>                  | <u>1,443</u>                                     | <u>232</u>                 | <u>298</u>  | <u>45</u>  |
| <b>Changes in carrying value</b>            |              |                               |  |                            |   |  |
| Acquisition through business combinations   | 63           | 37                            | 23   | 3                          |   |  |
| Divestitures                                | (25)         | (18)                          | (7)  |                            |   |  |
| Capital expenditures                        | 529          | 97                            | 318  | 87                         | 18  | 9  |
| Transfer between categories                 |              | 26                            | (7)  | 17                         | (35)  | (1)  |
| Disinvestments                              | (45)         | (23)                          | (7)  | (12)                       | (2)   | (1)  |
| Depreciation                                | (501)        | (107)                         | (310)  | (82)                       |   | (2)  |
| Impairments                                 | (19)         | (6)                           | (12)   |                            |   | (1)  |

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|  |                   |                   |                   |                   |                   |                   |
|--|-------------------|-------------------|-------------------|-------------------|-------------------|-------------------|
| Reversal of impairments                        | 2                 | 2                 |                   |                   |                   |                   |
| Transfer to noncurrent<br>assets held for sale | (27)              | (13)              | (11)              | (1)               | (2)               |                   |
| Changes in exchange rates                      | (63)              | (30)              | (17)              | (9)               | (1)               | (6)               |
|  | <u>          </u> | <u>          </u> | <u>          </u> | <u>          </u> | <u>          </u> | <u>          </u> |
| Total changes                                  | (86)              | (35)              | (30)              | 3                 | (22)              | (2)               |
| <b>Balance at December 31,<br/>2006</b>        |                   |                   |                   |                   |                   |                   |
| Cost of acquisition                            | 9,179             | 2,671             | 5,176             | 896               | 276               | 160               |
| Depreciation/impairment                        | (5,833)           | (1,292)           | (3,763)           | (661)             |                   | (117)             |
|  | <u>          </u> | <u>          </u> | <u>          </u> | <u>          </u> | <u>          </u> | <u>          </u> |
| Carrying value                                 | 3,346             | 1,379             | 1,413             | 235               | 276               | 43                |
|  | <u>          </u> | <u>          </u> | <u>          </u> | <u>          </u> | <u>          </u> | <u>          </u> |

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**NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS OF AKZO NOBEL**

If an impairment indicator exists, an impairment calculation is performed. In cases where the carrying value of an asset exceeds the recoverable amount, an impairment charge is recognized in the statement of income. In 2006, EUR 19 million impairment charges were recognized (2005: EUR 97 million; 2004: EUR 63 million), while EUR 2 million impairment charges were reversed. Both the impairment charges and the reversal of impairments were recognized in cost of sales. The 2006 impairment charges relate to several smaller restructurings.

In 2005 the asset impairments mainly related to Organon's active pharmaceutical ingredients activities and the Chemicals McCook plant in the United States. The impairment of Organon's active pharmaceutical ingredients activities was due to difficult market circumstances. The recoverable value of the business was calculated by determining the value in use, using a pre-tax discount rate of 16%. The impairment of the McCook plant was due to the restructuring of the production capacity in order to address the competitive environment in which the Surfactants business operates. The recoverable value of the plant was based on the value in use of the plant, assuming the plant will shut down in 2007 and using a discount rate of 8% after tax. In addition, several smaller impairments at Chemicals and Coatings were recognized.

The carrying value of property, plant and equipment financed by hire purchase and leasing, and not legally owned by the company was EUR 54 million at December 31, 2006 (at December 31, 2005: EUR 61 million). Of this amount EUR 39 million relates to buildings and land, EUR 3 million to plant equipment and machinery and EUR 12 million to other equipment.

Purchase commitments for property, plant and equipment totaled EUR 96 million at December 31, 2006. At December 31, 2005, these commitments totaled EUR 76 million.

At December 31, 2006 and 2005, no items of property, plant and equipment were registered as security for bank loans.

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**NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS OF AKZO NOBEL****Note 8 □ Intangible Assets**

| <i>Millions of euros</i>                           | <b>Total</b> | <b>Goodwill</b> | <b>Licenses,<br/>know-how,<br/>brand<br/>names,<br/>customer<br/>relationships<br/>and<br/>intellectual<br/>property<br/>rights</b> | <b>Development<br/>costs</b> |
|--|--------------|-----------------|---|------------------------------|
| <b>Balance at December 31, 2004</b>                |              |                 |   |                              |
| Cost of acquisition through business combinations  | 628          | 342             | 286   |                              |
| Cost of internally developed intangibles           | 13           |                 |   | 13                           |
| Amortization/impairment                            | (193)        | (65)            | (123)   | (5)                          |
| Carrying value                                     | <u>448</u>   | <u>277</u>      | <u>163</u>  | <u>8</u>                     |
| <b>Changes in carrying value</b>                   |              |                 |   |                              |
| Acquisitions through business combinations         | 36           | 13              | 23  |                              |
| Other investments - including internally developed | 67           | 5               | 59  | 3                            |
| Divestitures                                       | (2)          | (2)             |   |                              |
| Amortization                                       | (41)         |                 | (38)  | (3)                          |
| Impairments  | (35)         | (21)            | (14)  |                              |
| Change in exchange rates                           | 15           | 13              | 2   |                              |
| Total changes                                      | <u>40</u>    | <u>8</u>        | <u>32</u>   | <u>□</u>                     |
| <b>Balance at December 31, 2005</b>                |              |                 |   |                              |
| Cost of acquisition through business combinations  | 722          | 348             | 374   |                              |
| Cost of internally developed intangibles           | 16           |                 |   | 16                           |
| Amortization/impairment                            | (250)        | (63)            | (179)   | (8)                          |
| Carrying value                                     | <u>488</u>   | <u>285</u>      | <u>195</u>  | <u>8</u>                     |
| <b>Changes in carrying value</b>                   |              |                 |   |                              |
| Acquisitions through business combinations         | 276          | 174             | 102   |                              |
| Other investments - including internally developed | 12           |                 | 11  | 1                            |
| Transfer between categories                        |              | (3)             | 3   |                              |
| Amortization                                       | (51)         |                 | (47)  | (4)                          |
| Impairments  | (1)          | (1)             |   |                              |
| Transfer to noncurrent assets held for sale        | (16)         | (16)            |   |                              |
| Change in exchange rates                           | (26)         | (19)            | (7)   |                              |

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|   |            |            |            |          |
|---|------------|------------|------------|----------|
| Total changes                                     | 194        | 135        | 62         | (3)      |
| <b>Balance at December 31, 2006</b>               |            |            |            |          |
| Cost of acquisition through business combinations | 930        | 467        | 463        |          |
| Cost of internally developed intangibles          | 17         |            |            | 17       |
| Amortization/impairment                           | (265)      | (47)       | (206)      | (12)     |
| Carrying value                                    | <b>682</b> | <b>420</b> | <b>257</b> | <b>5</b> |

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**NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS OF AKZO NOBEL**

The amortization and impairment charges have been recognized on the following line items in the statement of income:

| <i>Millions of euros</i>             | <b>2006</b> | <b>2005</b> | <b>2004</b> |
|--------------------------------------|-------------|-------------|-------------|
| Cost of sales                        | 23          | 29          | 11          |
| Selling expenses                     | 9           | 8           | 5           |
| Research and development expenses    | 12          | 6           | 2           |
| General and administrative expenses  | 7           | 9           | 7           |
| Restructuring and impairment charges | 1           | 24          | 14          |
|                                      | <b>52</b>   | <b>76</b>   | <b>39</b>   |

An impairment test is performed for goodwill at balance sheet date, or whenever there is an indication for impairment. For all other intangible assets an impairment test is performed whenever an indicator for impairment exists.

The impairment test compares the carrying value and the recoverable amount of the cash-generating unit. The recoverable amount is determined based on calculation of the value in use and, where possible, compared to multiples of recent transactions to estimate the net selling price. Those calculations use cash flow projections based on actual operating results and the three-year operational plan as approved by the Board of Management. Projections are extrapolated beyond this three-year period using an appropriate perpetual growth rate that is consistent with the long term average market growth rate and that typically does not exceed 3%. The estimated post-tax cash flows are discounted to their present value using a post-tax weighted average cost of capital (WACC). A post-tax WACC is used because this is readily available in the financial markets. Calculating the recoverable amount on a post-tax basis using a post-tax WACC should lead to the same results as pre-tax calculations. The company often uses the WACC as starting point for the discount rate, which is adjusted to reflect the current market assessments of the time value of money and, if appropriate, the risks specific to the asset. The post-tax WACC used is 8%.

The key assumptions used in the predictions are:

- Revenue growth: based on the actual experience, an analysis of market growth and the expected development of market share
- Margin development: based on actual experience and managements long term projections.

The impairment test carried out in 2006 showed that in the majority of cases the recoverable amount for each Cash Generating Unit exceeds the carrying amount. Impairment charges of EUR 1 million were recognized. In 2005, the impairment charges were EUR 35 million, mainly related to Organon's active pharmaceutical ingredients activities and Ink and Adhesive Resins. The estimates of the recoverable amounts were based on value in use, using after-tax discount rates of 8% to 10%.

Both at December 31, 2006 and 2005, there were no purchase commitments for intangible assets. Neither were there any intangible assets registered as security for bank loans.

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**NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS OF AKZO NOBEL****Note 9 □ Financial noncurrent assets**

| <i>Millions of euros</i>                    | Total        | Deferred<br>tax<br>assets | Investment in<br>associates |           |            |
|---|--------------|---------------------------|-----------------------------|-----------|------------|
|   |              |                           | Share in<br>capital         | Loans     | Other      |
| <b>Balance at December 31, 2004</b>         | 1,418        | 794                       | 301                         | 17        | 306        |
| Change in accounting principles (IAS 32/39) | 264          | 5                         |                             |           | 259        |
| Acquisitions/loans granted/investments      | 210          |                           |                             | 4         | 206        |
| Divestitures/repayments                     | (208)        |                           | (37)                        | (5)       | (166)      |
| Amounts recognized as income/(expense)      | 79           | 36                        | 17                          |           | 26         |
| Dividends received                          | (19)         |                           | (19)                        |           |            |
| Fair value adjustments                      | (26)         |                           |                             |           | (26)       |
| Change in Medicare receivable               | (15)         |                           |                             |           | (15)       |
| Changes in exchange rates                   | 67           | 60                        | 23                          |           | (16)       |
| <b>Balance at December 31, 2005</b>         | 1,800        | 895                       | 285                         | 16        | 604        |
| Acquisitions/loans granted/investments      | 197          | (3)                       | 6                           | 52        | 142        |
| Divestitures/repayments                     | (123)        |                           | (49)                        | (5)       | (69)       |
| Withdrawals                                 | (46)         |                           |                             |           | (46)       |
| Amounts recognized as income/(expense)      | 197          | 102                       | 79                          |           | 16         |
| Dividends received                          | (37)         |                           | (37)                        |           |            |
| Fair value adjustments                      | (71)         |                           |                             | (26)      | (45)       |
| Unwind of discount                          | 4            |                           |                             |           | 4          |
| Transfer to noncurrent assets held for sale | (130)        |                           | (130)                       |           |            |
| Change in Medicare receivable               | (13)         |                           |                             |           | (13)       |
| Changes in exchange rates                   | (72)         | (41)                      | (14)                        |           | (17)       |
| <b>Balance at December 31, 2006</b>         | <b>1,706</b> | <b>953</b>                | <b>140</b>                  | <b>37</b> | <b>576</b> |

**Other financial noncurrent assets**

Other financial noncurrent assets at December 31, 2006, include the subordinated loan of EUR 100 million with a fair value of EUR 89 million granted to the Akzo Nobel Pension Fund (APF) in the Netherlands, which was recognized at inception at its fair value of EUR 87 million and subsequently accounted for at amortized cost, using the effective interest method. Also included is a loan to APF of EUR 21 million. Other long-term receivables related to the sale of the Sant Adria site (Barcelona), which amounted to EUR 81 million, and are included under other financial noncurrent assets as well.

**Deferred tax assets**

For details on deferred tax assets, see note 10.



**Investment in associates**

For details on investment in associates, see note 11.

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**NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS OF AKZO NOBEL****Note 10 □ Deferred tax assets and liabilities**

In assessing the valuation of the deferred tax assets, management considers whether it is probable that some portion or all of the deferred tax assets will be realized. The ultimate realization of the deferred tax assets is dependent upon the generation of future taxable income during the periods in which those temporary differences become deductible. Management considers the scheduled reversal of deferred tax liabilities, projected future taxable income, and tax planning strategies in making this assessment. The amount of the deferred tax assets considered realizable, however, could change in the near term if future estimates of projected taxable income during the carryforward period are revised.

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

| <i>Millions of euros</i>                     | <b>2006</b>   | <b>2005</b>        | <b>2005</b>   | <b>2005</b>        |
|--|---------------|--------------------|---------------|--------------------|
|  | <b>Assets</b> | <b>Liabilities</b> | <b>Assets</b> | <b>Liabilities</b> |
| Intangible assets                            | 100           | 33                 | 139           | 12                 |
| Property, plant and equipment                | 58            | 118                | 71            | 158                |
| Inventories                                  | 45            | 26                 | 25            | 14                 |
| Trade and other receivables                  | 55            | 82                 | 29            | 32                 |
| Provisions:                                  |               |                    |               |                    |
| – pensions and other postretirement benefits | 291           | 1                  | 347           | 27                 |
| – restructuring                              | 20            | 1                  | 30            | 1                  |
| – other provisions                           | 331           | 43                 | 399           | 48                 |
| Other items                                  | 104           | 80                 | 75            | 194                |
| Net operating loss carryforwards             | 192           |                    | 145           |                    |
| Deferred tax assets not recognized           | (33)          |                    | (35)          |                    |
| Tax assets/liabilities                       | <b>1,163</b>  | <b>384</b>         | <b>1,225</b>  | <b>486</b>         |
| Set-off of tax                               | (210)         | (210)              | (330)         | (330)              |
| Net deferred taxes                           | <b>953</b>    | <b>174</b>         | <b>895</b>    | <b>156</b>         |

Deferred tax assets and liabilities are offset only when there is a legally enforceable right to set off tax assets against tax liabilities and when the deferred tax assets and liabilities relate to the same tax authority. From the total amount of recognized deferred tax assets of EUR 953 million an amount of EUR 148 million is related to entities that have suffered a loss in either 2006 or 2005 in the tax jurisdiction to which a deferred tax asset relates, and where utilization is dependent on future taxable profits in excess of the profits arising from the reversal of existing taxable temporary differences.

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**NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS OF AKZO NOBEL**

The movement in temporary differences during the year is as follows:

| <i>Millions of euros</i>                           | <b>Net<br/>balance<br/>January<br/>1,<br/>2005</b> | <b>Changes<br/>in<br/>exchange<br/>rates</b> | <b>Acquisitions/<br/>divestitures</b> | <b>Recognized<br/>in income</b> | <b>Recognized<br/>in equity</b> | <b>Net<br/>balance<br/>December<br/>31, 2005</b> |
|--|--|--|---------------------------------------|---------------------------------|---------------------------------|--|
| Intangible assets                                  | 41   | 7  |                                       | 79                              |                                 | 127  |
| Property, plant and<br>equipment                   | (109)  | (5)  |                                       | 27                              |                                 | (87)   |
| Inventories  | (5)  | 1  |                                       | 15                              |                                 | 11   |
| Trade and other<br>receivables                     | 8  | 1  |                                       | (12)                            |                                 | (3)  |
| Provisions:  |  |  |                                       |                                 |                                 |  |
| – pensions and other<br>postretirement<br>benefits | 534  | 14   |                                       | (228)                           |                                 | 320  |
| – restructuring                                    | 34   | 2  |                                       | (7)                             |                                 | 29   |
| – other provisions                                 | 291  | 22   |                                       | 38                              |                                 | 351  |
| Other items  | (210)  | (2)  |                                       | 100                             | (7)                             | (119)  |
| Net operating loss<br>carryforwards                | 119  | 11   |                                       | 15                              |                                 | 145  |
| Deferred tax assets<br>not recognized              | (53)   | (4)  |                                       | 22                              |                                 | (35)   |
| <b>Net deferred tax<br/>assets/(liabilities)</b>   | <b>650</b>   | <b>47</b>                                    | <b>–</b>                              | <b>49</b>                       | <b>(7)</b>                      | <b>739</b>                                       |

| <i>Millions of euros</i>                        | <b>Net<br/>balance<br/>December<br/>31, 2005</b> | <b>Changes<br/>in<br/>exchange<br/>rates</b> | <b>Acquisitions/<br/>divestitures</b> | <b>Recognized<br/>in income</b> | <b>Recognized<br/>in equity</b> | <b>Net<br/>balance<br/>December<br/>31, 2006</b> |
|---|--|--|---------------------------------------|---------------------------------|---------------------------------|--|
| Intangible assets                               | 127  | (6)  | (30)                                  | (24)                            |                                 | 67   |
| Property, plant and<br>equipment                | (87)   | 2  | 7                                     | 18                              |                                 | (60)   |
| Inventories                                     | 11   | (1)  | (1)                                   | 10                              |                                 | 19   |
| Trade and other<br>receivables                  | (3)  | (1)  | (2)                                   | (21)                            |                                 | (27)   |
| Provisions:                                     |  |  |                                       |                                 |                                 |  |
| – pensions and other<br>postretirement benefits | 320  | (12)   | 4                                     | (22)                            |                                 | 290  |
| – restructuring                                 | 29   | (1)  |                                       | (9)                             |                                 | 19   |

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|  |            |             |             |           |           |            |
|--|------------|-------------|-------------|-----------|-----------|------------|
| - other provisions                       | 351        | (11)        | 2           | (54)      |           | 288        |
| Other items                              | (119)      | (1)         | 1           | 133       | 10        | 24         |
| Net operating loss<br>carryforwards      | 145        | (6)         | (4)         | 57        |           | 192        |
| Deferred tax assets not<br>recognized    | (35)       | 2           |             |           |           | (33)       |
| <hr/>                                    |            |             |             |           |           |            |
| Net deferred tax<br>assets/(liabilities) | <b>739</b> | <b>(35)</b> | <b>(23)</b> | <b>88</b> | <b>10</b> | <b>779</b> |
| <hr/>                                    |            |             |             |           |           |            |

**NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS OF AKZO NOBEL**

Classification of the deferred tax assets and liabilities, which is determined at fiscal entity level is as follows:

| <i>Millions of euros</i> | <b>2006</b> | <b>2005</b> |
|--------------------------|-------------|-------------|
| Deferred tax assets      | 953         | 895         |
| Deferred tax liabilities | (174)       | (156)       |
|                          | <b>779</b>  | <b>739</b>  |

At December 31, 2006, losses carried forward amounted to EUR 632 million, of which EUR 88 million is not expected to be recognized. As a result, the deferred tax effect of EUR 32 million is not recognized in the balance sheet. Of the total losses carried forward EUR 9 million will expire within one year. For EUR 102 million of losses, there is no expiration date. Of the net deferred taxes EUR 156 million is expected to reverse in 2007.

