LUBRIZOL CORP
Form 10-K/A
November 09, 2007

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UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549
FORM 10-K/A
(Amendment No. 1)

þ **ANNUAL REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**
For the fiscal year ended December 31, 2006

o **TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**
For the transition period from __________ to __________
Commission file number 1-5263
THE LUBRIZOL CORPORATION
(Exact name of registrant as specified in its charter)

OHIO	34-0367600
(State of incorporation)	(I.R.S. Employer Identification No.)

29400 Lakeland Boulevard
Wickliffe, Ohio 44092-2298
(Address of principal executive officers, including zip code)
Registrant s telephone number, including area code: (440) 943-4200
Securities registered pursuant to Section 12(b) of the Act:

Title of each class	Name of each exchange on which registered
Common Shares without par value	New York Stock Exchange
Common Share purchase rights	New York Stock Exchange

Securities registered pursuant to Section 12(g) of the Exchange Act: None
Indicate by check mark if the registrant is a well-known seasoned issuer, as defined by Rule 405 of the Securities Act of 1933. Yes þ No o
Indicate by check mark if the registrant is not required to file reports pursuant to Section 13 or 15(d) of the Exchange Act. Yes o No þ
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 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 þ No o
Indicate by check mark if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K is not contained herein, and will not be contained, to the best of registrant s knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10-K/A or any amendment to this Form 10-K/A. o
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: þ Accelerated filer: o Non-accelerated filer o
Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act). Yes o No þ
Aggregate market value (on basis of closing sale price) of voting stock held by nonaffiliates as of June 30, 2006: $2,722,535,900.
Number of the registrant s Common Shares, without par value, outstanding as of February 15, 2007: 69,160,429.

Documents Incorporated by Reference

Portions of the proxy statement for the 2007 Annual Meeting of Shareholders (Incorporated into Part III of this Form 10-K/A)

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References to Lubrizol , the company , we , us or our refer to The Lubrizol Corporation and its subsidiaries, ex where the context makes clear that the reference is only to The Lubrizol Corporation itself and not its subsidiaries.

EXPLANATORY NOTE

On October 22, 2007, we concluded to restate our previously issued financial statements because of reporting errors relating to five postemployment employee benefit plans in three foreign countries. Accordingly, we have restated our consolidated balance sheets as of December 31, 2006 and 2005 and our consolidated statements of income, consolidated statements of cash flows and consolidated statements of shareholders equity for fiscal years 2006, 2005 and 2004 as well as the related financial statement disclosures included in Item 15 to this annual report on Form 10-K/A. This annual report on Form 10-K/A also includes the effects of the restatement in Item 7 - Management s Discussion and Analysis of Financial Condition and Results of Operations and Item 6 - Selected Financial Data for the 2002 through 2006 fiscal years.

The impact of the restatement decreased income from continuing operations and net income for 2006 by $2.0 million or 1.1% and 1.9%, respectively, for 2005 by $2.1 million or 1.3% and 1.1%, respectively, and for 2004 by $1.7 million, or 1.9% and 1.8%, respectively, from amounts previously reported. The restatement had no effect on our previously reported revenues or net cash flows. The cumulative effect of the errors decreased shareholders equity as of December 31, 2006 by $24.3 million or 0.6% of total liabilities and shareholders equity and 1.4% of total shareholders equity. The cumulative effect of the errors decreased shareholders equity as of December 31, 2005 by $15.3 million or less than one-half percent of total liabilities and shareholders equity and 1.0% of total shareholders equity.

The errors primarily arose in three different postemployment employee benefit plans at a wholly owned subsidiary and in postemployment employee benefit plans at two of our consolidated joint ventures. Four of these postemployment employee benefit plans had been accounted for inappropriately on a cash basis rather than an accrual basis as required by U.S. generally accepted accounting principles (U.S. GAAP), while the accrual recorded in the financial statements for the fifth plan was not calculated in accordance with U.S. GAAP. The cumulative effect of the errors resulted in an understatement of postemployment employee benefit plan liabilities of $38.9 million and $27.1 million at December 31, 2006 and 2005, respectively.

See Item 7 - Management s Discussion and Analysis of Financial Condition and Results of Operations and Note 20 - Restatement of Consolidated Financial Statements contained in the Notes to Financial Statements for more information regarding the restatement and changes to previously issued financial statements.

We also concluded that a material weakness in internal control over financial reporting existed for deficiencies at some international locations due to insufficient requisite technical knowledge of accounting for postemployment employee benefit plans in accordance with U.S. GAAP for the 2004 through 2006 fiscal years and through June 30, 2007, and that our disclosure controls were not effective solely because of this material weakness. As such, we have modified our discussion of disclosure controls and procedures included in Item 9A and our report on internal control over financial reporting contained in this annual report on Form 10-K/A to disclose how the restatement affected our chief executive officer s and chief financial officer s assessment of internal controls over financial reporting.

Except as noted herein, we have not modified or updated disclosures presented in the original annual report on Form 10-K for the year ended December 31, 2006 except as required to reflect the effects of the restatement on this Form 10-K/A. Accordingly, this annual report on Form 10-K/A does not reflect events occurring after the filing of our original annual report on Form 10-K on February 28, 2007. This annual report on Form 10-K/A should be read in conjunction with our filings made with the Securities and Exchange Commission subsequent to the filing of the original annual report on Form 10-K, including any amendments to those filings. The following items have been amended as a result of the restatement:

Part I - Item 1. Business (page 5)

Part II - Item 6. Selected Financial Data

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PART I

ITEM 1. BUSINESS

Overview

We are an innovative specialty chemical company that produces and supplies technologies that improve the quality and performance of our customers products in the global transportation, industrial and consumer markets. Our business is founded on technological leadership. Innovation provides opportunities for us in growth markets as well as advantages over our competitors. From a base of approximately 1,700 patents, we use our product development and formulation expertise to sustain our leading market positions and fuel our future growth. We create additives, ingredients, resins and compounds that enhance the performance, quality and value of our customers products, while minimizing their environmental impact. Our products are used in a broad range of applications, and are sold into stable markets such as those for engine oils, specialty driveline lubricants and metalworking fluids, as well as higher-growth markets such as personal care and over-the-counter pharmaceutical products and performance coatings and inks. Our specialty materials products also are used in a variety of industries, including the construction, sporting goods, medical products and automotive industries.

We are an industry leader in many of the markets in which our product lines compete. We also produce products with well-recognized brand names, such as Anglamol® (gear oil additives), Carbopol® (acrylic thickeners for personal care products), Estane® (thermoplastic polyurethane) and TempRite® (engineered polymers resins and compounds used in plumbing, industrial and fire sprinkler systems).

We are geographically diverse, with an extensive global manufacturing, supply chain, technical and commercial infrastructure. We operate facilities in 29 countries, including production facilities in 20 countries and laboratories in 13 countries, in key regions around the world through the efforts of more than 6,700 employees. We derived approximately 45% of our consolidated total revenues from North America, 29% from Europe, 20% from the Asia/Pacific and the Middle East region and 6% from Latin America. We sell our products in more than 100 countries and believe that our customers recognize and value our ability to provide customized, high quality, cost-effective performance formulations and solutions worldwide. We also believe our customers value highly our global supply chain capabilities.

Our consolidated results for the year ended December 31, 2006 included total revenues of $4,040.8 million. We have generated consistently strong cash flows from our diverse product lines, leading market positions, disciplined capital expenditure programs and working capital management. We believe our strong cash flow will enable us to maintain our leading market positions and to invest in targeted growth strategies while continuing to reduce indebtedness.

We are organized into two operating and reporting segments. We made the final determination in January 2007 to change the names of our two reporting segments. The new segment names are Lubrizol Additives, previously known as Lubricant Additives, and Lubrizol Advanced Materials, previously known as Specialty Chemicals. The change was in name only as the management structure of the segments and product lines included in each segment remain unchanged.

Our principal executive offices are located at 29400 Lakeland Boulevard, Wickliffe, Ohio 44092-2298 and our telephone number is 440-943-4200. Our website is located at *www.lubrizol.com*. Information contained on our website does not constitute part of this annual report on Form 10-K/A. We make available free of charge on our website the annual reports on Form 10-K, the quarterly reports on Form 10-Q, current reports on Form 8-K and amendments to those reports filed or furnished pursuant to Section 13(a) or 15(d) of the Securities Exchange Act of 1934 as soon as reasonably practicable after we electronically file or furnish the material to the Securities and Exchange Commission.

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Acquisitions and Divestitures

On February 7, 2007, we acquired a broad line of additive products in the metalworking markets worldwide from Lockhart Chemical Company (Lockhart), a private company with headquarters in Gibsonia, Pennsylvania. We purchased Lockhart s entire metalworking product line, which includes: natural, synthetic and gelled sulfonates; emulsifier packages; corrosion inhibitors and lubricity agents; grease additives; oxidates; esters; soap; semi-finished coatings; and rust preventatives. In 2006, these product lines had annualized revenues of approximately $20.0 million.

In May 2006, we sold the food ingredients and industrial specialties business (FIIS) and the active pharmaceutical ingredients and intermediate compounds business (A&I), both of which were included in the Lubrizol Advanced Materials segment. A&I and most of the FIIS divestiture reported in to the Noveon consumer specialties product line, while a small portion of the FIIS divestiture reported into the performance coatings product line. We recorded a $15.9 million after-tax loss on the sale of these divested businesses.

In February 2006, we sold certain assets and liabilities of Noveon International, Inc. s Telene® resins business (Telene), which was included in the Lubrizol Advanced Materials segment.

In December 2005, we sold certain assets, liabilities and stock of our Engine Control Systems (ECS) business, with facilities located in Canada, the United States and Sweden. In September 2005, we sold certain assets and liabilities of our U.S. and U.K. Lubrizol Performance Systems (LPS) operations. Both of these businesses had been included in the Lubrizol Additives segment.

On June 3, 2004, we acquired Noveon International, Inc. (Noveon International) a leading global producer and marketer of technologically advanced specialty materials and chemicals used in the industrial and consumer markets.

In January 2004, we acquired the coatings hyperdispersants business from Avecia for cash totaling $129.7 million, including transaction costs of $2.2 million. This business is included in the Lubrizol Advanced Materials segment and develops, manufactures and markets high-value additives that are used in coatings and inks.

Business Segments

The Lubrizol Additives segment represents 64% of our 2006 consolidated revenues and is comprised of our businesses in engine additives and driveline and industrial additives. The Lubrizol Advanced Materials segment represents 36% of our 2006 consolidated revenues and is comprised of the businesses of the acquired Noveon International and our former performance chemicals product group.

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The following chart summarizes the product groupings within each of our key product lines.

The Lubrizol Corporation

Lubrizol Additives Segment

The Lubrizol Additives segment is the leading global supplier of additives for transportation and industrial lubricants. We pioneered the development of lubricant additives over 75 years ago and continue to maintain leadership in what we estimate to be an $8.0 billion industry. Our customers rely on our products to improve the performance and lifespan of critical components, such as engines, transmissions and gear drives for cars, trucks, buses, off-highway equipment, marine engines and industrial applications.

For the year ended December 31, 2006, the Lubrizol Additives segment generated revenues of $2,600.5 million and segment operating income of $303.0 million.

Our products serve to increase cost-effectiveness by reducing friction and heat, resisting oxidation, minimizing deposit formation, and preventing corrosion and wear. Through our in-house research, development and testing programs, we have the capability to invent and develop a broad range of proprietary chemical components, including antioxidants, anti-wear agents, corrosion inhibitors, detergents, dispersants, friction modifiers and viscosity modifiers. We formulate proprietary additive packages by combining these different components to create unique products targeting specific customer problems. We are recognized by our customers for innovative technology, the broadest product line and high-quality products. Our key components of our additive packages include:

antioxidants that retard oil thickening;

anti-wear agents that prevent surfaces metal-to-metal contact;

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- corrosion inhibitors that prevent rust;
- detergents that prevent deposit build-up;
- dispersants that protect equipment by suspending contaminant particles;
- friction modifiers that control friction at surfaces;
- polymer-based viscosity modifiers that allow lubricants to operate over broad temperature ranges; and
- pour point depressants that control low temperature fluid thickening.

Our products are essential to the performance of the finished lubricant, yet represent a relatively small portion of its volume. Our products are often designed to meet specific customer requirements. For example, we work with customers to develop additive packages that perform in combination with their proprietary base oil or that meet their marketing objectives to differentiate their lubricant. Extensive testing is conducted in our world-class laboratories, global mechanical testing facilities and in the field to determine additive performance under actual operating conditions. With this testing, we provide proof of performance, which enables our customers to label and certify the lubricant as meeting the exact performance specifications required for these products by the industry. The majority of our products are designed to meet an industry standard or specification.

During 2006, we had two primary product lines within our Lubrizol Additives segment: engine additives and driveline and industrial additives.

Engine Additives. Our engine additives products hold a leading global position for a wide range of additives for lubricating engine oils, such as for gasoline, diesel, marine and stationary gas engines. We also produce additives for fuel and refinery and oilfield chemicals. In addition, this product line sells additive components and viscosity improvers within its lubricant and fuel additives product areas. Our customers, who include major global and regional oil companies, refineries and specialized lubricant producers and marketers, blend our additive products with their base oil and distribute the finished lubricant to end users via retail, commercial or vehicle original equipment manufacturer (OEM) channels. Passenger car motor oils and diesel engine oils are approximately 80% of our engine additive sales. In 2006, our engine additives products generated total revenues of $1,665.4 million.

The following is a list of representative uses for and a description of our engine additives products:

Category	Product/Brand	Description
Engine Additives	Passenger car motor oils, heavy-duty diesel engine oils, marine diesel, small engines, stationery gas and viscosity modifiers	Additives that extend engine life, lower emissions and enhance fuel economy.
	Fuel, refinery and oilfield products and other components	Additives designed to eliminate deposits and provide fuel system cleanliness, prevent rust and corrosion, enhance fuel economy, provide anti-knock, lower volatility and improve storage stability.

Driveline and Industrial Additives. We are a global supplier of specialty driveline and industrial oil additive products for use in driveline and industrial applications. This product line also provides outsourcing services for supply chain and knowledge center management. In 2006, our driveline and industrial additives generated total revenues of $935.1 million.

Driveline Additives

Our driveline additives products include additives for driveline oils, such as automatic transmission fluids, gear oils and tractor lubricants. Relative to engine oils, specialty driveline additives are more complex formulations that carry higher average pricing and value and have longer product life cycles. We sell our products to major global and regional oil companies, specialized lubricant producers and marketers. Our customers use our products

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to blend with their lubricant fluids and distribute the finished lubricant to end users via retail, commercial or vehicle OEM channels. The specialty driveline additives industry is characterized by well-established product lines that meet OEM specifications and carry OEM approvals.

Industrial Additives

Our industrial oil additives products include additives for hydraulic lubricants, metalworking fluids, industrial gear oils and grease, as well as compressor lubricants. We sell our products to major global and regional oil companies, specialized lubricant producers and marketers. Our customers use our products to blend with their fluid products and distribute the finished lubricant to end users via retail, commercial or OEM channels. Because our products are sold to industrial end-markets, our industrial oil additives products are exposed to economic cycles more than other products within the Lubrizol Additives segment.

The following is a list of representative uses for and a description of our driveline and industrial oil additives products:

Category	Product/Brand	Description
Driveline and Industrial Additives	Driveline additives for automatic transmission fluids, gear oils and farm tractor fluids	Additives that provide multiple and complex performance properties, including reducing friction in order to prevent wear of transmissions, gears and farm tractor components.
	Additives for industrial fluids, including hydraulics, metalworking, industrial gear, grease and compressor fluids	A wide range of additives to meet the lubricant performance requirements of industrial equipment.

Lubrizol Advanced Materials Segment

The Lubrizol Advanced Materials segment represents a diverse portfolio of performance chemicals used in consumer and industrial applications, such as ingredients for personal care and pharmaceutical products, emulsions and additives for coatings and inks, and specialty plastics and materials.

For the year ended December 31, 2006, the Lubrizol Advanced Materials segment generated revenues of $1,440.3 million and segment operating income of $167.6 million.

We have three primary product lines within our Lubrizol Advanced Materials segment: Noveon consumer specialties, performance coatings and engineered polymers.

Noveon Consumer Specialties. We are a global producer of specialty chemicals targeting the personal care and pharmaceutical industries. Key products include Carbopol acrylic thickeners, film formers, fixatives, emollients, silicones, botanicals and process chemicals. In 2006, our Noveon consumer specialties products generated total revenues of $373.5 million.

We are a global producer of specialty chemicals targeting the personal care and pharmaceutical industries. Our products impart physical and sensory properties, such as texture, stability and thickness to products, including lotions, shampoos, hair gels, cosmetics and personal and oral hygiene products. Key products in this area include selected functional specialties and formulation additives such as specialty surfactants, methyl glucoside and lanolin derivatives, and acrylic thickeners, specialty monomers, film formers and fixatives. Our products are an important component of the functionality and aesthetics of the end product, but typically represent a small portion of the customer s total product costs. Key product families include:

Carbopol acrylic thickener, which is a global leader in synthetic thickeners due to its efficient stabilizing properties and superior thickening capabilities. Primary end-uses in the personal care industry include hair care, skin care and personal and oral hygiene products. Pharmaceutical primary end-uses include topical and controlled-release applications.

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Methyl glucoside and lanolin derivatives that enhance the functional and aesthetic properties of personal care products by delivering characteristics such as emulsification, thickening and moisturizing, as well as imparting the elegant feel to lotions and creams.

AMPS® specialty monomers that are used in the manufacture of polymers for a variety of applications such as dishwashing detergents to reduce spotting, skin creams to improve lubricity and feel, medical gels for defibrillator pads to enhance conductivity, and coatings and adhesives to improve adhesion.

Specialty surfactants and additives that enhance the functional and aesthetic properties of personal care products and household and industrial cleaners by improving characteristics such as foaming, cleansing, conditioning and mildness. Surfactants primarily are used in hair care products, such as shampoos and body washes.

The following is a list of representative uses for and a description of our personal care and pharmaceuticals products:

Category	Product/Brand	Description
Personal Care and Pharmaceuticals	Carbopol®	Acrylic thickener, which imparts stability and improves aesthetics. Often used as a controlled release agent.
	Pemulen®	Polymeric emulsifier reducing formulation irritancy and providing unique sensory properties.
	Avalure®	Polymers for color cosmetics and skin care.
	Specialty silicones	Polymers affecting slip-and-feel.
	Fixate®	Resin for hair styling.
	Emollients	Improve skin feel and appearance.
	Botanical extracts	Specialty additives for cosmetic and skin care formulations.
	Methyl glucoside derivatives, including Glucamate®	Natural thickeners, emulsifiers and moisturizers for shampoos, liquid cleansers, face and body creams and lotions.
	Lanolin derivatives	Natural emollients, emulsifiers and conditioners for creams, lotions and color cosmetics.
	AMPS® monomers	Specialty monomer for high performance polymers.
	Specialty surfactants, including Sulfochem®	Enhance cleansing, foaming and moisturizing of shampoos, body washes and industrial and household cleaners.
	Polycarbophil	Active agent for bulk laxatives.
	Cassia gum	Gelling agents for human food (Japan) and pet food.

Performance Coatings. We are a leading supplier of specialty resins and additives for the coatings and ink markets worldwide. We offer a wide range of products for formulating paints, coatings and inks. In 2006, our performance coatings products generated total revenues of $543.7 million.

Our business strategy for performance coatings is centered on our ability to formulate and compound polymer emulsions to create customized solutions meeting the specific needs of our customers. The performance coatings product line includes high-performance polymers and additives for specialty paper, graphic arts, paint and textile coating applications.

