BAYER AKTIENGESELLSCHAFT
Form 20-F
March 15, 2007

As filed with the Securities and Exchange Commission on March 15, 2007

UNITED STATES SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549

Form 20-F

(Mark One)

o **REGISTRATION STATEMENT PURSUANT TO SECTION 12(b) OR 12(g) OF THE SECURITIES EXCHANGE ACT OF 1934**

OR

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

OR

o **TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**

OR

o **SHELL COMPANY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**
Date of event requiring this shell company report....

For the transition period from _____ to _____
Commission file number 001-16829
BAYER AKTIENGESELLSCHAFT
(Exact name of Registrant as specified in its charter)
BAYER CORPORATION*
(Translation of Registrant s name into English)
Federal Republic of Germany
(Jurisdiction of incorporation or organization)
Bayerwerk, Gebäude W11
Kaiser-Wilhelm-Allee
51368 Leverkusen, GERMANY
(Address of principal executive offices)

Securities registered or to be registered pursuant to Section 12(b) of the Act.

Title of Each Class:	**Name of Each Exchange on Which Registered:**
American Depositary Shares representing Bayer AG ordinary shares of no par value	New York Stock Exchange
Bayer AG ordinary shares of no par value	New York Stock Exchange**

Securities registered or to be registered pursuant to Section 12(g) of the Act.

None

(Title of class)

Securities for which there is a reporting obligation pursuant to Section 15(d) of the Act.

None

(Title of class)

Indicate the number of outstanding shares of each of the issuer s classes of capital or common stock as of the close of the period covered by the annual report.

As of December 31, 2006, 764,341,920 ordinary shares, of no par value, of Bayer AG were outstanding.

Indicate by check mark if the registrant is a well-known seasoned issuer, as defined in Rule 405 of the Securities Act.

Yes þ No o

If this report is an annual or transition report, indicate by check mark if the registrant is not required to file reports pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934.

Yes o No þ

Note Checking the box above will not relieve any registrant required to file reports pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934 from their obligations under those Sections.

Indicate by check mark whether the Registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days.

Yes þ No o Not applicable o.

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, or a non-accelerated filer. See definition of accelerated filer and large accelerated filer in Rule 12b-2 of the Exchange Act. (Check one):

þ Large accelerated filer o Accelerated filer o Non-accelerated filer

Indicate by check mark which financial statement item the registrant has elected to follow:

Item 17 o Item 18 þ

If this is an annual report, indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act).

Yes o No þ

(APPLICABLE ONLY TO ISSUERS INVOLVED IN BANKRUPTCY PROCEEDINGS DURING THE PAST FIVE YEARS)

Indicate by check mark whether the registrant has filed all documents and reports required to be filed by Sections 12, 13 or 15(d) of the Securities Exchange Act of 1934 subsequent to the distribution of securities under a plan confirmed by a court.

Yes o No o

* Bayer Corporation is also the name of a wholly-owned subsidiary of the registrant in the United States.

** Not for trading, but only in connection with the registration of American Depositary Shares.

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Defined Terms and Conventions

Bayer AG is a corporation organized under the laws of the Federal Republic of Germany. As used in this annual report on Form 20-F, unless otherwise specified or required by the context, the term Company , Bayer or Bayer AG refers to Bayer AG and the terms we , us and our refer to Bayer AG and, as applicable, Bayer AG and its consolidated subsidiaries.

The names Bayer Schering Pharma or Schering as used in this annual report on Form 20-F 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. Bayer Schering Pharma AG and Schering-Plough Corporation, New Jersey, are unaffiliated companies that have been totally independent of each other for many years.

Due to rounding, numbers presented throughout this document may not add up precisely to the totals we provide and percentages may not precisely reflect the absolute figures.

Forward-Looking Information

This annual report on Form 20-F contains forward-looking statements that reflect our current plans and expectations. As these statements are based on current plans, estimates and projections, you should not place undue reliance on them. We generally identify forward-looking statements with words such as expect , intend , anticipate , plan , believe , estimate and similar expressions.

We caution you that known and unknown risks, uncertainties and other factors may cause our actual future results, performance, achievements, developments or financial position to be materially different from any results, performance, achievements, developments or financial position expressed or implied by forward-looking statements. These factors include, but are not limited to:

- cyclicality in our industries;
- reduced demand for older products in response to advances in technology;
- increasingly stringent regulatory controls;
- increased raw materials prices;
- the expiration of patent protections;
- environmental liabilities and compliance costs;
- failure to compete successfully, integrate acquired companies or develop new products and technologies;
- risks from hazardous materials;
- litigation and product liability claims; and
- fluctuations in currency exchange rates.

A discussion of these and other factors that may affect our actual future results, performance, achievements, developments or financial position is contained in Item 3, *Key Information Risk Factors*, various Strategy sections in Item 4, *Information on the Company*, Item 5, *Operating and Financial Review and Prospects* and elsewhere in this annual report on Form 20-F.

Forward-looking statements speak only as of the date they are made, and we undertake no obligation to update publicly any of them in light of new information or future events.

Enforceability of Civil Liabilities

We are a German corporation. All of our directors and executive officers are residents of Germany. A substantial portion of our assets and those of such individuals is located outside the United States.

As a result, although a multilateral treaty to which both Germany and the United States are a party guarantees service of writs and other legal documents in civil cases if the current address of the defendant is known, it may be difficult or impossible for you to effect service of process upon these persons from within the United States.

Also, because these persons and assets are outside the United States, it may be difficult for you to enforce judgments against them, even if these judgments are of U.S. courts and are based on the civil liability provisions of the U.S. securities laws.

If you wish to execute the judgment of a foreign court in Germany, you must first obtain from a German court an order for execution (*Vollstreckungsurteil*). A German court may grant an order to execute a U.S. court judgment with respect to civil liability under the U.S. securities laws if that judgment is final as a matter of U.S. law. In granting the order, the German court will not enquire whether the U.S. court judgment was, as a matter of U.S. law, correct. However, the German court must refuse to grant the order if:

the U.S. court lacked jurisdiction, as determined under German law;

the person against whom the judgment was obtained did not receive service of process adequate to permit a proper defense, did not otherwise acquiesce in the original action and raises the lack of service of process as a defense against the grant of the execution order;

the judgment would conflict with the final judgment of a German court or with the final judgment of another foreign court that is recognizable under German law;

recognition of the judgment would violate an important principle of German law, especially basic constitutional rights; or

there is a lack of reciprocity between Germany and the jurisdiction whose court rendered the original judgment.

You should be aware that German courts hold certain elements of some U.S. court judgments, for example, punitive damages, to violate important principles of German law. Judgments for ordinary compensatory damages are generally enforceable, unless in an individual case one of the reasons described above would prohibit enforcement.

If you bring an original action before a German court based on the provisions of the U.S. securities laws and the German court agrees to take jurisdiction over the case, the court will decide the matter in accordance with the applicable U.S. laws, to the extent that these do not violate important principles of German law. However, the German court may refuse to accept jurisdiction if another action is pending before a U.S. or other foreign court in the same matter. Furthermore, the German court might decide that, for a lawsuit brought by a U.S. resident under U.S. law against a defendant that, like Bayer, has a significant presence in the United States, a U.S. court would be the more proper forum.

PART I

Item 1. ***Identity of Directors, Senior Management and Advisors***

Not applicable.

Item 2. ***Offer Statistics and Expected Timetable***

Not applicable.

Item 3. ***Key Information***

Selected Financial Data

We derived the following selected financial data for each of the years in the five-year period ended December 31, 2006 from our consolidated financial statements. We have prepared our consolidated financial statements in accordance with International Financial Reporting Standards, or IFRS and, where indicated, in accordance with U.S. Generally Accepted Accounting Standards, or U.S. GAAP. Since 2002, IFRS is the term for the entire body of accounting standards issued by the International Accounting Standards Board (IASB), replacing the earlier International Accounting Standards, or IAS. Individual accounting standards that the IASB issued prior to this change in terminology continue to use the prefix IAS . Note 41 to our consolidated financial statements included in Item 18 of this annual report on Form 20-F describes the reconciliation of significant differences between IFRS and U.S. GAAP.

In this annual report on Form 20-F we have translated certain euro amounts into U.S. dollar amounts at the rate of $1.3197 = 1.00, the noon buying rate of the Federal Reserve Bank of New York on December 29, 2006, the last currency trading day in December 2006. We have translated these amounts solely for your convenience, and you should not assume that, on that or any other date, one could have converted these amounts of euros into dollars at that or any other exchange rate.

The financial information presented below is only a summary. You should read it together with the consolidated financial statements included in Item 18.

Consolidated Income Statement Data

	Year Ended December 31,					
	2002	**2003**	**2004**	**2005**	**2006**	**2006**
						$
	(In millions, except per share data)					
IFRS:						
Net sales (continuing operations)[a]	20,022	20,222	20,925	24,701	28,956	38,213
Operating result (continuing operations)[a]	788	526	1,657	2,514	2,762	3,645
Non-operating result[a]	(401)	(687)	(632)	(602)	(782)	(1,032)
Income before income taxes[a]	387	(161)	1,025	1,912	1,980	2,613
Income taxes[a]	3	74	(401)	(538)	(454)	(599)
Income (loss) after taxes[a]	390	(87)	624	1,374	1,526	2,014
Income (loss) after taxes from discontinued operations[a]	688	(1,204)	58	221	169	223
Income (loss) after taxes total	1,078	(1,291)	682	1,595	1,695	2,237
Minority stockholders interest	(3)	(12)	3	2	(12)	(16)
Net income (loss)	1,075	(1,303)	685	1,597	1,683	2,221
Adjustment for financing expenses for the mandatory convertible bond, net of tax effect [c]					72	95
Adjusted net income (loss)[c]	1,075	(1,303)	685	1,597	1,755	2,316
Average number of shares in issue[c]	730	730	730	730	746	746
Potential ordinary shares (mandatory convertible bond)[c]					46	46
Adjusted weighted average number of shares issued and potential ordinary shares[c]	730	730	730	730	792	792
Operating result from continuing operations per share[a][c]	1.08	0.72	2.27	3.44	3.49	4.60
Basic and diluted net income (loss) per share[c]	1.47	(1.78)	0.94	2.19	2.22	2.92
Dividends per share[c]	0.90	0.50	0.55	0.95	N/A[b]	N/A[b]
U.S. GAAP:						
Net income (loss)	1,277	(1,445)	653	1,327	269	353
Adjustment for guaranteed dividend[d]					(26)	(34)
Net income available to common stockholders [d]	1,277	(1,445)	653	1,327	243	319
Basic and diluted net income (loss) per share[d],[e]	1.75	(1.98)	0.89	1.82	0.33	0.43

(a)

Prior year data have been adjusted to reflect the fact that the Diagnostics division, the H.C. Starck business and the Wolff Walsrode business are reported as discontinued operations. For further information on these restatements, see Note 7.2 to the consolidated financial statements appearing elsewhere in this annual report on Form 20-F.

(b) The dividend payment for 2006 has not yet been decided on. Our Supervisory Board has accepted our Board of Management s proposal to recommend at our Annual Stockholders Meeting a dividend for 2006 of 1.00 per share, for a total dividend of 764 million.

(c) IAS 33 (Earnings per Share) provides that ordinary shares that will be issued upon the conversion of a mandatorily convertible instrument are included in the calculation of basic earnings per share from the date the convertible instrument is entered into. We therefore have added the shares to be issued upon conversion of our mandatory convertible bond to our average number of shares in issue. Because these shares are deemed already to have been converted into equity for

purposes of IAS 33, we have also adjusted our net income (loss) for purposes of the per share calculations to exclude the financing expenses (net of tax effect) we accrued on the mandatorily convertible bond.

(d) Under U.S. GAAP, net income available to common shareholders is reduced by the guaranteed dividend payable to the minority shareholders of Bayer Schering Pharma AG under the terms of the Domination and Profit and Loss Transfer Agreement we entered into with Bayer Schering Pharma AG.

(e) According to SFAS No. 128 (Earnings per Share), potential shares to be issued upon conversion of a mandatory convertible bond are not to be included in the calculation of basic earnings per share. The potential shares to be issued upon conversion were not included in the computation of diluted earnings per share for U.S. GAAP purposes because their effect would be antidilutive.

Consolidated Balance Sheet Data

	December 31,					
	2002	**2003**	**2004**	**2005**	**2006**	**2006**
						$
			(In millions)			
IFRS:						
Total assets	40,966	37,516	37,588	36,722	55,891	73,759
Stockholders equity	14,666	11,290	10,943	11,157	12,851	16,959
Liabilities	26,300	26,226	26,645	25,565	43,040	56,800
of which noncurrent financial obligations	7,228	7,288	7,025	7,185	14,723	19,430
U.S. GAAP:						
Stockholders equity	16,734	13,325	13,046	12,347	12,181	16,076
Total assets	42,668	38,012	38,496	38,133	54,756	72,261

Dividends

The following table indicates the dividends per share paid from 2004 to 2006. Stockholders who are U.S. residents should be aware that they will be subject to German withholding tax on dividends received. See Item 10, *Additional Information Taxation.*

	2004	**2005**	**2006**
Total dividend (in millions)	402	694	N/A(a)
Dividend per share ( )	0.55	0.95	N/A(a)
Dividend per share ($)	0.68	1.18	N/A(a)

(a) The dividend payment for 2006 has not yet been decided on. Our Supervisory Board has accepted our Board of Management s proposal to recommend at our Annual Stockholders Meeting a dividend for 2006 of 1.00 per share, for a total dividend of 764 million.

See also Item 8, *Financial Information Dividend Policy and Liquidation Proceeds.*

Exchange Rate Data

The following table shows, for the periods and dates indicated, the exchange rate of the U.S. dollar to the euro based on the noon buying rate of the Federal Reserve Bank of New York. Fluctuations in the exchange rate between the euro and the U.S. dollar will affect the market price of our shares and ADSs, the U.S. dollar amount received by holders of our shares and ADSs on conversion by the Depositary of any cash dividends paid in euro and the U.S. dollar translation of our results of operations and financial condition.

Year	Period End	Average	High	Low
		(U.S. dollar per euro)		
2002	1.0485	0.9454	1.0485	0.8594
2003	1.2597	1.1321	1.2597	1.0361
2004	1.3538	1.2438	1.3625	1.1801
2005	1.1842	1.2449	1.3476	1.1667
2006	1.3197	1.2563	1.3327	1.1860

Previous six months	High	Low
	(U.S. dollar per euro)	
September 2006	1.2833	1.2648
October 2006	1.2773	1.2502
November 2006	1.3261	1.2705
December 2006	1.3327	1.3073
January 2007	1.3286	1.2904
February 2007	1.3246	1.2933

The exchange rate of the U.S. dollar to the euro based on the noon buying rate of the Federal Reserve Bank of New York on February 28, 2007 was $1.3230 = 1.00. In this annual report on Form 20-F, we have translated certain euro amounts into U.S. dollar amounts at the rate of $1.3197 = 1.00, the noon buying rate of the Federal Reserve Bank of New York on December 29, 2006, the last currency trading day in December 2006.

Risk Factors

An investment in our shares or ADSs involves a significant degree of risk. You should carefully consider these risk factors and the other information in this annual report on Form 20-F before deciding to invest in our shares or ADSs. The risks described below are the ones we consider material. However, they are not the only ones that may exist. Additional risks not known to us or that we consider immaterial may also have an impact on our business operations. The occurrence of any of these events could seriously harm our business, operating results and financial condition. In that case, the trading price of our shares or ADSs could decline and you could lose all or part of your investment.

Failure to develop new products and production technologies may harm our competitive position

We devote substantial resources to research and development. Because of the lengthy development process, technological challenges, regulatory requirements and intense competition, any of the products we are currently developing, or may begin to develop in the future, may fail to become market-ready or fail to achieve commercial success in a timely manner or at all. For these reasons, we may be unable to meet our expectations and targets with respect to products we are currently developing, particularly in our Pharmaceuticals segment; Crop Protection and BioScience business groups. Our competitive position could be harmed, causing our results to suffer, if we are unsuccessful in developing and marketing commercially viable new products and production technologies.

The growing importance of plant biotechnology in the crop protection field could reduce market demand for some of our agrochemical products and, if our competitors rather than we supply those biotechnological products, could lead to declines in our revenues.

Regulatory controls and changes in public policy may reduce the profitability of new or current products

We must comply with a broad range of regulatory controls on the testing, manufacturing and marketing of many of our products. In some countries, including the United States, regulatory controls have become increasingly demanding. We expect that this trend will continue in the United States and will continue to expand in other countries, particularly those of the European Union (EU). Each of the risks relating to regulatory matters we describe here, as well as others that we may not foresee, may lead to material adverse effects on our financial condition and results of operations.

Our life science businesses are subject to particularly strict regulatory regimes. Increasing regulatory requirements, such as those governing clinical or (eco-) toxicological trials, may raise product development costs and the time it takes to bring new products to market, thus reducing the overall financial benefits deriving from these products. Failure to achieve regulatory approval of new products in a timely manner or at all can mean that we do not recoup our research and development costs and/or commercial investment through sales of that product.

Pharmaceutical product prices in particular are subject to controls or pressures in many markets. Some governments intervene directly in setting prices. In addition, in some markets major purchasers of pharmaceutical products (whether governmental agencies or private health care providers) have the economic power to exert substantial pressure on prices. Price controls limit the financial benefits of growth in the Pharmaceuticals segment and the introduction of new products. We expect that price controls and pressures on pricing will remain or increase, which may further limit our financial benefits from the affected products.

Adverse effects of our products discovered after regulatory approval or registration can lead to a withdrawal from the market, due either to regulatory actions or our voluntary decision to stop marketing the product. This can mean that the affected product ceases to generate revenue, and related expenses can lead to material losses. In particular, and as described below, litigation resulting from negative effects of our products can materially and adversely affect our financial condition and results of operations.

EU legislation on chemicals such as the Registration, Evaluation, Authorization of Chemicals (REACH) legislation adopted in December 2006 by the European Commission, the proposed regulation implementing the United Nations Globally Harmonized System of Classification and Labeling of Chemicals (GHS) and the proposed regulation replacing directive 91/414/ EEC concerning the placing of plant protection products on the market could mandate a significant increase in the testing and assessment of all chemicals. This may lead to increased costs and reduced operating margins for these products. For more detailed information on these regulations, see Item 4*, Information on the Company Business Governmental Regulation.*

The loss of patent protection/ineffective patent protection or patent expiration may reduce revenues

We are involved in lawsuits to enforce our patent rights in our products. In addition, generic manufacturers and others, particularly in the United States, may seek marketing approval for pharmaceutical or agricultural products currently under patent protection by attacking the validity or enforceability of a patent. If we are unsuccessful in defending our patent, our product could be exposed to generic competition before the patent expiration date. See Item 8, *Financial Information Legal Proceedings* for a discussion of patent-related proceedings.

We may also be required to defend ourselves against charges of infringement of patent or proprietary rights of third parties. This could result in a loss of rights to develop or make certain products or require us to pay monetary damages or royalties or license proprietary rights from third parties.

The extent of patent protection varies from country to country. In some of the countries in which we operate, patent protection may be significantly weaker than in the United States or the European Union. Piracy of patent-protected intellectual property has occurred in recent years, particularly in some Asian countries. In particular, these countries could facilitate competition within their markets from generic manufacturers who would otherwise be unable to introduce competing products for a number of years. We do not currently expect any proposed patent law modifications to affect us materially.

After a patent expires the producer of the formerly patented product is likely to face increased competition from generic products entering the market. See Item 4, *Information on the Company Business Intellectual Property Protection* for a discussion of the scheduled expiration dates of our significant patents.

In response to rising healthcare costs, many governments (including many U.S. states) and private health care providers, such as health maintenance organizations (HMOs) in the United States, have instituted reimbursement schemes favoring less expensive generic pharmaceuticals over brand-name pharmaceuticals, as well as other cost controls. We expect that the pressure for generic substitution will increase as a result of the implementation of the Medicare prescription drug benefit in 2006.

Reductions in the level of patent protections, and the competition posed by generic products, can materially and adversely affect our financial condition and results of operations.

Potential liabilities due to cross-contamination

A cross-contamination of our Crop Protection products especially with highly active herbicides, can cause damages to the targeted seeds and crops. Furthermore, even with state-of-the-art agricultural practices and grain handling processes, the possibility remains that unintended trace amounts of genetically modified organisms might appear in non-targeted crops and/or foodstuffs. Those contaminations may result in increasing regulations, product recalls and compensation claims, and could also harm our reputation.

Cyclicality may reduce our operating margins or cause operating losses

The performance of our Materials and Systems segments is affected by the cyclicality of the industries in which they operate. Low periods in the business cycles are characterized by decreasing demand and excess capacity. These factors lead to price pressure and intense competition. This may result in volatile operating margins across the business cycle and to operating losses in these businesses. Expectations of growth, especially in regions including China, Japan, Taiwan and India, among others, may lead 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, which can adversely affect our financial condition and results of operations.

The agriculture sector is particularly subject to weather conditions and fluctuations in commodity prices, which may lead to a negative impact on our business results. For example, a drought will often reduce demand for our fungicides products.

Our operating margins may decrease if we are not able to pass increased raw material prices on to customers

Our Materials and Systems segments use significant amounts of petrochemical based raw materials and energy for manufacturing a wide variety of our products. The prices of raw materials and energy vary with market conditions and may be highly volatile. Price increases for raw materials will lead to higher production costs. There have been in the past, and may be in the future, periods during which we are not able to pass all of those costs on to our customers. This consequently leads to decreasing profit margins and potentially to material adverse effects on our financial condition and results of operations.

Shortages of our products due to capacity decreases may reduce sales

Production at some of our manufacturing facilities could be adversely affected by, for example, technical failures, natural disasters, regulatory rulings, terrorist attacks or supply disruptions of key raw materials or intermediates. Production capacities at one or more of our sites or major plants could therefore decline temporarily or over the long term.

Our biological products business within the Pharmaceuticals segment, in particular, generally employs complicated production processes that are more subject to disruption than is the case with other processes and therefore pose increased risk of manufacturing problems, unplanned shutdowns and loss of products.

If in these or other cases we are unable to shift sufficient production to other plants or draw on our inventories, we may suffer declines in sales revenues and in our results, be exposed to damages claims and suffer negative effects on our corporate reputation. These may in turn have material adverse effects on our financial condition and results of operations.

Risks from the handling of hazardous materials and environmental liabilities could negatively impact our operating results

Bayer s operations are subject to the operating risks associated with chemical manufacturing, including the related risks associated with filling, storage and transportation of raw materials, products and wastes. These risks include, among other things, the following hazards: pipeline and storage tank leaks and ruptures; fires and explosions; malfunction and operational failure; and releases, discharges or disposal of toxic and/or hazardous substances resulting from these or other causes.

These operating risks have the potential to cause personal injury, property damage and environmental contamination, and may result in the shutdown of affected facilities, business interruptions and the imposition of civil or criminal penalties. Any of these events could negatively impact the reputation of the company and lead to material adverse effects on our financial condition and results of operations.

The environmental laws of various jurisdictions impose actual and potential obligations on Bayer to remediate contaminated sites. The costs of these environmental remediation obligations could be material. In particular, our accruals for these obligations may be insufficient if the underlying assumptions prove incorrect or if we are held responsible for additional, currently undiscovered, contamination. See Item 4, *Information on the Company Business Governmental Regulation.*

Disruptions in our information technology systems can lead to disruptions in our business processes

Bayer is increasingly dependent on information technology systems to support a wide variety of key business processes as well as internal and external communication. Significant disruption of these systems due to *e.g.*, technical failures, errors or viruses can, despite all safety measures, cause a loss of data and/or disruption of business processes such as production, sales, distribution or accounting. This could lead to loss of sales and to higher costs as we seek to recover from events like this.

Failure to compete successfully or integrate newly acquired businesses may reduce our operating profits

Bayer operates in highly competitive industries. Our competitors may realize significant product innovations or technical advances, or intensify price competition. Any failure by us to keep pace with these innovations or advances, or price strategies, could materially harm our operating results and financial condition.

We depend on third parties for the marketing of some of our products, most notably in our Pharmaceuticals segment. Therefore, our operating performance is influenced by the quality of our partners marketing and sales performance.

From time to time, we acquire all or a portion of an established business and combine it with our existing business units. Integration of existing and newly acquired businesses requires difficult decisions with respect to staffing levels, facility consolidation and resource allocation. We must also plan carefully to ensure that established product lines and brands retain or increase their market position. If we fail to effectively integrate a new business or if integration results in significant unexpected costs, our results of operations could suffer.

See Item 8, *Financial Information Legal Proceedings* for a description of legal challenges to the shareholder resolution on the domination and profit and loss transfer agreement between Bayer Schering Pharma AG, Berlin, Germany and Bayer Schering GmbH, Leverkusen, Germany passed at the Extraordinary Shareholders Meeting of Bayer Schering Pharma AG held on September 13, 2006.

The amount of goodwill and other intangible assets on our consolidated balance sheet has increased significantly in recent years, primarily as a result of our recent acquisitions. Although we do not currently have an indication of any significant additional impairments, impairment testing under IFRS 3 may lead to further

impairment charges in the future. Any significant impairment charges would have a significant adverse effect on our results of operations. For a detailed discussion of how we determine whether an impairment has occurred, what factors could result in an impairment and the increasing impact of impairment charges on our results of operations see Item 5, *Operating and Financial Review and Prospects Critical Accounting Policies Intangible assets and property, plant and equipment.*

Existing insurance coverage may turn out to be inadequate

We seek to cover losses resulting from foreseeable risks through insurance coverage. Our insurance coverage, however, may not fully cover the risks to which the company is exposed. This can be the case with respect to insurance covering legal, environmental and administrative claims, as discussed above, as well as with respect to insurance covering other risks. For certain risks, adequate insurance coverage may not be available on the market or may not be available at reasonable conditions. Any harm resulting from the materialization of these risks could result in significant capital expenditures and expenses and in liabilities, which could have material adverse effects on our results of operations and financial condition.

Significant fluctuations in exchange rates affect our financial results

Bayer conducts a significant portion of its operations outside the euro currency zone. Fluctuations in currencies of countries outside the euro zone, especially the U.S. dollar and the Japanese yen, can materially affect our revenue as well as our operating results. For example, changes in currency exchange rates may affect the relative prices at which our competitors and we sell products in the same market, the cost of products and services we require for our operations and other euro-denominated items in our financial statements. These fluctuations can harm our results. From time to time, we may use financial instruments to hedge some of our exposure to foreign currency fluctuations. Potential losses under these instruments can be material. For further information about the instruments we use, see Item 11, *Quantitative and Qualitative Disclosures about Market Risk.*

Negative developments affecting the capital markets may make additional contributions to our pension funds necessary, and changes in the yield assumptions could have an impact on the valuation of liabilities

Plan assets to cover our future pension obligations are comprised of equity, fixed-income instruments and other assets. Declining capital returns can have a negative impact on the funding status of our plans. Therefore, additional contributions to the plans could be necessary in order to cover future pension obligations. Additionally, changes in demographic assumptions (*e.g.*, compensation increase rates, retirement rates and health care cost trends) or biometric assumptions (*e.g.*, mortality rates) could also have a negative impact on the funding status of our plans. For further details on underfunding of pensions and other post-retirement benefit obligations, refer to Note 25 to the consolidated financial statements appearing elsewhere in this annual report on Form 20-F. Future expenses or cash contributions that become necessary under our pension or post-retirement benefit plans could have a material adverse effect on our financial condition and results of operations.

Litigation and administrative claims could harm our operating results and cash flows

We are involved in a number of legal proceedings and may become involved in additional legal proceedings. These proceedings include in particular claims alleging product liability, patent infringement, breach of contract and antitrust violations. If our opponents in these lawsuits obtain judgments against us or if we determine to settle any of these lawsuits, we could be required to pay substantial damages and related costs.

In cases where we consider it appropriate, we have established provisions to cover potential litigation-related costs. Increased risks currently result from litigation commenced in the United States after we voluntarily withdrew *Lipobay/ Baycol* (cerivastatin) from the market, antitrust proceedings relating to our polymers business and antitrust proceedings associated with Bayer s ciprofloxacin anti-infective product, *Cipro®.*

Since the existing insurance coverage with respect to *Lipobay/ Baycol* is exhausted, it is possible depending on the future progress of the litigation that Bayer could face further payments that are not covered

by the provisions already established. We will regularly review whether further accounting measures are necessary depending on the progress of the litigation. Please see also *Existing insurance coverage may turn out to be inadequate.*

Bayer expects that, in the course of the antitrust proceedings relating to our polymers business, additional charges, which are currently not quantifiable, will become necessary. Please see Item 8, *Financial Information Legal Proceedings* for a discussion of these proceedings.

Our transactions relating to LANXESS expose us to continuing liability

As of July 1, 2004 Bayer formed LANXESS AG as part of its portfolio realignment by combining parts of its former Bayer Chemicals and Bayer Polymers business. LANXESS became a legally independent company on January 28, 2005.

Our liability for prior obligations of the LANXESS subgroup following its spin-off is governed by both statutory and contractual provisions. Under the German Transformation Act, all entities that are parties to a spin-off are jointly and severally liable for obligations of the transferor entity that are established prior to the spin-off date. However, the company to which the respective obligations were not assigned under the Spin-Off and Acquisition Agreement, dated September 22, 2004, between Bayer AG and LANXESS AG ceases to be liable for such obligations after a five-year period.

Under the Master Agreement between Bayer AG and LANXESS AG of the same date, each of Bayer AG and LANXESS AG agreed to release the other party from those liabilities each has assumed as principal debtor under the Spin-Off and Acquisition Agreement. The Master Agreement applies to all activities of Bayer AG and LANXESS AG units throughout the world, subject to certain conditions for the United States. For a description of these agreements, please see Item 10, *Additional Information Material Contracts.*

Item 4. ***Information on the Company***

HISTORY AND DEVELOPMENT OF THE COMPANY

Bayer Aktiengesellschaft, or Bayer AG, is a stock corporation (*Aktiengesellschaft*) organized under the laws of the Federal Republic of Germany.

Bayer AG was incorporated in 1951 under the name Farbenfabriken Bayer AG for an indefinite term and adopted its present name in 1972. Bayer AG s registered office (*Sitz*) and principal place of business are at the Bayerwerk, 51368 Leverkusen, Germany. Its telephone number is +49 (214) 30-1 and its home page on the World Wide Web is at www.bayer.com. Reference to our website does not incorporate the information contained on the website into this annual report on Form 20-F. The headquarters of Bayer AG s U.S. subsidiary, Bayer Corporation, are located at 100 Bayer Road, Pittsburgh, Pennsylvania 15205-9741.

The major acquisitions and divestitures of the Bayer Group during the last three years are listed below. For capital expenditures (excluding acquisitions) for these years, please refer to Item 5, *Operating and Financial Review and Prospects Liquidity and Capital Resources 2004, 2005 and 2006 Capital Expenditures*. For capital expenditures by individual business segment for the last three years, refer to the segment data in Note 1 to our consolidated financial statements appearing elsewhere in this annual report on Form 20-F.

Our principal expenditures on **acquisitions** in the past three years were as follows:

In **2004**, Bayer spent a total of 0.4 billion on acquisitions. Of this amount, approximately 0.1 billion was used for the purchase of Crompton Corporation s 50 percent stake in the Gustafson joint venture (seed treatment business) based in the United States, Canada and Mexico, in which Bayer already held a 50 percent share. In connection with the acquisition of Roche s consumer health business in 2005, Bayer acquired, by the end of 2004, Roche s 50 percent interest in the Bayer-Roche joint venture that had been established in the United States in 1996. The purchase price for the 50 percent equity interest was 0.2 billion. Not included in the 2004 total acquisition amount is the initial payment of 0.2 billion we made for Roche s consumer health business outside the United States (except Japan), because, as of December 31, 2004, this business had not yet been transferred to Bayer.

In **2005**, we spent a total of 2.4 billion on acquisitions. Roche s consumer health business outside the United States (except Japan) was acquired for approximately 2.1 billion. Both this amount and the 2005 total acquisition amount include the initial payment of 0.2 billion we made in 2004 for Roche s consumer health business outside the United States (except Japan). Since January 2005, the business involving non-prescription drugs and vitamins has been part of Bayer HealthCare s Consumer Care division.

The remaining 2005 acquisition amount of approximately 0.3 billion related primarily to expenses incurred in connection with a license agreement for the active ingredient fipronil, and a co-marketing and distribution agreement with Schering-Plough for the cardiovascular drug *Zetia*®. Bayer Schering Pharma AG and Schering-Plough Corporation, New Jersey are unaffiliated companies that have been totally independent of each other for many years.

In **2006**, we spent a total of 15.4 billion net of acquired cash and cash equivalents on acquisitions. With effect from June 23, 2006, we acquired a majority of the shares of Schering AG, Berlin, Germany (subsequently renamed Bayer Schering Pharma AG, Berlin, Germany), which is fully consolidated in the Bayer Group financial statements beginning on that date. The purchase price for 96.24 percent of the shares (percentage of shares outstanding as of December 31, 2006) was 16.2 billion and ancillary acquisition costs of 0.1 billion were incurred. In addition, we assumed about 1 billion in cash and cash equivalents and liabilities of 0.2 billion. The acquired business activities concentrate in the areas gynecology and andrology (major brands: *Yasmin*® and *Mirena*®), diagnostic imaging (major brand: *Magnevist*®), specialized therapeutics (major brands: *Betaferon*® and *Betaseron*®) and oncology. The EU and U.S. antitrust authorities have unconditionally approved the transaction. For details on the financing

of this transaction, refer to Item 5, *Operating and Financial Review and Prospects Liquidity and Capital Resources 2004, 2005 and 2006 Development of net debt*.

The domination and profit and loss transfer agreement between Bayer Schering Pharma AG and Bayer Schering GmbH, a wholly-owned subsidiary of Bayer AG was approved at the Extraordinary General Stockholders Meeting of Bayer Schering Pharma AG on September 13, 2006 and became effective with its entry in the commercial register of Bayer Schering Pharma AG on October 27, 2006. On September 30, 2006, our interest in Bayer Schering Pharma AG s voting capital amounted to 96.1 percent, thus exceeding the proportion required to effect a squeeze-out of the minority stockholders, or forced transfer of the Bayer Schering Pharma AG shares held by these shareholders to Bayer Schering GmbH, as permitted under German corporate law. A resolution approving the squeeze-out in exchange for cash compensation determined in accordance with German law was passed at an Extraordinary General Shareholder s Meeting of Bayer Schering Pharma AG held in Berlin on January 17, 2007.

The remaining amount spent on acquisitions in 2006 of approximately 0.1 billion was primarily related to the acquisition of the U.S. based company Metrika, a manufacturer of diabetes monitoring systems.

Our principal **divestitures** in the past three years were as follows:

In July **2004**, we sold, pursuant to contractual obligations, our 15 percent interest in the KWS Saat AG, a seed company acquired as part of Aventis CropScience in 2002.

In **2005**, we divested our LANXESS subgroup, our plasma operations and several CropScience operations.

LANXESS: At the end of January 2005, the LANXESS subgroup was spun off and ceased to be part of the Bayer Group. As part of its portfolio realignment, Bayer had combined its former Bayer Chemicals segment (except for Wolff Walsrode and H.C. Starck) with parts of its former Bayer Polymers business to form the LANXESS subgroup with economic effect from July 1, 2004. LANXESS is reported as discontinued operations prior to the spin-off. For further details refer to Item 5, *Operating and Financial Review and Prospects Operating Results 2004, 2005 and 2006 Discontinued Operations* and Note 7.2 to the consolidated financial statements contained elsewhere in this annual report on Form 20-F.

Plasma: At the end of March 2005, Bayer divested the U.S. plasma operations of its former Biological Products division to two U.S. financial investors for approximately 0.2 billion. These operations are reported as discontinued operations. For further details refer to Item 5, *Operating and Financial Review and Prospects Operating Results 2004, 2005 and 2006 Discontinued Operations* and Note 7.2 to the consolidated financial statements contained elsewhere in this annual report on Form 20-F.

