2006 INTERIM REPORT

CARBONE LORRAINE

Dedicated Innovation, Dedicated Partner

Table of contents

1 GENERAL OVERVIEW OF THE GROUP

Chairman's message 5

Overview of the Group's businesses 6

Results 9

Outlook 11

2 CONSOLIDATED FINANCIAL STATEMENTS 12

Scope of consolidation 12

Consolidated balance sheet 16

Changes in equity 18

Consolidated income statement 19

Consolidated statement of cash flows 20

3 ANNEX 21

4 STATUTORY AUDITORS' REPORT 48

Chairman's message

To the Shareholders,

With another strong increase in its earnings, the first six months of 2006 again illustrated the momentum the Group has achieved as part of its ambitious plan to deliver sustained and profitable growth. Sales grew by 11% at constant exchange rates and operating income advanced by 32%.

These performances were driven by Carbone Lorraine's strategic model, which captures four sources of growth.

Proactive expansion in Asia. This region currently represents the Group's geographic expansion priority. It is an important aspect of our strategy of international expansion to achieve a balanced worldwide presence. To this end, we have reinforced our network of local workshops and we are completing the construction of our graphite block production facility in Chongqing, which is due to enter service by the end of the first quarter of 2007. This new facility represents a key underpinning of our strategy of further expansion in Asia. A combination of cost-effective manufacturing and greater responsiveness enhanced by our presence right at the heart of our target region will provide the Group with a vital competitive advantage helping us to penetrate new markets.

Positions in expanding markets. In accordance with its highly demanding environmental standards, Carbone Lorraine is making its contribution to the quest to find new energy sources. With an offering dedicated to renewable energies (solar power, wind power) and a range of components and systems optimizing energy efficiency, the Group provides solutions geared to its customers' current priorities and has positioned itself on an expanding trend.

Continuous innovation dedicated to our customers. Innovation lies right at the heart of our corporate culture at Carbone Lorraine. This ability to innovate is illustrated by the promising prospects for the CL Clad® project, which employs a patented new technology to manufacture tantalum-clad steel reactors and thus meet the increasingly high demands of our chemicals and pharmaceuticals industry customers. Production of these reactors is due to start in October 2006 at our new Pagny-sur-Moselle workshop, and the first major orders have already been taken.

Selective acquisitions to boost the pace of our organic growth. To make it even stronger, our organic growth is likely to be topped up through selective acquisitions. The resulting synergies with the Group's industrial and commercial network will expand the range of end applications we cover and boost our financial performance. This was precisely the logic behind our acquisition in February of Graphite Engineering & Sales, a US company specialized in tooling high-precision graphite components. The same applies to Kapp, a French company which we recently acquired. Its technologies should enable us to extend our range of tubular graphite and noble metals heat exchangers into plate anticorrosion exchangers.

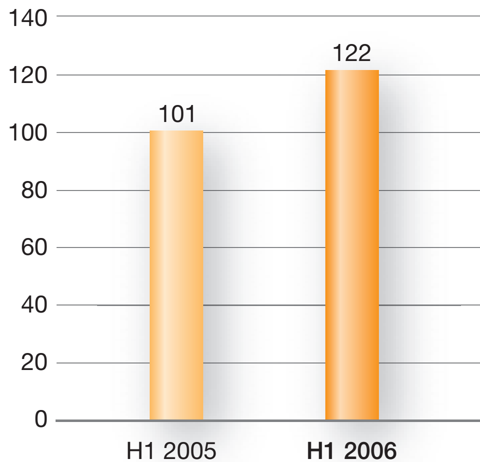
Bright outlook for 2006. The Group's performance during the first half of 2006 was thus very healthy, even though it does not reflect yet the benefits of the major expansion projects currently underway. Business trends are expected to remain very firm during the second half of the year, albeit with a slower pace of growth owing to the high level of deliveries recorded during the second six months of 2005.

2006 is shaping up to be another good year for our Group thanks to the efforts of our shareholder-focused teams who are working hard on our major expansion projects.

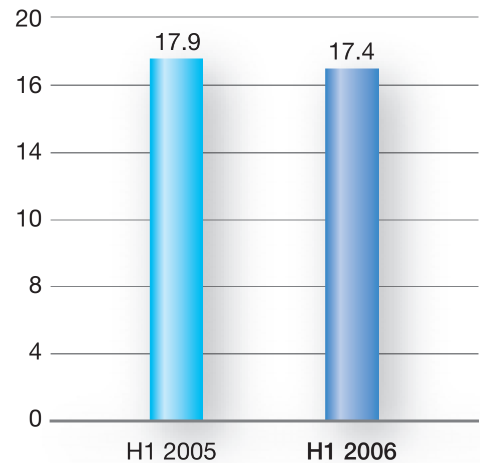
Claude Cocozza

Overview of the Group's businesses

Sales
(in millions of euros)



Operating margin*
(in %)



* *Operating income/Sales before corporate charges.*

Advanced Materials and Technologies

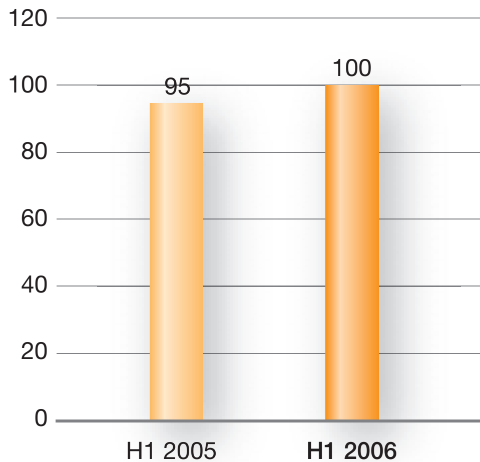
The **Advanced Materials and Technologies** division posted sales of €122 million, up 21% at constant exchange rates compared with the first half of 2005. This figure included the impact of the acquisition in early February 2006 of the US company Graphite Engineering & Sales, which came to €7 million. On a like-for-like basis, sales advanced by more than 11%.

High-temperature applications of graphite were boosted by the strength of the electronics market. Sales in the braking market also posted a significant increase in aerospace, rail and motorcycle applications. Sales of anticorrosion equipment in the chemicals and pharmaceuticals markets notched up a strong rise, particularly in Asia, in both noble metals and graphite equipment.

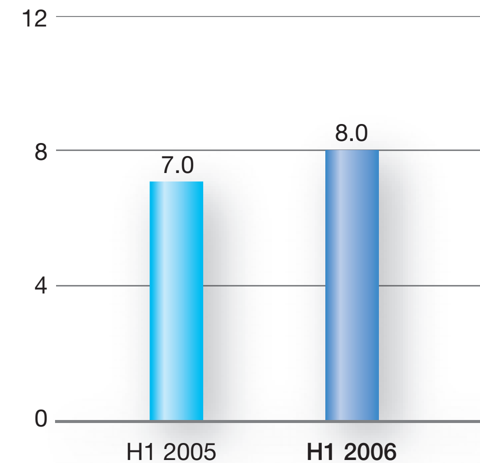
The operating margin recorded by the Advanced Materials and Technologies division exceeded 17%, with operating income moving up 18% to €21.4 million.

Sales and earnings were boosted by last year's capacity increase at our graphite block plant in Pennsylvania. A further capacity increase is planned at the end of the first quarter of 2007 with the entry into service of the first tranche of our manufacturing facility in China.

Sales
(in millions of euros)



Operating margin*
(in %)



** Operating income/Sales before corporate charges.*

Electrical Applications

The interim sales posted by the **Electrical Applications** division totaled €100 million, representing an increase of 5% at constant exchange rates and 2% on a like-for-like basis compared with the first half of 2005.

Sales of brushes and brushholders for industrial motors and traction applications posted growth across all our regions on the back of demand from the rail, aerospace and wind power industries.

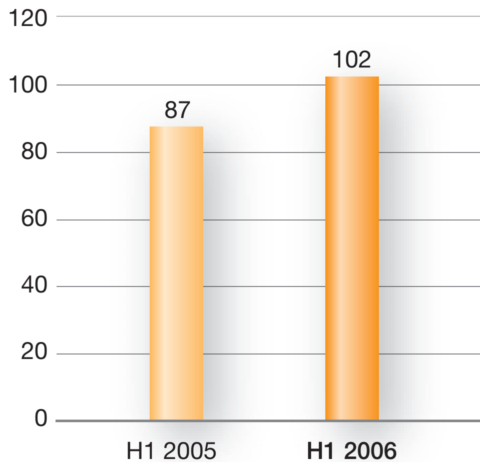
Sales to the automobile markets continued to decline notably as a result of the persistent difficulties affecting carmakers in North America.

The operating margin gained 1 point compared with the first half 2005 to reach 8%. Operating income advanced by 18% to €7.9 million.

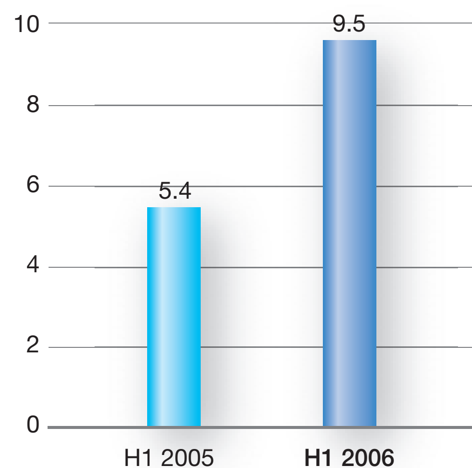
The North American plant manufacturing brushes for auxiliary automobile motors will be closed down gradually by the end of 2008. This move became necessary to bring our capacities and our production costs into line with the situation prevailing in the North American auto industry. Most of the production lines currently at Farmville (Virginia) are set to be transferred to other more competitive Group plants in Asia and Europe.

Overview of the Group's businesses

Sales
(in millions of euros)



Operating margin*
(in %)



* *Operating income/Sales before corporate charges*

Electrical Protection

The interim sales posted by the **Electrical Protection** division came to €102 million, up 17% at constant exchange rates and up 14% on a like-for-like basis compared with the first half of 2005.

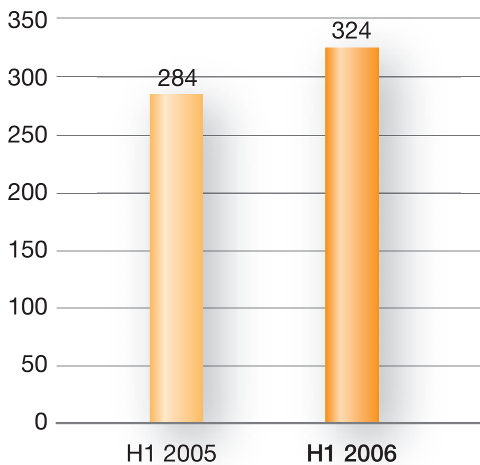
Sales moved sharply higher across all our regions in both general-purpose fuses and power semiconductor protection fuses. Sales of fuse-related products, such as high-power switches, subway and tramway power supply and protection equipment and coolers for power semiconductors, also recorded substantial increases.

Strong sales growth in Europe was driven by the market shares regained after having been lost during the overhaul of our manufacturing operations in 2004 and 2005. In North America, growth was driven by the upbeat economic environment, the launch of new products and market share gains. The steep increase in sales in Asia was attributable to the rapid start-up of the workshop that opened up in China last year and the buoyant economic conditions prevailing in Japan.

The sales growth and restructuring plans implemented in recent years in Europe fuelled a substantial rise in operating income, which more than doubled compared with the first half of 2005, reaching €9.7 million. The operating margin came to 9.5% compared with 5.4% in the first half of 2005.

Results

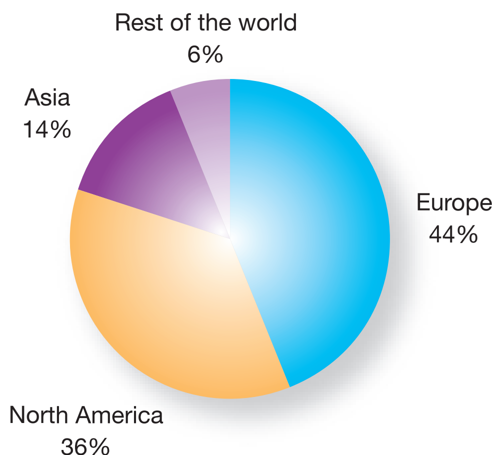
Consolidated sales
(in millions of euros)



Consolidated sales

Interim 2006 sales totaled €324 million. They rose by 14% on a reported basis. At constant exchange rates, but including the contribution made by Graphite Engineering & Sales, a US company acquired in early February, sales moved up by 11%. Organic sales growth, i.e. at comparable structure and exchange rates, remained strong at 9%.