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Specialty Resins and Polymers

Our water-based polymer emulsions and dispersions, including resins and auxiliaries, are used in the production of high-end paint and coatings for wood, paper, metal, concrete, plastic, textiles and other surfaces. Our acrylic emulsions and polyurethane dispersions, which are environmentally attractive substitutes for solvent-based and hydrocarbon products, are valued for the superior gloss and durability properties they provide. In addition, our polymers are used as ink vehicles, overprint varnishes and functional coatings for specialty paper, printing and packaging applications. We supply acrylic emulsions used to improve the appearance, texture, durability and flame retardance of high-end specialty textiles sold to the home furnishings and technical fabrics industries. In addition to water-based polymers, we specialize in unique, non-aqueous acrylic and other proprietary polymer resins for the paint and coatings, printing ink, laminating, adhesives and sealants markets. These value-added Doresco® specialty resins not only function as carriers for pigment, but also provide surface protection and adhesion properties. We work closely with our customers to develop resins that address their specific needs.

The following is a list of representative uses for and a description of our resins and polymer products:

Category	Product-line	Description
Specialty Resins and Polymers	Acrylic Emulsions, Polyurethane Dispersions and Other Water-based Systems, Hycar®, Sancure®, Algan®, Performax®	Provide superior gloss and durability properties to paints and coatings. End markets include wood, paper, metal, concrete, plastic and textiles.
	Acrylic and Other Polymer Resins, Doresco®	Function as carriers for pigments, and provide surface protection and adhesion properties. End-markets include paint and coatings, printing ink, laminating, adhesives and sealants.

Coating Additives

Our additives for coatings and inks are used to enhance the appearance and durability of coatings in architectural and industrial uses, as well as to improve their processing and application characteristics. Additives such as pigment dispersants enhance the processing and performance of printing ink, while also maximizing color strength and stability in coatings and plastics. We expanded this product line by purchasing the dispersants business of Avecia in January 2004. We are a leading global supplier of surface modifiers that improve the abrasion resistance properties, gloss, leveling and film characteristics of printing ink and coatings. Our products include:

High-performance hyperdispersants for coatings, inks, thermoplastics and thermoset composites. We are a world leader in polymeric hyperdispersant technology, sold under the Solsperse® and Solplus® trade names. Hyperdispersants improve the dispersion of almost any solid particulate (including pigments, fillers, flame retardants and fibers) into almost any liquid medium (water, solvents and resins). They are primarily used to achieve even color saturation. They enrich and strengthen color, while reducing production costs and solvent emissions. We also produce Ircosperse® pigment dispersants for coatings and COLORBURST pigment dispersants for printing inks.

Surface modifiers improve the performance of industrial, architectural, can, coil, wood and powder coatings by enhancing and protecting surfaces. Lanco®, Lanco® Glidd, Lanco® Matt and Aquaslip surface modifiers impart a variety of properties to a coating, including enhanced slip, improved abrasion and scratch resistance, matting, texturing and a silky, soft feel.

Rheology control additives improve the performance of coatings by providing thickening, sag control, pigment anti-settling and improved surface appearance. Rheology control additives are sold under the brand names Ircothix®, Ircogel® and Solthix®.

Specialized additives for inks improve rub resistance properties and film characteristics.

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The following is a list of representative uses for and a description of our coating additives products:

Category	Product/Brand	Description
Coating Additives	Dispersants, Solsperse® Ircosperse®, COLORBURST	Improve the dispersion of solid particulates into liquid mediums. End-markets include paints and printing inks.
	Surface Modifiers Lanco®, Lanco® Glidd, Lanco® Matt, Aquaslip	Impart a variety of properties to a coating, including enhanced slip, improved abrasion and scratch resistance, matting and texturing. End markets include industrial, architectural, can and coil, wood and powder coatings.
	Rheology Control Additives, Ircothix®, Ircogel® and Solthix®	Provide thickening, sag control and improved surface appearance of coatings.
	Specialized Additives for Inks, Duotron®, Liquitron®, Fluotron®	Improve the processing, performance and rub resistance properties.

Engineered Polymers. We are a leading global supplier of engineered polymers (EP) resins and compounds sold under the trademark TempRite. Applications for TempRite resins and compounds include piping for residential and commercial plumbing and fire sprinkler systems. In addition to TempRite, we are also a leading producer of thermoplastic polyurethane (TPU) sold under the trademark Estane. Applications for Estane TPU include plastic film and sheet for various coatings processes. In 2006, the engineered polymers product line generated total revenues of $523.1 million.

TempRite Engineered Polymers

TempRite EP is a technologically advanced heat, fire and chemical resistant polymer that we developed to serve technically demanding applications not well served by traditional PVC and other commodity plastics. Our TempRite EP is sold to customers who produce plastic piping for residential and commercial plumbing, fire sprinkler systems and industrial piping applications. TempRite EP piping has inherent advantages over copper and other metals due to its heat and corrosion resistance, increased insulation properties, mold resistance, ease of installation and lower installed cost. We market our branded TempRite EP products for specific applications: FlowGuard® and FlowGuard Gold® for residential and commercial plumbing, BlazeMaster® for fire sprinkler systems and Corzan® for industrial piping. We believe we have built strong end-user awareness of our brands by using a sales force that markets directly to builders, contractors, plumbers, architects, engineers and building owners.

In 2001, Noveon International purchased select assets and technology to manufacture PEX compounds, further used to produce PEX pipe. TempRite PEX enables us to add a flexible piping compound to our rigid piping product offering. TempRite PEX is a small but growing product for applications that demand flexible piping systems.

In January 2007, TempRite EP introduced two new piping products, FlowGuard Gold® Bendable and FlowGuard Flex. Both products are used in residential and commercial plumbing.

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The following is a list of representative uses for and a description of our EP and PEX products:

Category	Product/Brand	Description
EP	TempRite®	Residential plumbing
	FlowGuard®	Residential and commercial plumbing
	FlowGuard Gold®	Residential and commercial plumbing
	Corzan®	Industrial and commercial piping
	BlazeMaster®	Fire sprinkler piping
PEX	TempRite®	Flexible piping systems

Estane Engineered Polymers

Estane TPU, an engineered, highly versatile thermoplastic, provides a high performance alternative to rigid plastics and flexible rubber. Performance attributes of Estane TPU include abrasion, heat and chemical resistance, minimal fatigue from bending, ease of processing and good paintability. These performance characteristics make Estane TPU attractive for use in a broad range of end-uses, including film and sheet for various coating processes, wire and cable insulation, athletic equipment (such as footwear), medical applications, pneumatic tubing and automotive molded parts. In addition, Estane TPU has expanded into products that can be melt spun into elastic spandex fibers and materials that offer enhanced breathability for garments. We believe that Estane TPU is one of the industry s leading brand names. We also market Stat-Rite® conductive polymers, which are static dissipative materials used in packaging for the electronics industry. In addition, we market fiber-reinforced TPU under the Estaloc® brand. Estaloc reinforced engineering thermoplastics offer the functional properties of traditional TPU, yet are reinforced for higher stiffness to provide the strength, dimensional stability and impact resistance required to withstand a variety of tough applications and harsh environments. Applications include sporting goods, agricultural equipment and other mechanical components.

The following is a list of representative uses for and a description of our Estane engineered polymers products:

Category	Product/Brand	Description
TPU	Estane®	Aromatic grades for film and sheet, wire and cable insulation, athletic equipment, medical applications, pneumatic tubing, automotive molded parts and adhesives.
	Estaloc®	Automotive trim, sporting goods, agricultural equipment and other mechanical components.
	Stat-Rite®	Packaging of semiconductors, sensitive electronic components, disk drive heads and cell phone components.
	Tecoflex®	Aliphatic grades for optical film, medical tubing and general industrial applications.

Competition

Our Lubrizol Additives segment is highly competitive in terms of price, technology development, product performance and customer service. Our principal competitors, both in the United States and overseas, are: Infineum, a joint venture involving Shell Oil Company and Exxon Mobil Corporation; Chevron Oronite Company, a subsidiary of

Chevron Corporation; and Afton Chemical Corporation, a subsidiary of NewMarket Corporation (formerly Ethyl Corporation). Petroleum companies also produce, either directly or indirectly, lubricants and fuel additives for their own use and also sell additives to others. These petroleum companies also are our customers, and some of them sell raw materials to us. We believe, based on volume sold, that we are a leading supplier of performance additives for lubricants to the petroleum industry.

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Our Lubrizol Advanced Materials segment faces a variety of competitors in each of our product lines, but we believe no single company competes with us across all of our existing product lines. The advanced materials industry is highly fragmented. Individual products or service offerings compete on a global, regional and local level due to the nature of the businesses and products, as well as the applications and customers served. The following chart sets forth our principal competitors of the Lubrizol Advanced Materials segment by product line:

Product Line	**Principal Competitors**
Noveon consumer specialties	Cognis, Croda, Degussa Goldschmidt, ISP, NK Chemicals, Rhodia, Rohm and Haas, Stepan, Sumitomo Seika, 3V Sigma, Toagosei, Vinati
Performance coatings	BASF, Bayer, Byk, Ciba, Clariant, Cytec, Dow Chemical, DSM, Eastman, OMNOVA, Parachem, Reichhold, Rohm and Haas, Tego
Engineered polymers	Atofina, BASF, Bayer, Dow, Georgia Gulf, Huntsman, Kaneka, Merquinsa, Sekisui Chemical, SK, Vanguard, Victaulic, Wirsbo

Sales and Marketing

We primarily market our lubricant and fuel additives products worldwide through our own direct sales organization. In addition, we use sales agents and distributors where necessary. Our additive customers primarily consist of oil refiners and independent oil blenders and are located in more than 100 countries. Our 10 largest customers, most of which are international oil companies and a number of which are groups of affiliated entities, accounted for approximately 39% of our consolidated net sales in 2006. In 2006, there was no single customer that accounted for more than 10% of consolidated net sales.

In order to maximize our understanding of customer needs as well as emerging trends, our sales and marketing activities for our advanced materials products are organized by end-use applications. Each sales team includes representatives from sales, marketing and research and development.

Our sales and marketing staff is technically oriented and works closely with customers to develop products and formulations that deliver the desired product attributes. Some of our laboratories are equipped with small-scale equipment that replicates our customers processing capabilities, which ensure our solutions are easily and efficiently implemented at our customers facilities.

Finally, many of our sales and marketing resources are dedicated to stimulating end-use demand for our products. For example, in the case of our TempRite plumbing, fire sprinkler and industrial piping applications, our resources are focused on marketing to building contractors, plumbers, distributors and construction code officials to convince them to specify our products in their projects or building codes.

Backlog

We have no material backlog of orders in either business segment at December 31, 2006 or December 31, 2005. All unfilled orders that were placed by December 31, 2006 are reasonably expected to be filled during 2007.

Research, Development and Technology

Technology leadership in design and formulation of additives and specialty chemicals drives our business. Historically, we have emphasized consistent investment in research. We have developed internally a large percentage of the products we manufacture and sell. Our internal technical resources encompass chemical synthesis, world-class physical and analytical science, statistical and computer modeling expertise and extensive applications technology and testing laboratories. We balance centralized research facilities with applications technology capabilities that are closely tied to their counterparts in the commercial organizations. Our technical facilities are located all over the world. We provide tools and processes for knowledge sharing and for leveraging our technology globally and across product lines.

Lubrizol Additives. In our Lubrizol Additives segment, the majority of the additives we manufacture and sell are developed by our in-house research group. Technological advances in materials and in the design of engines and other automotive equipment, combined with rising demands for environmental protection and fuel economy, require increasingly sophisticated research capabilities to meet industry performance standards.

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We have technical facilities in Wickliffe, Ohio; Hazelwood, United Kingdom; and Kinuura, Japan for lubricant additives research. We also conduct a limited program of corporate research designed to leverage technology across our product lines. We maintain mechanical testing laboratories at those three locations, equipped with a variety of gasoline and diesel engines, driveline and other mechanical equipment to evaluate the performance of additives for lubricants and fuels. In addition, we make extensive use of independent research firms. Global field testing is conducted through various arrangements with fleet operators and others.

We maintain offices in Southfield, Michigan; Hazelwood, United Kingdom; Paris, France; Hamburg, Germany; Shanghai, China; Mumbai, India; Tokyo, Japan; and Seoul, South Korea to maintain close contact with the principal automotive OEMs of the world and to keep us abreast of the performance requirements for our products. These liaison activities also serve as contacts for cooperative development and evaluation of products for future applications.

Lubrizol Advanced Materials. Our Lubrizol Advanced Materials segment has had a long history as an industry innovator, creating proprietary, high-performance materials for our customers, including ingredients for personal care products, the invention of Carbopol acrylic thickener, additives for coatings and the commercial development of TempRite engineered polymers. We have leveraged our core surface activity chemistry into new specialty chemicals and materials markets through acquisitions and application technology expertise. Our specialty chemical and materials products are derived from a broad range of technology platforms developed either internally or externally through licensing, acquisition or joint technological alliances with global suppliers and customers.

Our primary research facility for our Lubrizol Advanced Materials segment is located in Brecksville, Ohio, where we develop new technologies and products and conduct applications development and technical service for our customers. We maintain other smaller technical facilities in various locations in the United States, Europe and Asia.

Patents. We own approximately 1,700 patents worldwide relating to our products and manufacturing processes. Although these domestic and foreign patents expire from time to time, we continue to apply for and obtain patent protection for new products on an ongoing basis. We believe that, in the aggregate, our patents constitute an important asset. However, we do not regard our business as being materially dependent upon any single patent or any group of related patents. We use patents in both of our reporting segments.

Research, Testing and Development Expenditures. Our consolidated research and development expenditures were $135.3 million in 2006, $128.1 million in 2005 and $103.7 million in 2004. These amounts were equivalent to 3.3%, 3.5% and 3.6% of the respective consolidated total revenues for those years. These amounts include expenditures for the performance evaluation of additive developments in engines and other types of mechanical equipment as well as expenditures for the development of specialty chemicals for industrial applications. In addition, we spent $70.2 million, $70.8 million and $81.1 million in 2006, 2005 and 2004, respectively, for technical service (testing) activities, principally for evaluation in mechanical equipment of specific lubricant formulations designed for the needs of petroleum industry customers throughout the world.

Our research and development staff works with both our sales force and customers to use our wide spectrum of technology platforms and processing capabilities to enhance our product offerings in the specialty chemicals industry. We have developed many of our products in cooperation with our customers, often as a result of their specific needs, resulting in long-standing customer relationships.

Raw Materials

We use a broad variety of specialty and commodity chemical raw materials in our manufacturing processes, and use oil in processing and blending additives. These raw materials are obtainable from several sources. The materials that we choose to purchase from a single source generally have long-term supply contracts as a basis to guarantee supply reliability. For the most part, our raw materials are derived from petroleum and petrochemical-based feedstocks.

Lubricant base oil is our single largest purchased raw material, representing approximately 30% of our purchases, by weight, for the Lubrizol Additives segment. Other major categories of raw materials for the Lubrizol Additives segment include olefins and esters (approximately 20% of purchases); inorganic acids, bases and oxides (approximately 10%); and alcohols and glycols (approximately 5%). We believe that raw materials derived from petrochemicals are approximately 80% of our purchases for the Lubrizol Additives segment. For our Lubrizol

Advanced Materials segment, no single raw material represents more than 9% of purchases. The top eight raw materials total about 40% of our purchases for the Lubrizol Advanced Materials segment. Principal raw materials for the Lubrizol Advanced Materials segment include three different acrylates for personal care and coatings, styrene for coatings, and PVC, PTMEG, MDI and BDO for engineered polymers.

Environmental Matters

We are subject to foreign, federal, state and local laws and regulations designed to protect the environment and limit manufacturing wastes and emissions. We believe that, as a general matter, our policies, practices and procedures are properly designed to prevent unreasonable risk of environmental damage and the consequent financial liability to us. Compliance with environmental laws and regulations requires continuing management effort and expenditures. We have incurred, and will continue to incur, costs and capital expenditures to comply with these laws and regulations and to obtain and maintain all necessary permits. We believe that the cost of complying with environmental laws and regulations will not have a material affect on our earnings, liquidity or competitive position, although we cannot provide you assurance in that regard.

We believe that our business, operations and facilities are being operated in compliance, in all material respects, with applicable environmental laws and regulations, many of which provide for substantial fines, penalties and criminal sanctions for violations. The operation of manufacturing plants entails environmental risks, and we may incur material costs or liabilities in the future that could adversely affect us. For example, we may be required to comply with evolving environmental laws, regulations or requirements that may be adopted or imposed in the future or to address newly discovered contamination or other conditions or information that require a response on our part.

Among other environmental laws, we are subject to the Comprehensive Environmental Response, Compensation and Liability Act of 1980 (commonly known as Superfund), under which we have been designated as a potentially responsible party that may be liable for cleanup costs associated with various waste or operating sites, some of which are on the U.S. Environmental Protection Agency Superfund priority list. Our experience, consistent with what we believe to be the experience of others in similar cases, is that Superfund site liability tends to be apportioned among parties based upon the contribution of materials to the Superfund site. Accordingly, we measure our liability and carry out our financial reporting responsibilities with respect to Superfund sites based upon this standard, even though Superfund site liability is technically joint and several in nature. We accrue for estimated environmental liabilities with charges to cost of sales. We believe our environmental accrual is adequate to provide for our portion of the costs of all such known environmental liabilities. Based upon consideration of currently available information, we believe liabilities for environmental matters will not have a material adverse affect on our financial position, operating results or liquidity, although we cannot provide you assurance in that regard.

Noveon International is the beneficiary of agreements with Goodrich Corporation (Goodrich) that require Goodrich to indemnify Noveon International for, among other things, certain environmental liabilities and costs relating to facilities of the former Performance Materials Segment of Goodrich. However, we cannot assure you that Goodrich or other third party indemnitors will, in the future, honor their indemnification obligations to us.

Employees

At December 31, 2006, we had approximately 6,700 employees of which approximately 53% were in the United States. We believe that our relationship with our employees is good. Three of our U.S. sites, and approximately 4% of our domestic employees, are organized by labor unions with collective bargaining agreements that are subject to periodic renegotiation. There are five agreements covering two plants expiring in 2007 and one agreement expiring in 2008. We expect to enter into new agreements with these unions as the current agreements expire.

Manufacturing and Properties

We possess global manufacturing, laboratory and sales and technical service facilities enabling us to provide customers with worldwide service and a reliable supply of products. Our corporate headquarters are located in Wickliffe, Ohio. We have manufacturing facilities and laboratories, which we own or lease, at 22 sites in the United States and approximately 41 sites in 19 other countries. We also have entered into long-term contracts for the exclusive use of major marine terminal facilities at various ports and leases for storage facilities. We maintain a capital expenditure program to support our operations and believe our facilities are adequate for our present operations and for the foreseeable future.

Geographic Area Information

Financial information with respect to our domestic and foreign operations is contained in Note 15 to our consolidated financial statements.

We supply our customers abroad through exports from the United States and from overseas manufacturing plants. We believe the political and economic risks related to our foreign operations are mitigated due to the stability of the countries in which our largest foreign operations are located.

ITEM 1A. RISK FACTORS

If any of the events contemplated by the following discussion of risks should occur, our business, results of operations and financial condition could suffer significantly. The risks described below are not the only risks that we face. Additional risks not currently known to us or that we currently deem immaterial may also impair our business.

Financial Risks

The limits imposed on us by the restrictive covenants contained in our credit facilities could prevent us from making acquisitions or capital improvements or cause us to lose access to these facilities.

Our existing credit facilities contain restrictive covenants that limit our ability to, among other things:

- borrow money or guarantee the debts of others;
- use assets as security in other transactions;
- change our business or enter into new lines of business; and
- sell assets or merge with or into other companies.

In addition, our credit facilities require us to meet financial ratios, including debt to consolidated earnings before income taxes, depreciation and amortization (EBITDA) (as defined in the credit facilities) and consolidated EBITDA (as defined in the credit facilities) to interest expense. These restrictions could limit our ability to plan for or react to market conditions or meet extraordinary capital needs and could otherwise restrict our financing activities.

