Management Report

2007: A very successful year for Bayer

Operational targets exceeded

- Sales grow 11.8 percent to €32.4 billion
- EBITDA before special items advances 21.4 percent to €6.8 billion
- EBIT before special items climbs 23.2 percent to €4.3 billion
- Divestments boost net income to €4.7 billion
- Dividend to be raised to €1.35
- Further earnings increase expected for 2008

Overview of Sales, Earnings and Financial Position

Full year 2007

The Bayer Group had a very successful **year** in **2007**. We again achieved a year-on-year improvement in the key indicators of operating performance and exceeded our earnings targets.

Sales gained 11.8 percent to €32,385 million (2006: €28,956 million). In the previous year the acquired business of Schering AG, Berlin, Germany, was only included on a pro-rated basis from June 23, 2006. Adjusted for currency and portfolio effects, Group sales rose by 6.1 percent, with HealthCare up 7.3 percent, CropScience 5.6 percent and MaterialScience 6.2 percent from the prior year.

Change in sales	2006	2007
%		
Volume	+4.6	+5.6
Price	+0.5	+0.5
Currency	−0.2	−3.6
Portfolio	+12.3	+9.3

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Bayer Group Quarterly Sales

€ million

		Domestic	Foreign	Total
Q1	2006	1,115	5,676	6,791
	2007	1,301	7,034	**8,335**
Q2	2006	1,060	5,676	6,736
	2007	1,199	7,018	**8,217**
Q3	2006	1,183	6,276	7,459
	2007	1,190	6,603	**7,793**
Q4	2006	1,167	6,803	7,970
	2007	1,125	6,915	**8,040**

Domestic Foreign

2006 figures restated

HealthCare Quarterly Sales

€ million

Q1	2006	2,203
	2007	**3,610**
Q2	2006	2,257
	2007	**3,717**
Q3	2006	3,482
	2007	**3,680**
Q4	2006	3,782
	2007	**3,800**

2006 figures restated

CropScience Quarterly Sales

€ million

Q1	2006	1,771
	2007	**1,786**
Q2	2006	1,578
	2007	**1,562**
Q3	2006	1,049
	2007	**1,157**
Q4	2006	1,302
	2007	**1,321**

MaterialScience Quarterly Sales

€ million

Q1	2006	2,486
	2007	**2,608**
Q2	2006	2,547
	2007	**2,623**
Q3	2006	2,596
	2007	**2,625**
Q4	2006	2,532
	2007	**2,579**

2006 figures restated

EBITDA before special items climbed by 21.4 percent to an all-time high of €6,777 million (2006: €5,584 million). We thus achieved an underlying EBITDA margin of 20.9 percent, exceeding our target margin for 2007. HealthCare saw EBITDA before special items climb by 45.1 percent to €3,792 million (2006: €2,613 million). This was attributable to the gratifying business performance of all divisions, the inclusion of the Schering business for the full year 2007 and the synergies already realized from its integration. CropScience posted underlying EBITDA of €1,324 million (2006: €1,204 million). This growth in earnings was mainly due to higher volumes and cost savings, which more than offset the impact of adverse currency shifts on margins. EBITDA before special items of Bayer MaterialScience amounted to €1,606 million, which was below the prior-year level of €1,677 million. Here, significant price increases for petrochemical raw materials and energies were largely offset by higher volumes and selling prices.

Bayer Group EBIT before special items also reached a record level, advancing 23.2 percent from the prior year to €4,287 million (2006: €3,479 million). EBIT in 2007 was diminished by net special charges of €1,133 million, against €717 million in the previous year. Of the 2007 figure, HealthCare accounted for €928 million, CropScience for €130 million and MaterialScience for €75 million. Special charges of €683 million (2006: €273 million) related to the integration of Schering AG, €172 million (2006: €224 million) to our ongoing restructuring, €152 million (2006: €60 million) to impairments of intangible assets and €139 million (2006: €172 million) to litigation. Bayer Group EBIT moved ahead 14.2 percent to €3,154 million (2006: €2,762 million).

After a non-operating result of minus €920 million (2006: minus €782 million), income before income taxes came in at €2,234 million (2006: €1,980 million). The non-operating result contained net interest expense of €701 million (2006: €728 million) and a €69 million loss (2006: €207 million income) from investments in affiliated companies. Included in the prior year figure is a €236 million gain from the sale of our interest in GE Bayer Silicones.

In 2007 we recorded net tax income of €72 million after a one-time, non-cash positive tax effect of €912 million arising in connection with the corporate tax reform in Germany. Without this one-time effect, tax expense in 2007 amounted to €840 million (2006: €454 million).

Income from continuing operations after taxes rose to €2,306 million (2006: €1,526 million), while after-tax income from discontinued operations totaled €2,410 million (2006: €169 million), mainly as a result of gains from the divestitures of the diagnostics business, H.C. Starck and Wolff Walsrode.

After minority stockholders' interest, net income of the Bayer Group improved to €4,711 million (2006: €1,683 million). Earnings per share came to €5.84 (2006: €2.22).

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Bayer Group Quarterly EBITDA Before Special Items

€ million

Q1	2006	1,564
	2007	**1,990**
Q2	2006	1,303
	2007	**1,806**
Q3	2006	1,459
	2007	**1,559**
Q4	2006	1,258
	2007	**1,422**

2006 figures restated

HealthCare Quarterly EBITDA Before Special Items

€ million

Q1	2006	465
	2007	**948**
Q2	2006	470
	2007	**969**
Q3	2006	882
	2007	**953**
Q4	2006	796
	2007	**922**

2006 figures restated

CropScience Quarterly EBITDA Before Special Items

€ million

Q1	2006	551
	2007	**584**
Q2	2006	368
	2007	**396**
Q3	2006	143
	2007	**167**
Q4	2006	142
	2007	**177**

MaterialScience Quarterly EBITDA Before Special Items

€ million

Q1	2006	539
	2007	**409**
Q2	2006	450
	2007	**409**
Q3	2006	381
	2007	**421**
Q4	2006	307
	2007	**367**

2006 figures restated

Gross Cash Flow

€ million		
Q1	2006	1,089
	2007	**1,411**
Q2	2006	928
	2007	**1,187**
Q3	2006	1,135
	2007	**1,165**
Q4	2006	761
	2007	**1,021**

2006 figures restated

Net Cash Flow

€ million		
Q1	2006	38
	2007	**375**
Q2	2006	882
	2007	**816**
Q3	2006	1,515
	2007	**1,623**
Q4	2006	1,493
	2007	**1,467**

2006 figures restated

Gross cash flow increased by €871 million to €4,784 million (2006: €3,913 million), due to the gratifying expansion of business and the full-year inclusion of Schering. Net cash flow advanced by 9.0 percent to €4,281 million (2006: €3,928 million).

Net debt of the Bayer Group as of December 31, 2007 amounted to €12.2 billion, compared with €17.5 billion at the end of 2006. This substantial reduction resulted from the improvement in operating cash flow and from the purchase price payments received in 2007 for the diagnostics business, H.C. Starck and Wolff Walsrode.

Provisions for pensions and other post-employment benefits declined by €1.0 billion compared with December 31, 2006, to €5.5 billion, mainly due to the rise in capital market interest rates.

Fourth quarter of 2007

The Bayer Group continued its positive performance of the first nine months in the **fourth quarter of 2007**. At €8,040 million, **sales** were up slightly from the prior-year figure of €7,970 million. On a currency- and portfolio-adjusted basis the increase came to 4.6 percent. HealthCare sales rose 4.6 percent, CropScience 4.5 percent and MaterialScience 5.8 percent over the same period of 2006.

Key Data by Subgroup and Segment, 4th Quarter

	Sales		EBIT before special items*		EBITDA before special items*		EBITDA margin before special items*	
€ million	4th Quarter 2006	**4th Quarter 2007**	4th Quarter 2006	**4th Quarter 2007**	4th Quarter 2006	**4th Quarter 2007**	4th Quarter 2006	**4th Quarter 2007**
HealthCare	**3,782**	**3,800**	**461**	**584**	**796**	**922**	**21.0 %**	**24.3 %**
Pharmaceuticals	2,698	2,619	263	367	563	670	20.9 %	25.6 %
Consumer Health	1,084	1,181	198	217	233	252	21.5 %	21.3 %
CropScience	**1,302**	**1,321**	**0**	**43**	**142**	**177**	**10.9 %**	**13.4 %**
Crop Protection	1,090	1,100	(11)	33	111	147	10.2 %	13.4 %
Environmental Science, BioScience	212	221	11	10	31	30	14.6 %	13.6 %
MaterialScience	**2,532**	**2,579**	**187**	**241**	**307**	**367**	**12.1 %**	**14.2 %**
Materials	749	778	18	1	62	42	8.3 %	5.4 %
Systems	1,783	1,801	169	240	245	325	13.7 %	18.0 %
Reconciliation	**354**	**340**	**(26)**	**(94)**	**13**	**(44)**	**3.7 %**	**(12.9) %**
Continuing operations	**7,970**	**8,040**	**622**	**774**	**1,258**	**1,422**	**15.8 %**	**17.7 %**

* for definition see Bayer Group Key Data table on front flap, also page 47

EBITDA before special items moved ahead in the fourth quarter by 13.0 percent to €1,422 million (Q4 2006: €1,258 million), with HealthCare posting a 15.8 percent increase to €922 million (Q4 2006: €796 million), CropScience a 24.6 percent advance to €177 million (Q4 2006: €142 million) and MaterialScience a 19.5 percent improvement to €367 million (Q4 2006: €307 million). EBIT before special items climbed by 24.4 percent to €774 million. Net special charges came to €389 million (Q4 2006: €416 million), with HealthCare accounting for most of these items. EBIT for the fourth quarter came in at €385 million (Q4 2006: €206 million).

The Bayer Group had net tax expense of €149 million (Q4 2006: net tax income of €130 million) in the fourth quarter of 2007. This result was diminished by one-time non-cash tax effects. The prior-year figure contained one-time tax income of €203 million due to the first-time recognition of deferred tax assets for loss carryforwards.

Group net income in the fourth quarter came to €67 million (Q4 2006: €311 million). Earnings per share for the quarter were €0.11 (Q4 2006: €0.41). Gross cash flow improved to €1,021 million (Q4 2006: €761 million), while net cash flow dropped by 1.7 percent to €1,467 million (Q4 2006: €1,493 million).

Operating Environment in 2007

The **global economy** grew strongly in 2007 for the fourth year, albeit not quite as fast as in the preceding years. From the second half, global business conditions were increasingly affected by the turbulence on the mortgage markets. Even though the financial crisis has not yet had a significant negative impact on the global economy, the risks to future economic development have since increased considerably. The emerging markets proved relatively resistant to the financial crisis. While the economy in Europe remained stable, the United States economy slowed noticeably over the course of the year due mainly to the domestic real estate and financial crisis. There was uncertainty in the euro zone as the euro continued to appreciate against the U.S. dollar. International trade remained robust thanks to strong demand from the emerging markets.

The **markets relevant to our HealthCare business** posted stable growth in the mid single digits in 2007, with the regional shift registered in prior years largely continuing. There was increasing growth in the emerging markets as health care services there became accessible to more and more people and the demand for treatment options for chronic diseases increased. By contrast, there were signs of slower growth in the United States and the major European countries, partly on account of declining treatment costs in areas where leading products have lost their patent protection and generics continue to gain market share. In addition, growth in western Europe in particular was hampered by health policy factors that led to stronger cost control and limited access to certain types of treatment. Following the biannual price reduction carried out in the previous year, the Japanese market grew once again in 2007, though at a below-average rate.

The **global seed and crop protection market** benefited in 2007 from more favorable weather patterns than in the previous year and from positive conditions on the world's agricultural markets. Significantly higher demand for food, energy and feed plants, coupled with declining inventories, led to higher prices and spurred both crop production and the related demand for crop protection products throughout the world. The Latin American and eastern European markets posted double-digit growth rates, and the crop protection market in western Europe also recovered despite adverse climatic conditions in some areas.

By contrast, the markets of North America and Asia expanded only slightly, with the trend varying from region to region. The upward trend in China and India was maintained, while the drought conditions that have prevailed for several years in Australia persisted and the Japanese market continued to shrink.

The trend in the sectors of greatest importance to our MaterialScience subgroup varied by region in 2007 but was positive overall.

The **automotive industry** registered moderate expansion overall, with considerable regional variations. Whereas growth was slow in western Europe, eastern Europe closed out the year with a double-digit increase in production. China and India were the growth drivers in Asia, but production stagnated in Japan. The big three U.S. automakers remained under strong pressure, while Asian and German producers continued to strengthen their positions.

Capital spending in the **construction industry** rose only slightly worldwide in 2007 as a result of the negative trend in the United States, where the mortgage crisis led to a double-digit decline in housing construction. The pace of growth in western Europe was modest, with a shift from new construction to renovation. In the other regions, the positive trend continued. Although the Japanese construction industry shrank again in 2007 following a brief upswing, growth in Asia as a whole was above the global average.

The **electrical and electronics sector** saw satisfactory growth worldwide, led by Asia and Europe. Strong global demand was registered in all major product segments. Steady expansion in western Europe was accompanied by double-digit growth in eastern Europe. In the United States, the effects of the home construction crisis left its mark on the electrical sector, too. The industry's performance in Japan was below the regional average, with strong growth being recorded in China, South Korea and India.

The **furniture industry** had a largely satisfactory year worldwide. The western European manufacturers enjoyed steady export sales despite the strength of the euro, while in eastern Europe the sector continued its recovery. In the United States, the real-estate crisis led to a significant decline in sales in the second half of the year. In Asia, China further reinforced its dominant position.

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Performance by Subgroup and Segment

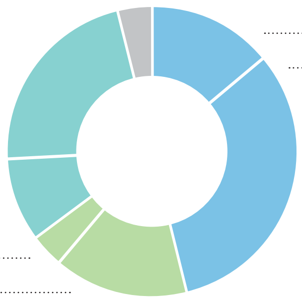
Group structure

Bayer AG, headquartered in Leverkusen, Germany, is the strategic management holding company for the Bayer Group. Business activities are conducted by the HealthCare, CropScience and MaterialScience subgroups, supported by the service companies Bayer Business Services, Bayer Technology Services and CURRENTA. There have been no material changes to the Bayer Group's structure since the 2006 Annual Report.

The commentaries in this report relate exclusively to continuing operations, except where specific reference is made to discontinued operations or to a total value (total). The divested activities of the Diagnostics Division from the HealthCare subgroup and of H.C. Starck and Wolff Walsrode from the MaterialScience subgroup are reported as discontinued operations. The prior-year figures have been restated accordingly.

The acquired business of Schering, Berlin, Germany, is included in the Pharmaceuticals segment of the HealthCare subgroup as of June 23, 2006. As of December 31, 2007, our interest in the voting capital of Bayer Schering Pharma AG, Berlin, Germany, amounted to 96.3 percent. The names "Bayer Schering Pharma" or "Schering" as used in this report always refer to Bayer Schering Pharma AG, Berlin, Germany, or its predecessor, Schering AG, Berlin, Germany, respectively. The reference to Bayer Schering Pharma AG or Schering AG also includes business conducted by affiliated entities in countries outside Germany. Bayer Schering Pharma AG and Schering-Plough Corporation, New Jersey, U.S., are unaffiliated companies that have been totally independent of each other for many years.

Sales by Segment in Percent, 2007 (2006 in parentheses)



Key Data by Subgroup and Segment, 2007

€ million	Sales 2006	Sales 2007	EBIT before special items* 2006	EBIT before special items* 2007	EBITDA before special items* 2006	EBITDA before special items* 2007	EBITDA margin before special items* 2006	EBITDA margin before special items* 2007
HealthCare	**11,724**	**14,807**	**1,715**	**2,492**	**2,613**	**3,792**	**22.3 %**	**25.6 %**
Pharmaceuticals	7,478	10,267	934	1,641	1,686	2,807	22.5 %	27.3 %
Consumer Health	4,246	4,540	781	851	927	985	21.8 %	21.7 %
CropScience	**5,700**	**5,826**	**641**	**786**	**1,204**	**1,324**	**21.1 %**	**22.7 %**
Crop Protection	4,644	4,781	441	632	927	1,093	20.0 %	22.9 %
Environmental Science, BioScience	1,056	1,045	200	154	277	231	26.2 %	22.1 %
MaterialScience	**10,161**	**10,435**	**1,210**	**1,117**	**1,677**	**1,606**	**16.5 %**	**15.4 %**
Materials	2,925	3,041	289	100	448	273	15.3 %	9.0 %
Systems	7,236	7,394	921	1,017	1,229	1,333	17.0 %	18.0 %
Reconciliation	**1,371**	**1,317**	**(87)**	**(108)**	**90**	**55**	**6.6 %**	**4.2 %**
Continuing operations	**28,956**	**32,385**	**3,479**	**4,287**	**5,584**	**6,777**	**19.3 %**	**20.9 %**

* for definition see Bayer Group Key Data on front flap, also page 47

Bayer HealthCare

Bayer HealthCare	2006	2007	Change
	€ million	€ million	%
Sales	**11,724**	**14,807**	**+26.3**
Pharmaceuticals	7,478	10,267	+37.3
Consumer Health	4,246	4,540	+6.9
Sales by Region			
Europe	4,737	6,184	+30.5
North America	3,689	4,439	+20.3
Asia/Pacific	1,649	2,023	+22.7
Latin America/Africa/Middle East	1,649	2,161	+31.0
EBITDA[1]	**1,947**	**3,065**	**+57.4**
Special items	*(666)*	*(727)*	
EBITDA before special items[2]	*2,613*	*3,792*	*+45.1*
EBITDA margin before special items	22.3 %	25.6 %	
EBIT[1]	**1,313**	**1,564**	**+19.1**
Special items	*(402)*	*(928)*	
EBIT before special items[2]	*1,715*	*2,492*	*+45.3*
Gross cash flow[1]	**1,720**	**2,389**	**+38.9**
Net cash flow[1]	**1,526**	**2,010**	**+31.7**

[1] for definition see Bayer Group Key Data on front flap
[2] for definition see also page 47

Sales of the **HealthCare** subgroup grew by 26.3 percent in 2007, to €14,807 million. The acquired business of Schering AG, Berlin, Germany, is included in this figure on a full-year basis (2006: June 23 – December 31). Adjusted for currency and portfolio effects, sales climbed by 7.3 percent. The increase was due to the positive business performance of both segments.

EBITDA before special items of Bayer HealthCare advanced by 45.1 percent in 2007 to €3,792 million (2006: €2,613 million). This increase was attributable to the gratifying business performance in all divisions, the full-year inclusion of Schering and the integration synergies already achieved. **EBIT** before special items came in at €2,492 million, which was also a considerable increase against the previous year's figure of €1,715 million. The net special charges of €928 million resulted primarily from expenses relating to the Schering integration and from a write-down of intangible assets in connection with negative results from the BEYOND study on Betaferon®/Betaseron®. EBIT rose by €251 million, or 19.1 percent, to €1,564 million.

Pharmaceuticals

Pharmaceuticals	2006	2007	Change
	€ million	€ million	%
Sales	**7,478**	**10,267**	**+37.3**
Primary Care [1]	3,091	3,055	−1.2
Women's Healthcare [2]	1,320	2,630	•
Diagnostic Imaging (including Medrad) [2]	697	1,298	•
Specialized Therapeutics [2]	678	1,253	•
Hematology/Cardiology	1,142	1,033	−9.5
Oncology [3]	432	754	•
Dermatology (Intendis) [2]	118	244	•
Sales by Region			
Europe	3,046	4,367	+43.4
North America	2,226	2,862	+28.6
Asia/Pacific	1,313	1,659	+26.4
Latin America/Africa/Middle East	893	1,379	+54.4
EBITDA [4]	**1,051**	**2,108**	•
Special items	*(635)*	*(699)*	
EBITDA before special items [5]	*1,686*	*2,807*	*+66.5*
EBITDA margin before special items	22.5 %	27.3 %	
EBIT [4]	**563**	**741**	**+31.6**
Special items	*(371)*	*(900)*	
EBIT before special items [5]	*934*	*1,641*	*+75.7*
Gross cash flow [4]	**1,086**	**1,685**	**+55.2**
Net cash flow [4]	**1,053**	**1,451**	**+37.8**

[1] Schering andrology business included in 2006 pro rata temporis
[2] Schering sales included in 2006 pro rata temporis
[3] Schering oncology business included in 2006 pro rata temporis
[4] for definition see Bayer Group Key Data on front flap
[5] for definition see also page 47

Sales of our **Pharmaceuticals** segment climbed by 37.3 percent in 2007, to €10,267 million (2006: €7,478 million). This figure contains €5,921 million (2006: €3,082 million pro-rated) in sales of the Schering business. Adjusted for portfolio and currency changes, sales were up by 5.7 percent.