In **2006**, we sold our 49.9 percent interest in the joint venture GE Bayer Silicones to the other partner General Electric. Furthermore, we divested manufacturing facilities formerly used by the Diagnostics and Diabetes Care businesses to the U.K.-based Kimball Electronics Wales Limited; an Animal Health vaccine factory in Cologne, Germany, to Intervet International BV; and a number of active ingredients used by the Crop Protection and the Environmental Science business groups.

In 2006, we completed the process of entering into agreements to divest our Diagnostics division and our H.C. Starck and Wolff Walsrode businesses. As discussed below, these transactions are expected to close or have already closed in 2007.

Diagnostics: At the end of June 2006, Bayer signed an agreement with Siemens AG to sell the Diagnostics division to Siemens for approximately 4.3 billion. The transaction closed in January 2007. The Diagnostics division is reported as discontinued operations prior to the sale. For details refer to Item 5, *Operating and Financial Review and Prospects Operating Results 2004, 2005 and 2006 Discontinued Operations* and Note 7.2 to the consolidated financial statements contained elsewhere in this annual report on Form 20-F.

H.C. Starck: In November 2006, Bayer signed an agreement with two financials investors, Advent International and The Carlyle Group, concerning the sale of the H.C. Starck business to them for approximately 1.2 billion. The transaction closed in early February 2007. The H.C. Starck business is reported as discontinued operations prior to the sale. For details refer to Item 5, *Operating and Financial Review and Prospects Operating Results 2004, 2005 and 2006 Discontinued Operations* and Note 7.2 to the consolidated financial statements contained elsewhere in this annual report on Form 20-F.

Wolff Walsrode: In December 2006, Bayer signed an agreement with The Dow Chemical Company concerning the sale of the Wolff Walsrode business. The sale is subject to the approval of the relevant antitrust authorities. Assuming these approvals are received, we expect the closing of the transaction to occur by the end of the first half of 2007. The Wolff Walsrode business is reported as discontinued operations prior to the sale. For details refer to Item 5, *Operating and Financial Review and Prospects Operating Results 2004, 2005 and 2006 Discontinued Operations* and Note 7.2 to the consolidated financial statements contained elsewhere in this annual report on Form 20-F.

BUSINESS

We are a global company offering a wide range of products, including ethical pharmaceuticals and other health care products, agricultural products and polymers. Bayer AG is headquartered in Leverkusen, Germany and is the management holding company of the Bayer Group, which includes approximately 430 consolidated subsidiaries.

Our business operations are organized in three subgroups:

Bayer HealthCare (consisting of the Pharmaceuticals segment and the Consumer Health segment) develops, produces and markets:

prescription pharmaceuticals, including, among others, medication for the treatment of multiple sclerosis, hormonal preparations for fertility control and menopause management, biological products, products for the treatment of cancer and coronary heart disease, anti-infective products and diagnostic imaging products; and

over-the-counter medications and nutritional supplements, blood glucose monitoring systems, veterinary medicines and nutritionals and grooming products for companion animals and livestock.

Bayer CropScience (consisting of the Crop Protection segment and the Environmental Science, BioScience segment) develops, produces and markets:

a comprehensive portfolio of fungicides, herbicides, insecticides and seed treatment products to meet a wide range of regional requirements; and

a wide range of products for the green industry, garden care, non-agricultural pest and weed control and conventional seeds, and is active in plant biotechnology.

Bayer MaterialScience (comprising the Materials segment and the Systems segment) primarily develops, manufactures and markets:

high-quality plastic granules, sheets and films; and

polyurethanes for a wide variety of applications as well as coating and adhesive raw materials and basic inorganic chemicals.

The following service organizations provide support functions to the three subgroups, Bayer AG and third parties:

Bayer Business Services, which provides information management, accounting, consulting and administrative services.

Bayer Technology Services, which provides engineering functions such as process development, process and plant engineering, construction and optimization.

Bayer Industry Services, which operates the Bayer Chemical Park network of industrial facilities in Germany and provides site-specific services in the areas of technology, environmental protection, waste management, utility supply, infrastructure, safety, chemical analysis and vocational training to Bayer and non-Bayer companies. Bayer Industry Services GmbH & Co. OHG is held by Bayer AG (60 percent) and by LANXESS (40 percent).

For the year ended December 31, 2006, Bayer reported total sales from continuing operations of 28,956 million, an operating result from continuing operations of 2,762 million and net income of 1,683 million. As of December 31, 2006, we employed 106,000 people worldwide. The Group s total sales in 2006 based on customer location, were as follow: 44 percent in Europe; 27 percent in North America; 16 percent in the Asia/ Pacific region; and 13 percent in the Latin America/ Africa/ Middle East region.

In 2006, due to the acquisition of the business of Schering AG, Berlin, Germany and the divestiture of the Diagnostics division, we changed our segment structure and reporting to reflect our new corporate structure in compliance with IAS 14 (Segment Reporting). We restated our segment reporting for 2004 and 2005,

accordingly. The changes in our segments are as follows: As of January 1, 2006, the former Pharmaceuticals, Biological Products segment has been renamed as the Pharmaceuticals segment. The historical Bayer pharmaceuticals and biological products businesses and the acquired Schering business form the Pharmaceuticals segment. The former Consumer Care and Animal Health segments were combined with the Diabetes Care division to form the new segment Consumer Health. Due to the divesting activities regarding the H.C. Starck and Wolff Walsrode businesses, the Materials segment comprises, beginning with the fourth quarter of 2006, the Polycarbonates and Thermoplastic Polyurethanes business units. The Diagnostics division as well as the H.C. Starck and Wolff Walsrode businesses are reported as discontinued operations.

The following table shows external sales from Bayer s continuing business activities by subgroup and reporting segment, with a reconciliation to the Bayer Group.

	2004	Percentage of total sales	2005	Percentage of total sales	2006	Percentage of total sales
			(Euros in millions)			
HealthCare	**6,736**	**32.2**	**7,996**	**32.4**	**11,724**	**40.5**
Pharmaceuticals[a]	3,961	18.9	4,067	16.5	7,478	25.8
Consumer Health	2,775	13.3	3,929	15.9	4,246	14.7
CropScience	**5,946**	**28.4**	**5,896**	**23.9**	**5,700**	**19.7**
Crop Protection	4,957	23.7	4,874	19.7	4,644	16.0
Environmental Science, BioScience	989	4.7	1,022	4.2	1,056	3.7
MaterialScience	**7,566**	**36.2**	**9,446**	**38.2**	**10,161**	**35.1**
Materials	2,217	10.6	2,837	11.4	2,925	10.1
Systems	5,349	25.6	6,609	26.8	7,236	25.0
Reconciliation	677	3.2	1,363	5.5	1,371	4.7
Total Sales from Continuing Operations[b]	**20,925**	**100.0**	**24,701**	**100.0**	**28,956**	**100.0**

(a) The segment s sales figures for 2006 include the acquired business of Schering AG as of June 23, 2006.

(b) In accordance with the accounting standard IFRS 5 and other related standards, the financial information presented in this annual report on Form 20-F only includes the continuing operations of the Bayer Group and its segments, except where specific reference is made to discontinued operations or Group total. Our revenues from discontinued operations were 2,845 million in 2006, 3,309 million in 2005 and 8,833 million in 2004.

BAYER HEALTHCARE

With effect from June 30, 2006, we have changed our segment reporting to reflect the new corporate structure resulting from the acquisition of Schering and the divestiture of the Diagnostics division. The names Bayer Schering Pharma or Schering as used in this annual report on Form 20-F 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. Bayer Schering Pharma AG and Schering-Plough Corporation, New Jersey are unaffiliated companies that have been totally independent of each other for many years. The Diabetes Care division is now combined with the former Consumer Care and Animal Health segment in a new segment called Consumer Health, while the acquired Schering business forms part of the Pharmaceuticals segment. The Diagnostics division is reported as discontinued operations. For details see Item 5, *Operating and Financial Review and Prospects Operating Results 2004, 2005 and 2006 Discontinued Operations*. Due to the divestiture of our U.S. Plasma business in 2005, we renamed our Pharmaceutical, Biological Products segment as the Pharmaceuticals segment on January 1, 2006.

PHARMACEUTICALS

Overview

With effect from June 23, 2006, we acquired a majority of the shares of Schering AG, Berlin, Germany (subsequently renamed Bayer Schering Pharma AG). The acquired business activities are concentrated in the areas gynecology and andrology (major brands: *Yasmin*® and *Mirena*®), diagnostic imaging (major brand: *Magnevist*®), specialized therapeutics (major brands: *Betaferon*® and *Betaseron*®) and oncology. The EU and U.S. antitrust authorities have unconditionally approved the transaction. Since the effectiveness of the domination and profit and loss transfer agreement with respect to Bayer Schering Pharma AG following its entry in the Commercial Register on October 27, 2006, the combined pharmaceuticals business is led by Bayer Schering Pharma AG, Berlin, Germany as the management company. For details see *History and Development of the Company*.

The Pharmaceuticals segment was initially comprised of the three business units Oncology, Primary Care and Hematology/ Cardiology. We added the acquired Schering businesses to it and now report the Pharmaceuticals segment as comprising the following seven business units: Primary Care (a combination of Bayer and Schering products, including the former andrology business of Schering), Women s Health (former gynecology business of Schering), Hematology/ Cardiology, Diagnostic Imaging, Specialized Therapeutics, Oncology (a combination of Bayer and Schering products) and Dermatology. The financial results of the acquired Schering businesses are reflected in our financial statements beginning on June 23, 2006.

The Pharmaceuticals segment focuses on the development and marketing of ethical pharmaceuticals, *i.e.*, medications requiring a physician s prescription and sold under a specific brand name.

The following table shows the segment s performance for the last three years.

	2004	2005	2006
	(Euros in millions except percentages)		
Total External net sales	3,961	4,067	7,478
Percentage of total sales from Group continuing operations	18.9%	16.5%	25.8%
External net sales by category of activity			
Primary Care[a]	2,950	2,831	3,091
Women s Health[b]			1,320
Hematology/ Cardiology	967	1,201	1,142
Diagnostic Imaging[c]			697
Specialized Therapeutics[c]			678
Oncology[d]	44	35	432
Dermatology[c]			118
Intersegment sales	38	58	51
Operating result	399	475	563

(a) For 2006, including the former andrology business of Schering AG.
(b) Represents the former gynecology business of Schering AG.
(c) Represents the respective acquired businesses of Schering AG.
(d) For 2006, including the acquired oncology business of Schering AG.

The segment s sales by region for the past three years are as follows.

	2004	2005	2006
	(Euros in millions)		
Europe	1,577	1,600	3,046
North America	1,172	1,129	2,226
Asia/ Pacific	851	900	1,313
Latin America/ Africa/ Middle East	361	438	893
Total	3,961	4,067	7,478

The following table shows our sales during the past three years from the products that account for the largest portion of segment sales.

	2004		2005		2006	
Product[a]	**Sales (Euros in millions)**	**Percentage of Segment Sales**	**Sales (Euros in millions)**	**Percentage of Segment Sales**	**Sales (Euros in millions)**	**Percentage of Segment Sales**
Betaferon®/*Betaseron*® (Specialized Therapeutics)[b]					535	7.2
Yasmin®/*YAZ*®/*Yasminelle*® (Women s Health)[b]					451	6.0
Kogenate® (Hematology/ Cardiology)	563	14.2	663	16.3	787	10.5
Adalat® (Primary Care)	670	16.9	659	16.2	657	8.8
Ciprobay®/ *Cipro*® (Primary Care)	837	21.2	525	12.9	513	6.9
Avalox®/ *Avelox*® (Primary Care)	318	8.0	364	9.0	396	5.3
Levitra® (Primary Care)	193	4.9	260	6.4	314	4.2
Mirena® (Women s Health)[b]					166	2.2
Magnevist® (Diagnostic Imaging)[b]					171	2.3
Glucobay® (Primary Care)	278	7.0	295	7.3	308	4.1
Other	1,102	27.8	1,301	31.9	3,180	42.5
Total	3,961		4,067		7,478	

[a] Products are ranked by the fourth quarter 2006 sales.

[b] Acquired as part of Schering s pharmaceutical business in 2006.

Segment Strategy

Our goal is to establish the Pharmaceuticals segment as a strong specialty business, *i.e.*, a business that markets to specialists rather than general practitioners, with a focus on diseases that have a great need for improvement in diagnosis and treatment.

The acquisition of Schering AG, Berlin, Germany in 2006 and the creation of Bayer Schering Pharma was a major step in this direction and considerably strengthened our business, adding to our portfolio products in the areas of oral contraception, diagnostics imaging and multiple sclerosis with well-established market positions like *Yasmin*®, *Magnevist*® and *Betaferon*®. The Schering product portfolio complements and significantly expands our existing specialty care portfolio in the areas of hemophilia and renal cell carcinoma with our products *Kogenate*® and *Nexavar*®.

With respect to our Primary Care business we pursue a strategy of value optimization. We continued our marketing alliance with Schering-Plough in the U.S. market. (Please note that Bayer Schering Pharma AG (formerly named Schering AG), Berlin, Germany, and Schering-Plough Corporation, New Jersey, are unaffiliated companies that have been totally independent of each other for many years.) Outside the United States we have a strong presence in the primary care market with the established products *Avalox®/Avelox®*, *Levitra®*, *Adalat®*, *Glucobay®* and *Ciprobay®/Cipro®*. The acquisition of marketing rights from GlaxoSmithKline for the antihypertensive product *Pritor®* and *PritorPlus®* in certain European countries is aimed to further sustain our primary care franchise.

We believe that one of the key drivers for the growth of our Pharmaceuticals segment are its research and development activities. As part of our strategy, Bayer HealthCare allocates the largest part of its research and development budget to the Pharmaceuticals segment. See Item 5, *Operating and Financial Review and Prospects Research and Development*. Life cycle management, licensing activities and alliances continue to be

major elements of our strategy. We use these business development activities in addition to research and development to strengthen our portfolio. See sections *Research and Development* and *Collaborations*.

Major Products

Primary Care

Adalat® is the trademark for nifedipine, a representative of the dihydropyridine class of calcium antagonists. Calcium plays an important role in the body s regulation of blood pressure and the supply of blood to the heart tissues. Calcium antagonists can reduce blood pressure and improve blood supply to the heart tissues.

Ciprofloxacin, marketed under the trademark *Cipro*®, mainly in the United States, and *Ciproxin*®, *Ciproxine*®, *Ciprobay*®, *Ciproxina*®, *Baycip*®, *Ciflox*® and *Uniflox*® in other countries, is a broad-spectrum antimicrobial agent of the fluoroquinolone class. Its main uses are in the treatment of urinary tract infections and in severe hospital infections. It is also approved for the treatment of anthrax. In June 2004, market exclusivity for the active pharmaceutical ingredient in *Cipro*® expired in the United States.

Moxifloxacin, marketed under the trademark *Avelox*®, mainly in the United States, and *Avalox*®, *Izilox*®, *Actira*® and *Octegra*® in other countries, is an antibiotic used to treat common bacterial respiratory tract infections. It is indicated for the treatment of community-acquired pneumonia, acute exacerbations of chronic bronchitis, acute sinusitis and uncomplicated skin and skin structure infections.

Vardenafil, our erectile dysfunction medication marketed under the trademark *Levitra*®, is marketed in the United States in co-operation with GlaxoSmithKline and Schering-Plough. (Please note that Bayer Schering Pharma AG (formerly named Schering AG), Berlin, Germany, and Schering-Plough Corporation, New Jersey, are unaffiliated companies that have been totally independent of each other for many years.) We also jointly perform the related life cycle management with these companies.

Acarbose, marketed under the trademarks *Glucobay*® and *Glucor*® in most countries, *Precose*®, in the United States, and *Prandase*®, mainly in Canada, is an oral antidiabetic product that delays carbohydrate digestion. *Glucobay*® improves metabolic control in diabetics alone or in combination with other antidiabetic drugs.

Women s Health

Yasmin® is an oral contraceptive that contains the synthetic hormone progestin drospirenone, developed by Bayer Schering Pharma AG, Berlin, Germany. *Yasmin*® is currently available in over 100 countries. In March 2006, we received marketing authorization in the United States for the oral contraceptive *YAZ*®, a low-dose version of *Yasmin*® and we started to market the product in April 2006 in the United States. In the meantime, the U.S. Food and Drug Administration (FDA) has expanded the registration for *YAZ*®, as an oral contraceptive that is also approved for the treatment of the emotional and physical symptoms of premenstrual dysphoria and for the treatment of moderate acne in women of at least 14 years of age. *Yasminelle*®, another low dose version of *Yasmin*® has been approved as an oral contraceptive in Europe in May 2006 and has been launched in several European countries since.

Mirena®, our progestin-based intrauterine system (IUS), is a long-term contraceptive that remains effective for five years. *Mirena*® was first launched in Europe in 1990 and is now also available in the United States, Asia and Latin America.

Hematology/ Cardiology

Kogenate® *FS* (*Kogenate*® *Bayer* in the EU) is a genetically-engineered recombinant version of the protein FVIII. Patients with hemophilia A cannot produce sufficient FVIII, and their blood therefore cannot clot properly. Physicians use both plasma-derived and recombinant FVIII to treat hemophilia A. Because recombinant products like *Kogenate*® do not derive from human donors, their users risk of inadvertently contracting infections, such as HIV, hepatitis or those caused by other viruses occasionally present in plasma-derived products, is greatly reduced.

Diagnostic Imaging

Our magnetic resonance imaging (MRI) contrast medium, *Magnevist*®, is an extracellular MRI contrast medium for cranial, spinal and body applications for patients of all age groups.

For *Ultravist*® 370, our X-ray contrast agent, the process of re-supplying the product into the market was started in January 2007.

Specialized Therapeutics

Betaferon® (marketed in the U.S. under the trademark *Betaseron*®) has received marketing authorization in the United States, Europe and Japan for the treatment of all relapsing forms of multiple sclerosis (MS), and, in the United States, Canada, Australia and Europe, also for the treatment of patients who have experienced a first clinical episode with diagnostic features consistent with MS.

Markets and Distribution

The Pharmaceuticals segment s principal markets are North America, Western Europe and Asia (especially Japan).

We do not experience any significant seasonality in our markets for the segment s products.

We generally distribute our products through wholesalers, pharmacies and hospitals as well as, to a limited extent, directly to patients. Where appropriate, we actively seek to supplement the efforts of our sales force through co-promotion and co-marketing arrangements. In the United States, our erectile dysfunction medication *Levitra*® (Vardenafil) is marketed and distributed jointly by GlaxoSmithKline and Schering-Plough. (Please note that Schering-Plough Corporation, New Jersey and the company acquired by Bayer in June 2006, Bayer Schering Pharma AG (formerly named Schering AG), Berlin, Germany, are unaffiliated companies that have been totally independent of each other for many years.) Schering-Plough also markets and distributes selected other of our primary care pharmaceutical products in the United States, including *Cipro*® and *Avelox*®. Furthermore, we are co-promoting selected Schering-Plough oncology products for a specified period of time in the United States and selected major European markets, *e.g.*, in Germany, France and Italy. We expect to cooperate in marketing Schering-Plough s *Zetia*® in Japan if approved by the Japanese regulatory authorities. Additionally, we have a co-marketing agreement with Wyeth, Inc., for the oral contraceptive substance gestodene for Europe.

In October 2005, we entered into a strategic alliance with Ortho-McNeil Pharmaceutical Inc., a Johnson & Johnson subsidiary. In this alliance, Ortho-McNeil will contribute to the development of Rivaroxaban (BAY 59-7939) and will later market and distribute Rivaroxaban in the United States. Rivaroxaban is an oral direct Factor Xa inhibitor, being developed for the prevention and treatment of thrombotic events. In addition, Bayer is co-promoting Johnson & Johnson s *Elmiron*®, a medication for the treatment of interstitial cystitis, in the United States.

We produce active pharmaceutical ingredients for our ethical pharmaceutical products at four locations: our primary facilities in Wuppertal and Bergkamen, Germany, and two smaller facilities in Spain and Mexico.

Recombinant FVIII products are produced at our facility in Berkeley, California, under an exclusive license from Genentech. *Betaferon*® is sourced from Chiron, in Emeryville, California and Boehringer Ingelheim, Germany for defined market regions.

We obtain raw materials for our active ingredients in ethical pharmaceuticals in part from LANXESS AG and the rest from other third parties mainly in Europe and Asia. For our *Kogenate*® product, we obtain raw materials and packaging materials from diverse third-party suppliers in various countries around the world. For the production of *Kogenate*® we use human albumin sourced from Talecris for the nutrition of the cell lines.

In addition to the chemical production operations, we presently operate production facilities for the formulation and packaging of pharmaceutical and biotechnological products on three continents. Our main such pharmaceutical production facilities are in Berlin, Weimar and Leverkusen, Germany; Berkeley, California; Garbagnate, Italy; Sao Paulo, Brazil; Madrid, Spain; Turku, Finland and Seattle, Washington.

We maintain strategic reserves of many of our key products to avoid shortages upon any breaks in the supply chain. Where a required material is available from only one supplier, our policy is to amass a strategic reserve, while mounting an intensive search for potential alternative suppliers. We obtain additional ingredients and packaging materials from diverse suppliers in various countries around the world. For building blocks and intermediates used to manufacture active ingredients in ethical pharmaceuticals, we either approve several suppliers or enter into global contracts. This also helps us to reduce the effects of price volatility.

We encounter competition in all of our geographical markets from large national and international competitors, such as:

Primary Care: Pfizer, GlaxoSmithKline and Abbott Laboratories (antibacterial products); Pfizer, Novartis, AstraZeneca and Merck & Co (hypertension and coronary heart disease therapy); Takeda, GlaxoSmithKline, Sanofi-Aventis and Bristol-Myers Squibb (oral antidiabetics); Pfizer and Eli Lilly (erectile dysfunction);

Women s Health: Wyeth, Johnson & Johnson, Novartis, Barr Laboratories and Watson Pharmaceuticals;

Hematology/ Cardiology: Baxter, Wyeth and CSL Behring;

Diagnostic Imaging: Bracco, Tyco Healthcare Group and Altana (Nycomed acquired Altana s pharmaceuticals business effective December 31, 2006) (X-ray and MRI contrast media products) and Liebel-Flarsheim (contrast media application technologies products);

Specialized Therapeutics: Biogen Idec, Serono.

Research and Development

The Research & Development function for the Pharmaceuticals segment has been restructured as part of our integration of Schering. (The names Bayer Schering Pharma or Schering as used in this annual report on Form 20-F always refer to Bayer Schering Pharma AG, Berlin, Germany, or its predecessor, Schering AG, Berlin, Germany, respectively. Bayer Schering Pharma AG, Berlin, Germany, and Schering-Plough Corporation, New Jersey are unaffiliated companies that have been totally independent of each other for many years.) It now encompasses the functions Global Drug Discovery and Global Development. We intend the changes in Research & Development to leverage the combined assets of Schering and Bayer to maximize both the output and effectiveness of our drug discovery and development programs. Research programs and activities will be consolidated into three major research and development sites: Berlin and Wuppertal, Germany, and Berkeley, California. The Berlin research group will take leadership for diagnostic imaging, oncology and gynecology and andrology research. Wuppertal will take leadership for the company s hematology and cardiology research. Both locations have significant capabilities and activities in target discovery, lead generation and optimization, drug metabolism and pharmacokinetics, toxicology and clinical pharmacology. Berkeley will remain an important global research and development center for protein-based biologics drug discovery and will continue to be home of the *Kogenate*® biological manufacturing facility. Bayer HealthCare s U.S. research site in West Haven, Connecticut, and that of Berlex Inc. (U.S. subsidiary of Bayer Schering Pharma AG, Berlin, Germany) in Richmond, California, will be closed.

Status of Development of Selected Compounds in Clinical Trials

Continuing Development of Compounds in Phase II/ III Clinical Trials

In 2006 we conducted clinical trials for several of our research and development pipeline candidates. The compounds listed in the table below with their respective indications represent a snapshot of Bayer s late stage pipeline of drug candidates in Phase II and III of clinical trials, excluding drug candidates of the acquired business of Schering AG, Berlin, Germany. The full combined research and development pipeline is currently under review and will be communicated at a later date.

The nature of drug discovery and development is such that not all compounds can be expected to meet the pre-defined project target profile. It is possible that any or all of the projects listed below 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.

Project	Indication	Status
Avelox®	New indications	In Phase III
Nexavar®	Advanced renal cell carcinoma	FDA approval
	Hepatocellular carcinoma	In Phase III
	Malignant melanoma	In Phase III
	NSCLC	In Phase III
	Other cancer types	In Phase II
Rivaroxaban (BAY 59-7939)	VTE prevention	In Phase III
	VTE treatment	In Phase III
	Stroke prevention in patients with atrial fibrillation	In Phase III
	Acute Coronary Syndrome/ Myocardial Infarction	In Phase II
VEGF Trap	Treatment of eye diseases	In Phase II

The following is a description of the status of development of *Nexavar*® and Rivaroxaban, two major drug candidates that are in Phase III clinical trials with respect to certain indications:

Nexavar® (sorafenib), co-developed by Bayer HealthCare and Onyx Pharmaceuticals, Inc., is a novel multi-kinase inhibitor that targets serine/threonine and receptor tyrosine kinases in both the tumor cell and the tumor vasculature. At the end of 2005, the FDA granted U.S. approval for *Nexavar*® for the treatment of patients with advanced renal cell carcinoma (RCC). It was approved by the EMEA in July 2006 for the same indication. During 2006, *Nexavar*® was approved in nearly 50 countries for the treatment of advanced RCC.

In addition to the launch of *Nexavar*® for advanced RCC, we actively pursued our Phase III clinical trial programs for the treatment of hepatocellular carcinoma (HCC), malignant melanoma and non-small cell lung cancer (NSCLC). In April 2006, the FDA and the EMEA both granted orphan drug designation to *Nexavar*® for the treatment of HCC. Furthermore, *Nexavar*® received fast track status by the FDA for the treatment of HCC and malignant melanoma. In February 2007, an independent data monitoring committee (DMC) reviewed the safety and efficacy data of the Phase III clinical trial on the treatment of HCC with the conclusion that the trial met its primary endpoint. The DMC recommended stopping the trial early and Bayer and Onyx followed that recommendation. The companies will continue discussions with health authorities worldwide regarding the next steps in filing for approval for the treatment of HCC, and intend to make those filings as rapidly as possible. In December 2006, results were announced from the Phase III malignant melanoma study evaluating the combination of *Nexavar*® or placebo tablets with the chemotherapeutic agents carboplatin and paclitaxel in patients with advanced malignant melanoma. This trial did not meet its primary endpoint of improving progression-free survival (PFS). Other tumor types are under investigation in earlier stages of clinical development.

Rivaroxaban (BAY 59-7939) is a novel oral direct Factor Xa inhibitor, being developed to meet currently unmet clinical needs in the anticoagulation market for prevention and treatment of thrombotic events. In October 2005, Bayer HealthCare and the Johnson & Johnson subsidiary Ortho-McNeil entered into an alliance under which Ortho-McNeil is contributing to the development of Rivaroxaban, and initiated Phase III clinical trials in December 2005 for the prevention of venous thromboembolism (VTE) after major orthopedic surgery. In June 2006 we announced Phase III clinical trials in the two chronic indications stroke prevention in atrial fibrillation and treatment of VTE in a once-daily dose regimen. Also in 2006, we began Phase II clinical trials in the indication acute coronary syndrome/myocardial infarction.

The following is a description of the status of development of *ZK-EPO* and *YAZ®*, two major drug candidates of the acquired Schering business that are in Phase II and Phase III clinical trials with respect to certain indications:

ZK-EPO is a novel epothilone specifically designed to overcome limitations associated with other microtubule stabilizing agents by combining high efficacy with a balanced tolerability profile. The compound exhibits efficacy across a broad spectrum of tumor models. Phase II clinical trials have started and will examine the activity of *ZK-EPO* in patients with various solid tumors, including several major cancers such as non-small-cell lung cancer (NSCLC), ovarian cancer, prostate cancer and breast cancer.

Clinical studies for ***YAZ®*** in the indication acne treatment have demonstrated the effectiveness of *YAZ®* in this indication. This effect is brought about by the ingredient progestin drospirenone which has anti-androgenic properties. FDA approval for *YAZ®* in the treatment of acne has been granted in January 2007. *YAZ®* is also examined in Phase III clinical trials as oral contraceptive (OC) in long-cycle administration.

Continuing Development of Compounds prior to Phase II/ III Clinical Trials

Kogenate. Key research and product development projects involving our *Kogenate®* product are *Kogenate® Next Generation* and *Kogenate® Bio-Set*, as well as gene therapy for hemophilia B. We have identified five constructs for potential development of products under the umbrella *Kogenate® Next Generation.* The evaluation of proteins as well as of the technology is ongoing. We expect the optimization of drug candidates to be completed by the end of 2007. Bayer has performed Phase I clinical trials in the United States for BAY 79-4980 (*Kogenate®-FS* reconstituted with pegylated liposome diluent) under an Investigational New Drug application process (IND) filed by Bayer in April 2005 and accepted by the FDA. On May 18, 2005, Bayer entered into an early stage research and collaboration agreement with Asklepios BioPharmaceutical, Inc., to develop gene therapy for the treatment of hemophilia.

Suspended and Discontinued Development of Compounds in Phase II/ III Clinical Trials

Alfimeprase. Nuvelo and Bayer HealthCare announced in December 2006 that the first Phase III clinical trial of alfimeprase, a blood clot dissolver, in patients with acute peripheral arterial occlusion (NAPA-2 trial: Novel Arterial Perfusion with Alfimeprase-2) did not meet its primary endpoint of avoidance of open vascular surgery within 30 days of treatment. The companies also announced that the Phase III clinical trial in catheter occlusion (SONOMA-2 trial: Speedy Opening of Non-functional and Occluded catheters with Mini-dose Alfimeprase-2) did not meet its primary endpoint of re-establishment of a functional central venous access device (CVAD) at 15 minutes post first infusion. In addition, the companies announced that they are temporarily suspending enrollment in the ongoing Phase III clinical trials, NAPA-3 and SONOMA-3, until further analyses and discussions with outside experts and regulatory agencies are completed.

Trasylol®. Bayer HealthCare has decided to end three ongoing clinical studies investigating the safety and efficacy of *Trasylol®* (aprotinin injection) on transfusion requirements and blood loss in adults undergoing: elective spinal fusion surgery, pneumonectomy or esophagectomy for cancer, and radical or total cystectomy in bladder cancer. Used prophylactically, *Trasylol®* is indicated to reduce blood loss and the need for blood transfusion in patients undergoing cardiopulmonary bypass in the course of coronary artery bypass graft surgery in patients who are at an increased risk for blood loss and blood transfusion. The *Trasylol®* labeling that was recently approved in the United States and is in the approval process in the European Union and other countries, includes a recommendation that in order to manage possible anaphylactic reactions, *Trasylol®* should be administered only in surgical settings where cardiopulmonary bypass (CPB) can be rapidly initiated. The use of CPB is not practical in non-cardiac surgical settings such as the ones for which we ended the clinical studies. See *Update on Trasylol®-marketed product* below for further information.

Bayer HealthCare posts information on clinical trials on the internet

Bayer HealthCare posts information on the clinical trials being conducted by its Pharmaceuticals segment and Consumer Care division on the internet. The database is intended to increase the transparency of the clinical trials for physicians, scientists and other interested parties. This measure is consistent with the recommendations

in the position paper issued by pharmaceutical associations in Europe, Japan and the United States, and the International Federation of Pharmaceutical Manufacturers and Associations.

Collaborations

Research Collaborations

To supplement our internal efforts, we collaborate with several companies in different stages of the typical pharmaceutical research cycle. Our more significant collaborations are described (in alphabetical order) in the table below.

Partner	Objective
Affimetrix	Understanding the disease mechanism and identifying new targets
ARTEMIS Pharmaceuticals GmbH	In vivo validation of targets
Avid	Radiopharmaceuticals compounds
Bausch&Lomb	SEGRA ophthalmology
ChemDiv	Synthesis of compounds
ComGenex	Synthesis of compounds
Genedata	Expressionist software
Inpharmatica	Kinase SARfari in Silico Drug Discovery
Monash University	New targets for gender health
MorphoSys AG	Antibody diagnostics and therapeutics for cancer and other life threatening diseases
Neurosciences Victoria Ltd.	Treatment of neurodegenerative disorders
Peregrine Pharmaceuticals, Inc.	Selective cancer diagnostics (vascular targeting agents)
Proteros	X-ray structure analysis
Seattle Genetics	Increasing the pool of potential drug candidates by biomolecules
University Stanford/ Gambhir	New PET tracers
Warner Chillcott	SEGRA for dermatology

Product Development Collaborations

The major collaborations in the area of product development are described below:

Onyx

Bayer and Onyx are co-developing *Nexavar*®. As part of this collaboration, Onyx is funding 50 percent of the costs of development for this compound other than in Japan. In return, Onyx has a 50 percent profit share in the United States, where the companies co-promote the product. In all markets outside Japan, Bayer has the contractual right to market the product exclusively and will share profits equally with Onyx. In Japan, Bayer has the contractual right to develop and market the product exclusively and Onyx has the contractual right to receive a royalty.

Johnson & Johnson

Bayer HealthCare and Ortho-McNeil, a subsidiary of Johnson & Johnson, have concluded an agreement in October 2005 to develop and market Rivaroxaban (BAY 59-7939) for the prevention and treatment of thrombotic events.

Nuvelo

In January 2006, we entered into an agreement with Nuvelo, Inc., for the global development and commercialization of alfimeprase, a novel blood clot dissolver. See *Research and Development Status of*

Development of Selected Compounds in Clinical Trials Suspended and Discontinued Development of Compounds in Phase II/ III Clinical Trials Alfimeprase above for further information on alfimeprase.

Regeneron Pharmaceuticals

In October 2006, we entered into a collaboration agreement with Regeneron Pharmaceuticals, Inc. for the global development and commercialization of the VEGF Trap for the treatment of eye diseases by local administration into the eye. The VEGF Trap for the treatment of eye diseases, currently in Phase I and Phase II clinical trials, is a protein that binds to or traps the vascular endothelial growth factor (VEGF) and blocks its activity. Bayer has the contractual right to market the drug outside the United States, if approved by the competent authorities.

Astra Zeneca

In September 2006, we agreed with AstraZeneca to co-develop and co-promote the selective estrogen receptor downregulator (SERD) for the treatment of hormonal dependent breast cancer. All development costs and all profits will be shared equally. While we will be the lead marketing partner in Europe, AstraZeneca has the right to be the lead marketing partner in the United States.

Celera Genomic

In June 2006, we acquired Celera Genomic s cathepsin S inhibitor drug development program. These oral cathepsin S inhibitors are small molecules with an innovative mode-of-action that have potential in the treatment of auto-immune diseases like multiple sclerosis, Crohn s, psoriasis and rheumatoid arthritis. We have exclusive rights worldwide. The technology is still in a pre-clinical stage.

Avid Radiopharmaceuticals

In February 2006, we signed an option agreement with Avid Radiopharmaceuticals for a positron emission tomography (PET) imaging agent, which can be used for the diagnosis of Alzheimer s disease and other neurodegenerative diseases. We can exercise this option for an exclusive license if a currently ongoing proof-of-concept study is successful.

Genzyme Corporation

In August 1999, we in-licensed *Campath*® from L&I Partners L.P., which later was acquired by Genzyme Corporation. Since then, we market *Campath*® worldwide in the area of chronic lymphocytic leukemia. Several studies for extension of this indication are ongoing. Additionally, both partners are jointly developing *Campath*® for the indication in multiple sclerosis.