Our ability to comply with the covenants and other terms of our credit facilities will depend on our future operating performance. If we fail to comply with such covenants and terms, we will be in default and the maturity of the related debt could be accelerated and become immediately due and payable. We may be required to obtain waivers from our lenders in order to maintain compliance under our credit facilities, including waivers with respect to our compliance with certain financial covenants. If we are unable to obtain any necessary waivers and the debt under our credit facilities is accelerated, our financial condition would be adversely affected.

We may not have access to capital in the future.

We may need new or additional financing in the future to expand our business or refinance existing indebtedness. If we are unable to access capital on satisfactory terms and conditions, we may not be able to expand our business or meet our payment requirements under our existing credit facilities. Our ability to obtain new or additional financing will depend on a variety of factors, many of which are beyond our control. We may not be able to obtain new or additional financing because we have substantial debt or because we may not have sufficient cash flow to service or repay our existing or future debt. In addition, depending on market conditions and our financial performance, equity financing may not be available on satisfactory terms or at all.

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We could be adversely affected if our debt is downgraded.

Our ability to complete offerings of debt securities on satisfactory terms in the future will depend on the status of our credit rating. The current rating of our senior unsecured long-term indebtedness is BBB- by Standard & Poor s Ratings Group (S&P) and Baa3 by Moody s Investors Service, Inc. (Moody s). Either S&P or Moody s or both may downgrade our credit rating at any time, which would make it more difficult to complete offerings of debt securities on satisfactory terms and generally would result in increased future borrowing costs and adversely affect our access to debt and capital markets.

Risks Relating to our Business

Volatility in raw material prices could reduce our profitability and reductions in the availability of raw material supplies could disrupt our operations.

Some of the raw materials that we use are derived from petrochemical-based feedstocks, such as crude oil and natural gas, which have been subject to historical periods of rapid and significant movements in price. These fluctuations in price could be aggravated by political instability, terrorist attacks or other hostilities in oil-producing countries or elsewhere in the world, and supply and demand factors, including OPEC production quotas and increased global demand for petroleum-based products. We also use natural gas as fuel at our facilities, and increases in the price of natural gas may reduce our profitability. Any significant variations in the cost and availability of our specialty and commodity materials or energy may negatively affect our business, financial condition or results of operations. We typically do not enter into hedging arrangements with respect to raw materials or energy, other than for natural gas and electricity. We selectively pass changes in the prices of raw materials to our customers from time to time. However, we cannot always do so, and any limitation on our ability to pass through any price increases could affect our financial performance.

We use significant quantities of a variety of specialty and commodity chemicals in our manufacturing processes, such as lubricant base oils (a derivative of crude oil); C4 feedstreams; acrylates; PVC; inorganic acids, bases and oxides; alcohols, glycols and polyols; olefins and esters; sulfonates; phenates; alkylates; sulfonic acids; and amines. These raw materials generally are available from numerous independent suppliers. However, some of our raw material needs are met by a sole supplier or only a few suppliers. If any supplier that we rely on for raw materials ceases or limits production, we may incur significant additional costs, including capital costs, in order to find alternate, reliable raw material suppliers. We may also experience significant production delays while locating new supply sources.

We face competition from other chemical companies, which could adversely affect our revenue and financial condition.

We actively compete with companies producing the same or similar products and, in some instances, with companies producing different products designed for the same uses. We encounter competition in price, delivery, service, performance, product innovation and product recognition and quality, depending on the product involved. For some of our products, our competitors are larger and have greater financial resources and less debt than we do. As a result, these competitors may be better able to withstand a change in conditions within the industries in which we operate, a change in the prices of raw materials or a change in the economy as a whole.

Our competitors can be expected to continue to develop and introduce new and enhanced products, which could cause a decline in market acceptance of our products. Current and future consolidation among our competitors and customers also may cause a loss of market share as well as put downward pressure on pricing. Additionally, a number of our niche product applications are customized or sold for highly specialized uses. Our competitors could cause a reduction in the prices for some of our products as a result of intensified price competition. Competitive pressures can also result in the loss of major customers. If we cannot compete successfully, our business, financial condition and consolidated results of operations could be adversely affected.

Failure to make continued improvements in our technology and productivity could hurt our competitive position.

We believe that we must continue to enhance our existing products and to develop and manufacture new products with improved capabilities in order to continue to be a market leader. We also believe that we must continue to make improvements in our productivity in order to maintain our competitive position. When we invest in new technologies, processes or production facilities, we face risks related to construction delays, cost over-runs

and unanticipated technical difficulties. Our inability to anticipate, respond to or utilize changing technologies could have a material adverse effect on our business and our consolidated results of operations.

Our and our suppliers production facilities are subject to operating risks that may adversely affect our operations.

We are dependent upon the continued safe operation of our and our suppliers production facilities. These production facilities are subject to hazards associated with the manufacture, handling, storage and transportation of chemical materials and products, including leaks and ruptures, explosions, fires, inclement weather and natural disasters, unscheduled downtime and environmental hazards. Incidents at our or our suppliers production facilities could temporarily shut down or otherwise disrupt our manufacturing operations, causing production delays and, with respect to our facilities, resulting in liability for workplace injuries and fatalities. In addition, some of our and our suppliers production facilities are highly specialized, which limits our ability to shift production to other facilities in the event of an incident at a particular facility. If a production facility, or a critical portion of a production facility, were temporarily shut down, we likely would incur higher costs for alternate sources of supply for our products. Some of our products involve the manufacture and/or handling of a variety of reactive, explosive and flammable materials. Use of these products by our customers also could result in liability if an explosion, fire, spill or other accident were to occur. We cannot assure you that we will not experience these types of incidents in the future or that these incidents will not result in production delays or otherwise have a material adverse effect on our business, financial condition or results of operations.

Some of our businesses are cyclical and demand by our customers for our products weakens during economic downturns.

A portion of our product sales is attributable to industries and markets, such as the construction and metalworking industries, that historically have been cyclical and sensitive to relative changes in supply and demand and general economic conditions. The demand for our products depends, in part, on the general economic conditions of the industries or national economies of our customers. Downward economic cycles in our customers industries or countries may reduce sales of some of our products. It is not possible to predict accurately the factors that will affect demand for our products in the future. Any significant downturn in the health of the general economy, either globally or regionally, or the markets in which we sell products could have an adverse effect on our revenues and financial performance.

Failure to implement our common information system platform successfully could negatively impact our ability to integrate our core business processes.

In 2006 we launched a company-wide initiative to extend our current information system platform to the entire organization so that our core business processes are integrated globally. We successfully implemented a common information system platform in 1998 and now we have begun rolling out the system to the acquired Lubrizol Advanced Materials segment and to those parts of Lubrizol Additives that are not yet utilizing it. Currently, this substantial investment is progressing on schedule; we expect to have more than 75% of our revenue base utilizing the same information system platform by mid-2008 and anticipate completing the migration to our entire company by mid-2009.

We consider the risk to be low that our information system implementation may significantly disrupt our business processes and impact our ability to serve customers. We essentially are implementing an existing design of the system that has worked for the past six years in our Lubrizol Additives segment. Moreover, we have put together a seasoned project management team. However, we face the risks that the common information system platform will not be completed on a timely basis, it may cost more than projected or we may not realize its anticipated benefits.

We face numerous risks relating to our foreign operations, including foreign currency exchange rate fluctuations, exchange controls and currency devaluations, that may adversely affect our results of operations.

In 2006 approximately 33% of our consolidated revenues were generated in currencies other than the U.S. dollar, which is our reporting currency, and 31% of our consolidated cost of sales and 30% of selling, technical, administrative and research (STAR) expenses were generated in currencies other than the U.S. dollar. We recognize foreign currency transaction gains and losses arising from our operations in the period incurred. As a result, currency fluctuations between the U.S. dollar and the currencies in which we do business have caused and

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will continue to cause foreign currency transaction gains and losses, which historically have been material and could continue to be material. We cannot predict the effects of exchange rate fluctuations upon our future operating results because of the number of currencies involved, the variability of currency exposures and the potential volatility of currency exchange rates. We take actions to manage our foreign currency exposure such as entering into hedging transactions, where available, but we cannot assure you that our strategies will adequately protect our consolidated operating results from the effects of exchange rate fluctuations.

We also face risks arising from the imposition of exchange controls and currency devaluations. Exchange controls may limit our ability to convert foreign currencies into U.S. dollars or to remit dividends and other payments by our foreign subsidiaries or businesses located in or conducted within a country imposing controls. Currency devaluations result in a diminished value of funds denominated in the currency of the country instituting the devaluation and, if they occur or continue for significant periods, could adversely affect our earnings or cash flow.

International social, political and economic conditions may adversely affect our operating performance.

Our international operations are also subject to the risk of labor unrest, regional economic uncertainty, political instability, terrorism, expropriation of property, restrictions on the transfer of funds into or out of a country, trade restrictions, export duties, taxes and quotas, domestic and foreign customs and tariffs, and current and changing regulatory environments. Any of these events could have an adverse effect on our international operations in the future by reducing the demand for our products, increasing the prices at which we can sell our products or otherwise having an adverse effect on our operating performance.

Our production facilities are of the type that may attract terrorist attacks, and any attack may disrupt our operations and cause us to incur significant costs and liabilities.

Uncertainty surrounding the possibility and scope of terrorist attacks may affect our operations in unpredictable ways, including the possibility that our chemical production facilities may become direct targets, or indirect casualties, of terrorist attacks. Although our production facilities are under a heightened level of security, this level of security may be insufficient to prevent a terrorist attack. The resulting damage may be severe and could include loss of life and property damage. In addition, some of our production and other facilities are located at sites near to other chemical plants that may be potential targets of terrorist attacks. The resulting collateral damage may be significant and substantial. Available insurance coverage may not be sufficient to cover all of the damage incurred or may be prohibitively expensive.

Certain of our employees are covered by collective bargaining agreements, and the failure to renew these agreements could result in labor disruptions and increased labor costs.

Employees at three of our U.S. sites, who constitute approximately 4% of our domestic employees, are organized by labor unions that have collective bargaining agreements with us that are subject to renegotiation. Five agreements covering two plants expire in 2007 and one agreement expires in 2008. Although we believe that our present labor relations are satisfactory, our failure to renew these agreements on reasonable terms as the current agreements expire could result in labor disruptions and increased labor costs, which could adversely affect our financial performance.

The applicability of numerous environmental laws to our manufacturing facilities could cause us to incur significant costs and liabilities.

We are subject to extensive federal, state, local and foreign environmental, safety and health laws and regulations concerning, among other things, emissions to the air, discharges to land and water and the generation, handling, treatment and disposal of hazardous waste and other materials. Under certain environmental laws, we can be held strictly liable for hazardous substance contamination of any real property we have ever owned, operated or used as a disposal site or for natural resource damages associated with such contamination. We are also required to maintain various environmental permits and licenses, many of which require periodic modification and renewal. Our operations entail the risk of violations of those laws and regulations, many of which provide for substantial fines and criminal sanctions for violations. We cannot assure you that we have been or will be at all times in compliance with all of these requirements.

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In addition, these requirements and their enforcement may become more stringent in the future. Although we cannot predict the ultimate cost of compliance with any such requirements, the costs could be significant. Non-compliance could subject us to significant liabilities, such as government fines, third-party lawsuits or the suspension of non-compliant operations. We also may be required to make significant site or operational modifications at substantial cost. Future developments also could restrict or eliminate the use of or require us to make modifications to our products, which could have a significant negative impact on our results of operations and cash flows.

At any given time, we are involved in claims, litigation, administrative proceedings and investigations of various types in a number of jurisdictions involving potential environmental liabilities, including clean-up costs associated with hazardous waste disposal sites, natural resource damages, property damage and personal injury. We cannot assure you that the resolution of these environmental matters will not have a material adverse effect on our results of operations or cash flows.

The ultimate costs and timing of environmental liabilities are difficult to predict. Liability under environmental laws relating to contaminated sites can be imposed retroactively and on a joint and several basis. One liable party could be held responsible for all costs at a site, regardless of fault, percentage of contribution to the site or the legality of the original disposal. We may also face liability with respect to acquired businesses for violations under environmental laws occurring prior to the date of our acquisition, and some or all of these liabilities may not be covered by indemnification from the sellers from which we acquired these businesses. We could incur significant costs, including cleanup costs, natural resources damages, civil or criminal fines and sanctions and third-party claims, as a result of past or future violations of, or liabilities under, environmental laws.

If we are unable to protect our intellectual property rights, our product sales and financial performance could be adversely affected.

We rely on a combination of patent, trade secret, copyright and trademark law, nondisclosure agreements and technical security measures to protect our intellectual property rights in our various lines of business. Our performance may depend in part on our ability to establish, protect and enforce intellectual property rights with respect to our patented technologies and proprietary rights and to defend against any claims of infringement, which involves complex legal, scientific and factual questions and uncertainties.

In the future, we may have to rely on litigation to enforce our intellectual property rights and contractual rights. In addition, we may face claims of infringement that could interfere with our ability to use technology or other intellectual property rights that are material to our business operations. If litigation that we initiate is unsuccessful, we may not be able to protect the value of some of our intellectual property. In the event a claim of infringement against us is successful, we may be required to pay royalties or license fees to continue to use technology or other intellectual property rights that we have been using or we may be unable to obtain necessary licenses from third parties at a reasonable cost or within a reasonable time. If we are unable to obtain licenses on reasonable terms, we may be forced to cease selling or using any of our products that incorporate the challenged intellectual property, or to redesign or, in the case of trademark claims, rename our products to avoid infringing the intellectual property rights of third parties, which may not be possible and may be time-consuming if possible. Any litigation of this type, whether successful or unsuccessful, could result in substantial costs to us and diversions of some of our resources. Our intellectual property rights may not have the value we believe them to have, which could result in a competitive disadvantage or adversely affect our business and financial performance.

ITEM 1B. UNRESOLVED STAFF COMMENTS

We have no unresolved Securities and Exchange Commission staff comments at this time.

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ITEM 2. PROPERTIES

Our corporate headquarters are located in Wickliffe, Ohio. Our commercial centers for Lubrizol Additives and Lubrizol Advanced Materials are located in Wickliffe, Ohio and Brecksville, Ohio, respectively. Our significant Lubrizol Additives segment manufacturing facilities are located in Bayport, Texas; Deer Park, Texas; Le Havre, France; Painesville, Ohio; and Rouen, France. Our significant Lubrizol Advanced Materials manufacturing facilities are located in Antwerp, Belgium; Avon Lake, Ohio; Calvert City, Kentucky; Louisville, Kentucky; and Oevel, Belgium. We have other offices and facilities around the world. The locations of our manufacturing and laboratory facilities are indicated below in the following chart.

Location	Owned/ Leased	Laboratory (R&D/Testing) or Manufacturing	Reporting Segments: Lubrizol Additives	Reporting Segments: Lubrizol Advanced Materials
Sydney, Australia	Owned	Manufacturing	x	x
Antwerp, Belgium	Owned	Laboratory, Manufacturing		x
Louvaine Leneuve, Belgium	Leased	Laboratory		x
Oevel, Belgium	Owned	Manufacturing		x
Vilvoorde, Belgium	Owned	Manufacturing		x
Rio de Janeiro, Brazil	Owned	Manufacturing	x	x
Sao Paulo, Brazil	Leased	Laboratory		x
Niagara Falls, Ontario, Canada	Owned	Manufacturing	x	
Hong Kong, China	Leased	Laboratory		x
Lanzhou, China(1)	Plant is owned; land is leased	Manufacturing	x	
Qingpu, China	Leased	Laboratory, Manufacturing		x
Shanghai, China	Leased	Laboratory		x
Shanghai, China	Leased	Laboratory	x	
Songjiang, China	Leased	Manufacturing		x
Tianjin, China (1)	Plant is owned; land is leased	Manufacturing	x	
Zhejiang, China(1)	Plant is owned; land is leased	Manufacturing		x
Le Havre, France	Owned	Manufacturing	x	
Mourenx, France	Owned	Manufacturing	x	
Rouen, France	Owned	Manufacturing	x	
Hamburg, Germany	Leased	Laboratory, Manufacturing	x	
Ritterhude, Germany	Owned	Laboratory, Manufacturing		x
Mumbai, India(1)	Plant is owned; land is leased	Manufacturing	x	
Mumbai, India	Leased	Laboratory		x
Vadadora, India	Owned	Laboratory, Manufacturing		x
Kinuura, Japan	Owned	Laboratory, Manufacturing	x	x
Sembilan, Malaysia	Owned	Manufacturing		x
Apodaca, Mexico(1)	Owned	Laboratory, Manufacturing	x	
Mexico City, Mexico	Leased	Laboratory		x
Delfzijl, The Netherlands	Leased	Manufacturing		x
Yanbu, Saudi Arabia(1)	Owned	Laboratory, Manufacturing	x	
Singapore	Plant is owned; land is leased	Manufacturing	x	
Singapore	Leased	Laboratory		x
Durban, South Africa	Owned	Manufacturing	x	x
Pohang, South Korea	Plant is owned; land is leased	Manufacturing		x
Barcelona, Spain	Owned	Laboratory, Manufacturing		x

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			Reporting Segments	
Location	Owned/ Leased	Laboratory (R&D/Testing) or Manufacturing	Lubrizol Additives	Lubrizol Advanced Materials
Muang, Thailand	Jointly Owned	Laboratory, Manufacturing		x
Barnsley, United Kingdom	Owned	Laboratory, Manufacturing		x
Blackley, United Kingdom	Leased	Laboratory		x
Hazelwood, United Kingdom	Owned	Laboratory	x	
Huddersfield, United Kingdom	Plant is owned; land is leased	Laboratory, Manufacturing		x
Grangemouth, United Kingdom	Leased	Laboratory		x
Paso Robles, CA	Plant is owned; land is leased	Laboratory, Manufacturing		x
Peachtree City, GA	Owned	Manufacturing		x
Countryside, IL	Owned	Laboratory, Manufacturing		x
McCook, IL	Leased	Laboratory, Manufacturing		x
Calvert City, KY	Owned	Manufacturing		x
Louisville, KY	Owned	Manufacturing		x
Lawrence, MA	Owned	Laboratory, Manufacturing		x
Wilmington, MA	Leased	Manufacturing		x
Midland, MI	Owned	Laboratory, Manufacturing	x	
Pedricktown, NJ	Owned	Manufacturing		x
Gastonia, NC	Owned	Laboratory, Manufacturing		x
Avon Lake, OH	Owned	Laboratory, Manufacturing		x
Bowling Green, OH	Owned	Laboratory, Manufacturing		x
Brecksville, OH	Owned	Laboratory		x
Chagrin Falls, OH	Owned	Laboratory, Manufacturing		x
Painesville, OH	Owned	Manufacturing	x	x
Wickliffe, OH	Owned	Laboratory	x	
Spartanburg, SC	Leased	Laboratory	x	
Spartanburg, SC	Owned	Laboratory, Manufacturing	x	x
Bayport, TX	Owned	Manufacturing	x	x
Deer Park, TX	Owned	Manufacturing	x	
Houston, TX	Owned	Manufacturing		x

(1) These manufacturing plants are owned and operated by joint venture companies licensed by Lubrizol.

In some cases, the ownership or leasing of these facilities is through a subsidiary or affiliate. We have entered into long-term contracts for our exclusive use of major marine terminal facilities at the Port of Houston, Texas.

In September 2006, we entered into an agreement to sell our Lubrizol Additives manufacturing plant in Bromborough, United Kingdom. The sale closed in January 2007 for a purchase price of approximately $5.9 million. Production from this U.K. facility was transferred to higher-capacity Lubrizol facilities in France and the United States. The sale of the facility will save approximately $3.0 million to $5.0 million in restructuring costs that would have been associated with the demolition of the plant facilities on the site. Cumulative pretax charges of approximately $12.8 million were incurred through 2006, of which $6.7 million were incurred in 2006, to satisfy severance and retention obligations, plant dismantling, site restoration and other site environmental evaluation costs.