The deferred tax assets not recognized in the balance sheet relate to the following items:

| <i>Millions of euros</i>         | <b>2006</b> | <b>2005</b> |
|----------------------------------|-------------|-------------|
| Deductable temporary differences | 1           | 1           |
| Tax losses                       | 32          | 34          |
|                                  | <b>33</b>   | <b>35</b>   |

For the movement schedule of deferred tax assets see note 9.

**Note 11 □ Investment in associates**

A summary of financial information for the investment in associates on a 100% basis is given below:

| <i>Millions of euros</i> | <b>2006</b> | <b>2005</b> | <b>2004</b> |
|--------------------------|-------------|-------------|-------------|
| Net revenues             | 1,668       | 2,500       | 2,653       |
| Income before taxes      | 65          | 74          | 248         |
| Net income               | 36          | 21          | 214         |

Total share in net income of investment in associates recognized in the consolidated statement of income

79      17

Current assets

420      629

Noncurrent assets

625      1,000

Total assets

**1,045      1,629**

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|                        |     |     |
|------------------------|-----|-----|
| Current liabilities    | 319 | 562 |
| Noncurrent liabilities | 388 | 455 |
| Shareholders' equity   | 338 | 612 |

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|                              |              |              |
|------------------------------|--------------|--------------|
| Total liabilities and equity | <b>1,045</b> | <b>1,629</b> |
|------------------------------|--------------|--------------|

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|  |            |            |
|--|------------|------------|
| Investments in and loans to investment in associates<br>included in the consolidated balance sheet | <b>177</b> | <b>301</b> |
|--|------------|------------|

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**NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS OF AKZO NOBEL**

Several Akzo Nobel companies are general partners in a number of partnerships that are included in the balance sheet under investment in associates and assets held for sale (Flexsys). Akzo Nobel's equity in the capital of these partnerships was EUR 35 million at year-end 2006 (at December 31, 2005: EUR 55 million). Equity in 2006 earnings was EUR 5 million (2005: loss of EUR 14 million). At year-end 2006, there were no short-term receivables from investment in associates related to these partnerships (at December 31, 2005: EUR 1 million).

**Note 12 □ Inventories**

| <i>Millions of euros</i>               | <b>2006</b>  | <b>2005</b>  |
|--|--------------|--------------|
| Raw materials and supplies             | 566          | 616          |
| Semifinished goods                     | 502          | 401          |
| Finished products and goods for resale | 970          | 963          |
| Inventory prepayments                  | 4            | 7            |
|  | <b>2,042</b> | <b>1,987</b> |

Of the total carrying value of inventories at December 31, 2006, EUR 59 million is measured at net realizable value (fair value less cost to sell). At December 31, 2005 and December 31, 2004 this was EUR 64 million and EUR 50 million, respectively. In 2006, EUR 36 million was recognized in the statement of income for the write-down of inventories (2005: EUR 43 million; 2004: EUR 35 million), while EUR 9 million of write-downs was reversed (2005: EUR 18 million; 2004: EUR 10 million). There are no inventories subject to retention of title clauses.

**Note 13 □ Income tax receivable and payable**

Income tax receivable of EUR 109 million (2005: EUR 137 million; 2004: EUR 210 million) represents the amount of income taxes recoverable in respect of current and prior periods. Income tax payable of EUR 321 million (2005: EUR 380 million; 2004: EUR 468 million) relates to the amount of taxes payable for current and prior periods.

Income taxes receivable and payable have been offset in cases where there is legally enforceable right to set off current tax assets against current tax liabilities and when the intention exists to settle on a net basis or to realize the receivable and payable simultaneously.

**NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS OF AKZO NOBEL****Note 14 ☐ Trade and other receivables**

| <i>Millions of euros</i>    | <b>2006</b>  | <b>2005</b>  |
|-----------------------------|--------------|--------------|
| Trade receivables           | 2,216        | 2,161        |
| Non-income taxes            | 119          | 108          |
| Receivables from associates | 39           | 63           |
| Prepaid expenses            | 136          | 114          |
| Fair value derivatives      | 10           | 28           |
| Other receivables           | 304          | 319          |
|                             | 2,824        | 2,793        |
| Discounted portion          | (14)         | (20)         |
|                             | <b>2,810</b> | <b>2,773</b> |

Trade receivables are presented net of impairment losses of EUR 126 million (2005: EUR 142 million). In 2006, EUR 29 million of impairment losses were recognized in the statement of income (2005: EUR 14 million).

**Note 15 ☐ Cash and cash equivalents**

| <i>Millions of euros</i>  | <b>2006</b>  | <b>2005</b>  |
|---------------------------|--------------|--------------|
| Short-term investments    | 1,427        | 1,144        |
| Cash on hand and in banks | 444          | 342          |
|                           | <b>1,871</b> | <b>1,486</b> |

Short-term investments almost entirely consist of cash loans, time deposits, marketable private borrowings, and marketable securities immediately convertible into cash.

At December 31, 2006, the amount of cash and cash equivalents was freely available.

**Note 16 ☐ Assets and liabilities classified as held for sale**

In February 2005, Akzo Nobel announced it would focus its Chemicals portfolio on five strategic areas with clear prospects for profitable leaderships. The process to realize these divestments is nearly completed. The divestment process for a number of these activities is in such a stage that the assets and liabilities thereof qualify as held for sale. The following activities are included in the disposal group: PVC Additives, MACC, Lubricants & Specialties and our investment in Flexsys.



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**NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS OF AKZO NOBEL**

Assets held for sale include the following:

| <i>Millions of euros</i>      | <b>2006</b> | <b>2005</b> |
|-------------------------------|-------------|-------------|
| Property, plant and equipment | 32          | 164         |
| Intangible assets             | 16          |             |
| Investment in associates      | 130         |             |
| Inventories                   | 16          | 75          |
| Trade and other receivables   | 25          | 83          |
|                               | <b>219</b>  | <b>322</b>  |

Liabilities classified as held for sale include the following:

| <i>Millions of euros</i> | <b>2006</b> | <b>2005</b> |
|--------------------------|-------------|-------------|
| Trade and other payables | <b>25</b>   | <b>60</b>   |

**Note 17 □ Equity****Subscribed share capital**

Authorized capital stock of Akzo Nobel N.V. is EUR 1,600,019,200 and consists of 48 priority shares of EUR 400, 600 million common shares of EUR 2, and 200 million cumulative preferred shares of EUR 2. Subscribed share capital consists of 48 priority shares, 287,268,350 common shares, and no preferred shares (December 31, 2005 and 2004: 48 priority shares, 286,147,260 common shares, and no preferred shares). In 2006, 1,121,090 common shares were issued. In connection with Akzo Nobel's stock option plan, the company held 239,910 common shares at December 31, 2006 (December 31, 2005 and 2004: 374,021). The holders of common shares are entitled to receive dividends as declared from time to time and are entitled to one vote per share at the annual meeting of shareholders. The holders of the priority shares are entitled to six percent per share or the statutory interest in the Netherlands, whichever is lower, plus any accrued and unpaid dividends. They have the right to draw up binding lists of nominees for appointment to the Supervisory Board and the Board of Management.

**Stock options and performance-related shares**

Performance-related stock options and performance-related shares are granted to all members of the Board of Management, Senior Vice Presidents, and executives. The number of participants was 685 in 2006 (2005: 675). The options for Senior Vice Presidents and executives expired after five years. Options granted from 2002 onwards expire after seven years. Options granted to members of the Board of Management as from 2000 expire after ten years. Options granted from 2003 onwards expire after seven years.

All outstanding options from the series 2001, except those for the members of the Board of Management, lapsed in 2006. Options issued as from 1999 cannot be exercised during the first three years. The company currently does not purchase own shares in connection with its stock option plan. No financing facilities exist for option rights or tax payable thereon. One option entitles the holder thereof to buy one Akzo Nobel NV common share of EUR 2 or one American Depositary Share (ADS). As of 2005, all options only entitle the holder thereof to buy Akzo Nobel common shares. The exercise price is the Euronext Amsterdam opening price on the first

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**NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS OF AKZO NOBEL**

day that the Akzo Nobel share is quoted ex dividend or the opening price for an ADS on NASDAQ/NMS on the first day that the Akzo Nobel ADS is quoted ex dividend.

In 2004, a performance-related share plan for the Board of Management was introduced. In 2005, the plan was also introduced for the executives. Under this plan, a number of conditional shares are granted to the members of the Board of Management, Senior Vice Presidents and executives each year. The actual number of shares to be granted depends on the company's Total Shareholder Return (TSR) performance over a three-year period, compared with TSR performance of a specified peer group.

**Outstanding option rights and performance-related shares (including Board of Management)**

| Year of issue                     | Exercise price in EUR | Outstanding at December 31, 2005 | Granted in 2006 | Exercised in 2006 | Lapsed in 2006 | Outstanding at December 31, 2006 | Expiry date    |
|-----------------------------------|-----------------------|----------------------------------|-----------------|-------------------|----------------|----------------------------------|----------------|
| <b>Unconditional options</b>      |                       |                                  |                 |                   |                |                                  |                |
| 2000                              | 44.82                 | 148,500                          |                 |                   |                | 148,500                          | April 27, 2010 |
| 2001                              | 46.75                 | 839,740                          |                 | (483,080)         | (356,660)      |                                  | April 30, 2006 |
| 2001                              | 46.75                 | 144,342                          |                 |                   |                | 144,342                          | April 30, 2011 |
| 2002                              | 46.53                 | 836,160                          |                 | (37,200)          | (21,230)       | 777,730                          | April 25, 2009 |
| 2002                              | 46.53                 | 176,550                          |                 |                   |                | 176,550                          | April 25, 2012 |
| 2003                              | 19.51                 | 961,510                          |                 | (426,080)         | (16,830)       | 518,600                          | April 22, 2010 |
|                                   |                       | 3,106,802                        |                 | (946,360)         | (394,720)      | 1,765,722                        |                |
| <b>Conditional options</b>        |                       |                                  |                 |                   |                |                                  |                |
| 2004                              | 31.45                 | 886,280                          |                 |                   | (19,580)       | 866,700                          | April 25, 2011 |
| 2005                              | 31.98                 | 815,898                          |                 |                   | (18,968)       | 796,930                          | April 24, 2012 |
| 2006                              | 46.46                 |                                  | 694,434         |                   | (7,276)        | 687,158                          | April 27, 2013 |
|                                   |                       | 1,702,178                        | 694,434         |                   | (45,824)       | 2,350,788                        |                |
| in USD                            |                       |                                  |                 |                   |                |                                  |                |
| <b>American Depository Shares</b> |                       |                                  |                 |                   |                |                                  |                |
| <b>Unconditional options</b>      |                       |                                  |                 |                   |                |                                  |                |
| 2001                              | 41.69                 | 133,210                          |                 | (128,810)         | (4,400)        |                                  |                |
| 2002                              | 42.05                 | 139,810                          |                 | (71,540)          | (2,640)        | 65,630                           | April 25, 2009 |
| 2003                              | 21.21                 | 178,970                          |                 | (81,730)          | (3,960)        | 93,280                           | April 22, 2010 |
| <b>Conditional options</b>        |                       |                                  |                 |                   |                |                                  |                |
| 2004                              | 37.25                 | 203,000                          |                 |                   | (12,800)       | 190,200                          | April 25, 2011 |

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|       |           |         |             |           |           |
|-------|-----------|---------|-------------|-----------|-----------|
|       | 654,990   |         | (282,080)   | (23,800)  | 349,110   |
| Total | 5,463,970 | 694,434 | (1,228,440) | (464,344) | 4,465,620 |

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**NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS OF AKZO NOBEL**

| Number of performance-related shares                     | Series    | Outstanding at    | Granted in 2006 | Accumulated dividend till | Forfeited        | Vested on       | Outstanding per  |
|--|-----------|-------------------|-----------------|---------------------------|------------------|-----------------|------------------|
|  |           | December 31, 2005 |                 | December 31, 2006*        |                  | January 1, 2007 |                  |
| Board of Management                                      | 2004-2006 | 99,000            |                 | 4,189                     | (59,400)         | 43,789          |                  |
|  | 2005-2007 | 99,000            |                 | 6,336                     |                  |                 | 105,336          |
|  | 2006-2008 |                   | 68,300          | 1,804                     |                  |                 | 70,104           |
| Executives and former members of the Board of Management | 2004-2006 | 22,000            |                 | 931                       | (13,200)         | 9,731           |                  |
|  | 2005-2007 | 1,076,888         |                 | 67,055                    | (29,139)         |                 | 1,114,804        |
|  | 2006-2008 |                   | 729,009         | 19,027                    | (8,275)          |                 | 739,761          |
| <b>Total</b>   |           | <b>1,296,888</b>  | <b>797,309</b>  | <b>99,342</b>             | <b>(110,014)</b> | <b>53,520</b>   | <b>2,030,005</b> |

\* Equivalent in shares related to accumulated dividend.

The share price of a common share Akzo Nobel as at December 31, 2006 amounted to EUR 46.18.

The number and weighted average exercise price of share options is as follows:

|                                  | Common shares     |   | American Depository Shares |   |
|----------------------------------|-------------------|---|----------------------------|---|
|                                  | Number of options | Weighted-average exercise price, in EUR | Number of options          | Weighted-average exercise price, in USD |
| Balance at December 31, 2004     | 4,902,942         | 38.08                                   | 665,610                    | 34.81                                   |
| Granted during the period        | 819,486           | 31.98                                   |                            |   |
| Forfeited during the period      | (913,448)         | 44.25                                   | (7,980)                    | 33.45                                   |
| Exercised during the period      |                   |   | (2,640)                    | 41.69                                   |
| Balance at December 31, 2005     | 4,808,980         | 35.87                                   | 654,990                    | 34.79                                   |
| Granted during the period        | 694,434           | 46.46                                   |                            |   |
| Forfeited during the period      | (440,544)         | 44.38                                   | (23,800)                   | 35.85                                   |
| Exercised during the period      | (946,360)         | 34.48                                   | (282,080)                  | 35.93                                   |
| Balance at December 31, 2006     | 4,116,510         | 37.07                                   | 349,110                    | 33.87                                   |
| Exercisable at December 31, 2006 | 1,765,722         | 38.47                                   | 158,910                    | 29.82                                   |

From July 1, 2005 the stock options are equity-settled. The employee receives the shares from the company upon exercise of the options and is free to sell the shares immediately afterwards.

The fair value is measured at grant date and amortized over the period during which the employees become unconditionally entitled to the options or performance shares.

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**NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS OF AKZO NOBEL**

The expected value of performance stock options for the Board of Management is based on the binominal option pricing model, using certain assumptions. These assumptions were used for these calculations only and do not necessarily represent an indication of management's expectations of future developments. In addition, option valuation models require the input of highly subjective assumptions, including expected share price volatility. The company's employee stock options have characteristics significantly different from those of traded options and changes in the subjective assumptions used for the calculation can materially affect the fair value estimate.

The fair value and the assumptions used for the options granted were as follows:

| <i>Common shares, in EUR</i>        | <b>2006</b>  | 2005  |
|-------------------------------------|--------------|-------|
| Fair value at measurement date      | <b>9.97</b>  | 7.45  |
| Share price                         | <b>46.46</b> | 31.98 |
| Exercise price                      | <b>46.46</b> | 31.98 |
| Expected share price volatility (%) | <b>24.80</b> | 33.40 |
| Expected option life (years)        | <b>5.00</b>  | 5.00  |
| Expected dividend yield (%)         | <b>2.74</b>  | 4.40  |
| Risk-free interest rate (%)         | <b>3.92</b>  | 3.25  |

The expected volatility is based on the historic volatility (calculated based on the weighted average remaining life of the share options), adjusted for any expected changes to future volatility due to publicly available information. Share options are granted under a service condition and a nonmarket performance condition. Such conditions are not taken into account in the grant fair value measurement. There are no market conditions associated with the share option grants.

The grant date fair value of the performance shares is amortized as a charge against income over the three-year vesting period. The fair value at grant date is based on the Monte Carlo simulation model taking market conditions into account. The value was calculated by external specialists and amounted to EUR 12.67 for the performance share conditionally granted in 2005 and EUR 16.80 for the 2006 performance shares. The 2006 charge recognized aggregated EUR 9.6 million (2005: EUR 3 million).

**Statutory and other reserves**

At the Annual General Meeting of Shareholders of April 26, 2001 an amendment to the Articles of Association was approved whereby the par value of the priority shares was adjusted from NLG 1,000 tot EUR 400 and of the common shares and the cumulative preferred shares from NLG 5 to EUR 2. As the revised par values are somewhat lower than the original par values, in accordance with section 67a of Book 2 of the Netherlands Civil Code, the company recognized a statutory reserve of EUR 77 million for this reduction in subscribed share capital. Statutory reserves also include EUR 5 million for capitalized development costs, as well as the reserves relating to earnings retained by subsidiaries, associates and joint ventures after 1983. Statutory reserves are nondistributable.

Cumulative translation reserves comprises all foreign exchange differences arising from the translation of the financial statements of foreign operations as well as from the translation of intercompany loans with a permanent nature and liabilities that hedge the net investments in a foreign subsidiary.

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**NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS OF AKZO NOBEL**

Changes in fair value of derivatives comprise the effective portion of the cumulative net change in the fair value of cash flow hedging instruments related to hedged transactions that have not yet occurred.

**Dividend proposal**

It was proposed that dividend on priority share of EUR 768 and on common shares of EUR 344 million will be distributed. Following acceptance of this proposal, holders of common shares received a dividend of EUR 1.20 per share of EUR 2, of which EUR 0.30 was paid earlier as an interim dividend. The final dividend of EUR 0.90 was made payable from May 7, 2007.