Novartis Pharma

We entered into a collaboration in 1995 with Novartis Pharma AG to jointly research and develop inhibitors of angiogenesis. Such inhibitors are expected to exhibit anti-tumor activity by cutting off the tumor s blood supply. In January 2005, the original cooperation agreement was amended by a commercialization agreement that governs joint development and global co-promotion of the lead compound PTK/ZK. All costs and profits are shared equally. We are the lead marketing partner in Europe, Novartis is the lead marketing partner in the United States.

Sonus Pharmaceuticals

In October 2005, we in-licensed TOCOSOL® Paclitaxel from Sonus Pharmaceuticals, Inc.

Titan Pharmaceuticals

In January 2000, we entered into an agreement with Titan Pharmaceuticals, Inc. for the global rights to Spheramine. Under this agreement Bayer is responsible for the manufacturing, development and commercializa-

tion. Spheramine consists of dopamine-producing cells adhered to spherical microscopic carriers, which are injected into the brains of patients suffering from Parkinson disease.

Life Cycle Management

We apply life cycle management measures to our marketed products to expand the scope of possible treatment opportunities by identifying new indications and improved formulations. *Adalat*® is a prime example of successful life cycle management: twenty-one years after the patent protection for the active ingredient nifedipine, its key component, expired, the drug generated 657 million in sales in 2006. Similarly, we are implementing life cycle management measures, such as improved formulations and dosage forms or identifying new indications, for other major products. *Fludara*®, an oncological product which lost patent protection in the United States in 2003, is another example of successful life cycle management measures. The product generated 120 million in sales in 2006, compared to 103 million in the first year after loss of patent protection.

In-licensing activities

We supplement our portfolio of products emerging from our own research and development with in-licensed products, both on a global and a national level. Recent examples are the purchase of the European business for Boehringer Ingelheim s blood pressure treatment telmisartan (*Prito*® and *PritorPlus*®) from GlaxoSmithKline in January 2006. Also in January 2006, we entered into an agreement with Nuvelo, Inc. for the global development and commercialization of alfimeprase, a novel clot dissolver. See *Research and Development Status of Development of Selected Compounds in Clinical Trials Suspended and Discontinued Development of Compounds in Phase II/ III Clinical Trials Alfimeprase* above for further information on alfimeprase. Bayer will have the contractual right to market the drug outside the United States, if approved by the competent authorities. In October 2006, we entered into a collaboration agreement with Regeneron Pharmaceuticals, Inc. for the global development, and commercialization of the VEGF Trap for the treatment of eye disease by local administration into the eye, currently in Phase I and Phase II clinical trials. Bayer will have the contractual right to market the drug outside the United States, if approved by the competent authorities. See *Product Development Collaborations*.

Update on *Trasylol*® -marketed product

Trasylol® Aprotinin, marketed under the trademark *Trasylol*®, is a natural proteinase inhibitor obtained from bovine lung tissue. Used prophylactically, it is indicated to reduce perioperative blood loss and the need for blood transfusion in patients undergoing cardiopulmonary bypass in the course of coronary artery bypass graft surgery who are at an increased risk for blood loss and blood transfusion.

In January 2006, two papers were published in the medical literature concerning *Trasylol*® (aprotinin). The New England Journal of Medicine (NEJM) published an observational study in which Mangano et al. proposed that aprotinin use was associated with an increased incidence of cardiovascular events (myocardial infarction and/or congestive heart failure), cerebrovascular events (stroke, encephalopathy and/or coma), and renal events (renal dysfunction and/or renal failure requiring dialysis) in patients undergoing elective coronary-artery revascularization with no history of cardiac surgery, vascular surgery or angioplasty, and with an increased incidence of renal events in patients undergoing complex coronary-artery surgery.

The journal Transfusion published an observational study comparing the use of aprotinin and tranexamic acid in high transfusion risk patients undergoing cardiac surgery with cardiopulmonary bypass which reported that Our results suggest that aprotinin use may be associated with worsening renal function in patients with existing renal dysfunction. Karkouti et al. did not find an increased rate of cardiovascular or cerebrovascular events in *Trasylol*®-treated patients and reported comparable mortality rates between patients who received *Trasylol*® and those who received tranexamic acid.

At the Advisory Committee meeting held by the Cardiovascular and Renal Drugs Division of the FDA on September 21, 2006, the data from Bayer s internal databases and from the observational study by Karkouti et al. (Mangano et al. had not provided the FDA with unrestricted access to the underlying data from their observational study) were reviewed and the complex scientific issues surrounding the risk/benefit profile of

Trasylol® (aprotinin injection) were discussed in detail. At the end of the session, the Advisory Committee affirmed (18-0 with 1 abstention) that the totality of clinical data presented at the meeting supported acceptable safety and efficacy for *Trasylol*® among coronary artery bypass graft (CABG) surgery patients.

On September 27, 2006, Bayer submitted a copy of a preliminary report of an observational study concerning the effects of aprotinin, aminocaproic acid and tranexamic acid in patients undergoing coronary artery bypass graft (CABG) surgery commissioned by the company and performed by i3 Drug Safety to the FDA, along with a copy of i3 Drug Safety s March 3, 2006 study proposal. Bayer also notified other regulatory authorities of the preliminary report. Bayer acknowledged that it mistakenly did not inform the FDA about this study prior to the Advisory Committee meeting. Data was not shared immediately with the agency because it was preliminary in nature and raised significant questions on the study population, outcomes and methodology. Although the preliminary report noted that, as compared with patients receiving lysine analogues, aprotinin-treated patients had a higher relative risk of death, serious kidney damage, congestive heart failure and strokes, the authors concluded only that their findings support the hypothesis that there is a higher risk of death and acute renal failure in aprotinin recipients, when compared with those receiving the lysine analogues. The company is now working with the FDA, i3 Drug Safety and other experts to analyze the preliminary report, to examine the underlying source data and to fully understand the results. Bayer is committed to patient safety. The company will continue to work closely with the FDA to address questions regarding this study and the overall safety and efficacy of *Trasylol*® (aprotinin injection).

Bayer had committed to making changes to the label regarding hypersensitivity and renal events prior to the Advisory Committee meeting in September 2006. On December 15, 2006, the FDA approved Bayer s label supplement reflecting new safety information and prescribing information regarding *Trasylol*®. The label changes were related to limiting *Trasylol*® use to patients who are at an increased risk for blood loss and blood transfusion in the setting of coronary bypass graft surgery with cardiopulmonary bypass, contraindicating the administration of *Trasylol*® to any patients with a known or suspected prior exposure to *Trasylol*® or other aprotinin-containing products within the previous 12 months, providing additional information on the management and prevention of anaphylactic reactions, including the administration of *Trasylol*® only in an operative setting where cardiopulmonary bypass (CPB) may be rapidly initiated and highlighting the risk for kidney dysfunction. In light thereof, Bayer decided to end three ongoing clinical studies of the safety and efficacy of *Trasylol*® in additional indications in non-cardiac surgical settings in which CPB is not practical. See *Research and Development Status of Development of Selected Compounds in Clinical Trials Suspended and Discontinued Development of Compounds in Phase II/ III Clinical Trials Trasylol*®. Bayer has been working and will continue to work closely with regulatory authorities worldwide to address questions of product safety.

In February 2007, another paper was published in the medical literature concerning *Trasylol*® (aprotinin). The Journal of the American Medical Association published an observational study in which Mangano et al. posit that aprotinin may increase the risk of mortality during the five-year period following coronary artery bypass graft surgery.

Results of additional review and analysis of data or the negative publicity associated with the studies or the regulatory review process could lead to a material reduction in the volume of *Trasylol*® sales and also potentially in liability claims, and this could have a material adverse affect on revenues or results of operations, at least at the Pharmaceuticals segment level.

CONSUMER HEALTH

Overview

As further explained in the introduction to *Business*, we have changed our segment reporting with effect from June 30, 2006 to reflect the new corporate structure resulting from the acquisition of the business of Schering AG, Berlin, Germany and the divestiture of the Diagnostics division. The Diabetes Care division is now combined with the former Consumer Care and Animal Health segment in a new segment called Consumer Health. The previous years segment data has been adjusted accordingly.

The following table shows the Consumer Health segment s performance in the last three years.

	2004	2005	2006
	(Euros in millions, except percentages)		
Total external net sales	2,775	3,929	4,246
Percentage of total sales from Group continuing operations	13.3%	15.9%	14.7%
External net sales by category of activity			
Consumer Care	1,336	2,355	2,531
Diabetes Care	653	718	810
Animal Health	786	856	905
Intersegment sales	18	21	7
Operating result	448	448	750

The segment s sales by region for the past three years are as follows. Segment data for 2004 and 2005 have been restated to reflect the changed segment presentation described above.

	2004	2005	2006
	(Euros in millions)		
Europe	927	1,592	1,691
North America	1,235	1,321	1,463
Asia/ Pacific	187	301	336
Latin America/ Africa/ Middle East	426	715	756
Total	2,775	3,929	4,246

The following table shows our sales during the past three years from the products that account for the largest portion of segment sales, restated as described above.

	2004		2005		2006	
Product	**Sales (Euros in millions)**	**Percentage of Segment Sales**	**Sales (Euros in millions)**	**Percentage of Segment Sales**	**Sales (Euros in millions)**	**Percentage of Segment Sales**
Ascensia® (Diabetes Care)	627	22.6	701	17.8	788	18.6
Aspirin® (Consumer Care)[a]	454	16.4	453	11.5	465	11.0
Advantage®/*Advantix*® (Animal Health)	206	7.4	249	6.3	275	6.5
Aleve®/*Naproxen* (Consumer Care)[b]	90	3.2	178	4.5	227	5.3
Canesten® (Consumer Care)	140	5.0	145	3.7	162	3.8
Baytril® (Animal Health)	160	5.8	163	4.1	162	3.8
Bepanthen®/*Bepanthol*® (Consumer Care)[c]			114	2.9	131	3.1
Supradyn® (Consumer Care)[c]			125	3.2	130	3.1
One-A-Day® (Consumer Care)	127	4.6	118	3.0	124	2.9
Alka-Seltzer® (Consumer Care)	94	3.4	95	2.4	101	2.4
Other	877	31.6	1,588	40.6	1,681	39.5
Total	2,775		3,929		4,246	

[a] *CardioAspirin* of our *Aspirin*® product family is also distributed by our Pharmaceuticals segment. These figures do not include sales by the Pharmaceuticals segment. The sales for *Aspirin*® and *CardioAspirin*, including the ones made by the Pharmaceuticals segment, amount to 674 million in 2006, 630 million in 2005 and 601 million in 2004.

[b] As the product *Aleve*® was part of the former U.S. joint venture with Roche, sales figures for 2004 only represent the Bayer portion of the joint venture s sales. 2005 sales figures represent total sales of the product after our acquisition of the remaining 50 percent of the U.S. joint venture from Roche. *Naproxen* is the active ingredient included in products marketed in the United States under the brand *Aleve*® and in other countries using different local brands, the latter having been acquired as part of Roche s consumer health business in 2005.

[c] Acquired as part of Roche s consumer health business in 2005.

Segment Strategy

The Consumer Health segment represents our three divisions Consumer Care, Diabetes Care and Animal Health.

The objective of our Consumer Care division is to further consolidate our strong global position in the consumer health market for medicinal products that consumers may generally purchase without a prescription (over-the-counter/ OTC products). The key element of our strategy in our Consumer Care division is to exploit organic growth potential

within our significant Consumer Care categories by leveraging the strength of our well-known brands (including *Aleve*®, *Aspirin*®, *Bepanthen*®, *Canesten*®, *One-A-Day*® and *Supradyn*®). We intend to drive expansion in high growth regions of the world (such as Eastern Europe and Asia/ Pacific) and develop business in new and emerging growth areas. We also intend to pursue external growth opportunities through acquisitions and licensing where the appropriate strategic fit can be found. In this context we agreed in October 2006 to acquire the Western medicines over-the-counter cough and cold portfolio business (including the transfer of personnel and a manufacturing facility) of the Topsun Group in China. We expect the transaction to close in 2007.

The Diabetes Care division s objective is to create a sustainable competitive advantage in the diabetes monitoring and management market while allowing Diabetes Care to profitably grow market share and expand its business. To achieve our overall goal in the Diabetes Care division, we are expanding our product offering by developing second and third generations of meters and strips that are more intuitive and easier to use, resulting in glucose testing with minimal pain for diabetic patients, and broadening our portfolio through investments into ancillary business opportunities. We intend to target our marketing efforts in order to direct customers to improved versions of our meters and to increase our competitiveness through continuous improvement of our products, reductions in our costs and operational efficiencies. We also plan to realign our research and development activities and investments. To support our objectives, we intend to continue to develop our strategic partnerships in desired areas of expertise to complement our in-house strengths.

Animal Health aims to be one of the leading suppliers in the food animal and companion animal market and strives to be the preferred partner for and provider of veterinary solutions. It is part of our business strategy for Animal Health to sustain its current profile by focusing on attractive countries and markets. Furthermore, Animal Health pursues a policy of organic growth by exploiting existing core brands through life cycle management activities supported by new business development activities. To complete the existing product portfolio, Animal Health periodically evaluates the possibility of acquisitions or strategic alliances. The Animal Health division collaborates closely with our Pharmaceuticals segment and the Bayer CropScience subgroup as well as other life science companies in research and development in order to bring to the market new active ingredients and products that combat diseases in animals.

Consumer Care

Major Products

Analgesics

The analgesics market comprises pain relief products both in oral form (for example, pills and tablets) and for topical use (for example, ointments and salves). We concentrate primarily on the oral products segment. Our consumer health products face competition from prescription drugs, for example cyclooxygenase (COX-II) inhibitor pain relievers and prescription non-steroidal anti-inflammatory drugs (NSAIDs).

Aspirin® (*Bayer*® Aspirin brand in the United States) is a non-steroidal anti-inflammatory drug (NSAID). It is used for pain relief and, in countries where so indicated, for the prevention of heart attacks. *Aleve*® (also known as *Flanax*® and *Apronax*® in some Latin American countries) is a nonprescription strength version of the analgesic naproxen sodium. *Aleve*® is a long-lasting pain reliever and can be used for fever reduction. Our *Midol*® product family competes in the menstrual pain relief category.

CardioAspirin (*e.g.*, *Aspirin*® *Protect* in Germany and *Bayer*® *Low Dose Aspirin Regimen* in the United States) refers to Bayer s collective group of products (distributed by both our Consumer Care division and our Pharmaceuticals segment depending on whether local regulations require a prescription for these products) that are professionally indicated for the prevention of an myocardial infarction (MI), or heart attack in either those individuals who have already had an initial MI (secondary prevention) or in individuals deemed at risk for a first MI by their physician (primary prevention).

Cough/Cold

Within the total cough and cold market, we concentrate on the cold/flu remedy segment. This consumer health category faces competition from non-medicinal remedies (for example, nutritional or herbal products), as well as from preventive medicines available by prescription or under development.

Alka-Seltzer Plus®, marketed in the United States, is a product to relieve symptoms accompanying the common cold. *Tabcin*®, primarily marketed in Latin America, is a product line similar to *Alka-Seltzer Plus*®. *Aleve*® *Cold & Sinus* is a long-lasting combination of the analgesic naproxen sodium and nasal decongestant.

Dermatologicals

The dermatological category of our Consumer Care division is not related to the Dermatology business unit of our Pharmaceuticals segment.

The dermatological category includes a broad range of skin treatments. Within this market, we focus on the antifungal, wound healing and skin protection categories. Competition in topical dermatologicals ranges from prescription antifungal products to cosmetic emollients and locally marketed generic products and low priced brands.

Canesten® is a treatment for vaginal yeast infections, athlete s foot and other dermatological fungal problems. *Rid*® is a topical head lice treatment marketed only in the United States. *Bepanthen*® is a topical wound healing brand with a sister brand *Bepanthol*® which is a skin protectant and emollient.

Gastrointestinals

The gastrointestinal (GI) category includes antacids, anti-gas products, digestives, laxatives and anti-diarrheals.

Alka-Seltzer® is used for speedy relief of acid indigestion, sour stomach or heartburn with headache, or body aches and pains. *Phillips*® *Milk of Magnesia* is a saline laxative used as an overnight remedy for constipation and acid indigestion, heartburn or sour stomach that may accompany it. *Rennie*® relieves symptoms of indigestion and is typically marketed directly to the consumer. *Talcid*® is used for the relief of symptoms from heartburn and acid indigestion.

Nutritionals

The nutritionals category is very broad, encompassing vitamins, minerals, multi-vitamins/minerals, herbals, sports nutrition and specialty supplements in many different forms. Applicable regulations vary greatly, both from country to country and across nutritional segments (for example, herbals vs. vitamins). As a general rule, however, regulation of nutritionals tends to be less stringent than that of other consumer health products. Bayer s primary interests in the nutritionals field are in the vitamin and mineral (especially multi-vitamins/minerals) areas.

One-A-Day® multivitamins offer a variety of special formulations, such as Men s, Women s, 50 Plus, Maximum, Essential and *WeightSmart*® formulas. *Flintstones*® are multivitamin dietary supplements containing (depending on type) 10-19 essential nutrients for children ages 2-12. *Supradyn*® is a multi vitamin/mineral brand, *Redoxon*®, a vitamin C brand, and *Berocca*®, a higher potency vitamin/mineral supplement.

In 2006, we launched various line extensions to our existing brands.

Markets and Distribution

Our Consumer Care division focuses on the consumer health market for medicinal products that consumers may generally purchase without a prescription.

The division experiences moderate seasonality, primarily due to the cough/cold market.

The typical sales and marketing channels of the division outside Europe are supermarket chains, drugstores and other mass marketers. In Europe, however, pharmacies are the usual distribution channel. Our principal markets are North America, Europe, Asia and Latin American countries.

Consumer Care procures some high-volume raw materials internally from within Bayer HealthCare. Our major externally procured high-volume raw materials are: Naproxen (the active ingredient of *Aleve*®, *Flanax*® and *Apronax*®), ascorbic acid, citric acid, paracetamol and phenylephrine. Most of these are readily available and are usually not subject to significant price fluctuations. The supply of strategic materials like Naproxen is secured by long term contracts. Changes in crude oil and energy prices can affect a few key items, such as phenol and acetic anhydride, basic materials for our major ingredient acetylsalicylic acid, and aluminum foil. We diversify

our raw materials sources internationally to help balance business risk and generally seek long-term contracts with manufacturers.

We regard Johnson & Johnson (including Johnson & Johnson s recently acquired Pfizer OTC business), Novartis and GlaxoSmithKline as our main competitors. In certain areas we also encounter competition from other companies such as Sanofi-Aventis, Procter & Gamble as well as Schering-Plough and Wyeth.

Research and Development

Consumer Care focuses its development activities on identifying, developing and launching products and initiatives that can contribute to achieving business growth through:

efficient development of new products and indications to support current brands; and

product development, clinical and regulatory strategies, which provide opportunity to capitalize on new technologies, expanded label indications and reclassifications of products from those for which a prescription is required to those dispensed over-the-counter.

The division s primary research and development facilities are located in Morristown, New Jersey and Gaillard, France.

Diabetes Care

Overview

The Diabetes Care division is headquartered in Tarrytown, New York. We support customers by delivering innovative products and services that empower people with diabetes to improve their quality of life.

Major Products

In the Diabetes Care division, we continue to expand the *Ascensia*® brand by introducing several new blood glucose monitoring products. Our key products include two platforms, the multi test platform and the single test strip platform. Our family of multi test products include *Ascensia*® *Breeze*®, *Ascensia*® *Confirm, Ascensia*® *Dex*® and *Ascensia*® *Esprit*. These products incorporate a 10-test disc to provide greater convenience to patients who test their blood sugar levels several times per day. Our family of single strip products includes the *Ascensia Elite*®, *Ascensia Brio*®, *Ascensia*® *Entrust* and *Ascensia*® *Contour*® with its no coding feature for greater convenience and accuracy. This platform serves a wide spectrum of patient needs.

Markets and Distribution

Outside Europe we channel our Diabetes Care products to the consumer market through supermarket chains, drugstores and other mass marketers. In Europe, however, pharmacies are the usual distribution channel. Our principal markets are North America, Western Europe and Japan.

On a worldwide basis, the activities of the Diabetes Care division are not subject to any significant seasonal effects.

We manufacture and/or assemble approximately one quarter (by units) of our own products, with the balance coming from Original Equipment Manufacturer (OEM) suppliers. We rely on a supplier management process to supply raw materials, sub-assemblies and finished goods, most of which are contractually controlled and are not subject to significant price fluctuations or changes in availability.

We do require some direct or OEM materials, the unavailability of which would adversely impact our results of operations. These materials include, for in-house manufacturing, customized integrated circuits and sensors for the *Ascensia*® strips. In these instances, we maintain strategic reserves of selected direct materials or finished products to avoid interruptions in our customers continuous and reliable supply. We maintain a global supplier base with the majority of materials and products being sourced from South-East Asia.

Our primary competitors in the diabetes care market are: Roche Diagnostics, Lifescan (a Johnson & Johnson company) and Abbott Diagnostics.

Research and Development

Our Diabetes Care division focuses its research and development activities primarily on strengthening its core product lines and on expanding into high growth/high margin segments of the market. We achieve this through internal development and collaborations with suppliers of mass market, user-friendly whole blood glucose monitoring systems. In addition, we are actively researching a minimally invasive system that requires only a small blood sample and has a short testing time. Beyond these research and development projects we are investing in technologies that will allow glucose monitoring without painful invasive sampling of body fluids.

During 2006 the division s headquarters as well as the research and development facility were consolidated in Tarrytown, New York.

Our research and development department continued to launch several newer blood glucose monitoring systems during 2006, including the *Ascensia*® system, and has been developing next generation systems that we intend to introduce in 2007 and thereafter.

In July 2006 our Diabetes Care division acquired Metrika Inc., located in Sunnyvale, California. Metrika manufactures and markets a new type of handheld diabetes monitoring system, capable of measuring the long-term diabetes parameter HbA1c, also known as glycated hemoglobin. Through this acquisition we expanded our offerings in diabetes management.

Animal Health

Overview

Our Animal Health division researches, develops and markets new products for the health care of animals. These products are divided between the two business units Food Animal Products and Companion Animal Products. This range of products is supplemented by a line of farm hygiene products as well as cosmetic care products for animals.

Major Products

Bayer Animal Health provides parasiticides such as *K9 Advantix*®, *Advantage*®, *Droncit*®, *Bayticol*® and *Baycox*®, which are most commonly used for flea, tick, mosquito, tapeworm, roundworm and coccidiosis control in cats, dogs, poultry, pigs and other major livestock animals. We provide antimicrobials such as *Baytril*®, which is used for the treatment of severe bacterial infections in animals. Included in our global portfolio are biological vaccines which prevent foot-and-mouth disease in livestock animals and nutritionals, or feed additives, such as vitamins, minerals and others which improve animal health and farm productivity. Our farm hygiene products assist in farm biosecurity management processes and include insecticides for fly control, rodenticides against rats and disinfectants against bacteria.

Markets and Distribution

The Animal Health business covers worldwide markets, including emerging markets such as China, Vietnam and others in South-East Asia. We divide our marketing activities into two main business areas: marketing for food animals, and marketing for companion animals, including horses.

On a worldwide basis, the activities of the Animal Health division are not subject to any significant seasonal effects.

Depending on national legislation, Animal Health products may be available to end users on a prescription or non-prescription basis. Consumers (pet owners) may purchase prescription products directly from veterinarians or from pharmacies with a written prescription issued from a licensed practicing veterinarian. Also, based on national legislation, non-prescription products may be available through retailers, drugstores and other specialized marketers.

We currently obtain the active pharmaceutical ingredients for our veterinary pharmaceutical products either within the Bayer Group or from third parties worldwide. We obtain additional ingredients and packaging materials from diverse suppliers on a worldwide basis. As a rule, we approve our suppliers for each required material. We take measures in order to assure continuous product supply and to reduce the effects of price volatility. This includes entering into long-term contracts or building strategic reserves of the material in question.

Our main pharmaceutical production facilities devoted to formulation and packaging of our products for shipment are Kiel, Germany and Shawnee, Kansas.

Merial, Pfizer and Intervet are our main competitors, with Merial and Pfizer being active in both companion animal and food animal products and Intervet concentrating mainly on food animal products.

Research and Development

The Animal Health division focuses its research and development activities on antimicrobials, parasiticides and active ingredients useful for the treatment of non-infectious diseases in animals such as renal failure, pain management, oncology and congestive heart failure. A particular goal of our research and development efforts is to provide the market with innovative and patent-protected products (new active ingredients, formulations and application technologies).

The division s primary research and development facilities are located in Monheim, Germany and Kansas City, Missouri.

We currently have several products or product families in late stages of development or awaiting regulatory approval. Major products are:

Projects/Products	**Indication**	**Status**
Imidacloprid Combinations	Control of fleas, ticks, heartworm and gastrointestinal worms in cats and dogs	Clinical development; one combination in launch in the United States
Emodepside	Gastrointestinal worms in cats and dogs	Clinical Development; one indication in registration in the United States
Red mite control remedy	Red mite control in Poultry	Submitted
Baycox® calves	Coccidiosis control in calves	In registration
Baytril® swine (North America)	Antimicrobial infections in pigs	In registration
Veraflox® (pradofloxacin)	Antimicrobial for dogs and cats	In development in the United States; resubmission after initial rejection in EU under evaluation
Projects on non-infectious diseases	Renal failure and congestive heart failure in dog and cats	Clinical development started

BAYER CROPSCIENCE

The Bayer CropScience subgroup is presented in the reportable segments Crop Protection and Environmental Science, BioScience.

CROP PROTECTION

Overview

Our Crop Protection segment markets chemical crop protection products for the control of insects, weeds and plant diseases and develops products for enhanced effectiveness against these target pests.

The following table shows Crop Protection s performance for the last three years.

	2004	2005	2006
	(Euros in millions, except percentages)		
Total External net sales	4,957	4,874	4,644
Percentage of total sales from Group continuing operations	23.7%	19.7%	16.0%
External net sales by category of activity			
Insecticides	1,378	1,311	1,219
Fungicides	1,277	1,248	1,200
Herbicides	1,855	1,840	1,758
Seed Treatment	447	475	467
Intersegment sales	71	70	59
Operating result	386	532	384

Crop Protection s sales by region and totals for the past three years are as follows.

	2004	2005	2006
	(Euros in millions)		
Europe	1,898	1,901	1,909
North America	979	1,076	996
Asia/ Pacific	820	811	772
Latin America/ Africa/ Middle East	1,260	1,086	967
Total	4,957	4,874	4,644

The following table shows the segment s sales by major products[a] during the past three years.

	2004		2005		2006	
Product	**Sales**	**Percentage of Segment Sales**	**Sales**	**Percentage of Segment Sales**	**Sales**	**Percentage of Segment Sales**
	(Euros in millions)		**(Euros in millions)**		**(Euros in millions)**	
Confidor®*/ Gaucho*®*/Admire*®[b][c] (Insecticides/ Seed Treatment)	455	9.2	444	9.1	416	9.0
Folicur®*/ Raxil*®[b] (Fungicides/ Seed Treatment)	401	8.1	327	6.7	261	5.6
Basta®*/* Liberty®[b] (Herbicides)	189	3.8	212	4.3	223	4.8
Puma®[b] (Herbicides)	226	4.6	202	4.1	193	4.2
Flint®*/ Stratego*®/Sphere®[b] (Fungicides)	235	4.7	188	3.9	172	3.7
Atlantis® (Herbicides)	97	2.0	142	2.9	169	3.6
Proline® (Fungicides)	23	0.4	91	1.9	144	3.1
Poncho® (Seed Treatment)	57	1.1	110	2.3	127	2.7
Betanal®[b] (Herbicides)	143	2.9	127	2.6	119	2.6
Temik® (Insecticides)	109	2.2	104	2.1	106	2.3
Other	3,022	61.0	2,927	60.1	2,714	58.4
Total	4,957		4,874		4,644	

[a] The amounts shown represent sales by main active ingredient group; for the sake of clarity, however, only the principal brands and categories of activity are listed.

[b] The main active ingredients contained in these products are also used in products sold by the Environmental Science business group. These figures do not include sales by the Environmental Science business group.

[c] The active ingredient imidacloprid contained in these products is also used in the Animal Health segment s *Advantage*® product. These figures do not include sales by the Animal Health segment.

Segment Strategy

Crop Protection aspires, together with Bayer CropScience s Environmental Science, BioScience segment, to be a leading partner in providing products and combined solutions for the production of quality food, feed and fiber. We strive to build long-term, consistent, predictable and mutually beneficial partnerships with our customers and stakeholders. We aim to fulfill our commitment to sustainable development and to achieve long-term profitable growth.

Key factors in achieving our profitability targets are new product launches, further portfolio optimization, fostering marketing excellence and focus on cost management. In addition to our ongoing performance programs, our newly launched cost structure initiative is intended to further enhance efficiency in all areas of Bayer CropScience. We expect this new initiative for the most part to become effective in 2009.

With its Crop Protection business, Bayer CropScience strives to maintain its leading position in the crop protection industry[1] by utilizing its broad regional representation and a well-balanced portfolio comprising innovative, high-performance insecticides, fungicides, herbicides and seed treatment products.

(1) This statement is based on 2005 sales data published in *AgriFutura, The newsletter of Phillips MCDougall-Agriservices, No. 77 (March 2006)* and the moving annual total sales data 2005/2006 published in *Cropnosis Agrochemical Monitor 182 (December 2006)*; the respective publications with data for the full year 2006 have not yet been published as of March 12, 2007.

We attempt to achieve these strategic objectives through the continuous introduction of new products from our research and development pipeline, our life cycle management and the complementary activities of our Environmental Science and BioScience businesses.

Major Products

Insecticides

Imidacloprid (major brands: *Confidor*® and *Admire*®) is an active ingredient in the chemical class of neonicotinoids. It controls a broad range of pests, including sucking pests (*e.g.*, aphids and whiteflies) and biting pests (*e.g.*, leafminers and beetles), and is suitable for a wide variety of application methods, including foliar spray, soil drench, seed treatment and drip irrigation. Imidacloprid is now marketed in more than 100 countries for use on a large variety of crops such as vegetables, fruits, rice, corn, soybeans and cereals.

Aldicarb (major brand: *Temik*®) is a broad-spectrum carbamate insecticide and nematicide in granular form. *Temik*® is applied to soil to protect crop roots from insects and nematodes and to protect against pests such as aphids or mites. *Temik*® is used on a large number of crops, such as cotton, citrus and potatoes.

Deltamethrin (major brand: *Decis*®) is a broad-spectrum pyrethroid insecticide. It is used primarily against biting insects and is also effective against various sucking pests. *Decis*® is marketed in more than 100 countries for use on a wide range of crops (including vegetables, cereals, cotton and soybeans).

Fungicides

Tebuconazole (major brand: *Folicur*®) is a broad-spectrum fungicide registered and sold in about 100 countries for use on numerous crops including cereals, vegetables, fruits, rice, soybeans and peanuts. *Folicur*® is especially effective against Fusarium and rusts (in particular, Asian soybean rust) as well as many other fungal diseases in cereals and is available in many liquid or solid formulations adapted to our customers needs.

Trifloxystrobin (major brand: *Flint*®), the active ingredient of the *Flint*® product family, is sold in more than 80 countries for broad-spectrum disease control in cereals, grapes, rice, soybeans and a wide range of fruit and vegetable crops. The product range consists of solo products and several co-formulations (*e.g.*, *Sphere*®, *Stratego*® and *Nativo*®), all formulated to meet the specific requirements of highly diverse crop production systems under various climatic conditions. In addition to efficient disease control these products offer crop safety and beneficial physiological effects on yield, quality and shelf life of fruit and grain.

Prothioconazole (major brand: *Proline*®) is a broad-spectrum fungicide for use on cereals, canola (oilseed rape), peanuts, soybeans and field vegetables. It provides long-term protection by means of a uniform and stable distribution in the leaves. Products containing prothioconazole are effective against stem-based diseases, leaf diseases, especially Septoria tritici, as well as ear diseases (Fusarium spp) in cereals.

Herbicides

Glufosinate-ammonium (major brand: *Basta*®), Crop Protection s best selling herbicide, is a post-emergence herbicide with a broad-spectrum of efficacy against annual and perennial weeds and grasses. It is primarily used on perennial tree crops, vegetables and non-crop areas and as a harvest aid. The product is also applied as *Liberty*® on herbicide-tolerant canola in Canada, in particular on varieties such as BioScience s *InVigor*®, and as *Ignite*® on herbicide-tolerant cotton in the United States, such as BioScience s *FiberMax*® cotton seeds.

Fenoxaprop-P-ethyl (major brand: *Puma*®) is used in more than 75 countries and is one of the leading products used worldwide against grass weeds in cereals. It is also used in rice, soybeans and canola and controls grass weed problems under a wide range of climatic and soil conditions.

Mesosulfuron-methyl (major brand: *Atlantis*®) belongs to the latest generation of safened cereal herbicide sulfonylureas. These products offer a broad and consistent grass control performance in global wheat production. Our ongoing development of new mesosulfuron-methyl combinations (major brands: *Alister*® and *Olympus*® *Flex*) is expected to continue to position Crop Protection as one of the leaders in cereal herbicides.

Seed Treatment

The insecticidal active ingredient imidacloprid (major brand: *Gaucho*®) is Crop Protection s best selling seed treatment product. It is marketed in over 70 countries for the treatment of early season pests and soil and leaf pests in key crops such as corn, cereals, cotton, sugar beet and soybeans.

Clothianidin (major brand: *Poncho*®) is an insecticidal active ingredient from the chemical class of neonicotinoids, jointly developed by Sumitomo Chemical Takeda Agro Co. Ltd. and Bayer CropScience AG. This active ingredient was developed primarily for the control of the major soil and early season pests in corn, sugar beet, cereals, canola and sunflower.

Tebuconazole (major brand: *Raxil*®) is a fungicide registered in many countries including France, Germany, the United Kingdom, the United States, Canada, Argentina and Australia as a seed treatment to control seed and soil-borne diseases in cereals.

Markets and Distribution

Europe has traditionally been our strongest market in Crop Protection, accounting for about 40 percent of our sales in this segment in 2006. Due to the fact that the major part of our business is realized in the northern hemisphere, the business is affected by the seasonality of the various crop and distribution cycles.

Crop Protection obtains a significant part of its raw materials from LANXESS, as well as from other non-Bayer companies, but also obtains part of its raw materials from within the Bayer Group. Some raw materials can be subject to price volatility caused by fluctuations in the price of crude oil, energy or transport costs.

Generally, we market our Crop Protection products through a two- or three-step distribution system, depending on local market conditions. Under this system, products are sold either to wholesalers or directly to retailers.

Our main competitors in the Crop Protection business are Syngenta, BASF, Dow AgroSciences, Monsanto and DuPont.

Research and Development

Crop Protection operates major research and development facilities on three continents: Monheim (headquarters) and Frankfurt, Germany; Lyon and Sophia Antipolis, France; Stilwell, Kansas and Raleigh, North Carolina; and Yuki City, Japan.

While research is concentrated in specialized sites, development activities range from central facilities to field testing stations across the globe, enabling product testing in the relevant geographical areas.

Crop Protection research and development is responsible for the identification and development of innovative, safe and economically sustainable solutions in crop protection. Research covers activities to identify new active ingredients that can be developed as insecticides, fungicides or herbicides and/or other areas in modern crop protection. In addition to classical chemistry, biology and biochemistry, modern technologies such as combinatorial chemistry, ultra-high-throughput-screening, genomics and bioinformatics play an important role in the identification of new lead structures. Collaborations with third parties supplement our internal research activities.

Once a compound is identified for development, its biological, environmental and toxicological profile, as well as its economic potential, is assessed. Suitable candidates are launched in the market after having obtained the required regulatory approvals.

We actively support our products through continuous life cycle management. This includes the development of new formulations for existing active ingredients and products, *e.g.*, expanding their applicability to additional crops or improving handling and facilitating application of the product.