Best-Selling Pharmaceutical Products	2006	**2007**	Change	Currency-adjusted change
	€ million	€ million	%	%
Yasmin®/YAZ®/Yasminelle® * (Women's Healthcare)	451	1,042	•	•
Betaferon®/Betaseron® * (Specialized Therapeutics)	535	1,028	•	•
Kogenate® (Hematology/Cardiology)	787	818	+3.9	+7.7
Adalat® (Primary Care)	657	614	−6.5	−1.5
Avalox®/Avelox® (Primary Care)	396	445	+12.4	+16.8
Cipro®/Ciprobay® (Primary Care)	513	383	−25.3	−22.8
Mirena® * (Women's Healthcare)	166	361	•	•
Levitra® (Primary Care)	314	332	+5.7	+10.6
Magnevist® * (Diagnostic Imaging)	171	301	•	•
Glucobay® (Primary Care)	308	298	−3.2	+1.2
Nexavar® (Oncology)	130	270	+107.7	+116.2
Ultravist® * (Diagnostic Imaging)	86	235	•	•
Aspirin Cardio® (Primary Care)	209	229	+9.6	+13.1
Iopamiron® * (Diagnostic Imaging)	117	211	•	•
Diane® * (Women's Healthcare)	88	175	•	•
Total	•	**6,742**	•	•
Proportion of Pharmaceuticals sales	•	66 %		

Products are ranked by full year 2007 sales.
* acquired Schering product, sales included in 2006 pro rata temporis

The 2006 sales figures include the acquired business of Schering for the period June 23 through December 31, 2006. The commentaries given below on business developments related to the acquired Schering AG products are based in part on Schering data for the first half of 2006 that do not form part of the Bayer Group financial statements. We therefore refer to the sales figures for these products as "pro forma."

Best-Selling Schering Products (pro forma)	2006	**2007**	Change	Currency-adjusted change
	€ million	€ million	%	%
Yasmin®/YAZ®/Yasminelle® (Women's Healthcare)	794	1,042	+31.2	+37.3
Betaferon®/Betaseron® (Specialized Therapeutics)	991	1,028	+3.7	+6.5
Mirena® (Women's Healthcare)	301	361	+19.9	+25.2
Magnevist® (Diagnostic Imaging)	323	301	−6.8	−1.3
Ultravist® (Diagnostic Imaging)	222	235	+5.9	+8.5
Iopamiron® (Diagnostic Imaging)	221	211	−4.5	+3.4
Diane® (Women's Healthcare)	175	175	0.0	+0.7

Sales of the Primary Care business unit dipped 1.2 percent in 2007, to €3,055 million (2006: €3,091 million). We significantly expanded sales of Avalox®/Avelox® (currency-adjusted: +16.8 percent), Aspirin Cardio® (currency-adjusted: +13.1 percent) and Levitra® (currency-adjusted: +10.6 percent). By contrast, sales of Cipro®/Ciprobay® (currency-adjusted: -22.8 percent) and Adalat® (currency-adjusted: -1.5 percent) were down as expected due to generic competition, while business with Glucobay® was at the previous year's level (+1.2 percent) on a currency-adjusted basis. Sales of Primary Care included €72 million in business with the andrology products acquired from Schering (2006: €31 million pro-rated). Currency- and portfolio-adjusted sales edged up by 1.8 percent year on year.

The Women's Healthcare business unit continued to develop very positively, posting sales of €2,630 million (2006: €1,320 million pro-rated). The principal growth drivers were the oral contraceptives of the Yasmin®/YAZ®/Yasminelle® family, which became our best-selling pharmaceutical product in 2007 with sales of €1,042 million. Sales of Yasmin®/YAZ®/Yasminelle® expanded by 37.3 percent (pro forma) on a currency-adjusted basis. Market introductions of YAZ® and Yasminelle® in various regions contributed significantly to this growth. Sales of the intra-uterine system Mirena® advanced by a pleasing 25.2 percent (pro forma) on a currency-adjusted basis, largely because of strong growth in the United States.

In the Diagnostic Imaging business unit, we had sales of €1,298 million (2006: €697 million pro-rated). Growth came mainly from the Medrad business and the stepwise relaunch of the 370 mgI/ml formulation of Ultravist®, which we had voluntarily withdrawn from the market in summer 2006. Total sales of Ultravist® moved ahead by 8.5 percent (pro forma) when adjusted for the effects of currency translation.

Sales of the Specialized Therapeutics business unit amounted to €1,253 million (2006: €678 million pro-rated). Business with Betaferon®/Betaseron® to treat multiple sclerosis (MS) expanded by 6.5 percent (pro forma) on a currency-adjusted basis.
In September 2007, we acquired from Novartis a production facility for biotechnological products in Emeryville, California, where Bayer manufactures Betaseron®. Due to negative results from the BEYOND study, we decided against a regulatory filing for the 500 mcg dose of Betaferon®/Betaseron®.

Sales of the Hematology/Cardiology business unit were down by 9.5 percent to €1,033 million (2006: €1,142 million). Currency- and portfolio-adjusted sales, however, rose by 3.1 percent. Business with Kogenate®, which received an expanded registration from the European Commission in January 2007, continued to develop positively, with a currency-adjusted 7.7 percent increase. Currency-adjusted sales of Trasylol®, our product to control bleeding during coronary bypass surgery, declined by a substantial 28.4 percent. In November 2007, Bayer suspended worldwide marketing of Trasylol® for the time being after preliminary results of an independent clinical study conducted in Canada indicated the possibility of an increased mortality risk for patients treated with Trasylol®. Marketing of the product will remain suspended until final results from the Canadian trial have been evaluated and the benefit-risk profile of Trasylol® can be reassessed together with the regulatory authorities.

Our Oncology business unit increased sales to €754 million (2006: €432 million). This figure contains €424 million (2006: €238 million pro-rated) in sales of the former Schering oncology business, including key products Fludara® and Campath®. Marketing authorization for Campath®/MabCampath®, which was jointly developed with Genzyme Corp. for the treatment of patients with B-cell chronic lymphocytic leukemia (B-CLL), was expanded in the United States in September 2007 and in the European Union at the end of December 2007. Currency- and portfolio-adjusted sales of the Oncology business unit improved by 33.7 percent, due particularly to the outstanding growth in business with our cancer drug Nexavar®, currency-adjusted sales of which jumped by 116.2 percent. In addition to its registration for the treatment of kidney cancer, Nexavar® was registered in the fall of 2007 in both Europe and the United States as the first medicine to treat liver cancer. Nexavar®, jointly developed by Bayer HealthCare and Onyx Pharmaceuticals, Inc., is the first product demonstrated to significantly extend overall survival in patients suffering from liver cancer.

The Dermatology (Intendis) business unit achieved sales of €244 million (2006: €118 million pro-rated). On a currency-adjusted basis, pro-forma sales of the two leading products Skinoren® and Advantan® rose by 11.0 and 5.6 percent, respectively.

EBITDA before special items for Pharmaceuticals in 2007 advanced by 66.5 percent to €2,807 million (2006: €1,686 million). **EBIT** before special items rose by €707 million, or 75.7 percent, to €1,641 million. The net special charges of €900 million largely comprise expenses associated with the integration of Schering. Also included in this figure are a €152 million write-down of intangible assets necessitated by the results of the BEYOND study on Betaferon®/Betaseron® and provisions recorded in connection with the suspension of marketing for Trasylol®. EBIT moved ahead by 31.6 percent to €741 million.

Consumer Health

In the **Consumer Health** segment, business expanded by 6.9 percent in 2007, to €4,540 million (2006: €4,246 million). Adjusted for currency and portfolio changes, **sales** were up by 10.3 percent. We registered above-market growth in all three divisions.

The Consumer Care Division grew sales by 4.1 percent to €2,634 million (2006: €2,531 million). This figure takes into account our first sales of the calcium dietary supplement Citracal®, acquired in the fourth quarter from Mission Pharmacal Company of the United States. Currency- and portfolio-adjusted sales improved by 7.8 percent. The highest growth rates were posted by Berocca® (currency-adjusted: +16.8 percent), Canesten® (currency-adjusted: +15.4 percent) and Aleve® (currency-adjusted: +13.9 percent).

Sales of the Diabetes Care Division came in at €950 million (2006: €810 million), with a currency- and portfolio-adjusted increase of 17.5 percent. This gratifying trend was chiefly attributable to the successful marketing, particularly in North America and Europe, of our Ascensia® Contour® and Ascensia® Breeze® blood glucose monitoring systems, which replace the Elite® systems of the Ascensia® product family.

Sales of the Animal Health Division increased by 5.6 percent to €956 million (2006: €905 million), or by 10.6 percent when adjusted for currency effects. The performance of our Advantage® product line was particularly gratifying, with currency-adjusted sales rising by 20.8 percent. In October 2007, the European Medicines Agency (EMEA) expanded the registration for the canine anti-parasitic Advocate®.

Consumer Health	2006	2007	Change
	€ million	€ million	%
Sales	**4,246**	**4,540**	**+6.9**
Consumer Care	2,531	2,634	+4.1
Diabetes Care	810	950	+17.3
Animal Health	905	956	+5.6
Sales by Region			
Europe	1,691	1,817	+7.5
North America	1,463	1,577	+7.8
Asia/Pacific	336	364	+8.3
Latin America/Africa/Middle East	756	782	+3.4
EBITDA[1]	**896**	**957**	**+6.8**
Special items	*(31)*	*(28)*	
EBITDA before special items[2]	*927*	*985*	*+6.3*
EBITDA margin before special items	21.8 %	21.7 %	
EBIT[1]	**750**	**823**	**+9.7**
Special items	*(31)*	*(28)*	
EBIT before special items[2]	*781*	*851*	*+9.0*
Gross cash flow[1]	**634**	**704**	**+11.0**
Net cash flow[1]	**473**	**559**	**+18.2**

[1] for definition see Bayer Group Key Data on front flap
[2] for definition see also page 47

Best-Selling Consumer Health Products	2006	2007	Change	Currency-adjusted change
	€ million	€ million	%	%
Ascensia® product line (Diabetes Care)	788	934	+18.5	+24.0
Aspirin®* (Consumer Care)	465	460	−1.1	+2.9
Advantage® product line (Animal Health)	275	314	+14.2	+20.8
Aleve®/naproxen (Consumer Care)	227	239	+5.3	+13.9
Canesten® (Consumer Care)	162	182	+12.3	+15.4
Baytril® (Animal Health)	162	156	−3.7	+1.2
Bepanthen®/Bepanthol® (Consumer Care)	131	145	+10.7	+11.2
Supradyn® (Consumer Care)	130	134	+3.1	+4.3
One-A-Day® (Consumer Care)	124	130	+4.8	+13.7
Rennie® (Consumer Care)	98	107	+9.2	+10.2
Total	**2,562**	**2,801**	**+9.3**	**+14.2**
Proportion of Consumer Health sales	60 %	62 %		

* total Aspirin® sales = €689 million (2006: €674 million), including Aspirin Cardio®, which is reflected in sales of the Pharmaceuticals segment

EBITDA before special items in the Consumer Health segment improved by 6.3 percent to €985 million (2006: €927 million), due especially to the gratifying expansion of business in all divisions. **EBIT** before special items moved ahead €70 million, or 9.0 percent, to €851 million. Earnings were diminished by special charges in connection with litigation-related accruals in the balance sheet. EBIT increased by €73 million, or 9.7 percent, to €823 million.

Bayer CropScience

Bayer CropScience	2006	2007	Change
	€ million	€ million	%
Sales	**5,700**	**5,826**	**+2.2**
Crop Protection	4,644	4,781	+3.0
Environmental Science, BioScience	1,056	1,045	−1.0
Sales by Region			
Europe	2,251	2,383	+5.9
North America	1,457	1,332	−8.6
Asia/Pacific	907	913	+0.7
Latin America/Africa/Middle East	1,085	1,198	+10.4
EBITDA [1]	**1,166**	**1,204**	**+3.3**
Special items	*(38)*	*(120)*	
EBITDA before special items [2]	*1,204*	*1,324*	*+10.0*
EBITDA margin before special items	21.1%	22.7%	
EBIT [1]	**584**	**656**	**+12.3**
Special items	*(57)*	*(130)*	
EBIT before special items [2]	*641*	*786*	*+22.6*
Gross cash flow [1]	**900**	**961**	**+6.8**
Net cash flow [1]	**898**	**1,040**	**+15.8**

[1] for definition see Bayer Group Key Data on front flap
[2] for definition see also page 47

Best-Selling Bayer CropScience Products*	2006	2007	Change	Currency-adjusted change
	€ million	€ million	%	%
Confidor®/Gaucho®/Admire®/Merit® (Insecticides/Seed Treatment/Environmental Science)	564	556	−1.4	+1.6
Flint®/Stratego®/Sphere® (Fungicides)	181	243	+34.3	+36.7
Basta®/Liberty® (Herbicides)	229	241	+5.2	+10.2
Poncho® (Seed Treatment)	127	237	+86.6	+98.1
Folicur®/Raxil® (Fungicides/Seed Treatment)	276	235	−14.9	−13.6
Atlantis® (Herbicides)	169	207	+22.5	+23.1
Puma® (Herbicides)	196	187	−4.6	−2.0
Decis®/K-Othrine® (Insecticides/Environmental Science)	183	178	−2.7	+0.4
Proline® (Fungicides)	144	175	+21.5	+22.3
Betanal® (Herbicides)	120	127	+5.8	+8.2
Total	**2,189**	**2,386**	**+9.0**	**+12.0**
Proportion of Bayer CropScience sales	38%	41%		

* Figures are based on active ingredient class. For the sake of clarity, only the principal brands and business units are listed.

CropScience raised its **sales** by 2.2 percent in 2007, to €5,826 million (2006: €5,700 million). Currency- and portfolio-adjusted sales increased by 5.6 percent.

EBITDA of the CropScience subgroup before special items grew by 10.0 percent to €1,324 million (2006: €1,204 million). This rise in earnings was attributable to higher volumes and cost savings, which more than offset the declining margins caused by negative currency effects. **EBIT** before special items climbed 22.6 percent to €786 million. Earnings were diminished by special charges for the cost-structure program initiated in 2006 and litigation-related defense costs. EBIT after special items advanced by 12.3 percent to €656 million (2006: €584 million).

Crop Protection

Sales of the **Crop Protection** segment in 2007 came in at €4,781 million, up 3.0 percent from the previous year (€4,644 million). Currency- and portfolio-adjusted sales grew by 6.3 percent.

Our crop protection business as a whole benefited from the positive conditions on the world's agricultural markets, particularly the higher prices for agricultural commodities, increased cultivation of crops for the production of biofuels and an improved market environment in Latin America. Our young, innovative products showed a particularly pleasing trend. Sales of active ingredients introduced in core markets since 2000 rose by a third compared with 2006, to nearly €1.4 billion.

Crop Protection	2006	**2007**	Change
	€ million	€ million	%
Sales	**4,644**	**4,781**	**+3.0**
Herbicides	1,758	1,725	−1.9
Fungicides	1,200	1,270	+5.8
Insecticides	1,219	1,181	−3.1
Seed Treatment	467	605	+29.6
Sales by Region			
Europe	1,909	2,035	+6.6
North America	996	912	−8.4
Asia/Pacific	772	769	−0.4
Latin America/Africa/Middle East	967	1,065	+10.1
EBITDA[1]	**889**	**1,008**	**+13.4**
Special items	*(38)*	*(85)*	
EBITDA before special items[2]	*927*	*1,093*	*+17.9*
EBITDA margin before special items	20.0 %	22.9 %	
EBIT[1]	**384**	**537**	**+39.8**
Special items	*(57)*	*(95)*	
EBIT before special items[2]	*441*	*632*	*+43.3*
Gross cash flow[1]	**691**	**799**	**+15.6**
Net cash flow[1]	**748**	**881**	**+17.8**

[1] for definition see Bayer Group Key Data on front flap
[2] for definition see also page 47

Sales in the Herbicides business unit amounted to €1,725 million, which was 1.9 percent below the previous year's figure of €1,758 million. On a currency- and portfolio-adjusted basis, however, business increased by 1.1 percent. While cotton and soybean herbicide sales in North America declined due to a reduction in acreages, business with cereal herbicides expanded strongly in Europe, thanks to the successful marketing of young products such as Atlantis® and Sekator®. We also further increased global sales of the Basta®/Liberty® product family.

In the Fungicides business unit, sales moved ahead by 5.8 percent to €1,270 million (2006: €1,200 million), or by 7.4 percent when adjusted to reflect the effects of currency translation and portfolio changes. The mild, wet weather in many parts of Europe led to higher sales, particularly of products used in cereals, potatoes and grapes. Business with our soybean fungicides benefited from the general market recovery in Latin America. In particular, we recorded an increased demand for our cereal fungicides Proline® and Fandango®, the potato fungicide Infinito® launched in 2006, and products from the Flint® family. The decline in sales of the Folicur® product group was mainly due to the planned shift toward our young fungicidal active ingredients and new mix products.

Sales in the Insecticides business, at €1,181 million, were down by 3.1 percent from the prior-year level of €1,219 million. Currency- and portfolio-adjusted sales grew by 1.7 percent. The Confidor® product family turned in a very gratifying performance, particularly in Latin America. Marketing of our innovative insecticide Biscaya® in Europe was also successful. By contrast, the North American insecticides business was impacted by the increasing shift from soil- and foliar-applied products toward seed treatment products.

In the Seed Treatment business unit, sales rose by a substantial 29.6 percent to €605 million (2006: €467 million), and by 34.9 percent on a currency- and portfolio-adjusted basis. This growth was supported by the positive global performance of our entire product portfolio. The strongest gain in sales was achieved in North America, where a significant expansion of corn acreages boosted demand. In Latin America, our new products CropStar® in corn and Atento® in soybeans showed a very pleasing development, while we successfully took advantage of the positive market environment in Europe with customized product solutions for cereal crops. Global business with Poncho® nearly doubled.

EBITDA of the Crop Protection segment before special items rose by 17.9 percent to €1,093 million (2006: €927 million), due mainly to higher volumes, savings from our cost-structure and efficiency programs and higher margin contributions from the new products. Exchange rates, however, had a negative impact. **EBIT** before special items improved substantially, advancing by 43.3 percent to €632 million. Special charges for the restructuring program launched in 2006 amounted to €95 million. EBIT after special items expanded to €537 million (2006: €384 million).

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Environmental Science, BioScience

Environmental Science, BioScience	2006	2007	Change
	€ million	€ million	%
Sales	**1,056**	**1,045**	**−1.0**
Environmental Science	714	663	−7.1
BioScience	342	382	+11.7
Sales by Region			
Europe	342	348	+1.8
North America	461	420	−8.9
Asia/Pacific	135	144	+6.7
Latin America/Africa/Middle East	118	133	+12.7
EBITDA[1]	**277**	**196**	**−29.2**
Special items	*0*	*(35)*	
EBITDA before special items[2]	*277*	*231*	*−16.6*
EBITDA margin before special items	26.2 %	22.1 %	
EBIT[1]	**200**	**119**	**−40.5**
Special items	*0*	*(35)*	
EBIT before special items[2]	*200*	*154*	*−23.0*
Gross cash flow[1]	**209**	**162**	**−22.5**
Net cash flow[1]	**150**	**159**	**+6.0**

[1] for definition see Bayer Group Key Data on front flap
[2] for definition see also page 47

In the **Environmental Science, BioScience** segment, **sales** dipped by 1.0 percent to €1,045 million (2006: €1,056 million). After adjusting for currency and portfolio effects, however, business was up by 2.6 percent. Environmental Science saw business move back by 7.1 percent in 2007, to €663 million (2006: €714 million). Currency-adjusted sales fell by 2.8 percent. Declining business with products for professional users due to strong generic competition and unfavorable weather conditions was partly offset by higher sales of home and garden products for consumers.

BioScience increased sales by 11.7 percent to €382 million (2006: €342 million), and by 14.1 percent on a currency- and portfolio-adjusted basis. Sales of our vegetable seed products rose primarily due to a strong market performance by our tomato, onion, carrot and melon seeds. In agricultural crop applications, we markedly expanded business with our canola seed marketed under the InVigor® brand, and increasing business with our Arize® rice seed also contributed to the expansion in sales.

EBITDA before special items of the Environmental Science, BioScience segment, at €231 million, came in €46 million below the previous year's figure of €277 million. Earnings were diminished particularly by higher research and development expenditures at BioScience and also by the decline in sales of our Environmental Science business in North America. We also registered a negative earnings contribution from the Stoneville business, as this company was acquired in June of last year and thus subsequent to the close of the cotton seed season. **EBIT** before special items dropped by 23.0 percent, from €200 million in the prior year to €154 million in 2007. The net special charges of €35 million primarily included defense costs resulting from pending litigation in the United States related to genetically modified rice, along with costs for the restructuring program we initiated in 2006. EBIT declined by 40.5 percent to €119 million (2006: €200 million).