**Note 18 □ Earnings per share**

Earnings per common share are calculated by dividing net income by the weighted average number of common shares outstanding during the year. The weighted average numbers were as follows:

|   | 2006               | 2005               | 2004               |
|---|--------------------|--------------------|--------------------|
| Issued common shares at January 1                         | 286,147,260        | 286,147,260        | 286,147,260        |
| Issued common shares during the year                      | 732,721            |                    |                    |
| Effect of own shares held                                 | (336,267)          | (374,021)          | (401,673)          |
| <b>Shares for basic earnings per share at December 31</b> | <b>286,543,714</b> | <b>285,773,239</b> | <b>285,745,587</b> |
| Effect of dilutive shares:                                |                    |                    |                    |
| - for stock options                                       | 1,023,823          | 658,646            | 423,348            |
| - for performance-related share plan                      | 860,761            | 519,841            | 236,962            |
| <b>Shares for diluted earnings per share</b>              | <b>288,428,298</b> | <b>286,951,726</b> | <b>286,405,897</b> |

**Note 19 □ Provisions**

| <i>Millions of euros</i>         | <b>Total</b> | <b>Pensions and<br/>other<br/>postretirement<br/>benefits</b> | <b>Restructuring<br/>activities</b> | <b>Environmental<br/>costs</b> | <b>Other</b> |
|----------------------------------|--------------|---|-------------------------------------|--------------------------------|--------------|
| Balance at December 31, 2005     | 2,976        | 2,070   | 199                                 | 268                            | 439          |
| Additions made during the year   | 433          | 137   | 109                                 | 35                             | 152          |
| Utilization                      | (527)        | (224)   | (119)                               | (47)                           | (137)        |
| Amounts reversed during the year | (164)        | (55)  | (29)                                | (50)                           | (30)         |
| Unwind of discount               | 22           | 2   | 3                                   | 12                             | 5            |
| Acquisitions/divestitures        | 26           | 12  | (1)                                 | 13                             | 2            |
| Change in Medicate receivable    | (13)         | (13)  |                                     |                                |              |
| Changes in exchange rates        | (50)         | (41)  | (1)                                 | (3)                            | (5)          |

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|                                      |              |              |            |            |            |
|--------------------------------------|--------------|--------------|------------|------------|------------|
| Balance at December 31,<br>2006      | <b>2,703</b> | <b>1,888</b> | <b>161</b> | <b>228</b> | <b>426</b> |
| Non-current portion of<br>provisions | 2,132        | 1,732        | 48         | 178        | 174        |
| Current portion of provisions        | 571          | 156          | 113        | 50         | 252        |
| Total                                | <b>2,703</b> | <b>1,888</b> | <b>161</b> | <b>228</b> | <b>426</b> |

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**NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS OF AKZO NOBEL****Provisions for pensions and other postretirement benefits**

Akzo Nobel has a number of defined benefit pension plans. The benefits of these plans are based primarily on years of service and employees' compensation. The funding policy for the plans is consistent with local requirements in the countries of establishment.

Obligations under the defined benefit plans are systematically provided for by depositing funds with trustees or separate foundations, under insurance policies, or by balance sheet provisions. Plan assets principally consist of long-term interest-earning investments, quoted equity securities, and real estate.

Akzo Nobel also provides certain healthcare and life insurance benefits for most of the company's retired employees in the United States and, until the end of 2005, in the Netherlands. The company accrues for the expected costs of providing such postretirement benefits during the years that the employee renders the necessary services.

Valuations of the obligations under the pension and other postretirement plans are carried out by independent actuaries.

During 2006, the postretirement healthcare and pensions plans in the United States were adjusted, whereby the benefit levens and the eligibility to participate in these plans were reduced. This is the major reason for the curtailment benefit of in total EUR 55 million, which was recognized. In addition, as a result of a change in medical provider in the United States, medical costs are expected to be lower. As a consequence, the defined benefit obligation reduced substantially in 2006, which resulted in a reduction of the unrecognized net loss.

During 2005, Akzo Nobel reached agreement with the unions on a change of its pension plan in the Netherlands, so that, effective December 31, 2005, it changed from a defined benefit plan to a defined contribution plan. In connection with this change, the company paid a one-time nonrefundable contribution of EUR 151 million and granted a EUR 100 million subordinated loan, which had a fair value at inception of EUR 87 million. The company also funded an interest-free loan of EUR 50 million, which will be redeemed by retaining future employee pension premiums. The fair value at inception of this loan was EUR 47 million. In addition, certain changes were made to the early retirement plan. These changes resulted in a curtailment and settlement of defined benefit obligations of EUR 4,575 million and of plan assets of EUR 4,502 million. All in all, the net pretax gain was EUR 114 million.

Effective December 31, 2005, due to changes in the Dutch national healthcare system, the company also terminated its postretirement healthcare plan in that country, except for a gradually declining transition arrangement until June 30, 2009. Due to this curtailment, the defined benefit obligation decreased by EUR 150 million. The net pretax gain on the termination was EUR 169 million.

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**NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS OF AKZO NOBEL**

The table below shows a summary of the changes in the pension and the other postretirement benefit obligations and plan assets for 2006 and 2005.

| <i>Millions of euros</i>              | <b>Pensions</b> |                | <b>Other Postretirement<br/>benefits</b> |              |
|---------------------------------------|-----------------|----------------|--|--------------|
| Asset/(liability)                     | <b>2006</b>     | <b>2005</b>    | <b>2006</b>                              | <b>2005</b>  |
| <b>Defined benefit obligation</b>     |                 |                |  |              |
| Balance at beginning of year          | (5,510)         | (8,975)        | (508)                                    | (514)        |
| Acquisitions/divestments              | (12)            | (4)            | (1)                                      |              |
| Settlements/curtailments              | 3               | 4,575          | 79                                       | 150          |
| Service costs                         | (82)            | (209)          | (13)                                     | (21)         |
| Contribution by employees             | (7)             | (32)           | (2)                                      |              |
| Interest costs                        | (249)           | (437)          | (20)                                     | (30)         |
| Benefits paid                         | 322             | 484            | 25                                       | 23           |
| Actuarial gains/(losses)              | (197)           | (747)          | 93                                       | (59)         |
| Changes in exchange rates             | (28)            | (165)          | 55                                       | (57)         |
| <b>Balance at end of year</b>         | <b>(5,760)</b>  | <b>(5,510)</b> | <b>(292)</b>                             | <b>(508)</b> |
| <b>Plan assets</b>                    |                 |                |  |              |
| Balance at beginning of year          | 3,596           | 6,781          | □  | □            |
| Acquisitions/divestments              |                 | 1              |  |              |
| Settlements                           | (2)             | (4,502)        |  |              |
| Contribution by employer              | 160             | 397            |  |              |
| Contribution by employees             | 7               | 32             |  |              |
| Benefits paid                         | (284)           | (436)          | □  | □            |
| Expected return on plan assets        | 233             | 461            | □  | □            |
| Actuarial gains                       | 214             | 736            |  |              |
| Changes in exchange rates             | 18              | 126            |  |              |
| <b>Balance at end of year</b>         | <b>3,942</b>    | <b>3,596</b>   | <b>□</b>                                 | <b>□</b>     |
| <b>Funded status</b>                  | <b>(1,818)</b>  | <b>(1,914)</b> | <b>(292)</b>                             | <b>(508)</b> |
| Unrecognized net loss/(gain)          | 302             | 328            | (9)                                      | 89           |
| Unrecognized prior service costs      | 1               | 1              | (26)                                     | 2            |
| Medicare receivable                   |                 |                | (46)                                     | (68)         |
| <b>Net balance pension provisions</b> | <b>(1,515)</b>  | <b>(1,585)</b> | <b>(373)</b>                             | <b>(485)</b> |

The defined benefit obligation breaks down as follows:

| 2006 | 2005 |
|------|------|
|------|------|

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|                               |              |              |
|-------------------------------|--------------|--------------|
| Wholly or partly funded plans | 4,892        | 4,663        |
| Unfunded plans                | 868          | 847          |
|                               | <b>5,760</b> | <b>5,510</b> |

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**NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS OF AKZO NOBEL**

The funded status at the beginning and end of 2004 was as follows:

| <i>Millions of euros</i>   | <b>Pensions</b>          |                        | <b>Other postretirement benefits</b> |                        |
|----------------------------|--------------------------|------------------------|--------------------------------------|------------------------|
|                            | <b>December 31, 2004</b> | <b>January 1, 2004</b> | <b>December 31, 2004</b>             | <b>January 1, 2004</b> |
| Asset/(liability)          |                          |                        |                                      |                        |
| Defined benefit obligation | (8,975)                  | (8,579)                | (514)                                | (521)                  |
| Plan assets                | 6,781                    | 6,347                  | –                                    | 1                      |
| <b>Funded status</b>       | <b>(2,194)</b>           | <b>(2,232)</b>         | <b>(514)</b>                         | <b>(520)</b>           |

As January 1, 2004 is the transition date for the implementation of IFRS, this information is not available for earlier years. The difference between the actual and the expected return on plan assets was a gain of EUR 214 million in 2006, of EUR 736 million in 2005, and of EUR 228 million in 2004. The 2006 actuarial gains and losses on the defined benefit obligation breakdown as follows:

| Gain/(loss)                  | <b>Pensions</b>   | <b>Other postretirement benefits</b> |
|------------------------------|-------------------|--------------------------------------|
|                              | Due to experience | 2                                    |
| Due to change in assumptions | (199)             | 19                                   |
|                              | <b>(197)</b>      | <b>93</b>                            |

In the United States, the Medicare Prescription Drug Improvement and Modernization Act of 2003 introduced prescription drug benefits for retirees as well as a federal subsidy to sponsors of postretirement healthcare plans, which both began at January 1, 2006. This reimbursement right has been recognized as an asset under other financial noncurrent assets, measured at fair value. At December 31, 2006, this value was EUR 46 million (December 31, 2005: EUR 68 million).

The net periodic pension costs for the defined benefit pension plans were as follows:

| Charge/(income)                                     | <b>Pensions</b> |             |             | <b>Other Postretirement benefits</b> |             |             |
|---|-----------------|-------------|-------------|--------------------------------------|-------------|-------------|
|   | <b>2006</b>     | <b>2005</b> | <b>2004</b> | <b>2006</b>                          | <b>2005</b> | <b>2004</b> |
| Service costs for benefits earned during the period | 82              | 209         | 208         | 13                                   | 21          | 22          |
| Interest costs on defined benefit obligations       | 249             | 437         | 456         | 20                                   | 30          | 32          |
| Expected return on plan assets                      | (233)           | (461)       | (427)       |                                      |             |             |
| Amortization of unrecognized losses/(gains)         | 9               | 11          | 13          | (1)                                  |             |             |

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|                             |            |           |            |             |              |             |
|-----------------------------|------------|-----------|------------|-------------|--------------|-------------|
| Settlement/curtailment gain | (4)        | (132)     | (86)       | (51)        | (169)        | (5)         |
|                             | <b>103</b> | <b>64</b> | <b>164</b> | <b>(19)</b> | <b>(118)</b> | <b>(49)</b> |

The remaining plans primarily represent defined contribution plans. Expenses for these plans totaled EUR 177 million in 2006 and EUR 57 million in 2005. This increase to a large extent concerns the transition in the Netherlands from a defined benefit pension plan to a defined contribution plan.

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**NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS OF AKZO NOBEL**

The weighted average assumptions underlying the computations were:

| Percent                                    | Pensions |      |      | Other Postretirement benefits |      |      |
|--|----------|------|------|-------------------------------|------|------|
|  | 2006     | 2005 | 2004 | 2006                          | 2005 | 2004 |
| Pension benefit obligation at December 31, |          |      |      |                               |      |      |
| □ discount rate                            | 4.9      | 4.7  | 4.9  | <b>5.8</b>                    | 5.5  | 5.4  |
| □ rate of compensation increase            | 4.2      | 3.9  | 3.2  |                               |      |      |
| Net periodic pension costs                 |          |      |      |                               |      |      |
| □ discount rate                            | 4.7      | 4.9  | 5.4  | <b>5.5</b>                    | 5.4  | 6.0  |
| □ rate of compensation increase            | 3.9      | 3.2  | 3.2  |                               |      |      |
| □ expected return on plan assets           | 6.5      | 6.7  | 6.7  |                               |      |      |

The assumptions for the expected return on plan assets were based on a review of the historical returns of the asset classes in which the assets of the pension plans are invested. The historical returns on these asset classes were weighted based on the expected long-term allocation of the assets of the pension plans.

Akzo Nobel's primary objective with regard to the investment of pension plan assets is to ensure that in each individual scheme sufficient funds are available to satisfy future benefit obligations. For this purpose so-called asset and liability management (ALM) studies are made periodically at each pension fund. For each of the pension plans an appropriate mix is determined on the basis of the outcome of these ALM studies, taking into account the national rules and regulations.

Pension plan assets principally consist of quoted equity securities, long-term interest-earning investments, and real estate. At December 31, 2006 and 2005, plan assets did not include financial instruments issued by the company, nor any property occupied or other assets used by it. The weighted average pension plan asset allocation at December 31, 2006 and 2005, and the target allocation for 2007 for the pension plans by asset category are as follows:

| Percent                                | Target allocation | Percentage of plan assets at December 31, |            |
|--|-------------------|---|------------|
|  |                   | 2006                                      | 2005       |
| Equity securities                      | 50-55             | 50  | 51         |
| Long-term interest earning investments | 35-45             | 37  | 36         |
| Real estate                            | 5-10              | 8   | 8          |
| Other                                  | 0-5               | 5   | 5          |
| Total                                  |                   | <b>100</b>                                | <b>100</b> |

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**NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS OF AKZO NOBEL**

Weighted average assumptions for other postretirement benefits were as follows :

| <i>Percent</i>   | <b>2006</b> | <b>2005</b> | <b>2004</b> |
|--|-------------|-------------|-------------|
| Assumed healthcare cost trend rates at December 31 :                                   |             |             |             |
| □ healthcare cost trend rate assumed for next year                                     | 9.0         | 8.5         | 6.3         |
| □ rate to which the cost trend rate is assumed to decline<br>(the ultimate trend rate) | 5.0         | 5.0         | 5.0         |
| □ year that the rate reaches the ultimate trend rate                                   | 2010        | 2009        | 2009        |

In line with plan agreements in place until December 31, 2006, allowances under the healthcare plan in the Netherlands are assumed not to increase anymore.

Assumed healthcare cost trend rates have a significant effect on the amounts reported for the healthcare plans. A one percentage point change in assumed healthcare cost trend rates would have the following effects:

| <i>Millions of euros</i>                     | <b>1 percentage<br/>point increase</b> | <b>1 percentage<br/>point<br/>decrease</b> |
|--|--|--|
| Effect on total of service and interest cost | 7                                      | (5)  |
| Effect on postretirement benefit obligations | 19                                     | (18)                                       |

**Cash flows**

The company expects to contribute EUR 122 million to its defined benefit pension plans in 2007. For other postretirement benefit plans the contribution for 2007 is expected to be EUR 20 million.

The following benefit payments, which take into account the effect of future service, are expected to be paid:

|           | <b>Pensions</b> | <b>Other<br/>postretirement<br/>benefits</b> |
|-----------|-----------------|--|
| 2007      | 296             | 23   |
| 2008      | 309             | 21   |
| 2009      | 317             | 22   |
| 2010      | 326             | 22   |
| 2011      | 336             | 24   |
| 2012-2015 | 1,732           | 141  |

**Provisions for restructuring of activities**

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Provisions for restructuring of activities comprise accruals for certain employee termination benefits and for costs which are directly associated with plans to exit specific activities and closing down of facilities. For all restructurings a detailed formal plan exists and the implementation of the plan has started or the plan has been announced before the balance sheet date. Most restructuring activities relate to relatively smaller restructurings

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**NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS OF AKZO NOBEL**

and are expected to be completed within two years from the balance sheet date. However, for certain plans payments of termination benefits to former employees may take several years longer.

**Provisions for environmental costs**

For details on environmental exposures, see note 25.

**Other provisions**

Other provisions relate to a great variety of risks and commitments, including provisions for antitrust cases, claims, other long-term employee benefits like long-service leave, jubilee payments, and other. The provision for antitrust cases amounted to EUR 177 million at December 31, 2006 (at December 31, 2005: EUR 204 million).

For details on antitrust cases, see note 25.

The majority of the cash outflows related to other provisions are expected to be within one to five years. In calculation the other provisions a pretax discount rate of on average 5% has been used.

**Note 20 □ Deferred income**

In December 2003, the company received an initial payment of EUR 88 million from Pfizer for the co-development and co-marketing agreement for asenapine. Such payments are to be reported as deferred income and to be recognized as revenue in subsequent years. For this payment, recognition is based on the development costs expected for the (remaining) first part of the development period. At December 31, 2006, the remaining balance of the deferred amount was EUR 7 million (2005: EUR 27 million).

**Note 21 □ Long-term borrowings**

|                                    | 2006         | 2005         |
|------------------------------------|--------------|--------------|
| Debtures:                          |              |              |
| □ issued by Akzo Nobel NV          | 2,327        | 2,368        |
| □ issued by consolidated companies | 121          | 220          |
| Debt to credit institutions        | 18           | 52           |
| Other borrowings                   | 85           | 62           |
|                                    | <b>2,551</b> | <b>2,702</b> |

At December 31, 2006 the total amount of long-term credit facilities arranged by Akzo Nobel was EUR 1.5 billion (at December 31, 2005: EUR 1.5 billion) maturing at 2013. At December 31, 2006 and December 31, 2005 the facilities were not used

During 2006, the average effective interest rate was 4.5% (2005: 4.2%) .

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**NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS OF AKZO NOBEL**

Aggregate maturities of long-term borrowings are as follows:

|                                    | 2008/2011    | after 2011 |
|------------------------------------|--------------|------------|
| Debtures:                          |              |            |
| □ issued by Akzo Nobel NV          | 2,327        |            |
| □ issued by consolidated companies | 20           | 101        |
| Debt to credit institutions        | 9            | 9          |
| Other borrowings                   | 48           | 37         |
|                                    | <b>2,404</b> | <b>147</b> |

For details on debtures issued by Akzo Nobel NV, see note 24.

At December 31, 2006 and December 31, 2005, none of the borrowings was secured by means of mortgages, etc.