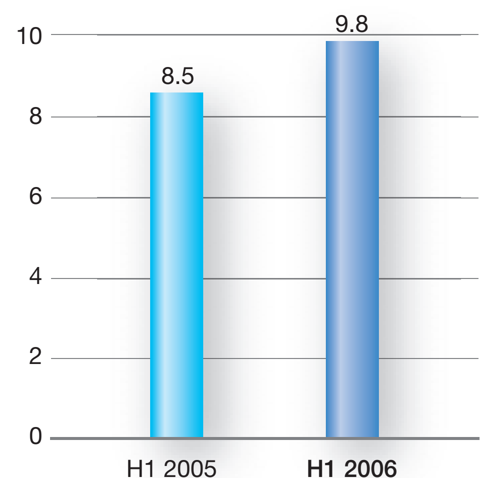
Analysis of interim 2006 sales
(In %)



Analysis of interim 2006 sales

Very strong sales growth was recorded in Asia (43%) during the first six months of the year, with a significant increase at all the divisions. Sales growth in Europe and North America was also brisk, with increases of 4% and 7% respectively. Sales in the rest of the world contracted by 5% owing primarily to downbeat trends in Brazil. Sharp appreciation in the Brazilian currency held back exports of manufactured goods, which had a knock-on effect on sales by our Brazilian subsidiary.

Operating margin*
(in %)



* Operating income/Sales before corporate charges.

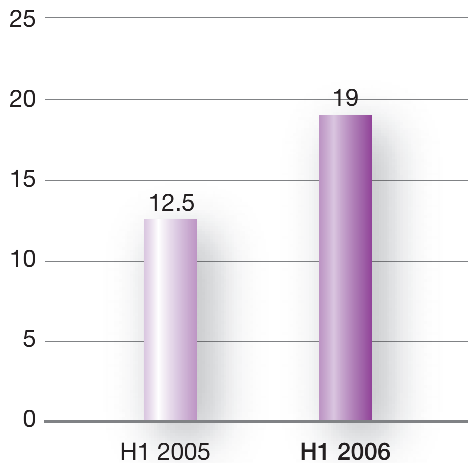
Operating margin

Operating income came to €31.8 million, up 32% compared with the year-earlier period. It was given a boost by a firm volume performance and a significant recovery in the Electrical Protection division's earnings. The operating margin came to 9.8% compared with 8.5% during the first half of 2005.

NB: Data relating to continuing operations.

Results

Net income, Group share
(in millions of euros)



Net income, Group share

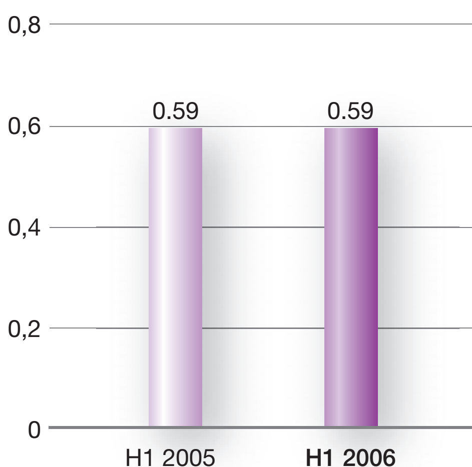
Financial costs increased by €0.9 million to €4.3 million on the back of the rise in interest rates and the debt burden.

Although income before tax posted a significant rise, tax expense declined by €0.3 million to €7.5 million as a result of a current tax repayment in North America and a decline in deferred taxation owing to exchange rate fluctuations. The Group's tax rate stood at 27% and would have been 34% had it not been for the aforementioned factors.

Net income from continuing operations advanced by 55% to €20 million, compared with €12.9 million during the first half of 2005.

Taking into account a negative impact of €1 million on divested and discontinued operations, representing residual charges related to the Magnets division's French plants, net income, Group share moved up to €19 million from €12.5 million in 2005. Earnings per share rose by 51% to €1.37.

Net debt/Equity



Net debt/Equity

Cash generated by operating activities during the first six months of 2006 after changes in the working capital requirements and taxes came to €15.5 million, compared with €14.7 million in the equivalent period of 2005. The increase in the working capital requirement was in line with the growth in sales, except for inventories, which were boosted as part of efforts to win new markets.

Capital expenditures totaled €34.5 million as a result of the acquisition of Graphite Engineering & Sales and spending linked to the major expansion projects currently being implemented. These expenditures account for the €19 million in cash used by operating and investing activities during the first six months of 2006.

This investment spending and payment of the dividend during the first half were the key factors contributing to the increase in debt to €175.7 million from €150.3 million at December 31, 2005. The growth in debt was curbed by €6.7 million owing to the favorable impact of exchange rate fluctuations.

At June 30, 2006, the debt-to-equity ratio stood at 59%, compared with 51% at December 31, 2005 and 59% at June 30, 2005.

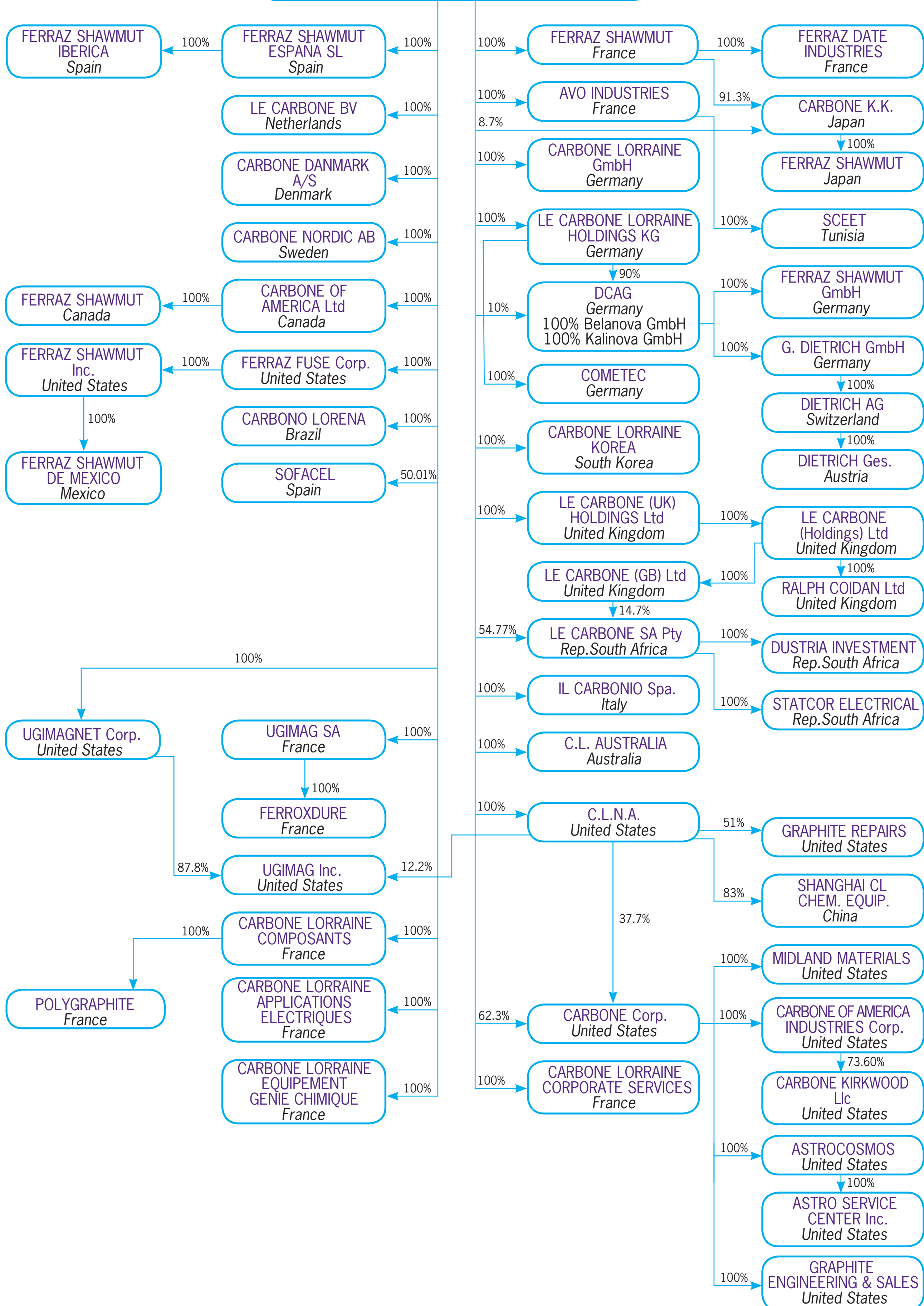
Outlook

Barring a downturn in economic conditions, sales growth is expected to remain brisk over the year as a whole. The pace of growth will nonetheless be slower during the second half, particularly in Asia, owing to the high level of anticorrosion equipment and braking deliveries made in the region during the second half of 2005.

The Group is set to continue implementing its major expansion projects during the second half. The workshop producing CL Clad®, the patented new material for the manufacture of anticorrosion equipment, is due to enter service on schedule in October. Construction of the new isostatic graphite block manufacturing facility in China is set to continue. Furthermore, the Group will continue to roll out action plans aimed at increasing the profitability of operations put under pressure by trends in the North American automobile industry.

All in all, 2006 is expected to be another good year for Carbone Lorraine in terms of both its sales and earnings performance.

Scope of consolidation at June 30, 2006



List of consolidated companies

	Method of consolidation (FC = Fully consolidated)	% of voting rights held by the Group	% of the capital held by the Group
1. Le Carbone-Lorraine SA (France)	FC	100	100
2. Carbone Lorraine Applications Electriques (France)	FC	100	100
3. Carbone Lorraine Composants (France)	FC	100	100
4. Carbone Lorraine Equipements Génie Chimique (France)	FC	100	100
5. Carbone Lorraine Corporate Services (France)	FC	100	100
6. AVO SA (France)	FC	100	100
SCEET (Tunisia)	FC	100	100
7. Ferraz Shawmut SA (France)	FC	100	100
Ferraz Date Industries	FC	100	100
8. Ugimag SA (France)	FC	100	100
9. Ferroxdure (France)	FC	100	100
10. Polygraphite (France)	FC	100	100
11. Carbone Lorraine Holdings KG (Germany)	FC	100	100
- Deutsche Carbone AG	FC	100	100
- Belanova-Kalbach GmbH	FC	100	100
- Kalinova-Kalbach GmbH	FC	100	100
- Ferraz Shawmut GmbH (ex-Berg)	FC	100	100
- Cometec			
12. Carbone Danmark A/S	FC	100	100
13. G. Dietrich GmbH (Germany)	FC	100	100
14. Dietrich AG (Switzerland)	FC	100	100
15. Dietrich Ges. (Austria)	FC	100	100
16. Carbone Lorraine GmbH (Germany)	FC	100	100
17. Sofacel (Spain)	FC	50	50
18. Ferraz Shawmut España	FC	100	100
Ferraz Shawmut Iberica	FC	100	100
19. Le Carbone (UK) Holdings Ltd (Great Britain)	FC	100	100
- Le Carbone (GB) Ltd	FC	100	100
- Le Carbone (Holdings) Ltd	FC	100	100
- Ralph Coidan Ltd	FC	100	100
20. Il Carbonio Spa. (Italy)	FC	100	100
21. Le Carbone-Lorraine BV (Netherlands)	FC	100	100
22. Carbone Nordic AB (Sweden)	FC	100	100
23. Carbone of America (LCL) Ltd (Canada)	FC	100	100
24. Ferraz Shawmut Canada	FC	100	100

List of consolidated companies (to be continued)

	Method of consolidation (FC = Fully consolidated)	% of voting rights held by the Group	% of the capital held by the Group
25. Carbone Lorraine North America (United States)	FC	100	100
- Graphite Repairs	FC	51	51
- Carbone Corp.	FC	100	100
- Carbone of America Industries Corp.	FC	100	100
- Carbone Kirkwood Llc	FC	73.6	73.6
- Astrocosmos Metallurgical Inc.	FC	100	100
- Astro Service Center Inc.	FC	100	100
- Midland Materials	FC	100	100
- Graphite Engineering and Sales	FC	100	100
26. Ferraz Fuse Corp. (United States)	FC	100	100
- Ferraz Shawmut Inc. (United States)	FC	100	100
- Ferraz Shawmut de Mexico (Mexico)	FC	100	100
27. Ugimagnet Corp. (United States)	FC	100	100
- Ugimag Inc. (United States)	FC	100	100
28. Le Carbone-Lorraine Australia	FC	100	100
29. Le Carbone KK (Japan)	FC	100	100
30. Ferraz Shawmut Japan	FC	100	100
28. Shanghai Carbone Lorraine Chemical Equipment Cy Ltd (China)	FC	83	83
31. Le Carbone (South Africa) **PTY Ltd** (RSA)	FC	69.5	69.5
- Statcor Electrical	FC	69.5	69.5
- Dustria Investment	FC	69.5	69.5
32. Carbono Lorena (Brazil)	FC	100	100
33. Carbone Lorraine Korea	FC	100	100

The fiscal year of all these companies is the same as the calendar year.

