

MANAGEMENT'S DISCUSSION & ANALYSIS

INTRODUCTION

• LG Chem was founded in 1947. Over the past six decades, we have grown to become one of Korea's leading chemical companies. Our business operations are divided into three groups: Petrochemicals, Industrial Materials, and Information & Electronic Materials. Among these, we consider the Information & Electronic Materials Group to represent the strategic future direction of our company. We believe that our active ongoing investments in the fields and businesses connected with this group will provide the foundation for our next great leap forward.

2006 OVERVIEW

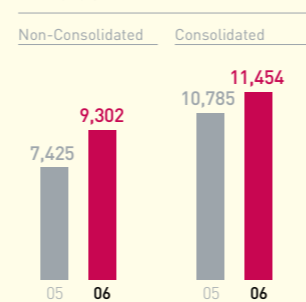
• Looking at parent company performance in 2006, we saw sales growth of approximately 25% to KRW 9,302.3 billion. This strong performance was due to our merger with LG Daesan Petrochemicals and steady growth by our Information & Electronic Materials Group. Contrary to expectations, operating profit fell KRW 87.8 billion to KRW 333.9 billion. Although the Information & Electronic Materials Group returned to profitability, high oil prices and a major facilities revamp by the Petrochemicals Group in the first-half of the year took a major toll on the group's profitability. Net income declined similarly, dropping KRW 81.5 billion to KRW 318.8 billion.

On a consolidated basis including all our global subsidiaries and affiliates, sales rose approximately 6.2% to KRW 11,453.7 billion. Operating profit tumbled KRW 116.1 billion to KRW 674.7 billion, while net income slid KRW 77.4 billion to KRW 324.7 billion.

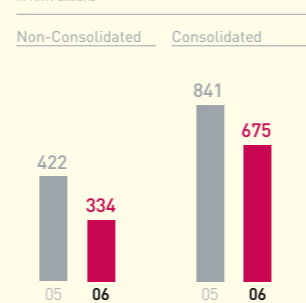
Looking at group performance on a parent-company basis, our Petrochemicals Group delivered sales growth of about 36% to top KRW 5,885 billion as it benefited from the merger with LG Daesan Petrochemicals. Operating profit, however, dropped nearly in half from KRW 310.5 billion to KRW 169.9 billion, affected by high prices for oil, ethylene, and other feedstocks as well as facility overexpansion in China by carbide-based PVC makers. On a positive note, the group did see operating profit begin to recover in the second-half of the year as it began to reap the benefits of vertical integration with LG Daesan and stability in oil prices.

Our Industrial Materials Group sales growth remained virtually flat at KRW 2,088.0 billion. The primary cause for this weak performance was a stagnant domestic real estate market and an extended strike that hit the Korean auto industry. This lack of

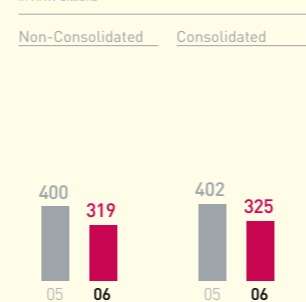
SALES



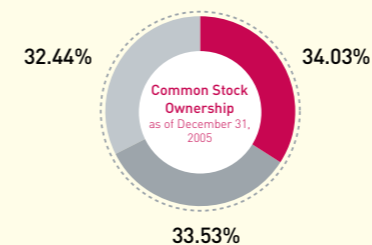
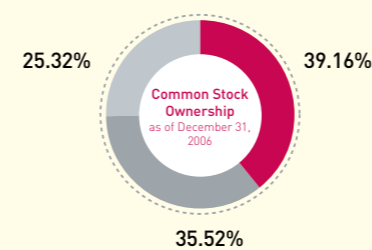
OPERATING PROFIT



NET INCOME



SHAREHOLDER COMPOSITION



• LG Corp.
• Korean Individuals & Institutions
• Foreign Shareholders

growth, coupled with high marketing costs associated with the launch of a new master brand, led to a roughly 16% fall in operating income to KRW 118.0 billion. On the positive side, the group's "Z:IN" (pronounced "z-in") master brand enjoyed rapid growth in awareness, projecting a premium image that's helping it gain market share. The group also began to see the results of its ongoing cost-cutting initiatives and diversification into new international markets in 2006.

Our Information & Electronic Materials Group returned to profitability after a major loss in 2005 as it dealt with low operating capacity ratios and slow orders in the aftermath of the battery quality problems and costly product recall. Strict quality control helped the battery business win new orders from high-volume clients such as HP and Dell, significantly reducing losses. The group's optical materials business made a remarkable turnaround thanks to the sales growth and cost reduction targets achieved despite sluggish demand for LCDs. Sales grew over 26% to KRW 1,610.7 billion, while operating profit rose KRW 73.6 billion to KRW 48.7 billion for the year.