Finance lease liabilities are included under other borrowings. The amounts payable in respect of these finance lease liabilities are due as follows:

|                       | Minimum<br>lease<br>payments | Interest | Principal |
|-----------------------|------------------------------|----------|-----------|
| Within 1 year         | 10                           | 1        | 9         |
| Between 1 and 5 years | 28                           | 2        | 26        |
| More than 5 years     | 1                            | —        | 1         |
|                       | <b>39</b>                    | <b>3</b> | <b>36</b> |

The amounts due within 1 year are presented under short-term borrowings. For details on the company's exposure to interest rate and foreign currency risk, see note 24.

**Note 22 □ Short-term borrowings**

|  | 2006       | 2005       |
|--|------------|------------|
| Debt to credit institutions              | 240        | 298        |
| Borrowings from investment in associates | 12         | 16         |
| Current portion of long-term borrowings  | 158        | 43         |
|  | <b>410</b> | <b>357</b> |

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Akzo Nobel has a commercial paper program in the United States, which at December 31, 2006, as at December 31, 2005, had a maximum of USD 1.0 billion (year-end 2006: EUR 0.7 billion; year-end 2005: EUR 0.8 billion), and a Euro commercial paper program, which at December 31, 2006, as at December 31, 2005, had a maximum of EUR 1.5 billion. Both at December 31, 2006 and at December 31, 2005, there was no commercial paper outstanding.

For details on financial instruments, see note 24.

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**NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS OF AKZO NOBEL****Note 23 □ Trade and other payables**

|   | <b>2006</b>  | 2005  |
|---|--------------|-------|
| Prepayments by customers                | <b>20</b>    | 24    |
| Suppliers                               | <b>1,221</b> | 1,180 |
| Debt to associates                      | <b>3</b>     | 4     |
| Taxes and social security contributions | <b>171</b>   | 153   |
| Amounts payable to employees            | <b>409</b>   | 369   |
| Dividends                               | <b>1</b>     | 4     |
| Pensions                                | <b>17</b>    | 7     |
| Fair value derivatives                  | <b>13</b>    | 13    |
| Other liabilities                       | <b>476</b>   | 437   |
|   | <b>2,331</b> | 2,191 |

**Note 24 □ Financial instruments****Foreign exchange risk management**

The company enters into forward exchange contracts to hedge the entire transaction risk on sales, purchases, and financing transactions denominated in currencies other than the functional currency of the subsidiary concerned. The purpose of Akzo Nobel's foreign currency hedging activities is to protect the company from the risk that the eventual functional currency net cash flows resulting from committed trade or financing transactions are adversely affected by changes in exchange rates. Most forward exchange contracts outstanding at year-end have a maturity of less than one year. Where necessary, the forward exchange contracts are rolled over at maturity. Incidentally, the company may apply hedge accounting. The company does not use financial instruments to hedge the translation risk related to equity, intercompany loans of a permanent nature, and earnings of foreign subsidiaries and investment in associates. Currency derivatives are not used for speculative purposes.

At December 31, 2006, outstanding contracts to buy currencies totaled EUR 775 million (at December 31, 2005: EUR 1.0 billion), while contracts to sell currencies totaled EUR 813 million (at December 31, 2005: EUR 1.0 billion). These contracts mainly relate to U.S. dollars, Swedish kronor, Norwegian kronor, pounds sterling, and Japanese yen, all having maturities within one year.

**Interest rate risk management**

In principle, the company manages interest risk by matching the duration of assets and liabilities. As a consequence, noncurrent assets and a certain portion of current assets are financed with equity, provisions, and long-term borrowings with fixed interest rates. The remainder of current assets is financed with short-term debt, including floating rate short-term borrowings. In order to achieve an appropriate mix of fixed and floating rate exposure within the company's policy, a number of swap contracts and forward rate agreements have been entered into. The company swapped EUR 250 million fixed rate liabilities with an interest rate of 5.63% with 3-month floating rate EURIBOR-related liabilities, maturing in 2009.

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In addition, the company swapped EUR 250 million 3-month floating rate EURIBOR liabilities into USD 223 million 3-month floating rate LIBOR liabilities, maturing in 2009. The combined effective interest rate was 5.0% .

The company swapped fixed rate liabilities with an interest rate of 4.25% with 6-month floating rate EURIBOR-related liabilities for an amount of EUR 650 million, maturing in 2011. The combined effective interest rate was 3.3% .

The company classifies the interest rate swaps as fair value hedges and states them at fair value.

The company concluded forward rate agreements whereby interest on deposits was fixed at 3.0% for a volume of EUR 100 million during the period January to April 2007. For the forward rate agreements no hedge accounting is applied.

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**NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS OF AKZO NOBEL**

The table below gives information on the company's financial instruments that are sensitive to changes in interest rates. The principal cash flows and effective interest rates are given.

| <i>Millions of euros</i>         | <b>Expected maturity date</b> |       |       |      |             | Total | Effective interest rate | Carrying amount | Estimated fair value |
|----------------------------------|-------------------------------|-------|-------|------|-------------|-------|-------------------------|-----------------|----------------------|
|                                  | 2008                          | 2009  | 2010  | 2011 | There after |       |                         |                 |                      |
| <b>Assets</b>                    |                               |       |       |      |             |       |                         |                 |                      |
| Subordinated loan to Akzo        |                               |       |       |      |             |       |                         |                 |                      |
| Nobel Pension Fund               |                               |       | (100) |      |             | (100) | 5.1                     | 89              | 89                   |
| Average interest rate            |                               |       | 3.5   |      |             | 3.5   |                         |                 |                      |
| <b>Liabilities</b>               |                               |       |       |      |             |       |                         |                 |                      |
| <b>Long-term borrowings</b>      |                               |       |       |      |             |       |                         |                 |                      |
| <b>Fixed Rate (EUR)</b>          |                               |       |       |      |             |       |                         |                 |                      |
| Bond loan 98/08                  | 511                           |       |       |      |             | 511   | 5.49                    | 513             | 521                  |
| Average interest rate %          | 5.38                          |       |       |      |             | 5.38  |                         |                 |                      |
| Bond loan 02/09                  |                               | 1,000 |       |      |             | 1,000 | 5.76                    | 1,051           | 1,030                |
| Average interest rate %          |                               | 5.63  |       |      |             | 5.63  |                         |                 |                      |
| Bond loan 03/11                  |                               |       |       | 750  |             | 750   | 4.41                    | 763             | 751                  |
| Average interest rate %          |                               |       |       | 4.25 |             | 4.25  |                         |                 |                      |
| <b>Fixed Rate (USD)</b>          |                               |       |       |      |             |       |                         |                 |                      |
| Bond loan 09                     |                               | 14    |       |      |             | 14    | 6.35                    | 14              | 14                   |
| Average interest rate %          |                               | 6.28  |       |      |             | 6.28  |                         |                 |                      |
| Bond loan 12                     |                               |       |       |      | 107         | 107   | 6.57                    | 107             | 110                  |
| Average interest rate %          |                               |       |       |      | 6.54        | 6.54  |                         |                 |                      |
| <b>Interest rate derivatives</b> |                               |       |       |      |             |       |                         |                 |                      |
| <b>Interest rate swaps</b>       |                               |       |       |      |             |       |                         |                 |                      |
| Fixed to variable (EUR)          |                               | 250   |       |      |             | 250   |                         | 13              | 13                   |
| Average pay rate %               | Euribor 3 months + 0.47       |       |       |      |             |       |                         |                 |                      |
| Average receive rate %           |                               | 5.625 |       |      |             | 5.625 |                         |                 |                      |
| Fixed to variable (EUR)          |                               |       |       | 450  |             | 450   |                         | 4               | 4                    |
| Average pay rate %               | Euribor 6 months + 0.43       |       |       |      |             |       |                         |                 |                      |
| Average receive rate %           |                               |       |       | 4.25 |             | 4.25  |                         |                 |                      |

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|  |  |      |    |    |
|--|--|------|----|----|
| Fixed to variable<br>(EUR)             | 200  | 200  | 2  | 2  |
|  | Euribor 6 months +   |      |    |    |
| Average pay rate %                     | 0.445  |      |    |    |
| Average receive rate<br>%              | 4.25   | 4.25 |    |    |
| <b>Cross currency<br/>swap</b>         |  |      |    |    |
| Variable (EUR) to<br>Variable<br>(USD) | 250 EUR/223 USD  |      | 83 | 83 |
| Average receive rate<br>%              | 250 EUR Euribor + 0.47   |      |    |    |
| Average pay rate %                     | 223 USD Libor + 0.439  |      |    |    |
| <b>Forward rate<br/>agreements</b>     |  |      |    |    |
|  | Fixed interest rate on deposits<br>-3% (fixed rate) on EUR 100 million maturity 2007 |      |    |    |

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**NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS OF AKZO NOBEL****Credit risk management**

The company has a credit risk management policy in place to limit credit losses due to nonperformance of financial counterparties and customers. The exposure to credit risk is monitored on an ongoing basis. Credit evaluations are performed on all customers requiring credit. Generally the company does not require collateral in respect of financial assets.

Investments in cash and cash equivalents are entered into with counterparties which have a high credit rating and limits per counterparty have been set. Transactions involving derivative financial instruments are with counterparties with sound credit ratings and with whom the group has contractual netting agreements. The company has no reason to expect nonperformance by the counterparties to these agreements.

Due to the geographical spread of the company and the diversity of its customers, at balance sheet date the company was not subject to any significant concentration of credit risks. The maximum exposure to credit risk is represented by the carrying amount of each financial asset, including derivative financial instruments, in the balance sheet.

**Commodity price risk management**

In order to hedge the price risk of natural gas, the company has entered into swap contracts for the underlying fuels, with an average volume per month of 36,500 tons for the period of January through December 2007, whereby the price is fixed. The company also concluded futures contracts for the purchase of 1,966 million m<sup>3</sup> of gas, reasonably spread over the period 2007-2009.

Furthermore, the company entered into futures contracts for electricity in order to hedge the price risk for the expected use of electricity by certain subsidiaries over the period 2007-2010, spread in tranches of three months. For these contracts cash flow hedge accounting is applied.

**Sensitivity Analysis**

By managing interest rate and currency risks, the company aims to reduce the impact of short-term fluctuations on the company's earnings. Over the longer-term, however, permanent changes in foreign exchange and interest rates would have an impact on consolidated earnings.

At December 31, 2006, the decrease in the company's profit before tax as a result of a general increase of one percentage point in interest rates would be negligible. Cash and cash equivalents, short-term borrowings and interest swaps have been included in this assessment.

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**NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS OF AKZO NOBEL****Fair value of financial instruments**

The carrying values and estimated fair values of financial instruments are as follows:

| Asset/(liability)                            | December 31, 2006 |                       | December 31, 2005 |                       |
|--|-------------------|-----------------------|-------------------|-----------------------|
|  | Carrying value    | Estimated fair values | Carrying value    | Estimated fair values |
| Subordinated loan to Akzo Nobel Pension Fund | 89                | 89                    | 87                | 87                    |
| Trade and other receivables                  | 2,810             | 2,810                 | 2,773             | 2,773                 |
| Cash and cash equivalents                    | 1,871             | 1,871                 | 1,486             | 1,486                 |
| Interest swap contracts                      | 19                | 19                    | 81                | 81                    |
| Cross currency swap contracts                | 83                | 83                    | 64                | 64                    |
| Forward rate agreements                      | □                 | □                     | □                 | □                     |
| Forward exchange contracts:                  |                   |                       |                   |                       |
| □ asset                                      | 10                | 10                    | 23                | 23                    |
| □ liability                                  | (13)              | (13)                  | (11)              | (11)                  |
| Long-term borrowings                         | (2,551)           | (2,529)               | (2,702)           | (2,833)               |
| Short-term borrowings                        | (410)             | (410)                 | (357)             | (357)                 |
| Trade and other payables                     | (2,331)           | (2,331)               | (2,191)           | (2,191)               |
| Electricity futures                          | 2                 | 2                     | 18                | 18                    |
| Petroleum swaps                              | (16)              | (16)                  | 4                 | 4                     |
| Gas futures                                  | (1)               | (1)                   | 1                 | 1                     |
|  | <b>(438)</b>      | <b>(416)</b>          | <b>(724)</b>      | <b>(855)</b>          |
| Unrecognized (losses)/gains                  |                   | <b>22</b>             |                   | <b>(131)</b>          |

The fair value of foreign currency contracts, swap contracts, forward rate agreements, petroleum options, and gas futures was estimated by calculation and obtaining quotes from dealers and brokers. The fair value of the company's long-term borrowings was estimated based on the quoted market prices for the same or similar issues or on the current rates offered to the company for debt with similar maturities.

The carrying amounts of cash and cash equivalents, receivables, short-term borrowings, and other current liabilities approximate fair value due to the short maturity period of those instruments.

**Note 25 □ Contingent liabilities and commitments****Environmental matters**

The company is confronted with substantial costs arising out of environmental laws and regulations, which include obligations to eliminate or limit the effects on the environment of the disposal or release of certain wastes or substances at various sites. Proceedings involving environmental matters, such as the alleged discharge of chemicals or waste materials into the air, water or soil, are pending against the company in various countries. In some cases this concerns sites divested in prior years or derelict sites belonging to companies acquired in the past.

**NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS OF AKZO NOBEL**

It is the company's policy to accrue and charge against earnings environmental cleanup costs when it is probable that a liability has materialized and an amount is reasonably estimable. These accruals are reviewed periodically and adjusted, if necessary, as assessments and cleanups proceed and additional information becomes available. Environmental liabilities can change substantially due to the emergence of additional information on the nature or extent of contamination, the necessity of employing particular methods of remediation, actions by governmental agencies or private parties, or other factors of a similar nature. Cash expenditures often lag behind the period in which an accrual is recorded by a number of years.

As stated in note 19, the provisions for environmental costs accounted for in accordance with the aforesaid policies aggregated EUR 228 million at December 31, 2006 (at December 31, 2005: EUR 268 million). The provision has been discounted using an average pretax discount rate of 5.25% .

While it is not feasible to predict the outcome of all pending environmental exposures, it is reasonably possible that there will be a need for future provisions for environmental costs which, in management's opinion, based on information currently available, would not have a material effect on the company's financial position but could be material to the company's results of operations in any one accounting period.

**Antitrust cases**

Akzo Nobel is involved in investigations by the antitrust authorities in the European Union, the United States, and Canada into alleged violations of the respective antitrust laws for some products in these jurisdictions. The company is fully cooperating with the authorities in these investigations. In addition, the company is defending civil damage claims in relation to some of these alleged antitrust violations. At December 31, 2005, the company had a provision for antitrust cases of EUR 204 million. Fines, civil damage settlements, and legal costs incurred in 2006 in connection with these cases amounted to EUR 50 million (2005: EUR 12 million).

In March 2006, Akzo Nobel Chemicals International BV entered into a Plea Agreement with the United States that involved, among other material terms, an agreement that Akzo Nobel Chemicals International BV would plead guilty to a one-count information charging it with violation of § 1 of the Sherman Act with respect to the sale of hydrogen peroxide over the period from July 1998 to December 2001. It also involved an agreement that the US DOJ would recommend a fine and related payments in the amount of USD 32 million (EUR 26 million). Pursuant to the Plea Agreement, on May 17, 2006, Akzo Nobel Chemicals International BV entered its plea of guilty and was sentenced by the Federal District Court in San Francisco, California, in accordance with the recommendation in the Plea Agreement.

In 2006, based on an estimate of probable fines, civil damage claims, and costs to be paid over a number of years to come – taking into account legal advice and the current facts and circumstances – the company added EUR 21 million to the provision for antitrust cases. At December 31, 2006, the provision for antitrust cases amounted to EUR 177 million. Included in this amount are provisions for three cases pending in appeal by the company with the EU Court of First Instance (EU CFI) against decisions by the EU Commission to impose fines on the company for violations of EU competition laws regarding the following products: choline chloride (EUR 21 million), monochloroacetic acid (EUR 84 million), and hydrogen peroxides (EUR 25 million). The company's appeal against the European Commission's decision to fine the company for violation of the European competition laws regarding sodium gluconates (EUR 10 million) was dismissed by the EU Court of First Instance, which judgment is now under appeal by the company at the European Court of Justice.

It should be understood, however, that in light of possible future developments such as (a) the outcome of investigations by the various antitrust authorities, (b) potential additional lawsuits by (direct or indirect) purchasers, (c) possible future civil settlements, and (d) rulings or judgments in the pending investigations or in related civil suits, the antitrust cases are likely to result in additional liabilities and related costs. The company at this point in time cannot estimate any additional amount of loss or range of loss in excess of the recorded amounts with sufficient certainty to allow such amount or range of amounts to be meaningful. Moreover, if and to the extent that the contingent liabilities materialize, they are typically paid over a number of years and the timing of such payments cannot be predicted with confidence.



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The company believes that the aggregate amount of any additional fines and civil damages to be paid will not materially affect the company's financial position. The aggregate amount, however, could be material to the company's results of operations or cash flows in any one accounting period.

With regard to Flexsys, a 50/50 joint venture for rubber chemicals with Solutia Inc., authorities in the United States, Canada, and Europe are investigating alleged antitrust violations in the rubber chemicals industry. We have been informed by Flexsys management that it is cooperating with the authorities and will continue to do so and pursuant to this cooperation has been granted conditional amnesty by the US DOJ, the Canadian DOJ and the EU Commission. We are aware that Flexsys entered into a settlement (which in 2005 received final approval by the Federal District Court in San Francisco, California) with a class of direct purchasers in the United States. We are also aware of a number of purported class actions having been filed against Flexsys in various state courts (by alleged indirect purchasers) and an individual action (by an alleged competition) in federal court in the United States, and in the province of Quebec, Canada. The company has been named as codefendant in the federal individual action. Flexsys has recognized certain provisions for these cases and the company does believe neither that the plaintiffs will be able to establish liability on the part of the company nor that it will be liable for funding any judgments against settlements made by, or related costs incurred by Flexsys. The carrying value of the company's investment in Flexsys, however, may be affected by these cases. At December 31, 2006 the carrying amount related to the Flexsys investment was EUR 131 million. This amount is included in assets held for sale. Reference is made to Note 28 □ Subsequent Events.