Bayer MaterialScience

Bayer MaterialScience	2006	2007	Change
	€ million	€ million	%
Sales	**10,161**	**10,435**	**+2.7**
Materials	2,925	3,041	+4.0
Systems	7,236	7,394	+2.2
Sales by Region			
Europe	4,402	4,585	+4.2
North America	2,622	2,376	−9.4
Asia/Pacific	2,007	2,229	+11.1
Latin America/Africa/Middle East	1,130	1,245	+10.2
EBITDA [1]	**1,499**	**1,542**	**+2.9**
Special items	*(178)*	*(64)*	
EBITDA before special items [2]	*1,677*	*1,606*	*−4.2*
EBITDA margin before special items	16.5 %	15.4 %	
EBIT [1]	**992**	**1,042**	**+5.0**
Special items	*(218)*	*(75)*	
EBIT before special items [2]	*1,210*	*1,117*	*−7.7*
Gross cash flow [1]	**1,166**	**1,228**	**+5.3**
Net cash flow [1]	**1,281**	**1,147**	**−10.5**

[1] for definition see Bayer Group Key Data on front flap
[2] for definition see also page 47

MaterialScience enjoyed further growth in **sales** in 2007. Sales rose by 2.7 percent to €10,435 million (2006: €10,161 million). Currency- and portfolio-adjusted sales advanced by 6.2 percent, due primarily to higher volumes in both segments. In addition, we were able to raise prices slightly overall.

EBITDA before special items came in at €1,606 million, slightly below the prior-year level of €1,677 million. We largely succeeded in offsetting the markedly higher costs for petrochemical raw materials and energies and the negative shifts in currency parities through higher volumes and selling prices. **EBIT** before special items fell by 7.7 percent to €1,117 million (2006: €1,210 million). We initiated an extensive restructuring program in the fall of 2007 to improve cost structures and further increase efficiency, taking special charges of €75 million for these measures. In the previous year we took special charges of €218 million, which were mainly litigation-related. After special items, EBIT rose by 5.0 percent to €1,042 million.

Materials

Materials	2006	2007	Change
	€ million	€ million	%
Sales	**2,925**	**3,041**	**+4.0**
Polycarbonates	2,720	2,811	+3.3
Thermoplastic Polyurethanes	205	230	+12.2
Sales by Region			
Europe	1,100	1,139	+3.5
North America	599	574	−4.2
Asia/Pacific	947	1,037	+9.5
Latin America/Africa/Middle East	279	291	+4.3
EBITDA [1]	**448**	**273**	**−39.1**
Special items	*0*	*0*	
EBITDA before special items [2]	*448*	*273*	*−39.1*
EBITDA margin before special items	15.3 %	9.0 %	
EBIT [1]	**289**	**100**	**−65.4**
Special items	*0*	*0*	
EBIT before special items [2]	*289*	*100*	*−65.4*
Gross cash flow [1]	**364**	**237**	**−34.9**
Net cash flow [1]	**324**	**183**	**−43.5**

[1] for definition see Bayer Group Key Data on front flap
[2] for definition see also page 47

Sales in the **Materials** segment moved ahead by 4.0 percent to €3,041 million (2006: €2,925 million) thanks to significantly higher volumes, especially in Asia. Sales climbed by 7.9 percent on a currency- and portfolio-adjusted basis. The Polycarbonates business unit increased sales by 3.3 percent to €2,811 million, and by 8.0 percent when adjusted for shifts in currency parities. Our Thermoplastic Polyurethanes business unit saw sales rise by 12.2 percent to €230 million. This figure contains the business of the Taiwanese group Ure-Tech, a leading supplier of thermoplastic polyurethanes in the Asia-Pacific region, from July 1, 2007. We have thus significantly strengthened this business unit and achieved a leading market position worldwide. After adjusting for currency- and portfolio-effects, sales of the Thermoplastic Polyurethanes business unit grew by 6.4 percent.

EBITDA before special items fell by a substantial 39.1 percent to €273 million. Earnings were diminished by declining margins due to higher petrochemical raw material and energy costs coupled with lower selling prices that the growth in volumes did not compensate. EBIT dropped by 65.4 percent to €100 million.

Systems

Systems	2006	2007	Change
	€ million	€ million	%
Sales	**7,236**	**7,394**	**+2.2**
Polyurethanes	5,182	5,224	+0.8
Coatings, Adhesives, Sealants	1,488	1,598	+7.4
Inorganic Basic Chemicals	403	423	+5.0
Other	163	149	−8.6
Sales by Region			
Europe	3,302	3,446	+4.4
North America	2,023	1,802	−10.9
Asia/Pacific	1,060	1,192	+12.5
Latin America/Africa/Middle East	851	954	+12.1
EBITDA[1]	**1,051**	**1,269**	**+20.7**
Special items	*(178)*	*(64)*	
EBITDA before special items[2]	*1,229*	*1,333*	*+8.5*
EBITDA margin before special items	17.0 %	18.0 %	
EBIT[1]	**703**	**942**	**+34.0**
Special items	*(218)*	*(75)*	
EBIT before special items[2]	*921*	*1,017*	*+10.4*
Gross cash flow[1]	**802**	**991**	**+23.6**
Net cash flow[1]	**957**	**964**	**+0.7**

[1] for definition see Bayer Group Key Data on front flap
[2] for definition see also page 47

Sales of our **Systems** segment came in at €7,394 million, up 2.2 percent from the prior-year figure of €7,236 million. To strengthen the forward integration of the Polyurethanes business unit, we acquired a systems house business in Dubai and another in the United States, sales of which were included for the first time in 2007. Currency- and portfolio-adjusted business expanded by 5.5 percent on account of higher volumes and selling prices increases. All business units grew sales in Asia and Europe. Business was down in North America, with sales to the automotive and construction industries particularly affected.

Sales of the Polyurethanes business unit edged ahead by 0.8 percent to €5,224 million. Currency- and portfolio-adjusted sales grew by 4.2 percent. Coatings, Adhesives, Sealants saw sales improve by a gratifying 7.4 percent to €1,598 million, and by 10.9 percent on a currency-adjusted basis. Sales of Inorganic Basic Chemicals moved forward by 5.0 percent to €423 million, and by 7.3 percent when adjusted for shifts in exchange rates.

EBITDA of the Systems segment before special items advanced by 8.5 percent to €1,333 million (2006: €1,229 million), with higher selling prices and volume gains more than offsetting increased costs for petrochemical raw materials and energy. **EBIT** before special items climbed by 10.4 percent to €1,017 million. We took special charges of €75 million in 2007 for our restructuring program, particularly the closure of our diphenylmethane diisocyanate (MDI) production facility in New Martinsville, West Virginia, United States. The previous year's figure contained special charges of €218 million, resulting primarily from an arbitration proceeding in the United States relating to the production of propylene oxide. After special items, EBIT improved by 34.0 percent to €942 million (2006: €703 million).

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Calculation of EBIT(DA) Before Special Items

To permit a more accurate assessment of business operations, EBIT and EBITDA are also stated "before special items." The special items concerned are detailed in the table below. "EBITDA," "EBITDA before special items" and "EBIT before special items" are not defined in the International Financial Reporting Standards and should therefore be regarded only as supplementary information.

Special Items Reconciliation	EBIT 2006	EBIT 2007	EBITDA 2006	EBITDA 2007
€ million				
After special items	**2,762**	**3,154**	**4,675**	**5,866**
HealthCare	**402**	**928**	**666**	**727**
Schering PPA effects*	84	177	429	216
Schering integration costs	189	506	170	418
Write-downs of intangible assets	60	152	0	0
Restructuring	48	0	46	0
Litigations	26	106	26	106
Other	(5)	(13)	(5)	(13)
CropScience	**57**	**130**	**38**	**120**
Restructuring	79	97	60	87
Litigations	0	33	0	33
Other	(22)	0	(22)	0
MaterialScience	**218**	**75**	**178**	**64**
Restructuring	60	75	20	64
Litigations	153	0	153	0
Other	5	0	5	0
Reconciliation	**40**	**0**	**27**	**0**
Restructuring	37	0	24	0
Litigations	(7)	0	(7)	0
Other	10	0	10	0
Total special items	**717**	**1,133**	**909**	**911**
Before special items	**3,479**	**4,287**	**5,584**	**6,777**

2006 figures restated

* The purchase price paid for Schering AG, Germany, was allocated among the acquired assets and assumed liabilities in accordance with the International Financial Reporting Standards (IFRS). The purchase price allocation resulted in total charges to EBIT of €1,037 million in 2007. To ensure comparability with future earnings data, the expected long-term effects of the step-up are reflected in EBIT and EBITDA before special items, whereas temporary, non-cash effects of the purchase price allocation are eliminated. When calculating EBIT before special items, we deducted a €177 million special charge recorded in this connection. EBIT before special items therefore reflects €860 million in charges resulting from the purchase price allocation. EBITDA before special items remains unaffected by the purchase price allocation.

Value Management

Cash value added-based system

One of the prime objectives of the Bayer Group is to sustainably increase enterprise value. In 1994 we became one of the first German companies to embark on the development of a value management system, which we introduced throughout the Group in 1997. The system is used for the planning, controlling and monitoring of our businesses. Our primary value-based indicator is the cash value added (CVA), which shows the degree to which the cash flows needed to cover the costs of equity and debt and of reproducing depletable assets have been generated. If the CVA is positive, the company or business entity concerned has created additional value. If it is negative, the anticipated capital and asset reproduction costs have not been earned. Gross cash flow (GCF) and CVA are profitability indicators for a single reporting period. For a year-on-year comparison we therefore use the delta CVA, which is the difference between the CVAs of two consecutive periods. A positive delta CVA shows that value creation has improved from one period to the next.

Calculating the cost of capital

Bayer calculates the cost of capital according to the debt/equity ratio by the weighted average cost of capital (WACC) formula. The cost of equity capital is the return expected by stockholders, computed from capital market information. The cost of debt used in calculating WACC is based on the terms for a ten-year corporate bond issue.

To take into account the different risk and return profiles of our principal businesses, we calculate individual capital cost factors after income taxes for each of our subgroups. In 2007 this was 8.0 percent (2006: 7.5 percent) for Bayer HealthCare, 7.0 percent (2006: 7.0 percent) for Bayer CropScience and 6.5 percent (2006: 6.5 percent) for Bayer MaterialScience. The minimum return required for the Bayer Group as a whole was 7.5 percent (2006: 7.0 percent).

Gross cash flow, cash flow return on investment, and cash value added as performance yardsticks

The gross cash flow (GCF), as published in our cash flow statement, is the measure of our internal financing capability. Bayer has chosen this parameter because it is relatively free of accounting influences and thus a more meaningful performance indicator.

The profitability of the Group and of its individual business entities is measured by the cash flow return on investment (CFROI). This is the ratio of the GCF to the capital invested (CI). The CI is derived from the balance sheet and basically comprises the property, plant and equipment and intangible assets required for operations – stated at cost of acquisition or construction – plus working capital, less interest-free liabilities (such as current provisions). To allow for fluctuations during the year, the CFROI is computed on the basis of the average CI for the respective year.

Taking into account the costs of capital and of reproducing depletable assets, we determine the GCF hurdle. If the GCF hurdle is equaled or exceeded, the required return on equity and debt plus the cost of asset reproduction has been earned. The CFROI hurdle for 2007 was 10.2 percent (2006: 10.0 percent), while the corresponding GCF hurdle was €4,035 million (2006: €3,188 million).

Actual GCF came in at €4,784 million, exceeding the hurdle by a substantial 18.6 percent. Thus in 2007 we earned our entire capital and asset reproduction costs, and the positive CVA of €749 million shows that Bayer created additional value. Given the previous year's CVA of €725 million, the Bayer Group therefore recorded a delta CVA of €24 million, showing that the rate of value creation increased. The CFROI edged up from the previous year's record figure of 12.1 percent, to 12.2 percent.

The CropScience subgroup exceeded, and MaterialScience equaled, its target return including asset reproduction. The CFROI for CropScience rose from 10.3 percent in the prior year to 11.3 percent in 2007. MaterialScience achieved a CFROI of 15.9 percent (2006: 15.6 percent). HealthCare achieved a CFROI of 11.1 percent (2006: 12.4 percent) despite the increase in capital invested associated with the Schering AG acquisition and integration-related charges.

Value Management Indicators by Subgroup

	HealthCare		CropScience		MaterialScience		Bayer Group	
€ million	2006	**2007**	2006	**2007**	2006	**2007**	2006	**2007**
Gross cash flow hurdle (GCF hurdle)	1,536	2,394	1,000	939	649	624	3,188	4,035
Gross cash flow* (GCF)	1,720	2,389	900	961	1,166	1,228	3,913	4,784
Cash value added (CVA)	184	(5)	(100)	22	517	604	725	749
Cash flow return on investment (CFROI)	12.4 %	11.1%	10.3 %	11.3 %	15.6 %	15.9 %	12.1%	12.2 %
Average capital invested (ACI)	13,865	21,608	8,728	8,500	7,489	7,722	32,276	39,203

* for definition see Bayer Group Key Data on front flap

Liquidity and Capital Resources

Bayer Group Summary Cash Flow Statements	2006	2007
€ million		
Gross cash flow*	**3,913**	**4,784**
Changes in working capital / other non-cash items	15	(503)
Net cash provided by (used in) operating activities (net cash flow), continuing operations	**3,928**	**4,281**
Net cash provided by (used in) operating activities (net cash flow), discontinued operations	275	2
Net cash provided by (used in) operating activities (net cash flow) (total)	**4,203**	**4,283**
Net cash provided by (used in) investing activities (net cash flow) (total)	**(14,730)**	**3,186**
Net cash provided by (used in) financing activities (net cash flow) (total)	**10,199**	**(7,730)**
Change in cash and cash equivalents due to business activities (total)	**(328)**	**(261)**
Cash and cash equivalents at beginning of period	**3,290**	**2,915**
Change due to exchange rate movements and to changes in scope of consolidation	(47)	(123)
Cash and cash equivalents at end of period	**2,915**	**2,531**

* for definition see Bayer Group Key Data on front flap

Operating cash flow

Gross cash flow improved in 2007 by 22.3 percent year on year to €4,784 million (2006: €3,913 million) due to the strong business performance and the full-year inclusion of Schering AG, Berlin, Germany. Net cash flow rose by only €353 million to €4,281 million (2006: €3,928 million) due to an increase in cash tied up in working capital.

Investing cash flow

In 2007 there was a net cash inflow of €3,186 million for investing activities (2006: €14,730 million outflow), including divestment proceeds totaling €4.6 billion (after taxes) for the diagnostics business, H.C. Starck and Wolff Walsrode.

The €4.3 billion transaction volume for the diagnostics business comprised an initial payment of €0.4 billion at the end of 2006 and a further purchase price payment of €3.9 billion received in 2007. After deducting approximately €0.2 billion in divested cash and €0.4 billion in tax payments made on the divestment gain, net proceeds from the divestiture of the diagnostics business totaled €3.3 billion. Further tax payments of approximately €0.1 billion will arise in 2008 in connection with this divestiture.

The proceeds of the divestitures of H. C. Starck and Wolff Walsrode amounted to €1.3 billion after compensation for financial liabilities and the assumption of pension obligations by the acquirers.

Cash outflows for acquisitions included the US$ 314 million (approx. €232 million) purchase price for U.S. cotton seed producer Stoneville. In June 2007, Bayer CropScience acquired Stoneville Pedigreed Seed Company from Monsanto in order to strengthen the position of the BioScience business unit in the U.S. cotton seed market. In September 2007, Bayer HealthCare completed the agreed acquisition of a biologics production facility in Emeryville, California, from Novartis and made a purchase price payment of US$ 183 million (approx. €137 million). On July 1, 2007, Bayer MaterialScience completed the acquisition of the Ure-Tech group, Taiwan, a supplier of TPU resins and films, at a purchase price of US$ 85 million (approx. €63 million). Cash outflows for acquisitions in the prior-year period were largely attributable to the acquisition of Schering, Berlin, Germany.

Cash outflows for property, plant and equipment in 2007 came to €1,546 million (2006: €1,534 million) and those for intangible assets to €314 million (2006: €342 million), giving a total of €1,860 million (2006: €1,876 million). This figure included the expenditures for the expansion of our polymers production facilities in Caojing, China. Depreciation of property, plant and equipment came to €1,140 million (2006: €1,086 million), and amortization of intangible assets to €1,338 million (2006: €1,000 million). Write-downs of €286 million were made in addition.

Major capital expenditures made by the Bayer Group in the past two years are listed in the following table:

Capital expenditures 2007

Segment	Description
Pharmaceuticals	Consolidation of biotech production facilities in Seattle, Washington, U.S.A.
	Integration of biotech production facilities in Emeryville, California, U.S.A.
	Consolidation of R&D activities in Germany and the U.S. due to the Schering integration
	Expansion of production facility for contrast media application systems in Warrendale, Pennsylvania, U.S.A.
Crop Protection	Capacity extension at the active ingredient and formulating facilities in Hangzhou, China
	Formulation site consolidation project, U.S.A.
	Modification of existing manufacturing units for intermediates and new active ingredients for insecticides in Dormagen, Germany
	Site consolidation projects in Thane, India, and Wolfenbüttel, Germany
	Reconstruction of an active ingredient unit in Belford Roxo, Brazil
BioScience	New greenhouse for vegetable seeds in ’s-Gravenzande, Netherlands
Materials	Expansion of the polycarbonate facility in Map Ta Phut, Thailand
	Expansion of the polycarbonate facility in Caojing, China
	Construction of a new logistics center for polycarbonate compounds in Krefeld-Uerdingen, Germany
Systems	Construction of a world-scale MDI production facility in Caojing, China
	Construction of a plant for polyurethane dispersions in Caojing, China
	Construction of a world-scale plant for polymer polyols in Antwerp, Belgium

Capital expenditures 2006

Segment	Description
Pharmaceuticals	Construction of a clinical manufacturing facility for Kogenate® in Berkeley, California, U.S.A.
	Expansion of a production facility in Beijing, China
Consumer Health	Expansion of a production facility in Jakarta, Indonesia
Crop Protection	Insourcing of intermediates in Knapsack, Germany
	Expansion of warehouse, manufacturing and formulation plants in Frankfurt and Dormagen, Germany
	Expansion of fungicide production capacity in Dormagen, Germany
	Site consolidation in Baranquilla, Colombia
Environmental Science, BioScience	Construction of a seed processing facility in Lethbridge, Canada
Materials	Expansion of the polycarbonate facility in Map Ta Phut, Thailand
	Capacity expansion projects for polycarbonate in Caojing, China
Systems	Construction of a world-scale MDI production facility in Caojing, China
	Installation of a new plant for MDI specialty products in Baytown, Texas, U.S.A.

Financing cash flow

Net cash outflow for financing activities in 2007 amounted to €7,730 million (2006: €10,199 million net inflow). Net loan repayments totaled €5,613 million, including €2.1 billion for the scheduled redemption of our 2002/2007 Eurobond in April 2007. The Bayer AG dividend for 2006, paid in the second quarter of 2007, and dividend payments to minority stockholders of consolidated companies accounted for a further €773 million (2006: €535 million). The item "Bayer AG dividend, dividend payments to minority stockholders" in the prior year contained an inflow of €176 million from the reimbursement of advance capital gains tax payments made on intragroup dividends in 2004.

Liquid assets and net debt

As of December 31, 2007 the Bayer Group held cash and cash equivalents of €2,531 million, including €755 million held in escrow accounts. These are earmarked for payments to be made in connection with the squeeze-out of the remaining minority stockholders of Bayer Schering Pharma AG and civil law settlements of antitrust proceedings. Pursuant to a resolution of the Extraordinary Stockholders' Meeting of Bayer Schering Pharma AG on January 17, 2007, the shares in that company that are still held by minority stockholders will be transferred to the main stockholder, Bayer Schering GmbH, a wholly owned subsidiary of Bayer AG, in return for cash compensation of €98.98 per share. Dissenting stockholders are seeking to have the stockholder resolution set aside or to have it declared null and void. In view of the restriction on its use, the liquidity held in escrow accounts was not deducted when calculating net debt.

Net Debt	Dec. 31, 2006	**Dec. 31, 2007**
€ million		
Noncurrent financial liabilities as per balance sheets (including derivatives)	14,723	12,911
of which mandatory convertible bond	2,276	2,285
of which hybrid bond	1,247	1,237
Current financial liabilities as per balance sheets (including derivatives)	5,078	1,287
Derivative receivables	(185)	(230)
Financial liabilities	**19,616**	**13,968**
Cash and cash equivalents*	(2,116)	(1,776)
Current financial assets	(27)	(8)
Net debt from continuing operations	**17,473**	**12,184**
Net debt from discontinued operations	66	0
Net debt (total)	**17,539**	**12,184**

* In view of the restriction on its use, the €755 million (2006: €799 million) liquidity in escrow accounts was not deducted when calculating net debt. December 31, 2007: €1,776 million = €2,531 million - €755 million (December 31, 2006: €2,116 million = €2,915 million - €799 million).