Our R&D efforts continue to position us for growth as a total solution provider in all our businesses. Our Information & Electronic Materials Group is focusing on batteries for hybrid and electric vehicles, LCD color filter photoresists, and the full internalization of the raw materials used to make them. Our Industrial Materials Group is focusing on construction materials, sign media, and functional film products. Our Petrochemicals Group is exploring high polymer compounds as well as process and feedstock technologies.

Our ongoing investment in R&D and a solid foundation of talent and facilities capable of delivering results continue to lead the way in our search for emerging business opportunities. Our R&D organization will play a pivotal role in meeting our target of generating 60% of sales from our core product portfolio by 2010. We plan to invest approximately KRW 310.0 billion in R&D in 2007.

In 2006, we planned to invest a total of KRW 646.1 billion on capital projects, including KRW 237.2 billion in petrochemical businesses, KRW 97.7 billion in industrial material businesses, KRW 221.7 billion in information and electronic material businesses, and KRW 89.5 billion on other projects. Our actual investments for the year totaled KRW 590.5 billion, about KRW 55 billion less than projected as we delayed some planned projects due to a slowdown in the global LCD market and an economic contraction at home.

MANAGEMENT'S DISCUSSION & ANALYSIS

FINANCIAL INFORMATION

Financial Structure

Although we suffered a setback in our operating performance in 2006, our parent company debt-to-equity ratio fell over 7 percentage points to 122% and our net debt-to-equity ratio dropped 16 percentage points to 61% thanks to an increase in cash from the merger with LG Daesan and a change in some of our investment plans. On a consolidated basis, the ratios were 133% and 74%, respectively.

With the global petrochemical market trending upward and a significantly larger post-merger Petrochemicals Group, we expect our cash flow to substantially improve in 2007. We aim to improve our financial structure in the coming year through sound investment planning, growing operational profitability, business restructuring, and efficient working capital management.

We plan to internally fund our 2006 R&D and capital expenditures. Our mid- to long-term target is to maintain our net debt-to-equity ratio around the 50% level.

KEY FINANCIAL RATIOS

	Non-Consolidated		Consolidated	
	2005	2006	2005	2006
Debt-to-equity	129.4%	121.9%	137.5%	133.0%
Net debt-to-equity	76.5%	60.6%	85.2%	73.6%
Interest coverage	4.5%	3.8%	6.8%	5.9%
Return on assets	7.1%	5.6%	7.9%	6.2%
Return on equity	17.3%	12.6%	19.3%	14.5%

• The consolidated ROE and ROA are calculated with total new income, which includes the income of minority interests.

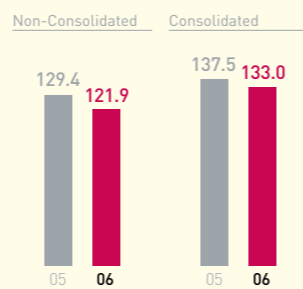
DEBT BY CURRENCY

in KRW billions

	Dec 2005	Dec 2006	Change
Korean won	1,529.8	1,269.2	-260.6
Foreign currency	335.6	316.1	-19.5
Total	1,865.4	1,585.3	-280.1

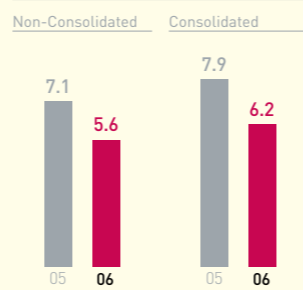
DEBT-TO-EQUITY

%



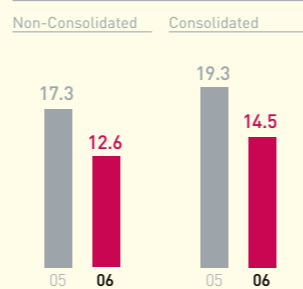
RETURN ON ASSETS

%



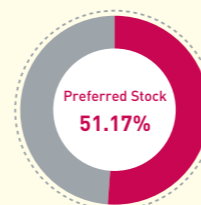
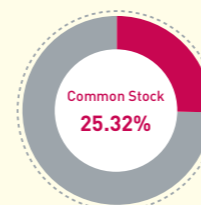
RETURN ON EQUITY

%



FOREIGN INVESTOR HOLDINGS

(in KRW billions)



Equity

Under current Korean trade regulations, holding companies must maintain at least a 30% ownership stake in the listed subsidiary's total outstanding shares-including preferred shares-to retain their status. In 2006, LG Corp. raised its ownership stake from 34% to 39% of LG Chem's common stock.