Changes in the scope of consolidation during the past two years

The principal changes that affected the consolidated financial statements in fiscal 2005 and the first half of fiscal 2006 are presented below:

- during fiscal 2005, Carbone Lorraine Composants absorbed Astrad, a brake marketing company that was acquired in the first quarter of 2005;
- during fiscal 2006, the Group acquired US company Graphite Engineering & Sales on February 1, 2006.

Given that these changes were not material, no pro forma accounts were prepared.

Disposal of the Magnets division

The divestment of the Magnets division, which was presented in the consolidated financial statements for fiscal 2005, took place on February 27, 2006.

At December 31, 2005 and at June 30, 2006, the balance sheet shows the assets and liabilities held for sale and discontinued operations on a separate line.

The income statement and the statement of cash flows for the six months to June 30, 2005 are shown on a pro forma basis for comparison purposes (see note 3).

Consolidated balance sheet

ASSETS

In millions of euros	Note	June 2006	December 2005	June 2005
NON-CURRENT ASSETS				
Intangible assets				
Goodwill	4	177.6	182.1	179.0
Other intangible assets		4.0	4.3	4.3
Property, plant and equipment				
Land		29.4	30.5	34.2
Buildings		24.3	23.9	28.0
Plant, equipment and other	6	67.0	70.7	76.1
Assets in progress		22.1	14.3	10.1
Non-current financial assets				
Investments	7	27.6	21.6	14.8
Non-current derivatives	14	0.9		0.5
Other financial assets	3/13	29.4	24.5	23.9
Non-current tax assets				
Deferred tax assets	19	28.6	29.8	23.8
Non-current income tax assets		0.9	1.9	1.7
Total non-current assets		**411.8**	**403.6**	**396.4**
CURRENT ASSETS				
Inventories	8	129.6	122.8	132.0
Trade receivables	9	131.0	114.8	131.3
Other receivables		29.3	18.4	21.8
Current tax assets		2.1	2.9	3.1
Other current financial assets	3	5.0		
Current financial assets	13	2.8	2.5	0.6
Current derivatives	14	3.2	0.9	0.8
Trading financial assets	13	3.7	0.6	1.8
Cash and cash equivalents	13	14.1	35.7	23.1
Assets held for sale and disc. op.	3	1.2	26.0	
Total current assets		**322.0**	**324.6**	**314.5**
Total assets		**733.8**	**728.2**	**710.9**

LIABILITIES AND EQUITY

In millions of euros	Note	June 2006	December 2005	June 2005
EQUITY				
Share capital	10	27.9	27.7	27.6
Reserves		273.6	253.2	252.1
Net income for the period		19.0	22.1	12.5
Cumulative translation adjustments		(28.9)	(14.3)	(19.9)
Equity attributable to Carbone Lorraine's shareholders		**291.6**	**288.7**	**272.3**
Minority interest		4.9	5.9	5.8
Total equity		**296.5**	**294.6**	**278.1**
NON-CURRENT LIABILITIES				
Non-current provisions	11	46.8	43.9	44.8
Employee benefits	12	46.1	46.7	53.0
Deferred tax liabilities	19	6.8	6.4	5.7
Borrowings	13	156.9	177.1	169.3
Non-current derivatives	14	4.5	2.8	1.0
Total non-current liabilities		**261.1**	**276.9**	**273.8**
CURRENT LIABILITIES				
Trade payables		64.1	60.9	69.1
Other payables		55.6	43.1	47.4
Current provisions	11	1.7	5.2	11.3
Current income tax liabilities		3.5	3.9	3.7
Other liabilities		7.0	9.2	6.5
Other current financial liabilities	13	2.0	3.0	2.6
Current derivatives	14	1.6	0.2	0.4
Current advances	13	2.3	1.4	2.6
Bank overdrafts	13	35.1	7.6	15.4
Liabilities related to assets held for sale and discontinued operations	3	3.3	22.2	
Total current liabilities		**176.2**	**156.7**	**159.0**
Total liabilities and equity		**733.8**	**728.2**	**710.9**

Consolidated statement of changes in equity

In millions of euros	Share capital	Premiums and reserves	Net income for the period	Cumulative translation adjustment	Total	Minority interest	Total equity
	Attributable to Carbone Lorraine's shareholders						
Equity at December 31, 2004	**27.5**	**239.5**	**19.4**	**(37.4)**	**249.0**	**5.7**	**254.7**
Impact of changes in accounting methods		(0.1)			(0.1)		(0.1)
Restated net equity at December 31, 2004	**27.5**	**239.4**	**19.4**	**(37.4)**	**248.9**	**5.7**	**254.6**
Prior period's net income		19.4	(19.4)				
Dividends paid		(7.6)			(7.6)	(0.5)	(8.1)
Issuance of new shares	0.1	1.5			1.6		1.6
Treasury shares		(0.9)			(0.9)		(0.9)
Increase in fair value of hedging derivatives		0.4			0.4		0.4
Translation adjustments and other		(0.1)		17.5	17.4	0.3	17.7
Net income for the period			12.5		12.5	0.3	12.8
Equity at June 30, 2005	**27.6**	**252.1**	**12.5**	**(19.9)**	**272.3**	**5.8**	**278.1**
Dividends paid						(0.1)	(0.1)
Issuance of new shares	0.1	0.3			0.4		0.4
Treasury shares		(0.3)			(0.3)		(0.3)
Increase in fair value of hedging derivatives		0.4			0.4		0.4
Translation adjustments and other		0.7		5.6	6.3	0.1	6.4
Net income for the period			9.6		9.6	0.1	9.7
Equity at December 31, 2005	**27.7**	**253.2**	**22.1**	**(14.3)**	**288.7**	**5.9**	**294.6**
Prior period's net income		22.1	(22.1)				
Dividends paid		(9.7)			(9.7)	(0.5)	(10.2)
Issuance of new shares	0.2	2.5			2.7		2.7
Treasury shares		0.2			0.2		0.2
Increase in fair value of hedging derivatives		0.9			0.9		0.9
Translation adjustments and other		4.4		(14.6)	(10.2)	(0.4)	(10.6)
Net income for the period			19.0		19.0	(0.1)	18.9
Equity at June 30, 2006	**27.9**	**273.6**	**19.0**	**(28.9)**	**291.6**	**4.9**	**296.5**

In 2005, the principal movements were as follows:

- an issue of shares arising from the exercise of subscription options granted to employees, leading to the issuance of 85,775 shares for €2.0 million;
- reduction of 34,182 treasury shares with an impact of €1.2 million;
- adoption of IAS 32 and 39 on January 1, 2005, leading to a negative impact of €0.1 million;
- an increase of €0.8 million in the fair value of derivatives at the balance sheet date.

In 2006, the principal movements were as follows:

- an increase in capital deriving from:
  - the issuance of 44,494 shares arising from the issue of shares reserved for employees, leading to an impact of €1.5 million (increase of €0.1 million in the share capital and an issue premium of €1.4 million);
  - the exercise of stock options granted to employees, leading to the issuance of 48,259 shares for €1.2 million (increase of €0.1 million in the share capital and an issue premium of €1.1 million);
- the reinstatement of 5,035 shares with an impact of €0.2 million reflecting the decrease in the number of shares held in treasury;
- an increase of €0.9 million in the fair value of derivatives at the balance sheet date.

Consolidated income statement

Given the disposal of the Magnets division (see note 3), the income statement at December 31, 2005 was presented in accordance with IFRS 5 by disclosing separately items specifically attributable to assets held for sale and discontinued operations. The income statement at June 30, 2005 was presented on a pro forma basis for comparison purposes.

In millions of euros	Note	June 2006	December 2005	June 2005 Pro forma
CONTINUING OPERATIONS				
Consolidated sales	16	324.4	583.4	283.7
Cost of sales		(224.3)	(407.1)	(197.4)
Gross income		**100.1**	**176.3**	**86.3**
Selling and marketing costs		(32.6)	(59.7)	(28.5)
Administrative and research costs		(32.2)	(54.8)	(29.1)
Other expense and additions to provisions		(0.9)	(1.1)	(0.6)
Financial components of operating income		(1.0)	(1.5)	(0.6)
Operating income excluding non-recurring items		**33.4**	**59.2**	**27.5**
Non-recurring income and expense	15	(1.6)	(5.7)	(3.4)
Operating income	**16/18**	**31.8**	**53.5**	**24.1**
Finance costs		(4.3)	(7.1)	(3.3)
Other financial income/(costs)				(0.1)
Finance costs, net		**(4.3)**	**(7.1)**	**(3.4)**
Income before tax and non-recurring items		**27.5**	**46.4**	**20.7**
Current and deferred income tax	19	(7.5)	(11.1)	(7.8)
Net income from continuing operations		**20.0**	**35.3**	**12.9**
ASSETS HELD FOR SALE AND DISCONTINUED OPERATIONS				
Net income from assets held for sale or discontinued operations	3	(1.1)	(12.8)	(0.1)
Net income		**18.9**	**22.5**	**12.8**
Attributable to:				
- Carbone Lorraine's shareholders		19.0	22.1	12.5
- Minority interest		(0.1)	0.4	0.3
EARNINGS PER SHARE				
Basic earnings per share (euros)		1.37	1.60	0.91
Diluted earnings per share (euros)		1.32	1.53	0.87
NET INCOME PER SHARE FROM CONTINUING OPERATIONS				
Basic earnings per share (euros)		1.45	2.53	0.92
Diluted earnings per share (euros)		1.39	2.43	0.88

Consolidated statement of cash flows

Given the disposal of the Magnets division (see note 3), the statement of cash flows for fiscal 2005 was presented in accordance with IFRS 5 by disclosing separately cash flows specifically attributable to assets held for sale and discontinued operations. The statement of cash flows for the first half of 2005 was presented on a pro forma basis for comparison purposes.

In millions of euros	June 2006	December 2005	June 2005 Pro forma
OPERATING ACTIVITIES			
Income before tax	27.5	46.4	20.7
Depreciation and amortization	12.1	21.1	10.7
Additions to/(write-backs from) provisions	(0.4)	(1.9)	(1.2)
Finance costs, net	4.3	7.1	3.4
Capital gains/(losses) on asset disposals	0.0	(0.6)	0.0
Other items	(1.5)	(2.3)	0.4
Cash generated by operating activities before change in the WCR	**42.0**	**69.8**	**34.0**
Change in the working capital requirement	(20.9)	(8.3)	(14.4)
Income tax paid	(5.6)	(8.7)	(4.9)
Cash generated by operating activities	**15.5**	**52.8**	**14.7**
INVESTING ACTIVITIES			
Increase in intangible assets	(0.1)	(0.4)	(0.2)
Increase in property, plant and equipment	(14.5)	(24.1)	(8.1)
Increase in financial assets	(6.1)	(28.5)	(23.0)
Changes in the scope of consolidation	(13.0)	(1.1)	(1.1)
Disposals or reductions in non-current assets	(0.8)	3.0	1.0
Cash generated/(used) by investing activities	**(34.5)**	**(51.1)**	**(31.4)**
Cash generated/(used) by operating and investing activities	**(19.0)**	**1.7**	**(16.7)**
FINANCING ACTIVITIES			
Proceeds from issuance of new shares	2.9	0.6	0.6
Net dividends paid to shareholders and minority interest	(10.2)	(8.2)	(8.1)
Interest payments	(4.0)	(6.3)	(2.9)
Change in debt (note 13)	(11.5)	38.1	27.3
Cash generated by financing activities	**(22.8)**	**24.2**	**16.9**
Change in cash held by assets held for sale and discontinued operations	**(3.3)**	**(4.6)**	**(2.8)**
Change in cash	**(45.1)**	**21.3**	**(2.6)**
Cash at beginning of period	28.7	10.3	10.3
Cash at end of period (note 13)	(17.3)	28.7	9.5
Impact of currency fluctuations	0.9	2.9	(1.8)
Change in cash	**(45.1)**	**21.3**	**(2.6)**

Notes to the interim financial statements

Note 1 Statement of conformity

The condensed interim consolidated financial statements were prepared in accordance with IAS 34 - Interim financial reporting. They do not include all the information required for complete annual financial statements and should be read together with the Group's financial statements for fiscal 2005 ended on December 31, 2005, which may be downloaded from www.carbonelorraine.com.