Net debt showed a significant €5.4 billion decrease on the year, standing at €12.2 billion on December 31, 2007. This was due to cash inflows from the divestitures and also to an improvement in operating cash flow.

As of December 31, 2007 we had noncurrent financial liabilities of €12,911 million, including the €1.2 billion subordinated hybrid bond issued in July 2005 and the €2.3 billion mandatory convertible bond issued in April 2006. Net debt should be viewed against the fact that Moody's and Standard & Poor's treat 75 percent and 50 percent, respectively, of the hybrid bond as equity. Both rating agencies consider the mandatory convertible bond wholly as equity. Unlike conventional borrowings, the hybrid bond thus has only a limited effect on the Group's rating-specific debt indicators, while the mandatory convertible bond has no effect.

In April 2007 we issued a three-year €0.3 billion floating-rate bond and a four-year €0.2 billion fixed-rate bond under the EMTN program. In the second quarter of 2007, we raised financing for the Japanese holding company founded at the end of 2006, which performs holding-company and service functions and provides financing for all Bayer subsidiaries in Japan. As well as borrowing from local banks, we launched three separate yen bonds in Japan with a total volume of ¥55 billion (approx. €0.3 billion) under the EMTN program.

We succeeded in significantly paying down the syndicated loan secured in connection with the acquisition of Schering AG by €4.4 billion to €1.3 billion, mainly through the cash flows received from the divestitures and our business operations. We also redeemed in full the €2.1 billion five-year Bayer AG bond due in April 2007.

Financial strategy

The financial management of the Bayer Group is conducted by the strategic management holding company Bayer AG. Finance is a global resource, generally procured centrally and distributed within the Group. The foremost objectives of our financial management are to help bring about a sustained increase in corporate value and ensure the Group's creditworthiness and liquidity. That means reducing our cost of capital, improving our financing cash flow, optimizing our capital structure and effectively managing risk. The management of currency, interest rate, raw material price and default risks helps to reduce the volatility of our earnings.

The rating agencies contracted by Bayer assess us as follows:

	Long-term rating	Outlook	Short-term rating
Standard & Poor's	BBB+	positive	A-2
Moody's	A3	negative	P-2

These credit ratings reflect the company's good solvency and ensure access to a broad investor base for financing purposes. Our strategy is geared toward achieving the single-A rating category in order to maintain our financial flexibility. We therefore plan to use part of our operating cash flows to reduce net debt.

We pursue a prudent debt management strategy aimed at ensuring flexibility, drawing on a balanced financing portfolio. Chief among these resources are a multi-currency European Medium Term Note program, syndicated acquisition financing, a syndicated credit facility and a multi-currency commercial paper program. We also have various structured products, especially asset-backed securities programs.

We use financial derivatives to hedge against risks arising from business operations or financial transactions, but do not employ contracts in the absence of an underlying transaction. It is our policy to diminish the default risk by selecting trading partners with a high credit standing. We closely monitor the execution of all transactions, which are conducted according to Group-wide guidelines.

Further details of our risk management objectives and the ways in which we hedge all the major types of transaction to which hedge accounting is applied, along with procurement market, credit and liquidity risks, as they relate to our use of financial instruments, are given in the Risk Report beginning on page 80.

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Earnings Performance

Bayer Group Summary Income Statements	2006	2007	Change
	€ million	€ million	%
Net sales	**28,956**	**32,385**	**+11.8**
Cost of goods sold	(15,275)	(16,352)	+7.1
Selling expenses	(6,534)	(7,782)	+19.1
Research and development expenses	(2,297)	(2,578)	+12.2
General administration expenses	(1,599)	(1,772)	+10.8
Other operating income and expenses – net	(489)	(747)	+52.8
EBIT (operating result)	**2,762**	**3,154**	**+14.2**
Non-operating result	**(782)**	**(920)**	**+17.6**
Income before income taxes	**1,980**	**2,234**	**+12.8**
Income taxes	(454)	72	•
Income from discontinued operations after taxes	169	2,410	•
Income after taxes	**1,695**	**4,716**	•
of which attributable to minority interest	12	5	•
of which attributable to Bayer AG stockholders (net income)	1,683	4,711	•

Net sales of the Bayer Group increased by 11.8 percent, or €3,429 million, from the previous year to €32,385 million. Adjusted for currency and portfolio effects, sales rose by 6.1 percent.

The cost of goods sold increased by 7.1 percent to €16.4 billion, mainly due to the full-year inclusion of the business of Schering AG, Berlin, Germany, but also because of the growth in business and higher raw material costs. The ratio of the cost of goods sold to total net sales was 50.5 percent (2006: 52.8 percent). With Schering AG included for the full year, selling expenses rose by a total of 19.1 percent to €7.8 billion. The ratio of selling expenses to sales thus rose to 24.0 percent, from 22.6 percent in 2006. Our research and development expenses also increased as a result of the inclusion of the Schering business for the full year, climbing by 12.2 percent to €2.6 billion; the ratio of R&D expenses to net sales was 8.0 percent (2006: 7.9 percent). General administration expenses came to €1.8 billion. The negative balance of other operating income and expenses resulted from costs related to the integration of Schering AG, restructuring, litigation and valuation write-downs.

EBIT for 2007 came in at €3,154 million. Before net special charges of €1,133 million (2006: €717 million), EBIT climbed by 23.2 percent to €4,287 million.

The non-operating result dropped by €138 million to minus €920 million. There was a net €69 million loss from investments in affiliated companies (2006: €207 million income), while net interest expense edged down €27 million to €701 million. Income from investments in affiliated companies in the previous year included the €236 million divestment gain from the sale of our interest in GE Bayer Silicones.

In 2007 we recorded net tax income of €72 million after one-time non-cash tax income of €912 million arising in connection with the corporate tax reform in Germany. This tax effect resulted mainly from the remeasurement of the deferred tax liabilities accrued in connection with the Schering acquisition, particularly in order to reflect the lower nominal rates of corporate income tax that apply in Germany from 2008. Before this one-time effect, we had tax expense in 2007 of €840 million (2006: €454 million).

Including the result of discontinued operations, which contains the proceeds from the divestments of H.C. Starck and Wolff Walsrode and part of the divestiture proceeds from the diagnostics business, and after minority interests, Group net income in 2007 rose by €3,028 million to €4,711 million (2006: €1,683 million).

Asset and Capital Structure

Bayer Group Summary Balance Sheets	Dec. 31, 2006	Dec. 31, 2007	Change
	€ million	€ million	%
Noncurrent assets	**35,897**	**34,712**	**−3.3**
Current assets	**17,069**	**16,582**	**−2.9**
Assets held for sale and discontinued operations	2,925	84	−97.1
Total current assets	**19,994**	**16,666**	**−16.6**
Total assets	**55,891**	**51,378**	**−8.1**
Stockholders' equity	**12,851**	**16,821**	**+30.9**
Noncurrent liabilities	**27,525**	**23,945**	**−13.0**
Current liabilities	**14,667**	**10,436**	**−28.8**
Liabilities directly related to assets held for sale and discontinued operations	848	176	−79.2
Total current liabilities	**15,515**	**10,612**	**−31.6**
Liabilities	**43,040**	**34,557**	**−19.7**
Total stockholders' equity and liabilities	**55,891**	**51,378**	**−8.1**

Total assets declined by €4.5 billion compared with December 31, 2006, to €51.4 billion. This was mainly due to the divestitures of H.C. Starck, Wolff Walsrode and the diagnostics business, which as of December 31, 2006 were already no longer reflected in the individual balance sheet items, but instead were recognized under "Assets held for sale and discontinued operations" and the corresponding liability item.

Noncurrent assets declined by €1.2 billion to €34.7 billion. They include goodwill of €8.2 billion resulting primarily from the Schering AG acquisition. Current assets of continuing operations declined by €0.5 billion from the previous year, to €16.6 billion.

Stockholders' equity expanded by €4.0 billion to €16.8 billion. The increase was mainly due to the Group net income of €4.7 billion, of which discontinued operations (primarily divestment gains) accounted for €2.4 billion. Stockholders' equity was diminished by the dividend payment of €0.8 billion made in 2007, among other factors. Negative currency effects of €0.8 billion were offset, mainly because of a decline in pension obligations that did not affect earnings. Our equity ratio (equity coverage of total assets), which had dropped to 23.0 percent by the end of 2006 as a result of the Schering acquisition, increased again considerably to 32.7 percent in 2007.

Liabilities decreased by €8.5 billion compared with December 31, 2006, to €34.6 billion. Current and noncurrent financial liabilities once again fell considerably following the sharp increase in the previous year as a result of the Schering acquisition, declining by €5.6 billion to €14.2 billion. Provisions for pensions were down by €1.0 billion to €5.5 billion compared with December 31, 2006, mainly as a result of actuarial changes recognized directly in stockholders' equity.

Balance Sheet and Financial Ratios		2006	2007
Cost of sales ratio (%)	Cost of goods sold / Net sales	52.8	50.5
R&D expense ratio (%)	Research and development expenses / Net sales	7.9	8.0
Inventory turnover	Cost of goods sold / Inventories	2.5	2.6
Receivables turnover	Net sales / Trade accounts receivable	5.0	5.6
EBIT margin before special items (%)	EBIT before special items / Net sales	12.0	13.2
EBITDA margin before special items (%)	EBITDA before special items / Net sales	19.3	20.9
Asset intensity (%)	Property, plant and equipment + intangible assets / Total assets (continuing operations) [1]	62.1	61.6
D&A/capex ratio (%)	Depreciation and amortization [3] / Capital expenditures [3]	100.1	128.3
Liability structure [2] (%)	Current liabilities / Liabilities	36.0	30.7
Gearing (%)	Net debt + pension provisions / Stockholders' equity	1.9	1.1
Equity ratio [2] (%)	Stockholders' equity / Total assets	23.0	32.7
Return on stockholders' equity [2] (%)	Income after taxes / Average stockholders' equity	14.1	31.8
Return on assets (%)	Income before taxes and interest expense / Average total assets for the year as per segment table	7.7	6.9

[1] Total assets (continuing operations) = noncurrent and current assets minus the balance sheet item "Assets held for sale and discontinued operations"
[2] Ratio refers to the total of continuing and discontinued operations
[3] Property, plant, equipment and intangible assets

Report pursuant to Section 315, Paragraph 4 of the German Commercial Code in conjunction with Section 120, Paragraph 3, Sentence 2 of the German Stock Corporation Act

The capital stock of Bayer AG amounts to €1,956,715,315.20 and is divided into 764,341,920 no-par bearer shares. Each share confers one voting right.

We received no notifications in 2007 of direct or indirect holdings of shares in Bayer AG that exceed 10 percent of the capital stock. We received the following notifications in 2006:

The Capital Group Companies, Inc., U.S.A., notified us pursuant to Section 21, Paragraph 1 of the German Securities Trading Act (WpHG) that the proportion of voting rights it holds in our company exceeded the 10 percent threshold on September 19, 2006, that since that date it has held 10.0179 percent of the voting rights and that all of these voting rights are attributable to it pursuant to Section 22, Paragraph 1, Sentence 1, No. 6 in conjunction with Section 22, Paragraph 1, Sentences 2 and 3 of the German Securities Trading Act. Further, the Capital Research and Management Company, U.S.A., which according to our information is a subsidiary of The Capital Group Companies, Inc., notified us that the proportion of voting rights it holds in our company exceeded the 10 percent threshold on November 8, 2006, that since that date it has held 10.0852 percent of the voting rights, and that all of these voting rights are attributable to it pursuant to Section 22, Paragraph 1, Sentence 1, No. 6 of the German Securities Trading Act.

Pursuant to Section 84, Paragraph 1 of the German Stock Corporation Act (AktG), the members of the Board of Management are appointed and dismissed by the Supervisory Board. Since Bayer AG falls within the scope of the German Codetermination Act, the appointment or dismissal of members of the Board of Management requires a majority of two-thirds of the votes of the members of the Supervisory Board on the first ballot.
If no such majority is achieved, the appointment may be approved pursuant to Section 31, Paragraph 3 of the Codetermination Act on a second ballot by a simple majority of the votes of the members of the Supervisory Board. If the required majority is still not achieved, a third ballot is held. Here again, a simple majority of the votes suffices, but in this ballot the Chairman of the Supervisory Board has two votes pursuant to Section 31, Paragraph 4 of the Codetermination Act.

Under Section 6, Paragraph 1 of the Articles of Incorporation of Bayer AG, the Board of Management must comprise at least two members. If further members are appointed to the Board of Management, the Supervisory Board may appoint one member to be Chairman of the Board of Management pursuant to Section 84, Paragraph 2 of the German Stock Corporation Act or Section 6, Paragraph 1 of the Articles of Incorporation.

Under Section 179, Paragraph 1 of the German Stock Corporation Act, amendments to the Articles of Incorporation require a resolution of the Stockholders' Meeting. Pursuant to Section 179, Paragraph 2 of the German Stock Corporation Act, this resolution must be passed by a majority of three-quarters of the voting capital represented at the meeting, unless the Articles of Incorporation provide for a different majority. However, where an amendment relates to a change in the object of the company, the Articles of Incorporation may only specify a larger majority. Section 17, Paragraph 2 of the Articles of Incorporation of Bayer AG utilizes the scope for deviation pursuant to Section 179, Paragraph 2 of the German Stock Corporation Act and provides that resolutions may be passed by a simple majority of the votes or, where a capital majority is required, by a simple majority of the capital.

Provisions of the Articles of Incorporation concerning Authorized Capital I and Authorized Capital II are entered in the commercial register of Bayer AG. With the approval of the Supervisory Board and until April 27, 2011, the Board of Management may use the

Authorized Capital I to increase the capital stock by up to a total of €465 million. The issue of new shares may take place in exchange for cash and/or contributions in kind, but capital increases in exchange for contributions in kind may not exceed a total of €370 million. If the Authorized Capital I is used to issue shares in return for cash contributions, stockholders must be granted subscription rights. With the approval of the Supervisory Board and until April 26, 2012, the Board of Management is also authorized to increase the capital by up to €195 million in one or more installments by issuing shares out of the Authorized Capital II in exchange for cash contributions. The stockholders must be granted subscription rights. However, the Board of Management is authorized, with the approval of the Supervisory Board, to exclude subscription rights for stockholders provided the capital increase out of the Authorized Capital II does not exceed 10 percent of the capital stock existing at the time this authorization becomes effective or the time this authorization is exercised.

Conditional capital of €186.88 million, corresponding to 73,000,000 shares, exists to service the conversion rights under a mandatory convertible bond issued by Bayer Capital Corporation B.V., Netherlands, on April 6, 2006. Further, the Annual Stockholders' Meeting on April 27, 2007 authorized the Board of Management to purchase and sell company shares representing up to 10 percent of the capital stock. This authorization expires on October 26, 2008.

Material agreements entered into by Bayer AG which are subject to the condition precedent of a change of control include, firstly, the agreement of March 23, 2006 establishing a €7 billion syndicated credit facility for Bayer AG. This agreement contains provisions entitling the banks participating in the syndication to terminate the agreement in the event of a change of control and demand repayment of any outstanding sums. The loan was paid down to €1.25 billion as of December 31, 2007.

Similarly, the €2.3 billion mandatory convertible bond issued by Bayer Capital Corporation B.V., Netherlands, on April 6, 2006, which is secured by a subordinated guarantee from Bayer AG, also contains a change of control clause. Under Section 6.5 of the conditions of issue, in the event of a takeover offer pursuant to Section 29, Paragraph 1 of the German Securities Acquisition and Takeover Act (WpÜG) or a mandatory offer, pursuant to Section 35, Paragraph 1 of that Act, bondholders shall be entitled to exercise their conversion rights. If they do so, they will receive Bayer AG shares in accordance with the applicable conversion ratio.

Finally, the terms of the approximately €3.9 billion in notes issued by Bayer in 2006 and 2007 under its multicurrency European Medium Term Note program also contain a change-of-control clause. Holders of these notes have the right to demand the redemption of their notes by Bayer AG in the event of a change of control if Bayer AG's credit rating is downgraded within 120 days after such change of control becomes effective.

In the event of a takeover offer for Bayer AG, the following agreements exist for members of the Board of Management:

The severance indemnity clause for the members of the Group Management Board described in the Compensation Report is currently supplemented by a change-of-control clause which, like the severance indemnity clause, only takes effect if a change of control results in the termination of a Group Management Board member's service contract and his leaving the Bayer Group prior to his 60th birthday. The potential benefits are the same as under the severance indemnity clause, except that if the contract of a member of the Group Management Board terminates on or before his 55th birthday, the monthly bridging allowance may be paid for 60 months, though not beyond his 60th birthday, provided that he does not take up another position on comparable terms before then. The exact amount of the monthly payments, which are intended to offset any difference in remuneration, depend on the remuneration received elsewhere.

Proposal for Distribution of the Profit

Under German law, the dividend payment is based on the balance sheet profit of the parent company, which amounted to €1,032 million in 2007:

Bayer AG Summary Income Statements according to the German Commercial Code	2006	2007
€ million		
Net sales	**196**	**242**
Cost of goods sold	(146)	(195)
Gross profit	**50**	**47**
Selling and administration expenses	(194)	(224)
Other operating income and expenses – net	(5)	(2)
Operating result	**(149)**	**(179)**
Non-operating result	**1,449**	**2,304**
Income before income taxes	**1,300**	**2,125**
Income taxes	(50)	(197)
Net income	**1,250**	**1,928**
Allocation to retained earnings	(486)	(896)
Balance sheet profit	**764**	**1,032**

We will propose to the Annual Stockholders' Meeting on April 25, 2008 that the balance sheet profit be used to pay a dividend of €1.35 (2006: €1.00) per share (764,341,920 shares) on the capital stock of €2.0 billion entitled to the dividend for 2007.

Employees

On December 31, 2007, the Bayer Group had 106,200 employees worldwide (2006: 106,000). North America accounted for 16,800 of these employees, while 18,900 were based in Asia-Pacific, 14,300 in Latin America/Africa/Middle East and 56,200 in Europe. In Germany we had 39,100 employees, who made up 36.8 percent of the Group workforce. The number of employees has been converted to full-time equivalents, which means part-time employees are included in proportion to their contractual working hours. We believe this presentation improves the comparability of personnel expenses and employee numbers. Personnel expenses rose by 14.2 percent in 2007 to €7,571 million (2006: €6,630 million). In the previous year's figure, personnel expenses for Schering employees are included from June 23, 2006.

Employees by Corporate Function	Dec. 31, 2006	Dec. 31, 2007
Production	47,800	48,800
Marketing	37,400	36,900
Research and development	12,300	11,600
General administration	8,500	8,900
Total	**106,000**	**106,200**
of which trainees	3,100	2,700

A breakdown of employees by segment is provided in the segment table in Note [1] to the consolidated financial statements.

Our company’s economic success is crucially dependent on a high level of commitment by the entire workforce. We therefore endeavor to foster the skills and capabilities of our employees through continuing education and human resources development programs worldwide. Our training programs are oriented toward the needs of our business operations and are planned, implemented and evaluated according to globally standardized processes. When developing new programs, we focus on combining topical subject-matter with modern teaching and learning methods. For example, our award-winning international leadership program “BayWay” – comprising virtual classroom instruction and on-site training – was revised in 2007 and successfully applied in our Group-wide management development. With our online training program “Discovering Bayer,” launched as a pilot project in the United States in the summer of 2007, we teach newly hired employees about our company’s values and organizational structure and support the building of personal networks as part of our Global Orientation Program.

Employee participation in the company’s success

We enable our employees to participate in the company’s success to a significant degree. Bayer is paying out roughly €490 million to employees in variable one-time payments for 2007 under its Short-Term Incentive program (2006 on a pro-forma basis: approx. €420 million).

Our employees also benefit from Bayer’s business success through various stock participation programs. In addition to the existing programs, we introduced a newly designed program called “BayShare” in Portugal, Spain, Italy and the Netherlands in 2007. Our employees in those countries have the opportunity to purchase Bayer shares at an attractive discount. A company-wide program called “Aspire” has existed since 2005 for senior management.

Wide range of career opportunities for young people

As part of our international human resources policy, we traditionally focus on offering young people good future perspectives through well-founded vocational training and on attracting qualified specialists to our company. In 2007, a total of 895 young people embarked on vocational training programs for over 20 occupations at our German sites, bringing the number of young people we are preparing for a career in Germany to some 2,700.

Bayer also offers a proven program designed to help youngsters with limited educational qualifications prepare within one year for a vocational training course. In 2007 this initiative was recognized by the Dublin-based European Foundation for the Improvement of Living and Working Conditions as a groundbreaking project and an important contribution to combating youth unemployment.