The following new active ingredients were launched in 2006 or are expected to be launched by Crop Protection in 2007, subject to regulatory approval.

New active ingredients	Product Family	Status
Fluopicolide	Fungicides	Launched in 2006
Flubendiamide	Insecticides	Launch expected in 2007
Tembotrione	Herbicides	Launch expected in 2007

Fluopicolide (major brand: *Infinito*®) belongs to a new chemical class named acylpicolides. Products containing this novel chemical compound have been developed for use to control oomycete diseases in potatoes, vegetables and ornamentals. The new mode of action is intended to enable farmers to control oomycete diseases that are resistant to standard fungicides.

Flubendiamide (major brand: *Belt*®) represents a novel chemical family of substituted phthalic acid diamides with potent insecticidal activity. *Belt*® is a new insecticide for foliar application in annual and perennial crops, offering protection primarily against all major Lepidoptera species. *Belt*® is being co-developed by Nihon Nohyaku Company and Bayer CropScience for worldwide use on vegetables, fruits, cotton, corn, beans, tea and a number of other crops.

Tembotrione (major brand: *Laudis*®) from the triketone chemical family is a new herbicide for foliar application in corn plants. *Laudis*® is a leaf-active substance that eliminates the protection of chlorophyll against UV light in weeds. Tembotrione is applied together with a safener component which enables the corn plants to metabolize the active substance and maintain the carotinoid layer protecting the corn plant against UV light, thereby offering a broad-spectrum weed control.

ENVIRONMENTAL SCIENCE, BIOSCIENCE

Overview

The two business groups Environmental Science and BioScience together form the Environmental Science, BioScience segment.

The following table shows the segment s performance for the last three years.

	2004	2005	2006
	(Euros in millions, except percentages)		
Total External net sales	989	1,022	1,056
Percentage of total sales from Group continuing operations	4.7%	4.2%	3.7%
External net sales by category of activity			
Environmental Science	678	694	714
BioScience	311	328	342
Intersegment sales	7	13	6
Operating result	106	158	200

The segment s sales by region and totals for the past three years are as follows:

	2004	2005	2006
	(Euros in millions)		
Europe	340	340	342
North America	433	452	461
Asia/ Pacific	107	122	135
Latin America/ Africa/ Middle East	109	108	118

Total	989	1,022	1,056

2006 sales of the segments material products were 148 million for *Merit*®/*Premise*® (representing 14.0 percent of total segment sales; compared to 143 million, or 14.0 percent, in 2005 and 148 million, or 15.0 percent, in 2004) and 86 million for *K-Othrine*®/*Deltagard*® (representing 8.1 percent of total segment sales; compared to 68 million, or 6.7 percent, in 2005 and 66 million, or 6.7 percent, in 2004). The foregoing amounts represent sales by main active ingredient group, however we only listed the principal brands. Apart from these two products, no product of this segment accounted for more than 5 percent of total segment sales in 2006, 2005 or 2004.

Segment Strategy

The segment Environmental Science, BioScience complements Bayer CropScience by addressing specific market needs. Environmental Science capitalizes on Crop Protection s development and production facilities and its pipeline of new active ingredients. BioScience leverages on Crop Protection s customer base and biological competence in bringing seeds and plant biotechnology products to the market.

Environmental Science is among the leading suppliers for non-agricultural pest control solutions worldwide in terms of sales. Our strategy is to strengthen our market position by developing and marketing quality products and providing solutions with health or hygiene benefits or that will allow growth of healthier plants and lawns. Our objectives also include the development of strong partnerships with our customers and the focus on proximity innovations , the ability to offer customized brand-connected solutions.

BioScience is internationally active in the research, development and marketing of seeds and solutions derived from plant biotechnology and breeding. Our strategic approach comprises three business fields: In Agricultural Seeds, we focus on delivering conventional and plant biotechnology seeds with improved performance and quality, particularly in respect of our three core crops cotton, canola (oilseed rape) and rice. In New Business Ventures, we are developing plant-derived materials for applications in fields such as nutrition, health and biomaterials. In the Vegetables field, we believe that the Nunhems unit of BioScience is among the leading developers and suppliers of high-quality vegetable seed varieties. Within all three business fields, we intend to pursue growth opportunities.

Environmental Science

Overview

Environmental Science serves non-crop professional and consumer markets worldwide, by developing and marketing products for the green industry (including the treatment of golf courses and industrial vegetation management), lawn, garden and household care, professional pest control, termite and vector control and rural hygiene. Our product portfolio includes a wide range of insecticides, fungicides and herbicides.

Major Products

Merit® and *Premise*® are our major imidacloprid-based insecticides. *Merit*® is used in the green industry, in particular in turf and ornamentals. It controls a large spectrum of insects such as grubs and cutworms. *Premise*® is a product for termite control.

K-Othrine® and *Deltagard*® (our major deltamethrin-based brands) control a large spectrum of flying and crawling insects. Deltamethrin has been used for many years to control insect-borne diseases such as malaria and is recommended by the World Health Organization for that purpose.

Maxforce® is an insecticide used in passive treatment applications such as gels and baits. *Maxforce*® s range of products includes the active ingredients fipronil, hydramethylnone or imidacloprid and controls a large number of crawling insects.

Our consumer-branded products intended for sale to non-professional users and leisure gardeners are marketed under the umbrella brands *Bayer Advanced*® in the United States and *Bayer Garden*® in Europe.

Markets and Distribution

Environmental Science s business is subject to seasonality. This seasonality is particularly pronounced for the consumer branded lawn and garden business.

Environmental Science obtains a significant part of its raw materials from within the Bayer Group, but also enters into agreements with non-Bayer companies. Some raw materials may be subject to price volatility caused by fluctuations in the price of crude oil, energy or transport costs.

Our products are sold in the non-crop professional and consumer markets. For professional markets, products are sold to the green industry, the pest control industry and the public health and rural hygiene sectors. In the consumer business, lawn and garden products are sold to consumers through specialized distribution channels. Active ingredients are sold to marketers of household products.

Dow AgroSciences, Syngenta, BASF and Scotts are our main competitors in the overall Environmental Science business.

Research and Development

The molecules discovered by Crop Protection research are also tested and evaluated in Environmental Science for potential development. Molecules from other companies may be tested and purchased if suitable. Development projects include passive treatments (gels, baits) and formulations to control insects, as well as new herbicide products and new mixtures of fungicides for the turf and ornamental market segments.

In 2006, our key launches were the fungicide *Tartan*™ (based on trifloxystrobin and triadimefon) and the insecticide *Forbid*™ (spiromesifen-based) in the green industry and the sprayable *Quickbayt*® (imidacloprid-based) for fly control in professional pest control applications. In 2007 we expect to launch, among others, *Termite Killer Granules* (imidacloprid-based) and *All-In-One Lawn Weed & Crabgrass Killer* (based on 2,4-D and dicamba) for the pest and weed consumer market in the United States, and the insecticide *Exemptor*® (thiacloprid-based) in the green industry in Europe.

BioScience

Overview

BioScience focuses on the research, development and marketing of conventional and genetically enhanced seeds and other plant biotechnology products.

Major Products

With Nunhems (*Nunhems*®), BioScience is one of the leading developers and suppliers of high-quality vegetable seed varieties that are marketed to professional growers, plant propagators, seed dealers and the fresh produce and food processing industries. The main crop seeds are carrots, onions, melons, leeks and tomatoes.

FiberMax® cotton seed brand is marketed in the United States, Greece, Spain and Turkey as well as Brazil and Mexico. *FiberMax*® varieties offer cotton growers high performance in lint yield and fiber quality as well as advanced technologies for insect control and herbicide resistance.

InVigor® hybrid canola varieties are available to farmers in Canada and the United States. *InVigor*® hybrid canola varieties provide high yield and require less cultivation, due to their tolerance to glufosinate-ammonium. BioScience promotes the application of *Liberty*® herbicides, developed and marketed by our Crop Protection segment, for use on *InVigor*® varieties.

Arize® is the trademark for our hybrid rice seed offering a high-yield, high quality solution requiring less seeds per hectare than conventional rice. It has been introduced in India, the Philippines, Indonesia, Brazil and Vietnam.

Markets and Distribution

BioScience markets its seeds to growers, distributors and processing industries. We distribute plant biotechnology traits either through out-licensing to seed companies for incorporation in their own commercial seeds or through our own seed companies, mainly under either the *InVigor*® or *FiberMax*® brands. In some cases, traits are provided to other companies that utilize the technology in their own research.

Due to the fact that the major part of our business is realized in the northern hemisphere, the business is affected by the seasonality of the crop and distribution cycles.

In the bio science business, Monsanto, DuPont/ Pioneer and Syngenta are the market leaders.

Research and Development

The primary BioScience research facilities are located in Lyon, France; Haelen, The Netherlands; Gent, Belgium; and Potsdam, Germany. Our main development sites are in the United States, Canada, Brazil, India and Australia.

Plant biotechnology research and development is predominantly directed towards agronomic and quality improvement. The technologies used include all relevant tools from identifying the gene of interest to developing it necessary to improve key crops (cotton, canola and rice) for growers and industrial partners. Research activities range from the exploration of novel agronomic traits to the discovery of new plant-based specialty products for the nutrition, health and biomaterials markets. This includes plants with improved stress tolerance (*e.g.*, drought resistance), health-promoting canola oils and the manufacture of materials based on renewable sources.

Our growth is supported by continuous new product introduction. We launched eight new varieties of cotton and four rice varieties in 2006. In 2007, we expect to launch several new varieties of cotton and one of canola.

BAYER MATERIALSCIENCE

The Bayer MaterialScience subgroup is presented in the reportable segments Materials and Systems.

MATERIALS

Overview

As described under *History and Development of the Company*, we have divested our H.C. Starck business and are in the process of divesting our Wolff Walsrode business. Both businesses are reported as discontinued operations. For details see Item 5, *Operating and Financial Review and Prospects Operating Results 2004, 2005 and 2006 Discontinued Operations*. As the divestiture of Wolff Walsrode has not yet been completed as of the date of this annual report on Form 20-F, details on this business also appear in this section under *WOLFF WALSRODE (Discontinued Operation)*.

As a result of the divestiture of H.C. Starck and the pending divestiture of Wolff Walsrode, our Materials segment now comprises the business units Polycarbonates and Thermoplastic Polyurethanes. The segment data appearing in the following tables for 2004 and 2005 have been restated to reflect the removal of H.C. Starck and Wolff Walsrode from the Materials segment.

The following table shows the segment s performance for the last three years.

	2004	2005	2006
	(Euros in millions, except percentages)		
Total External net sales	2,217	2,837	2,925
Percentage of total sales from Group continuing operations	10.6%	11.4%	10.1%
External net sales by category of activity			
Polycarbonates	2,035	2,645	2,720
Thermoplastic Polyurethanes	182	192	205
Intersegment sales	13	14	25
Operating result	184	514	289

The segment s external sales, by region and in total, for the past three years are as follows.

	2004	2005	2006
	(Euros in millions)		
Europe	863	1,063	1,100
North America	481	609	599
Asia/ Pacific	716	908	947
Latin America/ Africa/ Middle East	157	257	279
Total	2,217	2,837	2,925

Sales of the segments material products in 2006 were 1,443 million for the *Makrolon*® product family (representing 49.3 percent of total segment sales, compared to 1,513 million, or 53.3 percent, in 2005 and 1,088 million, or 49.1 percent, in 2004) and 563 million for *Bayblend*® (representing 19.3 percent of total segment sales, compared to 485 million, or 17.1 percent, in 2005 and 360 million, or 16.2 percent, in 2004). Apart from these two products, no product of this segment accounted for more than 5 percent of total segment sales in 2006, 2005 or 2004.

Segment Strategy

Our goal is to continue expanding our global market positions by exploiting the growth potential of our portfolio. The completion of initial investment projects in Asia supports our strong commitment to this fast growing region. We continue to look for opportunities to further strengthen our position in the Materials segment. We intend to enhance the segment s overall performance by making its research and development, marketing and administration structures more efficient and continuously improving its cost position.

We have recently started production in the first phase of our new world-scale polycarbonate production plant in Asia, which shares an integrated production site with the production of diphenylmethane diisocyanate (MDI) discussed under *Bayer MaterialScience Systems* below. We believe that this plant will help Polycarbonates (PCS) to improve its cost competitiveness and its access to state-of-the-art technology in this growth region. We plan further capacity expansions to meet growing demand for polycarbonates. We plan to monitor the product life cycles of current applications and to allocate sufficient resources for product and application development in growth segments. In addition to our current expansion in China, we intend to evaluate potential business opportunities in other regions on an ongoing basis in an effort to extend our market coverage. In our Compounding business, we intend to strengthen our business by increasing our geographic coverage. For our semifinished products in Polycarbonate Films and Sheets, we continue to strive for profitability with a focus on products with strong growth prospects.

Thermoplastic Polyurethanes (TPU) continues to shift its business focus towards high margin growth products. With this new focus, TPU intends to reach and maintain higher levels of profitability. With our acquisition of the Ure-Tech Group in Taiwan, expected to be completed in the second quarter of 2007, we intend to increase TPU s market share in Asia.

Polycarbonates

Overview

With its broad product portfolio, our business unit Polycarbonates (Polycarbonates, Polycarbonate Blends, Polycarbonate Films and Sheets) includes some of the leading global suppliers and manufacturers of engineering polycarbonates (based on capacity). Our Bayer Sheet Europe GmbH (formerly Makroform GmbH) has a strong position as a supplier of polycarbonate sheets. Our products have chemical and physical properties that enable them to resist low or high operating temperatures as well as corrosive chemicals and solvents.

Major Products

Polycarbonates (Makrolon®/APEC®)

Polycarbonates are plastics that are transparent and highly stable across a wide temperature range. Because of their light weight, impact stability and design flexibility, polycarbonates are used in the electrical/electronic industry in general and in the field of optical data storage media (such as pre-recorded and recordable CDs and DVDs), in particular and for injection molding purposes. The construction industry is also a major user of polycarbonates, for example, for polycarbonate sheet applications. *Makrolon®* is our leading polycarbonate product range. Our other polycarbonates include the *APEC®* product range for high temperature uses, for example as components for automobile headlights.

Polycarbonate Blends (Bayblend®/Makroblend®)

Blend technology can transform a palette of a few basic polymers into a wide range of new, advanced polymers with tailored properties, creating user-specific solutions. Polycarbonate blends are widely used in the automotive, electrical/electronic and business machine industries. The *Bayblend®* product lines of amorphous, thermoplastic polymer blends based on polycarbonate and ABS (acrylonitrile/butadiene/styrene) are our leading blends for a broad range of applications. *Makroblend®* is our brand name for engineering thermoplastics blends based on Polybutylene Terephthalate (PBT) or Polyethylene Terephthalate (PET).

Polycarbonate Films

Polycarbonate films, *Makrofol®*, are made of our polycarbonate *Makrolon®* and are characterized by product attributes such as high heat resistance, good printability and graphic quality. The polycarbonate films of our *Makrofol®* range are used for applications such as instrument dials, automotive heater control panels, nameplates and a variety of film insert molding parts (a combination of a back printed and formed foil with *Makrolon®* and *Bayblend®*) as well as for security identification cards.

Bayfol® is the trade name of our films made of polycarbonate blends and other polymers. *Bayfol®* CR films are noted for their strong chemical resistance and enhanced flexibility compared with pure polycarbonate film. They are both thermo formable and cold formable, with good electrical insulating and dielectric properties, and are easily printable with standard inks. Their main application areas are keypads or housings in the information technology industry. Further applications are in the area of IMD (In Mold Decoration) technology and automotive interior applications.

Polycarbonate Sheets (Fabricated Products)

We also produce solid and multiwall sheets with a broad range of characteristics for a wide variety of applications. These materials consist of polycarbonates, polycarbonate blends or thermoplastic polyesters. We market our sheets as *Makrolon®, Bayloy®, Vivak®* and *Axpet®*. *Makrolon®*, which accounts for the largest share of our revenues from sheets, is a material with high impact resistance and can be exposed to a wide range of temperatures.

Markets and Distribution

We sell the products of our Polycarbonates business entities to numerous customers worldwide. These customers include injection-molding operators and a large number of plastic-component manufacturers, whose products are predominantly used in the automotive, electrical, electrical engineering, construction, data technology, medical and leisure industries. We have recently commenced polycarbonate production at our new unit at the Bayer integrated polymers production site in Caojing, China. The unit s initial capacity is 100,000 tons per year. The new plant represents the first time that Bayer has installed a melt polycarbonate process on such a large scale.

Depending on the region and the general economic situation, sales of polycarbonates may show moderate seasonality. Generally, sales are lower in the first quarter in all regions.

Bayer does not produce basic petrochemicals. The principal petrochemical raw materials consumed by our Polycarbonates business unit are acetone and phenol, supplied exclusively by third parties. We do produce Bisphenol-A, which is a major precursor of polycarbonate based on phenol and acetone. Our costs are affected by fluctuations in raw material prices, mainly driven by the price volatility of crude oil and benzene. We typically procure third-party raw materials under long-term contracts that contain cost-based and market price formulas, which partially reduce raw material price fluctuation.

We market substantially all of our plastic products through regional distribution channels, supported by regional competence centers and by our head office. In addition, we also use trading houses and local distributors to work with small volume customers.

Our major global competitors are GE Plastics and Dow Chemical. In the Asia/Pacific region we also compete with a number of local competitors.

Research and Development

Our Polycarbonates business unit allocates resources for research and development both to process and product development, with the aim of constantly improving our manufacturing processes and of developing new formulations and applications of our products. The primary research and development facilities are located in Krefeld-Uerdingen, Leverkusen and Dormagen, Germany and Pittsburgh, Pennsylvania. The Polycarbonates business unit is also part of the new polymers research and development center (PRDC), at Pudong, China (near Shanghai) together with the other Bayer MaterialScience (BMS) business units.

We are currently working further on the optimization of our new polycarbonate melt manufacturing process. Other current projects relate to the analysis of our existing manufacturing processes to improve both product quality and cost performance.

In product development, we focus our activities on developing new blends, refining material for optical data storage, developing modified base materials for polycarbonate sheets and modifying the surface of polycarbonates using various coating technologies. Examples of our development areas are set forth in the following table:

Product/ Brand Name	**Application**
Surface-modified *Makrolon*®	Automotive, extrusion, architecture, electrical
Improved *Makrolon*® ODS grade	New ODS formats, such as Blue Laser based disks and HD-DVD
Extension of *Bayblend*® FR series	Business machines/ information technology
Makrolon® with improved flame retardant	Electrical, automotive
Diffusor sheets for LCD Screens	Electrical/electronic

In the area of polycarbonate films, we are developing value added films (comprising new resins as well as surface-modified films) to enter new market segments such as soft touch coated *Makrofol*® films interior parts used in the automotive industry and mobile phone housings.

Thermoplastic Polyurethanes

Overview

Our Thermoplastic Polyurethanes business unit develops and markets a wide variety of granules that serve as raw materials for extrusion, blow molding, calandering and injection molding processed products. Additionally, our subsidiaries Epurex Films (Germany) and Deerfield Urethane (Massachusetts) manufacture different grades of thermoplastic polyurethane films (TPU films).

Major Products

Thermoplastic polyurethanes, or TPUs (TPU Resins and Films), belong to the family of high-performance thermoplastic elastomers and possess a combination of properties such as high resilience, abrasion resistance and flexibility. We market our thermoplastic polyurethanes granulates under the trademarks *Desmopan®, Texin®* and *Desmomelt®*. TPU-containing elastomer compounds are also developed and marketed cooperatively by BMS and PTS (Plastic Technologie Service Marketing & Vertriebs GmbH) under the trademark *Desmoflex®*. Our TPU films are marketed under the trademarks *Walotex®*, *Walopur®,* and *Platilon®* (Epurex Films) and *Dureflex®* (Deerfield Urethane). The acquisition of the Ure-Tech Group in Taiwan, expected to be completed in the second quarter of 2007, will add products under the trademark *Utechllan®* to our portfolio.

Markets and Distribution

Our Thermoplastic Polyurethanes business entities (TPU Resins and TPU Films) primarily serve customers in the sports and leisure, automotive and engineering industries; other users include the textile, cable and agricultural industries (*e.g.*, animal ear tags).

Temporary fluctuations in prices for raw materials and energy can have an impact on the cost of our products. We secure our most important chemical raw materials through long-term contracts.

Our head office in Leverkusen, Germany, has global responsibility for the business. We coordinate and carry out our sales and marketing from Leverkusen, Germany, for the regions Europe, Middle East, Africa and Latin America, from our regional hubs in North America (Pittsburgh) and the Asia/ Pacific region (Hong Kong), and through our various national subsidiaries.

We regard the following companies as the main competitors of our TPU business entities:

TPU Resins: BASF/ Elastogran, Lubrizol/ Noveon, Huntsman, Dow Chemical;

TPU Films: Stevens Urethane, Fait Plast, Ding Zing.

Research and Development

The bulk of research and development activities conducted by the Thermoplastic Polyurethanes business entities consists of developing high performance thermoplastic polyurethanes resins and films, such as highly UV-stable and transparent grades for foils in solar modules.

TPU Resins primary development facilities are located in Dormagen, Germany and Pittsburgh, Pennsylvania. The development facilities of TPU Films are located in Bomlitz, Germany (Epurex Films) and in Whately, Massachusetts (Deerfield Urethane).

SYSTEMS

Overview

Our segment Systems comprises the business units Polyurethanes; Coatings, Adhesives, Sealants; and Inorganic Basic Chemicals.

The following table shows the segment s performance for the last three years.

	2004	2005	2006
	(Euros in millions, except percentages)		
Total External net sales	5,349	6,609	7,236
Percentage of total sales from Group continuing operations	25.6%	26.8%	25.0%
External net sales by category of activity			
Polyurethanes	3,872	4,792	5,182
Coatings Adhesives Sealants	1,237	1,330	1,488
Inorganic Basic Chemicals	218	380	403
Others	22	107	163
Intersegment sales	116	142	138
Operating result	348	736	703

The segment s external sales, by region and in total, for the past three years are as follows.

	2004	2005	2006
	(Euros in millions)		
Europe	2,494	3,035	3,302
North America	1,483	1,891	2,023
Asia/ Pacific	822	979	1,060
Latin America/ Africa/ Middle East	550	704	851
Total	5,349	6,609	7,236

2006 sales of the segments material products were 3,004 million for *Desmodur®/Mondur®* products (representing 41.5 percent of total segment sales, compared to 2,613 million, or 39.5 percent, in 2005 and 2,242 million, or 41.9 percent, in 2004) and 741 million for *Arcol®* (representing 10.2 percent of total segment sales, compared to 724 million, or 11.0 percent, in 2005 and 536 million, or 10.0 percent, in 2004). Apart from these two products, no other product of the segment accounted for more than 5 percent of segment sales in 2006, 2005 and 2004.

Segment Strategy

Our goal is to continue expanding our global market positions by exploiting the growth potential of our portfolio. The completion of initial investment projects in Asia supports our strong commitment to this fast growing region. We continue to look for opportunities to further strengthen our position in the Systems segment. We intend to enhance the segment s overall performance by making its research and development, marketing and administration structures more efficient and continuously improving its cost position.

We believe that the completion of the first phase of our world scale diphenylmethane diisocyanate (MDI) production facility in Asia will help Polyurethanes to improve its cost competitiveness and its access to state-of-the-art technology in this growth region. We intend our focus on quality, as well as on product and process innovation, to enhance our penetration of the strong growing Asia markets. With further increase of our MDI capacity, we intend to help meet the increasing global demand for these products. Portfolio management activities are planned in selected segments to improve profitability by shifting the focus towards high value products. Furthermore, we are planning to build a world-scale production facility for toluene diisocyanate (TDI) in Asia.

The business unit Coatings, Adhesives and Sealants intends to focus its activities on defending its market position in the field of Base Modified Isocyanates. We intend to meet increasing demand in growth regions by extension

and/or adaptation of our production facilities. In the field of Resins we intend to strive for profitability improvement by focusing on modern technologies and portfolio optimization. A stronger focus on high margin products is expected to further contribute to this goal.

Inorganic Basic Chemicals provides basic raw materials such as chlorine and caustic soda to the business units Polyurethanes; Coatings, Adhesives, Sealants; and Polycarbonates, as well as to third parties, using its modern technology. In an effort to ensure the best possible cost position and uninterrupted supply, various strategic options to produce such basic raw materials or to buy them from third parties are being pursued depending on the specific characteristics of our production sites.

The entity New Business within BMS identifies and evaluates market and technology trends across all of BMS business units and devolves business ideas into projects to develop new products and applications that extend beyond our existing core business of the company.

Polyurethanes

Overview

Our Polyurethanes business entities (MDI, TDI, Polyether) focus on the development, production and marketing of isocyanates and polyol materials for polyurethane formulations and systems used in producing a wide variety of polyurethane polymers for a broad range of industrial and consumer applications.

Major Products

Polyurethanes are polymers formed through the reaction of two liquid chemicals: an isocyanate typically diphenylmethane diisocyanate (MDI) or toluene diisocyanate (TDI) and a polymeric alcohol such as polyether polyols. We produce a range of different isocyanates and polyether polyols under such brand names as *Desmodur*® and *Desmophen*®. The characteristics of a given polyurethane depend on both the material components used as well as the precise proportion of each in the mix.

Our customers use our isocyanates or polyether polyols, or both, to create their own specific polyurethane formulations. In addition, we design and evaluate custom blends to meet specific customer requirements. The customer receives a ready-to-use two-component system. The precise formulation of each custom blend is proprietary.

Typical applications for which our customers use our polyurethane materials include furniture, mattresses, shoes, automotive components, appliances, sport and leisure equipment and construction.

Markets and Distribution

Europe and the NAFTA nations remain the primary markets for our Polyurethanes business entities, with the Asian market showing the strongest prospects for future growth.

The predominant cushioning material for upholstered furniture manufactured today is flexible polyurethane foam. For our customers applications, we are currently aware of no man-made or natural substitute materials that could replace significant amounts of flexible polyurethane foams in substantial quantity. Rigid polyurethane foam is used for thermal insulation purposes in competition with other insulating materials such as mineral fibers and polystyrene foam. Polyurethane elastomers compete with other thermoplastic materials on cost, performance and fit with the production mix at the customer s site.

In the automotive area, there is constant competition between polyurethanes and other polymers in many applications due to the required physical properties, costs, design or functional requirements.

On a worldwide level, the Polyurethanes business entities sales are not subject to significant seasonality. On the regional level, business can display seasonality where, for example, revenue depends on such seasonal industries as construction and other outdoor applications.

The basic raw materials for our isocyanates and polyols are petrochemical raw materials. We typically purchase these on the open market mostly under long-term contracts, as Bayer generally does not produce petrochemicals. However, through a global joint venture with Lyondell, we have acquired a source for propylene oxide, one of our key raw materials. These petrochemical raw materials are subject to price fluctuation driven by supply and demand factors and price volatility in the crude oil and derivates markets.

The Polyurethanes business entities coordinate and carry out their sales and marketing from the head office in Leverkusen, Germany, and through our various national subsidiaries. Our key account managers serve our globally active major customers directly. To a much smaller degree we sell our products through systems houses and traders. Systems houses are focused regionally and typically serve smaller-volume customers.

To further increase efficiency along the supply chain, we have established regional service centers. They act as a central point of contact for customers on all issues concerning order processing, logistics and billing.

Our main competitors for the Polyurethanes business entities are BASF, Dow Chemical and Huntsman.

Research and Development

The business entities primary research and technical development facilities are located in Dormagen and Leverkusen, Germany; Pittsburgh, Pennsylvania, South Charleston, West Virginia; Amagasaki, Japan; and Shanghai, China.

The main areas of innovation in the polyurethane field are currently the development of new or improved polyether polyol types and blends as well as the improvement of manufacturing processes. The Polyurethanes business entities concentrate their research and development efforts with respect to aromatic isocyanates on improving existing products and technologies for their manufacture. Our TDI facility in Caojing, China, that is planned to come on stream in 2009, will use such improved manufacturing processes. High-throughput experiments are used for the development of new formulations and are intended to help to reduce time-to-market for new products.

In product development, we focus our activities on extending the applications for new composite materials. We also work to improve flame resistance and thermal insulation properties. We develop other materials for durability aspects using various technologies as summarized in the following table:

Product/Brand Name	**Application**
Baypreg® F	Automotive door trim carrier
Multitec®	Bathtubs, hood/fender for agricultural vehicles
Baydur®	Combinations with wood

Coatings, Adhesives, Sealants

Overview

Our Coatings, Adhesives, Sealants business entities (Resins, RES; Base and Modified Isocyanates, BMI) develop and market a wide variety of products that serve as raw materials for lacquers, coatings, sealants and adhesives.

Major Products

Resins and Hardeners

Polyurethane lacquers are formed through the combination of an isocyanates component with a polyol-like polyester, polyacrylate-polyether- or polycarbonate-polyols. We offer a variety of polyol components branded as *Desmophen*®*, Rucote*® and *Bayhydrol*® (RES) and polyisocyanates such as *Desmodur*®, *Desmodur*® *BL, Crelan*® and *Bayhydur*® (BMI). This variety enables us to provide custom-tailored solutions for a number of different applications.

Special raw materials

Our special material unit produces such specialty products as *Pergut*® (RES) for coatings and adhesives, *Impranil*®, our polyurethane coating systems for textiles, and *Baybond*® for glass fiber sizing.

Adhesive raw materials

Dispercoll®, Desmocoll® and *Baypren®* (RES) are our raw materials for adhesives. Their primary users are shoe manufacturers, although we also have customers from the automotive, furniture and building industries.

Markets and Distribution

Our Coatings, Adhesives, Sealants business entities are a major producer of raw materials for coatings and adhesives. The primary ultimate end users of our products are the automotive, furniture, plastics, construction and adhesives industries; other users include the textile, shoe and building industries.

Generally, our revenue is not subject to significant seasonality. Some of the individual markets and regions that we serve experience seasonal fluctuation, such as the building industry during the winter months or southern Europe during the summer.

Temporary fluctuations in prices, such as the price of crude oil or energy, can have a significant effect on the cost of our raw materials. We secure our most important chemical raw materials primarily through long-term contracts.

We coordinate and carry out our sales and marketing from our head office in Leverkusen, Germany, and through our various national subsidiaries. Our key account managers serve our globally active major customers directly.

We regard the following companies as the chief competitors of our Coatings, Adhesives, Sealants business entities.

Resin components (RES): Cytec, Cray Valley, DIC (Dainippon Ink and Chemicals), DSM, Eternal, BASF;

Aliphatic isocyanates (BMI): Rhodia, Degussa, BASF, Asahi Kasei, NPU (Nippon Polyurethane Industry);

Aromatic isocyanates (BMI): Dow Chemical, Mitsui Chemicals, SAPICI.

Research and Development

The Coatings, Adhesives, Sealants business entities focus their research and development activities on developing products that we can formulate into high performance coatings, adhesives and sealants, such as aliphatic and aromatic polyisocyanates and resin components. We are also exploring ways of reducing the amount of solvent needed by technologies such as high solids and waterborne and powder coatings systems.

We are working, together with the U.S. company InPhase Technologies on the development of new photoactive polymers for holographic data-storage applications. InPhase s first generation product will be a read-only memory storage medium holding 300 GB of data.

In collaboration with the British coatings manufacturer E. Wood, we are developing a polyurea system based on a special aliphatic polyisocyanate. This new formulation is used for the rehabilitation of drinking water pipes.

The business entities primary research and development facilities are located in Leverkusen, Germany and Pittsburgh, Pennsylvania and Shanghai, China.

Inorganic Basic Chemicals

Overview

The business unit Inorganic Basic Chemicals (IBC) produces inorganic basic chemicals such as chlorine, caustic soda, hydrogen and hydrochloric acid. Its focus is on the safe and cost-efficient supply of chlorine to internal and external customers.

Major Products

Inorganic basic chemicals are of major importance for Bayer MaterialScience (BMS): about 70 percent of BMS sales are dependent on chlorine. Chlorine is used for the production of intermediates that are subsequently processed into a variety of products, such as polyurethanes and polycarbonates. The four IBC production sites in Leverkusen, Dormagen and Krefeld-Uerdingen, Germany and Baytown, Texas have a total chlorine capacity of around 1.4 million metric tons per year. At sites where Bayer does not produce any chlorine, IBC supports external chlorine procurement.

In addition to chlorine, sodium chloride electrolysis generates caustic soda and hydrogen. These by-products, as far as they are not used internally, are sold in external markets.

During the processing of chlorine into intermediate products, hydrochloric acid may be produced. If it is not sold or used internally, it is recycled in the hydrochloric acid electrolysis units of IBC in Leverkusen and Dormagen, Germany and Baytown, Texas.

Markets and Distribution

In general, chlorine is supplied by pipeline to internal and external customers located at Bayer sites where chlorine is produced. IBC markets the caustic soda and hydrochloric acid that is not used internally to customers from various industries worldwide.

The main raw materials for chlorine production are sodium chloride and electrical power. Sodium chloride is purchased on the open market under long term contractual agreements and therefore generally not subject to price volatility. Power is purchased via Bayer Industry Services in Germany. In 2006, our costs for electrical power increased by about 20 percent due to increased market prices.

Our main competitors are Dow Chemical, Solvay, Akzo Nobel, BASF, Vestolit, Ineos, Olin, PPG and Formosa Plastics.

Research and Development

Processes and plants are continuously enhanced and optimized within IBC while keeping in mind environmental compatibility. The main area of innovation in chlorine production is currently the development of the Oxygen Depolarized Cathode (ODC) in sodium chloride alkali (sodium chloride) and hydrochloric acid membrane electrolysis to significantly reduce power consumption. We intend to use this technology to supply the isocyanate production in Caojing, China, with chlorine beginning in 2008.

WOLFF WALSRODE (Discontinued Operation)

Overview

In December 2006, Bayer signed an agreement with Dow Chemical Company concerning the sale of Bayer s Wolff Walsrode business. The sale is subject to the approval of the relevant antitrust authorities. Assuming these approvals are received, we expect the closing of the transaction to occur by the end of the first half of 2007. The Wolff Walsrode business is reported as discontinued operations prior to the sale. For details refer to Item 5, *Operating and Financial Review and Prospects Operating Results 2004, 2005 and 2006 Discontinued Operations* and Note 7.2 to the consolidated financial statements contained elsewhere in this annual report on Form 20-F.

The following table shows Wolff Walsrode s performance in the last three years.

	2004	2005	2006
	(Euros in millions)		
External net sales	328	329	334
Operating result	40	36	40

Overview

We operate the Wolff Walsrode business primarily through Wolff Walsrode AG, our wholly-owned subsidiary, assisted by other companies of the Bayer Group. The Wolff Walsrode business develops, produces and markets cellulose derivatives as well as various sausage casings.

Major Products

Cellulose Derivatives

Walocel®M is an additive that regulates water balance. It improves the workability and adhesion of building materials such as tile adhesives, plasters, mortars and dispersion paints.

Walsroder® NC serves in resin form in wood coatings and other industrial coatings as well as in printing inks for flexible packaging. It is also used as a component of nail polish and other specialty items.

Walocel®C is used primarily as a thickener and binder in water-based systems. It is used in pharmaceuticals, dairy products and toothpaste, as well as in ceramics compounding, textile and paper manufacture and oil drilling.

Other

Under the brand name *Walsroder®*, we offer a wide range of sausage skins for industrial or handcraft usage.

INTELLECTUAL PROPERTY PROTECTION

To succeed, Bayer must continually seek new products that provide our customers with better solutions for existing problems and new solutions for emerging problems. This requires us to expend significant effort on research, development, manufacturing and marketing. To preserve the value of our investment, we rely on the patent and trademark laws of the jurisdictions where we do business. In addition, our production technologies typically incorporate specialized proprietary know-how.