Note 2 Accounting policies and principles of consolidation

The options adopted by the Group are stated in the following sections. They are identical to those used in the consolidated financial statements at December 31, 2005.

The mandatory standards and interpretations at January 1, 2006 did not have any impact on the interim financial statements.

A. Basis of consolidation

The consolidated financial statements include those of the parent company and those of all companies in which the Group holds a controlling interest at December 31 each year. Control is defined as the power to govern the financial and operating policies of an enterprise so as to obtain benefits from its activities. Subsidiaries over which the Group directly or indirectly exerts exclusive control are fully consolidated.

Jointly controlled companies are consolidated proportionately.

The results of subsidiaries acquired or disposed of during the period are included in the consolidated income statement from the acquisition date or up to the disposal date respectively.

All associate undertakings over which the Group exerts significant influence, which is presumed to exist when the latter holds at least 20% of voting rights, are accounted for under the equity method. Subsidiaries' financial statements have been adjusted where necessary to ensure consistency with the policies used by all Group entities within the scope of consolidation.

All material intra-group transactions and balances have been eliminated.

The consolidated financial statements have been prepared in euros.

B. Presentation of the financial statements

The Group prepares its condensed interim financial statements in accordance with the principles laid down in IAS 34.

B1. Income statement

Given customary practice and the nature of its business activities, the Group has opted for the by function of expense format of the income statement, which consists in classifying costs according to their function under cost of sales, selling, administrative, research and development costs.

B2. Balance sheet

Assets and liabilities arising during the operating cycle and those with a maturity of less than 12 months at the balance sheet date are classified as current. All other assets and liabilities are classified as non-current.

B3. Consolidated statement of cash flows

The Group prepares the consolidated statement of cash flows using the indirect method and as stipulated in IAS 7.

The indirect method consists in determining cash flows from operating activities for which net income or loss is adjusted for the effects of non-cash transactions and items of income or expense associated with investing or financing cash flows.

B4. Operations, assets and liabilities held for sale

In accordance with IFRS 5, assets and liabilities that are immediately available for sale in their current state and the sale of which is highly probable are shown on the balance sheet under assets and liabilities held for sale. Where a group of assets is held for sale in a single transaction, the group of assets and the corresponding liabilities are considered as a whole. The disposal must take place in the year following this presentation of the asset or group of assets.

The assets or group of assets held for sale are stated at the lower of their carrying amount and fair value net of disposal costs. Non-current assets appearing on the balance sheet as held for sale are no longer depreciated once they are presented as such.

Net income/(loss) from assets held for sale is presented by disclosing net income from continuing operations separately from that generated by discontinued operations, and cash flows generated by assets held for sale are stated on a separate line of the consolidated statement of cash flows.

C. Foreign currency translation

The financial statements of the Group's foreign subsidiaries are prepared in their functional currency.

The balance sheet of companies whose functional currency is not the euro is translated into euros at the closing rate, except for equity, which is translated at the historic exchange rate. Income statement items are translated at the average exchange rate for the period.

Cash flow statement items are translated at the average exchange rate, except for cash, which is translated at the closing rate.

Translation differences arising on balance sheet items are recorded separately in equity under cumulative translation adjustments. They comprise:

- the impact of changes in exchange rates on balance sheet items;
- the difference between net income calculated at the average exchange rate and net income calculated at the closing rate.

Goodwill and fair value adjustments deriving from the acquisition of subsidiaries whose functional currency is not the euro are treated as the relevant subsidiary's assets and liabilities. They are therefore stated in the subsidiary's functional currency and translated at the closing rate.

D. Foreign currency assets and liabilities

Foreign currency transactions are recognized and measured in line with IAS 21 - Effects of changes in foreign exchange rates.

Transactions denominated in currencies other than the euro are recorded at the exchange rate ruling at the transaction date. At the end of the fiscal year, monetary assets and liabilities denominated in foreign currencies are translated at the closing rate. Any gains and losses arising from currency translation are taken to operating income for the period under foreign exchange gains and losses.

Translation gains and losses on financial instruments denominated in foreign currencies representing a hedge of a net investment in a foreign operation are recorded in equity under cumulative translation adjustments. The accounting treatment for foreign currency gains and losses at the transition date is described in Section C above.

E. Hedging

Hedging transactions are recognized and measured in line with the principles laid down in IAS 32 and 39.

E1. Currency hedging

A currency derivative is eligible for hedge accounting where the hedging relationship was documented at the outset and its effectiveness has been demonstrated throughout its life.

A hedge is a way of protecting against fluctuations in the value of assets, liabilities and irrevocable commitments. A hedge also helps to protect against adverse fluctuations in cash flows (sales generated by the assets of the business, for instance).

Derivative instruments are stated at their fair value. Changes in the fair value of these instruments are accounted for as follows:

- changes in the fair value of instruments eligible as future cash flow hedges are accounted for directly in equity in respect of the effective portion of the hedge (intrinsic value); changes in the fair value of these instruments are then taken to operating income and offset fluctuations in the value of the assets, liabilities and irrevocable commitments that are hedged as they occur. The ineffective portion of the hedge (time value) is taken to operating income;
- changes in the fair value of instruments not eligible as cash flow hedges are taken directly to income.

E2. Interest rate hedging

Interest rate derivatives are stated at fair value on the balance sheet. Changes in their fair value are accounted for as follows:

- the ineffective portion of the derivative instrument is taken to income under the cost of debt;
- the effective portion of the derivative instrument is recognized as follows:
  - in equity for a derivative accounted for as a cash flow hedge (e.g. a swap turning a debt into a variable interest rate);
  - in income (cost of debt) in the case of a derivative accounted for as a fair value hedge (e.g. a swap turning a fixed interest rate into a variable interest rate). This accounting treatment is offset by changes in the fair value of the hedged debt.

F. Intangible assets

The applicable standards are IAS 38 - Intangible assets, IAS 36 - Impairment of assets and IFRS 3 - Business combinations.

In accordance with IAS 38 - Intangible assets, only items in respect of which future economic benefits are likely to flow to the Group and the cost of which may be reliably determined are accounted for as intangible assets.

The Group's intangible assets comprise primarily goodwill.

F1. Goodwill

In accordance with IFRS 3, the subsidiary's assets, liabilities and contingent liabilities are stated at fair value at the acquisition date following a business combination. Minority interest is stated at its share of the fair value of assets, liabilities and contingent liabilities recognized. The difference between the acquisition cost of the subsidiary and the Group's share of its net assets stated at fair value is accounted for under goodwill.

Goodwill is allocated individually to the Group's cash-generating units (CGUs). The Group has defined the following four CGUs:

- Electrical Applications;
- Electrical Protection;
- High-temperature applications and high-energy braking;
- Anticorrosion equipment.

In accordance with IFRS 3 - Business combinations, goodwill is not amortized. It undergoes an impairment test once signs of impairment in the value of assets appear and at least once every year.

In accordance with IAS 36, the impairment test method adopted by the Group consists in:

- preparing cash flow projections after normalized tax based on the Strategic Plan of the relevant CGU;
- determining a value in use using a method comparable to any business valuation by discounting cash flows at the segment's weighted average cost of capital (WACC);
- comparing this value in use with the carrying amount of the relevant assets to determine whether or not an impairment loss needs to be recognized.

Value in use is determined based on free cash flow projections discounted over a period of five years and a terminal value. The discount rate used for these calculations is the weighted average cost of capital for each of the cash-generating units (see note 6).

The assumptions made for sales growth and terminal values are reasonable and consistent with the market data available for each of the operating activities.

Goodwill impairment losses are irreversible.

F2. Patents and licenses

Patents and licenses are amortized on a straight line basis over the period for which they are protected by law.

Software is amortized on a straight line basis over its probable service life, which may not exceed five years.

F3. Development costs

Under IAS 38 - Intangible assets, development costs are capitalized where:

- the entity has the intent and the financial and technical ability to see the development project through to completion;
- it is probable that the expected future economic benefits that are deriving from development costs will flow to the entity;
- the cost of the asset can be measured reliably.

Research and development costs that do not meet the aforementioned criteria are expensed as incurred. Capitalized development costs meeting the criteria laid down in the new accounting standards are recognized as an asset on the balance sheet. They are amortized on a straight line basis over their useful life, which generally does not exceed three years.

G. Property, plant and equipment

In accordance with IAS 16 - Property, plant and equipment, only items whose cost may be determined reliably and in respect of which future economic benefits are likely to flow to the Group are accounted for as property, plant and equipment.

Property, plant and equipment is stated at historical cost less accumulated depreciation and any impairment losses recognized.

Depreciation is calculated based on the rate of consumption of the expected economic benefits per item based on acquisition cost, less, where appropriate, its residual value, where the latter is deemed to be significant.

The various components of an item of property, plant and equipment are accounted for separately where their estimated service life and thus their depreciation period are materially different. The Group applies the straight-line method of depreciation according to the expected service life of the item.

The periods used are as follows:

- buildings: 20 to 50 years;
- fixtures and fittings: 10 to 15 years;
- plant and equipment: 3 to 10 years;
- vehicles: 3 to 5 years.

These depreciation periods are reviewed and adjusted in the event of significant changes. These changes are applied prospectively.

Investment grants are recognized at the outset as a deduction from the gross value of the non-current asset.

H. Leases

Under IAS 17, a lease is classified as a finance lease if it transfers substantially to the lessee all the risks and rewards incidental to ownership of an asset.

Where the criteria laid down in the standard are not met, the costs resulting from agreements are charged to income for the period and the lease is considered to be an operating lease.

Non-current assets used under a finance lease give rise to the recognition on the balance sheet of both an item of property, plant and equipment and an obligation to make future lease payments. At the inception of the lease, the asset and relevant liability of the same value corresponding to future payments under the lease are recognized on the balance sheet.

Lease payments are broken down into a finance charge and the repayment of the outstanding debt. The finance charge is allocated to each period during the lease term so as to produce a constant periodic rate of interest on the remaining balance of the liability.

The capitalized asset is depreciated over the useful life adopted by the Group for non-current assets of the same type.

In addition, a portion of the capital amount of the debt is repaid in accordance with the debt repayment schedule contained in the finance lease agreement.

The Group has set a threshold based on the size and business activities of its units. The finance leases shown on the balance sheet are restated for all items of leased property with an initial value of over €1 million.

I. Impairment of property, plant and equipment and intangible assets

In accordance with IAS 36 - Impairment of assets, when events or changes in the market environment indicate a risk of impairment, the Group's intangible assets and property, plant and equipment undergo a detailed review to determine whether their carrying amount is below their recoverable amount. This amount is defined as the higher of fair value and value in use.

Should the recoverable amount of assets fall below their carrying amount, an impairment loss is recognized in respect of the difference between these two amounts. Impairment losses recognized on property, plant and equipment and intangible assets (except for goodwill) with a defined useful life may be reversed subsequently if the recoverable amount becomes higher than the carrying amount again (without exceeding impairment loss initially recognized).

The recoverable amount of assets is usually determined based on their value in use. Value in use is defined as the expected future economic benefits from their use and from their sale. It is assessed notably by reference to the future cash flows projected based on economic assumptions and operating budgets drawn up by Carbone Lorraine's senior management.

IAS 36 defines the discount rate to be used as the pre-tax interest rate reflecting the current assessment of time value per market and the risks specific to the asset. It represents the return that investors would require if they had to choose an investment the amount, maturity and risks of which are equivalent to those of the relevant asset or cash-generating unit (CGU).

The discount rate used for impairment test purposes takes into account the financial structure and gearing of companies in the sector, i.e. of peers and not of the business or group to which the asset or CGU belongs.

J. Financial assets and liabilities

Financial assets and liabilities are measured and recognized in line with IAS 39 - Financial instruments: Recognition and Measurement and by IAS 32 - Financial Instruments: Disclosure and Presentation.

Financial assets comprise investments available for sale, investments held to maturity, transition assets, margin deposits paid in relation to derivative instruments, derivative instruments held as assets, loans, receivables, and cash and cash equivalents.