The recruiting and advancement of young managers with an academic background is of great importance to Bayer. We currently operate four different international trainee programs for gifted university graduates.

Innovative tools

Mindful that all our employees need to prepare for a longer working life in the future, we run training programs specifically designed to help the various employee groups adapt to changes in life worktimes.

The long-term account system introduced in Germany in 2007 will enable our employees to more flexibly manage their individual working periods. Employees can save up value credit from various time and remuneration components which can then be used to finance paid leave prior to their official retirement.

Realignment of the Bayer-wide human resources function
Bayer is currently realigning its human resources function through the Group-wide "Transforming Human Resources" project. This realignment increases the contribution of the human resources function to the success of the business and enhances the quality and efficiency of global human resources processes.

As part of this realignment, the various human resources services are being performed by the company's own HR Shared Service Centers (SSCs). The SSC in Leverkusen currently serves employees in Germany and will in future be available to their colleagues in other European countries. The second HR Shared Service Center, which launched operations in Pittsburgh in April 2007, will support approximately 12,000 employees in North America.

Procurement and Distribution

Bayer HealthCare

The **Pharmaceuticals** segment generally procures the raw materials for manufacturing the active ingredients of its ethical pharmaceuticals from external suppliers. We hold strategic reserves to prevent supply bottlenecks and possible dependence on suppliers. To mitigate major price fluctuations, we generally purchase the building blocks and intermediates required to manufacture our principal active ingredients on the basis of global contracts or from several approved suppliers. The active ingredients of our ethical pharmaceuticals are currently manufactured almost entirely in Wuppertal and Bergkamen, Germany, for Bayer production facilities in Berlin, Leverkusen and Weimar, Germany; Berkeley and Emeryville, California; Garbagnate, Italy; São Paulo, Brazil; Madrid, Spain; Turku, Finland and elsewhere. Our products are primarily distributed through wholesalers, pharmacies and hospitals.

Since we compete with other drug suppliers worldwide, we actively seek to reinforce our external distribution network with co-promotion and co-marketing arrangements. In June 2007, we began co-marketing the Schering-Plough product Zetia® in Japan within the scope of the strategic alliance formed with that company in 2004. (Please note that Schering-Plough Corporation, New Jersey, and the company acquired by Bayer in June 2006, i. e. Bayer Schering Pharma AG (formerly named Schering AG), Berlin, Germany, are unaffiliated companies that have been totally independent of each other for many years.) In the United States, Schering-Plough also distributes Primary Care products from Bayer and co-markets our erectile dysfunction drug Levitra® with GlaxoSmithKline.

In our **Consumer Health** segment the focus is on products marketed directly to consumers. The Consumer Care Division, which concentrates on non-prescription drugs, procures certain high-volume raw materials such as acetylsalicylic acid and clotrimazole from within the Bayer Group, and other principal raw materials such as naproxen, ascorbic acid, citric acid and paracetamol from third parties. These are generally readily available. To minimize business risks, we diversify our raw material procurement sources worldwide and conclude long-term supply agreements. Among the division's largest production sites are the facilities in Myerstown, Pennsylvania, United States; Gaillard, France; and Grenzach, Germany. While the division's sales and distribution channels outside Europe are typically supermarket chains, drugstores and other large retailers, pharmacies are the usual distribution channel in Europe.

About one quarter of the products of the Diabetes Care Division are manufactured or assembled directly by Bayer, while the rest are procured from original equipment manufacturers (OEMs). The price and availability of most materials are safeguarded through contractual agreements and are therefore not subject to major fluctuations. We hold strategic reserves of certain direct materials or finished products in order to be able to supply our customers consistently and reliably. The division's biggest production site is located in Mishawaka, Indiana, United States. Our Diabetes Care products are generally marketed to consumers outside Europe through pharmacies, drugstores, mass merchants, hospitals and wholesalers. In Europe, they are sold mainly through pharmacies.

The Animal Health Division procures the pharmaceutical ingredients for its veterinary medicines both from within the Bayer Group and from external suppliers throughout the world. Its products are manufactured mainly at the sites in Kiel, Germany, and Shawnee, Kansas, United States, and marketed worldwide. Depending on local regulatory frameworks, animal health products may be available to end users with a prescription issued by a veterinarian or over the counter from retail stores, drugstores and pharmacies.

Bayer CropScience

Bayer CropScience procures most of its raw materials for the manufacture of crop protection products from external companies around the world. The cost of some raw materials depends on fluctuating crude oil and energy prices and freight charges.

Our business is subject to the growing seasons for the relevant crops and the respective distribution cycles.

Bayer CropScience operates more than 40 production facilities of its own around the world. Among the largest are the plants in Dormagen and Frankfurt, Germany; Institute, West Virginia and Kansas City, Missouri, United States; and Vapi, India. In addition to the central locations for the manufacture of our active ingredients, a network of decentralized formulation and filling plants enables us to respond rapidly to local market needs.

Our crop protection products are marketed either via wholesalers or directly through retailers by means of a two- or three-step distribution system, depending on local market conditions.

The products of the Environmental Science Business Group are addressed to both professional users and consumers in the non-agricultural segment and are distributed through different channels. Our green industry, pest control and vector control products are marketed directly to professional users, while home and garden products are sold to consumers through specialized retailers.

BioScience produces its commercial seeds in numerous breeding stations around the world. The products are made available to growers, breeders, specialist dealers and processing industries. Traits developed using plant biotechnology are either incorporated into our own seeds or outlicensed to other seed companies for use in their products. In some cases, traits are provided to other companies that use the technology in their research.

Bayer MaterialScience

The primary raw materials for our products are petrochemical feedstocks. We generally procure these on the open market by way of long-term agreements that serve to safeguard the supply of raw materials on competitive terms.

Bayer MaterialScience manufactures its products in close proximity to its customers at 30 locations around the world. Our largest production facilities for the European market are located in Dormagen, Krefeld-Uerdingen and Brunsbüttel, Germany; Antwerp, Belgium; and Tarragona, Spain. The major production sites for the U.S. market are at Baytown, Texas, while customers in the Asia-Pacific region are supplied chiefly from Map Ta Phut, Thailand and Caojing, China. Our focus is on world-scale facilities.

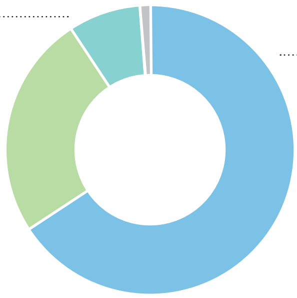
Products marketed by the MaterialScience subgroup are polyurethanes, polycarbonates, raw materials for coatings and adhesives, and selected basic chemicals.

These products are mainly used in the automotive, construction, electronics, information technology, furniture, timber, chemical, sports equipment, leisure goods, textile, medical technology and manufacturing industries.

Our plastics materials are marketed primarily through regional distribution channels or directly to customers. We also work together with trading houses and local distributors who are responsible for business with small customers. Major customers with global operations are serviced directly by our key account managers.

Research and Development

Research and Development Expenses by Subgroup in % (2006 in parentheses)



As a research-based company, the Bayer Group firmly believes in innovation as a key driver for future growth. We have the necessary resources in place to realize further growth opportunities for the future through research and development activities. In 2007 we invested a total of €2,578 million in research and development, compared with €2,297 million in the previous year. It is particularly important for us to develop new products that strengthen our core businesses while at the same time continuously optimizing our product portfolio and our manufacturing processes. Our research activities are closely aligned to the requirements of our markets, with customer needs and technological advances presenting opportunities for future innovation. With innovation projects in particular, our own research and development activities are supplemented by our international network of collaborations with leading universities, public-sector research institutes and partner companies. Through this pooling of expertise, we aim to rapidly translate new ideas into successful products.

Bayer HealthCare

In 2007 we invested €1,700 million (2006: €1,426 million) in R&D in the Pharmaceuticals and Consumer Health segments to lay the foundations for the introduction of further innovative products in the subgroup's expanding markets. This represented 65.9 percent of the Bayer Group's entire R&D expenditures and was equivalent to 11.5 percent of sales.

In connection with the integration of Schering AG, Berlin, Germany, we have carried out a strategic realignment and reorganized our global pharmaceutical research and development to adjust to the new situation. In drug discovery we now focus on four growth areas: oncology, cardiology, women's healthcare and diagnostic imaging. The respective research activities are consolidated at three main sites: Berlin and Wuppertal, Germany, and Berkeley, California. The Berlin and Wuppertal locations have significant capabilities and activities in the identification of molecular targets and the development and optimization of lead substances, as well as in drug metabolism, pharmacokinetics, toxicology and clinical pharmacology. Berkeley is an important global research and development center for protein-based active ingredients and is home to the biotechnological production facility for Kogenate®. Bayer HealthCare's U.S. research sites in West Haven, Connecticut, and Richmond, California, have been or will be closed.

To drive the development of new substances to treat diseases where there is a high unmet medical need, we conducted clinical studies with several drug candidates from our research and development pipeline during 2007. Products we submitted to one or more regulatory authorities for registration or extension of the existing registration included Xarelto® (prevention of venous thromboembolism following major orthopedic surgery), Menostar® transdermal VMS (menopause management), the E2/DNG project (contraception), the E2/LNG project (menopause management) and Zevalin® (follicular lymphoma). The following table shows the drug candidates currently in Phase II or III of clinical testing:

Research and development projects (Phases III and II)

	Indication	Status
Rivaroxaban/Xarelto®	Prevention of venous thromboembolism in medically ill, immobilized patients	Phase III
Rivaroxaban/Xarelto®	Stroke prevention in atrial fibrillation	Phase III
Rivaroxaban/Xarelto®	Treatment of venous thromboembolism	Phase III
Nexavar®	Melanoma	Phase III
Nexavar®	Non-small-cell lung cancer	Phase III
Bonefos®	Prevention of bone metastasis in breast cancer	Phase III
Zevalin®	Aggressive non-Hodgkin's lymphoma	Phase III
YAZ® Flex	Fertility control (long cycle)	Phase III
Combined oral contraceptive containing folate	Fertility control	Phase III
LCS (Levonorgestrel Contraceptive System)	Intrauterine fertility control	Phase III
Mirena®	Menorrhagia	Phase III
E2/DNG	Supplementary indication: dysfunctional uterine bleeding	Phase III
YAZ®	Dysmenorrhea (Japan)	Phase III
Angeliq® low-low	Menopause management	Phase III
Visanne®	Endometriosis	Phase III
VEGF Trap-Eye	Wet age-related macular degeneration (AMD)	Phase III
Alemtuzumab	Multiple sclerosis	Phase III
Ultravist® 370	Computed tomography	Phase III
Gadovist®	Magnetic resonance imaging	Phase III
Aspirin® i.v.	Acute coronary syndrome	Phase III
Avelox®	New indications	Phase III
Adenosine A1 agonist	Atrial fibrillation/stable angina pectoris	Phase II
sGC activator	Acute heart failure	Phase II
sGC stimulator	Pulmonary hypertension	Phase II
sGC stimulator 2	Heart failure	Phase II
Rivaroxaban/Xarelto®	Secondary prevention of acute coronary syndrome/myocardial infarction	Phase II
Kogenate®	Hemophilia (formulation based on liposome technology)	Phase II
Nexavar®	Breast cancer	Phase II
Nexavar®	Additional indications	Phase II
L19-Interleukin 2	Renal cell carcinoma	Phase II
ZK-PRA	Breast cancer	Phase II
Sagopilone (ZK-EPO)	Lung/ovarian/breast/prostate cancer	Phase II
FC Patch	Fertility control	Phase II
E2/DRSP	Fertility control	Phase II
Combined oral contraceptives/DHEA	Fertility control	Phase II
Valette® plus	Fertility control	Phase II
Spheramine®	Parkinson's disease	Phase II
Levitra®	New indications	Phase II
Amikacin Inhale	Pneumonia	Phase II
Cipro Inhale	Lung infection	Phase II

The nature of drug discovery and development is such that not all compounds can be expected to meet the pre-defined project goals. It is possible that any or all of the projects listed above may have to be discontinued due to scientific and/or commercial reasons and will not result in marketed products. It is also possible that the requisite FDA, European Medicines Agency (EMEA) or other regulatory approval will not be granted for these compounds.

We regularly evaluate our pharmaceutical research and development pipeline in order to prioritize the most promising projects.

Some important development candidates in our pipeline are described below. Our innovative cancer drug Nexavar® (sorafenib), developed jointly with Onyx Pharmaceuticals Inc., inhibits tumor growth by simultaneously blocking several serine/threonine and receptor tyrosine kinases in tumor cells. It also reduces the formation of new blood vessels that feed the tumor. We already market this product – first approved in December 2005 for the treatment of patients with advanced renal cell carcinoma – in more than 80 countries. In June 2007 we presented positive Phase III study results for the treatment of hepatocellular carcinoma with Nexavar®. Based on these data we obtained marketing authorization in this indication in Europe and the United States in the course of the year. Nexavar® is currently in various stages of clinical testing for the treatment of other tumor types.

In addition, our developmental product rivaroxaban (planned trade name: Xarelto®), a novel oral direct Factor Xa inhibitor, is being developed for the prevention and treatment of thrombotic events in order to address currently unmet needs in the anticoagulation market. This product is being jointly developed by Bayer HealthCare and Johnson & Johnson subsidiary Ortho-McNeil, Inc. under an agreement concluded in October 2005. Phase III clinical trials with Xarelto® were initiated in December 2005 for the prevention of venous thromboembolism (VTE) after major orthopedic surgery. In 2007 we applied to the European Medicines Agency (EMEA) for marketing approval for this indication. In 2006 we initiated Phase III clinical trials for the chronic indications of stroke prevention in atrial fibrillation and the treatment of venous thromboembolism and its secondary prevention. In 2007 we initiated the Phase III trial for the prevention of thrombosis in medically ill, immobilized patients. Phase II clinical trials for secondary prevention of acute coronary syndrome/myocardial infarction began in 2006.

An example of research and development activities in our Women's Healthcare business unit is our product YAZ® from the drospirenone product family. Featuring an innovative, patent-protected therapeutic regime, YAZ® is the first oral contraceptive with two additional indications: acne and PMDD (premenstrual dysphoric disorder). In addition to the benefits of drospirenone, the gestagen contained in the product, YAZ® reduces the typical monthly hormone fluctuations seen with traditional contraceptives with a 21-day regimen. The product has already been approved for all three indications in the United States. In June 2007, YAZ® was approved in the Netherlands for fertility control and the treatment of acne. On the basis of this registration, an application has been submitted for the product to receive marketing approval for these two indications throughout Europe via the Mutual Recognition Procedure (MRP).

Our research and development efforts for biological products in the Hematology/Cardiology business unit focus on strengthening and expanding our recombinant Factor VIII product Kogenate®. Key research and product development projects include a new presentation of Kogenate® based on patented pegylated liposome technology as well as Kogenate® – Next Generation and the evaluation of gene therapy for hemophilia B.

In the Specialized Therapeutics business unit, the humanized monoclonal antibody alemtuzumab successfully completed Phase II clinical trials and is now being tested in two global Phase III studies for the treatment of multiple sclerosis (MS). This novel approach to the treatment of the autoimmune disease MS is being developed in collaboration with Genzyme Corporation.

The portfolio of products emerging from our own research and development is supplemented by products inlicensed on a national, regional or global level. An example is the acquisition from U.S.-based ZymoGenetics, Inc., of commercialization rights outside the United States for recombinant human thrombin (rThrombin), which received marketing approval from the FDA in January 2008. The two companies plan to co-promote the product in the United States for an initial period of three years under the name Recothrom™ for the control of bleeding during surgery. In 2007 we entered into a partnership with Nektar Therapeutics Inc. to develop and commercialize an inhaled formulation of the antibiotic amikacin to treat pneumonia. Under the collaboration agreement entered into in 2006 with Regeneron Pharmaceuticals, Inc. on global development and marketing for the developmental product "VEGF Trap-Eye," the product has now entered Phase III testing in age-related macular degeneration. "VEGF Trap-Eye" is a protein which, when applied locally to the eye, binds to or "traps" the vascular endothelial growth factor (VEGF) and blocks its activity. Bayer has the right to market the drug outside the United States upon regulatory approval.

The agreement signed in 2006 with Nuvelo Inc. to globally develop and market alfimeprase was terminated after the drug failed to meet its primary endpoints in two Phase III trials (NAPA 2 and SONOMA 2).

We manage the life cycles of commercialized products by identifying new indications and developing improved formulations in order to expand the scope of possible treatment opportunities.

In our Consumer Health segment, research and development activities of the Consumer Care Division at the Morristown, New Jersey, and Gaillard, France, sites focus on identifying, developing and commercializing non-prescription (over-the-counter = OTC) products. These efforts are centered on support for existing brands and the implementation of product-specific, clinical and regulatory development strategies that enable the successful exploitation of new technologies, the expansion of indications for existing products or the reclassification of current prescription medicines as OTC products. We introduced several new products to the market in 2007.

In the Diabetes Care Division, headquartered in Tarrytown, New York, we focus on strengthening core product lines and continuing our expansion into attractive segments of the diabetes market. The results of our internal development work and our collaborations with partners enable us to offer user-friendly blood glucose monitoring systems to meet the individual needs of people with diabetes.

The Animal Health Division focuses its research and development activities in Monheim, Germany, on antiinfectives and parasiticides as well as active ingredients for the treatment of non-infectious disorders such as renal failure, pain, cancer and congestive heart failure, particularly in companion animals.

Bayer CropScience

In 2007, €637 million (2006: €614 million), or about 24.7 percent of the Bayer Group's research and development expenditures, was spent at Bayer CropScience. This is equivalent to 10.9 percent of the subgroup's sales.

CropScience maintains a global network of research and development facilities. Our biggest R&D sites for crop protection products are located in Monheim and Frankfurt, Germany, and Lyon, France. The major research centers of the BioScience Business Group are located in Ghent, Belgium, and Haelen, Netherlands.

While research is concentrated at a small number of centrally located sites, our development activities take place both there and at field testing stations across the globe, to enable future products to be tested under the relevant regional climatic conditions. Breeding activities for our seed business are also carried out at various decentralized locations to take account of specific local market requirements.

In the Crop Protection segment we identify and develop innovative, safe and economically sustainable insecticides, fungicides and herbicides and carry out research projects in new areas of future importance, such as plant health or stress tolerance. In addition to conventional chemistry, biology and biochemistry, modern technologies such as genomics, high-throughput screening, bioinformatics and combinatorial chemistry play an important role in the identification of new lead structures. Collaborations with external parties supplement our own activities.

Once a compound is identified for development, its biological, environmental and toxicological profile is assessed.

We work to actively extend the applications for our products by developing seed treatments and continuously managing product life cycles. This includes developing new formulations for active ingredients and products that are already on the market so that they can be applied to additional crops or are easier to use.

The Crop Protection active ingredient pipeline currently contains 18 projects that the company aims to bring to market maturity by 2015, and a further 45 projects in early-stage research. The following new active ingredients from the R&D pipeline of Bayer CropScience received their first marketing approvals in various countries in 2007:

New active ingredient	Indication	Status
Flubendiamide	Insecticide	Market introduction 2007
Spirotetramat	Insecticide	Market introduction expected in 2008
Tembotrione	Herbicide	Market introduction 2007
Pyrasulfotole	Herbicide	Market introduction expected in 2008

Flubendiamide (major brand: Belt®) is a new insecticide for foliar application in annual and perennial crops, offering protection primarily against all major Lepidoptera species. It belongs to a new chemical class of substances (substituted phthalic acid diamides) with a novel mechanism of action. The substance is also highly effective against insects that are resistant to certain conventional insecticides. Flubendiamide is intended for worldwide use in vegetables, fruit, cotton, corn, beans, tea and a number of other crops.

Spirotetramat (major brand: Movento®) is Bayer CropScience's third active ingredient from the ketoenols substance class. It is a highly effective systemic insecticide that offers protection against a broad spectrum of sucking insects. Spirotetramat protects pome and stone fruit, citrus fruit, grapes, nuts, vegetables and potatoes against pests such as aphids, cicadas, grape lice, mealybugs, whiteflies and cottony-cushion scales.

Tembotrione (major brand: Laudis®), from the triketone chemicals class, is absorbed by the plant through the leaves and can be used in corn to control a broad spectrum of weeds, including resistant varieties.

Pyrasulfotole (major brand: Huskie™), a member of the benzoylpyrazoles class, is a new herbicidal active ingredient offering farmers reliable control of a large number of broad-leaved weeds in cereals.

The compounds discovered in the course of crop protection research are also tested and evaluated by our Environmental Science unit to identify possible development potential for non-agricultural uses. Active ingredients from other companies may also be tested and purchased if suitable. Our current development projects include passive treatments such as gels and baits, formulations for pest control, new products for weed control, and active ingredient mixtures to control fungal diseases on turf and ornamental plants.