**Other Investigations and Litigation**

Certain wholly-owned operating subsidiaries of Organon and Intervet were named in the final report of the Independent Inquiry Committee into the United Nations' Oil for Food Program for humanitarian support to Iraq. The report states that these entities made some improper payments in connection with four contracts (with a total value of USD 3 million) with the Iraqi Government to provide pharmaceuticals and vaccines. Akzo Nobel has conducted an internal review of this matter and has voluntarily reported on that review to the U.S. Securities and Exchange Commission and to the US DOJ. The company is currently working with these authorities regarding the situation. Organon is also involved in an investigation by the competent Dutch public prosecutor. While neither of the said authorities has taken any action to date against Akzo Nobel or its subsidiaries, this matter could expose Akzo Nobel and/or its subsidiaries to regulatory and/or criminal charges and sanctions.

Late January 2006, Akzo Nobel Nederland B.V. and the Akzo Nobel Pension Fund in the Netherlands received a summons from the Association of Retired Akzo Nobel Employees with regard to the changed financing of the company's Dutch pension plan. In January 2007, the court dismissed all claims against Akzo Nobel Nederland BV and the Akzo Nobel Pension Fund. Reference is made to Note 28 □ Subsequent Events.

In December 2006 Akzo Nobel Nederland BV received a summons from certain Dutch labor unions, acting on behalf of retired Dutch Akzo Nobel employees, claiming that Akzo Nobel Nederland BV's decision no longer to reimburse part of the health insurance premiums for those employees over time after a transition period is in breach of Akzo Nobel's employment contracts with these employees. The company is defending its position and based on legal advice believes that there will be no material liability to it on this matter.

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**NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS OF AKZO NOBEL**

A number of other claims are pending against Akzo Nobel N.V. and its subsidiaries, all of which are contested. The company is also involved in disputes with tax authorities in several jurisdictions. While the outcome of these claims and disputes cannot be predicted with certainty, the company believes, based upon legal advice and information received, that the final outcome will not materially affect the consolidated financial position of the company but could be material to the company's result of operations or cashflows in any one accounting period.

**Commitments**

Purchase commitments for property, plant and equipment aggregated EUR 96 million at December 31, 2006. At December 31, 2005, these commitments totaled EUR 76 million. In addition, the company has purchase commitments for raw materials and supplies incident to the ordinary conduct of business, for a total of EUR 1.4 billion (2005: EUR 1.5 billion).

Long-term liabilities contracted in respect of leasehold, rental, operational leases, research, etc., aggregated EUR 776 million at December 31, 2006 (at December 31, 2005: EUR 822 million). Payments due within one year amount to EUR 225 million (2005: EUR 261 million); payments between one and five years EUR 416 million (2005: EUR 441 million) and payments due after more than five years amount to EUR 135 million (2005: EUR 120 million).

Guarantees related to investment in associates totaled EUR 5 million (at December 31, 2005: EUR 3 million). As general partners in several partnerships, Akzo Nobel companies are liable for obligations incurred by these partnerships. At December 31, 2006, the risk ensuing from these liabilities was EUR 93 million (at December 31, 2005: EUR 113 million).

**Note 26 ☐ Related party transactions**

Akzo Nobel purchases and sells goods and services to various related parties in which Akzo Nobel holds a 50% or less equity interest (investment in associates). Such transactions were not significant on an individual or aggregate basis. These transactions were conducted at arm's length with terms comparable to transactions with third parties.

In the ordinary course of business the company has transactions with various organizations with which certain of its members of the Supervisory Board of Management are associated, but no transactions responsive to this item were conducted in 2006. Likewise, there have been no transactions with members of the Supervisory Board or Board of Management, any other senior management personnel or any family member of such persons. Also no loans have been extended to members of the Supervisory Board or Board of Management, any other senior management personnel or any family member of such persons. For details on the remuneration of the Supervisory Board and Board of Management see Item 6 ☐ Directors, Senior Management and Employees, section B ☐ Compensation of this document.

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**NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS OF AKZO NOBEL****Note 27 Application of Generally Accepted Accounting Principles in the United States of America**

The accounting principles followed in the preparation of the consolidated financial statements (IFRS) differ in some respects from those generally accepted in the United States of America (US GAAP).

The reconciliation of net income is as follows:

| <i>Millions of euros</i>  | <b>For the year ended December 31,</b> |             |             |
|---|--|-------------|-------------|
|   | <b>2006</b>                            | <b>2005</b> | <b>2004</b> |
| Net income attributable to equity holders of the company, in accordance with IFRS | 1,153                                  | 961         | 945         |
| <i>Adjustments to reported income:</i>  |  |             |             |
| Goodwill write-downs (a)  | (29)                                   | (46)        | (92)        |
| Pensions (b)  | (37)                                   | (212)       | (140)       |
| Loans to pension fund in the Netherlands (b)                                      | (4)                                    | 15          |             |
| Other postretirement benefits (b)   | (29)                                   | (72)        | (14)        |
| Joint venture (c)   | (1)                                    | (2)         | (4)         |
| Stock compensation (d)  |  | 1           | 2           |
| Employee share plan (e)   |  |             | (1)         |
| Development costs (f)   | 3                                      |             |             |
| Restructuring provisions (g)  | 2                                      | (16)        | 14          |
| Tax on the elimination of intercompany profits (h)                                | 2                                      | (7)         | 43          |
| Derivatives (i)   | (80)                                   | 8           | 35          |
| Intangible assets (j)   | (2)                                    | (24)        |             |
| Sale and leaseback office building (l)  | (12)                                   |             |             |
| Joint venture (m)   | (18)                                   |             |             |
| Discounting of sundry provisions (n)  | (25)                                   |             |             |
| Reversal of impairments (o)   | (11)                                   |             |             |
| Minority interest (p)   | (2)                                    |             |             |
| Income taxes (s)  | 90                                     | 104         | 44          |
| <b>Net income/(loss) in accordance with US GAAP</b>                               | <b>1,000</b>                           | <b>710</b>  | <b>832</b>  |
| <i>Per share and ADS in accordance with US GAAP, in euros:</i>                    |  |             |             |
| Basic earnings/(loss) per share/ADS   | 3.49                                   | 2.48        | 2.91        |
| Diluted earnings/(loss) per share/ADS   | 3.47                                   | 2.47        | 2.90        |

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**NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS OF AKZO NOBEL**

Comprehensive income is as follows:

| <i>Millions of euros</i>   | <b>2006</b> | <b>2005</b> | <b>2004</b> |
|--|-------------|-------------|-------------|
| Net income/(loss) in accordance with US GAAP                                   | 1,000       | 710         | 832         |
| Other comprehensive income/(loss), net of taxes                                |             |             |             |
| Foreign currency translation adjustments                                       | (137)       | 253         | (78)        |
| Excess of minimum liability over unrecognized prior service cost, before taxes | 106         | (115)       | 72          |
| Tax on excess of minimum liability over unrecognized prior service cost        | (40)        | 41          | (7)         |
| <b>Comprehensive income/(loss)</b>   | <b>929</b>  | <b>889</b>  | <b>819</b>  |

The accumulated other comprehensive income/(loss) balances are as follows:

| <i>Millions of euros</i>  | <b>Foreign<br/>currency<br/>translation<br/>adjustments</b> | <b>Minimum<br/>pension<br/>liability<br/>adjustment</b> | <b>Pensions<br/>(SFAS<br/>158)</b> | <b>Accumulated<br/>other<br/>comprehensive<br/>income</b> |
|---|---|---|------------------------------------|---|
| Balance at December 31, 2003  | (1,066)   | (824)   |                                    | (1,890)   |
| 2004 change   | (78)  | 65  |                                    | (13)  |
| Balance at December 31, 2004  | (1,144)   | (759)   |                                    | (1,903)   |
| 2005 change   | 253   | (74) <sup>1</sup>                                       |                                    | 179   |
| Balance at December 31, 2005  | (891)   | (833)   |                                    | (1,724)   |
| 2006 change   | (137)   | 66  |                                    | (71)  |
| Adoption of SFAS 158 net of taxes of (EUR 355 million) and<br>EUR 424 million, respectively |   | 767   | (947) <sup>2</sup>                 | (180)   |
| <b>Balance at December 31, 2006</b>   | <b>(1,028)</b>  |   | <b>(947)</b>                       | <b>(1,975)</b>  |

1 Including a credit of EUR 10 million recognized for the joint venture Flexsys.

2 Including a charge of EUR 13 million recognized for the joint venture Flexsys.

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**NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS OF AKZO NOBEL**

The reconciliation of shareholders' equity is as follows:

| <i>Millions of euros</i>                               | <b>December 31,</b> |              |
|--|---------------------|--------------|
|  | <b>2006</b>         | <b>2005</b>  |
| Shareholders' equity in accordance with IFRS           | 4,144               | 3,415        |
| <i>Adjustments to reported shareholders' equity:</i>   |                     |              |
| Goodwill (a)   | 3,003               | 3,056        |
| Pensions (b)   | 93                  | 1,496        |
| Minimum pension liability (b)                          |                     | (1,228)      |
| Other postretirement benefits (b)                      | 36                  | 61           |
| Joint venture (c)                                      | (2)                 | 17           |
| Development costs (f)                                  | (5)                 | (8)          |
| Restructuring provisions (g)                           | 3                   | 1            |
| Tax effect on eliminations of intercompany profit (h)  | (37)                | (40)         |
| Derivatives (i)  | 18                  | 61           |
| Intangible assets (j)                                  | (26)                | (24)         |
| Sale and leaseback office building (l)                 | (12)                |              |
| Joint venture (m)                                      | (17)                |              |
| Discounting of sundry provisions (n)                   | (25)                |              |
| Reversal of impairments (o)                            | (11)                |              |
| Minority interest (p)                                  | (2)                 |              |
| Income taxes (s)                                       | 2                   | (106)        |
| <b>Shareholders' equity in accordance with US GAAP</b> | <b>7,162</b>        | <b>6,701</b> |

An analysis of the change of shareholders' equity under US GAAP is as follows:

| <i>Millions of euros</i>   | <b>2006</b>  | <b>2005</b>  | <b>2004</b>  |
|--|--------------|--------------|--------------|
| Balance at beginning of year   | 6,701        | 6,127        | 5,651        |
| Net income/(loss)  | 1,000        | 710          | 832          |
| Dividends paid   | (344)        | (343)        | (343)        |
| Equity settled transactions  | 16           | 28           |              |
| Issue of common shares   | 40           |              |              |
| Foreign currency translation adjustments   | (137)        | 253          | (78)         |
| Excess of minimum liability over unrecognized prior service costs, net of income taxes | 66           | (74)         | 65           |
| Adoption of SFAS 158   | (180)        |              |              |
| <b>Balance at end of year</b>  | <b>7,162</b> | <b>6,701</b> | <b>6,127</b> |



**NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS OF AKZO NOBEL**

The differences, which have an effect on net income and/or shareholders' equity, are as follows:

- (a) For NL GAAP purposes, until 1999 goodwill was charged directly to shareholders' equity. Under IFRS goodwill is capitalized and tested for impairment annually. Akzo Nobel has elected the transition option in IFRS 1 to apply IFRS 3 prospectively from the transition date. This implicates that all prior business combination accounting is frozen at transition date and the value of goodwill is frozen at January 1, 2004.

For US GAAP, until 2001 goodwill was capitalized and amortized over its estimated useful life not exceeding 40 years.

The company adopted the provisions of SFAS 141 as of July 1, 2001, and of SFAS 142 effective January 1, 2002. As of January 1, 2002, goodwill is determined to have an indefinite useful life, and therefore no longer amortized. Annually goodwill is tested for impairment in accordance with the provisions of SFAS 142.

As a consequence, the unamortized goodwill balances per January 1, 2002, of pre 2000 acquisitions are to be capitalized for US GAAP and are no longer amortized.

The company annually tests the US GAAP goodwill for impairment. The impairment test in accordance with the provisions of SFAS 142 did not result in additional charges in the company's statement of income, except for the write down of remaining unamortized goodwill associated with businesses disposed of. For 2006 and 2005, the write down mainly related to some Chemicals activities which are classified as held for sale. The goodwill has been written down to net realizable value. For 2004, the write down concerns unamortized goodwill of Catalysts, Phosphorus Chemicals, and Coating Resins.

An analysis of the change in the reconciling item for goodwill under US GAAP during 2006, 2005, and 2004 is as follows:

| <i>Millions of euros</i>                 |       |
|--|-------|
| Balance at December 31, 2003             | 3,163 |
| Additional write-downs                   | (92)  |
| Foreign currency translation adjustments | (35)  |
|  | <hr/> |
| Balance at December 31, 2004             | 3,036 |
| Additional write-downs                   | (46)  |
| Foreign currency translation adjustments | 66    |
|  | <hr/> |
| Balance at December 31, 2005             | 3,056 |
| Additional write-downs                   | (29)  |
| Foreign currency translation adjustments | (24)  |
|  | <hr/> |
| Balance at December 31, 2006             | 3,003 |

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**NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS OF AKZO NOBEL**

The movement schedule per segment of the total US GAAP goodwill is as follows:

| <i>Millions of euros</i>                 | <b>Organon</b> | <b>Intervet</b> | <b>Coatings</b> | <b>Chemicals</b> | <b>Total</b> |
|--|----------------|-----------------|-----------------|------------------|--------------|
| Balance at December 31, 2004             | 89             | 309             | 2,191           | 724              | 3,313        |
| Acquisitions                             |                |                 | 13              | 5                | 18           |
| Divestments                              |                |                 |                 | (3)              | (3)          |
| Impairments                              | (15)           |                 | (5)             | (48)             | (68)         |
| Foreign currency translation adjustments | 1              | 4               | 77              | (1)              | 81           |
| Balance at December 31, 2005             | 75             | 313             | 2,276           | 677              | 3,341        |
| Acquisitions                             |                |                 | 173             | 1                | 174          |
| Transfer to Assets held for sale         |                |                 |                 | (16)             | (16)         |
| Transfer to other intangible assets      |                |                 | (3)             |                  | (3)          |
| Impairments                              |                |                 | (1)             | (29)             | (30)         |
| Foreign currency translation adjustments |                | (3)             | (44)            | 4                | (43)         |
| Balance at December 31, 2006             | 75             | 310             | 2,401           | 637              | 3,423        |

- (b) Until December 31, 2004, the company used to account for pensions and other postretirement benefits in accordance with SFAS 87 and SFAS 106. For the adoption of IFRS, also IAS 19 Employee Benefits in respect of pensions and other postretirement benefits had to be implemented. As a consequence, the company had to recognize the funded status at January 1, 2004, of the projected benefit obligation insofar as this was not covered by provisions or prepaid pension assets. Any unvested portion of past service cost at that date had to be excluded. On January 1, 2004, the company had a significant deficit for its pensions and other postretirement benefit plans. For the IFRS opening balance this deficit has been charged against shareholders' equity. Going forward, the full recognition of the deficit at January 1, 2004 resulted in lower net periodic pension cost under IFRS, as the deferred losses under SFAS 87 and SFAS 106 no longer were to be amortized.

For US GAAP purposes these changes as a result of the IFRS implementation have been reversed.

Furthermore, the company had also recognized a minimum pension liability for the deficit determined on the accumulated benefit obligation (ABO) level, as required under SFAS 87. As this is not allowed under IAS 19, the minimum pension liability-related entries were reversed in the IFRS balance sheet.

*Pensions*

During 2005, Akzo Nobel reached an agreement with the unions on a change of its pension plan in the Netherlands, so that, effective December 31, 2005, it changed from a defined benefit plan to a defined contribution plan for IFRS, as the actuarial or investment risks related to the Dutch plan no longer rest with the company. However, SFAS 87 specifically prescribes for a defined contribution plan that the plan provides an individual account for each participant. The Dutch plan does not provide such individual accounts per participant as it is a collective defined contribution plan. Therefore, in accordance with SFAS 87 the changed pension plan in the Netherlands still is to be qualified as a defined benefit plan for US GAAP purposes.

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**NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS OF AKZO NOBEL**

Below a table is provided with a summary of the changes in the pension benefit obligation and plan assets for 2006 and 2005 on SFAS 87 basis.

| <i>Millions of euros</i>                                     | <b>The Netherlands</b> |                         | <b>Foreign</b> |                         | <b>Total</b>   |                         |
|--|------------------------|-------------------------|----------------|-------------------------|----------------|-------------------------|
|  | <b>2006</b>            | <b>2005<sup>1</sup></b> | <b>2006</b>    | <b>2005<sup>1</sup></b> | <b>2006</b>    | <b>2005<sup>1</sup></b> |
| <b>Benefit obligation</b>                                    |                        |                         |                |                         |                |                         |
| <i>Balance at beginning of year</i>                          | (4,913)                | (4,375)                 | (5,332)        | (4,476)                 | (10,245)       | (8,851)                 |
| Acquisitions/divestments                                     | (6)                    | (1)                     | (12)           | (3)                     | (18)           | (4)                     |
| Settlements/curtailments                                     |                        |                         | 4              |                         | 4              |                         |
| Service costs  | (137)                  | (129)                   | (75)           | (79)                    | (212)          | (208)                   |
| Contribution by employees                                    | (19)                   | (24)                    | (7)            | (10)                    | (26)           | (34)                    |
| Interest costs   | (192)                  | (192)                   | (242)          | (246)                   | (434)          | (438)                   |
| Plan amendments  |                        | 16                      |                |                         |                | 16                      |
| Benefits paid  | 214                    | 209                     | 291            | 274                     | 505            | 483                     |
| Actuarial gains and losses                                   | 370                    | (417)                   | (201)          | (631)                   | 169            | (1,048)                 |
| Changes in exchange rates                                    |                        |                         | (30)           | (161)                   | (30)           | (161)                   |
| <i>Balance at end of year</i>                                | (4,683)                | (4,913)                 | (5,604)        | (5,332)                 | (10,287)       | (10,245)                |
| <b>Plan assets</b>   |                        |                         |                |                         |                |                         |
| <i>Balance at beginning of year</i>                          | 4,643                  | 3,706                   | 3,596          | 3,044                   | 8,239          | 6,750                   |
| Acquisitions/divestments                                     | 6                      | 1                       | (2)            |                         | 4              | 1                       |
| Contribution by employer                                     | 113                    | 418                     | 129            | 120                     | 242            | 538                     |
| Contribution by employees                                    | 19                     | 24                      | 7              | 10                      | 26             | 34                      |
| Benefits paid  | (212)                  | (207)                   | (253)          | (228)                   | (465)          | (435)                   |
| Actual return on plan assets                                 | 466                    | 701                     | 447            | 527                     | 913            | 1,228                   |
| Changes in exchange rates                                    |                        |                         | 17             | 123                     | 17             | 123                     |
| <i>Balance at end of year</i>                                | 5,035                  | 4,643                   | 3,941          | 3,596                   | 8,976          | 8,239                   |
| Funded status  | 352                    | (270)                   | (1,663)        | (1,736)                 | (1,311)        | (2,006)                 |
| Unrecognized net loss/(gain)                                 |                        | 545                     |                | 1,392                   |                | 1,937                   |
| Unrecognized prior service costs                             |                        | 95                      |                | 11                      |                | 106                     |
| Net balances in accordance with US GAAP                      |                        | 370                     |                | (333)                   |                | 37                      |
| Difference between net balance according to IFRS and US GAAP | (402)                  | (424)                   | 309            | (1,072)                 | (93)           | (1,496)                 |
| <b>Net balances in accordance with IFRS<sup>2</sup></b>      | <b>(50)</b>            | <b>(54)</b>             | <b>(1,354)</b> | <b>(1,405)</b>          | <b>(1,404)</b> | <b>(1,459)</b>          |

<sup>1</sup> 2005 figures exclude the minimum pension liability.