Financial liabilities comprise borrowings, other financing and bank overdrafts, derivative instruments held as liabilities, margin deposits received in relation to derivative instruments and other liabilities.

Borrowings and other financial liabilities are stated at amortized cost using the effective interest rate (EIR). For example, lending fees are deducted from the initial amount of the debt, then added back period by period according to the calculation of the EIR, with the amounts added back being recognized in income.

K. Treasury shares

Treasury shares are deducted from equity at their acquisition cost. Any gains from the sale of these shares are recognized directly in equity and are not taken to income for the period.

L. Non-current financial assets

Investments in unconsolidated subsidiaries and associates are stated at fair value.

In the event of impairment, a loss is recognized if the carrying amount exceeds fair value, the latter being computed based on the relevant entity's medium-term development prospects, and is charged to income.

The principal activity of the unconsolidated subsidiaries is the distribution of products manufactured by the Group's consolidated companies. Including them in the scope of consolidation would not have a material impact on the Group's financial statements.

A company is included in the scope of consolidation when two of the following four criteria are met for two consecutive years:

- **equity:** the difference between the value of the securities and net equity exceeds 1% of the Group's equity in the previous year;
- **debt:** the amount of non-Group debt exceeds €5 million;
- **sales to third parties:** the entity's sales less intra-Group sales represent more than 1% of Group sales in the previous year;
- **net income:** net income exceeds €0.5 million.

M. Provisions

In accordance with IAS 37 - Provisions, contingent liabilities and contingent assets, provisions are recorded when the Group is under an obligation to a third party at the end of the fiscal year that is likely or certain to trigger an outflow of resources to the third party, without any equivalent benefit being anticipated by the Group.

The relevant obligation may be legal, regulatory, or contractual in nature. It may also derive from the Group's business practices or from its public commitments where the Group has created a legitimate expectation among such third parties that it will assume certain responsibilities.

The estimated amount shown in provisions represents the outflow of resources that the Group is likely to incur to extinguish its obligation. Where this amount cannot be measured reliably, no provision is recorded. In this instance, information is disclosed in the notes to the financial statements.

Contingent liabilities consist of a possible obligation arising from past events the existence of which will be confirmed only by the occurrence or non-occurrence of one or more uncertain future events not wholly within the control of the entity or a probable obligation for which the outflow of resources is not likely. They are disclosed in the notes to the financial statements.

With restructurings, an obligation exists where the restructuring has been announced and a detailed plan drawn up or execution of the plan has commenced prior to the balance sheet date.

Where the entity has a reliable schedule, the liabilities are discounted where discounting has a material effect.

N. Inventories

Inventories are carried at the lower of cost and their probable net realizable value.

Cost comprises acquisition or production cost.

The only indirect costs taken into account in the measurement of work in progress and finished products are production-related expenses. No interest costs are capitalized.

O. Consolidated sales

Net sales include sales of finished goods and related services, sales of scrap, sales of goods purchased for resale and invoiced shipping costs.

A product is recognized in sales when the entity transfers to the buyer the risks and benefits of ownership of the goods.

A sale is measured at the fair value of the consideration received or receivable. Where payment is deferred, leading to a significant impact on determination of its fair value, this is reflected by discounting future payments.

The amount of revenue from the sale of goods and equipment is usually recognized when there is a formal agreement with the customer stipulating that risks have been transferred, the amount of revenue can be measured reliably and it is likely that the economic benefits arising from the transaction will flow to the Group. With agreements providing for formal acceptance of the goods, equipment or services received by the customer, recognition of the revenue is normally deferred until the date of acceptance.

Income from ancillary activities is recorded under the appropriate heading of the income statement, i.e. other revenues, financial income, or as a deduction from (selling, general, administrative or research) expenses of the same type.

P. Employee benefits

Under defined contribution plans, the Group is under no obligation other than to pay contributions. The corresponding charge, which reflects the payment of contributions, is expensed.

In line with IAS 19, defined benefit pension plans undergo an actuarial valuation using the projected unit credit method. This method sees each period of service as giving rise to an additional unit of benefit entitlement and measures each unit separately to build up the final obligation. This final obligation is then discounted to present value.

These actuarial calculations are based on various estimates:
- mortality tables,
- retirement dates,
- rate of future salary and benefit increases and employee turnover,
- expected return on plan assets,
- discount and inflation rates set for each of the relevant entities taking into account their local macro-economic environment.

Actuarial gains and losses comprise the cumulative impact of:
- experience adjustments (difference between previous actuarial assumptions and what has actually occurred),
- changes in actuarial assumptions.

IAS 19 states that actuarial gains and losses may offset one another in the long term. As a result, it provides for the so-called corridor approach for the recognition of post-employment benefit obligations.

The Group has opted to use this method:
- cumulative unrecognized actuarial gains and losses falling outside a corridor of plus or minus 10% of the value of the higher of the plan's assets and obligations are recognized and amortized over the expected average remaining working lives of the employees participating in the plan;
- gains and losses falling within the 10% corridor are not recognized;
- unrecognized net cumulative actuarial gains and losses include both the cumulative portion of the 10% within the corridor, as well as the portion outside the corridor, which has not been recognized at the balance sheet date. In accordance with IAS 19, they are disclosed in the notes to the financial statements.

P1. Recognition of post-employment benefit obligations

The Group's post-employment benefit obligations are accounted for as follows:

On the face of the balance sheet

The amount recognized under liabilities in respect of defined contributions is equal to the total of:
- the present value of defined benefit obligations at the balance sheet date,
- less the fair value at the balance sheet date of plan assets used directly to pay or finance the obligations,
- plus unrecognized actuarial gains (or less unrecognized actuarial losses) that exist under the aforementioned rule,
- less as yet unrecognized past service cost and payments.

On the face of the income statement

The amount expensed or recognized in income (net periodic cost of employee benefits) is the total amount net of the following items:

- current service cost incurred during the period (or rights vested during the period);
- interest cost (also called the "discounting effect");
- expected return on plan assets: this expected return is determined based on market expectations at the beginning of the period for returns on plan assets over the entire duration of the corresponding liability (long term);
- actuarial gains and losses: portion recognized during the period;
- past service cost: portion recognized during the period;
- losses/(gains) on any curtailment or settlement of the plan.

P2. Recognition of unrecognized past service cost

Unrecognized past benefits are recognized in income on a pro rata basis with the corresponding obligation.

Q. Non-recurring income and expense

Non-recurring items correspond to income and expense not arising during the Group's day-to-day operations. They are characterized in general by their unusual nature and their material amount.

Non-recurring income and expense include the following items:

- disposal gains: on property, plant and equipment, intangible assets, investments, other financial assets and other assets;
- impairment losses recognized on investments, loans, goodwill and other assets;
- certain types of provision;
- reorganization and restructuring costs.

R. Operating income

Operating income is shown before net finance costs, taxes and minority interest.

Investment grants are shown as a deduction from costs to which the grant relates.

S. Deferred tax

Accounting restatements or consolidation adjustments may affect the results of the consolidated companies. Temporary differences are differences between the carrying amount of an asset or liability on the balance sheet and its tax base, which give rise to the calculation of deferred taxes.

In accordance with IAS 12, the Group discloses deferred taxes on the balance sheet separately from other assets and liabilities. Deferred tax assets are recognized on the balance sheet where it is more likely than unlikely that they will be recovered in subsequent years. Deferred tax assets and liabilities are not discounted.

When assessing the Group's ability to recover these assets, the following items in particular are taken into consideration:

- projections of its future taxable income;
- its taxable income in previous years.

Deferred tax assets and liabilities are stated using the liability method for the balance sheet, i.e. using the tax rate that is expected to be applied in the year in which the asset will be realized or the liability settled, based on tax rates (and tax laws) adopted or virtually adopted at the balance sheet date, taking into account future tax rate increases or decreases.

The valuation of deferred tax assets and liabilities reflects the tax consequences of the way in which the entity expects at the balance sheet date to recover or to settle the carrying amount of its assets and liabilities.

T. Segment reporting

In accordance with the requirements of IAS 14, the Group has opted to use business segments as its primary segment and geographical area as its secondary segment in view of its internal management and reporting structure. The Group is currently organized into three operating activities:

- **Advanced Materials and Technologies:** applications of graphite for high-temperature industrial processes, anticorrosion equipment and high-energy braking;
- **Electrical Applications:** brushes and sliding electrical contacts for industrial, automotive and small household appliances motors and diagnostic analysis of malfunctions in industrial and automotive electric motors in the contact between the brushes and the collector;
- **Electrical Protection:** fuses and fuseholders protecting industrial equipment and power semi-conductors, to ensure the safety of people and equipment.

The Group has divided its secondary reporting segment into five geographical segments: France, Rest of Europe, North America, Asia and the Rest of the world.

The Group's segment reporting is prepared in accordance with the accounting methods used to draw up and present the consolidated financial statements.

U. Earnings per share

Basic and diluted earnings per share are shown both for total net income and net income from continuing operations.

Basic earnings per share are calculated by dividing net income for the period attributable to holders of ordinary shares by the weighted average number of ordinary shares in issue during the period.

For the calculation of diluted earnings per share, net income attributable to holders of ordinary shares and the weighted average number of shares outstanding are adjusted for the effects of all dilutive potential ordinary shares.

V. Equity-settled benefits granted to employees

In accordance with IFRS 2 - Share-based payment, stock purchase and subscription options and offers reserved for employees related to shares in the Group are recognized at fair value at the grant date.

The value of stock purchase and subscription options depends notably on the exercise price, the probability of the conditions attached to exercise of the options being met, the life of the options, current price of the underlying shares, anticipated volatility of the share price, expected dividends and risk-free interest rate over the life of the option. This value is recognized in staff costs on a straight-line basis between the grant date and exercise date with a direct equivalent entry in equity for plans settled in equity and in liabilities to employees for plans settled in cash.

W. Use of estimates

For the preparation of the consolidated financial statements, the calculation of certain figures shown in the financial statements requires that assumptions, estimates or assessments be made, particularly in relation to the calculation of provisions and impairment testing. These assumptions, estimates or assessments are prepared on the basis of the information available and the position at the balance sheet date.

Actual events occurring after the balance sheet date may prove to be different from the assumptions, estimates or assessments used.

Note 3 Assets held for sale or discontinued operations

The disposal of the Magnets division, which was underway at December 31, 2005, was completed on February 27, 2006.

Of the net disposal price of €10 million, the €5 million payment due on the closing date was recognized under other current financial assets, with the remaining €5 million comprising the 3-year vendor's loan being recognized under other non-current financial assets.

Since the amount payable on the closing date in connection with the sale of the Magnets division was not settled, Carbone Lorraine initiated proceedings to secure payment of the consideration from the buyer Farinia. In response, the buyer initiated proceedings against Carbone Lorraine to challenge its demand for payment. The Group believes that Farinia is attempting to renegotiate the agreed price improperly and without due cause. Based on the information available at the closing date of the interim financial statements and pending the ruling expected during the second half of 2006, the amount due for payment from Farinia was not written down at June 30, 2006.

In accordance with IFRS 5, net income from assets held for sale or discontinued operations was disclosed on a separate line of the income statement. During 2005, the same heading reflected items related to the Magnets division prior to the disposal. In 2006, it included residual charges attributable to activities continued temporarily, but closely linked to the disposal of the Magnets and intended to be shut down.

Net income from assets held for sale and discontinued operations is disclosed separately on the Group's income statement and includes:

In millions of euros	June 2006	December 2005	June 2005 Pro forma
Net income from assets held for sale or discontinued operations	(0.9)	(0.8)	(0.1)
Net impairment losses recognized on assets and liabilities held for sale	(0.2)	(12.0)	-
Total	**(1.1)**	**(12.8)**	**(0.1)**

Net income from operations discontinued during the first half of fiscal 2006 included €1 million in sales and €1.9 million in operating costs.

The impairment loss was adjusted at June 30, 2006 following finalization of the disposal.

Pursuant to IFRS 5, the assets and liabilities held for sale and discontinued operations are shown on a separate line of the Group's balance sheet. During 2005, the same heading reflected the contribution made by the Magnets division prior to the disposal. In 2006, the heading included assets and liabilities attributable to activities continued temporarily, but closely linked to the disposal and intended to be shut down.

The assets and liabilities held for sale and discontinued operations are disclosed separately on the Group's balance sheet and include:

In millions of euros	June 2006	December 2005
Assets held for sale		23.2
Operations to be discontinued	1.2	2.8
Assets held for sale and discontinued operations	**1.2**	**26.0**
Liabilities held for sale	0.3	15.2
Liabilities related to operations to be discontinued	3.0	7.0
Liabilities related to assets held for sale and discontinued operations	**3.3**	**22.2**

At June 30, 2006, operations due to be discontinued included €1.2 million in current assets and the liabilities related to operations due to be discontinued comprised €1.7 million in provisions, €0.3 million in employee benefits and €1.0 million in current liabilities.