In 2007, Environmental Science introduced various new products for professional users and consumers. Key launches included the insecticide Exemptor® (thiacloprid) for the green industry in Europe and the new herbicide Destiny® (iodosulfuron) in Japan.

Research activities in our BioScience unit are based on plant biotechnology and modern breeding methods designed to optimize the properties of our core crops – cotton, canola and rice – and our vegetable seeds.

We have a promising pipeline comprising more than 40 lead projects. Our research and development activities are focused on stress tolerance, yield increases and qualitative plant traits. For example, we are working to develop new canola oil profiles, tomatoes with improved processing characteristics, and new cotton varieties with enhanced fiber properties. Other projects are directed toward improving plants' herbicide tolerance and their resistance to insect attack and diseases. We supplement our own research activities with research and licensing agreements, a key area here being the improvement and safeguarding of crop yields in stress situations by modulating specific genes in cotton, canola and rice.

The expansion of sales in our BioScience Business Group was supported by new product introductions in 2007.

Bayer MaterialScience

In 2007, Bayer MaterialScience spent €209 million (2006: €227 million) on research and development (not including joint development activities with customers) to further expand its leading position in market and process technology as a global supplier of high-quality customized materials and system solutions. The subgroup thus accounted for an 8.1 percent share of the Bayer Group's total research and development expenditures, with R&D expenses amounting to 2.0 percent of sales. In the four MaterialScience business units – Polyurethanes; Polycarbonates; Thermoplastic Polyurethanes; and Coatings, Adhesives, Sealants – the latest technologies and production processes are used to develop new products and applications in close cooperation with our customers and other external partners.

The Polycarbonates business unit strives to develop new formulations and applications for its products and continually improve its manufacturing processes. In product development, we focus our activities on developing new blends, refining materials for optical data storage, developing modified base materials for polycarbonate sheets and modifying the surface of polycarbonates using various coating technologies. Examples include polycarbonate windows and roof elements for cars. Noteworthy applications for polycarbonate films are LCD diffuser films for flat screens and formable coated films for electronic and automotive applications. Soft-touch Makrofol® films are used in automotive interior components and mobile phone housings.

Currently, the main areas of innovation in the Polyurethanes business unit are the development of new and improved polyether polyol types and blends, and the improvement of manufacturing processes for polyols and aromatic isocyanates. Our TDI facility in Caojing, China, due on stream in 2010, will employ gas-phase phosgenation, which uses between 40 and 60 percent less energy than previous processes. We are also investigating the feasibility of a new and highly efficient production process for MDI.

In product development, our activities are focused mainly on extending the applications for our polyurethane systems and improving their thermal insulation properties and flame retardance. The use of renewable raw materials also plays an important part. For example, we have developed polyols containing up to 70 percent by weight of renewable raw materials for use in mattresses, car seats and refrigerator insulation. One completely new application is a polyurethane foam system used to lay railroad ballast beds. The use of this innovative technology, which is currently being tested under regular rail traffic conditions, can result in a lower maintenance requirement for the railroad bed and also reduce train noise levels.

The Coatings, Adhesives, Sealants business unit focuses its research and development activities on developing polyurethane raw materials for the formulation of high performance coatings, adhesives and sealants, such as aliphatic and aromatic polyisocyanates and resin components. Important areas of research are raw materials for waterborne and UV-curing systems that help to conserve resources by obviating the need for organic solvents and reducing drying times for coatings. We are also collaborating with the U.S. company InPhase Technologies to develop holographic data-storage media with a capacity of 300 GB per first-generation disc. We are also working to open up more new applications in the areas of printing inks, cosmetics and medical technology.

Most research and development activities in the Thermoplastic Polyurethanes business unit are directed toward obtaining high-performance thermoplastic polyurethane resin granules and film products, such as solar-module films with very high transparency and UV stability.

The New Business section of MaterialScience constantly tracks and evaluates new technological and market trends, channeling the most promising ideas into research and development projects in order to create profitable business opportunities for the future or expand existing technology platforms. There are various approaches to implementing such projects, including collaboration with the business units or an external institution, or the establishment of an independent company as part of a "greenhouse" initiative. In a new technology initiative, Bayer in the fall of 2007 signed an agreement with Aachen Technical University concerning the establishment of a center for catalysis research in which novel catalytic processes are to be developed. Following the founding in 2006 of the start-up company LYTTRON for the production of three-dimensionally formable electroluminescent films, the internal start-up project Baytubes® was launched in 2007. We now manufacture multi-wall carbon nanotubes in a pilot facility with an annual capacity of 60 tons and market them under the trade name Baytubes®. Thus within a very short time, we have become one of the world's leading suppliers of such products.

Bayer Technology Services

The Bayer subgroups work closely with Bayer Technology Services on engineering and technology solutions, particularly in the fields of process technology, plant engineering and automation. This service company develops and implements innovative technology platforms that speed up development work and help the subgroups to manufacture new products, design system solutions and develop production processes. International sourcing of know-how plays a key strategic role in this. It involves country-specific expertise in the implementation of capital expenditure projects, global access to innovations and public funding, and the recruiting of top international personnel. The establishment of collaborations with other companies and with research institutes also has an important part to play in this respect.

Bayer Innovation

Bayer Innovation investigates and evaluates innovation themes outside of the subgroups' core activities and develops them into viable new businesses for the Bayer Group. The aim of Bayer Innovation is to incorporate Bayer's core competencies in the fields of health care, nutrition and high-tech materials into projects that complement Bayer's business portfolio, and to facilitate access to new and growing markets.

In 2007 Bayer Innovation focused on the manufacture of plant-made pharmaceuticals (PMP) and on novel concepts for the treatment of chronic wounds, such as wound dressings made from biodegradable silica gel fibers. The full potential of these technologies is being evaluated in close cooperation with Bayer HealthCare, Bayer CropScience, Bayer MaterialScience, Bayer Technology Services and external partners.

Triple-i: Inspiration, Ideas, Innovation

More than 3,000 suggestions have already been submitted in response to the innovation initiative launched by Bayer AG in 2006, entitled "Triple-i: Inspiration, Ideas, Innovation." Many of these proposals are currently undergoing further evaluation by our subgroups. The initiative is designed to motivate employees throughout the Group to submit ideas for new products and thus help to strengthen Bayer's innovation capability.

Sustainable Development

Our strategy to promote sustainable development is based on the Bayer Group's values, leadership principles and guidelines, and is defined by our Sustainable Development Policy and various voluntary commitments such as the Responsible Care Global Charter and the United Nations Global Compact. Our sustainable development strategy is spelled out and illustrated in directives and stated corporate positions. Our existing committees for sustainable development and for health, safety and environmental issues continued their work in 2007. We developed a Group-wide position on human rights and presented the "Bayer Climate Program," which is based on our new policy on climate change. Both apply in all countries and regions where Bayer operates throughout the world. The subgroups and service companies are charged with implementing these policies on a day-to-day basis.

How we measure and manage our performance in this area is illustrated by the Sustainable Development Program 2006+ ("Our goals for 2010"), comprising several fields of activity including innovation, product stewardship, excellence in corporate management, social responsibility and responsibility for the environment. Within these fields, we have assigned specific measures to each goal in order to monitor our progress and document the achievement of targets. The Bayer Group's Sustainable Development Program takes into account the goals of all the subgroups and service companies, and their management teams are responsible for its successful implementation.

In 2007, most of our key performance indicators held steady or further improved. The number of reportable environmental incidents and the industrial injuries rate both fell considerably. The number of reportable transportation incidents remained at the previous year's level; we have reorganized this process for the future and adapted Group regulations and responsibilities accordingly. Phosphorus and organic carbon emissions rose and energy use increased due to a higher production volume and the inclusion of the full data for the acquired Schering facilities. Greenhouse gas emissions remained level despite a higher production volume.

www.sustainability2006.bayer.com

In our 2006 Sustainable Development Report, we published not only direct greenhouse gas emissions, but also – for the first time – our indirect greenhouse gas emissions related to energy purchase on a portfolio-adjusted basis in line with the Greenhouse Gas Protocol. Our Sustainable Development Report, now issued annually, is based largely on Version G3 of the Global Reporting Initiative (GRI) for sustainability reporting, which was co-founded by the United Nations. Bayer's 2007 Sustainable Development Report is scheduled to appear at the end of May 2008.

It is important to us that we participate in shaping external conditions. Bayer is keenly involved in the discussion surrounding environmental and consumer protection strategies and regulations at both the national and international levels. Committed as we are to product stewardship, we also support the objectives of the E.U. chemicals policy (REACH), which are to ensure the safety of everyone who comes into contact with chemical products throughout their life cycles and to further improve consumer safety and environmental protection. We therefore played a constructive part in the revision of the E.U. chemicals policy. In 2007 the Group Management Board issued an internal directive entitled "REACH Implementation" to ensure that chemicals are registered, evaluated and – where necessary – submitted for approval in line with the REACH policy.

We endorse the goals of the E.U. action plan for improving health and the environment, which in its first cycle focuses particularly on children's health. It is essential here to look at all factors influencing children's health and focus on relevant health problems. Decision-making must continue to be based on the scientific assessment of risk, which is increasingly based on biomonitoring. We support scientifically founded biomonitoring programs and have developed a Group-wide position on this topic.

Category	Key Performance Indicator	2006 [1]	2007 [1]
Health, Safety and Environment			
Health and Safety	Industrial injuries to Bayer employees resulting in at least one day's absence (number of injuries per million hours worked)	2.8	2.4
	Reportable industrial injuries to Bayer employees (number of injuries per million hours worked)	4.3	3.7
	Major environmental incidents	8	3
	Transportation incidents	9	10
Emissions and waste	Direct greenhouse gas emissions (CO_2 equivalents in million metric tons)*	3.9	3.9
	Indirect greenhouse gas emissions (CO_2 equivalents in million metric tons)*	3.7	3.7
	Volatile organic compounds (VOC) (thousand metric tons/year)	2.9	2.9
	Total phosphorus in waste water (thousand metric tons/year)	0.8	1.0
	Total nitrogen in waste water (thousand metric tons/year)	0.7	0.7
	Total organic carbon (TOC) (thousand metric tons/year)	1.5	1.8
	Hazardous waste generated (million metric tons/year)	0.3	0.3
	Hazardous waste landfilled (million metric tons/year)	0.1	0.1
Use of resources	Water use (million m^3/day)	1.2	1.2
	Energy use (petajoules [10^{15} joules])/year)	86.4	91.7
Employees and Society			
Diversity and opportunity	Percentage of women in Bayer Group senior management**	3.8	4.3
	Number of nationalities in Bayer Group senior management**	17	16
Training and development	Training costs in percent of personnel expenses	2.2	2.0
Employment	Number of employees by region as of December 31 (permanent and temporary)		
	Europe	57,800	56,200
	North America	17,200	16,800
	Asia/Pacific	17,300	18,900
	Latin America/Africa/Middle East	13,700	14,300

2006 figures restated
[1] including Schering as of June 23, 2006; excluding the Diagnostics Division, H.C. Starck and Wolff Walsrode
* as per Greenhouse Gas Protocol
** At year end 2006 no former Schering employees had yet been named to the Bayer Group Leadership Circle.

Evaluating both benefits and possible risks is a key element in Bayer's product development. The safety and environmental compatibility of our products have top priority. Biotechnology and nanotechnology hold tremendous potential for major products and applications in the areas of health care, nutrition and environmental protection. In 2007 we therefore issued an updated position on the responsible use of genetic engineering, along with the "Bayer Position on Nanotechnology" and the "Bayer Code of Good Practice in the Manufacturing and On-Site Use of Nanomaterials." All of these underscore our commitment to safety and environmental protection. In the field of nanotechnology, we are also involved in the "Nanocare" and "TRACER" safety research projects of the German Ministry of Education and Research.

Working for climate protection

Climate change presents a major global challenge. Since 1992 Bayer has set for itself and published ambitious targets for the reduction of energy use and CO_2 emissions. Between 1990 and 2006 we reduced our direct and indirect greenhouse gas emissions by 36 percent. The calculation is in line with the Greenhouse Gas Protocol and is portfolio-adjusted. In 2007 Bayer launched the integrated Group-wide Bayer Climate Program with the goals

www.climate.bayer.com

of further reducing CO_2 emissions from its own production facilities and developing new solutions for protecting the climate and addressing climate change.

Initiated by the Group Management Board, the program comprises a package of measures to be implemented over a period of several years. As part of the Bayer Climate Program, the company is bundling its specific competencies and has initiated groundbreaking projects such as the "Eco Commercial Building" – a global concept for zero-emissions office and industrial buildings. Other projects include developing stress-resistant plants, helping to ensure the effective use of biofuels, and the "Bayer Climate Check" for production processes.

Bayer plans to provide €1 billion for climate-relevant R&D and projects over the next three years.

For the period from 2005 through 2020, Bayer has set itself new emission targets that are particularly ambitious in view of the greenhouse gas reductions it has already achieved. The Bayer MaterialScience subgroup aims to lower its global specific greenhouse gas emissions per ton of products sold by 25 percent. Bayer CropScience plans to reduce absolute emissions worldwide by 15 and Bayer HealthCare by 5 percent.

In the United States, Bayer Corporation is voluntarily participating in the emissions trading program of the Chicago Climate Exchange (CCX) and has committed to reduce its greenhouse gas emissions by 6 percent overall between 2003 and 2010. This goal has already been achieved.

Bayer is also involved with the Global Roundtable on Climate Change (GRoCC), participating in this worldwide dialogue with politicians, institutions, industry, science and environmental associations. We are also active in the business leadership initiative "3 C: Combat Climate Change" and the Climate Change Dialogue of GLOBE International.

Sustainable investment

Bayer stock is included in various indices and investment funds that focus on companies with sustainable and responsible corporate policies.

Bayer has been listed in the Dow Jones Sustainability Index World (DJSI World) since it was first established in 1999 and in the European Dow Jones Sustainability Index STOXX (DJSI STOXX) since its inception in 2001. Our stock has also been included in the annually published benchmark series of the FTSE4Good indices since it was launched by the Financial Times and the London Stock Exchange in 2001. In 2007, Bayer was additionally included in the newly established FTSE4Good Environmental Leaders Europe 40 Index, which lists European companies with optimal environmental management. Analysts at the Storebrand Principal Fund again rated Bayer among the top companies in its peer group at the beginning of 2007, awarding it the ranking "Best in Class – Environmental and Social Performance." In addition, our shares were again listed in the French "Advanced Sustainable Performance Indices" (ASPI) Eurozone Index in 2007. As in 2005 and 2006, Bayer was last year named "Best in Class" by the investor group Carbon Disclosure Project (CDP) as one of the world's leading companies in the area of climate protection. In 2007 the company was listed for the third consecutive year in the Climate Disclosure Leadership Index, the first global climate protection index. Bayer is the only European chemical company listed in this index.

Corporate Social Responsibility

Bayer's social commitment is illustrated by some 300 projects in various parts of the world, many of which we have organized and financed for a number of years. In 2007, Bayer once again underscored its role as a good corporate citizen with a range of social activities focused on the areas of Education and Research, Environment and Nature, Health and Social Needs, and Sports and Culture. We continued to develop these projects, extending them to more countries and launching new initiatives.

www.csr.bayer.com

Education and research

The newly established "Bayer Science & Education Foundation," in which the company is pooling and strengthening its activities in the field of education, science and research, started work in 2007. The main focus is on awarding prizes for scientific achievement, granting scholarships and supporting local schools. First payments by the new foundation were made in 2007. The €50,000 Hansen Family Award 2007 went to Professor Magdalena Götz of the Institute of Stem Cell Research at the Helmholtz Association in Neuherberg, Germany, who is also a teaching professor at the Physiological Institute of the Medical Faculty of Ludwig Maximilian University in Munich. The award honors the biologist for her pioneering research in the field of neurobiology. The foundation also awarded 21 scholarships with a total volume of €142,000 to dedicated science and medical students. In 2007, the "Bayer Science & Education Foundation" launched a new focus on school sponsorship, approving the allocation of €400,000 to support school projects in the communities close to Bayer's sites.

In cooperation with Tongji University and the United Nations Environment Programme (UNEP), Bayer has also established a Chair for Sustainable Development in Shanghai, China. The Science & Education Foundation provided an endowment of US$1 million for a period of five years to finance research projects in the field of environmental protection and socioeconomic development as well as training programs and scholarships. In 2007, we added a further group of countries to the "Making Science Make Sense" education program – this time India, Italy, Colombia, Singapore and Taiwan. Schoolchildren in a total of ten countries are now benefiting from the commitment of Bayer employees who visit schools to demonstrate the aims and benefits of science with the aid of hands-on experiments.

Environment and nature

A major focus of Bayer's activities in the field of youth environmental education was the week-long Tunza International Youth Conference 2007, the environment summit of the United Nations Environment Programme (UNEP) for young people that is held every two years and was attended this time by 180 young people from 85 countries. Through its partnership with UNEP, Bayer AG became the first private-sector company to host the TUNZA conference. This was also the first time it had been held in western Europe, the first two conferences having taken place in Asia and eastern Europe. At the beginning of the conference – for which the slogan was "Technology in Service of the Environment" – Bayer and UNEP announced an extension of their partnership for a further three years, accompanied by a €200,000 increase in Bayer's annual contribution to €1.2 million. Bayer also supported UNEP by helping to organize regional conferences in Asia, Latin America and Africa.

Another element of the collaboration between UNEP and Bayer in 2007 was the organization in Bangkok, Thailand, of "Eco-Minds 2007." This science symposium was dedicated to the topic of protecting freshwater supplies. Turkey was recently added to the "Young Environmental Envoy" program, which means 17 countries now send delegates on a week-long study trip to Germany at Bayer's invitation once a year. Climate change was the subject of this year's eastern European photo competition established by Bayer and entitled "Ecology in Focus," and also of the International Children's Painting Competition on the Environment, in which around 13,500 children from 104 countries took part.

At the beginning of 2007, UNEP launched its "Plant for the Planet: Billion Tree Campaign," which aimed to persuade organizations and individuals throughout the world to plant a billion trees during the course of the year to combat climate change. Bayer gave wholehearted support to this campaign, arranging for 100,000 trees to be planted at UNEP headquarters in Nairobi. Each of the delegates at the TUNZA conference symbolically planted a tree, and some two dozen Bayer companies around the globe joined in this statement of ecological solidarity. The Bayer Group contributed significantly to the success of the unique campaign by planting some 300,000 trees in all.

Health and social needs

In 2007, Bayer donated 2.5 million Lampit® tablets to the World Health Organization (WHO) and provided additional funding to safeguard the global supply of drugs for the next five years to patients suffering from the parasite-borne Chagas' disease.

In future, Bayer will pool its activities in the field of disaster aid in the new "Bayer Cares Foundation," which began operating in 2007. Among the aims of the foundation are to provide rapid and straightforward emergency aid and to support sustainable reconstruction projects. In 2007, Bayer provided various forms of relief for cyclone victims in Bangladesh, making some €100,000 available for infrastructure projects in addition, and the 3,000 or so Bayer employees in neighboring India donated one day's wages. The company aided flood victims in Mexico by donating drugs and insecticides worth US$ 350,000 to ease the consequences of the floods and help guard against epidemics. And in Greece, Bayer provided €150,000 for communities particularly hard hit by the bush fires.

Sports and culture

Announcing its new sports strategy, Bayer reaffirmed its long-standing commitment to supporting recreational, youth and disabled sports. Bayer provides annual funding of more than €14 million to the 27 company clubs, whose total membership is nearly 50,000.

In 2007 the Bayer Cultural Affairs Department celebrated the 100th anniversary of its founding. On this occasion the company emphasized that cultural activities would remain at the center of its social commitment to the communities near its sites. For its enduring commitment to the fine arts, Bayer was also presented with the "Freedom and Responsibility 2007" award, with which Germany's leading industry associations each year honor outstanding examples of corporate social responsibility in cooperation with the magazine *Wirtschaftswoche*.

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Compensation of the Board of Management

The compensation of the Board of Management basically comprises four components: a fixed annual salary, a short-term incentive award on a yearly basis in relation to a target amount, a long-term incentive award for a three-year period in relation to a target amount, and a company pension plan conferring pension entitlements that increase with years of service. Remuneration in kind and other benefits are also provided, such as the use of a company car for private purposes or reimbursement of the cost of health screening examinations.

The fixed salary consists of two parts: a base salary and a fixed supplement. The short-term incentive award for 2007 is calculated partly according to the Group's EBITDA margin before special items, and partly according to the weighted average target attainment of the HealthCare, CropScience and MaterialScience subgroups. The latter is based mainly on the subgroups' target attainment measured by EBITDA before special items as well as on a qualitative appraisal in relation to the market and competitors. In addition, the variable bonus for 2007 includes a special one-time individual bonus linked to outstanding achievements in connection with the restructuring of the Bayer Group.