<sup>2</sup>

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The net balances for the Netherlands and Total include the IFRS book values of the two loans granted to APF at the time of the transition to the new pension arrangement, amounting to EUR 111 million at December 31, 2006, and to EUR 126 million at December 31, 2005.

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**NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS OF AKZO NOBEL**

Classification of the net balances is as follows:

| <i>Millions of euros; asset/(liability)</i>              | <b>The Netherlands</b> |                         | <b>Foreign</b> |              | <b>Total</b>   |             |
|--|------------------------|-------------------------|----------------|--------------|----------------|-------------|
|  | <b>2006</b>            | <b>2005<sub>1</sub></b> | <b>2006</b>    | <b>2005</b>  | <b>2006</b>    | <b>2005</b> |
| Other financial noncurrent assets                        | 352                    | 371                     | 4              | 297          | 356            | 668         |
| Current portion of provisions under current liabilities  |                        |                         | (120)          | (201)        | (120)          | (201)       |
| Provisions for pension and other postretirement benefits |                        | (1)                     | (1,547)        | (429)        | (1,547)        | (430)       |
| <b>Net balance</b>                                       | <b>352</b>             | <b>370</b>              | <b>(1,663)</b> | <b>(333)</b> | <b>(1,311)</b> | <b>37</b>   |

Since 2005, the measurement date of all plans is December 31.

Details for minimum pension liability are as follows:

| <i>Millions of euros</i>  | <b>The Netherlands</b> |             | <b>Foreign</b> |                         | <b>Total</b> |             |
|---|------------------------|-------------|----------------|-------------------------|--------------|-------------|
|   | <b>2006</b>            | <b>2005</b> | <b>2006</b>    | <b>2005<sub>1</sub></b> | <b>2006</b>  | <b>2005</b> |
| Accumulated benefit obligation  | (4,197)                | (4,223)     | (5,435)        | (4,992)                 | (9,632)      | (9,215)     |
| Plan assets   | 5,035                  | 4,643       | 3,941          | 3,596                   | 8,976        | 8,239       |
| Minimum pension liability   |                        |             | (1,131)        | (1,241)                 | (1,131)      | (1,241)     |
| Intangible asset  |                        |             | 9              | 13                      | 9            | 13          |
| Total credit/(charge) to shareholders equity:                                   |                        |             |                |                         |              |             |
| before taxes  |                        |             | (1,122)        | (1,228)                 | (1,122)      | (1,228)     |
| after taxes   |                        |             | (767)          | (833)                   | (767)        | (833)       |
| Credit/(charge) to shareholders equity for change in minimum pension liability: |                        |             |                |                         |              |             |
| before taxes  |                        | 120         | 106            | (245)                   | 106          | (125)       |
| after taxes   |                        | 82          | 66             | (166)                   | 66           | (84)        |

At December 31, 2006, for one foreign plan the accumulated benefit obligation (EUR 35 million) was lower than plan assets (EUR 39 million). For the other plans accumulated benefit obligation exceeded plan assets. At December 31, 2005, and at December 31, 2004, for all foreign plans the accumulated benefit obligation exceeded plan assets.

In September 2006, SFAS 158 was issued. This statement requires an employer to recognize the funded status of a benefit plan measured as the difference between plan assets at fair value and the benefit obligation in the balance sheet. The offset

of recognizing the funded status is recorded in accumulated other comprehensive income (within shareholders' equity). Additionally, the minimum pension liability and related intangible assets are derecognized upon adoption of this standard.

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**NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS OF AKZO NOBEL**

The following table summarizes the effect of the adoption of SFAS 158 for pensions, effective December 31, 2006.

| <i>Millions of euros; asset/(liability)</i>               | <b>Before<br/>adoption<br/>of SFAS<br/>158</b> | <b>Minimum<br/>pension<br/>liability</b> | <b>SFAS 158</b> | <b>After<br/>adoption<br/>of SFAS<br/>158</b> |
|---|--|--|-----------------|---|
| Financial noncurrent assets                               | 430  | 478                                      | (552)           | 356   |
| Pension related intangible asset                          | 9  | (9)                                      |                 |   |
| Current portion of provisions                             | (120)  |  |                 | (120)   |
| Provisions for pensions and other postretirement benefits | (1,384)  | 653                                      | (816)           | (1,547)                                       |
| Deferred tax assets                                       | 324  | (353)                                    | 410             | 381   |
| Deferred tax liabilities                                  | 60   | (2)                                      | 18              | 76  |
| Accumulated other comprehensive income/(loss)             | (767)  | 767                                      | (940)           | (940)   |

Amounts recognized in accumulated other comprehensive income/(loss) (before tax) as at December 31, 2006 were as follows:

| <i>Millions of euros; income/(loss)</i> | <b>The<br/>Netherlands</b> | <b>Foreign</b> | <b>Total</b>   |
|---|----------------------------|----------------|----------------|
| Unrecognized net loss                   | 10                         | (1,288)        | (1,278)        |
| Unrecognized prior service costs        | (84)                       | (6)            | (90)           |
|   | <b>(74)</b>                | <b>(1,294)</b> | <b>(1,368)</b> |

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**NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS OF AKZO NOBEL**

The 2006, 2005, and 2004 net periodic pension costs for the defined benefit pension plans were as follows:

| <i>Millions of euro; charge/(income)</i>               | <b>The Netherlands</b> |             |             | <b>Foreign</b> |             |             | <b>Total</b> |             |             |
|--|------------------------|-------------|-------------|----------------|-------------|-------------|--------------|-------------|-------------|
|  | <b>2006</b>            | <b>2005</b> | <b>2004</b> | <b>2006</b>    | <b>2005</b> | <b>2004</b> | <b>2006</b>  | <b>2005</b> | <b>2004</b> |
| Service costs for benefits earned during the period    | 137                    | 129         | 130         | 75             | 79          | 79          | 212          | 208         | 209         |
| Interest costs on projected benefit obligation         | 192                    | 192         | 212         | 242            | 246         | 244         | 434          | 438         | 456         |
| Expected return on plan assets                         | (286)                  | (248)       | (228)       | (234)          | (212)       | (203)       | (520)        | (460)       | (431)       |
| Amortization of prior service costs                    | 11                     | 12          | 14          | 2              | 4           | 3           | 13           | 16          | 17          |
| Amortization of net actuarial losses                   | 4                      | 10          | 10          | 71             | 64          | 63          | 75           | 74          | 73          |
| Settlement/curtailment loss/(gain)                     |                        |             | (23)        | 26             |             | 3           | 26           |             | (20)        |
| Net periodic pension costs in accordance with US GAAP  | 58                     | 95          | 115         | 182            | 181         | 189         | 240          | 276         | 304         |
| Difference between costs according to IFRS and US GAAP | 56                     | (143)       | (78)        | (93)           | (69)        | (62)        | (37)         | (212)       | (140)       |
| Net periodic pension costs in accordance with IFRS     | <b>114*</b>            | <b>(48)</b> | <b>37</b>   | <b>89</b>      | <b>112</b>  | <b>127</b>  | <b>203*</b>  | <b>64</b>   | <b>164</b>  |

\* Includes EUR 100 mln in defined contribution premiums and certain other premiums charged by the Akzo Nobel Pension Fund in the Netherlands to the company. These have to be taken into account in order to determine the reconciling item between IFRS and US GAAP.

The difference between the US GAAP and IFRS pension cost in 2005 in the Netherlands mainly concerns the reversal of the special benefit for the curtailment and settlement recognized under IFRS, due to the transition to a defined contribution plan.

In connection with the change of the pension plan in the Netherlands in 2005, the company gave a loan to APF EUR 50 million, which is redeemed by retaining employee pension premium (of which at year-end 2006 EUR 22 million was still outstanding; year-end 2005: EUR 40 million) and granted a subordinated loan of EUR 100 million. The subordinated loan is interest-bearing and will be redeemed after five years on the condition that a certain minimum funding level at APF is reached, based on APF's local Dutch accounting principles. The funded status of APF at year-end 2006 and 2005 was such that no impairment of the subordinated loan needed to be considered.

The first loan recognized at discounted value of EUR 39 million at year-end 2005. The subordinated loan was recognized at fair value (and thereafter on that basis at amortized cost) of EUR 87 million. The difference between book value and nominal value was taken into account in the special benefit upon the curtailment and settlement. Under SFAS 87 such payments qualify as plan assets at nominal value, so that the recognized assets in the IFRS balance sheet have to be reversed. The difference between the book value and nominal value of EUR 15 million has been taken into account in US GAAP 2005 net income. For 2006, the changes in the IFRS values of the loans should be reversed, resulting in a charge of EUR 4 million.

The aforementioned payments were treated as investing activities in the IFRS statement of cash flows. For US GAAP however, they should be included in the cash flow from operating activities.



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**NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS OF AKZO NOBEL**

The weighted average assumptions underlying the computations were:

| <i>Percent</i>                             | <b>The Netherlands</b> |             |             | <b>Foreign</b> |             |             | <b>Total</b> |             |             |
|--|------------------------|-------------|-------------|----------------|-------------|-------------|--------------|-------------|-------------|
|  | <b>2006</b>            | <b>2005</b> | <b>2004</b> | <b>2006</b>    | <b>2005</b> | <b>2004</b> | <b>2006</b>  | <b>2005</b> | <b>2004</b> |
| Pension benefit obligation at December 31, |                        |             |             |                |             |             |              |             |             |
| discount rate                              | 4.6                    | 4.0         | 4.5         | 4.9            | 4.7         | 5.5         | 4.8          | 4.4         | 5.0         |
| rate of compensation increase              | 2.9                    | 2.9         | 2.5         | 4.2            | 4.0         | 4.0         | 3.6          | 3.4         | 3.2         |
| Net periodic pension costs:                |                        |             |             |                |             |             |              |             |             |
| discount rate                              | 4.0                    | 4.5         | 5.3         | 4.7            | 5.5         | 5.6         | 4.4          | 5.0         | 5.4         |
| rate of compensation increase              | 2.9                    | 2.5         | 2.5         | 4.0            | 4.0         | 3.8         | 3.4          | 3.2         | 3.2         |
| expected return on plan assets             | 6.3                    | 6.8         | 6.8         | 6.5            | 6.7         | 6.7         | 6.4          | 6.8         | 6.7         |

The assumptions for the expected return on plan assets were based on a review of the historical returns of the asset classes in which the assets of the pension plans are invested. The historical returns on these asset classes were weighted based on the expected long-term allocation of the assets of the pension plans.

Akzo Nobel's primary objective with regard to the investment of pension plan assets is to ensure that in each individual scheme sufficient funds are available to satisfy future benefit obligations. For this purpose so-called asset and liability management (ALM) studies are made periodically at each pension fund. For each of the pension plans an appropriate mix is determined on the basis of the outcome of these ALM studies, taking into account the national rules and regulations.

Pension plan assets principally consist of long-term interest-earning investments, quoted equity securities, and real estate. At December 31, 2006 and 2005, plan assets did not include financial instruments issued by the company, nor any property occupied or other assets used by it.

The weighted average pension plan asset allocation at December 31, 2006 and 2005, and the target allocation for 2007 for the pension plan in the Netherlands by asset category are as follows:

| <i>Percent</i>                         | <b>Target allocation</b> |      | <b>Percentage of plan assets at December 31,</b> |             |
|--|--------------------------|------|--|-------------|
|  | <b>2007</b>              |      | <b>2006</b>                                      | <b>2005</b> |
| Equity securities                      | 30                       | 50   | 46   | 49          |
| Long-term interest earning investments | 40                       | 60   | 41   | 41          |
| Real estate                            | 7.5                      | 12.5 | 12   | 10          |
| Other                                  | (5)                      | 10   | 1  |             |
| Total                                  |                          |      | 100  | 100         |

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**NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS OF AKZO NOBEL**

The weighted pension plan asset allocation at December 31, 2006 and 2005, and the target allocation for 2007, for the foreign pension plans by asset category are as follows:

| <i>Percent</i>                         | <b>Target allocation</b> |    | <b>Percentage of plan assets at December 31,</b> |             |
|--|--------------------------|----|--|-------------|
|  | <b>2007</b>              |    | <b>2006</b>                                      | <b>2005</b> |
| Equity securities                      | 50                       | 55 | 50   | 51          |
| Long-term interest earning investments | 35                       | 45 | 37   | 36          |
| Real estate                            | 5                        | 10 | 8  | 8           |
| Other                                  | 0                        | 5  | 5  | 5           |
| <b>Total</b>                           |                          |    | <b>100</b>                                       | <b>100</b>  |

The estimated amounts that will be amortized from accumulated other comprehensive income into the net periodic pension costs in 2007 are as follows:

| <i>Millions of euros; charge</i> | <b>The Netherlands</b> | <b>Foreign</b> | <b>Total</b> |
|----------------------------------|------------------------|----------------|--------------|
| Unrecognized net loss            | 59                     | 59             |              |
| Unrecognized prior service costs | 11                     | 3              | 14           |
|                                  | <b>11</b>              | <b>62</b>      | <b>73</b>    |

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**NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS OF AKZO NOBEL***Other Postretirement Benefits*

Postretirement benefit plans concern healthcare benefits plans in the Netherlands and the United States. Below a table is provided with a summary of the changes in the accumulated postretirement benefit obligations and plan assets for 2006 and 2005.

| <i>Millions of euros; asset/(liability)</i>              | <b>The Netherlands</b> |             | <b>The United States</b> |             | <b>Total</b> |             |
|--|------------------------|-------------|--------------------------|-------------|--------------|-------------|
|  | <b>2006</b>            | <b>2005</b> | <b>2006</b>              | <b>2005</b> | <b>2006</b>  | <b>2005</b> |
| Benefit obligation                                       |                        |             |                          |             |              |             |
| <i>Balance at beginning of year</i>                      | (23)                   | (156)       | (485)                    | (345)       | (508)        | (501)       |
| Acquisitions/divestments                                 |                        |             | (1)                      |             | (1)          |             |
| Plan amendment   |                        |             | 41                       |             | 41           |             |
| Settlements/curtailments                                 |                        | 150         | 38                       |             | 38           | 150         |
| Service costs  |                        | (4)         | (13)                     | (17)        | (13)         | (21)        |
| Interest costs   |                        | (7)         | (20)                     | (23)        | (20)         | (30)        |
| Benefits paid  | 7                      | 8           | 18                       | 15          | 25           | 23          |
| Contribution by employees                                |                        |             | (2)                      |             | (2)          |             |
| Actuarial gains and losses                               |                        | (14)        | 94                       | (58)        | 94           | (72)        |
| Changes in exchange rates                                |                        |             | 55                       | (57)        | 55           | (57)        |
| <i>Balance at end of year</i>                            | (16)                   | (23)        | (275)                    | (485)       | (291)        | (508)       |
| Plan assets  |                        |             |                          |             |              |             |
| <i>Balance at beginning of year</i>                      |                        |             |                          |             |              |             |
| Benefits paid  |                        |             |                          |             |              |             |
| Actual return on plan assets                             |                        |             |                          |             |              |             |
| Changes in exchange rates                                |                        |             |                          |             |              |             |
| <i>Balance at end of year</i>                            |                        |             |                          |             |              |             |
| Funded status  | (16)                   | (23)        | (275)                    | (485)       | (291)        | (508)       |
| Unrecognized net loss                                    |                        |             |                          | 148         |              | 148         |
| Unrecognized prior service costs                         |                        | 2           |                          | 2           |              | 4           |
| Net balances in accordance with US GAAP                  |                        | (21)        |                          | (335)       |              | (356)       |
| Difference between accrual according to IFRS and US GAAP | (2)                    | (4)         | (34)                     | (57)        | (36)         | (61)        |
| Net balances in accordance with IFRS                     | (18)                   | (25)        | (309)                    | (392)       | (327)        | (417)       |

In the United States, the Medicare Prescription Drug Improvement and Modernization Act of 2003 introduced prescription drug benefits for retirees as well as a federal subsidy to sponsors of postretirement healthcare plans, which both began at January 1, 2006. This reimbursement right under IFRS has been recognized as an asset under Other Financial Noncurrent Assets,

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measured at fair value. At December 31, 2006, this value was EUR 46 million (December 31, 2005: EUR 68 million). In accordance with US GAAP, this reimbursement right is netted with the postretirement healthcare benefit liability.

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Classification of the net balances is as follows:

| <i>Millions of euros; asset/(liability)</i>              | <b>The Netherlands</b> |             | <b>Foreign</b> |              | <b>Total</b> |              |
|--|------------------------|-------------|----------------|--------------|--------------|--------------|
|  | <b>2006</b>            | <b>2005</b> | <b>2006</b>    | <b>2005</b>  | <b>2006</b>  | <b>2005</b>  |
| Current portion of provisions under current liabilities  | (7)                    | (10)        | (13)           | (23)         | (20)         | (33)         |
| Provisions for pension and other postretirement benefits | (9)                    | (11)        | (262)          | (312)        | (271)        | (323)        |
| <b>Net balance</b>                                       | <b>(16)</b>            | <b>(21)</b> | <b>(275)</b>   | <b>(335)</b> | <b>(291)</b> | <b>(356)</b> |

In September 2006, SFAS 158 was issued. This statement requires an employer to recognize the funded status of a benefit plan measured as the difference between plan assets at fair value and the benefit obligation in the balance sheet. The offset of recognizing the funded status is recorded in accumulated other comprehensive income (within shareholders' equity).