Note 4 Goodwill

In millions of euros	June 2006	December 2005	June 2005
Net value at January 1	182.1	164.4	164.4
Acquisitions	4.7		
Disposals			
Translation adjustments	(9.2)	17.7	14.6
Net value at end of period	177.6	182.1	179.0
Gross value at end of period	177.6	182.1	179.0
Total impairment losses at end of period	**0.0**	**0.0**	**0.0**

A breakdown by cash-generating unit is shown in the following table:

In millions of euros	June 2006	Movements during first-half 2006			December 2005
	Net value	Acquisition	Impairment	Translation adjustments	Net value
Anticorrosion equipment	60.4			(3.8)	64.2
High-temperature applications and high-energy braking	28.2	4.7		(1.2)	24.7
Electrical Applications	30.1			(0.6)	30.7
Electrical Protection	58.9			(3.6)	62.5
Total	**177.6**	**4.7**		**(9.2)**	**182.1**

US company Graphite Engineering & Sales was acquired on February 1, 2006. Goodwill totaling USD5.7 million (€4.7 million) was recognized on the acquisition. Determination of fair values will be finalized within 12 months of the acquisition, in accordance with IFRS 3.

Note 5 Asset impairment tests

Impairment tests were conducted for each of the cash-generating units when the balance sheet for fiscal 2005 was prepared.

Under IAS 36, tests were carried out on the basis of the value in use determined using the discounted cash flow method. The key assumptions used were as follows:

- five-year cash flow forecasts based on the 2006 budget and projections for the following four fiscal years;
- an after-tax discount rate of 8%;
- a perpetual growth rate of 1% for calculating terminal value;
- a normalized tax rate of 34%.

No impairment was identified during the tests.

The interim earnings reported by the Group do not call into question the assumptions adopted at the end of fiscal 2005 and no impairment was identified.

Note 6 Property, plant and equipment

In millions of euros	June 2006	December 2005	June 2005
Gross value	419.1	399.7	472.2
Accumulated depreciation	(276.3)	(260.3)	(323.8)
Net value	**142.8**	**139.4**	**148.4**
Accumulated impairment losses			

In millions of euros	Land	Buildings	Plant, equipment and other	Assets in progress	Total
Net value at December 31, 2004	**33.6**	**27.5**	**75.7**	**6.9**	**143.7**
Acquisitions		0.3	4.9	4.2	9.4
Retirements and disposals	(0.2)	(0.1)	(0.5)		(0.8)
Depreciation		(1.3)	(9.5)		(10.8)
Translation adjustments	0.8	1.9	4.3	0.3	7.3
Other movements		(0.3)	1.2	(1.3)	(0.4)
Net value at June 30, 2005	**34.2**	**28.0**	**76.1**	**10.1**	**148.4**
Net value at December 31, 2005	**30.5**	**23.9**	**70.7**	**14.3**	**139.4**
Acquisitions		0.2	5.5	5.8	11.5
Retirements and disposals			(0.6)		(0.6)
Depreciation		(1.0)	(9.5)		(10.5)
Translation adjustments	(0.2)	(1.4)	(2.8)	(0.6)	(5.0)
Other movements	(0.9)	0.1	0.5	2.6	2.3
Changes in scope		2.5	3.2		5.7
Net value at June 30, 2006	**29.4**	**24.3**	**67.0**	**22.1**	**142.8**

Note 7 Investments

In millions of euros	June 2006	December 2005	June 2005
At year end, the unconsolidated shareholdings held by consolidated companies had a gross value	40.4	34.4	24.9
Less impairment losses	(12.8)	(12.8)	(10.1)
Representing a net value	27.6	21.6	14.8
Investments in other companies			
Total	**27.6**	**21.6**	**14.8**

The increase in investments during the first six months of fiscal 2006 was primarily attributable to the Group's investment spending in China.

The main investments in unconsolidated subsidiaries and associates are as follows:

Company name	% held	Gross value (in millions of euros)	Net value (in millions of euros)
CL Mauritius	100	15.3	15.3
Carbone Lorraine India Private Ltd	100	8.4	6.1
Carbone Lorraine Sanayi Urünleri A.S (Turkey)	100	5.0	1.0
Carbone Lorraine Argentina SA (Argentina)	100	3.7	0.8
Carbono Lorena de Mexico S.A.	100	2.2	0.6
Carbone Lorraine Holding (Singapore)	100	1.1	0.1
Nortroll (Norway)	34	0.8	0.5
Clisa (Mexico)	49	0.7	0.7
Carbone Lorraine Greece	100	0.6	0.6
Carbone Lorraine Madras Private Ltd	100	0.5	0.5
Ferraz Electric Protection Hinode (China)	70	0.3	0.3
Carbone-Lorraine Chile (Chile)	100	0.2	0.2
Carbone-Lorraine Shanghai (China)	100	0.2	0.2
GMI Metaullics (United States)	25	0.2	0.2
Carbone Lorraine de Colombia S.A.	80	0.1	0.1
Le Carbone Materials KK	49	0.1	0.1
Investments in other companies		1.0	0.3
Total		**40.4**	**27.6**

The interim sales and net income of these companies based on as-yet unaudited individual financial statements totaled around €15.8 million and €0.6 million respectively in the first half of 2006 (compared with €17.4 million and €0.8 million in the first six months of fiscal 2005). Their impact on the consolidated financial statements is not material. The consolidated sales of all these companies is estimated at around €7.7 million or 2.4% of total consolidated sales, after the elimination of intra-group flows.

Note 8 Stocks

In millions of euros	June 2006	December 2005	June 2005
Raw materials and other supplies	61.0	57.7	52.8
Work in progress	39.8	36.7	44.6
Finished goods	39.9	39.3	45.3
Carrying amount of inventories	**140.7**	**133.7**	**142.7**
Impairment losses	(11.1)	(10.9)	(10.7)
Net carrying amount of inventories	**129.6**	**122.8**	**132.0**

During the first six months of fiscal 2006, net inventories increased by €6.8 million, with a reduction of €3.8 million attributable to currency effects. On a like-for-like basis, inventories grew by €10.6 million (9%).

Note 9 Trade receivables

In millions of euros	June 2006	December 2005	June 2005
Gross trade receivables	137.8	124.2	139.2
Impairment losses	(6.8)	(9.4)	(7.9)
Net trade receivables	**131.0**	**114.8**	**131.3**

Note 10 Share capital

In number of shares (unless stated otherwise)	Ordinary shares
Number of shares at January 1, 2006	13,841,352
Issue of new shares (in millions of euros)	2.7
Number of shares at June 30, 2006	13,934,105
Number of shares in issue and fully paid-up	92,753
Number of shares in issue and not fully paid-up	0
Per value of shares (in euros)	2.00
Entity's shares held by itself or by its subsidiaries and associates	29,147

The increase in the share capital during 2006 derived from the exercise of subscription options granted to employees (48,259 shares) and the issue of capital reserved for employees, leading to the issuance of 44,494 shares.

The number of voting rights stood at 13,904,958 after deducting the 29,147 treasury shares held by the Company at June 30, 2006.

No shares carry double voting rights.

The number of share subscription options granted to company officers and employees and still outstanding stood at 497,118, taking into account the canceled options.

A bonus share allotment plan was set up for company officers and employees during fiscal 2005. The number of bonus share allotment options still outstanding at June 30, 2006 stood at 32,025.

In addition, no public tender or exchange offer, nor any guaranteed share price offer has been made in respect of the Company's shares over the past three years. The Company has not initiated any such offers for other companies over the same period.

Note 11 Provisions and contingent liabilities

In millions of euros	June 2006		December 2005		June 2005	
	Non-current	Current	Non-current	Current	Non-current	Current
Provision for restructuring	0.1	0.7	0.1	0.9	0.1	7.0
Provision for litigation	46.0	0.5	43.0	3.7	43.1	3.7
Other provisions	0.7	0.5	0.8	0.6	1.6	0.6
Total	**46.8**	**1.7**	**43.9**	**5.2**	**44.8**	**11.3**

At June 30, 2006, provisions for litigation primarily covered the entire amount of the fine handed down to the Group by the European authorities (€43 million) and class-action lawsuits in the US (€3.0 million reclassified under non-current provisions at June 30, 2006). A settlement of these class-action lawsuits amounting to USD6 million (including USD3 million paid in 2005) was agreed in August 2004. This settlement agreement was reduced to USD3.7 million in May 2006 following the actions taken by certain automobile equipment customers, who withdrew from the federal lawsuit and lodged a specific compensation claim. The Group believes that there is no legal basis for this separate legal action.

No material contingent liabilities were identified at June 30, 2006.

Note 12 Employee benefits

The Carbone Lorraine group's principal pension plans are defined benefit plans and are located in the UK (27% of obligations), the US (26% of obligations), France (18% of obligations) and Germany (15% of obligations).

The Group's obligations were assessed at December 31, 2005 with the assistance of independent actuaries in accordance with IAS 19. The charge during June 30, 2006 was calculated by extrapolating on the assessment at December 31, 2005.

2005	Discount rate	Return on plan assets	Average rate salary increases	Inflation rate
France	4.10%	4.25%	2.00%	2.00%
Germany	4.10%	Not applicable	2.50%	2.00%
United States	5.50%	6.75%	Not applicable	Not applicable
United Kingdom	5.00%	6.75%	3.30%	2.80%

The Group's obligations at June 30, 2006 were thus as follows:

In millions of euros	France	Germany	United States	United Kingdom	Rest of the world	Total
Actuarial obligation	18.6	15.1	26.1	27.7	13.3	100.8
Fair value of plan assets	(2.9)		(15.9)	(24.7)	(7.2)	(50.7)
Unrecognized actuarial gains and losses	(2.4)		(2.7)	2.0	(1.2)	(4.3)
Unrecognized past service cost (rights not vested)	0.3					0.3
Net amount recognized	**13.6**	**15.1**	**7.5**	**5.0**	**4.9**	**46.1**

The Group's obligations at December 31, 2005 were thus as follows:

In millions of euros	France	Germany	United States	United Kingdom	Rest of the world	Total
Actuarial obligation	18.2	17.7	26.2	27.1	13.8	103.0
Fair value of plan assets	(2.8)		(15.4)	(24.1)	(7.1)	(49.4)
Unrecognized actuarial gains and losses	(2.1)	(2.4)	(2.9)	2.0	(1.5)	(6.9)
Unrecognized past service cost (rights not vested)						
Net amount recognized	**13.3**	**15.3**	**7.9**	**5.0**	**5.2**	**46.7**

The cost recognized over the period came to €3.3 million (vs. €3.4 million at June 30, 2005).

Note 13 Net debt

In millions of euros	June 2006	December 2005	June 2005
Borrowings	156.9	177.1	169.3
Bank overdrafts	35.1	7.6	15.4
Current financial liabilities	2.0	3.0	2.6
Current financial assets	2.3	1.4	2.6
Cash and cash equivalents	(2.8)	(2.5)	(0.6)
Total gross debt	**193.5**	**186.6**	**189.3**
Trading financial assets	(3.7)	(0.6)	(1.8)
Total net debt	(14.1)	(35.7)	(23.1)
Total net debt	**175.7**	**150.3**	**164.4**

NB: + liabilities; - assets.

Net cash breaks down as follows:

In millions of euros	June 2006	December 2005	June 2005
Bank overdrafts	(35.1)	(7.6)	(15.4)
Trading financial assets	3.7	0.6	1.8
Cash and cash equivalents	14.1	35.7	23.1
Net cash	**(17.3)**	**28.7**	**9.5**

NB: - liabilities; + assets.

Net debt came to €175.7 million compared with €150.3 million at December 31, 2005.

This increase of €25.4 million was driven notably by payment of the €10.2 million dividend and €34.5 million in investment (including the acquisition of Graphite Engineering & Sales). It also takes into account an impact of €6.7 million deriving from favorable exchange rate fluctuations caused predominantly by appreciation in the euro against the US dollar since December 31, 2005.

In millions of euros	June 2006	December 2005	June 2005
Total net debt	175.7	150.3	164.4
Net debt/equity	0.59	0.51	0.59

Net debt amounted to 59% of equity at June 30, 2006, compared with 51% at December 31, 2005.