We have both developed intellectual property internally and acquired it as assignee through acquisitions. In addition, Bayer may from time to time grant licenses to third parties to use our patents and know-how, and may obtain licenses from others to manufacture and sell products using their technology and know-how.

Patents

We seek to protect our products with patents in major markets. Depending on the jurisdiction, patent protection may be available for:

individual active ingredients;

specific compounds, formulations and combinations containing active ingredients;

manufacturing processes;

intermediates useful in the manufacture of products;

genomic research; and

new uses for existing products.

The protection that a patent provides varies from country to country, depending on the type of claim granted, the scope of the claim s coverage and the legal remedies available for enforcement. For example, although patent protection in the United States is generally strong, under some circumstances, U.S. law permits generic pharmaceuticals manufacturers to seek regulatory approval of generic products before the patents expire. See Item 8, *Financial Information Legal Proceedings.* In addition, some developing countries have announced plans to reduce patent protection for some drugs.

The advance of genomic research has accelerated our patent filings for biological products. We typically seek protection upon determining a gene s function.

We currently hold thousands of patents, and have applications pending for a significant number of new patents. Although patents are important to our business, we believe that, with the exception of the patents covering *Adalat*®, *Avelox*®, *Betaferon*®, *Campath*®, *Cipro*®, *Leukine*®, *Levitra*®, *Magnevist*®, *Mirena*®, *Ultravist*® and *Yasmin*® and imidacloprid, no single patent (or group of related patents) is material to our business as a whole.

Term and Expiration of Patents

Patents are valid for varying periods, depending on the laws of the jurisdiction granting the patent. In some jurisdictions, patent protection begins from the date a patent application was filed; in others, it begins on the date the patent is granted.

The European Union, the United States, Japan and certain other countries extend or restore patent terms or provide supplementary protection to compensate for patent term loss due to regulatory review and substantial investments in product research and development and regulatory approval. Our policy is to obtain these extensions where possible.

Patent protection in our major markets for some of our key products is scheduled to expire in the near term. Although the expiration of a patent for an active ingredient normally results in the loss of market exclusivity, we may continue to derive commercial benefits from:

subsequently granted patents on processes and intermediates used in manufacturing the active ingredient;

patents relating to specific uses for the active ingredient;

patents relating to novel compositions and formulations; and

in certain markets (including the United States), market exclusivity under laws other than patent laws.

The following table sets forth the expiration dates in our major markets of the patents covering *Adalat*®, *Avelox*®, ciprofloxacin, imidacloprid, vardenafil, sorafenib, *Betaseron*®, *Yasmin*®, *Magnevist*®, *Ultravist*®, *Mirena*®, *Campath*® and *Leukine*®:

	Market							
Product	**Germany**	**France**	**U.K.**	**Italy**	**Spain**	**Japan**	**U.S.A.**	**Canada**
Adalat®								
Crystal patent (Retard)							2010	
Adalat® CC (Coat Core)	2008	2008	2008	2008	2008	2008	2008	2009
Avelox®								
Compound	2014	2014	2014	2014	2014	2009	2014	2015
Hydrochloride-Monohydrate	2016	2016	2016	2016	2016	2016	2016	2016
Tablet formulation	2019	2019	2019	2019	2019	2019	2019	2019
Ciprofloxacin								
Active ingredient				2007(a)				
IV formulation	2006	2006	2006	2006	2006	2011	2007	2008
Tablet formulation	2007	2007	2007	2007	2007	2007	2011	2009
Imidacloprid	2006	2006	2006	2006	2007		2006	2007
Vardenafil compound	2018	2018	2018	2018	2018	2018	2018	2018
Sorafenib compound	2020	2020	2020	2020	2020	2020	2022	2020
Betaseron® product	2008	2008	2008	2008	2008	2008	2007	2016
Yasmin® formulation	2020(b)	2020(b)	2020(b)	2020(b)	2020(b)	2020(b)	2020(b)	2020(b)
Magnevist®								
Product				2007			2011	
Formulation	2007	2007	2007	2007	2007	2007	2009	2010
Method of use							2013	
Ultravist® product				2009				
Mirena®								
Device (inserter)	2015	2015	2015	2015	2015		2015	2015
Process	2013	2013	2013	2013	2013	2013	2013	2013
Campath® product	2014	2014	2014	2014	2014	2014	2015	2014
Leukine® product							2012	2017

(a) Including extension of the original patent term which was scheduled to expire in 2001 by national supplementary protection certificate until 2009 and later reduction of said extension until 2007 under Italian Law No. 112/2002. The final reduced term remains uncertain and falls within the jurisdiction of an ordinary court. The law and its application by the Italian Patent and Trademark office has been legally challenged and may be subject to further legal challenges.

(b) Composition comprising micronized drospirenone together with ethinylestradiol.

See Item 8, *Financial Information Legal Proceedings* for a description of patent-related litigation in which we are involved.

Trademarks

Our best-known trademarks include *Adalat*®, *Aleve*®, *Ascensia*®, *Aspirin*®, *Avalox*®/ *Avelox*®, *Basta*®/ *Liberty*®, *Betaferon*®/*Betaseron*®, *Ciprobay*®/ *Cipro*®, *Confidor*®/ *Gaucho*®/ *Admire*®/ *Merit*®, *Flint*®/ *Stratego*®/ *Sphere*®,

Kogenate®, Levitra®, Magnevist®, *Makrolon®* and *Yasmin®*, as well as the Bayer name itself and our distinctive Bayer cross ; and the corporate names Schering and Medrad . (Please note that the rights to the name Schering in the United States and Canada do not belong to us but to Schering-Plough Corporation, New Jersey. Schering-Plough Corporation and the company acquired by Bayer in June 2006, Bayer Schering Pharma AG (formerly named Schering AG), Berlin, Germany, are unaffiliated companies that have been totally independent of each other for many years.) Trademark protection varies widely throughout the world. In some countries, trademark protection continues as long as the mark is used. Other countries require registration of

trademarks. Registrations are generally for fixed but renewable terms. Although our portfolio of trademarks is important to our business, we do not believe that any single trademark is material to Bayer s business as a whole.

GOVERNMENTAL REGULATION

Our business is subject to significant governmental regulation. Many of our products must be examined and approved by regulatory agencies for safety, environmental impact and effectiveness before we may market them. In addition, all our operations must comply with applicable environmental regulations. Relevant regulations are typically of a national scope, although within the European Union (EU), a considerable degree of harmonization exists. The EU institutions have created a common regulatory framework that applies in all of the EU Member States (and that sometimes allows EU Member States to adopt more detailed and more stringent regulations), and has indirect harmonizing effects in certain other European countries.

Product Regulation

The primary emphasis of product regulation is to assure the safety and effectiveness of our products. In the United States, the Food and Drug Administration (FDA) regulates many of our products, primarily in our HealthCare business. In addition, our pharmaceutical facilities typically require regulatory approval and are subject to periodic re-inspection. Comparable regulatory frameworks are in place in other regions as well, such as the EU, Japan, China and in most other industrialized countries.

The Toxic Substance Control Act (TSCA) administered under the U.S. Environmental Protection Agency (EPA) regulates product registrations, called premanufacture notices (PMNs), for new industrial chemicals and polymers and can also regulate existing chemicals under test rules. In addition, the FDA food-contact regulations permit use of many of our chemicals and materials in food-contact applications. Furthermore, the EPA registers biocidal products for use in antimicrobial applications in addition to those for agricultural uses. For industrial chemicals and polymers in the United States, in order to insure proper use and handling, product safety is regulated by the Occupational Safety and Health Administration (OSHA). The OSHA Hazard Communication Standard requires information concerning the hazards of chemicals to be transmitted to our workers and customers through material safety data sheets and precautionary product labels for potential hazards from exposure to chemicals.

Similarly, in the EU as well as in other regions, there are restrictive rules applicable to areas including the production, marketing, processing, use and disposal of dangerous substances and preparations , food and feeding stuffs and the use of biocides.

Pharmaceutical Products

Pharmaceutical products must be examined and approved by regulatory agencies for safety and efficacy before we may market them. Our pharmaceutical facilities require regulatory approval and are subject to periodic re-inspection. All our operations must comply with applicable quality and environmental regulations. For more information on how regulatory requirements may impact our business, refer to Item 3, *Key Information Risk Factors Regulatory controls and changes in public policy may reduce the profitability of new or current products.*

The various regulatory authorities administer and execute requirements covering the testing, safety, efficacy, labeling, approval, manufacturing, marketing and post-marketing surveillance of prescription pharmaceuticals. Pharmaceutical products must receive regulatory approval before they can be marketed. The regulatory requirements follow stringent standards that vary by country. Before a drug can qualify for marketing approval, a registration dossier must be submitted to a regulatory authority for review and evaluation. The registration dossier principally contains detailed information about the safety, efficacy and quality of a new medication. It also provides details about the manufacturing process, the production facilities and information to be provided to patients. The registration process can last from a few months to a few years and depends on the nature of the medication under review, the quality of the submitted data and the efficiency of the relevant agency. If a drug meets the approval requirements, the regulatory authority will grant a product license for marketing. In some

countries, negotiation on pricing and reimbursement follow the grant of the product license. The process of developing a pharmaceutical product from discovery through testing, registration and initial product launch can take approximately ten years but this period varies considerably for different products and countries. For marketed products, the pharmaceutical company is required to monitor adverse reactions and submit periodic reports on these reactions, if any, to the appropriate authorities.

Within the EU three registration procedures with different regional coverage are available: Centralized Procedure, Mutual Recognition Procedure and National Procedure. In the Centralized Procedure, after the dossier is submitted to the EMEA, the Committee for Medicinal Products for Human Use (CHMP) carries out a scientific evaluation. The CHMP opinion is then transmitted to the European Commission for its opinion, which, if also favorable, results in a binding decision for marketing authorization in all EU Member States. A company is obliged to use the Mutual Recognition Procedure if it intends to sell a medicinal product in more than one Member State, but not necessarily throughout the entire EU. After a Marketing Authorization has been granted for a product in one Member State selected by the company (a so-called Reference Member State , or RMS), this RMS has to produce an Assessment Report. The Authorities in the other Member States where the product is to be approved receive a copy of the original dossier and a copy of the Assessment Report. They then mutually recognize the decision of the RMS. A National Procedure can be used if a company wishes to license a product in just one Member State.

In recent years, the EMEA in the EU, the FDA in the United States and the Ministry of Health, Labor and Welfare (MHLW) in Japan have sought to shorten development and registration times for pharmaceutical products by harmonizing the individual requirements of the three regions. This initiative is called the International Conference on Harmonization. For the foreseeable future, however, we will need to obtain a separate approval in each market.

Our Hematology/ Cardiology business unit markets, among others, substances known as biologicals. Biologicals are derived from biological sources (*e.g.*, from human plasma or from cell lines genetically engineered to produce a specific protein). In the United States and other markets, biologicals are regulated under specific sets of regulations that contain unique requirements specifically for biologicals. For example, in order to minimize the risk of infectious disease transmission, human plasma-derived products require donor screening and plasma testing, as well as multiple manufacturing steps designed to remove viruses and other infectious agents. Biological products are chemically complex, often depending on a precise structure (*e.g.*, the specific folding of a molecule) for their effectiveness. Regulations require us to subject these products to rigorous testing to ensure stability throughout their shelf life. Because biological products cannot withstand conventional sterilization techniques, we must use special processes to ensure sterility. Under applicable regulatory requirements, we must submit detailed documentation to demonstrate appropriate controls over our manufacturing facilities, including associated equipment and supporting utilities such as water supply and climate control.

Prices for pharmaceuticals may be subject to governmental interventions. Direct price controls as well as budgets or patient contribution requirements affect the prices and may result in price and profit differentials between markets.

Consumer Care Products

Most Consumer Care products are subject to regulations similar to those in the Pharmaceuticals segment. In the United States, for example, the FDA and, in part, the Federal Trade Commission, oversee the marketing, manufacturing and labeling of Consumer Care products.

Diabetes Care Products

The products of the Diabetes Care division are in vitro diagnostic (IVD) and medical device products, subject to regulatory controls similar to those governing the development and marketing of pharmaceutical products. In the United States, the FDA regulates IVD products as medical devices, through its Center for Devices and Radiological Health (CDRH). All manufacturers of medical devices must register their facilities with the FDA. Registered establishments are subject to periodic inspections by FDA investigators to ensure compliance with quality standards.

Most IVD products require FDA clearance or approval before they may be marketed. For devices requiring clearance, where possible we seek to obtain it on the grounds that the new product is substantially equivalent to a product the FDA has already cleared. For truly new IVD products, we must submit extensive data to the FDA based on actual clinical trials. FDA clearance usually takes between two and eighteen months, depending on the degree of novelty involved. After obtaining FDA clearance, we must report all adverse incidents in which a product was allegedly involved.

In the United States the FDA and, in part, the Federal Trade Commission, oversee the marketing, manufacturing and labeling of Diabetes Care products, while in the EU and in Japan, they are regulated by the Conformité Européenne (CE) and the MHLW, respectively. In the EU, two directives regulate these products. The Medical Device Directive governs diagnostic products that come in direct contact with the human body. The IVD Directive, as the name implies, applies to products used in vitro, that is those that do not come in direct contact with the human body. In Japan, a special section of the Pharmaceutical Affairs Law (PAL) regulates Diagnostic Care products. The Japanese Ministry of Health is currently implementing significant PAL reforms with which all IVD manufacturers and their Japanese representatives must comply. In Australia and Canada, the applicable laws and regulations are similar to the European model. Many countries in South America and Asia have regulatory requirements similar to those promulgated either by the FDA or the European Commission. All of these requirements involve product registration and approval and the reporting of adverse incidents and corrective actions.

Animal Health Products

Veterinary products must be examined and approved by regulatory agencies for quality, safety and efficacy before marketing in all countries. In the United States, the FDA s Center for Veterinary Medicine is responsible for ensuring that animal drugs are safe and effective for their intended uses and that food from treated animals is safe for human consumption. Animal health products are also regulated in the United States by the U.S. Department of Agriculture (USDA) and the EPA.

In the EU, animal health products are subject to regulations similar to those governing the pharmaceutical sector. The Centralized Procedure is also governed by the EMEA, but the committee responsible for animal health products is the Committee for Medicinal Products for Veterinary Use. For details on the registration procedure within the EU, refer to *Pharmaceutical Products.*

Crop Protection Products

In most countries, crop protection products must obtain government regulatory approval prior to marketing. This regulatory framework seeks to protect the consumer, the operator and the environment. Strict standards are applied in the United States, Japan and in the EU. Because humans may be exposed to these products (for example, through residues on food), the safety assessment considers human risk as well. If the product is used on a food crop, a legal limit for chemical residue is established.

It generally takes seven to nine years from discovery of a new crop protection product until the dossier is submitted to the appropriate regulatory authority for product approval. Afterwards, the authorities usually need another two to four years to evaluate the data submitted in order to decide whether a registration can be granted. The relatively long evaluation period, which may include new requirements imposed on a company after it has submitted a dossier for approval, shortens a company s utilizable patent protection time. In some jurisdictions, part of the patent period lost due to the long regulatory process can be regained through the granting of a supplemental protection certificate.

The introduction of new regulations, data requirements or test guidelines is a normal part of enhancing safety assessments for crop protection products. However, unpredictable new requirements and the imposition of deadlines have led to numerous delays of registrations of crop protection products in the past, especially in the authorization processes in the EU and in the NAFTA countries. Therefore, Bayer CropScience must anticipate new regulatory trends and must closely follow the process of developing and requiring new data. Bayer CropScience also actively participates in these processes by commenting on draft regulations proposed by the

authorities (*e.g.*, on the proposed replacing of the European Directive 91/414/ EEC concerning the placing of crop protection products on the market).

Environmental Science Products

In both the professional and the consumer pest control business, as in crop protection, our products must obtain regulatory approval prior to marketing. In most countries, environmental science products are regulated by authorities other than those which regulate the crop protection products. The regulatory requirements are often different from crop protection products, due to different routes of exposure. Generally, there has been an increase of regulatory requirements for environmental science products, in particular in the United States, Europe and Japan. To some extent, the regulatory dossiers developed for crop protection products with the same active ingredients can also be used for regulatory purposes in the environmental science area.

In the EU, certain products sold in the professional pest control area, as well as pest control products available to consumers, fall under the Biocidal Products Directive (BPD), which requires that complete regulatory dossiers be developed before placing these products or active substances for use in such products on the EU market. Certain green industry products and consumer lawn and garden products are governed by the Plant Protection Directive, which requires authorization before products can be placed on the market.

In the United States, registration of environmental science products is granted by the EPA. There has been an increase of registration requirements due to the implementation of the Food Quality Protection Act (FQPA), which considers both dietary and non-dietary exposure aspects. Certain food-related regulatory requirements applicable to environmental science products exist in other regions, notably in the EU.

The review period for registration depends on the country and could vary from two to five years for a product containing a new active ingredient. These regulatory procedures may lead to an increase in the time period required for and costs involved in developing new environmental science products.

BioScience Products

Plant biotechnology products, marketed by our BioScience business group, in particular those based on genetic modification, are subject to specific regulatory oversight covering environmental impact as well as use and trade of products and derivatives in food and feed. The number of countries that have regulatory frameworks concerning plant technology is increasing each year and, in countries that already have such regulations, the requirements are also increasing or changing. The most important countries, based on their importance to us as an agricultural center and/or trading partner, include the United States, Canada, the EU, Japan, Brazil, Argentina, Australia and China. In the United States, the main regulatory authorities are the USDA, the FDA and the EPA. The EU has implemented a set of new regulations including the creation of a new EU Food Safety Authority. Similar regulations have been implemented in Japan. Many Asian countries have developed regulatory frameworks over the last few years, most recently China, Taiwan, Korea and the Philippines. With the Cartagena Protocol on BioSafety, which came into force in September 2003, it is expected that more countries will establish relevant regulatory frameworks over the next few years.

The timeframe for approvals varies substantially around the world. The development of the regulatory dossier generally takes two to three years. In the United States, Canada and Japan, the review of a regulatory dossier will typically take another one to two years. After over five years of moratoria and regulation changes, the EU is now operating under its new procedures with dossiers advancing slowly. To date the only significant progress has been on importation uses. Approvals of biotechnology-derived products for agricultural growing in the EU are not expected for some time yet.

EU Regulations

We must comply with an increasing range of regulatory measures concerning testing, manufacturing and marketing of our products. In some countries, including the United States, regulatory controls have become increasingly demanding. We expect this trend to continue and expand to other countries. We are monitoring further developments and participate in relevant stakeholder processes such as internet consultations of the

European Commission, projects (*e.g.*, EU research projects, European Partnership for Alternative Approaches to Animal Testing) and conferences.

Within the European Union a new regulation on chemicals (Registration, Evaluation, Authorization of Chemicals, REACH) has been adopted and will be enforced by June 2007. By this legislation new regulatory requirements will be imposed on the testing and assessment of chemicals. This may lead to increased costs and reduced margins for some products, and may affect the availability of certain chemicals. A strict project management has been established to meet the regulatory requirements of the REACH legislation.

In addition, the EU directive on emissions trading may affect our business opportunities, especially in Europe. The directive requires EU member states to meet the carbon dioxide emissions targets set for each member state under EU legislation and based on the Kyoto Protocol. Emissions levels have to be reduced by 21 percent in Germany and 7.5 percent in Belgium, in each case based on 1990 carbon dioxide emissions levels. Compliance and increasing prices for electricity may require material capital expenditures in the future depending on developments in the markets for emissions trading and energy.

A communication entitled European Environment and Health Strategy was published by the European Commission in June 2003 (SCALE). The strategy is intended to reduce the burden of disease caused by environmental factors in the EU by identifying and preventing new health threats caused by environmental factors. In furtherance of this strategy, the European Commission adopted the European Environment and Health Action Plan for 2004-2010 on June 9, 2004. Currently, specific consequences of SCALE on our business cannot be estimated, but we are monitoring further developments and participate in relevant stakeholder processes (*e.g.*, the Consultative Forum organized by the European Commission in this context).

Health, Safety and Environmental Regulations

The production and distribution of Bayer products involves the use, storage, transportation, handling and disposal of toxic and hazardous materials. We are subject to increasingly stringent environmental regulations, which address:

- emissions into the air;
- discharges of waste water;
- incidental and other releases into the environment;
- generation, handling, storage, transportation, treatment and disposal of hazardous and non-hazardous materials; and
- construction and operation of facilities.

It is our policy to comply with all health, safety and environmental requirements and to provide workplaces for employees that are safe. We track, check and evaluate all environmental legal initiatives and laws regarding their potential impact on our current and past activities in order to develop appropriate measures in a timely and effective manner. When necessary, we incur capital expenditures to ensure this. We expect that Bayer will continue to be subject to stringent environmental regulation. Although we cannot predict future expenditures, we believe that current spending trends will continue.

We are subject to regulations that may require us to remove or mitigate the effects of the disposal or release of chemical substances into the environment. Under some of these regulations, a current or previous owner or operator of property may be held liable for the costs of remediation on, under, or in the property, without regard as to whether it knew of or caused the presence of the contaminants, regardless of whether the contaminations resulted from common or best practices or practices of third parties and regardless of whether the practices were legal at the time they occurred. As many of our industrial sites have long histories, we cannot predict the full impact of these regulations on us. We cannot assure that all soil or groundwater contamination will be discovered.

In the United States, we are subject to potential liability under the U.S. Federal Comprehensive Environmental Response, Compensation, and Liability Act (CERCLA, commonly known as Superfund), the U.S. Resource

Conservation and Recovery Act and related state laws for investigation and clean-up costs at a

number of sites. At many of these sites, companies including Bayer have been notified that the EPA, the state governing body or private individuals consider such companies to be potentially responsible parties under Superfund or related laws. The proceedings relating to these sites are in various stages. The clean-up process at many sites is ongoing. We regularly review the liabilities for these sites and have accrued those currently quantifiable costs.

It is difficult to estimate the future costs of environmental protection and remediation because of uncertainties about the status of regulations and their future developments. Taking into consideration our experience and currently known facts, we believe that capital expenditures and remedial actions to comply with environmental regulations will not have a material adverse effect on our financial position, results of operations or cash flows. As of December 31, 2006, we had reserved 262 million for environmental matters.

We believe that we are in substantial compliance with applicable health, safety and environmental laws and regulations. We devote considerable attention to the health and safety of our employees and the protection of public health and the environment. As a member of the International Council of Chemical Associations (ICCA) and the American Chemistry Council, Bayer is committed to the principles of the *Responsible Care Global Charter*, the chemical industry s health, safety and environmental performance improvement initiative.

While our compliance has not adversely affected our competitive position or business, we cannot predict the impact of possible future regulations. Although we have adopted measures to address the stricter regulations, such as increasing the efficiency of our internal research and development process in order to reduce the impact of extended testing on time-to-market, stricter regulatory regimes could delay product development or restrict marketing and sales.

ORGANIZATIONAL STRUCTURE

As the management holding company of the Bayer Group, Bayer AG determines the long-term strategy for the Group and its subgroups and prescribes guidelines and principles for the corporate policy derived therefrom. Bayer AG holds equity interests in the subgroup management companies and the service companies (described below) and also in other domestic and foreign entities. The Bayer Group is managed by the four-member Board of Management of Bayer AG, which is supported by the Corporate Center. The Board of Management is responsible for the supervision of management and for the Group s financial management.

The Corporate Center, which provides services to the Board of Management and to the subgroup management companies, consists of the following corporate center functions: the Corporate Office; Communications; Investor Relations; Corporate Auditing; Corporate Human Resources & Organization; Corporate Development; Law & Patents, Insurance; Finance; Group Accounting & Controlling; Governmental & Product Affairs; and Regional Coordination.

The Bayer Group conducts its business operations in the three subgroups Bayer HealthCare, Bayer CropScience and Bayer MaterialScience. The subgroup management companies Bayer HealthCare AG, Bayer CropScience AG and Bayer MaterialScience AG, heading up the three subgroups, manage the business activities of the domestic and foreign affiliates assigned to them. Each subgroup is, within the framework of strategies, goals and guidelines determined by the Bayer AG Board of Management, an independent operating area with worldwide business accountability and its own management. Each of the subgroup management companies has entered into a domination and profit and loss transfer agreement with Bayer AG.

Three service companies, Bayer Technology Services GmbH, Bayer Business Services GmbH and Bayer Industry Services GmbH & Co. OHG (in which Bayer AG owns a 60 percent stake and LANXESS owns a 40 percent stake), provide support functions to the three subgroups as well as to Bayer AG.

For more information on our current organizational structure, see the introduction to *Business.*

Subsidiaries

The financial statements of the Bayer Group as of December 31, 2006 included 432 fully or proportionally consolidated companies, compared to 283 companies in 2005. The increase of 148 companies is largely due to the first-time inclusion of Schering AG s group companies in the second quarter of 2006.

The following table lists Bayer AG s principal consolidated subsidiaries for our continuing business as of December 31, 2006 and its beneficial ownership interest in each.

Company Name and Place of Business	**Bayer s Interest (%)**
Germany	
Bayer Business Services GmbH, Leverkusen	100
Bayer CropScience AG, Monheim	100
Bayer CropScience Deutschland GmbH, Langenfeld	100
Bayer CropScience GmbH, Frankfurt	100
Bayer HealthCare AG, Leverkusen	100
Bayer Industry Services GmbH & Co. OHG, Leverkusen	60
Bayer MaterialScience AG, Leverkusen	100
Bayer Schering GmbH, Leverkusen	100
Bayer Schering Pharma AG, Berlin	96.2
Bayer Technology Services GmbH, Leverkusen	100
Bayer Vital GmbH, Leverkusen	100
Schering Deutschland GmbH, Berlin	100
Other European Countries	
Bayer Antwerpen Comm.V, Belgium	100
Bayer Biologicals S.r.l., Italy	100
Bayer Consumer Care AG, Switzerland	100
Bayer CropScience France S.A.S., France	100
Bayer CropScience Limited, U.K.	100
Bayer CropScience S.A., France	99.9
Bayer CropScience S.r.l., Italy	100
Bayer International S.A., Switzerland	99.7
Bayer Pharma SAS, France	99.9
Bayer Polyols S.N.C., France	100
Bayer Polyurethanes B.V., The Netherlands	100
Bayer Public Limited Company, U.K.	100
Bayer S.p.A., Italy	100
Bayer SP.Z.O.O., Poland	100
Quimica Farmaceutica Bayer, S.A., Spain	100

Company Name and Place of Business	Bayer s Interest (%)
North America	
Bayer Corporate and Business Services LLC, USA	100
Bayer CropScience Inc., Canada	100
Bayer CropScience LP, USA	100
Bayer HealthCare LLC, USA	100
Bayer Inc., Canada	100
Bayer MaterialScience LLC, USA	100
Bayer Pharmaceuticals Corporation, USA	100
BAYPO Limited Partnership, USA	100
Berlex Inc., USA	100
Medrad, Inc., USA	100
Asia/Pacific	
Bayer Australia Limited, Australia	99.9
Bayer CropScience K.K., Japan	100
Bayer HealthCare Co. Ltd., China	100
Bayer Korea Ltd., Republic of Korea	100
Bayer MaterialScience Limited, Hong Kong	100
Bayer MaterialScience Trading (Shanghai) Company Limited, China	100
Bayer Thai Company Limited, Thailand	99.9
Bayer Yakuhin, Ltd., Japan	100
Nihon Schering K.K., Japan	100
Sumika Bayer Urethane Co., Ltd., Japan	60
Latin America/Africa/Middle East	
Bayer (Proprietary) Limited, South Africa	100
Bayer de Mexico, S.A. de C.V., Mexico	100
Bayer S.A., Argentina	99.9
Bayer S.A., Brazil	99.9
Bayer Türk Kimya Sanayi Limited Sirketi, Turkey	100

Also included in the consolidated financial statements are the following material associated companies:

Company Name and Place of Business	Bayer s Interest (%)
Lyondell Bayer Manufacturing Maasvlakte VOF, The Netherlands	50.0
Palthough Industries (1998) Ltd., Israel	25.0
PO JV, LP, USA	43.4
Polygal Plastics Industries Ltd., Israel	25.8

PROPERTY, PLANTS AND EQUIPMENT

We operate through a large number of offices, research and development facilities and production sites throughout the world. The principal executive offices of Bayer AG are located in Leverkusen, Germany. Our key production facilities are located in Germany and the United States. We also have other properties, including office buildings, laboratories and distribution centers throughout the world. For the major research and development

facilities by segment please refer to *Markets and Distribution* and *Research and Development* for each of the segments.

Our policy is to acquire full ownership rights in our manufacturing facilities whenever possible. We own most of our manufacturing facilities and other properties. Where locally applicable law does not permit this or acquisition of full property rights is otherwise unfeasible, we acquire possessor interests conferring substantially the same rights of use as ownership (for example, German-law hereditary building rights or *Erbbaurechte* and granted land-use rights in Asian countries).

We believe that our production plants and manufacturing facilities have capacities adequate for our current and projected needs. In 2006, liabilities of 3 million (2005: 7 million) were secured by mortgages.

The acquisition of the business of Schering AG, Berlin, Germany includes major production sites in Germany, Finland and the United States. For further details on the acquisition, refer to *History and Development of the Company.*

As part of the divestiture of the Diagnostics division, eight sites with offices and production facilities located in five countries ceased to be part of the Bayer Group. For further details on the divestiture, refer to *History and Development of the Company* and to Item 5, *Operating and Financial Review and Prospects Operating Results 2004, 2005 and 2006 Discontinued Operations Diagnostics.*

The following table summarizes our major facilities by subgroup:

Location	Size of developed property in thousand square meters	Major use
Bayer HealthCare		
Leverkusen, Germany	125	Formulation and packaging of pharmaceutical products
Wuppertal, Germany	448	Production of active ingredients for ethical pharmaceutical products, research and development
Berkeley, California	112	Production of recombinant FVIII
Myerstown, Pennsylvania	44	Formulation and packaging of Consumer Care products
Mishawaka, Indiana	32	Production of instruments for Diabetes Care division
Bergkamen, Germany	505	Production of active pharmaceutical ingredients, administration
Berlin-Wedding, Germany	173	Production and packaging of contrast media; packaging of solids; research and development, offices
Turku, Finland	98	Production of gynecological and andrological products, and solids (Oncology); research and development, offices
Bayer CropScience		
Monheim, Germany	650	Research and development of insecticidal and fungicidal active ingredients, global Bayer CropScience headquarters
Frankfurt, Germany	90	

		Research and development of herbicidal active ingredients, manufacturing for Crop Protection and Environmental Science
Dormagen, Germany	140	Manufacturing for Crop Protection and Environmental Science, industrialization of new active ingredients
Kansas City, Missouri	340	Manufacturing for Crop Protection and Environmental Science
Haelen, The Netherlands	560	Research and development as well as production of seeds for BioScience

Location	Size of developed property in thousand square meters	Major use
Bayer MaterialScience		
Krefeld-Uerdingen, Germany	208	Production of polycarbonates, diphenylmethane diisocyanates, chlorine, caustic soda, hydrochloric acid and hydrogen
Baytown, Texas	1,628	Production of base- and modified isocyanates, polycarbonates, diphenylmethane diisocyanates, toluene diisocyanates, chlorine, caustic soda, hydrochloric acid and hydrogen
Dormagen, Germany	264	Production of modified isocyanates, resins, polycarbonate films, toluene diisocyanates, polyether, thermoplastic polyurethanes, chlorine, caustic soda, hydrochloric acid and hydrogen
Antwerp, Belgium	639	Production of polycarbonates, aniline, nitrobenzene and polyether
Brunsbüttel, Germany	137	Production of diphenylmethane diisocyanates, toluene diisocyanates, chlorine, hydrochloric acid and hydrogen

Since the end of 2003, Bayer MaterialScience has been expanding capacities and establishing large-scale facilities at its integrated production site in Caojing, China (near Shanghai), as presented in the following table:

	Plant Capacity (in kt)	Start-Up	Status
Coatings, Adhesives, Sealants (*Desmodur® N*)	12	April 2003	In operation
Coatings, Adhesives, Sealants (*Desmodur® L*)	11	January 2005	In operation
Polycarbonates (Compounding)	40	July 2005	In operation
Polycarbonates (PCS Phase I)	100	September 2006	In operation
Polyurethanes (MDI Phase I, MMDI-Splitter),	80	September 2006	In operation
Coatings, Adhesives, Sealants (HDI-4)	30	February 2007	In operation
Polyurethanes (MDI Phase II)	350	2008	Under construction
Polycarbonates (PCS Phase II)	100	2008	Under construction
Polyurethanes (TDI)	300	2009	Planning phase

For information on environmental issues relating to Bayer s properties see *Business Governmental Regulation Health, Safety and Environmental Regulations.* Additional information regarding Bayer s property, plant and equipment is contained in Item 5, *Operating and Financial Review and Prospects Liquidity and Capital Resources*

2004, 2005 and 2006 *Capital Expenditures* and in Note 18 to the consolidated financial statements appearing elsewhere in this annual report on Form 20-F.

Item 4A. ***Unresolved Staff Comments***

None.

Item 5. ***Operating and Financial Review and Prospects***

Investors should read the following operating and financial review and prospects together with the consolidated financial statements and the notes to those financial statements included elsewhere in this annual report on Form 20-F. We have prepared these financial statements in accordance with IFRS, which differs in some respects from U.S. GAAP. For a reconciliation of net income and stockholder s equity to U.S. GAAP, see Note 41 to our consolidated financial statements.

The forward-looking statements in this Item 5 are not guarantees of future performance. They involve both risk and uncertainty. Several important factors could cause our actual results to differ materially from those anticipated by these statements. Many of those factors are macroeconomic in nature and are, therefore, beyond the control of our management. See *Forward-Looking Information.*

We have based the presentation of our results in this section on certain significant accounting assumptions. For a more detailed description of these assumptions, see *Critical Accounting Policies*, below.

In connection with IFRS 5, as well as the application of related IFRS standards, the financial information presented in this annual report on Form 20-F for 2004, 2005 and 2006 only reflects continuing operations of the Bayer Group and its segments, except where specific reference is made to discontinued operations. The 2004 and 2005 figures for operating result, non-operating result, operating expenses and related key figures have been restated to give effect to this form of presentation. For more details, refer to Note 2 to the consolidated financial statements appearing elsewhere in this annual report on Form 20-F.

OVERVIEW

We are a global company focusing on our strengths in the fields of health care, nutrition and innovative materials. Our goal is to strengthen the competitiveness of our businesses in the HealthCare, CropScience and MaterialScience subgroups by concentrating on the special needs of these businesses.

Bayer comprises the parent company, Bayer AG of Leverkusen, Germany, and approximately 430 consolidated subsidiaries. We are organized into three subgroups and, for reporting purposes, structured into six reportable segments Pharmaceuticals; Consumer Health; Crop Protection; Environmental Science, BioScience; Materials and Systems. For further information on our organizational structure, see Item 4, *Information on the Company Business* and *Organizational Structure.*

With effect from June 23, 2006, we acquired a majority of the shares of Schering AG, Berlin, Germany (subsequently renamed Bayer Schering Pharma AG), which is fully consolidated in the Bayer Group financial statements beginning on that date. (The names Bayer Schering Pharma or Schering as used in this annual report on Form 20-F 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. Bayer Schering Pharma AG and Schering-Plough Corporation, New Jersey, are unaffiliated companies that have been totally independent of each other for many years.) In 2006, we completed the process of entering into agreements to divest our Diagnostics division and our H.C. Starck and Wolff Walsrode businesses. These transactions are expected to close or have already closed in 2007. For our principal acquisitions and divestitures during the last three years, refer to Item 4, *Information on the Company History and Development of the Company* and Note 7.2 to the consolidated financial statements appearing elsewhere in this annual report on Form 20-F.