We have invested approximately $15.3 million in capital related to the Bromborough plant closure through December 31, 2006 for capacity upgrades in France and the United States. We expect additional capacity upgrades through the first quarter of 2007 to total approximately $4.0 million.

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We maintain a capital expenditure program to support our operations and believe our facilities are adequate for our present operations and for the foreseeable future.

ITEM 3. LEGAL PROCEEDINGS

In the fourth quarter of 2006, we received a notice of violation from the Louisville (KY) Metro Air Pollution Control District relating to alleged violations of the air permit held by our Louisville, Kentucky facility. Initial discussions with the regulators indicate that the final resolution of this matter may include a penalty greater than the applicable reporting threshold. At this time, however, we do not have sufficient information to make a reasonable assessment of the penalty.

In the third quarter of 2005, we voluntarily notified the U.S. Departments of Treasury and Commerce that an internal review of certain export transactions within the personal care and pharmaceuticals business of the Lubrizol Advanced Materials segment indicated that some exports were made that were not in compliance with current U.S. trade sanctions. We voluntarily completed a thorough review of all possibly non-complying transactions and detailed our findings in a subsequent report that was made to the government in the third quarter of 2005. While the sales involved were not substantial in relation to the company or the Lubrizol Advanced Materials segment, we consider legal compliance to be very important. In 2006, the U.S. Department of Treasury, Office of Foreign Assets Control, alleged that we violated the Iran Trading Regulations applicable to U.S. companies and persons and they fined us $5,500 for the behaviors disclosed. Separately, the U.S. Department of Commerce investigated us and issued a finding that, while the acts committed and disclosed could have been referred to the U.S. Department of Justice for criminal prosecution and/or been the basis of a monetary penalty against the company, it had closed the matter with a written warning and an order to cease and prevent offending acts in the future. We believe our self-reporting and corrective measures, including disciplinary actions taken, mitigated the penalties assessed against us.

ITEM 4. SUBMISSION OF MATTERS TO A VOTE OF SECURITY HOLDERS

No matters were submitted to the vote of the security holders during the three months ended December 31, 2006.

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EXECUTIVE OFFICERS OF THE REGISTRANT

The following sets forth the name, age, recent business experience and certain other information relative to each person who was an executive officer as of February 28, 2007.

Name	Age	Position
James L. Hambrick	52	Chairman of the Board, President and Chief Executive Officer
Joseph W. Bauer	53	Vice President and General Counsel
Donald W. Bogus	59	Senior Vice President and President - Lubrizol Advanced Materials
Charles P. Cooley	51	Senior Vice President, Treasurer and Chief Financial Officer
W. Scott Emerick	42	Corporate Controller
Stephen F. Kirk	57	Senior Vice President and President - Lubrizol Additives
Mark W. Meister	52	Vice President and Chief Ethics Officer
Leslie M. Reynolds	46	Corporate Secretary
Patrick Saunier	51	Vice President, Information Systems
Gregory D. Taylor	48	Vice President, Corporate Planning, Development and Communications
Jeffrey A. Vavruska	46	Chief Tax Officer
Joanne Wanstreet	55	Vice President, Investor Relations

James L. Hambrick is chairman of the board of directors, president and chief executive officer of The Lubrizol Corporation. He was elected president in January 2003, chief executive officer in April 2004 and chairman of the board effective January 3, 2005. From May 2000 to January 2003, he was vice president responsible for managing corporate strategies in the Asia Pacific region.

Joseph W. Bauer has been the vice president and general counsel of The Lubrizol Corporation since April 1992.

Donald W. Bogus became a senior vice president of The Lubrizol Corporation in July 2004 and president of the Lubrizol Advanced Materials segment in April 2004. He joined Lubrizol in 2000 as vice president responsible for the Fluid Technologies for Industry segment. He also led Lubrizol s mergers and acquisitions committee.

Charles P. Cooley is a senior vice president and the chief financial officer of The Lubrizol Corporation. He joined Lubrizol in 1998 as its chief financial officer and vice president. He was also treasurer from April 1998 to September 2001 and since September 2006. Mr. Cooley became a senior vice president in July 2004.

W. Scott Emerick joined The Lubrizol Corporation as corporate controller in June 2004. Prior to that, Mr. Emerick was at Noveon International, where he held the positions of director of finance - TempRite products from September 2003 to June 2004 and director of accounting and external financial reporting from April 2001 to September 2003.

Stephen F. Kirk became a senior vice president of The Lubrizol Corporation in July 2004 and the president of the Lubrizol Additives segment in June 2004. Previously, he was vice president of sales and marketing for Lubrizol since January 1999.

Mark W. Meister has been the vice president of human resources for The Lubrizol Corporation since 1993 and chief ethics officer since 1994.

Leslie M. Reynolds is corporate secretary and counsel for The Lubrizol Corporation. She has been counsel since February 1991. She served as assistant secretary from 1997 until her appointment as corporate secretary in April 2001.

Patrick H. Saunier became the vice president for information systems and business processes for The Lubrizol Corporation in July 2004. From 1999 to 2004, Mr. Saunier led the European shared services organization.

Gregory D. Taylor became the vice president for corporate planning, development and communications for The Lubrizol Corporation in February 2007. From 2003 to 2007, Mr. Taylor was the managing director of corporate planning for Lubrizol. From 2000-2003, he was a global business manager for Lubrizol.

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Jeffrey A. Vavruska joined The Lubrizol Corporation as chief tax officer in April 2004. Previously, he worked at American Greetings Corporation, where he was executive director of tax from September 2001 to April 2004.

Joanne Wanstreet was elected vice president with responsibility for global communications and investor relations for The Lubrizol Corporation in April 2002. From January 2001 to April 2002, Ms. Wanstreet was manager, investor relations.

All executive officers serve at the pleasure of the Board.

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PART II

ITEM 5. MARKET FOR REGISTRANT S COMMON EQUITY AND RELATED STOCKHOLDER MATTERS

Our common shares are listed on the New York Stock Exchange under the symbol LZ. The number of shareholders of record of common shares was 3,229 as of February 15, 2007.

Information relating to the recent price and dividend history of our common shares follows:

	Common Share Price History				Dividends Per Common Share	
	2006		2005			
	High	Low	High	Low	2006	2005
1st quarter	$ 46.44	$ 41.70	$ 43.57	$ 35.25	$ .26	$ .26
2nd quarter	45.20	38.52	44.51	36.74	.26	.26
3rd quarter	46.25	38.03	44.50	39.12	.26	.26
4th quarter	50.75	44.16	44.16	39.83	.26	.26
					$ 1.04	$ 1.04

We have no restrictions on the payment of dividends on Lubrizol common shares.

On October 2, 2006, 235 common shares were issued in a private placement transaction exempt from registration under the Securities Act of 1933 pursuant to Section 4(2) of that Act. We issued the common shares to a former officer under a deferred compensation plan for officers.

On December 1, 2006, 193 common shares were issued in a private placement transaction exempt from registration under the Securities Act of 1933 pursuant to Section 4(2) of that Act. We issued the common shares to a former officer under a deferred compensation plan for officers.

The following table provides information regarding our purchases of Lubrizol common shares during the quarter.

Period	Total Number of Shares (or Units) Purchased[1]	Average Price Paid per Share (or Unit)	Total Number of Shares (or Units) Purchased as Part of Publicly Announced Plans or Programs	Maximum Number (or Approximate Dollar Value) of Shares (or Units) that May Yet be Purchased Under the Plans or Programs
Month #1 (Oct. 1, 2006 through Oct. 31, 2006)	0 Shares	N/A	N/A	N/A
Month #2 (Nov. 1, 2006 through Nov. 30, 2006)	12,267 Shares	$ 47.84	N/A	N/A
Month #3 (Dec. 1, 2006 through Dec. 31, 2006)	0 Shares	N/A	N/A	N/A
Total	12,267 Shares			

[1] This column represents common shares that we purchased pursuant to:
(a) our option plan, whereby participants exchange already owned shares to us to pay for the exercise price of an option or whereby we withhold shares upon the exercise of an option to pay the withholding taxes on behalf of the employee.

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(b) our deferred compensation plans, whereby we withhold shares upon a distribution to pay the withholding taxes on behalf of the employee.

Performance Comparisons

The following chart compares our combined total shareholder returns for the five years ended December 31, 2006 to the combined total shareholder returns of the Standard & Poor s 500 Index and the Standard & Poor s Chemicals Industry.

We have selected the Standard & Poor s 500 Index, because we believe it provides a broad equity market comparison and is widely used for comparison by our peer group. We believe we have a peer group relationship with companies in the Standard & Poor s Chemicals Industry.

No single peer index or peer company is comparable totally to our business. Included in the Standard & Poor s Chemicals Industry are companies that supply specialty chemicals and other related products to a wide variety of markets. Some of our direct competitors are chemical divisions that represent small portions of large oil companies. These chemical divisions are not included in the peer comparison because information is not available to us that shows those divisions separately from the parent company.

	12/01	12/02	12/03	12/04	12/05	12/06
The Lubrizol Corporation	100.00	89.77	98.98	115.83	139.99	165.43
S&P Chemicals Industry	100.00	96.97	123.06	148.05	147.91	171.48
S&P 500	100.00	77.90	100.24	111.15	116.61	135.03

The above chart assumes the investment of $100 on December 31, 2001 and the immediate investment of all dividends.

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ITEM 6. SELECTED FINANCIAL DATA
Historical Summary (as restated)

(In Millions, Except Shareholders, Employees and Per-Share Data)	2006	2005	2004*	2003**	2002**
OPERATING RESULTS:					
Revenues	$ 4,040.8	$ 3,622.2	$ 2,864.4	$ 1,984.2	$ 1,934.0
Total cost and expenses***	3,708.0	3,286.8	2,663.2	1,842.6	1,737.9
Net interest expense and other income	(70.8)	(95.2)	(66.7)	(17.8)	(17.8)
Income from continuing operations before cumulative effect of change in accounting principle	179.8	159.4	85.5	87.6	125.6
(Loss) income from discontinued operations, net of income taxes	(76.2)	27.8	6.3	1.9	(0.1)
Income before cumulative effect of change in accounting principle	103.6	187.2	91.8	89.5	125.5
Cumulative effect of change in accounting principle					(7.8)
Net income	103.6	187.2	91.8	89.5	117.7
Income from continuing operations, per diluted share before cumulative effect of change in accounting principle	2.59	2.32	1.53	1.70	2.43
Discontinued operations per diluted share	(1.10)	0.40	0.11	0.04	
Cumulative effect of change in accounting principle per diluted share					(0.15)
Diluted earnings per share	1.49	2.72	1.64	1.74	2.28
FINANCIAL RATIOS:					
Gross profit percentage	24.6	25.4	26.4	26.3	28.4
Percent of revenues:					
Selling and administrative expenses	9.4	9.6	9.9	9.6	9.6
Research and testing expenses	5.1	5.5	6.5	8.3	8.6
Return on average shareholders equity (%)	6.4	12.2	7.5	9.9	14.4
Debt to capitalization (%)	47.8	51.8	56.5	28.6	31.0
Current ratio	2.9	2.4	2.4	3.1	3.0
OTHER INFORMATION:					
Dividends declared per share	$ 1.04	$ 1.04	$ 1.04	$ 1.04	$ 1.04
Average common shares outstanding:					
Basic	68.7	67.9	55.7	51.7	51.5
Diluted	69.3	68.8	56.0	51.9	51.8
Capital expenditures - Continuing Operations	125.7	121.9	122.6	88.2	65.0
Depreciation expense - Continuing Operations	133.4	139.4	123.8	93.7	90.1

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Historical Summary (as restated) - continued

(In Millions, Except Shareholders, Employees and Per-Share Data)	**2006**	**2005**	**2004***	**2003****	**2002****
At year end:					
Total assets	$ 4,390.9	$ 4,371.2	$ 4,571.1	$ 1,944.9	$ 1,860.2
Total debt	1,541.7	1,670.8	1,972.3	389.6	401.9
Total shareholders equity	$ 1,683.1	$ 1,551.9	$ 1,508.5	$ 941.0	$ 860.1
Shareholders equity per basic share	24.39	22.81	22.58	18.24	16.71
Common share price	50.13	43.43	36.86	32.52	30.50
Number of shareholders	3,265	3,500	3,698	3,903	4,081
Number of employees	6,746	7,515	7,725	5,032	5,231

* The 2004 results include the revenues and expenses of Noveon International, Inc. since June 3, 2004, the date of acquisition.

** Amounts derived from previously issued financial statements have been restated to include the effects of the restatement as described in the Explanatory Note contained in the front section of this annual report on Form 10-K/A for the year ended December 31, 2006.

*** Includes restructuring and impairment charges of

$51.9 million in 2006, $15.9 million in 2005, $38.1 million in 2004 and $22.5 million in 2003. Also includes the write-off of acquired in-process research and development of $34.0 million in 2004.

Total debt reported in the Historical Summary includes the following amounts classified as long-term at December 31: $1,538.0 million in 2006, $1,662.9 million in 2005, $1,964.1 million in 2004, $386.7 million in 2003 and $384.8 million in 2002.

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ITEM 7. MANAGEMENT S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

This Management s Discussion and Analysis of Financial Condition and Results of Operations should be read in conjunction with the consolidated financial statements, the notes thereto and the historical summary appearing elsewhere in this annual report. Historical results and percentage relationships set forth in the consolidated financial statements, including trends that might appear, should not be taken as indicative of future operations. The following discussion contains forward-looking statements that involve risks and uncertainties. Our actual results may differ materially from those discussed in such forward-looking statements as a result of various factors, including those described under the section Cautionary Statements for Safe Harbor Purposes included elsewhere in this annual report.

RESTATEMENT OF CONSOLIDATED FINANCIAL STATEMENTS

On October 22, 2007, we concluded to restate our previously issued financial statements because of reporting errors relating to five postemployment employee benefit plans in three foreign countries. Accordingly, we have restated our consolidated balance sheets as of December 31, 2006 and 2005 and our consolidated statements of income, consolidated statements of cash flows and consolidated statements of shareholders equity for fiscal years 2006, 2005 and 2004. The effects of the restatement are reflected in this Management s Discussion and Analysis of Financial Condition and Results of Operations and we have not modified or updated disclosures except as required to reflect the effects of the restatement. See the Explanatory Note included in the front section of the annual report on Form 10-K/A and Note 20 - Restatement of Consolidated Financial Statements contained in the Notes to Financial Statements for more information regarding the restatement and changes to previously issued financial statements.

The impact of the restatement decreased income from continuing operations and net income for 2006 by $2.0 million or 1.1% and 1.9%, respectively, for 2005 by $2.1 million or 1.3% and 1.1%, respectively, and for 2004 by $1.7 million or 1.9% and 1.8%, respectively, from amounts previously reported. The restatement had no effect on our previously reported revenues or net cash flows. The cumulative effect of the errors decreased shareholders equity as of December 31, 2006 by $24.3 million or 0.6% of total liabilities and shareholders equity and 1.4% of total shareholders equity. The cumulative effect of the errors decreased shareholders equity as of December 31, 2005 by $15.3 million or less than one-half percent of total liabilities and shareholders equity and 1.0% of total shareholders equity.

The errors primarily arose in three different postemployment employee benefit plans at a wholly owned subsidiary and in postemployment employee benefit plans for employees at two of our consolidated joint ventures. Four of these postemployment employee benefit plans had been accounted for inappropriately on a cash basis rather than an accrual basis as required by U.S. generally accepted accounting principles (U.S. GAAP), while the accrual recorded in the financial statements for the fifth plan was not calculated in accordance with U.S. GAAP. The cumulative effect of the errors resulted in an understatement of postemployment employee benefit plan liabilities of $38.9 million and $27.1 million at December 31, 2006 and 2005, respectively.

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OVERVIEW

General

We are an innovative specialty chemical company that produces and supplies technologies that improve the quality and performance of our customers products in the global transportation, industrial and consumer markets. Our business is founded on technological leadership. Innovation provides opportunities for us in growth markets as well as advantages over our competitors. From a base of approximately 1,700 patents, we use our product development and formulation expertise to sustain our leading market positions and fuel our future growth. We create additives, ingredients, resins and compounds that enhance the performance, quality and value of our customers products, while minimizing their environmental impact. Our products are used in a broad range of applications, and are sold into stable markets such as those for engine oils, specialty driveline lubricants and metalworking fluids, as well as higher-growth markets such as personal care and over-the-counter pharmaceutical products and performance coatings and inks. Our engineered polymers products also are used in a variety of industries, including the construction, sporting goods, medical products and automotive industries. We are an industry leader in many of the markets in which our product lines compete.

We are geographically diverse, with an extensive global manufacturing, supply chain, technical and commercial infrastructure. We operate facilities in 29 countries, including production facilities in 20 countries and laboratories in 13 countries, in key regions around the world through the efforts of more than 6,700 employees. We sell our products in more than 100 countries and believe that our customers value our ability to provide customized, high-quality, cost-effective performance formulations and solutions worldwide. We also believe that our customers value our global supply chain capabilities.

As part of our corporate goal to enhance our one company identity and to reflect more accurately our positioning in the marketplace, we completed a corporate identity review in the fourth quarter of 2006. We made a final determination in January 2007 that the trade name Noveon no longer would be used to describe the specialty chemicals business segment of our company and that its use would be discontinued except in connection with the consumer specialties product line. We acquired the rights to the Noveon trade name in June 2004 when we acquired Noveon International, Inc. (Noveon International). At the time of acquisition, an appraised value was attached to the Noveon trade name. We recorded a pretax charge of $41.2 million ($25.4 million after-tax) to reduce the related asset to its estimated fair value. This charge was reflected in the fourth quarter of 2006 as we believed at that time we would more likely than not discontinue the use of the Noveon trade name, except in the limited context of our consumer specialties product line.

In addition, we made a decision to change the names of our business segments. We believe that these names are a better fit with the corporate brand that we are presenting to our markets. These name changes do not change the way we manage our segments or the product lines included in the segments.

Following are the name changes to our segments:

Former Name	New Name
Lubricant Additives	Lubrizol Additives
Specialty Chemicals	Lubrizol Advanced Materials

On February 7, 2007, we completed the acquisition of a broad line of additive products used in the metalworking markets worldwide from Lockhart Chemical Company (Lockhart), a private company with headquarters in Gibsonia, Pennsylvania. Lockhart is recognized in the metalworking industry for its application and formulation capabilities and quality products. We purchased Lockhart s entire metalworking product line, which includes: natural, synthetic and gelled sulfonates; emulsifier packages; corrosion inhibitors and lubricity agents; grease additives; oxidates; esters; soap; semi-finished coatings; and rust preventatives. In 2006, these product lines had annualized revenues of approximately $20.0 million.

In May 2006, we sold the food ingredients and industrial specialties business (FIIS) and the active pharmaceutical ingredients and intermediate compounds business (A&I), both of which were included in the Lubrizol Advanced

Materials segment. A&I and almost all of the FIIS divestiture reported into the Noveon consumer specialties product line, while a small portion of the FIIS divestiture reported into the performance coatings product line. We recorded a

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$15.9 million after-tax loss on the sale of these divested businesses. During the first quarter of 2006 and in connection with the held-for-sale classification, we performed an impairment test resulting in a $60.6 million after-tax impairment charge in the first quarter of 2006. We have reflected the results of these divested businesses in the discontinued operations - net of tax line item in the consolidated statements of income for all periods presented.