In December 2000, Carbone Lorraine arranged a USD300 million syndicated loan with a pool of international banks to refinance its debt. This loan was structured in two tranches, namely a one-year USD105 million tranche extendible twice until December 2003 and a five-year USD195 million tranche.

The USD105 million tranche was repaid by Carbone Lorraine during June 2003, shortly ahead of its due date. This tranche was refinanced by means of a USD85 million private placement subscribed by US investors, including a USD65 million tranche with a final maturity of 10 years and a USD20 million tranche with a final maturity of 12 years.

The average duration of the private placement was initially around eight years because it is repayable in installments. Carbone Lorraine pays a fixed rate of interest every six months. Following the purchase of interest rate swaps, Carbone Lorraine receives these fixed-rate interest payments from a bank and pays a variable interest rate plus a margin.

The USD195 million tranche was repaid in January 2005 following the signature in late December 2004 of a new five-year USD220 million syndicated loan.

At June 30, 2006, the Group's confirmed credit lines amounted to USD305 million, USD112 million of which were not used.

Confirmed credit lines at June 30, 2006

In millions of US dollars		Interest rate	Nominal amount	Drawn down at June 30, 2006	Maturity date
Syndicated loan		Variable	220	108	December 2009
US private placements, Tranche A		Fixed	65	65	May 2013
	- including		9.3	9.3	May 2007
			9.3	9.3	May 2008
			9.3	9.3	May 2009
			9.3	9.3	May 2010
			9.3	9.3	May 2011
			9.3	9.3	May 2012
			9.3	9.3	May 2013
US private placements, Tranche B		Fixed	20	20	May 2015
	- including		4.0	4.0	May 2011
			4.0	4.0	May 2012
			4.0	4.0	May 2013
			4.0	4.0	May 2014
			4.0	4.0	May 2015
Total			**305**	**193**	

The interest rates on the syndicated loan are the interbank rate for the relevant currency when drawings are made plus a fixed credit margin. A fixed rate of interest is paid to investors in the US private placements. This fixed rate was swapped into a variable rate of interest for the entire duration of the private placements.

Covenants on confirmed borrowings

In connection with its various confirmed borrowings, Carbone Lorraine has to comply with a number of obligations, which are customary with this type of lending arrangement. Should it fail to comply with some of these obligations, the banks or investors (for the US private placements) may oblige Carbone Lorraine to repay the relevant borrowings ahead of schedule. Under the cross-default clauses, early repayment of a significant borrowing may oblige the Group to repay other borrowings immediately.

Carbone Lorraine must comply with the following financial covenants at June 30 and December 31 each year:

In millions of euros

Financial covenants (consolidated financial statements)	Net debt/EBITDA	Net debt/equity	EBITDA/net interest expense
Covenants*	The ratio must be:	The ratio must be:	The ratio must be:
- US private placement	< 3.25	< 1.3	> 3
- syndicated loan		< 1.3	
Actual ratios			
June 30, 2006			
- US private placement	1.99	0.62	11.40
- syndicated loan		0.62	
December 31, 2005**			
- US private placement	1.84	0.53	11.99
- syndicated loan		0.53	

* *Method for calculating the covenants. In line with the accounting rules, the net debt shown in the financial statements uses closing rates to calculate the euro-equivalent value of debt denominated in foreign currencies. For the purposes of the covenants, net debt does not take into account short-term financial receivables. In addition, solely for the calculation of the net debt/EBITDA ratio, net debt has to be recalculated at the average €/USD exchange rate for the period in the event of a difference of over 5% between the average exchange rate and the closing rate. To calculate the covenants at June 30, the convention is for EBITDA or gross operating income to be deemed to be EBITDA reported for the first six months of the year multiplied by two.*

** *In view of the first-time adoption of IFRS, EBITDA and net debt were recalculated on a pro forma basis under French GAAP for the purpose of the covenants at June 30, 2006.*

At June 30, 2006, there were no material borrowings or liabilities secured by assets or guaranteed by third parties.

Operating receivables and payables all mature in less than one year. A breakdown of borrowings by maturity is shown below.

Breakdown of borrowings, including the current portion at June 30, 2006

In millions of euros	Total	< 1 year	> 1 and < 5 years	> 5 years
Borrowings in USD	103.3	7.3	68.8	27.2
Borrowings in euros	51.1		51.1	
Borrowings in GBP	7.9		7.9	
Borrowings in CAD	0.2		0.2	
Total	**162.5**	**7.3**	**128.1**	**27.2**
Amortization of issuance costs at EIR	(1.1)			
Fair value of interest-rate derivatives	(4.5)			
Total	**156.9**	**7.3**	**128.1**	**27.2**

Of the €128.1 million in debt due to mature in between one and five years' time, €101.7 million had a maturity of over 3 years at June 30, 2006.

Analysis of total net debt at June 30, 2006

By currency	%	By interest rate	%
Euro	35.4	Fixed	22
USD	62.1	Variable	78
Other	2.5		

Interest rate risk management

The Group's policy for managing interest rate risk consists solely in taking limited positions from time to time depending on trends in borrowing rates.

In May 2003, the Group purchased several interest-rate swaps covering an aggregate nominal amount of USD85 million to turn the interest payable on the private placements into a variable rate. Under the terms of these swaps, the Company receives the interest payable to investors and pays 3-month USD Libor plus a credit margin. The starting date of the swap was May 28, 2003, and the swap has the same duration as the private placement.

In May 2003, the Group purchased several 3-year interest-rate swaps covering an aggregate nominal amount of USD60 million. Under the terms of these swaps, Carbone Lorraine paid a fixed interest rate of 2.565% and received 3-month USD Libor.

To refinance partly the swaps that matured, the Group entered into several interest-rate swaps in October 2005 covering an aggregate nominal amount of USD50 million. These swaps, which had a duration of three years, became effective in May 2006. Under the terms of these swaps, Carbone Lorraine pays a fixed interest rate of 4.6325% and receives 3-month USD Libor.

All the Group's interest rate hedging activities are carried out by the parent company (Le Carbone Lorraine France).

In millions of euros	Total	With a maturity < 5 years**	With a maturity > 5 years
Floating rate debt*	162.6	135.4	27.2
Financial assets and liabilities	(13.1)	(13.1)	
Net position before hedging	**175.7**	**148.5**	**27.2**
Fixed-rate hedge	39.3	39.3	
Net position after hedging	**136.4**	**109.2**	**27.2**

** After the fixed-for-variable rate swap on the US private placements and before amortization of issuance costs at the effective interest rate.*

*** After May 30, 2006, the size of the fixed-interest rate hedge decreased from USD60 million to USD50 million.*

Assuming Carbone Lorraine's debt and exchange rates remain unchanged at their June 30, 2006 level, an increase of 100 basis points in variable interest rates would increase the Group's annual interest costs by around €1.4 million.

Note 14 Derivative financial instruments

The deferred tax assets and liabilities recognized on the balance sheet are as follows:

In millions of euros	June 2006	December 2005	June 2005
Non-current derivatives, assets	0.9		0.5
Current derivatives, assets	3.2	0.9	0.8
Non-current derivatives, liabilities	(4.5)	(2.8)	(1.0)
Current derivatives, liabilities	(1.6)	(0.2)	(0.4)
Net position	**(2.0)**	**(2.1)**	**(0.1)**

The market values of the majority of the financial instruments held by the Group were estimated based on market rates at the end of the fiscal year. They were either calculated by the Group or obtained from the banking counterparties with which the financial transactions were conducted. These instruments match borrowings (interest rates) or sales transactions certain or almost certain (currency and raw materials) to occur.

In millions of euros	June 2006 Gains/(losses) on hedging transactions*	June 2006 Nominal amount**	December 2005 Nominal amount**	June 2005 Nominal amount**
Interest rate instruments	(3.6)	106.2	165.3	119.9
Foreign exchange instruments	0.5	13.9	26.7	16.2
Commodity instruments	1.1	3.1	4.0	0
Total	**(2.0)**	**123.2**	**196.0**	**136.1**

** including accrued interest (for interest rate instruments).*

*** sum of net positions by foreign currency (for foreign exchange instruments).*

Note 15 Other non-recurring income and expense

Other non-recurring income and expense break down as follows:

In millions of euros	June 2006	December 2005	June 2005
Restructuring costs	(0.3)	(3.7)	(1.4)
EU fine and US class-action lawsuits	(0.1)	(1.2)	(0.7)
Impairment losses on investments in unconsolidated subsidiaries and associates		(0.9)	(0.9)
Asset impairment losses	(1.0)		
Non-current asset disposal program			0.2
Other	(0.2)	0.1	(0.6)
Total	**(1.6)**	**(5.7)**	**(3.4)**

The non-recurring income and expense recognized during the first half of fiscal 2006 amounted to a loss of €1.6 million. The principal contributors were:

- the impairment loss of €1.0 million recognized on land and a building, which are no longer used in Germany;
- an additional €0.3 million in industrial restructuring costs.

During 2005, non-recurring income and expense amounted to a net charge of €5.7 million, which broke down as follows:

- an additional €3.7 million in industrial restructuring costs;
- an outlay of €1.0 million in connection with the settlement of US class-action lawsuits;
- recognition of an impairment loss of €0.9 million on the investment in the Mexican subsidiary.

At June 30, 2005, non-recurring income and expense amounted to a net charge of €3.4 million. The principal contributors were:

- €1.4 million in industrial restructuring costs;
- an outlay of €0.6 million in connection with the settlement of US class-action lawsuits;
- recognition of an impairment loss of €0.9 million on the investment in the Mexican subsidiary.

Note 16 Segment reporting

In millions of euros	Advanced Materials and Technologies (AMT)		Electrical Applications (EA)		Electrical Protection (EP)		Total for continuing operations	
Sales	June 2006	June 2005	June 2006	June 2005	June 2006	June 2005	June 2006	June 2005
Sales to third parties	122.5	101.3	99.6	95.2	102.3	87.2	324.4	283.7
Breakdown of sales	37.8%	35.7%	30.7%	33.5%	31.5%	30.8%	100%	100%
Operating income								
Segment operating income	21.4	18.1	7.9	6.7	9.7	4.7	39.0	29.5
Segment operating margin*	17.4%	17.9%	8.0%	7.0%	9.5%	5.4%		
Unallocated costs							(7.2)	(5.4)
Operating income from continuing operations							31.8	24.1
Operating margin from continuing operations							9.8%	8.5%
Finance costs, net							(4.3)	(3.4)
Current and deferred income tax							(7.5)	(7.8)
Net income from continuing operations							20.0	12.9

** Segment operating margin = Operating income/Segment sales to third parties.*

Inter-segment sales realized by the Advanced Materials and Technologies division came to €2.2 million in the first half of fiscal 2006 compared with €2.2 million in the same period of 2005.

Analysis of sales and sales trends by geographical area

In millions of euros	June 2006	%	June 2005	%
France	45.6	14	46.5	16
Rest of Europe	97.2	30	90.3	32
North America	117.7	36	97.7	35
Asia	45.4	14	31.5	11
Rest of the world	18.5	6	17.7	6
Total	**324.4**	**100**	**283.7**	**100**

Net carrying amount of assets at end of period by segment

In millions of euros	AMT	EA	EP	Total	Intra-Group transactions eliminated	Total at June 30, 2006
Non-current assets, net (excluding investments)	175.1	92.2	87.4	354.7		354.7
Inventories, net	56.2	35.5	37.9	129.6		129.6
Trade receivables	54.7	44.4	56.2	155.3	(24.3)	131.0
Other receivables	21.3	6.4	6.0	33.7	(4.4)	29.3
Total segment assets	**307.3**	**178.5**	**187.5**	**673.3**	**(28.7)**	**644.6**
Total unallocated assets						**89.2**
Total						**733.8**

Net carrying amount of liabilities at end of period by segment

In millions of euros	AMT	EA	EP	Total	Intra-Group transactions eliminated	Total at June 30, 2006
Trade payables	33.9	22.3	32.2	88.4	(24.3)	64.1
Other payables and other liabilities	36.8	14.5	15.7	67.0	(4.4)	62.6
Non-current and current provisions	5.1	43.0	0.4	48.5		48.5
Employee benefits	16.5	21.2	8.4	46.1		46.1
Total segment liabilities	**92.3**	**101.0**	**56.7**	**250.0**	**(28.7)**	**221.3**
Total unallocated liabilities						**216.0**
Total liabilities excluding equity						**437.3**

Note 17 Staff costs and headcount

Group payroll costs (including social security contributions, provisions for pension obligations and retirement indemnities) came to €105.5 million in the first six months of fiscal 2006 compared with €97.1 million in the year-earlier period, representing an increase of 4.4% on a like-for-like basis.