CRITICAL ACCOUNTING POLICIES

The preparation of the financial statements for the Bayer Group requires the use of estimates and assumptions. These affect the classification and valuation of assets, liabilities, income, expenses and contingent liabilities. Estimates and assumptions mainly relate to the useful life of noncurrent assets, the discounted cash flows used in impairment testing and the establishment of provisions for litigation, pensions and other benefits, taxes, environmental protection, inventory valuations, sales allowances, product liability and guarantees.

Estimates are based on historical experience and other assumptions that are considered reasonable under the circumstances. Actual values may vary from the estimates. The estimates and the assumptions are continually reviewed.

To enhance the information content of the estimates, certain provisions that could have a material effect on the financial position and results of operations of the Group are selected and tested for their sensitivity to changes in the underlying parameters. To reflect uncertainty about the likelihood of the assumed events actually occurring, the impact of a 5 percent change in the probability of occurrence is examined in each case. For long-term interest-bearing provisions, the impact of a 1 percent change in the interest rate used is analyzed. Analysis has not shown other provisions to be materially sensitive. The interest sensitivity of pension obligations is discussed in Note 25 to the consolidated financial statements appearing elsewhere in this annual report on Form 20-F.

Critical accounting and valuation policies and methods are those that are both most important to the portrayal of the Bayer Group s financial position, results of operations and cash flows, and that require the application of difficult, subjective and complex judgments, often as a result of the need to make estimates about the effects of matters that are inherently uncertain and may change in subsequent periods. The critical accounting policies that we disclose will not necessarily result in material changes to our financial statements in any given period but rather contain a potential for material change. The main accounting and valuation policies used by the Bayer Group are outlined in Note 4.3 to the consolidated financial statements appearing elsewhere in this annual report on Form 20-F. While not all of the significant accounting policies require difficult, subjective or complex judgments, the Company considers that the following accounting policies should be considered critical accounting policies.

Intangible assets and property, plant and equipment

As discussed in Notes 17 and 18 appearing elsewhere in this annual report on Form 20-F, at December 31, 2006 the Bayer Group had intangible assets with a net carrying amount of 24,034 million including goodwill of 8,227 million, and property, plant and equipment with a net carrying amount of 8,867 million. Intangible assets with finite useful lives and property, plant and equipment are amortized over their estimated useful lives. The estimated useful lives are based on estimates of the period during which the assets will generate revenue.

Intangible assets with finite useful lives and property, plant and equipment are tested for impairment whenever events or changes in circumstances indicate that the carrying amount of the assets may no longer be recoverable. Goodwill and intangible assets with indefinite useful lives must be tested annually for impairment. In compliance with IAS 36 (Impairment of Assets), impairment losses are measured by comparing the carrying amounts to the discounted cash flows expected to be generated by the respective assets. Where it is not possible to estimate the impairment loss for an individual asset, the loss is assessed on the basis of the discounted cash flow for the cash-generating unit to which the asset belongs. Estimating the discounted future cash flows involves significant assumptions, especially regarding future sales prices, sales volumes and costs. The discounting process is also based on assumptions and estimations relating to business-specific costs of capital, which in turn are based on country risks, credit risks as well as additional risks resulting from the volatility of the respective line of business. The present value of future cash flows measures an asset s value based on our continuing use of the asset and its retirement at the end of its useful life. Further information on the procedure for impairment testing and the residual carrying amounts of goodwill at the balance sheet date is presented in Note 4.5 and Note 17 to the consolidated financial statements appearing elsewhere in this annual report on Form 20-F, respectively.

To illustrate the Bayer Group s impairment loss measurement on a segment level, if the actual present value of future cash flows were 10 percent lower than the anticipated present value, the net carrying amount of goodwill in the Crop Protection segment as of December 31, 2006 would have to be impaired by 146 million. In the Systems segment, the net carrying amounts of goodwill and intangible assets as of December 31, 2006 would have to be impaired by 42 million. We have focused our analysis on the Crop Protection and Systems segments because we believe that these are the only of our segments where impairments of goodwill and other intangibles under the assumptions described above are reasonably likely to have a material adverse effect on the results of operations of the respective segments. If the weighted average cost of capital used for the impairment test were

increased by 10 percent, assets of the Crop Protection and Systems segment would have to be impaired by 85 million or 34 million, respectively. In quantifying our sensitivity analysis, we modeled a 10 percent decline as a negative change up to this magnitude is in our view reasonably likely. We do not now believe that greater changes are reasonably likely given our experiences in the Crop Protection and System segments.

Applying these policies, we recognized impairment charges in each of the years 2006, 2005 and 2004. The following table sets forth these charges based on their allocation to our continuing businesses and our discontinued operations.

	2004	2005	2006
	(Euros in millions)		
Impairment charges (continuing operations)	26	77	172
Impairment charges (discontinued operations)	63	0	18
Total impairment charges	89	77	190

In 2004 and 2005, we recognized impairment charges largely as a result of our decisions to close or relocate several facilities and sites within our continuing businesses as part of our strategic reorientation and focus on our core businesses.

The impairment charges within discontinued operations 2004 related to the sale of our plasma business (24 million in 2004) and the spin-off of the former LANXESS segment (39 million in 2004). We recorded an additional 24 million impairment charge related to this business in 2004 based on price negotiations with the purchaser. We updated our cash flow assumptions for the LANXESS businesses as a result of sustained pressure on its margins resulting from adverse foreign exchange rates, ongoing consolidation in customers in the industries LANXESS served, overcapacities in certain market segments and an increase in competition, particularly from Asian suppliers. We recognized an additional 39 million in impairment charges for the spun off LANXESS businesses in 2004 due to further revisions of the economic assumptions within the strategic business entities Performance Chemicals, Engineering Plastics and Chemical Intermediates.

Impairment charges and write-downs on tangible assets in 2005 originated especially from our decision to shut down or to relocate different production facilities and sites in the United States in our continuing operations (33 million). Also, in 2005 capitalized marketing rights for our product, *Viadur*®, were impaired by 15 million because of unfavorable market conditions related to the product (*e.g.*, additional competition from other manufacturers). We revised this estimate in 2006 and wrote off the remaining intangible asset of 19 million.

Impairment charges and write-downs in 2006 were predominantly due to further restructurings of our sites in the United States (14 million) partly related to acquisitions as well as changes in plans for the expansion of our chlorine alkali facilities in Baytown, Texas (31 million). In addition, restructuring efforts pursued in the year 2006 within the Bayer CropScience subgroup and the Bayer Industry Services GmbH & Co. OHG resulted in impairment charges and write-downs on tangible assets of 19 million and 30 million, respectively. In 2006 the capitalized costs of an acquired development project for the product alfimeprase within the Bayer HealthCare subgroup were impaired by 41 million. Within discontinued operations an impairment charge was recognized within the H.C. Starck group for its battery business in Canada (17 million).

Although we believe that our estimates of the relevant expected useful lives, our assumptions concerning the macroeconomic environment and developments in the industries in which the Bayer Group operates, and our estimations of the discounted future cash flows, are appropriate, changes in assumptions or circumstances could require changes in the analysis. This could lead to additional impairment charges in the future or to valuation write-backs should the trends we expect reverse.

Research and development

In addition to the in-house research and development activities, various research and development collaborations and alliances are maintained with third parties. These collaborations and alliances involve provision of funding and/or payments for the achievement of performance milestones. All research costs are expensed as incurred. Since development projects are subject to regulatory approval procedures and other

uncertainties, the conditions for the capitalization of development costs incurred with respect to in-house research and development activities before receipt of regulatory approvals are not satisfied, and these costs are also expensed as incurred. With respect to costs incurred in collaborations and alliances with third parties, under IAS 38 (revised), which entered into effect on January 1, 2005, milestone payments relating to acquired assets in development must be capitalized to the extent that they are related to the acquisition of the related technology rights, even if uncertainties exist as to whether the research and development will ultimately be successful in producing a saleable product. If research and development collaborations are embedded in contracts for a strategic alliance, considerable judgment is involved in determining whether milestone-based payments reflect the funding of research and development or if they are related to the acquisition of an underlying compound or other rights. Factors considered in reaching this determination are (a) the nature of the payment, for example whether it is related to regulatory approval, a sales target or outsourced research and development activities, and (b) the relative fair values of the planned research and development activities compared to the total value of the payment.

Net sales

We recognize revenue for product sales and the rendering of services when:

the significant risks and rewards of ownership of the goods are transferred to the customer,

the company retains neither continuing managerial involvement to the degree usually associated with ownership nor effective control over the goods sold,

the amount of revenue and costs incurred or to be incurred can be measured reliably, and

it is probable that the economic benefits associated with the transaction will flow to the company.

At the time revenue is recognized, we also record estimates for revenue deductions including cash discounts, rebates and product returns. Also, we record revenues net of items we collect on behalf of third parties, such as sales taxes and goods and service taxes. We report our net sales after deducting all sales deductions from our gross revenue.

The majority of our sales deductions are subject to formula-based determination using factors such as a fixed percentage of the sales volume or gross sales proceeds. Accordingly, estimates related to sales deductions are predominantly based on historical experience, specific contractual terms and future expectations of our sales development in each of our business segments. We believe that assumptions other than those that we discuss are not reasonably likely to occur or not applicable to our business. We estimate the potential for future variability in provisions for anticipated sales deductions to be insignificant with respect to our reported operating results. We have not made adjustments to our provisions for rebates, cash discounts or returns for sales made in prior periods that were material in relation to our income before income taxes in any of the periods covered by the financial statements included in this annual report on Form 20-F.

Provisions for rebates were 1.6 percent of our total net sales in 2006 (2005: 1.4 percent; 2004: 1.5 percent). In addition to rebates, we offer cash discounts for prompt payment in some countries. Our provisions for cash discounts were less than 0.1 percent of total net sales as of December 31, 2006, 2005 and 2004.

We deduct provisions for returned defective goods or related to contractual arrangements to return saleable products on the date of sale or at the time when the amount of future returns can be reasonably estimated. If future product returns cannot be reasonably estimated and are significant to the sale transaction, both the recognition of revenues and of the related cost of sales are deferred until an estimate may reasonably be made or when the right to return the goods has expired. Provisions for product returns were 0.1 percent of total net sales in 2006 (2005: 0.3 percent; 2004: 0.3 percent).

Some of the Bayer Group s revenues are generated from licensing agreements under which third parties are granted rights to certain of our products and technologies. Upfront payments and similar non-refundable payments received under these agreements are recorded as other liabilities and recognized in income over the estimated performance period stipulated in the agreement. Milestone payments linked to the achievement of a significant and substantive technical/regulatory hurdle in the research and development process, pursuant to collaborative agreements, are

recognized as revenue upon the achievement of the specified milestone. Revenues

are also derived from research and development collaborations and co-promotion agreements. Such agreements may consist of multiple elements and provide for varying consideration terms, such as upfront, milestone and similar payments, which may be complex and require significant analysis by management in order to separate individual revenue components and recognize them on the most appropriate dates. This may have to be done partially on the basis of assumptions.

Pensions and other post-employment benefits

Group companies provide retirement benefits for most of their employees, either directly or by contributing to independently-administered funds. The way these benefits are provided varies according to the legal, fiscal and economic conditions of each country, the benefits generally being based on the employees remuneration and years of service. The obligations relate both to existing retirees pensions and to pension entitlements of future retirees. Group companies provide retirement benefits under defined contribution and/or defined benefit plans. In the case of defined contribution plans, the company pays contributions to publicly or privately administered pension insurance plans on a mandatory, contractual or voluntary basis. Once the contributions have been paid, the company has no further payment obligations. All other retirement benefit systems are defined benefit plans, which may be either unfunded, *i.e.*, financed by provisions (accruals), or funded, *i.e.*, financed through pension funds. Statistical and actuarial methods are used to anticipate future events in calculating the expenses and liabilities related to the plans. These calculations include assumptions about the discount rate, expected return on plan assets and rate of future compensation increases.

The interest rate used to discount post-employment benefit obligations to present value is derived from the yields of senior, high-quality corporate bonds in the respective country at the balance sheet date. These generally include AA-rated securities. The discount rate is based on the yield of a portfolio of bonds whose weighted residual maturities approximately correspond to the duration necessary to cover the entire benefit obligation. If AA-rated corporate bonds of equal duration are not available, a discount rate equivalent to the effective interest rate for government bonds at the balance sheet date is used instead but increased by about 0.5 to 1.0 percentage point since corporate bonds generally provide higher yields by virtue of their risk structure.

Determination of the discount rate is also based on a bond portfolio corresponding to the expected cash outflows from the pension plans. The average return of this bond portfolio serves as our benchmark when determining the discount rate.

The assumption for the expected return-on-assets reflects a long-term global capital market return that corresponds to the duration of the pension obligation, and a diversified investment strategy. The investment policy of Bayer Pensionskasse is geared toward regulatory compliance and toward maintaining the risk structure corresponding to the benefit obligations. To this end, Bayer Pensionskasse has developed a strategic target portfolio commensurate with the risk profile. This investment strategy focuses principally on stringent management of downside risks rather than on maximizing absolute returns. In other countries, too, the key criteria for the funds investment strategies are the structure of the benefit obligations and the risk profile. Other determinants are risk diversification, portfolio efficiency and a country-specific and global risk/return profile capable of ensuring payment of all future benefits. The expected return is applied to the fair market value of plan assets at each year end.

Statistical information such as withdrawal and mortality rates is also used in estimating the expenses and liabilities under the plans. Because of changing market and economic conditions, the expenses and liabilities actually arising under the plans in the future may differ materially from the estimates made on the basis of these actuarial assumptions. The plan assets are partially comprised of equity and fixed-income instruments. Therefore, declining returns on equity markets and markets for fixed-income instruments could necessitate additional contributions to the plans in order to cover future pension obligations. Also, higher or lower withdrawal rates or longer or shorter life of participants may have an impact on the amount of pension income or expense recorded in the future.

On December 31, 2006, the present value of our defined benefit obligations for pensions and other post-employment benefits payable under defined benefit plans was 16,708 million. Note 25 to the consolidated financial statements appearing elsewhere in this annual report on Form 20-F contains an analysis of the

sensitivities of our defined benefit obligation to a 0.5 percent increase or decrease in any of our discount rate, projected remuneration increases and projected future benefit increases and the effects on our results of operations in which these changes would result. It also sets forth the changes in our accumulated actuarial losses related to changes in these actuarial parameters.

Environmental provisions

The business of the Bayer Group is subject to a variety of laws and regulations in the jurisdictions in which it operates or maintains properties. Provisions for expenses that may be incurred in complying with such laws and regulations are set aside if environmental inquiries or remediation measures are probable, the costs can be reliably estimated and no future benefits are expected from such measures. Our provisions for environmental protection measures amounted to 262 million on December 31, 2006 and 279 million on December 31, 2005.

It is difficult to estimate the future costs of environmental protection and remediation because of many uncertainties, particularly with regard to the status of laws, regulations and the information available about conditions in the various countries and at the individual sites. Significant factors in estimating the costs include previous experiences in similar cases, the conclusions in expert opinions we obtain regarding our environmental programs, current costs and new developments affecting costs, management s interpretation of current environmental laws and regulations, the number and financial position of third parties that may become obligated to participate in any remediation costs on the basis of joint liability, and the remediation methods which are likely to be deployed. Changes in these assumptions could impact future reported results. Subject to these factors, but taking into consideration experience gained to date regarding environmental matters of a similar nature, we believe our provisions to be adequate based upon currently available information. There were no significant changes in our assumptions or estimates that impacted our statements of income in 2004, 2005 or 2006.

However, given the inherent difficulties in estimating liabilities in the businesses in which we operate, especially those for which the risk of environmental damage is relatively greater (CropScience and MaterialScience), it remains possible that material additional costs will be incurred beyond the amounts accrued. It is possible that final resolution of these matters may require expenditures to be made in excess of established provisions, over an extended period of time and in a range of amounts that cannot be reasonably estimated. Management nevertheless believes that such additional amounts, if any, would not have a material adverse effect on the Group s financial position or results of operations. Further information on environmental provisions can be found in Note 26.2 to the consolidated financial statements appearing elsewhere in this annual report on Form 20-F.

Litigation provisions

As a global company with a diverse business portfolio, the Bayer Group is exposed to numerous legal risks, particularly in the areas of product liability, patent disputes, tax assessments, competition and antitrust law, and environmental matters. The outcome of the currently pending and future proceedings cannot be predicted with certainty. Thus, an adverse decision in a lawsuit could result in additional costs that are not covered, either wholly or partially, under insurance policies and that could significantly impact the business and results of operations of the Bayer Group. If the Bayer Group loses a case in which it seeks to enforce its patent rights, a decrease in future earnings could result as other manufacturers could be permitted to begin to market products that the Bayer Group or its predecessors had developed.

Litigation and other judicial proceedings as a rule raise difficult and complex legal issues and are subject to many uncertainties and complexities including, but not limited to, the facts and circumstances of each particular case, issues regarding the jurisdiction in which each suit is brought and differences in applicable law. Upon resolution of any pending legal matter, the Bayer Group may be forced to incur charges in excess of the presently established provisions and related insurance coverage. It is possible that the financial position, results of operations or cash flows of the Bayer Group could be materially affected by the unfavorable outcome of litigation. Litigation and administrative proceedings are evaluated on a case-by-case basis considering the available information, including that from legal counsel, to assess potential outcomes. Where it is considered probable that a future obligation will result in an outflow of resources, a provision is recorded in the amount of

the present value of the expected cash outflows if these are deemed to be reliably measurable. These provisions cover the estimated payments to plaintiffs, court fees, attorney costs and the cost of potential settlements. We have in the past adjusted existing provisions as proceedings have continued, been settled or otherwise provided further information on which we could review the likelihood of outflows of resources and their measurability, and we expect to continue to do so in future periods.

During 2004, we recorded the following litigation related charges: 83 million in respect of fines paid in antitrust proceedings for rubber and urethane products, 47 million with respect to the *Lipobay/ Baycol* proceedings and 16 million with respect to the *Phenylpropanolamine* (PPA) proceedings.

During 2005, we had operating charges based on our expected payments totaling 336 million related to our rubber-and urethane-related antitrust proceedings, as well as charges in respect of our *Lipobay/ Baycol* proceedings (43 million) and our PPA proceedings (62 million).

Provisions for litigation-related expenses totaled 434 million on December 31, 2006. During 2006, we recorded 135 million other operating expenses on the basis of expected payments, which mainly relate to proceedings in connection with *Lipobay/ Baycol* (35 million), to a patent infringement proceeding (24 million) and to proceedings in connection with former rubber product lines (51 million). We refer to the antitrust proceedings in connection with urethane products and rubber products collectively as antitrust proceedings related to polymer products elsewhere in this annual report on Form 20-F.

Further details on legal risks and the related effects on our results of operations are contained in Item 8 as well as in Notes 32 and 41 to the consolidated financial statements appearing elsewhere in this annual report on Form 20-F.

Income taxes

To compute provisions for taxes, estimates have to be made. Estimates are also necessary to determine whether valuation allowances are required against deferred tax assets. These involve assessing the probabilities that deferred tax assets resulting from deductible temporary differences and tax losses can be utilized to offset taxable income.

Uncertainties exist with respect to the interpretation of complex tax regulations and the amount and timing of future taxable income. Given the wide range of international business relationships and the long-term nature and complexity of existing contractual agreements, differences arising between the actual results and the assumptions made, or future changes to such assumptions, could necessitate adjustments to tax income and expense in future periods. The Group establishes what it believes to be reasonable provisions for possible consequences of audits by the tax authorities of the respective countries. The amount of such provisions is based on various factors, such as experience with previous tax audits and differing interpretations of tax regulations by the taxable entity and the responsible tax authority. Such differences of interpretation may arise on a wide variety of issues depending on the conditions prevailing in the respective Group company s domicile. On December 31, 2006, net liabilities for current tax payments amounted to 908 million, and net deferred tax liabilities amounted to 3,141 million. We reversed provisions in our U.S. subsidiary totaling 104 million in 2005 that related to tax positions taken in periods that were closed with the Internal Revenue Service.

Further information on income taxes is provided in Note 14 to the consolidated financial statements appearing elsewhere in this annual report on Form 20-F.

Acquisition accounting

We account for the acquired businesses using the purchase method of accounting which requires that the assets acquired and liabilities assumed be recorded at the date of acquisition at their respective fair values. The application of the purchase method requires certain estimates and assumptions especially concerning the determination of the fair values of the acquired intangible assets and property, plant and equipment as well as the liabilities assumed at the date of the acquisition. Moreover the useful lives of the acquired tangible and intangible assets have to be determined. The judgments made in the context of the purchase price allocation can materially impact our future results of operations. Accordingly, for significant acquisitions, we obtain assistance from third

party valuation specialists. The valuations are based on information available at the acquisition date. Significant judgments and assumptions made regarding the purchase price allocation in the course of the acquisition of Schering AG, Berlin, Germany included the following:

For intangible assets associated with products, product related technology, and qualified in-process research and development (IPR&D) we base our valuation on the expected future cash flows using the Multi-Period Excess Earnings approach. This method employs a discounted cash flow analysis using the present value of the estimated after-tax cash flows expected to be generated from the purchased intangible asset using risk adjusted discount rates and revenue forecasts as appropriate. The period of expected cash flows was based on the individual patent protection, taking into account the term of the product s main patent protection and essential extension of patent protection, as well as market entry of generics, considering sales, volume, prices, potential defense strategies and market development at patent expiry.

For the valuation of brands the relief-from-royalty method was applied which includes estimating the cost savings that result from the company s ownership of trademarks and licenses on which it does not have to pay royalties to a licensor. The intangible asset is then recognized at the present value of these savings. The brand-specific royalty rates were calculated using a product-specific scoring model. The corporate brands Schering and Medrad were assumed to have an unlimited life. (Please note that the rights to the name Schering in the United States and Canada do not belong to us but to Schering-Plough Corporation, New Jersey. Schering-Plough Corporation 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.) Product brands, however, were assumed to have limited lives depending on the respective products life cycles. The expected amortization of these assets is determined on the basis of expected product-specific revenues.

The net carrying amount of acquired intangible assets after a step-up of 11,745 million resulting from the purchase price allocation was 12,042 million, as of June 23, 2006. This figure includes 1,191 million for IPR&D which relates to new compounds development as well as new versions of existing drugs. The valuation of acquired intangible assets is to a great extent based on anticipated cash flows. Nevertheless it is not impossible that actual outcomes vary significantly from such estimated future cash flows. In particular, the estimation of discounted cash flows of intangible assets under development and developed technologies is subject to highly sensitive assumptions, which are closely related to the nature of our pharmaceutical activities and whose changes may have material consequences such as:

- Outcome of research and development activities regarding compound efficacy, results of clinical trials, etc.;
- Probability of obtaining regulatory approval in several countries;
- Long-term sales forecast;
- Anticipation of selling price erosion rates after the end of patent protection due to generic competition in the market;
- Behavior of competitors (launch of competing products, marketing initiatives, etc.).

Measures pursued in the course of restructuring efforts such as the closing of facilities or changes in the planned use of buildings, machinery or equipment may result in shortened useful lives or impairments.

For land acquired in general the comparison approach was based on the fair market values of properties situated in locations similar to those of the acquired properties and utilized for similar purposes. Unitary land values were derived from public or official sources and expert appraisals such as those made by advisory committees, contained in market reports or produced by local real estate agents. For buildings that could be leased, the income approach was predominantly applied, discounting projected rental charges.

For technical equipment and machinery as well as for other equipment the indirect cost approach was applied, utilizing replacement costs. These costs are depreciated on a straight-line basis over the assets economic

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useful life according to an age analysis. Utilization and condition of the related technical equipment and machinery were reflected by adjustments and deduction for obsolescence.

The valuation of the patented finished goods on stock at date of acquisition and work in process was based on the corresponding selling price less estimated costs of completion or estimated costs to make the sale.

The excess of the purchase price for Schering AG over the estimated fair values of the net assets acquired is recorded as goodwill amounting to 5,771 million as of June 23, 2006. The step-ups have led to a corresponding deferred tax liability of 4,546 million as of June 23, 2006, which will be amortized analogously to the respective assets.

OPERATING RESULTS 2004, 2005 AND 2006

Introduction

Most significant drivers of our sales, results of operations and cash flows in 2006

The most significant drivers of our sales, results of operations and cash flows in 2006 were:

Acquisition and divestiture activities particularly our acquisition of Schering (The names Bayer Schering Pharma or Schering as used in this annual report on Form 20-F 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. Bayer Schering Pharma AG and Schering-Plough Corporation, New Jersey, are unaffiliated companies that have been totally independent of each other for many years.);

The general economic situation and the continued positive business climates in the industries of some of our customers in the course of 2006; and

Raw materials, pricing *i.e.*, the effects on our results of operations of the increased prices of petrochemical raw materials, other precursors and energy.

In addition, we present charges and expenses in connection with the transactions and other measures we have been taking as part of the strategic reorientation of our business and the related reorganization of our remaining businesses in order to assist readers in understanding the effects of these measures on our results of operations. Moreover, we separately disclose charges relating to several major legal matters that we distinguish from our ongoing operations. For details refer to *Expenses and gains relating to the reorientation of our business and to other material unusual effects.*

Acquisition and divestiture activities

Effects on net sales from acquisitions and divestitures

Acquisitions and divestitures during 2006 and 2005 had a positive effect on net sales in 2006 of 3,025 million, and acquisitions and divestitures during 2005 and 2004 had a positive effect on net sales in 2005 of 2,070 million. These portfolio changes affected the comparison between the three years sales figures as shown in the following two tables:

	Change in 2006 from 2005 (Euros in millions)
Acquisitions	
Schering AG, Germany	3,082
Other	24
	3,106
Divestitures	
Termination of distribution activities for Plasma in Canada (divested in 2005)	(100)
Net sales to LANXESS (until spin-off on January 31, 2005, sales to LANXESS were classified as internal sales)	69
Disposition of several active ingredients, CropScience in 2005	(50)
	(81)
Net effects on sales	3,025

	Change in 2005 from 2004 (Euros in millions)
Acquisitions	
Roche consumer health business	1,061
Divestitures	
Net sales to LANXESS after the spin-off on January 31, 2005 (in 2004, sales to LANXESS were classified as internal sales)	981
Other (net effect)	28
Net effects on sales	2,070

Effect on operating result from the purchase price allocation in connection with the acquisition of Schering AG, Berlin, Germany

When we consolidated the acquired Schering businesses, we allocated the purchase price for those businesses among the assets and liabilities we acquired, in accordance with IFRS 3 (Business Combinations). Further details concerning these allocations are set forth in Note 7.2 to the consolidated financial statements appearing elsewhere in this annual report on Form 20-F and in *Critical Accounting Policies Acquisition accounting*.

The purchase price allocation as of December 31, 2006 remains preliminary with respect to the restructuring plans under consideration, the ongoing negotiations with Novartis regarding *Betaferon*®/*Betaseron*® and other events occurring after the balance sheet date that will improve our understanding of the fair values. One of the effects of the purchase price allocation is an upward revaluation or step-up of the acquired inventories and non-current assets. Most of the non-current assets subject to the step-up are intangible assets related to production (*e.g.*, patents, production know-how, etc.). Our annual amortization charges will be materially increased by

approximately 1 billion per annum as a result of the step-up for a weighted average period of 14 years. This in turn will result in a long-term increase in the cost of production of goods manufactured after the acquisition date.

The step-up in value of the acquired inventory of 848 million, by contrast, will materially affect our results of operations in the short term, as we will recognize the difference between the sales prices of the affected inventory we sell and its stepped-up values as charges to our earnings in the periods in which the inventory is sold. About 50 percent of the charges relating to the inventory step-up have been recognized in 2006 and the remaining ones are expected to be recognized until 2008. See also *Critical Accounting Policies Acquisition accounting*.

Effect on operating result from Schering AG integration

In 2006, we incurred expenses totaling 179 million in connection with the integration of Schering AG, Berlin, Germany. This amount includes an offsetting gain of 74 million from the related sale of a building. The expenses mainly relate to severance and retention payments, restructuring activities and accelerated asset depreciation, and external advisors.

Effect on cash flows from Schering AG acquisition

The cash outflow in connection with the acquisition of Schering, AG, Berlin, Germany totaled 15.2 billion, including the purchase price for 96.24 percent of the outstanding shares of Bayer Schering Pharma AG (as of December 31, 2006), less the assumed cash and cash equivalents of approximately 1 billion. In addition, we assumed financial liabilities of 0.2 billion. Fur further details refer to *Liquidity and Capital Resources 2004, 2005 and 2006 Cash Flows Financing Activities*.

General Economic Situation

The dynamic pace of global economic growth established in 2005 continued into 2006, although the upswing slowed down somewhat during the course of the year. Due to brisk demand for raw materials, especially in Asia and the United States, coupled with political instability in some oil-producing countries, the price of oil rose significantly in the first half of 2006, clouding the general economic picture. Economic expansion nonetheless remained remarkably robust and became much more broadly based as the year progressed, buoyed in the second half by still favorable monetary conditions and relenting pressure from oil prices. The positive economic trend spurred the employment markets in the major industrialized countries, with private consumption being strengthened as a result. Slackening growth in the United States was partially offset by more rapid expansion in Europe. Growth in the emerging economies remained basically robust throughout the year.

Raw Materials, Pricing

The single most important factor that affects our costs is the price of raw materials especially for our Materials and Systems products. Petrochemical feedstocks are important raw materials in many of our products, especially in our Materials and Systems segments. We do not produce petrochemical raw materials. For this reason and due to the volatility of oil and petroleum commodity and futures markets in recent years, our single greatest raw materials sensitivity is to fluctuations in the price of petrochemicals and related derivative products. In 2006, these prices were approximately 9 percent above the average prices in 2005. During the same period, the average annual crude oil price (IPE Brent) increased by approximately 20 percent.

Expenses and gains relating to the reorientation of our business and to other material unusual effects

We have recorded a number of charges and expenses in recent years in connection with the transactions and other measures we have been taking as part of the strategic reorientation of our business and the related reorganization of our remaining businesses to concentrate on and refocus our core businesses. These charges and expenses include selective divestitures of businesses and assets that no longer fit our strategic plan, such as the spin-off of LANXESS and the related reorganization of portions of our remaining polymers activities, the divestiture of our plasma business and the divestitures of a number of operations within CropScience and related restructuring and consolidation of CropScience s activities in different countries. The reorganization also includes

the reorientation of our Pharmaceuticals segment, including the restructuring of the research and development and other pharmaceutical activities and ultimately the acquisition of Schering AG, Berlin, Germany. Moreover, these charges also include charges relating to several major legal matters that we believe are sufficiently distinguishable from our normal operating business that an understanding of their magnitudes may enhance the comparability of our results of operations among financial periods.

The following table sets forth charges and expenses relating to these activities. We have presented them individually and in the aggregate to assist readers in understanding their effects on our results of operations in prior periods. Consistent with our consolidated income statement presentation and in accordance with IFRS 5 (Non-current Assets Held for Sale and Discontinued Operations), the figures presented below are for our continuing business only.

Description	**2004**	**2005**	**2006**
Impairment charges and write-downs	**0**	**(18)**	**(66)**
Restructuring Charges and unscheduled amortization			
Relating to HealthCare activities	(69)	(41)	(24)
Relating to CropSciences activities	(13)	(35)	(79)
Relating to MaterialScience activities	0	(33)	(60)
Relating to Others activities	0	0	(37)
	(82)	**(109)**	**(200)**
Portfolio changes			
Expenses relating to the integration of Schering AG, Germany[(a)]	0	0	(179)
Expenses relating to the integration of the Roche consumer health business	(14)	(71)	(24)
Miscellaneous	(26)	(1)	41
	(40)	**(72)**	**(162)**
Litigation related and other charges			
Arbitration proceedings in the United States relating to the production of propylene oxide	0	0	(109)
Provisions in connection with antitrust litigation related to polymer products	(27)	(336)	(37)
Charges in connection with the termination of the co-promotion agreement with GlaxoSmithKline for *Levitra*®	0	(106)	0
One-time non-cash gain due to changes to our pension plans in the United States and Germany	0	238	0
Litigation-related expenses in connection with HealthCare products	(63)	(105)	(59)
Miscellaneous	(30)	(25)	0
	(120)	**(334)**	**(205)**
Total	**(242)**	**(533)**	**(633)**

[(a)] For details on charges relating to the Schering AG acquisition refer to *Acquisition and divestiture activities*.

Impairment charges and write-downs

In 2006, the charge of 66 million resulted from the write-downs relating to our cancer drug *Viadur*® and an in-process research and development asset. In 2005, impairment charges and write-downs related to *Viadur*®. In 2004, we did not incur material impairment charges or write-downs.

Restructuring charges

In 2006, the restructuring charges resulted mainly from the restructuring project in our CropScience business (74 million), restructuring activities at our MaterialScience s sites in New Martinsville, West Virginia and Baytown, Texas (55 million); and from restructuring measures regarding the reorganization of the business activities by Bayer Industry Services (30 million).

In 2005, the restructuring charges related mainly to the reorganization of our polyurethane business (33 million), restructuring measures for our CropScience activities in France (23 million) and for our pharmaceutical activities in Germany and the United States (22 million). In 2004, the major charges related to restructuring of our pharmaceutical research and development activities (24 million) and personnel reductions in connection with the Schering-Plough alliance (45 million). (Bayer Schering Pharma AG and Schering-Plough Corporation, New Jersey, are unaffiliated companies that have been totally independent of each other for many years.)

Portfolio changes

Acquisition and disposition activities also affect our results of operations, and are responsible for substantial fluctuations in our results from year to year. In connection with our strategic reorientation of our business and the related reorganization of our remaining businesses to concentrate on and refocus our core businesses, we have been disposing of numerous businesses, investments and participations. Our most recent transactions are described in Item 4, *Information on the Company History and Development of the Company.* Regarding the changes resulting from the acquisition of Schering AG, Berlin, Germany refer to *Acquisition and divestiture activities*.

In 2006, gains under Miscellaneous of 41 million related to the divestment of a family of mature herbicide products of our Crop Protection segment and the sale of an in-process research and development asset of our Pharmaceuticals segment. In 2004, the net negative effect under Miscellaneous of 26 million included 77 million in charges for the stock exchange listing of LANXESS and 51 million in gains from sales of licenses.

Litigation related and other charges

Our litigation related charges are described in Item 8, *Financial Information Legal Proceedings*.

Changes in Exchange Rates

Our net sales and our operating result are generally affected by changes in exchange rates. Because a substantial portion of our assets, liabilities, sales and earnings are denominated in currencies other than the euro zone currency, we have exposure to fluctuations in the values of these currencies relative to the euro. These currency fluctuations, especially the fluctuation of the value of the U.S. dollar relative to the euro, but also fluctuations in the currencies of the countries in which we have significant operations and/or sales, can have a material impact on our results of operations. We face both transaction risk, where our businesses generate sales in one currency but incur costs relating to that revenue in a different currency, and translation risk, which arises when we translate the income statements of our subsidiaries into euro for inclusion in our financial statements. We do not quantify the effects on our financial statements of transaction risks. Translation risks, which we do quantify and against which we do not hedge, do not affect our local currency cash flows or results of operations, but do affect our consolidated financial statements. For further information on transaction and translation risk, see Item 11, *Quantitative and Qualitative Disclosures about Market Risk Currency Risk.*

Changes in exchange rates were a significant driver of our results of operations in recent years. In 2005 and 2006, these changes were insignificant. The translation effects of exchange rate changes on our sales in 2006 were immaterial (compared to an increase of 0.3 billion in 2005 and to a decrease of 0.9 billion in 2004). The discussion of our operating results in *Bayer Group* and *Segment Data* includes sales figures adjusted for these translation effects. These adjusted sales figures represent the sales that we would have generated had the average exchange rates we used to translate our non-euro denominated revenues into euros remained constant in

the year under review as compared with the previous year. See Note 4.2 to the consolidated financial statements appearing elsewhere in this annual report on Form 20-F for the exchange rates for the euro to other currencies important for our results of operations.