In February 2006, we sold certain assets and liabilities of our Telene® resins business (Telene), which was included in the Lubrizol Advanced Materials segment. We have reflected the results of Telene in the discontinued operations - net of tax line item in the consolidated statements of income for all periods presented, including an after-tax loss on the sale of $0.7 million.

In December 2005, we sold certain assets, liabilities and stock of our Engine Control Systems (ECS) business and, in September 2005, we sold certain assets and liabilities of our U.S. and U.K. Lubrizol Performance Systems (LPS) operations, both of which were included in the Lubrizol Additives segment. We have reflected the results of these businesses in the discontinued operations - net of tax line item in the consolidated statements of income for 2005 and 2004.

On June 3, 2004, we completed the acquisition of Noveon International, a leading global producer and marketer of technologically advanced consumer specialties, engineered polymers and performance coatings used in the industrial and consumer markets. We acquired Noveon International for cash of $920.2 million (inclusive of certain seller expenses of $32.9 million) plus transaction costs of $11.4 million and less cash acquired of $103.0 million. In addition, we assumed $1,103.1 million of long-term indebtedness from Noveon International.

In connection with the acquisition of Noveon International, we targeted non-core businesses with total revenues of approximately $500.0 million for disposition. All disposition activities related to these businesses were completed by the end of 2006.

LUBRIZOL ADDITIVES SEGMENT

Challenging industry market forces and conditions continue to influence the Lubrizol Additives business. A key factor is the low global growth rate for this market, which we believe is in the range of approximately 0% to 1% per year. Additional characteristics of this market are:

- Consolidation of the additive industry and capacity reductions in recent years, which has tightened the supply of lubricant additive components and packages.

- Frequent product specification changes primarily driven by original equipment manufacturers (OEMs) and the impact of environmental and fuel economy regulations on the OEMs. The specification changes require us to incur product development and testing costs, but also enable us to apply our technology know-how to create products and solve problems. We believe our technology, and our expertise in applying it, are key strengths.

- Improved engine design, which can result in longer lubricant drain intervals. Longer drain intervals reduce demand for finished lubricants.

- New vehicle production levels, which affect our driveline fluids in particular because the initial factory fill is an important market factor in that product line.

- In recent years, a general tightening of supplies leading to significant increases in raw material and energy costs.

We believe we are the market leader in lubricant additives and intend to remain the leader by continuing to invest in this business. Our strategy is to continue to optimize our product line mix with existing production capacity. Our Lubrizol Additives segment represents approximately 64% of consolidated revenues.

LUBRIZOL ADVANCED MATERIALS SEGMENT

Our Lubrizol Advanced Materials segment s growth strategy involves a combination of internal growth and acquisitions. Since 2000 and prior to the Noveon International acquisition, we made eight acquisitions with aggregate annual revenues at the time of acquisition of approximately $200.0 million.

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We have a strategy to continue to achieve internal growth in the Lubrizol Advanced Materials segment by using our strengths, including our technology, formulating skills and broad geographic infrastructure, to develop and invest in new performance technologies in higher-growth industrial and consumer markets. Key factors to our success continue to be the introduction of new products, development of new applications for existing products, cross-selling of products, the integration of acquisitions and geographic expansion. Our Lubrizol Advanced Materials segment represents approximately 36% of consolidated revenues.

PRIMARY FACTORS AFFECTING 2006 RESULTS FROM CONTINUING OPERATIONS

The factors that most affected our consolidated 2006 results from continuing operations were:

- Our ability to raise selling prices to recover raw material cost increases from 2006 and prior years.

- Volume increases of 6% in the Lubrizol Advanced Materials segment and just under one-half percent in the Lubrizol Additives segment.

- Increased operating costs due to general salary and benefit cost increases and the hiring of growth resources, costs associated with a newly commenced project to implement a common information systems platform primarily in the Lubrizol Advanced Materials segment, the impact of variable accounting for some of our liability-based incentive compensation plans, the adoption of Statement of Financial Accounting Standards (SFAS) No. 123R Share-Based Payment for the accounting of stock-based awards, and a $2.9 million pension settlement charge for a non-qualified plan distribution.

- Pretax impairment charges of $41.2 million associated with the impairment of the Noveon trade name and $10.7 million related to plant and line closures in both the Lubrizol Additives and Lubrizol Advanced Materials segments.

- Reduced interest expense - net of $17.7 million as a result of higher interest income of $12.3 million associated with greater cash and short-term investment balances, primarily related to the cash proceeds from the 2006 divestitures and lower interest expense of $5.4 million associated with reduced debt levels.

- Increased other income of $6.7 million primarily from legal settlements with suppliers.

- Reduced effective tax rate primarily due to the favorable provision impacts of foreign operations.

Raw material costs increased 14% in 2006 after increasing 18% excluding the impact of acquisitions in 2005. Our results were affected by how quickly and the extent to which we were able to raise selling prices in response to raw material, utility and other operating cost increases. Both the Lubrizol Additives and Lubrizol Advanced Materials segments implemented price increases throughout 2006 in response to continuing increases in these costs. However, we have not yet recovered the full effect of the cumulative cost increases.

2006 RESULTS OF OPERATIONS COMPARED WITH 2005

Income from continuing operations increased $20.4 million to $179.8 million for 2006 compared to $159.4 million for 2005. The increase in earnings from continuing operations primarily was attributable to improvements in the combination of price and product mix, higher volume and reduced interest expense - net, which more than offset higher raw material and utility costs, higher restructuring and impairment charges and higher selling, technology, administrative and research (STAR) expenses.

We recorded restructuring and impairment charges that reduced income from continuing operations by $0.47 per diluted share in 2006, which primarily related to a pretax impairment charge associated with the Noveon trade name and the phase-out of a manufacturing facility located in Bromborough, United Kingdom. We incurred restructuring and impairment charges of $0.15 per diluted share in 2005, which primarily related to the phase-out of manufacturing facilities located in Bromborough, United Kingdom; Linden, New Jersey; and Mountaintop, Pennsylvania, as well as other workforce reductions.

Net income for 2006 includes the factors described above for income from continuing operations and the impact of discontinued operations. Loss from discontinued operations - net was $76.2 million in 2006 compared to income from discontinued operations - net of $27.8 million in 2005. The loss from discontinued operations - net in 2006 primarily related to a $60.6 million after-tax impairment charge recorded in the first quarter of 2006 to reflect the FIIS business at its fair value and a $16.6 million after-tax loss on the sale of divested businesses.

ANALYSIS OF REVENUES The changes in consolidated revenues are summarized as follows:

(In Millions of Dollars)	2006	2005	$ Change	% Change
Net sales	$ 4,036.4	$ 3,618.8	$ 417.6	12%
Royalties and other revenues	4.4	3.4	1.0	29%
Total revenues	$ 4,040.8	$ 3,622.2	$ 418.6	12%

The increase in revenues in 2006 compared to 2005 primarily was due to a 10% improvement in the combination of price and product mix and a 2% increase in volume. We experienced volume gains in all geographic zones except Europe.

ANALYSIS OF VOLUME - 2006 VS. 2005 Volume patterns vary in different geographic zones. The following table shows our 2006 volume by geographic zone as well as the changes compared with 2005:

	2006 Volume	% Change
North America	46%	1%
Europe	27%	(1%)
Asia-Pacific / Middle East	22%	6%
Latin America	5%	11%
Total	100%	2%

Segment volume variances by geographic zone, as well as the factors explaining the changes in segment revenues for 2006 compared with 2005, are contained under the Segment Analysis section.

ANALYSIS OF COSTS AND EXPENSES

(In Millions of Dollars)	2006	2005	$ Change	% Change
Cost of sales	$ 3,045.2	$ 2,700.1	$ 345.1	13%
Selling and administrative expenses	381.7	348.4	33.3	10%
Research, testing and development expenses	205.5	198.9	6.6	3%
Amortization of intangible assets	23.7	23.5	0.2	1%
Restructuring and impairment charges	51.9	15.9	36.0	*
Total costs and expenses	$ 3,708.0	$ 3,286.8	$ 421.2	13%

The increase in cost of sales for 2006 compared to 2005 primarily was due to higher average raw material cost and higher manufacturing expenses. Average raw material cost increased 14% in 2006 compared to 2005 primarily due to higher petrochemical raw material cost. Total manufacturing expenses increased 4% in 2006 compared to 2005, primarily due to higher salaries and benefits, higher utility costs and increased volume. On a per-unit-sold basis, manufacturing costs increased 2% in 2006 compared to 2005.

Gross profit (net sales less cost of sales) increased $72.5 million, or 8%, in 2006 compared to 2005. The increase primarily was due to improvement in the combination of price and product mix and higher volume partially offset by higher average raw material cost. In addition, gross profit was impacted unfavorably by higher salaries and benefits, an increase in utility costs and an unfavorable currency impact in 2006 when compared to 2005. Although we were successful in raising selling prices to offset higher cost of sales, our 2006 gross profit percentage (gross profit divided by net sales) decreased to 24.6% compared to 25.4% in 2005 due to the increase in net sales from our pricing responses to escalating raw material costs.

Selling and administrative expenses increased $33.3 million, or 10%, in 2006 compared to 2005. The increase primarily reflects an increase in salaries and benefits including the addition of growth resources, an increase of $4.5 million

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associated with a newly commenced project to implement a common information systems platform primarily in the Lubrizol Advanced Materials segment, the unfavorable impact of variable accounting for some of our liability-based incentive plans, a $2.9 million pension settlement charge for a non-qualified pension plan distribution and incremental stock-based compensation expense of $2.4 million associated with the adoption of SFAS No. 123R.

The timing and amount of research, testing and development expenses (technology expenses) are affected by lubricant additives product standards, which change periodically to meet new emissions, efficiency, durability and other performance factors as OEMs improve engine and transmission designs. Technology expenses increased $6.6 million, or 3%, in 2006 compared to 2005 primarily due to increases in annual salaries and benefits. During 2006 and 2005, approximately 87% of our technology costs were incurred in company-owned facilities and approximately 13% were incurred at third-party facilities.

In 2006, we recorded aggregate restructuring and impairment charges of $51.9 million, or $0.47 per diluted share, primarily related to the write-down of a trade name in the Lubrizol Advanced Materials segment and the phase-out of a manufacturing facility in the Lubrizol Additives segment.

The components of the 2006 restructuring and impairment charges are detailed as follows:

(In Millions of Dollars)	Asset Impairments	Other Plant Exit Costs	Severance	Total
Noveon trade name impairment	$ 41.2	$	$	$ 41.2
Bromborough, U.K. closure		4.8	1.9	6.7
Lubrizol Advanced Materials plant and line closures and workforce reductions	3.3	0.2	0.6	4.1
Other			(0.1)	(0.1)
Total restructuring and impairment charges	$ 44.5	$ 5.0	$ 2.4	$ 51.9

As part of our corporate goal to enhance our one company identity and to reflect more accurately our positioning in the marketplace, we completed a corporate identity review in the fourth quarter of 2006. We made a final determination in January 2007 that the trade name Noveon no longer would be used to describe the specialty chemicals business segment of our company and that its use would be discontinued except in connection with the consumer specialties product line. We acquired the rights to the Noveon trade name in June 2004 when we acquired Noveon International. At the time of acquisition, an appraised value was attached to the Noveon trade name. We calculated a pretax charge of $41.2 million ($25.4 million after-tax) to reduce the related asset to its estimated fair value. This charge was reflected in the fourth quarter of 2006 as we believed at that time we would more likely than not discontinue the use of the Noveon trade name, except in the limited context of the consumer specialties product line.

In September 2006, we entered into an agreement to sell the manufacturing facility located in Bromborough, United Kingdom. The sale closed in January 2007. In connection with the sale, we received net cash proceeds of $5.9 million and recorded a pretax gain of $2.9 million during the first quarter of 2007. The gain will be classified as a restructuring credit associated with closure of the facility. Production from the Bromborough facility was transferred to higher-capacity Lubrizol facilities in France and the United States. The sale of the facility will avoid approximately $3.0 million to $5.0 million in restructuring costs that would have been associated with demolition of the plant facilities on the site. On January 17, 2005, we announced our plans to phase-out production at the Bromborough facility by the end of 2006. At that time, we estimated that total restructuring costs, including employee severance and other plant closure costs (including planned demolition costs), would be approximately $15.0 million. Cumulative pretax charges of approximately $12.8 million were incurred through 2006, of which $6.7 million were incurred in 2006, to satisfy severance and retention obligations, plant dismantling, site restoration and other site environmental evaluation costs.

We have invested approximately $15.3 million in capital related to the Bromborough closure through December 31, 2006 for capacity upgrades in France and the United States. We expect to invest an additional $4.0 million related to these capacity upgrades through the first quarter of 2007.

In the first quarter of 2005, we decided to close two Lubrizol Advanced Materials performance coatings production facilities in the United States. One facility, located in Mountaintop, Pennsylvania, was closed in October 2005 and sold in January 2006. We recorded an additional $0.8 million in asset impairments and other exit costs and $0.6 million in severance obligations in 2006 relating to the other facility located in Linden, New Jersey, which was closed in the third quarter of

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2006. Additional asset impairment charges of $2.7 million were recorded in 2006, which primarily related to the planned closure of a performance coatings production line in the first quarter of 2007.

In addition, we expect these workforce reductions, facility closures and transfers of production to more efficient manufacturing locations to generate annual pretax savings of approximately $5.3 million for the Lubrizol Advanced Materials segment and approximately $12.0 million for the Lubrizol Additives segment. Approximately $8.4 million of these savings were realized in 2006.

The charges for these cost reduction initiatives and impairments are reported as a separate line item in the consolidated statements of income, entitled Restructuring and impairment charges and are included in the Total cost and expenses subtotal on the consolidated statements of income.

ANALYSIS OF OTHER ITEMS AND NET INCOME

(In Millions of Dollars)	2006	2005	$ Change	% Change
Other income - net	$ 8.5	$ 1.8	$ 6.7	*
Interest expense - net	79.3	97.0	(17.7)	(18%)
Income from continuing operations before income taxes	262.0	240.2	21.8	9%
Provision for income taxes	82.2	80.8	1.4	2%
Income from continuing operations	179.8	159.4	20.4	13%
Discontinued operations - net of tax	(76.2)	27.8	(104.0)	*
Net income	$ 103.6	$ 187.2	$ (83.6)	(45%)

* *Calculation not meaningful*

The increase in other income - net for 2006 compared to 2005 primarily was due to the favorable legal settlements of insurance and commercial matters of $10.4 million and an increase in the net gain on the sale of property of $1.3 million, partially offset by an increase in currency transaction losses of $2.4 million and an increase in the elimination of minority interest of $2.4 million due to higher profitability of our joint ventures.

The decrease in interest expense - net for 2006 compared to 2005 primarily was due to an increase in interest income of $12.3 million as a result of our increased cash and short-term investments from the divestiture proceeds and a decrease in interest expense of $5.4 million due to a reduction in our long-term debt balances.

Our effective tax rate was 31.4% in 2006 compared to 33.6% in 2005. The decrease in the effective tax rate primarily was due to the favorable provision impacts of foreign operations.

Primarily as a result of the above factors, income from continuing operations per diluted share was $2.59 in 2006 compared to $2.32 in 2005. Loss from discontinued operations per diluted share was $1.10 in 2006 compared to income from discontinued operations per diluted share of $0.40 in 2005. The loss from discontinued operations per diluted share of $1.10 in 2006 consisted of operating income of $0.01 per diluted share, excluding an $0.87 per diluted share impairment charge and a $0.24 per diluted share loss on the sale of divested businesses.

2005 RESULTS OF OPERATIONS COMPARED WITH 2004

Our 2005 revenues as compared to 2004, excluding the impact of acquisitions, increased primarily due to improvements in the combination of price and product mix, offset by a slight decrease in volume. The increased revenues partially were offset by higher raw material costs and higher utility costs. Primarily as a result of these factors and the impact of acquisitions, gross profit increased 22% in 2005 compared with 2004. Excluding the impact of acquisitions, gross profit increased 4% in 2005 compared to 2004.

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ANALYSIS OF REVENUES The changes in consolidated revenues are summarized as follows:

					Excluding the Impact of Acquisitions	
(In Millions of Dollars)	2005	2004	$ Change	% Change	$ Change	% Change
Net sales	$ 3,618.8	$ 2,860.5	$ 758.3	27%	$ 333.0	12%
Royalties and other revenues	3.4	3.9	(0.5)	(13%)	(0.5)	(13%)
Total revenues	$ 3,622.2	$ 2,864.4	$ 757.8	26%	$ 332.5	12%

The 2004 acquisitions contributed $425.3 million toward the increase in 2005 consolidated revenues compared with 2004. Acquisitions in 2004 included Noveon International and the hyperdispersants business purchased from Avecia.

Excluding the impact of acquisitions, the increase in consolidated revenues in 2005 compared to 2004 was due to a 12% increase in the combination of price and product mix.

ANALYSIS OF VOLUME - 2005 VS. 2004 Volume patterns vary in different geographic zones. The following table shows our 2005 volume by geographic zone as well as the changes compared with 2004:

	2005 Volume	% Change	Excluding the Impact of Acquisitions % Change
North America	46%	6%	(6%)
Europe	28%	8%	3%
Asia-Pacific / Middle East	21%	13%	8%
Latin America	5%	6%	2%
Total	100%	8%	

Segment volume variances by geographic zone, as well as the factors explaining the changes in segment revenues for 2005 compared with 2004, are contained under the Segment Analysis section.

ANALYSIS OF COSTS AND EXPENSES

(In Millions of Dollars)	2005	2004	$ Change	% Change
Cost of sales	$ 2,700.1	$ 2,104.6	$ 595.5	28%
Selling and administrative expenses	348.4	284.8	63.6	22%
Research, testing and development expenses	198.9	184.8	14.1	8%
Amortization of intangible assets	23.5	16.9	6.6	39%
Write-off of acquired in-process research and development		34.0	(34.0)	*

Restructuring and impairment charges	15.9	38.1	(22.2)	*
Total costs and expenses	$ 3,286.8	$ 2,663.2	$ 623.6	23%

* *Calculation not meaningful*

Cost of sales increased due to acquisitions, higher average raw material cost and higher manufacturing expenses. Excluding the impact of acquisitions, average raw material cost increased 18% in 2005 compared with 2004. The increase in the material costs during the latter half of 2005 largely was driven by supply disruptions caused by the U.S. Gulf coast hurricanes. Material cost, including acquisitions, also included inventory step-up adjustments associated with the increased valuation of inventory of $12.5 million in 2004 for the Noveon International and hyperdispersants acquisitions. The Noveon International portion of the inventory step-up adjustment was $9.8 million, or $0.11 per diluted share.

Total manufacturing expenses increased 19% (5% excluding the impact of acquisitions) in 2005 compared with 2004. Excluding the impact of acquisitions, the increase primarily was due to an increase in utility costs as well as an unfavorable currency impact. On a per-unit-sold basis, manufacturing costs increased 5% in 2005 compared to 2004, excluding the impact of acquisitions.

Gross profit increased $162.8 million, or 22% ($29.2 million, or 4%, excluding the impact of acquisitions), in 2005 compared with 2004. Excluding the impact of acquisitions, the increase primarily was due to higher average selling price, partially offset by higher unit average raw material cost and higher utility costs. Our 2005 gross profit percentage decreased to 25.4% (24.6% excluding the impact of acquisitions) compared to 26.4% in 2004. The decrease primarily was due to higher raw material costs outpacing our ability to raise selling prices sufficiently to sustain gross profit percentages.

Selling and administrative expenses increased $63.6 million, or 22% ($9.1 million, or 3%, excluding the impact of acquisitions), in 2005 compared with 2004. The increase in selling and administrative expenses, excluding the impact of acquisitions, primarily was due to an increase in salaries and incentive compensation expense, offset partially by non-recurring litigation expense of $1.9 million incurred in 2004.