The directly effected remuneration of members of the Board of Management in 2007 (fixed salaries, short-term incentives and remuneration in kind) amounted to €8,882,552 (2006: €8,143,822), comprising €1,985,580 (2006: €2,260,400) in base salaries and €982,792 (2006: €1,096,556) in fixed supplements, €5,768,862 (2006: €4,644,475) in short-term incentive payments as well as €145,318 (2006: €142,391) of remuneration in kind and other benefits. Remuneration in kind mainly consists of values assigned to remuneration in kind and other benefits in accordance with German taxation guidelines.

The long-term incentive evolved in the following way: Through 2004, members of the Board of Management were permitted to participate in a cash-settlement-based stock option program. The last of the options were exercised in 2007, therefore no further claims existed under this program as of December 31, 2007.

Since 2005, the members of the Board of Management have participated in the long-term stock-based compensation program Aspire I (2005, 2006 and 2007 tranches). Further details of this program are provided under "Personnel commitments" in Note [26] to the consolidated financial statements.

The entitlements earned in 2007 relate to the 2007 parts of the respective three-year performance periods of the long-term stock-based compensation programs granted in current and previous years. The changes in the value of previously existing entitlements under long-term stock-based compensation programs that were earned prior to 2007 are shown separately. They result from the upward trend in the price of Bayer stock in 2007. Additionally, the fair value of the stock-based compensation as of the grant date in 2007 is given separately.

The table on page 78 shows the remuneration components of those individual members of our Board of Management who actively served in the course of 2007.

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Remuneration of the members of the Board of Management

€		Werner Wenning	Klaus Kühn	Udo Oels [1]	Wolfgang Plischke [2]	Richard Pott	Total
Base salary	2007	748,872	412,236	-	412,236	412,236	1,985,580
	2006	748,872	412,236	343,526	343,530	412,236	2,260,400
Fixed supplement	2007	325,132	316,366	-	170,647	170,647	982,792
	2006	325,132	316,366	142,205	142,206	170,647	1,096,556
Short-term incentive	2007	2,168,878	1,379,994	-	1,109,995	1,109,995	5,768,862
	2006	1,525,086	1,034,615	567,335	689,745	827,694	4,644,475
Remuneration in kind and other benefits	2007	51,104	35,769	-	25,208	33,237	145,318
	2006	47,926	35,571	9,594	18,163	31,137	142,391
Directly effected remuneration	**2007**	**3,293,986**	**2,144,365**	**-**	**1,718,086**	**1,726,115**	**8,882,552**
	2006	2,647,016	1,798,788	1,062,660	1,193,644	1,441,714	8,143,822
Long-term incentive (stock-based compensation entitlements earned in the respective year)	2007	1,149,675	698,890	-	358,924	631,618	2,839,107
	2006	820,514	480,609	538,181	193,188	461,939	2,494,431
Change in value of existing entitlements	2007	889,725	510,121	-	100,950	491,935	1,992,731
	2006	339,733	229,617	104,125	66,262	164,952	904,689

[1] member of the Board of Management until April 28, 2006
[2] member of the Board of Management effective March 1, 2006

The fair value of the stock-based compensation as of the grant dates for 2007 and 2006 is shown in the following table:

€		Werner Wenning	Klaus Kühn	Udo Oels [1]	Wolfgang Plischke [2]	Richard Pott	Total
Fair value of newly granted stock-based compensation as of grant date	2007	299,173	202,957	-	162,366	162,366	826,862
	2006	268,113	181,886	40,419	117,597	145,509	753,524

[1] member of the Board of Management until April 28, 2006
[2] member of the Board of Management effective March 1, 2006

The fair value of the entitlements to newly granted stock-based compensation already earned in the respective year is included in the preceding table under "Long-term incentive."

The current members of the Board of Management are entitled to receive a pension from the age of 60 in an annual amount equal to at least 30 percent of the last yearly fixed salary. This percentage increases depending on years of service as a Board of Management member and, according to the inception of the respective service contract, is capped between 60 and 80 percent. We refer to the maximum such percentage a member of the Board of Management can reach as his final target pension level. Pension provisions for the current members of the Board of Management amounted to €25,810,477 (2006: €29,564,478).

The current service cost for the pension entitlements of the members of the Board of Management was as follows:

€		Werner Wenning	Klaus Kühn	Udo Oels[1]	Wolfgang Plischke[2]	Richard Pott	Total
Current service cost for pension entitlements earned in the respective year	2007	-	588,064	-	187,344	223,453	998,861
	2006	398,564	1,651,294	-	1,644,517	233,284	3,927,659

[1] member of the Board of Management until April 28, 2006
[2] member of the Board of Management effective March 1, 2006

For active Board of Management members a general severance indemnity clause applies if the service contract is terminated at the company's instigation prior to a member's 60th birthday. The basic principles according to this clause are as follows:

If a member of the Board of Management is not offered a new service contract upon expiration of his existing service contract because he is not reappointed to the Board of Management, or if the member is removed from the Board of Management prematurely during the term of his contract in the absence of grounds for termination without notice, he will receive a monthly bridging allowance amounting to 80 percent of his last monthly fixed salary for a period of 60 months from the date of expiration of his service contract less the period for which he was released from his duties on full pay or otherwise compensated. (If he were removed during the term of his contract, he would also receive the payment due for the rest of the term, though this would be reduced to the amount of his annual fixed salary plus the target amount for the short-term incentive payment for at least twelve months). His earnings from any new employment elsewhere would be offset against the bridging allowance. In the case of premature termination at the instigation of the company, further years of service might be credited under certain circumstances for the purpose of computing his Board of Management pension entitlement, though not beyond his 60th birthday. Special supplementary arrangements apply in the event of a change of control; for details see page 57 f.

There were no loans to members of the Board of Management outstanding as of December 31, 2007, nor any repayments of such loans during the year.

We currently pay former and retired members of the Board of Management a monthly pension equal to 80 percent of the last monthly base salary received while in service. The pensions paid to former members of the Board of Management or their widows are normally reassessed every three years and adjusted taking into account the development of consumer prices. These benefits are in addition to any amounts they receive under previous employee pension arrangements. The pensions paid to retired members of the Board of Management and their surviving dependents amounted to €10,997,016 (2006: €10,924,768). Pension provisions for former members of the Board of Management and their surviving dependents amounted to €115,103,558 (2006: €117,866,846).

Compensation of the Supervisory Board

The compensation of the Supervisory Board is based on the provisions of the Articles of Incorporation, the current version of which was adopted by the stockholders at the Annual Stockholders' Meeting on April 29, 2005. This provides that, in addition to reimbursement of their expenses, each member of the Supervisory Board receives fixed annual remuneration of €60,000 and a variable annual remuneration component. The variable remuneration component is based on corporate performance in terms of the gross cash flow reported in the Group financial statements for the fiscal year. The members of the Supervisory Board receive €2,000 for every €50,000,000 or part thereof by which the gross cash flow exceeds €3,100,000,000, but the variable component for each member may not exceed €30,000.

In accordance with the provisions of the German Corporate Governance Code, additional remuneration is paid to the Chairman and Vice Chairman of the Supervisory Board and for chairing and membership of committees. The Chairman of the Supervisory Board receives three times the basic remuneration, while the Vice Chairman receives one-and-a-half times the basic remuneration. Members of the Supervisory Board who are also members of a committee receive an additional one quarter of the amount, with those chairing a committee receiving a further quarter. However, no member of the Supervisory Board may receive total remuneration exceeding three times the basic remuneration. If changes are made to the Supervisory Board and its committees during the fiscal year, members receive remuneration on a pro-rated basis. No remuneration or benefits were paid for personal services, in particular, the provision of consultancy or intermediary services. The Company has purchased insurance for the members of the Supervisory Board to cover their legal liability arising from their service on the Supervisory Board.

In addition to their remuneration as members of the Supervisory Board, those employee representatives who are employees of Bayer Group companies receive compensation unrelated to their service on the Supervisory Board. The total amount of such compensation was €686,661 (2006: €647,813).

There were no loans to members of the Supervisory Board outstanding as of December 31, 2007, nor any repayments of such loans during the year.

The remuneration of the individual members of the Supervisory Board is shown in the table in the Corporate Governance Report on page 15.

Risk Report

Risk management

Business operations necessarily involve opportunities and risks. Effective risk management is therefore a key factor in maintaining the company's value over the long term.

The management of opportunities and risks at Bayer is an integral part of the Group-wide corporate governance system, not the task of one particular organizational unit. Key elements of the risk management system are the planning and controlling process, Group regulations and the reporting system. In regular conferences the company's results and its potential opportunities and risks are discussed, and targets and necessary actions are agreed upon.

Corporate Auditing monitors the effectiveness of, and compliance with, the internal management and control system. The effectiveness of the risk management system is audited at regular intervals. In addition, during the year-end audit the external auditor issues an opinion on the risk management system and briefs the Group Management Board and the Supervisory Board on the outcomes of these evaluations. These outcomes are taken into account in the continuing enhancement of our risk management system.

As a global company with a diverse business portfolio, the Bayer Group is exposed to numerous risks. We have purchased insurance coverage – where it is available on economically acceptable terms – in order to minimize related financial impacts. The level of this coverage is continuously re-examined.

Significant risks for the Bayer Group are outlined in the following sections. The order in which the risks are listed is not intended to imply any assessment as to the likelihood of their materialization or the extent of any resulting damages.

Legal risks

We are exposed to numerous legal risks from legal disputes or proceedings to which we are currently a party or which could arise in the future, particularly in the areas of product liability, competition and antitrust law, patent disputes, tax assessments, and environmental matters. The outcome of any current or future proceedings cannot be predicted with certainty. It is therefore possible that legal or regulatory judgments could give rise to expenses that are not covered, or not fully covered, by insurers' compensation payments and could significantly affect our revenues and earnings.

Legal proceedings currently considered to involve material risks are described in Note [32] to the consolidated financial statements.

Overall business risks

Pharmaceutical product prices are subject to regulatory controls in many markets. Some governments intervene directly in setting prices. In addition, in some markets major purchasers of pharmaceutical products have the economic power to exert substantial pressure on prices. We expect that price controls and pressures on pricing will persist or increase. Price controls, as well as price pressure from generic manufacturers as a result of government reimbursement systems favoring less expensive generic pharmaceuticals over brand-name products, diminish earnings from our pharmaceutical products and could potentially make the market introduction of a new product unprofitable.

Sales of crop protection products are affected by weather conditions, such as droughts, and by fluctuations in agricultural commodity prices.

The performance of our MaterialScience subgroup is affected by cyclicality in customer industries. A downturn in the business cycle, characterized by weak demand and overcapacities, may lead to price pressure and more intense competition. Expectations of growth, especially in Asian economies, encourage producers to increase their production capacities. Future growth in demand may not be sufficient to absorb those capacity additions without significant downward pressure on prices.

The early identification of trends in the economic or regulatory environment and active portfolio management are important elements of our business management. Our analyses of the global economy and forecasts of medium-term economic development are documented in detail on a quarterly basis and used to support operational business planning. For a summary forecast, see Future Perspectives – Economic outlook on page 89.

Product development risks

The Bayer Group's competitive positions, sales and earnings depend significantly on the development of commercially viable new products and production technologies. We therefore devote substantial resources to research and development. Because of the lengthy development processes, technological challenges, regulatory requirements and intense competition, we cannot assure that all of the products we are currently developing and will begin to develop in the future will actually reach the market and achieve commercial success as scheduled or at all.

Furthermore, adverse effects of our products that may be discovered after regulatory approval or registration despite thorough prior testing may lead to a partial or complete withdrawal from the market, due either to regulatory actions or our voluntary decision to stop marketing a product. In particular, litigation, including claims for damages, in connection with negative effects of our products may materially diminish our net income.

To ensure an effective and efficient use of resources, the Bayer Group has implemented an organizational structure and process organization comprising functional departments, working groups and reporting systems to monitor internal research and development projects.

Regulatory risks

The Bayer Group must comply with a broad range of regulatory requirements relating to the testing, manufacturing and marketing of many of our products. In some countries regulatory controls have become increasingly demanding. We expect this trend to continue, particularly in the United States and the European Union.

Our life science businesses, in particular, are subject to strict regulatory regimes. Increasing regulatory requirements, such as those governing clinical or (eco-)toxicological studies, may increase product development costs and/or delay product (re-)registration.

In addition, the Globally Harmonized System of Classification and Labeling of Chemicals (GHS) could mandate a significant increase in the testing and assessment of chemical substances.

To counter risks arising from legal or other requirements, we make our decisions and engineer our business processes on the basis of comprehensive legal advice provided both by our own experts and by acknowledged external specialists. Projects have been initiated to coordinate the implementation of new regulatory controls and mitigate any negative implications for the business.

Patent risks

A large proportion of our products, especially in the life sciences, is protected by patents. We are currently involved in lawsuits to enforce patent rights in our products. Generic manufacturers and others attempt to contest patents prior to their expiration. When a patent defense is unsuccessful, or if one of our patents expires, our prices are likely to come under pressure because of increased competition from generic products entering the market. Details of related litigation are provided as part of the description of legal risks in Note [32] to the consolidated financial statements.

With certain types of product we may also be required to defend ourselves against charges of infringement of patent or proprietary rights of third parties. This could impede or even halt the development or manufacturing of certain products or require us to pay monetary damages or royalties to third parties.

Our life science units have a comprehensive system in place for the management of product life cycles. In addition, our legal department regularly reviews the patents situation in conjunction with the relevant functional departments and watches for potential infringements of our patents by other companies so that legal action can be taken if necessary.

Production, procurement market and environmental risks

Production capacities at some of our manufacturing facilities could be adversely affected by, for example, technical failures, natural disasters, regulatory rulings or supply disruptions to key raw materials or intermediates. This applies particularly to our biotech products because of the highly complex manufacturing process. If in such cases we are unable to meet demand by shifting sufficient production to other plants or drawing on our inventories, we may suffer declines in sales revenues.

The supply of strategically important raw materials is ensured on the basis of long-term contracts with multiple suppliers wherever possible. Furthermore, all stages of our production processes and our material inputs are continuously monitored by the relevant technical units of the company.

The manufacturing of chemical products is subject to risks associated with the production, filling, storage and transportation of raw materials, products and wastes. These risks have the potential to cause personal injury, property damage, environmental contamination or business interruptions, as a result of which the company may be required to pay compensation.

Furthermore, the possibility of accidental cross-contamination among our crop protection products or the presence of unintended trace amounts of genetically modified organisms in agricultural products and/or foodstuffs cannot be completely excluded.

We address product and environmental risks by way of suitable quality assurance measures. An integrated quality, health, environmental and safety management system ensures process stability. In addition, we are committed to the international Responsible Care initiative of the chemical industry and report regularly on our own safety and environmental management system.

Operational risks

Business and production processes and the internal and external communications of the Bayer Group are increasingly dependent on information technology systems. Major disruptions or failure of global or regional business systems may result in loss of data and/or impairment of business and production processes. Technical precautions such as data recovery and continuity plans have been established to address this risk.

Where it appears strategically advantageous we may acquire a company or part of a company and combine it with our existing business. The amount of goodwill and other intangible assets reflected in the consolidated balance sheet of the Bayer Group has increased significantly in recent years, primarily as a result of the acquisition of Schering, Berlin, Germany. Failure to successfully integrate a newly acquired business or unexpectedly high integration costs could jeopardize the achievement of quantitative or qualitative targets, such as synergies, and adversely impact earnings. Our acquisition processes are observed by integration teams, and appropriate resources are provided to steer the integration processes.

Risk to pension obligations from capital market developments

The Bayer Group has obligations to current and former employees related to pensions and other post-employment benefits. Changes in relevant valuation parameters (such as interest rates, mortality and rates of increases in compensation) may negatively impact the valuation of our pension obligations and could lead to increased pension costs.
A large proportion of our pension and other post-employment benefit obligations is covered by plan assets including fixed-income securities, shares, real estate and other investments. Declining or even negative returns on these investments may negatively impact the value of plan assets, thus necessitating additional contributions by the company. Further details are given in Note [25] to the consolidated financial statements. We address the risk of market-related fluctuations in plan asset values through prudent strategic investment and constantly monitor investment risks for our global pension obligations.

Financial risks

Management of financial and commodity price risks

As a global enterprise, Bayer is exposed in the normal course of business to credit risk, liquidity risk and various market risks that could materially affect its net assets, financial position and results of operations.

It is company policy to use derivative financial instruments to minimize or eliminate the risks associated with operating activities and the resulting financing requirements. Derivative financial instruments are used almost exclusively to hedge booked or forecasted transactions. The use of derivative financial instruments is subject to strict internal controls based on centrally defined mechanisms and uniform guidelines. The derivatives used are mainly over-the-counter instruments, particularly forward exchange contracts, currency option contracts, interest rate swaps, cross-currency interest-rate swaps, commodity swaps and commodity option contracts concluded with banks. We set counterparty limits for such banks depending on their creditworthiness.

The various risks associated with financial instruments are outlined below together with the relevant risk management systems.

Credit risk

In the Bayer Group credit risk arises from the possibility of the value of its receivables or other financial assets being impaired because counterparties cannot meet their payment or other performance obligations. Since the Bayer Group does not conclude master netting arrangements with its customers, the total amounts recognized in assets represent the maximum exposure to credit risk.

Bayer has a standardized process in place to effectively manage the credit risk from trade receivables. Regular creditworthiness analysis takes place in relation to exposures; these receivables are partially secured. Credit limits are generally set for all customers. All credit limits for debtors where total risk exposure is €10 million or more are evaluated by operational credit management and also submitted to the company's Central Financial Risk Committee.

To minimize credit risk from transactions with financial assets and instruments, such transactions are only conducted with counterparties of first-class credit standing. For any other counterparties, pre-determined risk limits based on a methodological model are observed.

Country risks relating to trade receivables and intragroup loans are continuously monitored, systematically evaluated and centrally managed.

Liquidity risk
Liquidity risk, i.e. the risk of not being able to fulfill current or future payment obligations because insufficient cash is available, is centrally managed in the Bayer Group. Sufficient liquid assets are held to meet all of the Group's payment obligations when they fall due, thereby ensuring solvency at all times. Such payment obligations take the form of both operating cash flows and changes in current financial liabilities and are derived from our liquidity planning. In addition, a reserve is maintained for unbudgeted shortfalls in cash receipts or unexpected disbursements. For this purpose, budget deviation analyses are performed on the basis of historical time series, adjusted for variations in business structure. The liquidity reserve is then determined which, with a defined probability, will cover a negative deviation from planned cash flows. The size of this reserve is regularly reviewed and adjusted as necessary to current conditions. Liquid assets are kept mainly in the form of overnight and term deposits. Furthermore, credit facilities with banks are available.

Market risk
Market risk is the risk that the fair value or future cash flows of a financial instrument could fluctuate due to variations in market prices. Market risks include currency risk, interest-rate risk and other price risks, especially commodity price risk.

Sensitivity analysis is a widely used risk measurement tool that allows our management to make judgments regarding the potential loss in future earnings, fair values or cash flows of market-risk-sensitive instruments resulting from one or more selected hypothetical changes in interest rates, foreign currency exchange rates, commodity prices and other relevant market rates or prices over a selected period of time. We use sensitivity analysis because it provides reasonable risk estimates using straightforward assumptions (for example, an increase in interest rates). The risk estimates we provide below assume:

- a simultaneous, parallel shift in foreign exchange rates in which the euro depreciates against all currencies by 10 percent;
- a simultaneous commodity price increase of 20 percent in all relevant commodities with respect to which we hold derivatives; and
- a parallel shift of 100 basis points in the interest rate yield curves of all currencies.

We use market information and additional analytics to manage our risk exposure and mitigate the limitations of our sensitivity analysis. We have found sensitivity analysis to be a useful tool in achieving some of our specific risk management objectives. Sensitivity analysis offers an easy-to-understand risk exposure estimate that allows an approximation of the effect changing market conditions could have on our business. Additionally, it allows our management to take the necessary steps to address such risks.

We continually refine our risk measurement and reporting procedures. This includes periodically re-examining the underlying assumptions and parameters utilized.

The sensitivity analyses included in the following sections present the hypothetical loss in cash flows of financial instruments and derivative financial instruments held as of December 31, 2007 and December 31, 2006. The range of sensitivities chosen for these analyses reflects our view of changes in foreign exchange rates, commodity prices and interest rates that are reasonably possible over a one-year period.

Currency risk
Since the Bayer Group conducts a significant portion of its operations outside the euro currency zone, fluctuations in currency exchange rates can materially affect earnings. Currency risk from financial instruments exists with respect to receivables, payables, cash and cash equivalents that are not denominated in a company's functional currency. In the Bayer Group this risk is particularly significant for the U.S. dollar, the Japanese yen and the Canadian dollar.

Currency risks are identified, analyzed and managed centrally and systematically. The scope of hedging is evaluated regularly and defined in a corporate directive. The booked foreign currency exposure from operating items as well as from financial positions, i.e. receivables and payables, is normally fully hedged.