Discontinued Operations

Reporting of Discontinued Operations

In the financial statements and other financial information included in this annual report on Form 20-F, certain business activities, that were divested or are in the process of being divested, are reported under discontinued operations in accordance with IFRS 5 and other applicable standards. Therefore, the Group s financial reporting is based primarily on continuing operations.

In 2006, the Diagnostics division as well as the H.C. Starck and Wolff Walsrode businesses are presented in the balance sheet line items Assets held for sale and discontinued operations and Liabilities directly related to assets held for sale and discontinued operations . In accordance with IFRS 5, the previous year s balance sheet has not been adjusted for any of these businesses.

The income statement and net cash provided by (used in) operating activities have been adjusted for the comparative periods 2005 and 2004 to reflect all discontinued operations. The individual items of the income statement such as sales, functional costs and non-operating result reflect only continuing operations of the Bayer Group for all years presented.

Diagnostics

At the end of June 2006, Bayer signed an agreement to sell the Diagnostics division to Siemens for approximately 4.3 billion. The transaction was closed in January 2007. The Diagnostics division is reported as discontinued operations prior to the sale.

The Diagnostics division offered a wide portfolio of in-vitro diagnostics products for evaluating and monitoring the therapy of numerous diseases. In the field of laboratory testing, the *Advia*® product family included medium- and high-throughput systems for immuno-diagnostics (the measurement of such substances as proteins, steroids, drugs and antibodies in patients blood), clinical chemistry, hematology and other diagnostic disciplines. In the area of near patient testing, products for use in the hospital and in physicians office laboratories included trademarks such as the *Rapid*™ family, *Multistix*® and the *Clinitek*® line of instruments. In the area of molecular testing, the product portfolio for virology infectious diseases included quantitative analysis, genotyping and resistance testing.

The Diagnostics division had net sales of 1,526 million in 2006, 1,433 million in 2005 and 1,322 million in 2004. Operating results of the Diagnostics division were 203 million in 2006, 179 million in 2005 and 109 million in 2004. The income from discontinued operations after taxes attributable to the Diagnostics division was 117 million in 2006, 118 million in 2005 and 71 million in 2004.

H.C. Starck

In November 2006, Bayer signed an agreement with two financials investors, Advent International and The Carlyle Group, concerning the sale of the H.C. Starck business to them for approximately 1.2 billion. The transaction closed in early February 2007.

The H.C. Starck business comprised a broad portfolio of products ranging from ceramic materials to metals such as tungsten, molybdenum, tantalum and niobium and their alloys and compounds for industrial customers in the aircraft, medical, chemical, electronic, lighting, tooling and optical components industries.

The H.C. Starck business had net sales of 985 million in 2006, 920 million in 2005 and 703 million in 2004. Operating results of the H.C. Starck business were 55 million in 2006, 83 million in 2005 and 69 million in 2004. The income from discontinued operations after taxes attributable to the H.C. Starck business was 32 million in 2006, 46 million in 2005 and 34 million in 2004.

Wolff Walsrode

In December 2006, Bayer signed an agreement with The Dow Chemical Company concerning the sale of the Wolff Walsrode business. The sale is subject to the approval of the relevant antitrust authorities. Assuming these approvals are received, we expect the closing of the transaction to occur by the end of the first half of 2007.

The Wolff Walsrode business develops, produces and markets cellulose derivatives for use in building materials, industrial coatings, flexible packaging ink and life sciences markets, as well as in specialized industrial fields. See Item 4, *Information on the Company Business WOLFF WALSRODE (Discontinued Operation)*.

The Wolff Walsrode business had net sales of 334 million in 2006, 329 million in 2005 and 328 million in 2004. Operating results of the Wolff Walsrode business were 40 million in 2006, 36 million in 2005 and 40 million in 2004. The income from discontinued operations after taxes attributable to the Wolff Walsrode business was 20 million in 2006, 20 million in 2005 and 20 million in 2004.

LANXESS

At the end of January 2005, we spun off the LANXESS subgroup to our stockholders, LANXESS thereupon ceased to be part of the Bayer Group. The shares of LANXESS AG have been listed on the Frankfurt Stock Exchange since January 31, 2005.

The LANXESS subgroup was deconsolidated from the Bayer Group effective January 31, 2005 and is no longer included in the balance sheet as of December 31, 2005. Net earnings of the LANXESS group for the month of January 2005 are recognized in Bayer Group net income for 2005. In the income and cash flow statements for 2005, as well as for the comparative period of 2004, LANXESS is reported under discontinued operations. Since February 1, 2005, sales from Bayer companies to LANXESS are reported as external net sales.

LANXESS had net sales of 503 million in 2005 (for January only) and 6,053 million in 2004. Operating results of LANXESS were 62 million in 2005 (for January only) and 78 million in 2004. The income from discontinued operations after taxes attributable to LANXESS was 38 million in 2005 (for January only) and minus 4 million in 2004.

For a discussion of the risks and uncertainties that continue to face us in connection with the LANXESS spin-off, please see Item 3, *Key Information Risk Factors Our transactions relating to LANXESS expose us to continuing liability* and Item 10, *Additional Information Material contracts*.

Plasma activities

At the end of March 2005, Bayer divested the U.S. plasma operations of its Biological Products division to two U.S. financial investors, Cerberus Capital Management, L.P., New York, New York and Ampersand Ventures, Wellesley, Massachusetts by transferring those activities to Talecris BioTherapeutics, Inc., a corporation formed by those two investors. The agreement covers the products, facilities and employees representing the plasma portion of the division. The remaining portion, consisting of our *Kogenate*® business, is not affected by this agreement and, effective January 1, 2006, forms part of our Pharmaceuticals segment.

2005 net earnings of minus 1 million from the discontinued U.S. plasma operations as well as purchase price adjustments are included in Bayer Group net income through March 31, 2005. We reduced our purchase price by 15 million as a result of purchase price adjustments that occurred after we divested our U.S. Plasma operations on March 31, 2005. The purchase price adjustments determined pursuant to the final sales agreement with the purchaser consisted of unfavorable working capital adjustments of 42 million, offset in part by contingent consideration received of 27 million. To account for the final agreement signed at the end of March 2005, we show the continued non-U.S. distribution as part of our continuing operations. In our financial statements for 2005 only the U.S. plasma business is reflected in discontinued operations. Revenues from our marketing activities for plasma products outside the United States are reflected in sales from continuing operations of our Pharmaceuticals segment.

The U.S. plasma operations had net sales of 124 million in 2005 (through March 31 only) and 427 million in 2004. Operating result of the U.S. plasma activities was minus 2 million in 2005 (through March 31 only) and

minus 97 million in 2004. The loss from discontinued operations after taxes attributable to the U.S. plasma operations was 1 million in 2005 (through March 31 only) and 63 million in 2004.

The following table sets forth net sales, operating result and income (loss) from discontinued operations after tax attributable to Diagnostics, H.C. Starck, Wolff Walsrode, LANXESS and the U.S. activities of our former plasma business for the three years under review. For further information, refer also to Note 7.2 to the consolidated financial statements appearing elsewhere in this annual report on Form 20-F.

	Diagnostics			**H.C. Starck**			**Wolff Walsrode**		
	2004	**2005**	**2006**	**2004**	**2005**	**2006**	**2004**	**2005**	**2006**
	(Euros in millions)			**(Euros in millions)**			**(Euros in millions)**		
Net sales	1,322	1,433	1,526	703	920	985	328	329	334
Operating result	109	179	203	69	83	55	40	36	40
Net income (loss)	71	118	117	34	46	32	20	20	20
Affected segments	(Former Diagnostics, Diabetes Care)			Materials			Materials		

	LANXESS			**Plasma**			**Total Discontinued Operations**		
	2004	**2005**	**2006**	**2004**	**2005**	**2006**	**2004**	**2005**	**2006**
	(Euros in millions)			**(Euros in millions)**			**(Euros in millions)**		
Net sales	6,053	503		427	124		8,833	3,309	2,845
Operating result	78	62		(97)	(2)		199	358	298
Net income (loss)	(4)	38		(63)	(1)		58	221	169
Affected segments	(LANXESS)			Pharmaceuticals					

Bayer Group

The financial information presented for 2004, 2005 and 2006 reflects the continuing operations of the Bayer Group and its segments, except where specific reference is made to discontinued operations or Group total. In 2006, due to the Schering acquisition and the discontinued Diagnostics division, we changed our segment structure and reporting to reflect our new corporate structure. We restated our segment reporting for 2004 and 2005 accordingly. The Diagnostics division and the H.C. Starck and Wolff Walsrode businesses are reported as discontinued operations. (The names Bayer Schering Pharma or Schering as used in this annual report on Form 20-F always refer to Bayer Schering Pharma AG, Berlin, Germany, or its predecessor, Schering AG, Berlin, Germany, respectively. Bayer Schering Pharma AG also includes business conducted by affiliated entities. Bayer Schering Pharma AG and Schering-Plough Corporation, New Jersey are unaffiliated companies that have been totally independent of each other for many years.)

The following table shows the operating and financial results for Bayer.

	2004[a]	Change from Previous Year (%)	2005[a],[b]	Change from Previous Year (%)	2006[c]
			(Euros in millions)		
Net sales	20,925	18.0	24,701	17.2	28,956
Gross profit	9,839	14.7	11,289	21.2	13,681
as percentage of sales (%)	47.0		45.7		47.2
Selling expenses	(4,783)	(9.7)	(5,247)	(24.5)	(6,534)
Research and development expenses	(1,772)	2.4	(1,729)	(32.9)	(2,297)
General administration expenses	(1,285)	(1.7)	(1,307)	(22.3)	(1,599)
Other operating income	802	(3.4)	775	(5.8)	730
Other operating expenses	(1,144)	(10.8)	(1,267)	3.8	(1,219)
Operating result	1,657	51.7	2,514	9.9	2,762
as percentage of sales (%)	7.8		10.2		9.5
Non-operating result	(632)	4.7	(602)	(29.9)	(782)
Income before income taxes	1,025	86.5	1,912	3.6	1,980
Income from continuing operations after taxes	624	120.2	1,374	11.1	1,526
Income from discontinued operations after taxes	58		221	(23.5)	169
Group net income (total)	685	133.1	1,597	5.4	1,683

(a) 2004 and 2005 data have been adjusted to reflect the fact that the Diagnostics division, the H.C. Starck business and the Wolff Walsrode business are reported as discontinued operations. For further information on these restatements, see *Discontinued Operations* and Note 7.2 to the consolidated financial statements appearing elsewhere in this annual report on Form 20-F.

(b) The consumer health business acquired from Roche is reflected in the income statement with effect from January 1, 2005.

(c) The pharmaceuticals business acquired from Schering AG, Germany is reflected in the income statement with effect from June 23, 2006.

The following table shows a geographical breakdown of our sales from continuing operations based on where we sold our products.

	2004[a]	Change from Previous Year (%)	2005[a],[b]	Change from Previous Year (%)	2006[c]
			(Euros in millions)		
Europe	8,751	23.1	10,771	17.5	12,652
North America	5,790	12.2	6,496	19.8	7,779
Asia/ Pacific	3,509	16.1	4,073	13.2	4,610
Latin America/ Africa/ Middle East	2,875	16.9	3,361	16.5	3,915

(a) 2004 and 2005 data have been adjusted to reflect the fact that the Diagnostics division, the H.C. Starck business and the Wolff Walsrode business are reported as discontinued operations. For further information on these restatements, see *Discontinued Operations* and Note 7.2 to the consolidated financial statements appearing elsewhere in this annual report on Form 20-F.

(b) The consumer health business acquired from Roche is reflected in the income statement with effect from January 1, 2005.

(c) The pharmaceuticals business acquired from Schering AG, Germany is reflected in the income statement with effect from June 23, 2006.

2006 compared with 2005

Net Sales

Net sales represent the gross inflow of economic benefits that are recognized upon the transfer of risk or rendering of services to third parties. Net sales exclude rebates and discounts that we give our customers, as well as the amounts that we collect on behalf of third parties, such as sales taxes, goods and services taxes and value added taxes. Net sales of the Bayer Group rose by 17.2 percent, or 4,255 million, to 28,956 million in 2006, compared with 24,701 million in 2005. Had the average exchange rates we used to translate our non-euro denominated revenues into euros stayed constant in 2006 as compared with 2005, our net sales would have increased by 17.4 percent.

The acquired Schering AG business, which has been included in our financial statements since June 23, 2006, accounted for 3.1 billion, or 12.5 percent of the increase. Changes in our portfolio of businesses, primarily relating to the acquisition of the business of Schering AG, Berlin, Germany, accounted for a net increase of 3,025 million (12.2 percent) in our net sales (For the composition of the changes in our portfolio, see *Introduction Acquisition and divestiture activities*). Without those portfolio changes, our net sales grew by 5.0 percent, with this increase primarily attributable to our HealthCare (plus 9.4 percent) and MaterialScience (plus 7.0 percent) businesses. Sales of our CropScience business fell slightly by 2.6 percent, when considered without the portfolio changes.

Gross Profit

Gross profit represents net sales after deducting cost of goods sold. Cost of goods sold includes the production costs of goods sold and the cost of goods purchased for resale. The cost of goods sold and services provided increased by 13.9 percent in 2006 to 15,275 million, due mainly to the acquired Schering business (1,338 million), and also as a result of the overall growth in our businesses and higher raw material costs. The ratio of cost of goods sold to total net sales was 52.8 percent in 2006, compared with 54.3 percent in 2005.

Operating Result

Operating result represents gross profit after deducting selling expenses, research and development expenses, general administration expenses and other operating income and expenses.

Selling expenses increased by 1,287 million, or 24.5 percent, to 6,534 million in 2006, primarily due to inclusion of the Schering business (956 million) and also as a result of the overall growth in our businesses. Due to the increase in the proportion of life science activities in our portfolio (which include HealthCare and CropScience), for which selling cost tend to be higher than in our other business, the ratio of selling expenses to sales rose to 22.6 percent, from 21.2 percent in 2005.

Research and development expenses rose by 568 million, or 32.9 percent, to 2,297 million in 2006, mainly because of the inclusion of Schering activities (552 million).

General administration expenses increased by 292 million, or 22.3 percent, to 1,599 million in 2006, due primarily to the acquired Schering business (187 million).

Other operating income decreased by 45 million, or 5.8 percent, to 730 million in 2006. The Schering entities accounted for 86 million of the total. Income in 2006 included gains from the sale of a building (74 million) and the divestiture of low-volume product lines and active ingredients of our CropScience business (totaling 47 million). Whereas in 2005, other operating income included a one-time non-cash gain of 238 million from changes to our pension systems in the United States and Germany.

Other operating expenses decreased by 48 million, or 3.8 percent, to 1,219 million. In 2006, other operating expenses mainly related to charges in connection with the integration of the Schering business (253 million). Charges relating to restructuring activities include the project initiated in summer 2006 in our CropScience business (74 million), restructuring activities at our MaterialScience sites in New Martinsville, West Virginia and Baytown, Texas (55 million) and the reorganization of the business activities of Bayer Industry Services (30 million). Litigation-related charges, totaling 205 million (2005: 451 million), mainly related to arbitration proceedings in the United States in connection with the production of propylene oxide (109 million), to the pending antitrust litigation in polymer products (44 million) and to further charges in connection with HealthCare products (59 million). Furthermore, other operating expenses include write-downs of 66 million relating to our cancer drug *Viadur®* and an in-process research and development asset. In 2005, expenses included the establishment of provisions in connection with antitrust proceedings involving products in the polymers area (336 million) and litigation-related expenses in connection with HealthCare products (105 million).

Operating result improved by 9.9 percent to 2,762 million in 2006, compared with 2,514 million in 2005. The acquired Schering AG business accounted for minus 119 million. Inventory step-up and amortization related to the acquired long-lived assets decreased our operating result from the Schering business by 551 million.

Non-Operating Result

Non-operating result represents income and expenses from investments in affiliated companies, interest income and expenses, and other non-operating income and expenses. Non-operating result declined by 180 million, or 29.9 percent, to an expense of 782 million. Net income from investments in affiliated companies improved significantly from minus 22 million in 2005 to 207 million in 2006, while net interest expense rose to 728 million due to the acquisition-related increase in debt in the middle of the year. Interest expense of 370 million relates to the financing of the acquisition of Schering AG, Germany. The income from investments in affiliated companies mainly comprises the gain of 236 million from the sale of our 49.9 percent interest in the joint venture GE Bayer Silicones.

Income Before Income Taxes

Income before income taxes represents operating result plus non-operating result. In 2006, the income before income taxes was 1,980 million, as compared with 1,912 million in 2005.

Income Taxes

Income taxes represent the income taxes paid or accrued in the individual countries, plus deferred taxes. We recognized an income tax charge of 454 million in 2006, as compared with 538 million in 2005. The tax rate

for our Group was 22.9 percent in 2006, as compared to 28.1 percent in 2005. The tax result was composed of income taxes paid or payable of 763 million as well as deferred taxes that led to a net income of 309 million. The lower tax expense was due mainly to first-time recognition of deferred tax assets for loss carry-forwards of 203 million.

Income from Discontinued Operations After Taxes

According to IFRS 5 (Non-current Assets Held for Sale and Discontinued Operations) the post-tax profit or loss of discontinued operations and the post-tax gain or loss recognized on the measurement to fair value less costs to sell or on the disposal of the disposal group are reported separately in a single line item on the income statement.

Income from discontinued operations after taxes amounted to 169 million in 2006, compared to 221 million in 2005. Income from discontinued operations after taxes relate to the Diagnostics division and the H.C. Starck and Wolff Walsrode businesses in all periods presented. In 2005, the divested U.S. plasma operations and LANXESS are also included in this figure. Due to the composition of the discontinued operations group of business, the figures presented are not comparable.

For details refer to *Discontinued Operations* or to Note 7.2 to the consolidated financial statement included elsewhere in this annual report on Form 20-F.

Net Income

Net income represents income from continuing operations after taxes plus income from discontinued operations after taxes minus minority stockholders interest. Group income rose by 86 million to 1,683 million from net income of 1,597 million in 2005. Income from continuing operations after taxes amounted to 1,526 million in 2006 and 1,374 million in 2005. Income from discontinued operations after taxes was 169 million in 2006 and 221 million in 2005.

2005 compared with 2004

Net Sales

Net sales of the Bayer Group rose by 18.0 percent, or 3,776 million, to 24,701 million in 2005, compared with 20,925 million in 2004. Had the average exchange rates we used to translate our non-euro denominated revenues into euros stayed constant in 2005 as compared with 2004, our net sales would have increased by 16.7 percent. In comparison with 2004, price increases of 7.0 percent that were primarily attributable to MaterialScience led to an increase of 1,472 million in net sales. Changes in our portfolio of businesses, primarily relating to the consumer health business acquired from Roche in the first quarter of 2005 and our spin-off of LANXESS (leading to a reclassification of sales to LANXESS from inter-segment sales to external sales), accounted for an increase of 2,070 million (9.9 percent) in our net sales.

Gross Profit

The cost of goods sold and services provided increased by 21.0 percent in 2005 to 13,412 million, due mainly to the overall growth in our business, in particular in our MaterialScience business, and due to the changes in our portfolio, primarily relating to the acquired consumer health business and the LANXESS spin-off (analogous to presenting sales to LANXESS as external sales, cost of goods sold increased because of related costs). The ratio of the cost of goods sold to total net sales was 54.3 percent in 2005, compared with 53.0 percent in 2004. The single largest driver of this increase was higher raw material prices.

Operating Result

Selling expenses increased by 464 million, or 9.7 percent, to 5,247 million in 2005, primarily due to higher marketing and distribution costs in our HealthCare and MaterialScience businesses.

Research and development expenses declined by 43 million, or 2.4 percent, to 1,729 million in 2005, mainly because of our concentration on our strategic core businesses within Bayer HealthCare and Bayer CropScience.

General administration expenses increased by 22 million, or 1.7 percent, to 1,307 million in 2005, due primarily to the acquisition of Roche s consumer health business. The resulting increase in cost could only partly be offset by cost reduction measures.

Other operating income decreased by 27 million, or 3.4 percent, to 775 million in 2005. Income in 2005 included gains of 238 million from changes to our pension systems in the United States and Germany. In 2004, other operating income included 161 million gains relating to pension and 51 million in gains from sales of licenses.

Other operating expenses increased by 123 million, or 10.8 percent, to 1,267 million. The expenses included the establishment of provisions in connection with antitrust proceedings involving products in the polymers area (336 million) and litigation-related expenses in connection with HealthCare products (105 million). Other operating expenses in 2004 included 139 million in connection with a number of legal matters. Moreover, in 2004 before the adoption of IFRS 3, amortization of goodwill and intangible assets with indefinite useful lives was 176 million.

Operating result improved by 51.7 percent, or 857 million, to 2,514 million in 2005, compared with 1,657 million in 2004. The largest contributions to the growth in operating result were made by the Materials (330 million) and Systems segments (388 million) and resulted largely from price increases.

Non-Operating Result

Non-operating result improved by 30 million, or 4.7 percent, to an expense of 602 million. Net loss from investments in affiliated companies declined significantly, while net interest expense rose due to the acquisition-related increase in net debt at the beginning of the year. The loss from affiliated companies mainly comprises an equity-method loss of 47 million (2004: 131 million) from two production joint ventures with Lyondell.

Income Before Income Taxes

In 2005 we had positive income before income taxes of 1,912 million, as compared with 1,025 million in 2004.

Income Taxes

We recognized an income tax charge of 538 million in 2005, as compared with 401 million in 2004. The tax rate for our Group was 28.1 percent in 2005. The tax result was composed of income taxes paid or payable of 463 million as well as deferred taxes that led to a net charge of 75 million.

Income from Discontinued Operations After Taxes

Income from discontinued operations after taxes amounted to income of 221 million in 2005, compared to 58 million in 2004. Income from discontinued operations after taxes relate to the Diagnostics division, H.C. Starck and Wolff Walsrode business, as well as to the divested U.S. plasma operations and LANXESS. The 2005 figure includes the income from our former LANXESS segment for January 2005 as well as the income from the U.S. activities of our former plasma business for the first quarter 2005, including adjustments in connection with the purchase price. We reduced our purchase price by 15 million as a result of purchase price adjustments that occurred after we divested our U.S. Plasma operations on March 31, 2005. The purchase price adjustments determined pursuant to the final sales agreement with the purchaser consisted of unfavorable working capital adjustments of 42 million, offset in part by contingent consideration received of 27 million.

For details refer to *Discontinued Operations* or to Note 7.2 to the consolidated financial statement included elsewhere in this annual report on Form 20-F.

Net Income

Group income rose by 912 million to 1,597 million from a net income of 685 million in 2004. Income from continuing operations after taxes amounted to 1,374 million in 2005 and 624 million in 2004. Income from discontinued operations after taxes was 221 million in 2005 and 58 million in 2004.

Segment Data

In 2006, due to the acquisition of the business of Schering AG, Berlin, Germany and the divestiture of the Diagnostics division, we changed our segment structure and reporting to reflect our new corporate structure in compliance with IAS 14 (Segment Reporting). We restated our segment reporting for 2004 and 2005, accordingly. The changes in our segments are as follows: Due to the divestiture of our U.S. Plasma business in 2005, the former Pharmaceuticals, Biological Products segment has been renamed as the Pharmaceuticals segment with effect from January 1, 2006. The historical Bayer pharmaceuticals and biological products businesses and the acquired Schering business form the Pharmaceuticals segment. The former Consumer Care and Animal Health segments were combined with the Diabetes Care division to form the new segment Consumer Health. Due to the divestment activities regarding the H.C. Starck and Wolff Walsrode businesses, the Materials segment comprises the Polycarbonates and Thermoplastic Polyurethanes business units. The Diagnostics division, as well as the H.C. Starck and Wolff Walsrode businesses, are reported as discontinued operations. See also Discontinued Operations.

Pharmaceuticals

	2004	Change from Previous Year	2005	Change from Previous Year	2006[a]
		(%)		(%)	
			(Euros in millions)		
Net sales (external)	3,961	2.7	4,067	83.9	7,478
Intersegment sales	38	52.6	58	(12.1)	51
Operating result	399	19.0	475	18.5	563

[a] The acquired pharmaceuticals business of Schering AG is reflected in the income statement with effect from June 23, 2006.

The following table shows our sales during the past three years from the products that account for the largest portion of segment sales.

	2004		2005		2006	
Product[a]	**Sales (Euros in millions)**	**Percentage of Segment Sales**	**Sales (Euros in millions)**	**Percentage of Segment Sales**	**Sales (Euros in millions)**	**Percentage of Segment Sales**
Betaferon®/Betaseron® (Specialized Therapeutics)[b]					535	7.2
Yasmin®/YAZ®/Yasminelle® (Women s Health)[b]					451	6.0
Kogenate® (Hematology/ Cardiology)	563	14.2	663	16.3	787	10.5
Adalat® (Primary Care)	670	16.9	659	16.2	657	8.8
Ciprobay®/ Cipro® (Primary Care)	837	21.2	525	12.9	513	6.9
Avalox®/ Avelox® (Primary Care)	318	8.0	364	9.0	396	5.3
Levitra® (Primary Care)	193	4.9	260	6.4	314	4.2
Mirena® (Women s Health)[b]					166	2.2
Magnevist® (Diagnostic Imaging)[b]					171	2.3
Glucobay® (Primary Care)	278	7.0	295	7.3	308	4.1
Other	1,102	27.8	1,301	31.9	3,180	42.5
Total	3,961		4,067		7,478	

[a] Products are ranked by the fourth quarter 2006 sales.

[b] Acquired as part of Schering AG s pharmaceutical business in 2006.

The 2006 sales figures include the acquired Schering business beginning on June 23, 2006. The Bayer Group financial statements do not include Schering results for the previous years and for the period from January 1 through June 22, 2006. The commentaries given below on business developments related to the products acquired from Schering are based on full year data that do not form part of the Bayer Group financial statements. Sales per product for the following discussion are based on sales data for the years ended December 31, 2006 and 2005 as prepared by Schering. We refer to those unaudited full-year figures as year-on-year . In some cases in the following discussion where the context requires, we refer to the Schering sales from June 23, 2006 to December 31, 2006 as *pro rata temporis*.

The following table shows unaudited sales figures for the full year 2006 and 2005 as prepared by Schering AG.

Year-on-year sales per product (unaudited)	**2005**	**2006**
	(Euros in millions)	
Betaferon®/*Betaseron*® (Specialized Therapeutics)	867	991
Yasmin®/*YAZ*®/*Yasminelle*® (Women s Health)	586	794
Magnevist® (Diagnostic Imaging)	328	323
Mirena® (Women s Health)	243	301

2006 compared with 2005

Sales of the Pharmaceuticals segment rose by 3,411 million, or 83.9 percent, to 7,478 million in 2006, mainly due to the inclusion of the Schering business. (The names Bayer Schering Pharma or Schering as used in this annual report on Form 20-F always refer to Bayer Schering Pharma AG, Berlin, Germany, or its

predecessor, Schering AG, Berlin, Germany, respectively. Bayer Schering Pharma AG also includes business conducted by affiliated entities. Bayer Schering Pharma AG and Schering-Plough Corporation, New Jersey, are unaffiliated companies that have been totally independent of each other for many years.) Had the average exchange rates we used to translate our non-euro denominated revenues into euros stayed constant in 2006 as compared with 2005, our net sales in this segment would have increased by 84.5 percent. Changes in our portfolio of businesses relating to the acquired Schering business in 2006 (3,082 million) and to the termination of distribution activities in Canada for our divested Plasma business (minus 100 million), accounted for an increase of 2,982 million (73.3 percent) in our net sales. Leaving aside those portfolio changes, our net sales grew by 10.8 percent, which was mainly attributable to our Primary Care and Oncology business units.

Sales of the Primary Care business unit rose by 9.2 percent in 2006, to 3,091 million. This increase was due primarily to higher sales of *Levitra*® (plus 20.8 percent), *CardioAspirin*® (plus 18.1 percent) and *Avalox*®/ *Avelox*® (plus 8.8 percent). In addition, sales were boosted by the inclusion of the blood pressure treatments *Pritor*® and *PritorPlus*®, for which we acquired the marketing rights for certain European countries from GlaxoSmithKline in January 2006. Sales from the andrology business acquired from Schering in 2006 were included for the first time, amounting to 31 million in 2006. Mounting competition from generic products led to a slight 2.3 percent decline in sales of *Cipro*®/*Ciprobay*®.

Sales of the Hematology/ Cardiology business unit receded by 4.9 percent to 1,142 million. The effects of terminating our plasma distribution, primarily in Canada at the end of March 2006, and markedly lower sales of *Trasylol*® (minus 33.5 percent) were nearly offset by the growth in sales of *Kogenate*® (plus 18.7 percent). Two separate observational studies and a follow-up study to one of the observational studies reported on the possible link between the administration of *Trasylol*®(aprotinin), our product for use during open-heart surgery, and severe renal dysfunction and vasoconstriction (myocardial infarction and stroke) or increased long-term mortality rates. We are currently cooperating closely with the relevant regulatory authorities to resolve these questions. For further details refer to Item 4, *Information on the Company Business Bayer HealthCare Pharmaceuticals Update on Trasylol®-marketed product*.

Our Oncology business unit increased sales by 397 million to 432 million. This figure includes 238 million in sales of the acquired oncology business of Schering AG as of June 23, 2006 with the key products *Fludara*®, *Androcur*® and *Campath*®. Our new cancer drug *Nexavar*®, first launched in December 2005, performed well in the market, with sales of 130 million.

In our Women s Health business unit, which focuses on contraception, we achieved *pro rata temporis* sales of 1,320 million. The main growth driver was the oral contraceptive product family *Yasmin*®/*YAZ*®/*Yasminelle*®, year-on-year sales of which were up by 35.5 percent in 2006. Year-on-year sales of our intrauterine system *Mirena*® also advanced by 23.9 percent.

Sales of the Diagnostic Imaging business unit were 697 million (*pro rata temporis*). Year-on-year sales of our two main products *Magnevist*® and *Ultravist*® dropped by 1.5 and 10.5 percent, respectively, with lower sales of the latter attributable to the voluntary withdrawal of the 370 mgI/ml formulation. We resumed marketing of this product in numerous countries in the first quarter of 2007. By contrast, Medrad, which markets application technologies for contrast agents worldwide, grew year-on-year sales by 13.1 percent.

Sales of the Specialized Therapeutics business unit amounted to 678 million (*pro rata temporis*). Sales of our top product *Betaferon*®/*Betaseron*® used to treat multiple sclerosis expanded by 14.3 percent year-on-year.

The Dermatology business unit had sales of 118 million (*pro rata temporis*), with improved performance by the unit s two best-selling products, *Skinoren*® (plus 17.1 percent year-on-year) and *Advantan*® (plus 10.6 percent year-on-year).

Operating result of the Pharmaceuticals segment improved by 88 million, or 18.5 percent, to 563 million, with the acquired Schering business accounting for an operating loss of 119 million. Inventory step-up and amortization related to the acquired long-lived assets decreased our operating result from the Schering business by 551 million. Without the changes in our portfolio of businesses, operating result increases by 207 million, due especially to improved sales performance by *Kogenate*®, *Levitra*® and *Avalox*®/*Avelox*®. Operating result in 2006 was negatively affected by charges, totaling 371 million, primarily relating to expenses for the integration

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of Schering (179 million), to litigation-related charges (59 million) and to write-downs relating to our cancer drug *Viadur*® and an in-process research and development asset (together 66 million). The amount of 179 million in connection with the Schering integration includes an offsetting gain from a related sale of a building of 74 million. Operating result in 2005 was negatively affected by charges, totaling 140 million, including charges in connection with the termination of our co-promotion agreement with GlaxoSmithKline for *Levitra*® outside the United States (106 million), further litigation-related charges and measures relating to restructuring projects and unscheduled amortization.

2005 compared with 2004

Sales of the Pharmaceuticals segment rose by 106 million, or 2.7 percent, to 4,067 million in 2005. Had the average exchange rates we used to translate our non-euro denominated revenues into euros stayed constant in 2005 as compared with 2004, our net sales in this segment would have increased by 1.7 percent.

We achieved growth in our sales of specialty products, particularly *Trasylol*®, in the United States, and of *Avelox*® and *Levitra*® outside the United States. This enabled us partially to offset a 312 million decline in sales due to the expiration of the U.S. patent on our anti-infective *Cipro*® and the marketing and distribution of our primary care products in the United States by Schering-Plough. (Bayer Schering Pharma AG and Schering-Plough Corporation, New Jersey, are unaffiliated companies that have been totally independent of each other for many years.) Our sales of *Kogenate*® expanded, mostly in Europe and the United States, by 100 million, or 17.8 percent, to 663 million. In Europe and Canada, we benefited from the market introduction of our *Bio-Set*® delivery device for more convenient infusion.

Operating result of the Pharmaceuticals segment improved by 76 million, or 19.0 percent, to 475 million, due mainly to improved cost structures and increases in sales as discussed above. Operating result in 2005 was negatively affected by charges, totaling 140 million, including charges in connection with the termination of our co-promotion agreement with GlaxoSmithKline for *Levitra*® outside the United States (106 million), further charges for *Lipobay/ Baycol* (43 million) and measures relating to restructuring projects and unscheduled amortization in the United States and Germany (40 million). Those charges were partially offset by a one-time non-cash gain of 49 million due to changes to our pension plans in the United States and Germany. In 2004, items with material impact on operating result totaling minus 53 million comprised mainly restructuring charges (69 million), *Lipobay/ Baycol* charges (47 million), gains from a license sale (39 million) and curtailment of pension plans (24 million).

Consumer Health

With effect from June 30, 2006, the former Consumer Care and Animal Health segments were combined with the Diabetes Care division in the new segment Consumer Health. The Diagnostics division is reported as discontinued operations.

	2004	Change from Previous Year	2005[a]	Change from Previous Year	2006
		(%)	(Euros in millions)	(%)	
Net sales (external)	2,775	41.6	3,929	8.1	4,246
Intersegment sales	18	16.7	21	(66.7)	7
Operating result	448	0.0	448	67.4	750

[a] The consumer health business acquired from Roche is reflected in the income statement with effect from January 1, 2005.

2006 compared with 2005

Sales of the Consumer Health segment rose by 317 million, or 8.1 percent, to 4,246 million in 2006. Had the average exchange rates we used to translate our non-euro denominated revenues into euros stayed constant in 2006 as compared with 2005, our net sales in this segment would have increased by 8.5 percent.

All divisions contributed to the improved performance of our Consumer Health segment. Sales of the Consumer Care division expanded by 7.5 percent to 2,531 million. Among our top products, *Aleve*® (plus 27.5 percent), *Bepanthen*®/*Bepanthol*® (plus 14.9 percent) and *Canesten*® (plus 11.7 percent) posted the largest sales gains.

Sales of our Diabetes Care division saw a significant increase by 12.8 percent to 810 million, due mainly to the outstanding performance of our blood glucose monitoring system *Ascensia*® *Contour*® (plus 69.6 percent), which replaces the older *Elite* systems in the *Ascensia*® product line, sales of which rose by 12.4 percent overall.

Sales of the Animal Health division rose by 5.7 percent to 905 million, due primarily to the improved performance of our *Advantage*® product line (plus 10.4 percent) and the continued market introduction of *Profender*®.

For a table with changes in sales of our major products, please refer to the relevant segment discussion in Item 4, *Information on the Company Business.*

Operating result of the Consumer Health segment grew by 302 million, or 67.4 percent, to 750 million. This increase was attributable to positive sales development and reduced production costs. Operating result for 2006 was negatively affected by charges totaling 31 million, with the primary charges being expenses for the integration of the consumer health business acquired from Roche (24 million) and restructuring activities in the United States (14 million). The previous year s operating result was primarily negatively affected by charges, totaling 114 million, related to integration activities and to litigation.