Technology expenses, excluding the impact of acquisitions, decreased 3% in 2005 compared with 2004. The decrease primarily was due to the 2004 reduction in workforce. During 2005 and 2004, approximately 87% of our technology costs were incurred in company-owned facilities and approximately 13% were incurred at third-party facilities.

The increased amortization expense in 2005 compared with 2004 primarily was due to the Noveon International and hyperdispersants acquisitions in 2004. These two acquisitions resulted in an increase in gross amortizable intangible assets of approximately $320.3 million with useful lives ranging between 3 and 20 years.

We included a one-time, non-cash charge of $34.0 million, or $0.39 per share, in total costs and expenses in 2004 to write-off the estimated fair value of acquired in-process research and development (IPR&D) projects associated with the Noveon International acquisition. Costs to acquire IPR&D projects that have no alternative future use and that have not yet reached technological feasibility at the date of acquisition are expensed upon acquisition. We obtained appraisals to determine the estimated fair value of IPR&D projects. There were approximately nine projects acquired in the Noveon International transaction in several different product lines. The projects were at varying stages of completeness ranging from the early development stage to prototype testing at the time of acquisition. No further adjustments were made in 2005 to the valuation in connection with the completion of the Noveon International purchase accounting.

In 2005, we recorded restructuring and impairment charges aggregating $15.9 million, or $0.15 per diluted share, primarily related to the decision to close three manufacturing facilities, as well as other workforce reductions.

The components of the 2005 restructuring and impairment charges are detailed as follows:

(In Millions of Dollars)	Asset Impairments	Other Plant Exit Costs	Severance	Total
Lubrizol Advanced Materials plant closures and workforce reductions	$ 4.2	$ 1.0	$ 3.8	$ 9.0
Bromborough, U.K. closure	0.7	1.7	3.7	6.1
Corporate / other workforce reductions			0.7	0.7
Noveon International restructuring liabilities assumed			0.1	0.1
Total restructuring and impairment charges	$ 4.9	$ 2.7	$ 8.3	$ 15.9

In May 2005, we announced the reorganization of the Lubrizol Advanced Materials performance coatings product line. This product line includes businesses acquired from Noveon International as well as businesses included in our legacy operations. In connection with the reorganization, we eliminated 26 positions in North America and Europe. These reductions were completed during 2005 and resulted in a severance charge of $1.9 million in 2005.

In the first quarter of 2005, we made the decision and the announcement to close two Lubrizol Advanced Materials performance coatings production facilities in the United States. The aggregate restructuring charge recorded for these closures for the year ended December 31, 2005 was $6.6 million, comprised of $4.2 million in asset impairments, $0.9 million in exit costs and $1.5 million in severance costs. We recorded an impairment charge for both plants in the first quarter of 2005 to reduce the related assets to their estimated fair values. The estimated fair value of the assets was determined primarily from third-party appraisals. Production from these sites was transferred to other facilities in the United States. One facility, located in Mountaintop, Pennsylvania, was closed in October 2005 and sold in January 2006, while the other facility, located in Linden, New Jersey, was closed in the third quarter of 2006. These closures resulted in a workforce reduction of 62 employees. We also recorded European-related restructuring charges in the Lubrizol Advanced Materials segment of $0.4 million in severance costs and $0.1 million in other exit costs during the fourth quarter of 2005.

In December 2004, we decided to close the Lubrizol Additives manufacturing facility in Bromborough, United Kingdom. We announced this decision in January 2005. A $17.0 million impairment charge was recorded in December 2004 to reduce the related assets to their estimated fair values. Production phase-out of this site began in the third quarter of 2005 and was completed in the third quarter of 2006. During this phase-out, U.K. production was transferred to facilities in France and the United States. There were 70 employees impacted by this closure. The aggregate restructuring charge recorded for this closure through December 31, 2005 was $6.1 million. Total 2005 charges were comprised of $0.7 million in asset impairments, $1.7 million in exit costs and $3.7 million in severance costs.

In the second quarter of 2005, we continued a process of identifying further opportunities to increase efficiency and productivity, reduce costs and support our integration strategy of the Noveon International acquisition. As a result, we reduced headcount in the general and administrative area of our Ohio headquarters. Through these restructuring efforts, we eliminated seven positions resulting in a severance-related charge of $0.7 million in 2005. All of the affected employees had left their positions by June 30, 2005 and the remaining personnel-related costs were paid by the end of 2006.

In addition, we realized approximately $18.3 million of pretax savings in 2005 relating to the 2004 restructuring programs.

The charges for these cost reduction initiatives and impairments are reported as a separate line item in the consolidated income statements, entitled Restructuring and impairment charges and are included in the Total cost and expenses subtotal on the consolidated statements of income.

ANALYSIS OF OTHER ITEMS AND NET INCOME

					Excluding the Impact of Acquisitions	
(In Millions of Dollars)	2005	2004	$ Change	% Change	$ Change	% Change
Other income - net	$ 1.8	$ 5.6	$ (3.8)	*	$ (4.5)	*
Interest expense - net	97.0	72.3	24.7	*	(8.8)	*
Income from continuing operations before income taxes	240.2	134.5	105.7	79%	86.8	65%
Provision for income taxes	80.8	49.0	31.8	65%	28.0	57%
Income from continuing operations	159.4	85.5	73.9	86%	58.8	69%
Discontinued operations - net of tax	27.8	6.3	21.5	*	8.7	*
Net income	$ 187.2	$ 91.8	$ 95.4	104%	$ 67.5	74%

* *Calculation not meaningful*

The change in other income - net in 2005 predominantly was due to the non-recurring 2004 gain of $6.4 million on a currency forward contract to purchase pound sterling related to the acquisition of the hyperdispersants business. We secured the forward contract in December 2003 and completed the acquisition at the end of January 2004.

The increase in interest expense - net in 2005, compared with 2004, primarily was due to the Noveon International pretax acquisition-related financing costs of $82.0 million, or $0.77 per diluted share, in 2005 compared to $56.7 million, or $0.66 per diluted share, in 2004. These costs were comprised of the interest incurred relating to the permanent financing as well as interest on the bridge loan and assumed Noveon International debt not repaid at the time of the acquisition of $42.6 million, amortization of bridge loan fees of $11.2 million and termination of an interest rate swap of $2.9 million. We obtained permanent financing for the Noveon International acquisition in the third quarter of 2004.

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We had an effective tax rate of 33.6% in 2005 as compared with 36.4% in 2004. Items driving the decrease in tax rate included reduced tax costs associated with actual and planned foreign dividends, the more favorable impact of foreign tax rate differences and higher U.S. tax benefits on exports. These factors partially were offset by increased state income taxes and lower non-taxable currency gains as compared to 2004.

As of December 31, 2005, we had U.S. net operating loss carryforwards (NOLs) of $178.4 million. These NOLs are a combination of NOLs acquired from Noveon International, as well as those generated in 2004 primarily as a result of transaction-related costs.

Primarily as a result of the above factors, our income from continuing operations per diluted share was $2.32 in 2005 compared to $1.53 in 2004. Income from discontinued operations per diluted share was $0.40 in 2005 compared to $0.11 in 2004. Income from discontinued operations in 2005 included $0.28 per diluted share of operating income from the FIIS and A&I businesses, $0.10 per diluted share related to LPS and ECS, of which $0.04 was attributable to the gain on sale, and $0.02 per diluted share in operating income related to the Telene resins business. Restructuring and impairment charges recorded in 2005 reduced earnings by $0.15 per diluted share. Earnings in 2004 included a one-time write-off for IPR&D projects from the Noveon International acquisition of $0.38 per diluted share, a purchase adjustment associated with the increased valuation of Noveon International-acquired inventory of $0.11 per diluted share, restructuring charges of $0.46 per diluted share, acquisition-related financing costs of $0.66 per diluted share and a gain on a foreign currency forward contract of $0.07 per diluted share.

SEGMENT ANALYSIS

We primarily evaluate performance and allocate resources based on segment operating income, defined as revenues less expenses identifiable to the product lines included within each segment, as well as projected future returns. Segment operating income will reconcile to consolidated income from continuing operations before income taxes by deducting corporate expenses and corporate other income (expense) that are not attributable to the operating segments, restructuring and impairment charges and net interest expense.

The proportion of consolidated revenues and segment operating income attributed to each segment was as follows:

	2006	2005	2004
Revenues:			
Lubrizol Additives	64%	63%	70%
Lubrizol Advanced Materials	36%	37%	30%
Segment Operating Income:			
Lubrizol Additives	64%	64%	75%
Lubrizol Advanced Materials	36%	36%	25%

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OPERATING RESULTS BY SEGMENT

(In Millions of Dollars)	2006	2005	2004	2006 vs. 2005 $ Change	2006 vs. 2005 % Change	2005 vs. 2004 Excluding the Impact of Acquisitions $ Change	2005 vs. 2004 Excluding the Impact of Acquisitions % Change
Revenues:							
Lubrizol Additives	$ 2,600.5	$ 2,280.0	$ 1,998.6	$ 320.5	14%	$ 281.4	14%
Lubrizol Advanced Materials	1,440.3	1,342.2	865.8	98.1	7%	51.1	6%
Total	$ 4,040.8	$ 3,622.2	$ 2,864.4	$ 418.6	12%	$ 332.5	12%
Gross Profit:							
Lubrizol Additives	$ 578.0	$ 527.7	$ 505.5	$ 50.3	10%	$ 23.0	5%
Lubrizol Advanced Materials	413.2	391.0	250.4	22.2	6%	6.2	2%
Total	$ 991.2	$ 918.7	$ 755.9	$ 72.5	8%	$ 29.2	4%
Operating Income:							
Lubrizol Additives	$ 303.0	$ 263.3	$ 238.2	$ 39.7	15%	$ 25.9	11%
Lubrizol Advanced Materials	167.6	150.9	78.6	16.7	11%	18.1	23%
Total	$ 470.6	$ 414.2	$ 316.8	$ 56.4	14%	$ 44.0	14%

LUBRIZOL ADDITIVES SEGMENT

2006 COMPARED WITH 2005 Revenues increased 14% in 2006 when compared to 2005. The increase primarily was due to improvement in the combination of price and product mix, while a slight increase in volume was offset by a slight unfavorable impact of currency.

Volume patterns vary in different geographic zones. The following table shows our volume by geographic zone in 2006 as well as the changes compared with 2005:

	2006 Volume	% Change
North America	38%	1 %
Europe	30%	(3%)
Asia-Pacific / Middle East	26%	2 %
Latin America	6%	6 %
Total	100%	

Volume increased slightly in 2006 compared to 2005; however, excluding the impact of nonrecurring, temporary business gains in 2005, volume increased 2% in 2006 compared to 2005.

The decrease in volume in Europe was due in part to a change in a customer sourcing from Europe to North America. The volume growth in the Asia-Pacific / Middle East region primarily resulted from growth in China, which represents our third largest country in terms of volume sold despite the fact that a majority of the 2005 temporary business gains occurred in this region. The volume growth in Latin America primarily was driven by stronger demand by our major international customers.

Segment gross profit increased 10% in 2006 compared to 2005 as we continued to recover from margin erosion that occurred in 2005 and prior years. The Lubrizol Additives segment implemented a series of price increases in 2006 and 2005 in response to continued raw material and utility cost increases. The effective dates of the selling price increases varied by geographic zone. The gross profit increase primarily was due to an improvement in the combination of price and product mix partially offset by a 19% increase in average material cost in 2006 as compared to 2005.

Manufacturing costs on a per-unit-sold basis increased 3% in 2006 compared to 2005. The increase was due in part to higher utility costs as well as higher operating supplies and outside services partially offset by lower depreciation expense, employee benefits and a reclassification of certain expenses from manufacturing to STAR due to a change in organization structure in our European operations. In addition, manufacturing costs were impacted favorably by approximately $5.2 million in

2006 as we curtailed production activity at our Bromborough, U.K. plant in accordance with our previously announced timetable to close this facility.

The gross profit percentage declined to 22.3% in 2006 compared with 23.2% in 2005. The decline in gross profit percentage primarily was due to continuing raw material cost increases throughout most of 2006 outpacing the timing of price increases.

STAR expenses increased 7% in 2006 compared to 2005. This increase primarily was due to an increase in selling and administrative expenses of $14.8 million. The higher selling and administrative costs primarily resulted from the impact of reclassifying to STAR certain expenses that previously were classified as manufacturing resulting from a change in organization structure in our European operations, increases in base and variable compensation and a change in the timing of annual salary increases. The balance of the change in STAR expenses was due to an increase in technical expenses of $3.5 million primarily associated with technical programs within our driveline and industrial oils additives packages.

Other income was impacted favorably by $11.7 million primarily due to legal settlements of insurance and commercial matters as well as the gain on sale of certain properties.

Segment operating income (revenues less expenses attributable to the product lines aggregated within each segment) increased 15% in 2006 compared to the prior year due to the factors discussed above.

2005 COMPARED WITH 2004 Segment revenues increased 14% in 2005 compared to 2004, due to a 12% improvement from the combination of price and product mix, and a 1% increase in both volume and currency.

Volume patterns vary in different geographic zones. The following table shows our volume by geographic zone in 2005 as well as the changes compared with 2004:

	2005 Volume	% Change
North America	38%	(5 %)
Europe	31%	3 %
Asia-Pacific / Middle East	25%	9 %
Latin America	6%	2 %
Total	100%	1 %

Total volume increased 1% in 2005 compared to 2004. Our results reflect some spot business or temporary business gains during 2005. This increase partially was offset by the final piece of lost business of a major international customer in the second half of 2004 and the impact on volumes of the higher concentration associated with the new passenger car technical standard GF-4 as compared to GF-3. Excluding these three specific factors, volume increased 3% globally and 1% in North America compared to 2004.

Higher volume in Europe in 2005 compared with 2004 primarily was due to increases in our engine additives product line due to improved product mix and market share gains. The Asia-Pacific / Middle East region benefited from overall expanded growth in that market, particularly China, as well as spot business gains. Excluding the spot business gains, volumes increased 5% in Asia-Pacific / Middle East.

The Lubrizol Additives segment implemented a series of price increases in 2005 in response to continued raw material cost increases as well as higher prices for natural gas and electricity used in our plants. The effective dates of the price increases varied by geographic zone.

Segment gross profit increased $23.0 million, or 5%, in 2005 compared to 2004. The increase primarily was due to the cumulative impact of the selling price increases as well as an increase in volume, largely offset by higher average raw material cost and to a lesser extent, higher utility costs. In 2005, average unit raw material cost increased 22% compared to 2004. Manufacturing expenses increased 3% in 2005; however, on a per-unit-sold basis, manufacturing expenses increased only 2% as compared to the prior year. The increase in manufacturing expenses was driven by higher utilities and maintenance costs in 2005 partially offset by lower employee benefit expense and lower environmental accruals.

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Gross profit as a percentage of net sales for the segment was 23.2% for 2005 compared with 25.3% in 2004. The decline primarily was due to the time lag between the effective date of selling price increases in the wake of continuing raw material cost increases and raw material costs rising proportionally faster than selling prices.

STAR expenses decreased 1% in 2005 compared to 2004, primarily due to lower technical expenses of $3.1 million. The decrease in technical expenses primarily was due to lower outside technical expenses impacted by delays in the industry specifications for new lubricant additive programs.

Segment operating income increased 11% in 2005 compared with 2004 due to the factors discussed above.

LUBRIZOL ADVANCED MATERIALS SEGMENT

2006 COMPARED WITH 2005 Revenues for the Lubrizol Advanced Materials segment increased 7% in 2006 compared with 2005. The increase was due to a 6% increase in volume and a 1% improvement in the combination of price and product mix. The improvement in the combination of price and product mix primarily occurred in our Noveon consumer specialties product line.

Volume patterns vary in different geographic zones. The following table shows our volume by geographic zone in 2006 as well as the changes compared with 2005:

	2006 Volume	% Change
North America	65%	1%
Europe	18%	4%
Asia-Pacific / Middle East	13%	28%
Latin America	4%	32%
Total	100%	6%

Our engineered polymers and Noveon consumer specialties product lines both had increases in volume in North America in 2006 compared to 2005. The increase in our engineered polymers product line was due to increased customer demand in both our Estane® thermoplastic polyurethane business (Estane) and our TempRite® engineered polymers business (TempRite). TempRite benefited from continued conversions from metals to plastics. The increase in the Noveon consumer specialties product line primarily was due to increased customer demand in our personal care and home care business and tolling sales to the buyer of our FIIS business. Our performance coatings product line had a slight decrease in volume in North America in 2006 compared to 2005, which we believe primarily was due to the continued migration of the textile industry from North America to China.

Our engineered polymers and performance coatings product lines had increases in Europe in 2006 compared to 2005. The increase in our performance coatings product line primarily was due to customer demand and market share gains in the textiles market and customer demand in the paints and coatings market. The increase in our engineered polymers product line was due to market-share gains in our Estane business and business gains in our TempRite business resulting from continued conversions from metals to plastics. Our Noveon consumer specialties product line had a decrease in volume in Europe in 2006 compared to 2005 primarily attributable to our AMPS® specialty monomers business. The increase in Asia-Pacific / Middle East volume for 2006 primarily was due to higher customer demand and market-share gains in both our Estane business and performance coatings product line, predominately in the textiles market, and higher customer demand in our Noveon consumer specialties product line. We also experienced higher customer demand in the TempRite business, particularly in the Middle East and India.

Segment gross profit increased $22.2 million, or 6%, in 2006 compared to 2005. The increase in segment gross profit in 2006 primarily was the result of higher revenues due to the increase in volume and improvement in the combination of price and product mix partially offset by higher average raw material cost and manufacturing costs. Average raw material cost increased 4% in 2006 compared to 2005. Manufacturing costs primarily were higher due to increased utility costs, the impact of reclassifying certain expenses from STAR to manufacturing as a result of a change in organizational structure in our European operations and higher volume.

The gross profit percentage for this segment was 28.7% in 2006 compared to 29.1% in 2005. The decrease in gross profit percentage in 2006 was due to higher average raw material cost partially offset by an improvement in the combination of price and product mix.

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STAR expenses increased $9.0 million, or 4%, in 2006 compared to 2005. The increase in STAR was due to higher salaries and incentive compensation and increased hiring to support growth initiatives partially offset by the impact of reclassifying certain expenses from STAR to manufacturing as a result of a change in organizational structure in our European operations and reductions in bad debt expense.

Segment operating income increased $16.7 million in 2006 compared to 2005. The increase in segment operating income primarily was due to the increase in segment gross profit as described above, partially offset by the increase in STAR expenses.

2005 COMPARED WITH 2004 In 2005, revenues for the Lubrizol Advanced Materials segment increased 55% compared with 2004 primarily due to the 2004 acquisitions of Noveon International and the hyperdispersants business. Excluding the impact of acquisitions, segment revenues increased 6% in 2005 compared with 2004 due to a 10% improvement in the combination of price and product mix partially offset by a 4% decrease in volume. The improvements in price and product mix occurred relatively evenly across all three of our product lines as we had implemented price increases to offset rising raw material costs.

Volume patterns vary in different geographic zones. The following table shows our volume by geographic zone in 2005 as well as the changes compared with 2004:

	2005 Volume	% Change	Excluding the Impact of Acquisitions % Change
North America	68%	28%	(7%)
Europe	19%	40%	2%
Asia-Pacific / Middle East	10%	44%	(3%)
Latin America	3%	32%	
Total	100%	31%	(4%)

Excluding the impact of acquisitions, all three product lines showed volume decreases in North America. These decreases primarily were due to our exiting certain low-margin business, deterioration in the textiles market and some market-share loss as a result of competitive activity in response to our price increases. The volume increase in Europe primarily was in our Noveon consumer specialties product line and was due to increased sales in our AMPS specialty monomers business.