The anticipated foreign currency exposure from forecasted transactions in the next 12 months is hedged on a basis agreed between the Group Management Board, the central finance department and the operating units. A significant proportion of contractual and foreseeable currency risks is hedged, mainly through forward exchange contracts and currency options.

The Board of Management has provided clear guidance on how to limit and monitor cash flow risks that result from this approach.

To determine sensitivities we applied a hypothetical adverse scenario in which all currencies simultaneously appreciate by 10 percent against the euro compared with their year-end exchange rates. Under this scenario the estimated hypothetical loss of cash flows from derivative and non-derivative financial instruments as of December 31, 2007 would be €119 million (2006: €111 million). Of this €119 million, €97 million is related to the U.S. dollar, €14 million to the Japanese yen and €8 million to other currencies. Of the €119 million estimated hypothetical loss of cash flow, €122 million results from derivatives used to hedge anticipated exposure from planned sales denominated in foreign currencies. Such transactions qualify for hedge accounting, and the respective changes in value are recognized in other comprehensive income. The impact of exchange-rate fluctuations on our anticipated sales in foreign currencies is not included in this calculation. The offsetting position of €3 million is primarily attributable to unhedged currency derivatives embedded in supply contracts.

Interest-rate risk
The Bayer Group's interest-rate risk arises primarily from financial assets and liabilities with maturities exceeding one year. In the case of fixed-rate financial instruments, such as fixed-rate bonds, the risk of fluctuations in capital-market interest rates results in a fair-value risk because the fair values fluctuate as a function of interest rates. In the case of floating-rate instruments, a cash flow risk exists because interest payments could increase in the future.

Interest rate risk is analyzed centrally in the Bayer Group and managed by the central finance department using a mix of fixed-rate and floating-rate instruments defined by the management and subject to regular review. Derivatives – mainly interest-rate swaps, cross-currency interest-rate swaps and interest options – are employed to preserve the target structure of the portfolio.

Financial liabilities including derivatives amounted to €14,198 million as of December 31, 2007 (December 31, 2006: €19,801 million). The sensitivity analysis was performed on the basis of our floating-rate debt position at year end 2007, taking into account the interest rates relevant to our liabilities in all principal currencies. A hypothetical increase of 100 basis points, or 1 percent per annum, in these interest rates (assuming constant currency exchange rates) effective January 1, 2007, would have raised our interest expense for the year ended December 31, 2007 by €65 million (2006 based on floating-rate liabilities at year end 2006: €147 million).

Other price risks (especially commodity price risks)
The Bayer Group requires significant quantities of petrochemical feedstocks and energy for its various production processes. The prices of these inputs may fluctuate considerably depending on market conditions. As in the past, there will be times when it is not possible for us to pass on increased raw material costs to customers through price adjustments. This applies particularly to our MaterialScience business.

A commodity price risk therefore exists, which can impact net assets, financial position and results of operations. We have addressed this risk by concluding long-term contracts with multiple suppliers. In addition, derivatives are employed where possible to hedge against commodity price risks in order to smooth variations in income-statement items due to changes in commodity prices – and the resulting changes in stockholders' equity – over the long term. The procurement departments of the subgroups are responsible for managing these price risks on the basis of internal, centrally issued directives and limits, which are subject to constant review.

Commodity swaps and commodity options, in particular, are employed to hedge changes in the prices of energy, especially gas, and of crude oil, naphtha and benzene feedstocks. These instruments are also used in the case of long-term, fixed-price supply contracts.

We applied a hypothetical adverse scenario in which all commodity and energy prices simultaneously decrease by 20 percent. Under this scenario the estimated hypothetical loss of cash flows from derivatives as of December 31, 2007 would be €34 million (2006: €31 million). Of this €34 million, €2 million would be directly disclosed in the income statement and €32 million would be recognized as a value adjustment in other comprehensive income according to hedge accounting rules. In considering sensitivities for commodity futures and commodity option contracts, we have borne in mind to a limited extent that forward rates are less volatile than spot rates. The stated long-term contract volumes are therefore based on somewhat smaller price changes. The derivative financial instruments used by the Bayer Group to mitigate the risk of changes in exchange rates, interest rates and commodity prices are described in Note [30] to the consolidated financial statements.

Assessment of the overall risk situation

Compared to the previous year, the overall risk situation did not change significantly in the reporting period. The overall risk assessment is based on a consolidated view of all significant individual risks. At present, no potential risks have been identified that either individually or in combination could endanger the continued existence of the Bayer Group.

Subsequent Events

Bayer's U.S. affiliate Medrad, Inc. and U.S.-based Possis Medical, Inc. have entered into a definitive merger agreement pursuant to which Medrad will acquire Possis Medical in a cash tender offer for US$ 19.50 per share, or a total equity value of approximately US$ 361 million. The offer price represents a premium of approximately 39 percent over Possis Medical's average closing price for the 30 days prior to February 8, 2008. The board of directors of Possis Medical has unanimously approved the transaction and will recommend the offer to the company's shareholders.

Anticipated development opportunities

As an international enterprise, Bayer is subject to a wide variety of developments in the various national and international markets in which it operates in its three areas of business. The following forecasts are based on the business performance described in this report, taking into account the potential risks and opportunities.

We aim to take maximum advantage of the opportunities that present themselves in our various fields of activity. We continuously evaluate potential additional opportunities in all areas. Through our research and development activities in particular, we constantly strive to discover new products and to further develop and improve existing ones. Various risks described in our Risk Report, and particularly those related to financial matters, are counterbalanced by corresponding opportunities that could result from positive changes to forecasted developments. In addition, our initiated cost and structural measures are aimed at further improving our earnings performance. We also attempt to realize business opportunities through suitable portfolio measures.

Economic outlook and market opportunities in 2008

We currently expect the global economy to go on expanding in 2008. The pace of growth will decline somewhat compared with 2007, yet remain satisfactory overall in light of healthy business conditions in Europe and the continuing dynamic development of the emerging countries. We anticipate that the world economy will more or less sustain its present growth trend, with the economic weakness in the United States being partially offset by continuing strong growth in the emerging markets. However, there is an increased risk particularly from possible negative repercussions of the ongoing financial crisis for the real economy or in the event of further increases in oil and raw material prices.

We anticipate that expansion in the **pharmaceuticals market** will trend slightly slower during 2008 but still give a growth rate in the mid single digits. Growth here will be generated increasingly by countries such as China, Brazil, Mexico, South Korea, India, Turkey and Russia, where we expect to see a low double-digit percentage rate of expansion. Due to improvements in health systems, patients in these markets will increasingly gain access to medical care, particularly in rural areas. This trend will be supported by strong economic growth.

In the major European countries and especially in the United States, however, growth is expected to be dampened by the expiration of patent protection for leading products and increasing cost pressure coming from health care institutions.

The global **consumer care market** should grow by roughly 4 percent annually in the medium term. In 2008, the worldwide OTC market is expected to expand at the same rate as in the past two years. Slower growth in the United States is likely to be partially offset by more rapid growth in Europe, while expansion in the Asia-Pacific region in 2008 is again expected to be buoyed primarily by China and India.

There are again some positive signs regarding the development of the global **seed and crop protection markets** in 2008. Continuing high prices are forecasted for the world's agricultural markets as a result of steadily rising demand for crops used to generate energy and low inventories of key agricultural commodities throughout the world. We therefore anticipate a sustained increase in the production of important crops such as cereal, corn, canola, soybeans and rice, and intensified use of agricultural inputs in order to achieve the necessary higher yields. The seed and crop protection markets worldwide will likely benefit from this trend.

For the **industries relevant to our MaterialScience** subgroup, we expect that the positive development will continue in 2008 at the level of the long-term trend and thus match or slightly exceed global economic growth.

We expect a moderate increase in output of the **automotive industry**, with trends varying significantly from one region to another. Production is likely to stagnate in western Europe while continuing to grow by double-digit percentages in the eastern part of the continent. China and India will probably continue to act as growth engines for Asia, with a slight recovery expected in Japan as well. In the United States, the outlook is clouded by the economic uncertainties, with declining demand expected to hold back both production and imports.

We anticipate that the mortgage crisis in the United States will continue to affect the **construction industry** and that residential construction there will not recover before 2009. In western Europe, we should see slow but steady growth. The pleasingly positive trend in the remaining regions is likely to continue, with Asia once again exceeding the global average thanks particularly to the rapid pace of growth in China.

The **electrical and electronics sector** will likely maintain its robust global growth trend, led by Asia. We expect to see sustained expansion in this industry in western Europe, with double-digit growth rates continuing in eastern Europe. A temporary downswing is looming in the United States, and dynamic growth is not predicted for this sector in Japan either. By contrast, strong growth is expected to continue in China, South Korea and India.

Business expectations for 2008 in the **furniture industry** are again clouded by the ongoing effects of the real-estate crisis in the United States. Lower demand in the U.S. market is expected to adversely impact production in the Asia-Pacific region and European exports, resulting in heightened competition. Eastern Europe should see continuing growth in furniture production and increasingly help to supply the world market.

Business strategy

The Bayer Group is focusing on the fast-growing, innovation-driven health care, nutrition and high-tech materials businesses in line with its mission statement: "Bayer: Science For A Better Life." By strategically aligning ourselves to these attractive markets and concentrating on our core competencies, we are able to invest more intensively in growth areas and innovative technologies. We aim to achieve leadership roles and expand our already strong market positions. We will also press ahead with cost-containment and efficiency-improvement efforts in order to further increase the company's value over the long term. For a detailed description of our financial strategy, please consult the Liquidity and Capital Resources section on page 50 ff.

Bayer HealthCare

Bayer HealthCare's goal remains to grow with or above the market in all divisions.

Our biggest HealthCare segment, Pharmaceuticals, comprises both Specialty Care and Primary Care activities. We aim to position our Pharmaceuticals segment as a strong supplier of products for medical specialists, while at the same time seizing opportunities in the primary care arena. We also want to focus more closely on indications in which there is major potential for improving diagnosis and therapy.

The acquisition of Schering AG, Berlin, Germany, in 2006 was a key step in this direction. Our promising Specialty Care portfolio in the fields of hemophilia (Kogenate®), cardiology (Xarelto®, currently in registration) and oncology (Nexavar®) was significantly expanded and strengthened by the acquisition-related addition of leading products in the fields of gynecology (YAZ®/Yasmin®), diagnostic imaging (Magnevist®) and multiple sclerosis (Betaferon®/Betaseron®).

Our Primary Care business offers products for general practitioners. We are well represented in the primary care market with our established brands Avalox®/Avelox®, Levitra®, Adalat®, Glucobay® and Ciprobay®/Cipro®. In the United States, these products are marketed through the existing alliance with Schering-Plough. (Please note that Schering-Plough Corporation, New Jersey, and the company acquired by Bayer in June 2006, i.e. Bayer Schering Pharma AG (formerly named Schering AG), Berlin, Germany, are unaffiliated companies that have been entirely independent of each other for many years.) Since 2007, we have also been co-marketing Schering-Plough's cholesterol-lowering drug Zetia® in Japan following its registration there, further strengthening our Primary Care business in this region.

Research and development is an important growth driver for our Pharmaceuticals business, which is why this segment accounts for the biggest proportion of R&D spending within the HealthCare subgroup. Life cycle management, inlicensing and cooperation agreements are important elements of our strategy, as such business development activities supplement our own research efforts and are designed to strengthen our portfolio.

Our Consumer Health segment is comprised of the Consumer Care, Diabetes Care and Animal Health divisions.

The goal of our Consumer Care Division is to build a leading position in the global over-the-counter (OTC) medicines market. Our strategy is primarily aimed at fully leveraging the growth potential of proven brands such as Aspirin®, Aleve®, Canesten®, Bepanthen®, One-A-Day®, Rennie® and Alka-Seltzer®. We are pursuing a clear course of expansion in fast-growing regions such as eastern Europe and Asia/Pacific, and we aim to further develop our business in new growth segments. We also intend to seize external growth opportunities through acquisitions and inlicensing. An example of this is the acquisition of Citracal® in 2007.

Our Diabetes Care Division aims to enhance its competitive position in the area of blood glucose measurement and diabetes management. To this end, we are expanding our product range by developing new measurement systems and test strips to facilitate even more user-friendly blood glucose monitoring for diabetics. We also aim to expand our portfolio by investing in additional business areas. We intend to enhance our competitiveness by continuously improving our products, as well as through cost-containment measures and the more efficient use of our resources. Our strategy also includes supplementing our own strengths through strategic partnerships in specific fields of expertise.

In the Animal Health Division, we aim to achieve global leadership positions in the livestock and companion animal markets and to become a preferred supplier and partner. Our strategy is directed at achieving organic growth by focusing on attractive countries and markets, as well as through the successful life cycle management of existing core brands.

Bayer CropScience

Bayer CropScience is aligning its corporate planning to the long-term trends in agricultural markets. As a leading innovation-driven enterprise comprising the Crop Protection, Environmental Science and BioScience business units, its aim is to provide products and integrated solutions that contribute to the production of high-quality food, animal feed, energy crops and natural fibers. Against the background of limited acreages and a steadily increasing world population that places growing demands on the quality of food and clothing and consumes more energy, it is essential to safeguard and further increase agricultural yields. We seek to maintain mutually beneficial, long-lasting and dependable partnerships with our customers and all other interest groups. We manage our business responsibly in keeping with our commitment to sustainable development and in order to achieve profitable long-term growth.

Innovation forms the basis for the company to create value in the future. The development of new active ingredients and formulations along with high-quality seed enables us to replace older products and technologies with innovative products that have an improved performance spectrum, offer better environmental compatibility and user safety, and increase value-added for our customers. These new products also help us to boost sales and are an important prerequisite for meeting our profitability targets. Our strict cost management is making a further significant contribution. To optimize our cost structures, we introduced a program of measures in August 2006 that should be largely implemented by 2009, leading to annual savings of about €300 million by 2010. We thus aim to make Bayer CropScience even more efficient in all areas.

In the Crop Protection segment, Bayer CropScience aims to defend and further expand its leading market positions in insecticides, fungicides, herbicides and seed treatment by maintaining a broad regional presence and offering a balanced portfolio of innovative and highly effective products.

We endeavor to achieve this strategic goal by steadily enhancing our product mix. This not only means regularly launching new products from our research and development pipeline and successfully managing product life cycles, but also carrying out research in new growth areas. Examples include projects aimed at making plants healthier and increasing yields by improving nutrient uptake and stress tolerance.

Environmental Science makes use of the development and production capacities of Crop Protection and its new active ingredient developments. In terms of sales, it is one of the world's leading suppliers of products for non-agricultural use. Our strategy is to further expand this position by developing and marketing high-quality products for consumers and professional users. The focus here is on the development of innovative, customer-oriented products and solutions that are easy to use, safe to handle and satisfy society's increasing demands with regard to health, hygiene, growing and greening.

BioScience comprises the research, development and marketing of commercial seeds and solutions based on plant biotechnology and modern breeding methods. We aim to create integrated offerings for farmers through a combination of seeds, new plant traits and crop protection products. BioScience subsidiary Nunhems is a leading developer and supplier of high-quality vegetable seed. With regard to agricultural applications, we focus our activities on three core crops – cotton, canola and rice. We aim to market the technologies we develop not just in our own seed products, but also - with the help of our partners – for other crops such as corn and soybeans. We strengthened our cotton activities in 2007 through the acquisition of U.S. cotton seed producer Stoneville. Bayer CropScience is stepping up its commitment to the seed and plant biotechnology segment in the future with the aim of expanding BioScience sales to approximately €1 billion within the next ten years.

Bayer MaterialScience

MaterialScience aims to defend its leading market position in the future. Here we are relying in particular on our technological know-how, new applications for our products in the Materials and Systems segments and the targeted expansion of our presence in the growth markets of Asia. Our recently completed capital expenditure projects in Asia therefore represent an important step in the expansion of our business activities in this fast-growing region. We also intend to enhance this segment's performance in all areas by continuously improving its cost structures.

The "New Business" section identifies and evaluates market and technology trends for all MaterialScience business units, translating business ideas into projects for the development of new products and applications beyond the company's existing core business.

In the Materials segment, the acquisition of the Ure-Tech group of Taiwan has greatly strengthened the market position of our Thermoplastic Polyurethanes business unit, boosted our market share in Asia and given us global market leadership in this field. Thermoplastic Polyurethanes will further enhance its focus on high-margin, fast-growing products with the aim of achieving and maintaining higher profitability.

The commissioning of the first phase of our world-scale production facility for polycarbonates in Caojing, China, has helped to raise cost efficiency. If demand rises sufficiently, we aim to bring the second phase on stream at the end of 2008, enabling us to supply the Chinese polycarbonate market from local production to a large extent. Furthermore, we intend to make available sufficient resources for product and applications development in growth areas of this market. In addition to our current expansion course in China, we aim to constantly evaluate business potential in other regions with a view to expanding our market coverage. We plan to strengthen our compounds business through targeted investment and expand it geographically. In the case of semi-finished products such as polycarbonate sheet and film, we continue to aim for higher returns by optimizing our product portfolio.

We are endeavoring to strengthen the world market position of our Systems segment, too, by exploiting growth potential. Here again, we have recently completed a number of capital expenditure projects in Asia. Our world-scale production facility in Asia should make our Polyurethanes business unit more efficient and allows us to deploy the latest technologies in this growth region. We are focusing primarily on quality, product innovation and process improvements in order to capture further market share in the fast-growing Asian markets. Our aim is to meet globally increasing demand for our products by further expanding our MDI capacities. We are striving to improve the performance of the Polyurethanes business unit by increasing the efficiency of our research and development and steadily improving our cost structures. Portfolio management activities are planned in some market segments to achieve a shift toward higher-performance products, thereby improving profitability. We continue to work toward strengthening our market position in the polyurethane systems business.

The Coatings, Adhesives, Sealants business unit is seeking to defend the market position of its basic and modified isocyanates segment and plans to meet increasing demand in the growth regions by expanding production capacities. We aim to achieve higher profitability in our resins activities by increasing the use of leading-edge technologies and optimizing our product portfolio. In addition, leaner distribution structures at our newly established company Viverso, based in Bitterfeld, Germany, should contribute to increased profitability in this business unit.

In the newly formed Industrial Operations unit, we plan to use modern technologies to produce raw materials such as chlorine and sodium hydroxide for the Polyurethanes; Coatings, Adhesives, Sealants; and Polycarbonates business units, as well as for sale to third parties. We also plan to tap additional synergy potential for MaterialScience by bundling procurement activities and our trading activities regarding by-products.

Bayer Group sales and earnings forecast

In 2008 we expect the global economy to continue 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. Our planning is based on an exchange rate of US$ 1.45 to the euro, compared to the average rate of US$ 1.37 in 2007.

In this environment we aim to continue growing the business in 2008 and anticipate that we can raise Bayer Group sales by about 5 percent 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, in anticipation of a gratifying earnings trend for HealthCare and CropScience along with a difficult market environment for MaterialScience.

We plan to take special charges of about €650 million, of which between €400 million and €450 million will be cash items. These charges will result primarily from the integration of Schering and also from ongoing restructuring projects at CropScience and MaterialScience. We are budgeting for cash expenses of approximately €200 million in 2008 and €50 million in 2009 for the Schering integration.

To safeguard long-term growth, we plan to spend €1.7 billion for property, plant and equipment in 2008. We estimate total depreciation and amortization at about €2.6 billion, with property, plant and equipment accounting for €1.2 billion of this figure. We expect to increase our research and development spending to €2.8 billion.

We can confirm that we still plan to achieve an EBITDA margin before special items in excess of 22 percent in 2009.

Subgroups' sales and earnings forecasts

Bayer HealthCare
HealthCare is targeting a market or above-market rate of currency-adjusted sales growth in all divisions in 2008, and an improvement in its EBITDA margin before special items to approximately 27 percent. We confirm our goal of reaching an EBITDA margin before special items of around 28 percent in 2009.

Bayer CropScience
For CropScience we expect a generally positive market environment in 2008 and aim to raise sales by approximately 5 percent on a currency-adjusted basis. Our goal is to improve the EBITDA margin before special items to more than 23 percent. We plan to further increase our profitability by 2009 and continue to target an EBITDA margin before special items of around 25 percent in a normal market environment.

Bayer MaterialScience
MaterialScience is planning to achieve good volume growth once again in 2008. Due to the uncertain business environment and highly volatile raw material prices, it is currently not possible to make a firm prediction concerning earnings for the full year. We expect to achieve a good, value-creating earnings level, though without matching the 2007 figure. For the first quarter of 2008 we believe EBITDA before special items will remain practically level with the fourth quarter of 2007.

We continue to believe that in the future, under favorable economic conditions, we can post an EBITDA margin before special items of more than 18 percent. Our cost-structure program is designed to help achieve this objective.