

# Bayer's most successful year



*Dear Stakeholders:*

2007 was the most successful year yet for Bayer AG. Our key figures were outstanding:

- Sales rose by 12 percent to €32.4 billion. Adjusted for currency and portfolio changes, business expanded by 6 percent.
- EBITDA before special items came in at €6.8 billion, improving by 21 percent from our already very strong performance in the previous year. This gave us an underlying EBITDA margin of 20.9 percent, ahead of the target we had announced for 2007.
- EBIT before special items grew by 23 percent to €4.3 billion, while EBIT after special items climbed by 14 percent to €3.2 billion.

We owe our success in the past year to the tremendous commitment displayed by all our employees, who once again demonstrated their innovative capabilities, their diligence and their customer orientation. On behalf of the entire Board of Management, I would like to thank them explicitly for their valuable contribution.

I am pleased to say that all the subgroups contributed to our success last year.

Bayer HealthCare registered significant growth, thanks to the strong performance of our leading products and the acquisition of Schering, Berlin, Germany. We are more than satisfied with our progress in integrating that business, and we made considerable strides with our pharmaceutical pipeline. The other divisions of Bayer HealthCare are also developing very well, outpacing the growth in their markets.

At Bayer CropScience, business was lifted by higher prices for agricultural commodities, increased cultivation of crops for the production of biofuels and a more favorable market environment in Latin America. We further expanded our BioScience business and are now the world's second-leading supplier of cotton seed following our acquisition of the U.S. producer Stoneville.

Bayer MaterialScience maintained the positive sales trend of the previous year. Earnings, however, were held back mainly by higher raw material and energy costs. Targeting a sustainable improvement in profitability, Bayer MaterialScience has initiated a new cost structure program. It has also shored up its strategic positions in growth regions, partly by further expanding the production facilities in China.

Our success in 2007 is also evident in the dynamic performance of Bayer stock. The price of our shares rose by 57 percent on the year, considerably outpacing both the DAX and the EURO STOXX 50 and peaking above €60 for the first time.

Bayer's market capitalization rose by more than €16 billion in 2007, to over €47 billion – the highest absolute gain ever in a single year.

It goes without saying that we want you, our stockholders, to share in the solid performance of the business. The Board of Management and the Supervisory Board are therefore proposing an increase in the dividend to €1.35 per share – 35 percent more than for the previous year.

Both stockholders and management rate Bayer as a company with bright future prospects. We will do everything in our power to achieve our objectives and continue the strong performance of the past.

First, let us look ahead to 2008. We expect the global economy to go on expanding, with regional variations. We believe the strongest growth will occur in Asia and Latin America. In Europe we anticipate that economic expansion will remain robust. Uncertainty surrounds the economic trend in the United States and its possible impact on the global economy. Exchange rates also remain unpredictable.

In this environment we aim to continue growing and anticipate that we can raise Bayer Group sales by about 5 percent this year on a currency-adjusted basis. This would mean a slight nominal increase over 2007. We also expect to further increase EBITDA before special items and improve our operating margin.

Economic development in the coming years will be heavily influenced by basic trends:

- Life expectancy continues to rise, resulting in increased demand for innovative medicines and therapies.
- The global population is growing rapidly. Ever-higher crop yields must be achieved on the same amount of arable land in order to ensure sufficient food supplies.
- Last year's alarming status reports on climate change have firmly anchored the issue of climate protection, and how to tackle the effects of climate change, in the public consciousness.

Our portfolio addresses these significant challenges and fundamental trends. We therefore see excellent opportunities for the continued development of our business beyond 2008.

At Bayer HealthCare, our attractive product portfolio and well-stocked pharmaceutical research and development pipeline offer optimal perspectives for a successful future. Our cancer drug Nexavar is on track to establish itself as a standard therapy for several types of cancer. Sales of this product more than doubled in 2007. The anti-thrombosis drug Xarelto, currently in registration for a first indication, has the potential to become a "blockbuster" and achieve sales in the billion euro range.

The long-term trends and challenges in the agricultural industry offer tremendous opportunities for Bayer CropScience. For example, we are employing our innovative capability to enhance the stress tolerance of plants and thereby safeguard yields even under extreme conditions such as heat, drought or saline soil. This should help mitigate the consequences of significantly worsened growing conditions in some parts of the world and also represents a step toward tackling the effects of climate change.

In a variety of ways, the products of Bayer MaterialScience already play a key role in conserving energy and natural resources. One example is the use of our polyurethanes as insulating materials in buildings or refrigerators, which opens up the potential for considerable energy savings.

The Bayer Climate Program, unveiled in the fall of 2007, draws greater attention to our specific contribution in this area and is at the same time a pledge to work even harder in the future on innovative products and concepts for climate protection. We also intend to further improve the energy efficiency of our production processes and have set ourselves ambitious emissions targets. We plan to make €1 billion available through 2010 for climate-related R&D and projects.

For 2008 we have a capital expenditure budget of around €1.7 billion. We also plan to spend some €2.8 billion on research and development – by far the largest R&D budget of any German company in our sector. This investment is designed to support our future growth and ensure a high level of innovation.

Yet we can only remain competitive over the long term if we have highly skilled employees. After all, ideas, creativity and innovation are the main drivers of our future success.

Demographic change presents large corporations with new challenges. In important disciplines such as science and engineering, good specialists and highly qualified academics are already scarce, and this shortage is likely to deepen in the future. Our competitive compensation packages, the Group's international alignment and the numerous social benefits we provide make us an attractive employer. We place great importance on the continuing professional advancement and personal development of our employees.

We are also committed to arousing the interest of school students in science and technology, providing targeted financial support to improve study conditions at schools in the communities near our sites. This forms an integral part of our activities in the field of corporate social responsibility.

We are convinced that Germany can only ensure its long-term competitiveness as an industrial base if politics, society and industry join together to invest in education and training. In 2008 we again plan to offer vocational training places to approximately 800 young people and hire about 200 university graduates in Germany.

We can look back on a very successful year – and we can look forward to exciting challenges and promising perspectives. On behalf of the Board of Management, I thank you for your trust. We will do all we can to ensure that we continue along our successful path.

Sincerely,

A handwritten signature in blue ink, appearing to read 'Werner Wenning', with a stylized flourish at the end.

Werner Wenning  
Chairman of the Board of Management of Bayer AG