Segment gross profit increased $140.5 million, or 56% (increased $6.2 million, or 2%, excluding the impact of acquisitions), in 2005 compared with 2004. Excluding the impact of acquisitions, the increase in segment gross profit in 2005 resulted from higher revenues due to an improvement in the combination of price and product mix partially offset by lower volume and higher raw material costs and utility expenses. Average raw material cost increased 12% in 2005 compared with 2004. Raw material cost for 2004 included the impact of $7.5 million of inventory step-up amortization from acquisition accounting. Excluding the impact of the step-up in 2004, average raw material cost increased 13% in 2005 compared with 2004. Manufacturing expenses increased 9% in 2005 compared with 2004 primarily due to higher spending related to utilities. Average unit manufacturing expense increased 14% due to the combination of lower volumes and higher utility and operating expenses.

Gross profit as a percentage of net sales was 29.1% (28.0% excluding the impact of acquisitions) in 2005 compared with 29.0% in 2004. Excluding the impact of the inventory step-up amortization, the gross profit percentage for 2004 was 29.8%. The decrease in gross profit percentage in 2005 was due to higher average raw material cost and higher manufacturing costs partially offset by an improvement in the combination of price and product mix.

STAR expenses increased $62.9 million, or 40%, in 2005 (decreased $11.4 million, or 7%, excluding the impact of acquisitions) compared with 2004. Excluding the impact of acquisitions, the decrease in STAR expenses primarily was due to reduced corporate administrative and technical services provided to the segment, the consolidation of some segment administrative functions into corporate functions and savings from a restructuring in our performance coatings product line.

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Segment operating income increased $72.3 million in 2005 (increased $18.1 million, excluding the impact of acquisitions) compared with segment operating income of $78.6 million in 2004. Excluding the impact of acquisitions, the increase in segment operating income primarily was due to the increase in segment gross profit and lower STAR expenses.

RETURN ON AVERAGE SHAREHOLDERS EQUITY

Return on average shareholders equity was 6.4% in 2006, 12.2% in 2005 and 7.5% in 2004. The return on average shareholders equity is calculated as current year net income divided by the rolling 12-month average of shareholders equity for the current and prior years. The earnings (loss) impact of discontinued operations, restructuring and impairment charges and the write-off of acquired IPR&D in 2004 lowered the return on average shareholders equity by approximately 5.8%, 1.0% and 3.8% in 2006, 2005 and 2004, respectively.

WORKING CAPITAL, LIQUIDITY AND CAPITAL RESOURCES

SELECTED MEASURES OF LIQUIDITY AND CAPITAL RESOURCES The following table summarizes our financial performance indicators of liquidity:

	2006	2005
Cash and short-term investments (in millions of dollars)	$ 575.7	$ 262.4
Working capital (in millions of dollars)	$ 1,201.9	$ 906.6
Current ratio	2.9	2.4
Debt as a % of capitalization	47.8%	51.8%
Net debt as a % of capitalization	36.5%	47.5%

SUMMARY OF CASH FLOWS The following table summarizes the major components of cash flows:

(In Millions of Dollars)	2006	2005	2004
Cash provided by (used for):			
Operating activities	$ 334.8	$ 362.2	$ 331.6
Investing activities	151.4	(106.8)	(1,088.8)
Financing activities	(183.9)	(312.8)	808.5
Effect of exchange-rate changes on cash	11.0	(16.1)	25.9
Net increase (decrease) in cash and short-term investments	$ 313.3	$ (73.5)	$ 77.2

OPERATING ACTIVITIES

The decrease in cash provided by operating activities in 2006 compared with 2005 primarily relates to a decrease in payables and accrued expenses, including the payment of accounts payable of approximately $27.0 million that were retained at the closing of the FIIS divestiture and unfavorable timing of accounts payable disbursements in 2006 compared to 2005. In addition, we experienced higher inventory levels due to increased raw material costs, as well as an increase in finished goods inventory caused by lower year-end shipment volumes.

We manage our levels of inventories and accounts receivable on the basis of average days sales in inventory and average days sales in receivables. We establish our target for accounts receivable by taking into consideration the weighted average of our various terms of trade for each segment. We establish our target for days sales in inventory with the goal of minimizing our investment in inventories while at the same time ensuring adequate supply for our customers. Despite the increase in working capital due to higher average selling price and higher inventory costs, we improved our days outstanding in accounts receivable and days in inventory.

INVESTING ACTIVITIES

Our capital expenditures in 2006 were $130.9 million, as compared with $136.7 million and $133.2 million in 2005 and 2004, respectively. Capital expenditures for the Lubrizol Additives segment primarily are made to maintain existing manufacturing capacity. Approximately 30% of the capital expenditures in the Lubrizol Advanced Materials segment

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related to increasing capacity. In 2007, we estimate annual capital expenditures will be approximately $175.0 million to $180.0 million. The higher level of estimated capital expenditures in 2007 is driven by our plans to build production capacity for our Lubrizol Advanced Materials product lines in China, North America and Europe to meet growing demand, as well as to bring both segments onto a common information systems platform.

The sales of FIIS and A&I were completed on May 1, 2006 and May 23, 2006, respectively. In consideration for these divested businesses, we received net cash proceeds of approximately $254.8 million and $10.4 million, respectively. The FIIS sale resulted in a taxable gain, which was offset by our remaining net operating loss carryforwards. The sale of Telene was completed in February 2006 for net cash proceeds of $6.2 million.

FINANCING ACTIVITIES

Cash used for financing activities of $183.9 million in 2006 primarily consisted of repayments of long-term debt and the payment of dividends, partially offset by proceeds from the exercise of stock options. This compares to $312.8 million used for financing activities in 2005, which primarily consisted of net repayments of long-term debt of $280.4 million and the payment of dividends, partially offset by borrowings under our euro revolving credit facility and proceeds from the exercise of stock options.

Other than the 85.0 million outstanding under our euro revolving credit facility, we have no other debt that is prepayable without incurring a penalty.

CAPITALIZATION AND CREDIT FACILITIES

At December 31, 2006, our total debt outstanding of $1,541.7 million consisted of 67% fixed-rate debt and 33% variable-rate debt, including $400.0 million of fixed-rate debt that effectively has been swapped to a variable rate. Our weighted-average interest rate as of December 31, 2006 was approximately 5.8%.

Our net debt to capitalization ratio at December 31, 2006 was 36.5%. Net debt represents total short-term and long-term debt, excluding original issue discounts and unrealized gains and losses on derivative instruments designated as fair-value hedges of fixed-rate debt, reduced by cash and short-term investments. Capitalization is calculated as shareholders equity plus net debt. Total debt as a percent of capitalization was 47.8% at December 31, 2006.

Our ratio of current assets to current liabilities was 2.9 and 2.4 at December 31, 2006 and 2005, respectively.

On September 20, 2006, we amended our five-year unsecured committed U.S. bank credit agreement to reduce the revolving credit facility from $500.0 million to $350.0 million and extend the maturity date to September 2011. In addition, as of September 20, 2006, our direct and indirect domestic subsidiaries were released as guarantors under the credit agreement, and we no longer are subject to any investment or acquisition restrictions. This credit facility allows us to borrow at variable rates based upon the U.S. prime rate or LIBOR plus a specified credit spread. As of December 31, 2006, we had no outstanding borrowings under this agreement.

In addition, at December 31, 2006, two of our wholly owned foreign subsidiaries had a 250.0 million revolving credit facility that matures in September 2010. This credit agreement permits these foreign subsidiaries to borrow at variable rates based on EURIBOR plus a specified credit spread. We have guaranteed all obligations of the borrowers under the credit agreement. On September 20, 2006, we amended this credit agreement such that we no longer are subject to any investment or acquisition restrictions. No other terms or conditions of the agreement were modified. As of December 31, 2006, we had outstanding borrowings of 85.0 million under this agreement.

The cash and short-term investments balance of $575.7 million at December 31, 2006 will be used to fund ongoing operations, pay down debt, pursue acquisition opportunities and buy back shares sufficient to offset future dilution from our stock-based incentive compensation plans. Given the call premium on our long-term debt, it is unlikely that we will reduce debt significantly before our next scheduled maturity in late 2008. Therefore, it is possible that we will carry excess cash until our next scheduled maturity.

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CONTRACTUAL CASH OBLIGATIONS

The following table shows our contractual cash obligations under debt agreements, leases, non-cancelable purchase commitments and other long-term liabilities at December 31, 2006:

	Payments Due by Period				
(In Millions of Dollars)	Total	2007	2008 - 2009	2010 - 2011	2012 and After
Total debt (1)	$ 1,549.1	$ 3.7	$ 582.6	$ 112.7	$ 850.1
Interest (2)	954.6	80.9	150.1	103.0	620.6
Operating leases	62.3	17.1	23.0	13.6	8.6
Non-cancelable purchase commitments (3)	178.0	77.9	86.6	9.2	4.3
Other long-term liabilities (4)(5)	90.8	66.1	8.6	0.6	15.5
Total contractual cash obligations	$ 2,834.8	$ 245.7	$ 850.9	$ 239.1	$ 1,499.1

(1) Total debt includes both the current and long-term portions of debt as reported in Note 7 to the consolidated financial statements, excluding original issue discounts and unrealized gains on derivative instruments designated as fair-value hedges of fixed-rate debt.

(2) Represents estimated contractual interest payments for fixed-rate debt only. We are not able to estimate reasonably the cash payments for interest associated with variable-rate debt

due to the significant estimation required relating to both market interest rates as well as projected principal payments.

(3) Non-cancelable purchase commitments primarily include raw materials purchased under take-or-pay contracts, drumming, warehousing and service contracts, utility purchase agreements, terminal agreements and toll processing arrangements.

(4) Other long-term liabilities disclosed in the table represent long-term liabilities reported in our consolidated balance sheet at December 31, 2006 under noncurrent liabilities, excluding pension, postretirement, postemployment, environmental and other non-contractual liabilities.

(5)

We are required to make minimum contributions to our U.S. defined benefit pension plans pursuant to the minimum funding requirements of the Internal Revenue Code of 1986, as amended, and the Employee Retirement Income Security Act of 1974, as amended. Funding requirements for plans outside the United States are subject to applicable local regulations. In 2007, we expect to make employer contributions of approximately $59.5 million to the qualified plans to satisfy these minimum statutory funding requirements. In 2007, we expect to make payments of approximately $1.8 million relating to our unfunded pension plans. The expected payments associated with the unfunded plans represent an actuarial estimate of future assumed payments based upon retirement and payment patterns. Actual amounts paid could differ from this estimate. In addition, non-pension postretirement benefit payments are expected to approximate $4.8 million in 2007. We have included these expected contributions of $66.1 million in the above table. Due to uncertainties regarding significant assumptions involved in estimating future required contributions to our defined benefit pension and other plans, such as interest rate levels, the amount and timing of asset returns and future restructurings, if any, we are not able to reasonably estimate our contributions beyond 2007.

In addition, at December 31, 2006, we had $45.7 million of contingent obligations under standby letters of credit issued in the ordinary course of business to financial institutions, customers and insurance companies to secure short-term support for a variety of commercial transactions, insurance and benefit programs.

We had $1,541.7 million of debt outstanding at December 31, 2006 compared to $1,670.8 million outstanding at December 31, 2005. Our total debt as a percent of capitalization has decreased from 51.8% at December 31, 2005 to 47.8% at December 31, 2006. We believe our future operating cash flows will be sufficient to cover our debt repayments, other contractual obligations, capital expenditures and dividends. In addition, we have untapped borrowing capacity that can provide us with additional financial resources. We currently have a shelf registration statement filed with the Securities and Exchange Commission (SEC) under which $359.8 million of debt securities, preferred shares or common shares may be issued. In addition, as of December 31, 2006, we maintained cash and short-term investment balances of $575.7 million and had $304.3 million available under our U.S. revolving credit facility and 165.0 million available under our euro revolving credit facility.

GUARANTEES

On May 1, 2006, we sold the FIIS business to SPM Group Holdings, LLC, now known as Emerald Performance Materials, LLC (Emerald). As a result of the sale, Emerald became responsible for a supplier contract with SK Corporation (SK). We have provided a guarantee to SK for the timely performance of Emerald s payment obligations. SK may make a demand for payment of outstanding obligations under this guarantee, which extends to January 31, 2008, provided they are unable to collect payment from Emerald using commercially reasonable efforts. The guarantee is revocable by us upon 60 days prior written notice. Because of the existing revocation clause, we estimate that the maximum liability under the guarantee would be approximately $15.2 million. However, we believe that it is highly unlikely that an event would occur requiring us to pay any monies pursuant to the guarantee. Accordingly, no liability has been reflected in our consolidated balance sheet at December 31, 2006.

INDEMNIFICATIONS

In connection with the sale of the FIIS business, we have provided indemnifications to Emerald with respect to the business sold. These indemnifications have been associated with the price and quantity of raw material purchases, permit costs, costs incurred due to the inability to obtain permits and environmental matters. We believe that losses incurred in any of these matters would not have a material effect on our business, financial condition or results of operations. For those indemnification agreements where a payment by us is probable and estimable, a liability has been recorded as of December 31, 2006.

CRITICAL ACCOUNTING POLICIES

The preparation of financial statements and related disclosures in accordance with accounting principles generally accepted in the United States of America requires us to make judgments, assumptions and estimates at a specific point in time that affect the amounts reported in the accompanying consolidated financial statements and related notes. In preparing these financial statements, we have utilized available information including our past history, industry standards and the current economic environment, among other factors, in forming our estimates and judgments of certain amounts included in the consolidated financial statements, giving due consideration to materiality. It is possible that the ultimate outcome as anticipated by management in formulating our estimates inherent in these financial statements may not materialize. Application of the critical accounting policies described below involves the exercise of judgment and the use of assumptions as to future uncertainties and, as a result, actual results could differ from these estimates. In addition, other companies may utilize different estimates, which may impact the comparability of our results of operations to similar businesses.

ACCOUNTING FOR RESERVES AND CONTINGENCIES

Our accounting policies for reserves and contingencies cover a wide variety of business activities, including reserves for potentially uncollectible receivables, slow-moving or obsolete inventory, legal and environmental exposures and tax exposures. We accrue these reserves when our assessments indicate that it is probable that a liability has been incurred or an asset will not be recovered and an amount can be reasonably estimated. We review these estimates quarterly based on currently available information. Actual results may differ from our estimates and our estimates may be revised upward or downward, depending upon the outcome or changed expectations based on the facts surrounding each exposure. We discuss annually with the audit committee of our board of directors our reserves and contingencies, as well as our policies and processes for evaluating them.

ACCOUNTING FOR SALES DISCOUNTS AND REBATES

Sales discounts and rebates are offered to certain customers to promote customer loyalty and to encourage greater product sales. These rebate programs provide that upon the attainment of pre-established volumes or the attainment of revenue milestones for a specified period, the customer receives credits against purchases. We estimate the provision for rebates based upon the specific terms in each agreement at the time of shipment and an estimate of the customer s achievement of the respective revenue milestones. Customer claims, returns and allowances and discounts are accrued based upon our history of claims and sales returns and allowances. The estimated provisions significantly could be affected if future occurrences and claims differ from these assumptions and historical trends.

DETERMINATION OF NET PERIODIC PENSION COST

Each year we review with our actuaries the actuarial assumptions used in the determination of net periodic pension cost, as prescribed by SFAS No. 87, Employers Accounting for Pensions. The determination of net periodic pension cost is based upon a number of actuarial assumptions. The two most critical assumptions are the expected return on plan assets and the

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discount rate for determining the funded status. Other assumptions include the rate of compensation increase and demographic factors such as retirement age, mortality and turnover. We review the critical assumptions for our U.S. pension plans with the audit committee of our board of directors. Our net periodic pension cost for all pension plans was $52.9 million in 2006, $43.5 million in 2005 and $37.7 million in 2004. The net periodic pension cost included a settlement loss of $2.9 million, $0.3 million and $7.7 million in 2006, 2005 and 2004, respectively. In accordance with generally accepted accounting principles, actual results that differ from the assumptions are accumulated and amortized over future periods and, therefore, affect expense recognized and obligations recorded in future periods.

In developing our assumption for the expected long-term rate of return on plan assets, we considered historical returns and the future expectations for returns for each asset class, as well as the target asset allocation of the pension portfolio. In 2006, we lowered our assumption for the U.S. pension plans by 25 basis points to 8.25% (7.48% on a weighted-average basis for all plans) based on our investment mix and projected market conditions. We believe 8.25% represents a reasonable return that could be achieved over the long term using our current asset allocation. At December 31, 2006, our U.S. pension plans assets had an investment mix that approximated 73% in equity securities and 27% in debt securities.

A change in the rate of return of 100 basis points would have the following effects on 2007 net periodic pension cost:

	100 Basis Point	
(In Millions of Dollars)	Increase	Decrease
U.S. pension plans	$ (2.7)	$ 2.7
International pension plans	(1.9)	1.9
All pension plans	$ (4.6)	$ 4.6

The selection of a discount rate for pension plans is required to determine the value of future pension obligations and represents our best estimate of our cost in the marketplace to settle all pension obligations through annuity purchases. We determined the discount rate based upon current market indicators, including yields from dedicated bond portfolios that provide for a general matching of bond maturities with the projected benefit cash flows from our plans. The dedicated bond portfolios consist of non-callable corporate bonds that are at least AA- quality. The 2006 year-end discount rate assumption for our U.S. pension plans was set at 6.25%, which is an increase from 5.75% used in 2005. On a worldwide basis, the 2006 weighted-average discount rate utilized increased to 5.63% from 5.25% used in 2005.

A change in the discount rate of 100 basis points would have the following effects on 2007 net periodic pension cost:

	100 Basis Point	
(In Millions of Dollars)	Increase	Decrease
U.S. pension plans	$ (3.0)	$ 7.0
International pension plans	(5.3)	3.6
All pension plans	$ (8.3)	$ 10.6

The accumulated benefit obligation for all pension plans worldwide exceeds the value of plan assets by $83.3 million. This represents a $44.3 million improvement in funded status from the $127.6 million in the total unfunded accumulated benefit obligation reported in 2005. The accumulated benefit obligation exceeded the plan assets for the U.S. pension plans by $30.3 million and the non-U.S. plans by $53.0 million in 2006. The primary driver behind the $44.3 million decrease in the unfunded benefit obligations was a result of favorable investment returns during 2006. Changes in pension plan assumptions are expected to decrease pension expense for most pension plans worldwide in 2007. The 2007 pension expense is expected to be approximately $42.7 million, excluding the impact of any settlement charges. The expected decrease in pension expense in 2007, excluding the impact of settlement charges, primarily is due to an increase in expected returns on assets due to the increase in fair value of plan assets at December 31, 2006, a reduction in the amortization of actuarial losses and the increase in the discount rate for all plans, offset by an increase in interest cost associated with an increase in the projected benefit obligation.

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DETERMINATION OF POSTRETIREMENT BENEFIT COST

Annually, we review with our actuaries the key economic assumptions used in calculating postretirement benefit cost as prescribed by SFAS No. 106, Employers Accounting for Postretirement Benefits Other than Pensions. Postretirement benefits include health care and life insurance plans. The determination of postretirement benefit cost is based upon a number of actuarial assumptions, including the discount rate for determining the accumulated postretirement benefit obligation, the assumed health care cost trend rates and the ultimate health care trend rate. Except for the U.S. plans, the same discount rate selected for the pension plans generally is used for calculating the postretirement benefit obligation by country. Net non-pension postretirement benefit (credit) cost was ($0.1) million in 2006, $3.4 million in 2005 and $6.8 million in 2004.