The average headcount stood at 6,305 employees at June 30, 2006. It was 5,996 employees at June 30, 2005, representing an increase of 5%. At comparable scope, the average headcount rose by 210 employees.

Breakdown of the consolidated average headcount by geographical area

	June 2006	%	June 2005	%
France	1,729	27	1,764	29
Rest of Europe (+ Tunisia)	1,671	27	1,633	27
North America (+ Mexico)	2,228	35	2,030	34
Asia	230	4	158	3
Rest of the world	447	7	411	7
Total	**6,305**	**100**	**5,996**	**100**

Note 18 Operating income

An analysis of operating income by nature of income and expense is shown in the following table:

In millions of euros	June 2006	June 2005 pro forma
Product sales	298.2	262.7
Trading sales	26.2	21.0
Total sales	**324.4**	**283.7**
Other operating revenues	3.3	1.4
Cost of trading sales	(18.1)	(7.6)
Raw materials costs	(73.6)	(70.3)
Costs on other operating revenues	(1.8)	(0.9)
Manufacturing costs	(53.5)	(45.6)
Salary costs	(106.4)	(97.7)
Employee incentives and profit-sharing	(2.3)	(1.9)
Other expenses	(26.6)	(23.2)
Financial components of operating income and discounts	(1.4)	(1.1)
Depreciation and amortization	(11.1)	(10.6)
Additions to provisions	(0.1)	(0.6)
Impairment losses	(1.0)	(1.5)
Operating income	**31.8**	**24.1**

Note 19 Income tax

In millions of euros	June 2006	December 2005	June 2005
Current income tax	(6.8)	(9.9)	(4.2)
Deferred income tax	(0.7)	(1.2)	(3.6)
Total tax charge	**(7.5)**	**(11.1)**	**(7.8)**

In France, Le Carbone-Lorraine SA, Carbone Lorraine Applications Electriques, Carbone Lorraine Composants, Carbone Lorraine Equipements Génie Chimique, Carbone Lorraine Corporate Services, Ferraz Shawmut SA, Ugimag, Ferroxdure, Polygraphite and AVO are consolidated for tax purposes.

There are also:
- two consolidated tax groups in the US, one encompassing Carbone Lorraine North America and its subsidiaries;
- three consolidated tax groups in Germany;
- and a consolidated tax group in Japan encompassing Carbone KK and Ferraz Shawmut Japan.

The Group's effective tax rate came to 27% in the first half of fiscal 2006 owing to a current income tax repayment in the US and a reduction in deferred tax owing to exchange rate fluctuations. Had it not been for these specific factors, the Group's effective tax rate would have been 34%.

Analysis of income tax expense

In millions of euros	June 2006
Net income	19.0
Income tax expense/(benefit)	7.5
Taxable income	26.5
Current tax rate in France	34.4%
Theoretical tax benefit/(expense) (taxable income x current income tax rate in France)	(9.1)
Difference between income tax rate in France and other jurisdictions	0.5
Transactions qualifying for a reduced rate of taxation	
Permanent timing differences	0.9
Impact of limiting deferred tax assets	0.5
Other items	(0.3)
Actual income tax benefit/(expense) recognized	(7.5)

The deferred tax assets and liabilities recognized on the balance sheet are as follows:

In millions of euros	June 2006	December 2005	June 2005
Deferred taxes assets	28.6	29.8	23.8
Deferred taxes liabilities	(6.8)	(6.4)	(5.7)
Net position	**21.8**	**23.4**	**18.1**

Deferred tax movements during the first half of fiscal 2006 were as follows:

In millions of euros	June 2006	Other items	Net income for the year	Translation adjustments	December 2005
Employee benefit obligations	7.3	1.6	(0.2)	(0.1)	6.0
Provisions for restructuring	0.5		(0.9)		1.4
Depreciation of non-current assets	(14.4)	(0.7)	(0.6)	1.0	(14.1)
Tax-regulated provisions	(3.1)	0.1	0.7		(3.9)
Impact of tax losses	21.5	(0.6)	1.7	(0.4)	20.8
Impairment losses	2.1	(0.9)	(4.1)		7.1
Other items	7.9	(0.2)	2.7	(0.7)	6.1
Deferred tax on the balance sheet – net position	**21.8**	**(0.7)**	**(0.7)**	**(0.2)**	**23.4**

NB: - liabilities; + assets.

Deferred tax assets were recognized based on their recoverability. France, Germany and the United States were the main tax jurisdictions affected.

Note 20 Dividends

A dividend of €0.70 per share was paid to shareholders in May 2006 in respect of fiscal 2005, representing an aggregate amount of €9.7 million (vs. €0.55 in respect of 2004).

Note 21 Leases

Finance leases

Carrying amount by asset category:

In millions of euros	June 2006	June 2005
Buildings	0.7	0.8

The investments financed comprise the leasing of manufacturing facilities at Poitiers and Airvault in France. The lease payments are fixed, without a buyback clause and with a final maturity in July 2014.

The Group is the lessee (operating lease)

Schedule of minimum payments:

In millions of euros	Total at June 30, 2006	Less than one year ahead	More than one year ahead	More than five years ahead
Minimum payments	15.0	2.7	12.3	4.4

Minimum payments represent the amount of certain future property lease payments up until the expiration of the lease prior to any renewals. The leases do not contain any clause restricting debt or dividend payments. The largest obligations relate to two sites in the US for an aggregate amount of €10.9 million and have respective durations of 6 and 13 years.

Note 22 Relations between the parent company and its subsidiaries

Le Carbone-Lorraine SA is a holding company that manages the Group's investments in subsidiaries and associates and its financing activities and charges subsidiaries for services related to the intangible assets and property, plant and equipment that it owns.

Le Carbone-Lorraine SA belongs to the Carbone Lorraine group, which encompasses 87 consolidated and unconsolidated companies in 34 countries.

Transactions between the Group's consolidated companies are eliminated for consolidation purposes.

Relations with unconsolidated subsidiaries

Group sales to unconsolidated subsidiaries and associates amounted to €8.2 million in the first half of fiscal 2006, compared with €6.2 million in the first half of fiscal 2005.

In the first half of fiscal 2006, the management and administrative fees charged to unconsolidated subsidiaries and associates by the Group (deducted from administrative costs) amounted to €0.2 million (vs. €0.2 million in the first half of fiscal 2005).

The amounts receivable by the Group from its unconsolidated subsidiaries and associates came to €4.8 million at June 30, 2006, while amounts payable came to €0.2 million.

Shareholders' advances made to unconsolidated subsidiaries and associates by Le Carbone-Lorraine SA amounted to €0.7 million at June 30, 2006 (vs. €0.5 million in the first half of fiscal 2005).

Disclosure of compensation paid to key management personnel (Executive Committee, including the Chairman and CEO):

In millions of euros	June 2006	June 2005
Salaries, bonuses, benefits in kind and directors' fees	0.8	0.8
Top-up pension plan payments charged to income*	0.3	0.2
Other long-term employee benefits	0.0	0.0
Total	**1.1**	**1.0**

** Members of the Executive Committee, including the Chairman and Chief Executive Officer, qualify for top-up pension payment. This regime guarantees a top-up pension payment of 15 % of the basic reference salary (i.e. salary during the final three years prior to retirement plus a flat-rate of 50% of bonuses) provided that the relevant person is still employed by the Group upon their retirement. Pension income is capped at 55% of this basic reference salary.*

Members of the Executive Committee do not qualify for any other long-term employee benefits.

Furthermore, Executive Committee members (including the Chairman and CEO) were awarded the following share-based payments:

- stock options: no stock subscription options were granted to members of the Executive Committee (including the Chairman and CEO) during fiscal 2004, 2005 or the first half of 2006,
- bonus shares allotments: see the table of previous allotments to the Executive Committee (including the Chairman and CEO) below.

	2005 Plan Tranche 1	Total
Date of Board of Directors' meeting	June 30, 2005	
Total number of shares allotted	11,475	11,475
Share price at allotment date	39.25	
Definitive allotment date	July 1, 2007	
End of lock-up period	July 1, 2009	

Note 23 Commitments and contingencies

Financial commitments and liabilities

In millions of euros	June 2006	December 2005	June 2005
Commitments received			
Guarantees and endorsements	0.6	0.2	0.1
Other commitments received	1.7	1.7	1.1
Total	**2.3**	**1.9**	**1.2**
Commitments given			
Collateralized debts and commitments	0.1	0.3	0.3
Market guarantees and endorsements	8.1	9.9	15.3
Payment guarantees on acquisition			
Other guarantees	45.6	45.4	47.1
Other commitments given	0.1	0.1	1.1
Total	**53.9**	**55.7**	**63.8**

The above table summarizes the Group's commitments and contingencies.

Nature

The largest item totaling €45.6 million includes a €24.5 million guarantee (initially €43 million) given to the European Commission as a result of the fine handed down by the European Commission in respect of which the Group has currently lodged an appeal before the European Communities Court of First Instance. This guarantee has enabled the Group to postpone payment of the fine for the duration of the appeal procedure. This line item also includes a guarantee of €16 million covering the maximum daily drawings by subsidiaries under the European cash pooling arrangements.

Maturity

Commitments and contingencies with a maturity of over one year amount to €21.6 million and include a €16 million cash pooling guarantee that will remain in force for as long as the cash pooling agreements are in place. Market guarantees generally last for less than one year, except for a few market guarantees the duration of which does not exceed three years. The €24.5 million guarantee given to the European Commission expires in December 2006. It may be extended with the consent of the guarantor banks depending on the date of the Court's ruling.

Internal control

Under the Group's internal control framework, Group companies are not authorized to enter into transactions giving rise to commitments and contingencies without obtaining the prior approval of the Group's Finance department and, where appropriate, of the Chairman and Chief Executive Officer or the Board of Directors. Nonetheless, certain Group companies have the option of issuing market guarantees not exceeding €150,000 with a maturity of less than two years without prior authorization in the normal course of their business activities. These guarantees are listed in the documents completed by the companies as part of the account consolidation procedure.

As far as the Company is aware, no material commitments or contingencies under the accounting standards in force have been omitted.

Title retention clause

None.

Note 24 Subsequent events

Carbone Lorraine announced at the beginning of September the closure of a manufacturing facility in Farmville (Virginia). This plant specializes in the production of brushes for auxiliary automobile electric motors. This move became necessary to bring our production costs into line with the fierce competition prevailing in the North American auto industry. Most of the production lines currently at Farmville (Virginia) are set to be transferred to other more competitive Group plants in Asia and France. The closure of the Farmville facility is likely to be completed within two years.

Note 25 Approval of the financial statements

The Group's consolidated financial statements for the fiscal year to June 30, 2006 were approved by the Board of Directors at its meeting on September 12, 2006.

Statutory auditors' review report on the half year Condensed consolidated financial statements

As statutory auditors and as required by article L. 232-7 of the French Companies Act (Code de commerce), we have:

- reviewed the accompanying half year condensed consolidated financial statements of Le Carbone Lorraine, covering the period from January 1st to June 30th, 2006 and,
- verified the information contained in the half year management report.

The half year condensed consolidated financial statements are the responsibility of your Board of Directors. Our responsibility is to issue a report on these financial statements based on our review.

We conducted our review in accordance with professional standards applicable in France. Those standards require that we perform limited procedures, to obtain an assurance, which is less than obtained in an audit, as to whether the half year consolidated condensed financial statements are free of material misstatement. We have not performed an audit as a review is limited primarily to analytical procedures and to inquiries of group management and knowledgeable personnel on information that we deemed necessary.

Based on our review, nothing has come to our attention that causes us to believe that the half-year condensed consolidated financial statements are not prepared, in all material respects and as described in the notes, in accordance with IAS 34, a standard of the IFRS framework such as adopted by the European Union and related to interim financial statements.

We have also verified, in accordance with professional standards applicable in France, the information contained in the half year management report supplementing the half year consolidated condensed financial statements submitted to our review.

We have no comment to make as to the consistency with the half year consolidated condensed financial statements and the fairness of the information contained in the half year management report.

This is a free translation of the original French text for information purposes only.

Paris La Défense, September 12, 2006

KPMG Audit
Department of KPMG SA

Jean-Paul Vellutini

Neuilly-sur-Seine, September 12, 2006

Deloitte & Associés

Alain Penanguer

Immeuble La Fayette
2 place des Vosges
92400 Courbevoie La Défense
France

Design and production: Franklin Partners, Groupe Mediagérance.