As of December 31, 2006, LG Corp.'s holdings totaled 39.2%, foreign shareholders held 25.3%, and Korean individual and institutional investors held 35.5%.

STOCK INFORMATION

as of December 31, 2006

	Outstanding Shares	Paid-In Capital in KRW billions	Foreign Investor Holdings
Commons Stock	64,425,064	322.1	25.32%
Preferred Stock	8,661,251	43.3	51.17%
Total	73,086,315	365.4	28.38%

Funding Strategy

Long- and Short-Term Borrowings

Our policy is to use long-term loans to fund plant and equipment investments, and short-term loans for operating capital. To guard against liquidity risk, we limit short-term borrowings to less than 90% of our net working capital.

Interest Rates

We use an appropriate mix of fixed and floating-rate loans to give us flexibility in responding to interest rate fluctuations. We limit floating-rate loans to between 20% and 40% of total borrowings.

Foreign Currency Borrowings

We maintain a certain level of foreign borrowings as a natural hedge against foreign exchange exposure. In 2007, our estimated exposure will be approximately USD 1.8 billion, and we will maintain foreign borrowings of around USD 400 million as a hedge.

COST OF CAPITAL

in KRW billions

	2006	2007 (E)	Change
Interest paid	88.6	86.3	-2.3
Interest rate	5.19%	5.32%	+13 bp

MANAGEMENT'S DISCUSSION & ANALYSIS

DEBT BY CURRENCY

in KRW billions

	Dec 2006	Dec 2007 (E)	Change
Korean won	1,269.2	1,206.5	-62.7
Foreign currencies	316.1	372.0	+55.9
Total	1,585.3	1,578.5	-6.8

Dividend Policy & Dividends

We consider dividends to be the most fundamental way to return profits to our shareholders. When determining the dividend, we consider a variety of factors such as the company's financial structure and funding requirements for planned investments.

Taking into account the financial performance setback we had in 2005, the ongoing revamp of our Daesan naphtha cracking center to improve the competitiveness of our Petrochemicals Group, our investment in both R&D and production facilities for polarizers and other growth businesses, and our policy to maintain our net debt-to-equity ratio at the 50% level, we have declared a 2006 dividend payout of 20% for common stock and 21% for preferred stock, both 5 percentage points lower than 2005. The payout is based on the share face value of KRW 5,000.

We aim to continuously increase shareholder value by enhancing the competitiveness of our core businesses and generating solid profits. It is our intention to maintain dividends at a level that satisfies both our commitment to sound financial governance and investor expectations for profit sharing.

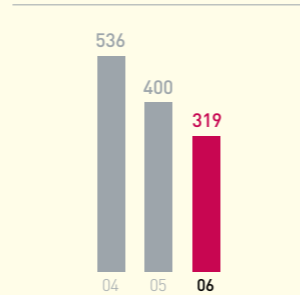
DIVIDEND SUMMARY

	2004	2005	2006
Net income in KRW billions	536,420	400,258	318,782
EPS in KRW	7,341	5,501	4,392
Total dividends in KRW billions	109,976	91,028	72,909
Dividends-to-net income	20.51%	22.74%	22.87%
Dividend payout, common	30%	25%	20%
Dividend payout, preferred	31%	26%	21%
Dividend yield ratio	3.6%	2.2%	2.3%

* Dividend payout is percentage of KRW 5,000 face value.

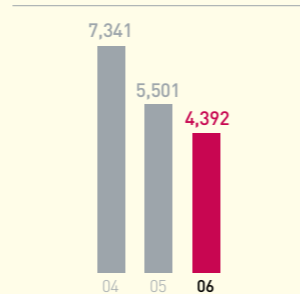
NET INCOME

in KRW billions



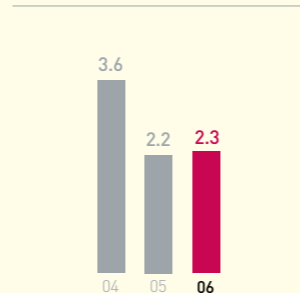
EPS

in KRW



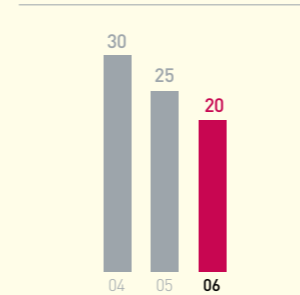
DIVIDEND YIELD RATIO

in %



COMMON STOCK DIVIDEND PAYOUT

in %



MERGER WITH LG DAESAN PETROCHEMICALS

The merger with LG Daesan Petrochemicals on January 1, 2006 enabled us to generate consolidated sales of approximately KRW 11,453.7 billion as we continued to grow as a global general chemical company. The merger has enabled us to achieve cost leadership through vertical integration in our mainstay petrochemicals businesses. Once the revamp of our Daesan naphtha cracking center is completed in 2007, we will have an even greater capacity to supply ourselves with major feedstocks, giving us a substantial overall competitive edge. We believe that our merged companies will help significantly improve profitability as global petrochemical markets recover in the coming years.