A change in the discount rate of 100 basis points would have the following effects on 2007 postretirement benefit cost:

	100 Basis Point	
(In Millions of Dollars)	Increase	Decrease
U.S. postretirement plans	$ (0.4)	$ 0.4
International postretirement plans	(0.3)	0.4
All postretirement plans	$ (0.7)	$ 0.8

A change in the assumed health care cost trend rate of 100 basis points would have the following effects on 2007 postretirement benefit cost:

	100 Basis Point	
(In Millions of Dollars)	Increase	Decrease
U.S. postretirement plans	$ 1.1	$ (1.0)
International postretirement plans	0.7	(0.5)
All postretirement plans	$ 1.8	$ (1.5)

ACCOUNTING FOR BUSINESS COMBINATIONS

We allocate the purchase price of business combinations to assets acquired and liabilities assumed based on their relative fair value at the date of acquisition pursuant to the provisions of SFAS No. 141, Business Combinations. In estimating the fair value of the tangible and intangible assets and liabilities acquired, we consider information obtained during our due diligence process and utilize various valuation methods including market prices, where available, appraisals, comparisons to transactions for similar assets and liabilities and present value of estimated future cash flows. We are required to make subjective estimates in connection with these valuations and allocations.

ACCOUNTING FOR IMPAIRMENT OF LONG-LIVED ASSETS

We review the carrying value of our long-lived assets, including property and equipment, whenever events or changes in circumstances indicate that the carrying value of the assets may not be recoverable. An impairment loss exists when estimated undiscounted future cash flows expected to result from the use of the asset, including disposition, are less than the carrying value of the asset. The measurement of the impairment loss to be recognized is based on the difference between the fair value and the carrying amounts of the assets. Fair value generally is determined based upon a discounted cash flow analysis. In order to determine if an asset has been impaired, assets are grouped and tested at the lowest level for which identifiable, independent, cash flows are available.

The determination of both undiscounted and discounted cash flows requires us to make significant estimates and considers the expected course of action at the balance sheet date. Subsequent changes in estimated undiscounted and discounted cash flows arising from changes in anticipated actions could impact the determination of whether an impairment exists, the amount of the impairment charge recorded and whether the effects could materially impact our consolidated financial statements.

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DISCONTINUED OPERATIONS

The results of a component of our business that either has been disposed of or is classified as held for sale are reported in discontinued operations in accordance with the requirements of SFAS No. 144. We classify a component of our business as held for sale if it meets the following criteria as of each balance sheet date:

- We commit to a plan to sell the disposal group.
- The disposal group is available for immediate sale in its present condition, subject only to the terms that are usual and customary for sales of such disposal groups.
- An active program to locate a buyer and other actions required to complete the plan to sell have been initiated.
- The sale of the disposal group is probable and the transfer is expected to qualify for recognition as a completed sale within one year.
- The disposal group is being marketed actively for sale at a price that is reasonable in relation to its current fair value.
- Actions necessary to complete the plan indicate that it is unlikely that significant changes to the plan will be made or that the plan will be withdrawn.

The results of operations of all entities that have been disposed of or are classified as held for sale have been classified in the (loss) income from discontinued operations - net of tax line item in the consolidated statements of income for all periods presented. The 2006, 2005 and 2004 cash flow statements are presented on a consolidated basis, including both continuing operations and discontinued operations.

ACCOUNTING FOR IMPAIRMENT OF GOODWILL AND INTANGIBLE ASSETS

Goodwill represents the excess of purchase price and related costs over the value assigned to the net tangible and identifiable intangible assets of businesses acquired. In accordance with SFAS No. 142, Goodwill and Other Intangible Assets, goodwill is to be tested annually and between annual tests if events occur or circumstances change that would more likely than not reduce the fair value of an operating segment below its carrying amount. We have elected October 1 as the annual evaluation date to test for potential goodwill impairment. The annual goodwill impairment test requires us to make a number of assumptions and estimates concerning future levels of earnings and cash flow, which are based upon our strategic plans. The combination of a discounted cash flow analysis and terminal value model is used to determine the fair value of each reporting unit. While we use available information to prepare estimates and to perform the impairment evaluation, actual results could differ significantly resulting in future impairment and losses related to recorded goodwill balances. No impairment of goodwill was identified in the annual impairment test completed in 2006. (See Note 6 to the consolidated financial statements.)

Intangible assets resulting from business acquisitions, including customer lists, purchased technology, trademarks, patents, land-use rights and non-compete agreements, are amortized on a straight-line method over periods ranging from 3 to 40 years. Under SFAS No. 142, intangible assets determined to have indefinite lives are not amortized, but are tested for impairment at least annually. We have elected October 1 as the annual evaluation date to test for potential impairment of indefinite lived intangible assets. The combination of a discounted cash flow analysis and terminal value model is used to determine whether the fair value of an intangible asset exceeds its carrying amount. As part of the annual impairment test, the non-amortized intangible assets are reviewed to determine if the indefinite status remains appropriate.

We completed a corporate identity review in the fourth quarter of 2006 and made a final determination in January 2007 that the trade name Noveon no longer would be used to describe the specialty chemicals business segment of our company and that its use would be discontinued except in connection with the consumer specialties product line. As a result, an impairment charge for the Noveon trade name was recognized in accordance with SFAS No. 142. We calculated a pretax charge of $41.2 million ($25.4 million after-tax) to reduce the related asset to its estimated fair value. This charge was reflected in the fourth quarter of 2006 as we believed at that time we would more likely than not discontinue the use of the Noveon trade name, except in the limited context of the consumer specialties product line.

ASSET-RETIREMENT OBLIGATIONS

We account for asset retirement obligations in accordance with SFAS No. 143, Accounting for Asset Retirement Obligations and Financial Accounting Standards Board (FASB) Interpretation (FIN) No. 47, Accounting for Conditional Asset-Retirement Obligations - an interpretation of FASB Statement No. 143. FIN No. 47 requires the recognition of a liability for the fair value of a legal obligation to perform asset-retirement obligations (AROs) that are conditional on a future event if the amount can be reasonably estimated. We have identified AROs related to certain of our leased facilities and to asbestos remediation activities that may be required at other company-owned facilities in the future. We record liabilities for AROs at the time that they are identified and when they can be reasonably estimated. Due to the long-term, productive nature of some of our manufacturing operations, absent plans or expectation of plans to initiate asset retirement activities, we are unable to reasonably estimate the fair value of such asbestos remediation liabilities since the potential settlement dates cannot be determined at this time.

NEW ACCOUNTING STANDARDS

SFAS No. 158

In September 2006, the FASB issued SFAS No. 158, Employers Accounting for Defined Benefit Pension and Other Postretirement Plans - an amendment of FASB Statements No. 87, 88, 106, and 132(R). This statement requires an employer to recognize a plan s funded status in its statement of financial position, measure a plan s assets and obligations as of the end of the employer s fiscal year and recognize the changes in a plan s funded status in comprehensive income in the year in which the changes occur. SFAS No. 158 s requirement to recognize a plan s funded status and new disclosure requirements are effective for us as of December 31, 2006. The requirement to measure plan assets and benefit obligations as of the date of our fiscal year-end statement of financial position is effective for fiscal years ending after December 15, 2008. Currently, we measure plan assets and benefit obligations as of the date of our fiscal year-end. We adopted the required provisions of SFAS No. 158 on December 31, 2006.

The incremental effects of adopting SFAS No. 158 on our consolidated balance sheet at December 31, 2006 were as follows:

	Balance Before Applying SFAS No. 158	SFAS No. 158 Adjustments	Balance After Applying SFAS No. 158
Current assets:			
Other current assets	$ 104.9	$ (6.9)	$ 98.0
Noncurrent assets:			
Other assets	$ 65.5	$ 1.2	$ 66.7
Intangible assets - net	$ 329.2	$ (6.4)	$ 322.8
Total assets	$ 4,403.0	$ (12.1)	$ 4,390.9
Current liabilities:			
Accrued expenses and other current liabilities	$ 287.2	$ 3.0	$ 290.2
Noncurrent liabilities:			
Pension obligations	$ 149.1	$ 88.8	$ 237.9
Other postretirement health care obligations	$ 104.7	$ (11.2)	$ 93.5
Deferred income taxes	$ 110.3	$ (29.9)	$ 80.4
Total liabilities	$ 2,605.8	$ 50.7	$ 2,656.5
Accumulated other comprehensive income (loss)	$ 2.0	$ (62.8)	$ (60.8)
Total shareholders equity	$ 1,745.9	$ (62.8)	$ 1,683.1

SFAS No. 157

In September 2006, the FASB issued SFAS No. 157, Fair Value Measurements. This statement defines fair value, establishes a framework for measuring fair value in accordance with U.S. GAAP and expands disclosure about fair value measurements. SFAS No. 157 does not expand the use of fair value measures in financial statements, but simplifies and codifies related guidance within U.S. GAAP. SFAS No. 157 establishes a fair value hierarchy using observable market data as the highest level and an entity s own fair value assumptions as the lowest level. SFAS No. 157 is effective for fiscal years beginning after November 15, 2007 and interim periods within those years. SFAS No. 157 requires adoption prospectively as of the beginning of the fiscal year in which this statement is initially applied, with the exception of certain financial instruments in which adoption is applied retrospectively as of the beginning of the fiscal year in which this statement is initially applied. We currently are evaluating the impact of this recently issued standard on our consolidated financial statements.

SAB No. 108

In September 2006, the SEC released Staff Accounting Bulletin (SAB) No. 108, Considering the Effects of Prior Year Misstatements when Quantifying Misstatements in Current Year Financial Statements. This bulletin provides guidance on how the effects of prior-year uncorrected financial statement misstatements should be considered in quantifying a current-year misstatement. SAB No. 108 requires registrants to quantify misstatements using both an income statement (rollover) and balance sheet (iron curtain) approach and evaluate whether either approach results in a misstatement that, when all relevant quantitative and qualitative factors are considered, is material. If prior-year errors that previously had been considered immaterial now are considered material based on either approach, no restatement is required so long as management properly applied its previous approach and all relevant facts and circumstances were considered. If prior years are not restated, a cumulative-effect adjustment is recorded in opening accumulated earnings as of the beginning of the fiscal year of adoption. SAB No. 108 is effective for us for the fiscal year ending December 31, 2006. Our adoption of this standard did not have an impact on our consolidated financial statements.

FIN No. 48

In July 2006, the FASB issued FIN No. 48, Accounting for Uncertainty in Income Taxes, that 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. Under FIN No. 48, a contingent tax asset only will be recognized if it is more likely than not that a tax position ultimately will be sustained. After this threshold is met, a tax position is reported at the largest amount of benefit that is more likely than not to be realized. FIN No. 48 also provides guidance on derecognition, classification, interest and penalties, accounting in interim periods and disclosure. FIN No. 48 is effective for fiscal years beginning after December 15, 2006. FIN No. 48 requires the cumulative effect of applying the provisions to be reported separately as an adjustment to the opening balance of retained earnings in the year of adoption. We currently are evaluating the impact of this recently issued Interpretation on our consolidated financial statements.

SFAS No. 154

In May 2005, the FASB issued SFAS No. 154, Accounting Changes and Error Corrections. This standard establishes new standards on accounting for changes in accounting principles. Pursuant to the new rules, all such changes must be accounted for by retrospective application to the financial statements of prior periods unless it is impracticable to do so. SFAS No. 154 completely replaces Accounting Principles Board (APB) Opinion No. 20, Accounting Changes, and SFAS No. 3, Reporting Accounting Changes in Interim Financial Statements, though it carries forward the guidance in those pronouncements with respect to accounting for changes in estimates, changes in the reporting entity and the correction of errors. This statement is effective for accounting changes and corrections of errors beginning January 1, 2006. Our adoption of this standard did not have a material impact on our consolidated financial statements.

SFAS No. 123R

In December 2004, the FASB issued SFAS No. 123R. This standard requires compensation costs related to share-based payment transactions to be recognized in the financial statements. With limited exceptions, the amount of compensation cost is measured based on the grant-date fair value of the equity or liability instruments issued. In addition, liability awards are remeasured each reporting period. Compensation cost is recognized over the period that an employee provides service in exchange for the award. This standard replaces SFAS No. 123, Accounting for Stock-Based Compensation, and supersedes APB Opinion No. 25, Accounting for Stock Issued to Employees, and applies to all awards granted, modified, repurchased or cancelled after July 1, 2005. In April 2005, the SEC amended the compliance date of SFAS No. 123R through an amendment of Regulation S-X. We adopted SFAS No. 123R on January 1, 2006. The adoption of SFAS No. 123R incrementally increased before-tax compensation expense by approximately $2.4 million during 2006.

SFAS No. 151

In November 2004, the FASB issued SFAS No. 151, Inventory Costs, to clarify the accounting for abnormal amounts of idle facility expense, freight, handling costs and wasted material. This standard requires that such items be recognized as current-period charges. The standard also establishes the concept of normal capacity and requires the allocation of fixed-production overhead to inventory based on the normal capacity of the production facilities. Any unallocated

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overhead must be recognized as an expense in the period incurred. This standard was effective for inventory costs incurred beginning January 1, 2006. The adoption of this standard did not have a material impact on our consolidated financial statements.

CAUTIONARY STATEMENTS FOR SAFE HARBOR PURPOSES

This Management s Discussion and Analysis of Financial Condition and Results of Operations contains forward-looking statements within the meaning of the federal securities laws. As a general matter, forward-looking statements are those focused upon future plans, objectives or performance as opposed to historical items and include statements of anticipated events or trends and expectations and beliefs relating to matters not historical in nature. Forward-looking statements are subject to uncertainties and factors relating to our operations and business environment, all of which are difficult to predict and many of which are beyond our control. These uncertainties and factors could cause our actual results to differ materially from those matters expressed in or implied by any forward-looking statements, although we believe our expectations reflected in those forward-looking statements are based upon reasonable assumptions. For this purpose, any statements contained herein that are not statements of historical fact should be deemed to be forward-looking statements.

We believe that the following factors, among others, could affect our future performance and cause our actual results to differ materially from those expressed or implied by forward-looking statements made in this annual report:

- The cost, availability and quality of raw materials, especially petroleum-based products.
- Our ability to sustain profitability of our products in a competitive environment.
- The demand for our products as influenced by factors such as the global economic environment, longer-term technology developments and the success of our commercial development programs.
- The risks of conducting business in foreign countries, including the effects of fluctuations in currency exchange rates upon our consolidated results and political, social, economic and regulatory factors.
- The extent to which we are successful in expanding our business in new and existing markets and in identifying, understanding and managing the risks inherent in those markets.
- The effect of required principal and interest payments on our ability to fund capital expenditures and acquisitions and to meet operating needs.
- Our ability to identify, complete and integrate acquisitions for profitable growth and operating efficiencies.
- Our success at continuing to develop proprietary technology to meet or exceed new industry performance standards and individual customer expectations.
- Our ability to implement a new common information systems platform primarily into our Lubrizol Advanced Materials segment successfully, including the management of project costs, its timely completion and realization of its benefits.
- Our ability to continue to reduce complexities and conversion costs and modify our cost structure to maintain and enhance our competitiveness.
- Our success in retaining and growing the business that we have with our largest customers.
- The cost and availability of energy, especially natural gas and electricity.
- The effect of interest rate fluctuations on our net interest expense.
- The risk of weather-related disruptions to our Lubrizol Additives production facilities located near the U.S. Gulf coast.
- Significant changes in government regulations affecting environmental compliance.

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ITEM 7A. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

We operate manufacturing and blending facilities, laboratories and offices around the world and utilize fixed-rate and variable-rate debt to finance our global operations. As a result, we are subject to business risks inherent in non-U.S. activities, including political and economic uncertainties, import and export limitations, and market risks related to changes in interest rates and foreign currency exchange rates. We believe the political and economic risks related to our foreign operations are mitigated due to the stability of the countries in which our largest foreign operations are located.

In the normal course of business, we use derivative financial instruments including interest rate and commodity hedges and forward foreign currency exchange contracts to manage our market risks. Our objective in managing our exposure to changes in interest rates is to limit the impact of such changes on our earnings and cash flow. Our objective in managing the exposure to changes in foreign currency exchange rates is to reduce volatility on our earnings and cash flow associated with such changes. Our principal currency exposures are the euro, the pound sterling, the Japanese yen and certain Latin American currencies. Our objective in managing our exposure to changes in commodity prices is to reduce the volatility on earnings of utility expense. We do not hold derivatives for trading purposes.

We measure our market risk related to our holdings of financial instruments based on changes in interest rates, foreign currency rates and commodity prices utilizing a sensitivity analysis. The sensitivity analysis measures the potential loss in fair value, cash flow and earnings based on a hypothetical 10% change (increase and decrease) in interest, currency exchange rates and commodity prices. We use current market rates on our debt and derivative portfolios to perform the sensitivity analysis. Certain items such as lease contracts, insurance contracts and obligations for pension and other postretirement benefits are not included in the analysis.

Our primary interest rate exposures relate to our cash and short-term investments, fixed-rate and variable-rate debt and interest rate swaps. The calculation of potential loss in fair value is based on an immediate change in the net present values of our interest rate-sensitive exposures resulting from a 10% change in interest rates. The potential loss in cash flow and income before tax is based on the change in the net interest income/expense over a one-year period due to an immediate 10% change in rates. A hypothetical 10% increase in interest rates would have had a favorable impact and a hypothetical 10% decrease in interest rates would have had an unfavorable impact on fair values of $41.1 million and $42.7 million at December 31, 2006 and 2005, respectively. In addition, a hypothetical 10% increase in interest rates would have had an unfavorable impact and a hypothetical 10% decrease in interest rates would have had a favorable impact on cash flows and income before tax of $1.6 million and $1.8 million in 2006 and 2005, respectively.

Our primary currency exchange rate exposures are to foreign currency-denominated debt, intercompany debt, cash and short-term investments and forward foreign currency exchange contracts. The calculation of potential loss in fair value is based on an immediate change in the U.S. dollar equivalent balances of our currency exposures due to a 10% shift in exchange rates. The potential loss in cash flow and income before tax is based on the change in cash flow and income before tax over a one-year period resulting from an immediate 10% change in currency exchange rates. A hypothetical 10% increase in currency exchange rates would have had an unfavorable impact and a hypothetical 10% decrease in currency exchange rates would have had a favorable impact on fair values of $3.5 million at December 31, 2006. In addition, a hypothetical 10% increase in currency exchange rates would have had a favorable impact and a hypothetical 10% decrease in currency exchange rates would have had an unfavorable impact on fair values of $6.8 million at December 31, 2005. Further, a hypothetical 10% increase in currency exchange rates would have had an unfavorable impact and a hypothetical 10% decrease in currency exchange rates would have had a favorable impact on cash flows of $21.1 million and $21.4 million and on income before tax of $4.0 million and $4.4 million in 2006 and 2005, respectively.

Our primary commodity hedge exposures relate to natural gas and electric utility expenses. The calculation of potential loss in fair value is based on an immediate change in the U.S. dollar equivalent balances of our commodity exposures due to a 10% shift in the underlying commodity prices. The potential loss in cash flow and income before tax is based on the change in cash flow and income before tax over a one-year period resulting from an immediate 10% change in commodity prices. A hypothetical 10% increase in commodity prices would have had a favorable impact and a hypothetical 10% decrease in commodity prices would have had an unfavorable impact on fair values, cash flows and income before tax of $1.3 million and $0.9 million in 2006 and 2005, respectively.

ITEM 8. FINANCIAL STATEMENTS AND SUPPLEMENTARY DATA

The response to this item is submitted in a separate section of this report following the signature page.

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ITEM 9. CHANGES IN AND DISAGREEMENTS WITH ACCOUNTANTS ON ACCOUNTING AND FINANCIAL DISCLOSURE

Not applicable.

ITEM 9A. CONTROLS AND PROCEDURES

(a) Evaluation of Disclosure Controls and Procedures

As discussed elsewhere in this annual report on Form 10-K/A, we are restating certain of our previously issued financial statements. See Item 7 - Management s Discussion and Analysis of Financial Condition and Results of Operations and Note 20 - Restatement of Consolidated Financial Statements contained in the Notes to Financial Statements for more detailed information regarding the restatement.