The following table summarizes the effect of the adoption of SFAS 158 for other postretirement benefits, effective December 31, 2006.

| <i>Millions of euros; asset/(liability)</i>               | <b>Before adoption of SFAS 158</b> |                 | <b>After adoption of SFAS 158</b> |            |
|---|------------------------------------|-----------------|-----------------------------------|------------|
|   | <b>158</b>                         | <b>SFAS 158</b> | <b>158</b>                        | <b>158</b> |
| Current portion of provisions                             | (20)                               |                 | (20)                              |            |
| Provisions for pensions and other postretirement benefits | (281)                              | 10              | (271)                             |            |
| Deferred tax assets                                       | 118                                | (4)             | 114                               |            |
| Accumulated other comprehensive income/(loss)             |                                    | 6               | 6                                 |            |

Amounts recognized in accumulated other comprehensive income/(loss) (before tax) as at December 31, 2006 were as follows:

| <i>Millions of euros; income/(loss)</i> | <b>The Netherlands</b> | <b>United States</b> | <b>Total</b> |
|---|------------------------|----------------------|--------------|
| Unrecognized net loss                   |                        | (26)                 | (26)         |
| Unrecognized prior service costs        | (1)                    | 37                   | 36           |
|   | <b>(1)</b>             | <b>11</b>            | <b>10</b>    |



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Net periodic other postretirement benefit costs are as follows:

| <i>Millions of euros; charge/(income)</i>                                  | <b>The Netherlands</b> |              |             | <b>The United States</b> |             |             | <b>Total</b> |              |             |
|--|------------------------|--------------|-------------|--------------------------|-------------|-------------|--------------|--------------|-------------|
|  | <b>2006</b>            | <b>2005</b>  | <b>2004</b> | <b>2006</b>              | <b>2005</b> | <b>2004</b> | <b>2006</b>  | <b>2005</b>  | <b>2004</b> |
| Service costs for benefits allocated to the period                         |                        | 4            | 7           | 13                       | 17          | 15          | 13           | 21           | 22          |
| Interest costs on accumulated postretirement obligation                    |                        | 7            | 10          | 20                       | 23          | 22          | 20           | 30           | 32          |
| Amortization of prior service costs  | 1                      |              | 1           | (2)                      |             |             | (1)          |              | 1           |
| Amortization of unrecognized losses  |                        | 1            | 4           | 2                        | 4           | 3           | 2            | 5            | 7           |
| Settlements/curtailments (gain)/loss                                       |                        | (102)        |             | (24)                     |             | 1           | (24)         | (102)        | 1           |
| Net periodic other postretirement benefit costs in accordance with US GAAP | 1                      | (90)         | 22          | 9                        | 44          | 41          | 10           | (46)         | 63          |
| Difference between costs according to IFRS and US GAAP                     | (1)                    | (68)         | (9)         | (28)                     | (4)         | (5)         | (29)         | (72)         | (14)        |
| Net periodic other postretirement benefit costs in accordance with IFRS    |                        | <b>(158)</b> | <b>13</b>   | <b>(19)</b>              | <b>40</b>   | <b>36</b>   | <b>(19)</b>  | <b>(118)</b> | <b>49</b>   |

During 2006, the postretirement healthcare plans in the United States were adjusted, whereby the benefit levels and the eligibility to participate in these plans were reduced. This is the major reason for the curtailment benefit of in total EUR 24 million, which was recognized under US GAAP. In accordance with IFRS this benefit was EUR 51 million. Under US GAAP, curtailment gains first have to be offset by unrecognized losses before they result in a benefit in income. Under IFRS, curtailment gains are first offset by any related unrecognized actuarial gains and losses and unrecognized past service costs before they result in a benefit in income. Because of the Group's accounting treatment of employee benefit plans on transition to IFRS, the amount of unrecognized actuarial losses and unamortized past service costs is lower under IFRS than under US GAAP. Accordingly, the curtailment gain is higher under IFRS.

In addition, as a result of a change in medical provider in the United States, medical costs are expected to be lower. As a consequence, the defined benefit obligation reduced substantially in 2006, which resulted in a reduction of the unrecognized net loss.

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The assumptions for postretirement benefits were as follows:

| <i>Percent</i>  | <b>The Netherlands</b> |             |             | <b>The United States</b> |             |             |
|---|------------------------|-------------|-------------|--------------------------|-------------|-------------|
|   | <b>2006</b>            | <b>2005</b> | <b>2004</b> | <b>2006</b>              | <b>2005</b> | <b>2004</b> |
| Discount rate for net periodic benefit cost                           | 4.0                    | 4.5         | 5.3         | 5.5                      | 6.0         | 6.3         |
| Discount rate for benefit obligations at December 31                  | 4.6                    | 4.0         | 4.5         | 5.8                      | 5.5         | 6.0         |
| Assumed healthcare cost trend rates at December 31:                   |                        |             |             |                          |             |             |
| healthcare trend rate assumed for next year                           |                        |             |             | 9.0                      | 8.5         | 9.0         |
| rate to which the cost rate is assumed to decline (the ultimate rate) |                        |             |             | 5.0                      | 5.0         | 5.0         |
| year that the rate reaches the ultimate trend rate                    | 2007                   | 2006        | 2005        | 2010                     | 2009        | 2009        |

Assumed healthcare cost trend rates have a significant effect on the amounts reported for the healthcare plans. A one percentage point change in assumed healthcare cost trend rates would have the following effects:

| <i>Millions of euros</i>                      | <b>The Netherlands</b>             |                 | <b>The United States</b>           |                 | <b>Total</b>                       |                 |
|---|------------------------------------|-----------------|------------------------------------|-----------------|------------------------------------|-----------------|
|   | <b>1 percentage point increase</b> | <b>decrease</b> | <b>1 percentage point increase</b> | <b>decrease</b> | <b>1 percentage point increase</b> | <b>Decrease</b> |
| Effect on total of service and interest costs |                                    |                 | 7                                  | (5)             | 7                                  | (5)             |
| Effect on postretirement benefit obligation   |                                    |                 | 19                                 | (18)            | 19                                 | (18)            |

The estimated amounts that will be amortized from accumulated other comprehensive income into the net periodic other postretirement benefit costs in 2007 as a charge are as follows:

| <i>Millions of euros; charge/(income)</i> | <b>The Netherlands</b> | <b>Foreign</b> | <b>Total</b> |
|---|------------------------|----------------|--------------|
| Unrecognized net loss                     |                        | 1              | 1            |
| Unrecognized prior service costs          | 1                      | (6)            | (5)          |
|   | <b>1</b>               | <b>(5)</b>     | <b>(4)</b>   |

*Cash Flows*



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The company expects to contribute EUR 190 million to its pension plans in 2007 (the Netherlands: EUR 90 million; foreign: EUR 100 million). For the other postretirement benefit plans the company expects to contribute EUR 20 million (the Netherlands: EUR 7 million; the United States: EUR 13 million).

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The following benefit payments, which take into account the effect of future service, are expected to be paid.

| <i>Millions of euros</i> | Pensions        |         |       | Other retirement benefits |                   |       |
|--------------------------|-----------------|---------|-------|---------------------------|-------------------|-------|
|                          | The Netherlands | Foreign | Total | The Netherlands           | The United States | Total |
| 2007                     | 219             | 279     | 498   | 7                         | 16                | 23    |
| 2008                     | 225             | 286     | 511   | 5                         | 16                | 21    |
| 2009                     | 232             | 292     | 524   | 3                         | 19                | 22    |
| 2010                     | 239             | 298     | 537   | 1                         | 21                | 22    |
| 2011                     | 246             | 308     | 554   |                           | 24                | 24    |
| 2012-2016                | 1,345           | 1,653   | 2,998 |                           | 141               | 141   |

- (c) During 1995, the company transferred its rubber chemicals activities into a 50-50 joint venture, Flexsys, with Solutia Inc. Under IFRS the carrying value of the investment at December 31, 2006, was EUR 130 million and under US GAAP EUR 128 million, (at December 31, 2005: EUR 127 million and EUR 144 million, respectively). The different carrying value under US GAAP is principally related to the goodwill associated with the Akzo Nobel businesses transferred into the joint venture and differences in pension accounting between IFRS and US GAAP. Goodwill had been previously charged directly to equity for NL GAAP purposes. Under IFRS, IAS 19 has been applied, whereas for US GAAP SFAS 87/158 is applicable.

For 2006, US GAAP net income was EUR 1 million lower than 2006 IFRS net income, whereas for 2005 the difference was EUR 2 million loss. The implementation of SFAS 158 resulted in a charge of EUR 13 million, while in 2005 the minimum pension liability recognized was reduced by EUR 10 million.

- (d) In accordance with IFRS, IFRS 2 has been applied for 2004 and 2005. In 2004 the company applied APB 25, whereby compensation costs included the change in the liability for the difference between the exercise and the market price. This resulted in a credit reconciling item of EUR 2 million for 2004. No proforma information is required, as the compensation expenses calculated pursuant to the provisions of FAS 123 are the same as those for APB 25, due to the cash settlement feature of the company's stock option scheme until June 2005.

As of 2005, the company has elected to apply SFAS 123R, as a result of which there no longer is a difference with IFRS 2. The remaining difference of EUR 1 million (charge to equity) at December 31, 2004 has been reversed in 2005 income.

- (e) Under the Akzo Nobel Employee Share Plan Akzo Nobel granted shares to employees. From 2002 onwards in accordance with IFRS, the value of the shares on the grant date was recognized as a charge in the income statement spread over the vesting period, which was 3 years. For the shares granted in 2001 no charge was recognized. In accordance with US GAAP the fair value of the shares granted in 2001 had to be recognized as a charge against income over the vesting period of the grant. For 2004 this resulted in an additional charge of EUR 1 million. In November 2003, the Board of Management decided to accelerate the settlement of the Employee Share Plan. As a result all shares granted became unconditional at May 1, 2004.

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(f) In accordance with IFRS development costs are to be capitalized and amortized, if certain conditions have been met. US GAAP does not allow capitalization and amortization of development costs. For US GAAP purposes, these costs have to be expensed as incurred. During 2006, the company capitalized additional development costs for EUR 1 million (2005 and 2004: EUR 3 million) and recognized an amortization charge of EUR 4 million (2005 and 2004: EUR 3 million) for IFRS purposes.

(g) In accordance with IFRS a provision for restructuring is recognized at the moment a formal plan is approved, the plan identifies all significant actions to be taken to complete the plan, the period of time necessary to complete the plan indicates that significant changes to the plan are not likely, and in case of termination benefits, communication to the people involved an communication of the benefit arrangement is communicated before balance sheet date. For US GAAP purposes SFAS 146 *Accounting for Costs Associated with Exit or Disposal Activities* became effective for exit or disposal activities that are initiated after December 31, 2002, which means that a provision for exit cost can only be recognized if the goods or services for the exit program have been delivered. As a consequence, at December 31, 2006, provisions for exit costs of EUR 4 million (EUR 3 million after taxes) recognized in accordance with IFRS could not be recognized for US GAAP purposes since the goods or services for the exit program had not been delivered. At December 31, 2005, provisions for exit costs of EUR 9 million (EUR 6 million after taxes) could not be recognized for US GAAP purposes. In 2004, this was EUR 17 million (EUR 11 million after taxes).

In addition, EUR 1 million of provisions for termination benefits (EUR 1 million after tax) have to be recognized for US GAAP purposes in accordance with SFAS 88 *Employers Accounting for Settlements and Curtailments of Defined Benefit Pension Plans and for Termination Benefits*, since these cost qualify as part of ongoing restructuring plans. For IFRS the criteria for recognition were not met, since announcement of the plans took place after balance sheet date. For 2005, this was EUR 8 million (EUR 5 million after taxes). In 2004 there were no ongoing plans which did not qualify for IFRS purposes which had to be recognized for US GAAP.

In 2004, EUR 9 million (EUR 6 million after tax) were recognized under IFRS for provisions for termination benefits, which already were recognized for US GAAP in 2003 as part of ongoing plans in accordance with SFAS 88 *Employers Accounting for Settlements and Curtailments of Defined Benefit Pension Plans and for Termination Benefits*.

(h) In accordance with IFRS the tax effect on the elimination of intercompany profit in inventories is based on the tax rate of the country of the company receiving the goods. For US GAAP purposes, the tax effect on the elimination of intercompany profit in inventories should be based on the tax rate of the company sending the goods, thus fully eliminating intercompany sales in the statement of income. For 2006, this resulted in an increase in net income of EUR 2 million, a positive currency translation effect of EUR 1 million and a decrease in shareholders' equity at December 31, 2006 of EUR 37 million. For 2005, this resulted in a decrease in net income of EUR 7 million and a decrease in shareholders' equity of EUR 40 million. For 2004 net income increased with EUR 43 million, while shareholders' equity decreased with EUR 33 million.

(i) In accordance with the NL GAAP standard for financial instruments, which was still applied in the 2004 IFRS financial statements, results on foreign currency forward hedging contracts (determined at year-end exchange rates) are recognized in income to offset the foreign exchange differences on the related hedged items. Exchange differences on anticipatory hedges of firm commitments regarding sales and purchases are deferred on the balance sheet until the hedged transactions have been reflected in the accounts. For interest swap contracts, interest is accrued in the statement of income as part of interest expense.

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Statement of Financial Accounting Standards No. 133, *Accounting for Derivative Instruments* ( SFAS 133 ), as amended, was adopted by Akzo Nobel in 2001. This statement establishes accounting and reporting standards for derivative instruments, including certain derivative instruments embedded in other contracts (collectively referred to as derivatives), and for hedging activities. The Statement requires every derivative instrument be recorded in the balance sheet as either an asset or liability measured at its fair value. SFAS 133 requires that changes in the derivatives fair value be recognized currently in earnings unless specific hedge accounting criteria are met. The company does not designate its derivatives for hedge accounting in accordance with US GAAP. Accordingly for US GAAP, all changes in fair value of derivative instruments are recognized currently in earnings.

The development for the year ended December 31, 2004, was as follows:

| <i>Millions of euros; gain/(loss)</i> | <b>2004</b> |
|---------------------------------------|-------------|
| Foreign currency contracts            | 3           |
| Interest rate currency swaps          | 8           |
| Interest rate swap contracts          | 28          |
| Forward rate agreements               |             |
| Petroleum options                     | (2)         |
| Petroleum swaps                       |             |
| Gas futures                           | (2)         |
| <b>Total</b>                          | <b>35</b>   |
| <b>Net effect after taxes</b>         | <b>24</b>   |

Effective January 1, 2005, the Company adopted IAS 32 and 39 for financial instruments. As a consequence all derivative instruments are measured at fair value in the balance sheet, with changes in the fair value recognized in income, unless cash flow hedging is applied. In the latter case, the effective part of the fair value change is deferred in shareholders' equity until the hedged transactions have been reflected in the accounts. During 2006, the company deferred pre-tax losses of EUR 37 million (EUR 26 million after taxes) in shareholders' equity (2005: gains of EUR 16 million; EUR 11 million after taxes). The company does not elect to apply hedge accounting for US GAAP purposes. As a consequence, the charge against IFRS shareholders' equity has to be taken into account in US GAAP income.

For the interest rate derivatives under IFRS the company in principle applies fair value hedge accounting. The changes in fair value are recognized in the statement of income, where the effective part is offset by the fair value change of the underlying synthetic bond. The company has elected not to apply hedge accounting for US GAAP. As a consequence, the hedged bonds have to be valued at amortized cost, not at fair value. During 2006, under IFRS the company recognized a benefit for the change in fair value of the bonds of EUR 43 million, which after taxes amounted to EUR 30 million (2005: EUR 8 million; EUR 5 million after taxes), which for US GAAP has to be reversed.

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## NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS OF AKZO NOBEL

On balance, the effect on 2006 US GAAP income is a loss of EUR 80 million, which after taxes amounted to EUR 56 million (2005: a gain of EUR 8 million; EUR 6 million after taxes).

The difference between the fair value and amortized cost of the bonds for which under IFRS hedge accounting was applied is a decrease of the liability (i.e. a credit to shareholders' equity) of EUR 18 million (EUR 13 million after taxes). At December 31, 2005, this amount was EUR 61 million (EUR 43 million after taxes).

- (j) During 2005, Akzo Nobel made upfront payments of EUR 27 million for cooperations with Thérámex and Lexicon, which under IFRS were capitalized as intangible asset. The 2006 and 2005 amortization charges on these intangibles were EUR 6 million and EUR 3 million, respectively.

Under US GAAP, such amounts cannot be capitalized as intangible asset, because they relate to research and development. As a consequence, the investment amount less the 2005 amortization charge, on balance EUR 24 million, is recognized as expense in US GAAP net income. For 2006, the amortization charge of EUR 6 million has to be reversed for US GAAP purposes.

During 2006, similar intangible assets were acquired for an amount of EUR 8 million, which were expensed in the US GAAP reconciliation.

- (k) The company holds minority stakes (mostly 49 or 50 percent) in certain companies, which have been fully consolidated into the consolidated financial statements of Akzo Nobel, taking into account the minority interest of the other shareholders. This treatment is allowed for IFRS purposes, as there is de facto control. This mainly concerns the following companies:

International Paint (Gulf) LLC  
International Paint Saudi Arabia Ltd  
Akzo Nobel Inda SA de CV.  
Akzo Nobel Chang Cheng (Vietnam) Ltd  
Maricogen P/S  
Maricogen Komplementarselskab Aps

The effect of the difference with US GAAP-which requires accounting under the equity method of such interests-on shareholders' equity and net income is nil.

If these interests had been treated associates on a US GAAP basis the Consolidated Statement of Income for the year ended December 31, 2006, would have shown a decrease in revenues of EUR 87 million, in operating income of EUR 10 million, in earnings of consolidated companies less income taxes of EUR 8 million, and in minority interest of EUR 4 million. On the other hand, share in profit of associates would have increased by EUR 4 million.

The Consolidated Statement of Income for the year ended December 31, 2005, would have shown a decrease in revenues of EUR 84 million, in operating income of EUR 8 million, in earnings of consolidated companies less income taxes of EUR 6 million, and in minority interest of EUR 3 million. On the other hand, share in profit of associates would have increased by EUR 3 million.