Our cash flow has also improved as we have been able to tap LG Daesan's surplus cash flow, enabling us to significantly reduce our outstanding borrowings. Going forward, this continuing cash flow will be a key source of funding for investments in both future growth businesses and R&D.

CAPITAL EXPENDITURES

Of the KRW 590.5 billion we invested in 2006, KRW 240.8 billion went to our Petrochemicals Group for projects such as the revamping of the Daesan naphtha cracking center slated for completion in 2007. Another KRW 167.8 billion went to projects in the fast-growing Information & Electronic Materials Group. The latter group originally had KRW 221.7 billion budgeted for projects, however slower-than-forecast growth in global infotech markets prompted us to adjust the scope of the plans, resulting in overall capital expenditures of approximately KRW 55 billion less than planned.

We will continue to invest conservatively in 2007. Our main focus will be on getting the maximum benefit from recovering global petrochemical markets by finishing the Daesan NCC revamping project as well as pushing ahead with selected Information & Electronic Materials Group projects related to LCD polarizers and other businesses projected to enjoy explosive growth in the coming years.

MANAGEMENT'S DISCUSSION & ANALYSIS

CAPITAL EXPENDITURES

in KRW billions

	2006	2007 (E)
Petrochemicals	240.8	257.5
Industrial Materials	80.8	115.2
Information & Electronic Materials	167.8	184.3
Other Projects	101.1	114.5
Total	590.5	671.5

2007 OUTLOOK

While economic and market recovery are still nowhere in sight in Korea and the global LCD and other infotech markets are equally uncertain, core information and electronic material businesses like LCD polarizers are expected to continue to generate sales growth, as is the steadily improving global petrochemical market. These latter positives are why we are forecasting parent company sales growth of around 4% to KRW 9,700 billion and consolidated sales growth of about 5% to KRW 12,130 billion in 2007.

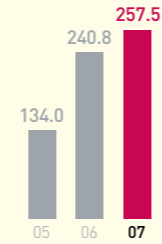
The petrochemical industry is now poised for recovery after a lackluster year in 2006 caused by high oil prices and weak demand. While our home market prospects are expected to gradually improve, we will continue to pursue greater profitability by breaking into new global markets and expanding sales of value-added products.

Our Petrochemicals Group will focus on cost competitiveness as it continues to bolster vertical integration with the revamped Daesan NCC facility and new EDC and VCM plants in Tianjin. The group will be aiming to secure a fundamental competitive edge in its PVC and ABS businesses, executing a total tear-down and redesign of production, sales, and R&D operations as it continues to pursue emerging opportunities for growth.

CAPITAL INVESTMENT BY BUSINESS GROUP

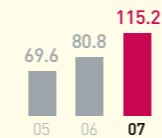
PETROCHEMICALS

in KRW billions



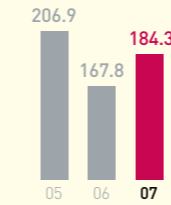
INDUSTRIAL MATERIALS

in KRW billions



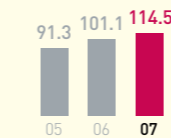
INFORMATION & ELECTRONIC MATERIALS

in KRW billions



OTHER PROJECTS

in KRW billions



Our Industrial Materials Group will counter the slow-to-recover Korean construction market by leveraging its excellent R&D and marketing capabilities to drive value-added product sales in the United States, China, and other strategic global markets. The group's launch of the new "Z:IN" master brand continues to rapidly build customer awareness, projecting a premium brand image as part of its differentiation strategy. The group also plans to conduct a full review of operations to reduce costs in the pursuit of greater competitiveness.

Our Information & Electronic Materials Group will face a tough market environment as competition intensifies in these steadily growing fields, bringing the dual challenges of falling prices and unfavorable exchange rates. The group plans to overcome these obstacles by quickly ramping up production capabilities to meet rapidly rising demand, continuously cutting production costs, expanding its product mix with high-performance products, and diversifying into new markets. It will continue to pursue growth and profitability by achieving greater economies of scale in LCD polarizers, bringing the production of core battery materials in-house, and developing entirely new kinds of materials.