The Consolidated Statement of Income for the year ended December 31, 2004, would have shown a decrease in revenues of EUR 38 million, in operating income of EUR 5 million, in earnings of consolidated companies less income taxes of EUR 4 million, and in minority interest of EUR 2 million. On the other hand, share in profit of associates would have increased by EUR 2 million.

**NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS OF AKZO NOBEL**

The major effects on the Consolidated Balance Sheet as at December 31, 2006, would have been a decrease in current assets of EUR 32 million, in property, plant and equipment of EUR 14 million, in intangible assets of EUR 1 million, in short-term liabilities of EUR 20 million, in minority interest of EUR 11 million, and in long-term borrowings of EUR 4 million. On the other hand, investment in associates would have increased by EUR 11 million.

The major effects on the Consolidated Balance Sheet as at December 31, 2005, would have been a decrease in current assets of EUR 29 million, in property, plant and equipment of EUR 16 million, in short-term liabilities of EUR 16 million, in minority interest of EUR 12 million, and in long-term borrowings of EUR 5 million. On the other hand, investment in associates would have increased by EUR 12 million.

- (l) In September 2006, Akzo Nobel divested an office building in Stockholm Sweden, in a sale and leaseback transaction. In accordance with IAS 17, this transaction resulted in an operating lease and the transaction was established at fair value. As a result, the profit on the transaction of EUR 16 million was recognized immediately.

In accordance with US GAAP, with this sale and leaseback transaction Akzo Nobel retains more than a minor part, but less than substantially all of the use of the property. As a consequence, the amount up to the present value of the minimum lease payments has to be deferred, being EUR 12 million (EUR 9 million after taxes) and will be recognized based on the remaining period for the lease contract. The effect of the release of this deferral during the latter part of 2006 was negligible.

- (m) In November 2006, Akzo Nobel entered into a 50/50 joint venture with OCI Chemicals for the hydrogen peroxide production in the United States. In accordance with IFRS, Akzo Nobel contributed the production assets at fair value into this joint venture. Half of the book profit on this transfer at market value was deferred, reflecting Akzo Nobel's own 50%-share in this profit. The ultimate book profit recognized amounted to EUR 18 million (EUR 11 million after taxes). The company recorded the profit related to this transaction as it received cash of EUR 27 million from the joint venture partner.

Under US GAAP, this transaction represents a transfer of a partial interest in a real estate asset (plant) and is accounted for pursuant SFAS 66 Accounting for Sales of Real Estate. Because of the Company's continuing support of the operation on a long term basis, the transaction does not qualify as a sale under US GAAP, but would be accounted for as a leasing transaction. Accordingly, under US GAAP (1) the profit on the sale would not be recorded, (2) the investment in the associate is eliminated and property, plant and equipment is increased by EUR 9 million, and (3) the cash proceeds received are recorded as deferred revenues to be amortized over the life of the plant. The revenue to be recognized in 2006 along with additional depreciation was not material.

Due to a EUR 1 million currency translation effect, the year-end balance of the reconciling item is EUR 17 million.

- (n) In accordance with IFRS, sundry provisions are discounted based on the best estimates of cash flows as per the balance sheet date. Under US GAAP, such provisions can only be discounted if future cash flows can be determined reasonably objectively and verifiably. During 2006, management has come to the conclusion that for the sundry provisions the US GAAP criteria for discounting are not met, as legal procedures tend to take much longer than earlier seriously envisaged. Therefore, at year-end 2006 the sundry provisions are no longer discounted for US GAAP.

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The discounted value of the sundry provisions as at December 31, 2006 was EUR 426 million and the undiscounted value was EUR 451 million. As a result a charge was recognized in US GAAP net income of EUR 25 million (EUR 20 million after taxes).

- (o) In accordance with IFRS, during 2006 the company reversed impairments on inventories of EUR 9 million and on property, plant and equipment of EUR 2 million, because the reason for the original impairment ceased to exist. Under US GAAP, an impairment, once made, is not reversed.
- (p) The owner of the 24%-minority stake in Vivechrom S.A. has a put option to sell the shares to the company. In accordance with IFRS, as a result of the put option this company was consolidated for 100% in 2006, without taking a minority interest on Vivechrom s results into account. The liability under this option of EUR 28 million was entered in the December 31, 2006 balance sheet as a liability, eliminating the minority interest of EUR 3 million, and recognizing goodwill of EUR 25 million. Under US GAAP, this entry should not have been made and the minority interest on Vivechrom s results, being a charge of EUR 2 million, should be recognized in the reconciliation.

In addition, under US GAAP this put option should have been at its fair value, which given the mechanism to determine the liability under the option, is immaterial.

- (q) In November 2002, the FASB issued interpretation No. 45, Guarantor s Accounting and Disclosure Requirements for Guarantees, including Indirect Guarantees of Indebtedness to Others.

At December 31, 2006, there were some small agreements to provide additional consideration in a business combination to the seller if contractually specified conditions related to the acquired entity are achieved. The company had not recognized any contingent liabilities for estimated payments. The total maximum exposure amounted to EUR 3 million.

At December 31, 2005, we had recognized contingent liabilities for estimated payments amounting to EUR 1 million, while the total maximum exposure also amounted to EUR 1 million.

At December 31, 2004, we had recognized contingent liabilities for estimated payments amounting to EUR 5 million, while the total maximum exposure amounted to EUR 21 million.

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- (r) During 2004, the company divested the Catalysts, Phosphorus Chemicals, and Coatings Resins activities. For IFRS these divested activities do not qualify for treatment as discontinued operation. For US GAAP, however, these activities do qualify as discontinued operation. The disclosures as prescribed in SFAS 144 are as follows.

| <i>Millions of euros; gain/(loss)</i>                             | <b>For the year ended<br/>December 31, 2004</b> |
|---|---|
| <b>Revenues</b>   |   |
| Continued operations  | 12,063  |
| Discontinued operations   | 617   |
| Total   | <u>12,680</u>                                   |
| Income from continuing operations before income taxes             | 624   |
| Income taxes  | (251)   |
| Income from continuing operations                                 | <u>373</u>                                      |
| Income from discontinued operations (including gains on disposal) | 531   |
| Income taxes  | (72)  |
| Income from discontinued operations                               | <u>459</u>                                      |
| Net income  | <b>832</b>                                      |
| Earnings from continuing operations per share                     |   |
| Basic   | 1.31  |
| Diluted   | 1.30  |
| Earnings from discontinued operations per share                   |   |
| Basic   | 1.61  |
| Diluted   | 1.60  |

The activities qualified as assets and liabilities held for disposal in 2005 and 2006, did not qualify as discontinued operation due to their relatively limited size, both under IFRS and US GAAP.

- (s) Represents the income tax effects of the aforementioned adjustments, excluding adjustment (h).

**(t) Additional disclosures required under US GAAP**

At December 31, 2006, consolidated retained earnings included EUR 22 million (2005: EUR 128 million) of *undistributed earnings from Akzo Nobel's investments in associates*. Accounts receivable from and payable to associates are separately presented in Notes 14 and 23 of the Notes to the Consolidated Financial Statements.



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**NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS OF AKZO NOBEL**

The total book value of land at December 31, 2006, was EUR 201 million (at December 31, 2005: EUR 222 million)

At December 31, 2006, the *most important associates* are the 50-percent interests in Flexsys (included in assets held for sale at December 31, 2006), Delesto, Eka Chile, and Fort Amanda Specialties.

No taxes have been provided for approximately EUR 2.6 billion of *unremitted earnings of certain foreign subsidiaries* as of December 31, 2006 (2005: EUR 2.4 billion). The remittance of these amounts would not lead to an income tax charge in the Netherlands and, in case of nonrefundable withholding taxes, part of these withholding taxes would be available for tax credits.

In accordance with IFRS *deferred tax assets and liabilities* are classified as noncurrent. Under US GAAP, the classification is based on the nature of the item it relates to. The US GAAP classification for the IFRS deferred tax amounts is as follows:

| <i>Millions of euros; asset/(liability)</i>              | <b>2006</b> | <b>2005</b> |
|--|-------------|-------------|
| Deferred tax assets under other current assets           | 254         | 254         |
| Deferred tax assets under noncurrent assets              | 699         | 641         |
| Deferred tax liabilities under other current liabilities | (33)        | (25)        |
| Deferred tax liabilities under noncurrent liabilities    | (141)       | (131)       |
| <b>Net deferred tax assets</b>                           | <b>779</b>  | <b>739</b>  |

*Profit before tax* under IFRS in the Netherlands and from foreign operations is as follows:

| <i>Millions of euros</i> | <b>2006</b>  | <b>2005</b>  | <b>2004</b>  |
|--------------------------|--------------|--------------|--------------|
| The Netherlands          | 25           | 423          | 455          |
| Foreign                  | 1,415        | 913          | 942          |
| <b>Total</b>             | <b>1,440</b> | <b>1,336</b> | <b>1,397</b> |

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**NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS OF AKZO NOBEL**

The *income tax (charges)/benefits* in the Netherlands and from foreign operations were as follows:

| <i>Millions of euros</i> | <b>2006</b>  | <b>2005</b>  | <b>2004</b>  |
|--------------------------|--------------|--------------|--------------|
| <i>Current tax</i>       |              |              |              |
| The Netherlands          | (94)         | (29)         | (44)         |
| Foreign                  | (252)        | (358)        | (383)        |
|                          | (346)        | (387)        | (427)        |
| <i>Deferred tax</i>      |              |              |              |
| The Netherlands          | 56           | (103)        | (33)         |
| Foreign                  | 32           | 152          | 44           |
|                          | 88           | 49           | 11           |
| <b>Total</b>             | <b>(258)</b> | <b>(338)</b> | <b>(416)</b> |

The *valuation allowance for deferred tax assets* as of December 31, 2006, 2005, and 2004 was EUR 33 million, EUR 35 million, and EUR 53 million, respectively. The net change in the total valuation allowance for each of the years ended December 31, 2006, 2005 and 2004, was a decrease of EUR 2 million, a decrease of EUR 18 million, and an increase of EUR 13 million respectively. The valuation allowance at December 31, 2006 and 2005 was primarily related to net operating loss carryforwards that, in the judgment of management, are not more likely than not to be realized. In assessing the realizability of deferred tax assets, management considers whether it is more likely than not that some or all of the deferred tax assets will not be realized. The ultimate realization of deferred tax assets depends on the generation of future taxable income during the periods in which those temporary differences are deductible. Management considers the scheduled reversal of deferred tax liabilities (including the impact of available carryback and carryforward periods), projected taxable income, and tax planning strategies in making this assessment. In order to fully realize the deferred tax asset, the Company will need to generate future taxable income prior to the expiration of the deferred tax assets governed by the tax code in the jurisdictions concerned. Total taxable income for the years ended December 31, 2006, 2005, and 2004 was EUR 1,440 million, EUR 1,336 million, and EUR 1,397 million, respectively. Based on the level of historical taxable income and projections for future taxable income over the periods for which the deferred tax assets are deductible, management believes that it is more likely than not that the Company will realize the benefits of these deductible differences, net of the existing valuation allowances at December 31, 2006. The amount of the deferred tax asset considered realizable; however, could be reduced in the near term if estimates of future taxable income during the carryforward period are reduced.

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**NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS OF AKZO NOBEL**

The expiration scheme of tax loss and credits carryforwards are as follows:

| <i>Millions of euros</i>                 | <b>2007</b> | <b>2008</b> | <b>2009</b> | <b>2010</b> | <b>2011</b> | <b>There-after</b> | <b>No<br/>expi-ration</b> | <b>Total</b> |
|--|-------------|-------------|-------------|-------------|-------------|--------------------|---------------------------|--------------|
| Total tax loss and credits carryforwards | 9           | 10          | 10          | 14          | 22          | 465                | 102                       | 632          |

The obligations for *environmental liabilities* for each of the next five years and thereafter are as follows:

| <i>Millions of euros</i> | <b>Obligation</b> |
|--------------------------|-------------------|
| 2007                     | 50                |
| 2008                     | 65                |
| 2009                     | 24                |
| 2010                     | 23                |
| 2011                     | 21                |
| Later                    | 45                |
| <b>Total</b>             | <b>228</b>        |

The undiscounted amount of environmental liabilities was EUR 272 million.

Obligations under *long-term non-cancelable operating leases and other commitments* for each of the next five years and thereafter are as follows:

| <i>Millions of euros</i> | <b>Lease</b> | <b>Other</b> | <b>Total</b> |
|--------------------------|--------------|--------------|--------------|
| 2007                     | 104          | 121          | 225          |
| 2008                     | 82           | 68           | 150          |
| 2009                     | 61           | 66           | 127          |
| 2010                     | 42           | 37           | 79           |
| 2011                     | 32           | 28           | 60           |
| Later                    | 82           | 53           | 135          |
| <b>Total</b>             | <b>403</b>   | <b>373</b>   | <b>776</b>   |

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The amount paid during 2006 for long-term non-cancelable operating leases was EUR 96 million and for other commitments EUR 94 million. In total it was EUR 190 million.

The *compensation cost related to the nonvested awards not yet recognized* for the stock option plan amount to EUR 9 million, which are expected to be recognized over an average period of one one-third year. For the performance share plan this is EUR 14 million and one and a half year, respectively.

*Dividends received from associates* (2006: EUR 37 million; 2005: EUR 19 million; 2004: EUR 123 million) in accordance with IFRS are included in net cash from investing activities. Under US GAAP, this item is included in cash flows from operating activities.

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**NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS OF AKZO NOBEL***IFRS shareholders' equity breaks down as follows:*

| <i>Millions of euros; December 31</i> | <b>2006</b>  | <b>2005</b>  |
|---------------------------------------|--------------|--------------|
| Subscribed share capital              | 574          | 572          |
| Additional paid-in capital            | 1,841        | 1,803        |
| Statutory reserves                    | 200          | 209          |
| Cumulative translation differences    | 30           | 142          |
| Other reserves                        | 432          | (186)        |
| Undistributed profits                 | 1,067        | 875          |
| <b>Shareholders' equity</b>           | <b>4,144</b> | <b>3,415</b> |

IFRS requires presentation of *minority interest* within equity on the face of the balance sheet. Under US GAAP, minority interest is presented as a separate item on the face of the balance sheet outside equity.

**Note 28 Subsequent Events****Binding cash offer for Organon BioSciences from Schering-Plough**

On March 12, 2007, the company announced its intention to divest Organon BioSciences to Schering-Plough, following their EUR 11 billion binding cash offer. The parties expect that the transaction could be completed in the second half of 2007, after consultation with social partners and clearance from regulatory bodies.

At December 31, 2006, the company had not made a decision to sell Organon BioSciences, but was in the process of preparing for an IPO, while still retaining a majority control of Organon BioSciences. Therefore, it was not a discontinued operation at December 31, 2006.

**EUR 1.6 billion share buyback program**

On April 24, 2007, the company announced that it would commence a EUR 1.6 billion open market share buyback program on May 3, 2007. At the current share price, this represents approximately 10% of the common shares outstanding. Following shareholder approval on April 25, 2007, the repurchased shares will be cancelled. The open market repurchase program is expected to be completed by the end of 2007. Up to June 8, 2007, 6,430,000 common shares have been purchased for a total amount of EUR 383.1 million.

**Flexsys divestment**

The company's 50%-stake in Flexsys was divested per May 1, 2007.

**Court case in the Netherlands on pensions**

Late January 2006, Akzo Nobel Nederland B.V. and the Akzo Nobel Pension Fund in the Netherlands received a summons from the Association of Retired Akzo Nobel Employees with regard to the changed financing of the company's Dutch pension plan. In January 2007, the court dismissed all claims against Akzo Nobel Nederland BV and the Akzo Nobel Pension Fund. The Association of retired Akzo Nobel Employees has instituted an appeal against the judgment of the court.



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**Schedule II VALUATION AND QUALIFYING ACCOUNTS**

| <i>Millions of euros</i>              | <b>Balance at<br/>beginning<br/>of period</b> | <b>Additions<br/>charged<br/>to<br/>income</b> | <b>Foreign<br/>currency<br/>translation<br/>results</b> | <b>Deductions</b> | <b>Other*</b> | <b>Balance<br/>at end of<br/>period</b> |
|---------------------------------------|---|--|---|-------------------|---------------|---|
| <b>Reserves for doubtful accounts</b> |   |  |   |                   |               |   |
| Year ended December 31, 2004          | 166   | 33   | (1)   | (29)              | (4)           | 165                                     |
| Year ended December 31, 2005          | 165   | 19   | 9   | (41)              | 4             | 156                                     |
| Year ended December 31, 2006          | 156   | 21   | (3)   | (37)              | 3             | 140                                     |

\* Other is principally due to divestments.

Other reserves of a similar nature, such as for warranties, are not material to the consolidated financial statements.

**Item 19. EXHIBITS**

(a) Financial statements filed as a part of this annual report. (See index to financial statements and schedule set forth in Item 18.)

(b) Exhibits filed as part of this annual report

1. Articles of Association of Akzo Nobel N.V. (incorporated by reference from the Form 6-K furnished to the U.S. Securities and Exchange Commission on July 12, 2005).

4.c Service contract of Board of Management of Akzo Nobel N.V. (incorporated by reference from the Form 20-F filed with the U.S. Securities and Exchange Commission on May 31, 2002.)

8. Subsidiaries.

12.a Rule 13a 14(a) Certification for Akzo Nobel CEO

12.b Rule 13a 14(a) Certification for Akzo Nobel CFO

13.a Rule 13a 14(b) Certification for Akzo Nobel CEO

13.b Rule 13a 14(b) Certification for Akzo Nobel CFO

15.a Consent of Independent Registered Public Accounting Firm

The amount of long-term debt securities of Akzo Nobel authorized under any individual instrument does not exceed 10 percent of the total assets of Akzo Nobel and its subsidiaries on a consolidated basis. Akzo Nobel agrees to furnish copies of any or all such instruments to the Securities and Exchange Commission upon request.





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**SIGNATURES**

The registrant hereby certifies that it meets all of the requirements for filing on Form 20-F and that it has duly caused and authorized the undersigned to sign this annual report on its behalf.

Akzo Nobel N.V.

|                      |                       |        |                                       |
|----------------------|-----------------------|--------|---------------------------------------|
| By:                  | /s/ G.J. Wijers       | By:    | /s/ R.J. Frohn                        |
| Name:                | G.J. Wijers           | Name:  | R.J. Frohn                            |
| Title:               | Chairman of the Board | Title: | Chief Financial Officer of Management |
| Dated: June 13, 2007 |                       |        |                                       |

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