2005 compared with 2004

Sales of the Consumer Health segment rose by 1,154 million, or 41.6 percent, to 3,929 million in 2005. Had the average exchange rates we used to translate our non-euro denominated revenues into euros stayed constant in 2005 as compared with 2004, our net sales in this segment would have increased by 40.3 percent.

Sales of the Consumer Care division rose by 1,019 million, or 76.3 percent, to 2,355 million in 2005. The integration of the consumer health business acquired from Roche proceeded more favorably than we had anticipated. Large sales increases were recorded by products integrated into our portfolio, especially *Bepanthen*®/ *Bepanthol*®, *Rennie*® and *Supradyn*®, with the new activities accounting for sales of 1,061 million in 2005. Without taking into account the sales attributable to the acquired consumer health business, our segment sales declined by 3.1 percent.

In the Diabetes Care division, sales increased by 10.0 percent to 718 million, mainly due to strong growth in Europe.

Sales of the Animal Health division rose by 70 million, or 8.9 percent, to 856 million in 2005. The increase was mainly the result of a strong performance by our *Advantage*® product line in the United States. Also contributing to growth were the market introductions of our parasiticides *Advocate*® in Europe and Canada and *Profender*® in Europe.

Operating result of the Consumer Health segment stayed constant at 448 million. This was after the effect of acquiring inventories from Roche at fair value, which decreased margins by 57 million. In 2005, operating result was negatively affected by net charges (in total 114 million, 2004: 30 million) with material impact on operating result including charges of 71 million related to the integration of the consumer health business acquired from Roche, litigation-related expenses of 62 million and charges of 19 million in connection with the relocation of the Diabetes Care headquarters. These charges were partially offset by a one-time non-cash gain of 38 million due to changes to our pension plans in the United States and Germany.

Crop Protection

	2004	Change from Previous Year (%)	2005	Change from Previous Year (%)	2006
			(Euros in millions)		
Net sales (external)	4,957	(1.7)	4,874	(4.7)	4,644
Intersegment sales	71	(1.4)	70	(15.7)	59
Operating result	386	37.8	532	(27.8)	384

2006 compared with 2005

Sales in the Crop Protection segment declined 230 million, or by 4.7 percent, to 4,644 million in 2006. Had the average exchange rates we used to translate our non-euro denominated revenues into euros stayed constant in 2006 as compared with 2005, our net sales in this segment would have decreased by 5.2 percent in 2006.

Sales of our Insecticides business unit fell by 7.0 percent overall, to 1,219 million. The decline was attributable to the adverse market environment in Brazil, unfavorable regional weather conditions, increasing competition from generics and divestitures of mature insecticide products. Business with insecticides in China, however, developed favorably. Worldwide sales of our new ketoenols *Oberon*® and *Envidor*® increased significantly. Sales of the Fungicides business unit receded 3.8 percent to 1,200 million. One reason for the decrease was the prolonged droughts in Australia, parts of the United States and parts of Europe, which led to a decrease in fungal infestation in these areas. Another was the weakness of the farm economy in Brazil, which led to declining acreages, particularly for soybeans. These effects primarily impacted sales of our *Folicur*® and *Flint*® product lines. In the Herbicides business unit, sales dropped by 4.5 percent to 1,758 million. Herbicide sales, too, were hampered by the drought conditions in many regions and the increasing cultivation of genetically modified corn and soybeans in the United States and Latin America. *Atlantis*® and *Olympus*® performed strongly in the market, further strengthening our position as one of the leading suppliers of cereal herbicides. Business with our herbicides *Basta*® and *Liberty*® expanded considerably. Sales of our Seed Treatment business unit dipped by 1.7 percent to 467 million. Sales of our recently introduced seed treatment products *Poncho*®, *EfA*®, *Bariton*® and *Scenic*® compensated for the decline in sales due to the drought in Australia and the European sugar market reform. For a table with changes in sales of our major products, please refer to the relevant segment discussion in Item 4, *Information on the Company Business.*

Operating results of the Crop Protection segment decreased by 148 million, or 27.8 percent, to 384 million. The decrease in margins brought about by price erosion was only partly compensated for by savings achieved through our cost structure and efficiency improvement programs. Operating results were affected by charges (in total 57 million) relating to the restructuring program (74 million), which were partially offset by gains from the divestment of a family of mature herbicide products (25 million). In 2005, operating results were affected by charges and gains (amounting in total to a net gain of 7 million) relating to expenses for restructuring measures, which were offset by a one-time non-cash gain due to changes to our pension plans in the United States and Germany.

2005 compared with 2004

Sales in the Crop Protection segment decreased by 83 million, or 1.7 percent, to 4,874 million in 2005. Had the average exchange rates we used to translate our non-euro denominated revenues into euros stayed constant in 2005 as compared with 2004, our net sales in this segment would have decreased by 4.3 percent in 2005.

In the Insecticides business unit, sales decreased by 4.9 percent to 1,311 million. The continuing drought in southern Europe, Brazil and Australia led to lower sales of some products. Furthermore, much lower pest infestation diminished sales of our products, particularly in the Asian-Pacific region. Sales in the Fungicides business unit declined by 2.3 percent to 1,248 million. Although Asian rust, a disease affecting soybean crop, persisted in large areas of Brazil, business with our *Flint*® and *Folicur*® fungicides declined considerably due to

the extreme prolonged drought in the south of the country and farmers economic predicament. Sales in the Herbicides business unit decreased by 0.8 percent to 1,840 million. Although unfavorable weather conditions impacted our sales in southern Europe, aggregate sales of our new products *Atlantis*®, *Hussar*®, *MaisTer*® and *Olympus*® increased 16 percent. Sales of the Seed Treatment business unit rose by 6.3 percent to 475 million, largely due to the 2004 acquisition of the remaining 50-percent interest in Gustafson.

Operating results of the Crop Protection segment grew by 146 million, or 37.8 percent, to 532 million, which was primarily attributable to the absence of scheduled goodwill amortization of 98 million. Operating results were affected by charges and gains (amounting in total to a net gain of 7 million) relating to restructuring measures in France (20 million) and the termination of research and development activities (15 million), which were offset by a one-time non-cash gain due to changes to our pension plans in the United States and Germany (46 million). In the previous year, operating result was impacted by charges (in total 42 million), including in particular restructuring charges (13 million) and pension accruals (14 million).

Environmental Science, BioScience

	2004	Change from Previous Year	2005	Change from Previous Year	2006
		(%)	(Euros in millions)	(%)	
Net sales (external)	989	3.3	1,022	3.3	1,056
Intersegment sales	7	85.7	13	(53.8)	6
Operating result	106	49.1	158	26.6	200

2006 compared with 2005

Sales of the Environmental Science, BioScience segment expanded by 34 million, or 3.3 percent, to 1,056 million in 2006. Had the average exchange rates we used to translate our non-euro denominated revenues into euros stayed constant in 2006 as compared with 2005, our net sales in this segment would have increased by 3.7 percent in 2006.

The Environmental Science business group saw sales rise by 2.9 percent to 714 million, due especially to a strong performance by our products for professional users. BioScience increased sales by 4.3 percent to 342 million, mainly because of buoyant sales of vegetable and canola seed products. For a table with changes in sales of our major products, please refer to the relevant segment discussion in Item 4, *Information on the Company Business.*

Operating result of the Environmental Science, BioScience segment improved by 42 million, or 26.6 percent, to 200 million, due to growth in business and cost savings in the Environmental Science business group.

2005 compared with 2004

Sales of the Environmental Science, BioScience segment rose by 33 million, or 3.3 percent, to 1,022 million in 2005. Had the average exchange rates we used to translate our non-euro denominated revenues into euros stayed constant in 2005 as compared with 2004, our net sales in this segment would have increased by 2.1 percent in 2005.

The Environmental Science business group saw business expand by 2.4 percent to 694 million, due in part to higher sales of *Premise*®, *Revolver*® and *K-O Tab*®. Sales of Consumer Products remained constant. In the BioScience business group, sales advanced by 5.5 percent to 328 million, the main contributions to growth coming from *InVigor*® (canola seed) in North America, *FiberMax*® (cotton seed) in the United States and Europe, and the vegetable seeds business.

Operating result of the Environmental Science, BioScience segment improved by 52 million, or 49.1 percent to 158 million, due primarily to the expansion of the Professional Products business and the absence of scheduled goodwill amortization of 36 million. Operating result was affected by charges primarily relating to the consolidation of smaller sites in the United States (charge of 8 million) and a one-time non-cash gain due to

changes to our pension plans in the United States and Germany (9 million). In the previous year, operating result included gains of 12 million from a sale of biotechnology assets.

Materials

Due to the divestment activities regarding the H.C. Starck and Wolff Walsrode businesses, the Materials segment comprises the Polycarbonates and Thermoplastic Polyurethanes business units. Both H.C. Starck and Wolff Walsrode are reported as discontinuing operations. See also Discontinued Operations.

	2004	Change from Previous Year	2005	Change from Previous Year	2006
		(%)	(Euros in millions)	(%)	
Net sales (external)	2,217	28.0	2,837	3.1	2,925
Intersegment sales	13	7.7	14	78.6	25
Operating result	184	179.3	514	(43.8)	289

2006 compared with 2005

Sales in the Materials segment rose by 88 million, or 3.1 percent, to 2,925 million in 2006. Had the average exchange rates we used to translate our non-euro denominated revenues into euros stayed constant in 2006 as compared with 2005, our net sales in this segment would have increased by 3.4 percent. Sales in the Polycarbonates business increased by 2.8 percent, with the increases located particularly in Europe and Asia/ Pacific, due to higher sales volumes despite heavy pressure on prices. The Thermoplastic Polyurethanes business grew sales by 6.8 percent, mainly as a result of higher volumes. For a table with changes in sales of our major products, please refer to the relevant segment discussion in Item 4, *Information on the Company Business*.

Operating result of the Materials segment decreased by 225 million, or minus 43.8 percent, to 289 million, mainly as a result of decreased margins caused by lower selling prices and higher raw material costs, which were not offset by the higher sales volumes. Fourth quarter 2006 earnings were affected by the temporary production shortfalls in Krefeld-Uerdingen, Germany (See also *Systems*). The 2005 operating result included a gain resulting from changes to our pension plans (19 million).

2005 compared with 2004

Sales in the Materials segment grew by 620 million, or 28.0 percent, to 2,837 million in 2005. Had the average exchange rates we used to translate our non-euro denominated revenues into euros stayed constant in 2005 as compared with 2004, our net sales in this segment would have increased by 27.4 percent. Sales of our Polycarbonates business increased by approximately 30 percent attributable to slight volume growth and considerably higher selling prices for some products.

Operating result of the Materials segment improved by 330 million, or 179.3 percent, to 514 million, mainly due to selling price increases that compensated not only for higher raw material costs but also improved our margins. Additionally, in 2005 the operating result included a gain resulting from changes to our pension plans (19 million).

Systems

	2004	Change from Previous Year	2005	Change from Previous Year	2006
		(%)	(Euros in millions)	(%)	
Net sales (external)	5,349	23.6	6,609	9.5	7,236
Intersegment sales	116	22.4	142	(2.8)	138
Operating result	348	111.5	736	(4.5)	703

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2006 compared with 2005

Sales of the Systems segment climbed by 627 million, or 9.5 percent, to 7,236 million. Had the average exchange rates we used to translate our non-euro denominated revenues into euros stayed constant in 2006 as compared with 2005, our net sales in this segment would have increased by 9.7 percent. The growth was attributable to both selling price and volume increases in all businesses. Sales of our Polyurethanes business advanced by 8.1 percent, while our Coatings, Adhesives, Sealants business posted a gratifying 11.9 percent increase. For a table with changes in sales of our major products, please refer to the relevant segment discussion in Item 4, *Information on the Company Business.*

Operating result of the Systems segment decreased by 33 million, or minus 4.5 percent, to 703 million. Higher selling prices and increases in volumes were largely able to compensate for the rise in raw material costs, but earnings were negatively affected by temporary production shortfalls in Krefeld-Uerdingen, Germany, in the fourth quarter of 2006. Operating result in 2006 was affected by net charges (totaling 218 million) relating primarily to the arbitration proceedings in the United States in connection with the production of propylene oxide (109 million) and to charges in connection with pending antitrust litigation in polymer products (44 million). Furthermore, we incurred restructuring charges for our U.S. sites in New Martinsville, West Virginia and Baytown, Texas (55 million). Operating result in 2005 was affected by charges (totaling 62 million) relating to the reorganization and to antitrust litigation. The charges were partially offset by a one-time non-cash gain due to changes to our pension plans in the United States and Germany.

2005 compared with 2004

Sales of the Systems segment increased by 1,260 million, or 23.6 percent, to 6,609 million in 2005. Had the average exchange rates we used to translate our non-euro denominated revenues into euros stayed constant in 2005 as compared with 2004, our net sales in this segment would have increased by 22.8 percent. Growth in net sales was primarily attributable to our Polyurethanes business unit that benefited from considerably higher selling prices. Sales growth in the Inorganic Basic Chemicals business unit resulted from higher market prices for sodium hydroxide solution and from product sales to LANXESS. Prior to the spin-off of LANXESS, such sales were recorded as inter-segment sales. Excluding the additional sales due to the reclassification of sales to LANXESS, this segment s sales would have increased by 17.5 percent.

Operating result of the Systems segment improved by 388 million to 736 million. The growth was mainly attributable to higher selling prices, which offset the rise in raw material costs. Operating result in 2005 was affected by net charges (totaling 62 million) relating to the reorganization of the polyurethanes business (33 million) and to legal provisions in connection with antitrust litigation related to polymer products (66 million). These charges were partially offset by a one-time non-cash gain due to changes to our pension plans in the United States and Germany (47 million). In the previous year operating result was impacted by legal provisions of 27 million.

LIQUIDITY AND CAPITAL RESOURCES 2004, 2005 AND 2006

Cash Flows

In recent years, our primary source of liquidity has been cash from operations. We use cash in investing activities primarily for acquisitions as well as for additions to property, plant, equipment and investments; these activities represented our primary liquidity requirements. In 2004 and 2005, we used cash in financing activities primarily to retire debt and pay dividends. In 2006, we used cash provided by financing activities primarily to finance the Schering acquisition. (The names Bayer Schering Pharma or Schering as used in this annual report on Form 20-F 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. Bayer Schering Pharma AG and Schering-Plough Corporation, New Jersey, are unaffiliated companies that have been totally independent of each other for many years.) We believe that our working capital levels are sufficient to fund our present requirements. The proceeds from our divestitures and the net cash provided by operating activities will mainly be used to retire debt maturing in 2007. There are no material legal or economic restrictions on the ability of member companies of the Bayer Group to transfer funds to Bayer AG. For cash held in escrow accounts see *Financing Activities*.

The following table summarizes our cash flows in each of the last three years:

	2004	Change from Previous Year	2005	Change from Previous Year	2006[b]
		(%)		(%)	
			(Euros in millions)		
Net cash provided by (used in) operating activities *(net cash flow, continuing operations)*[a]	1,959	64.7	3,227	21.7	3,928
Net cash provided by (used in) operating activities *(net cash flow, discontinued operations)*[a]	491	(44.0)	275		275
Net cash provided by (used in) operating activities (net cash flow, total)	2,450	42.9	3,502	20.0	4,203
Net cash provided by (used in) investing activities (total)	(814)	(113.9)	(1,741)		(14,730)
Net cash provided by (used in) financing activities (total)	(761)	(147.2)	(1,881)		10,199
Change in cash and cash equivalents	875		(120)	(173.3)	(328)
Cash and cash equivalents at beginning of period	2,734	30.6	3,570	(7.8)	3,290
Change in scope of consolidation	6		(196)	99.0	(2)
Exchange rate movements	(45)		36		(45)
Cash and cash equivalents at end of year	3,570	(7.8)	3,290	(11.4)	2,915

[a] 2004 and 2005 data have been adjusted to reflect the fact that the Diagnostics division, the H.C. Starck business and the Wolff Walsrode business are reported as discontinued operations. For further information on these restatements, see *Operating Results 2004, 2005 and 2006 Discontinued Operations* and Note 7.2 to the consolidated financial statements appearing elsewhere in this annual report on Form 20-F.

(b) The pharmaceuticals business of Schering AG, Germany is reflected in the financial statements with effect from June 23, 2006.

Cash from Operating Activities

Net cash flow from continuing operations rose by 21.7 percent, or 701 million including 483 million from the Schering business for the period beginning on June 23, 2006 to 3,928 million in 2006. Tax payments of 763 million (2005: 463 million) had a negative effect. The 2005 figure contained tax payment free gains of

238 million from changes in our company pension plans in the United States and Germany, while in 2006 the charges resulting from the revaluation of assets from the Schering acquisition were not tax-deductible. Net cash provided by operating activities from our continuing operations in 2005 amounted to 3,227 million, a 64.7 percent increase from the 1,959 million in 2004. All of the subgroups posted significant year-on-year growth in cash flow. The overall increase resulted from both a better business performance and a positive change in working capital. Cash outflow for inventories in 2005 was much lower than in 2004, especially in MaterialScience. In addition, the cash contribution from changes in accounts receivables improved significantly from minus 359 million in 2004 to 211 million in 2005.

Net cash provided by operating activities from discontinued operations relate to the Diagnostics division, the H.C. Starck business and the Wolff Walsrode business in all periods presented. In 2005 and 2004, the divested U.S. plasma operations and LANXESS are also included in this figure. Net cash provided by operating activities from discontinued operations represented an inflow of 275 million in 2006, 275 million in 2005 and 491 million in 2004. The total net cash flow from operating activities amounted to 4,203 million in 2006, 3,502 million in 2005 and 2,450 in 2004, respectively.

Investing Activities

Net cash used in investing activities totaled 14.7 billion in 2006, as compared to a net cash outflow of 1.7 billion in 2005. This was chiefly attributable to disbursements totaling 15.2 billion for the Schering acquisition, including the purchase price payments for the 96.2 percent of Bayer Schering Pharma AG shares outstanding as of December 31, 2006, less approximately 1 billion in assumed cash and cash equivalents. We also acquired the biotech company Icon Genetics and the U.S.-based Metrika for a total of 75 million.

Cash outflows for additions to property, plant and equipment (1,534 million) and other intangible assets (342 million) totaled 1,876 million, up 487 million from the previous year. The outflows included 137 million in capital expenditures made by Schering. Capital expenditures for property, plant, equipment and intangible assets included, among others, disbursements for the purchase of the European marketing rights for the hypertension treatments *Pritor*® and *PritorPlus*® and expenditures for the expansion of our polymers production facilities at the Caojing site, China (near Shanghai). Receipts from sales of property, plant, equipment and other assets totaled 185 million, while the proceeds of divestitures amounted to 489 million. At the end of 2006 we received an initial payment of 395 million related to the sale of our Diagnostics division; this transaction closed at the beginning of 2007.

Cash inflow from sales of noncurrent financial assets came to 850 million. This figure primarily included the sale of our 49.9 percent interest in GE Bayer Silicones to the other partner General Electric (431 million) and the repayment of a loan made to the chemical company Symrise. This loan had been granted in connection with the sale of the Haarmann & Reimer group to the purchaser in 2002.

In 2005, net cash outflow from investing activities amounted to 1,741 million. The cash outflow for acquisitions amounted to 2,188 million, including approximately 1.9 billion for the consumer health business of Roche in 2005. Cash outflow for additions to property, plant, equipment and intangible assets amounted to 1,389 million in 2005. Cash inflows from sales of noncurrent financial assets amounted to 1,189 million in 2005. This figure primarily included the scheduled repayment of loans from LANXESS, the expiration of currency-hedging derivatives and the sale of the LANXESS mandatory convertible bond with a nominal volume of 200 million. Cash receipts from divestitures totaled 293 million, mainly relating to the divestment of the plasma business in the first quarter of 2005.

In 2004, the net cash outflow from investing activities amounted to 814 million. The cash outflow of 1,251 million for additions to property, plant and equipment and 358 million for acquisitions were partially offset by 200 million in cash receipts from sales of property, plant and equipment and divestitures, 90 million in inflows related to noncurrent financial assets, 400 million in interest and dividend receipts and 105 million in inflows from current financial assets. The 358 million in cash outflow for acquisitions comprised mainly the 100 million purchase price for the remaining 50 percent of the shares of Gustafson and 208 million for the remaining 50 percent interest in the U.S. joint venture with Roche, both of which we now wholly own. The 90 million cash inflow from sales of noncurrent financial assets comprised mainly a 327 million payment from

Aventis in connection with the 2002 acquisition of Aventis CropScience, as well as outflows of around 200 million for advance payments related to the acquisition of the Roche consumer health business.

Financing Activities

Net cash provided by financing activities was 10.2 billion in 2006, mainly due to net borrowings of 10.7 billion in connection with the financing of the acquisition of Schering AG, Berlin, Germany, compared to net cash used in financing activities of 1.9 billion in 2005. The proceeds from the placement of 34 million new shares amounted to 1.2 billion. Cash outflows for dividend payments amounted to 535 million, including a cash inflow of 176 million resulting from the reimbursement of advance capital gains tax payments made on intragroup dividends in 2004. Interest payments rose to 1,155 million primarily as a result of borrowings made to finance the Schering acquisition.

On December 31, 2006 we had cash and cash equivalents of 2,915 million, including 799 million held in escrow accounts. Following the entry into force of the domination and profit and loss transfer agreement between Bayer Schering Pharma AG, Berlin, Germany and Bayer Schering GmbH, an amount of 710 million was placed in escrow following the decision to effect a squeeze-out of the remaining minority stockholders of Bayer Schering Pharma AG. The remaining amount of 89 million held in escrow accounts is earmarked exclusively for payments relating to civil law settlements in antitrust proceedings. In view of the restriction on its use, the 799 million in cash and cash equivalents held in escrow accounts was not deducted when calculating net debt. Net debt rose to 17.5 billion as of December 31, 2006, due mainly to the financing of the Schering acquisition. For a net debt reconciliation and details on financing of the Schering acquisition, see *Development of net debt*.

In 2005, the cash used in financing activities amounted to 1,881 million. The 2005 outflow included 440 million in dividend payments, 654 million in net repayments of borrowings and 787 million in interest payments. Taking advantage of favorable market conditions, a subordinated hybrid bond with a maturity of 100 years was issued in the third quarter of 2005 in the nominal amount of 1.3 billion with a 5 percent coupon. At the same time, part of the 5.375 percent Bayer bond due on April 10, 2007 was repurchased early. The repurchased volume had a face value of approximately 860 million. The higher interest payments were primarily attributable to a one-time charge of 56 million in connection with this transaction. Including marketable securities and other instruments, the Group had liquid assets of 3,523 million on December 31, 2005. Cash of 253 million was deposited in escrow accounts to be used solely for payments in connection with civil litigation settlements (See also Item 8, *Financial Information Legal Proceedings*).

In 2004, the cash used in financing activities amounted to 761 million. The outflow contained a total of 559 million in dividends paid to our stockholders and advance capital gains tax payments on intra-Group dividends as well as 724 million in interest payments. These outflows were partially offset by 512 million in net borrowing and 10 million in capital contributions to subsidiaries. On December 31, 2004, we had liquid assets of 3,599 million.

Development of net debt

In 2006, net debt (continuing operations) was at 17,473 million, compared to 5,494 million in 2005 and 4,891 million in 2004. The following table sets forth the calculation of the net debt figure.

	Dec. 31, 2004	Dec. 31, 2005	Dec. 31, 2006
		(Euros in millions)	
Noncurrent financial liabilities as per balance sheet (including derivatives)	7,025	7,185	14,723
thereof mandatory convertible bond			2,276
thereof hybrid bond		1,268	1,247
Current financial liabilities as per balance sheet (including derivatives)	2,166	1,767	5,078
Derivative receivables	(701)	(188)	(185)
Cash and cash equivalents as per balance sheet less cash earmarked for civil litigation settlements and the squeeze-out	(3,570)	(3,037)[(a)]	(2,116)[(b)]
Marketable securities and other instruments	(29)	(233)	(27)
Net debt* (continuing operations)	4,891	5,494	17,473
Net debt* (discontinued operations)	531	0	66
Net debt* (total)	5,422	5,494	17,539

(a) Cash and cash equivalents as per balance sheet (3,290 million) minus cash deposited in escrow accounts (253 million) equals 3,037 million.

(b) Cash and cash equivalents as per balance sheet (2,915 million) minus cash deposited in escrow accounts (799 million) equals 2,116 million.

* Net Debt is defined neither under IFRS nor under U.S. GAAP and may not be comparable with measures of the same or similar title that are reported by other companies. Under SEC rules Net Debt is considered a non-GAAP financial measure. It should not be considered as a substitute for, or confused with, any IFRS or U.S. GAAP financial measure. We believe the most comparable IFRS and U.S. GAAP measures are noncurrent and current financial obligations. Bayer defines Net Debt as described above and believes that this measure provides investors, analysts and credit rating agencies with useful information disclosing and summarizing the status of the net financial borrowings due to third parties. We believe that subtracting cash and cash equivalents from our noncurrent and current financial obligations (that includes liabilities from derivative financial instruments) and netting this with the receivables resulting from derivative financial instruments is appropriate in providing a useful measure of the obligations associated with our outstanding debt. We thus believe that Net Debt is an indicator of the Bayer Group s creditworthiness. However, the subtraction of cash and cash equivalents should not cause the reader to believe that we have less debt than actually appears on our balance sheet. For this reason, you should consider our net debt measure in conjunction with the noncurrent and current financial obligations recorded on our balance sheet.

The disbursements for the acquisition of Schering AG, Berlin, Germany in 2006 totaled 16.3 billion. From Schering we assumed financial liabilities of 0.2 billion and acquired cash and cash equivalents of approximately 1 billion. In order to ensure that we would have available the required funds to fully consummate the voluntary public cash takeover offer for all shares of Schering AG at the time when the payment obligations became due, the Company had entered into a bridge facility and a syndicated credit facility in an amount of 7 billion each. In order to repay the bridge facility and the short-term portion of the syndicated credit facility, equity and debt issuances as well as disposals were contemplated. Bayer issued 2.6 billion Eurobonds and 0.5 billion Sterling bonds under the multi-currency Euro Medium Term Note (EMTN) program. Furthermore, Bayer Capital Corp., a wholly-owned subsidiary of Bayer AG, issued a guaranteed subordinated mandatory convertible bond due 2009 with an aggregate nominal value of 2.3 billion. The bond is convertible into shares of Bayer AG. We raised an additional 1.2 billion through the successful placement of 34 million new shares of Bayer AG.

The following table shows the components of the acquisition financing package and their status at year end.

	June 30, 2006	**Dec. 31, 2006**
	(Euros in billions)	
Credit utilization:		
Bridge financing (7 billion facility)	0.6	0
Syndicated loan (7 billion facility)	7.0	5.7
Thereof due within one year	3.0	1.7
Bond issues		
Three-year floating Eurobond	1.6	1.6
Seven-year fixed-rate Eurobond	1.0	1.0
Twelve-year fixed-rate sterling bond	0.4	0.5
Mandatory convertible bond	2.3	2.3
Stock placement		
New shares		1.2
Total	12.9	12.3

The remainder of the acquisition price for Schering AG was financed mainly with liquid assets. In addition to fully redeeming the bridge financing, we had also paid down the syndicated 7.0 billion loan to 5.7 billion by the end of 2006.

In China, Bayer secured a RMB 6.1 billion (0.6 billion) credit line to finance the ongoing construction of a production facility for polyurethane raw materials in Caojing, China (near Shanghai).

As of December 31, 2006 we had noncurrent financial liabilities of 14.7 billion, including the 1.2 billion hybrid bond issued in July 2005 and the 2.3 billion mandatory convertible bond issued in April 2006 (for further details on our noncurrent financial liabilities, see Note 27 to the consolidated financial statements appearing elsewhere in this annual report on Form 20-F). Moody s treats 75 percent and Standard & Poor s treats 50 percent of the hybrid bond as equity. Both rating agencies treat the mandatory convertible bond entirely 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 at all. This, together with the issuance of new shares, completed the equity raising announced in connection with the acquisition of Schering AG. The total 3.5 billion thus raised is below the 4 billion limit originally set.

Further portfolio adjustments were completed at the beginning of 2007. In January we closed the sale of the Diagnostics division to Siemens for a purchase price of 4.3 billion. The difference compared with the purchase price of 4.2 billion communicated in July 2006 results mainly from a purchase price adjustment due to the higher working capital at the Diagnostics division at the time of sale. The transaction resulted in a cash inflow of 0.4 billion at the end of 2006, while the remaining 3.9 billion was received at the beginning of 2007. We divested the H.C. Starck business

to the two financial investors, Advent International and The Carlyle Group. The purchase price for the H.C. Starck business was 1.2 billion, consisting of a cash component of about 0.7 billion and the assumption by the purchasers of financial liabilities and pension commitments totaling about 0.5 billion.

The divestiture was closed at the beginning of February 2007. We intend to use the cash inflows from these transactions, along with the proceeds of the planned sale of the Wolff Walsrode business to The Dow Chemical Company, to reduce net debt.

Financing Strategy

The financial management of the Bayer Group is conducted by the 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 in effecting 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.

Due to the increase in debt in connection with the acquisition of Schering AG, Standard & Poor s in July 2006 downgraded Bayer AG s long-term issuer rating from A with stable outlook to BBB+ with positive outlook. Also in July 2006, Moody s confirmed our current A3 rating, changing the outlook from stable to negative. Bayer AG s short-term ratings are A-2 (Standard & Poor s) and P-2 (Moody s). These investment-grade ratings evidence a continuing high level of the Group s creditworthiness.

Our financial strategy is geared toward the single-A rating category in order to maintain our financial flexibility. We therefore plan to use both the proceeds of divestitures and our operating cash flows to further reduce net debt.

We generally pursue a prudent debt management strategy aimed at ensuring flexibility by drawing on a balanced financing portfolio to finance our activities. Chief among these resources in keeping with our requirements are a syndicated credit facility, a multi-currency commercial paper program and a multi-currency Euro Medium Term Note program. We also supplement our financing with various structured products, such as an asset-backed securities program.

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, liquidity and cash flow risks, as they relate to our use of financial instruments, are given in Note 30 to the consolidated financial statements appearing elsewhere in this annual report on Form 20-F.

At December 31, 2006, we had approximately 11.7 billion of total lines of credit, of which 6.8 billion was used and 4.9 billion was unused and available for borrowing on an unsecured basis. To provide flexible short- to medium-term funding, we established a U.S. $8 billion global commercial paper program and a 10 billion EMTN program. We issued 4.6 billion under the EMTN program in years prior to 2006. In connection with the acquisition of Schering AG in 2006, we issued 3.1 billion bonds under the EMTN program. Holders of the bonds issued in 2006 have the right to demand the redemption of their bonds by Bayer AG if both a change in control with respect to Bayer AG occurs and its credit rating is downgraded within 120 days after such change of control becomes effective. As of December 31, 2006, U.S. $8 billion were available for funding under the global commercial paper program and approximately 2.3 billion were available for funding under the EMTN program. The long-term liabilities to banks principally comprise loans of 5.7 billion in connection with the acquisition of Schering AG. The agreements for these credit facilities contain provisions entitling the participating banks to terminate the agreements in the event of change of control with respect to Bayer AG and demand repayment of any then-outstanding sums.

For details on lines of credit see Note 27 to our consolidated financial statements appearing elsewhere in this annual report on Form 20-F.

Capital Expenditures

We generally fund our capital expenditures with cash flows from operating activities and, if such funds are not sufficient, through other cash on hand and from the sale of liquid investments, including cash equivalents and marketable securities. We fund any further capital expenditures with borrowings.

Capital expenditures amounted to 1.7 billion in 2006, compared to 1.4 billion in 2005 and 1.0 billion in 2004.

We spent a total of 1.7 billion for intangible assets and property, plant and equipment in 2006. Besides the acquisition of Schering AG, which is not reported as capital expenditures but as an acquisition, the focus of our capital expenditures were our Material and Systems segments.

Our major capital expenditures since 2004 included:

Year	Segment	Description
2004	Pharmaceuticals	Construction of a process development facility (*Kogenate*®) in Berkeley, California
	Crop Protection	Installation of a production line for the new fungicide Fandango, Kansas City, Kansas
	Materials	Construction of a production facility for polycarbonate in Caojing, People s Republic of China (PRC)
	Systems	Expansion of isocyanate capacities in Tarragona, Spain; Baytown, Texas, and Brunsbüttel, Germany
		Construction of production facility for methylene-diphenyl-diisocyanate in Caojing, PRC
		Expansion of polyisocyanate capacity in Caojing, PRC
		Construction of a production facility for hexamethylene-diisocyanate in Caojing, PRC
2005	Pharmaceuticals	Construction of a clinical manufacturing facility for *Kogenate*® in Berkeley, California
	Consumer Health	Expansion of a production facility in Jakarta, Indonesia
	Crop Protection	Insourcing and relocation of products/intermediates in Dormagen, Knapsack and Frankfurt, Germany
		Product insourcing projects in Vapi and Ankleshwar, India
	Environmental Science, BioScience	Expansion of greenhouse facilities in Haelen, The Netherlands
	Materials	Construction of a polycarbonate compounding facility in Caojing, PRC
		Expansion of the polycarbonate facility in Map Ta Phut, Thailand
		Start of capacity expansion projects for polycarbonate in Caojing, PRC
	Systems	Construction of a *Desmodur*®-L production facility in Caojing, PRC
		Start of construction of a world-scale MDI production facility in Caojing, PRC
		Installation of a new plant for MDI specialty products in Baytown, Texas
		Capacity increase of the chlorine production facility in Baytown, Texas
2006	Pharmaceuticals	Construction of a clinical manufacturing facility for *Kogenate*® in Berkeley, California
		Expansion of a production facility in Beijing, PRC
	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, Columbia
	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, PRC
Systems	Construction of a world-scale MDI production facility in Caojing, PRC
	Installation of a new plant for MDI specialty products in Baytown, Texas

Commitments

Off-Balance Sheet Arrangements

We do not consider our unconsolidated entities that qualify as special-purpose entities to be material and we do not have other material off-balance sheet arrangements. For a description of the contingencies relating to the LANXESS spin-off, see Note 31 to our consolidated financial statements appearing elsewhere in this annual report on Form 20-F.

Contractual Obligations and Commercial Commitments

The table below summarizes all of the Group s contractual and commercial obligations as of December 31, 2006. The timing of payments for collaborative agreements assumes that milestones or other conditions are met. We do not foresee any material payment triggers or milestone payments in our current collaborative arrangements.

Contractual Obligations	Total	Under One Year	One Year to Less than Three Years	Three Years to Less than Five Years	After 5 Years
			(Euros in millions)		
Long-term debt, excluding capital leases	19,417	5,009	4,775	4,021	5,612
Capital leases without interest portion	384	69	46	40	229
Operating leases	559	148	194	140	77
Purchase obligations	507	467	40	0	0
Other long-term liabilities (collaboration agreements)	956	168	314	167	307
Other liabilities[(a)]	3,504	3,055	242	31	176
Total contractual obligations	25,327	8,916	5,611	4,399	6,401

[(a)] Other liabilities comprise primarily guarantees of bills and checks, payment guarantees and indirect financial guarantees; commissions to customers and expense reimbursements; as well as social security and payroll liabilities and other liabilities as set forth in Note 29 to the consolidated financial statements included elsewhere in this annual report on Form 20-F.

Payments for guarantees and endorsements of bills and of warranties of 136 million have been excluded from the other commercial commitments table above, as we do not expect to make any payments under these commercial commitments.

Our future interest payments are not included in these figures. Financial debt, including derivative receivables, amounted to 19,616 million as of December 31, 2006. For details on the financing of the acquisition of the business of Schering AG, Berlin, Germany, see *Development of net debt.* For details on our bonds and pension obligations see Note 27 and Note 25, respectively, to our consolidated financial statements appearing elsewhere in this annual report on Form 20-F.

Other Commitments

In 2006, our minimum non-discounted future payments relating to long-term lease and rental arrangements totaled 1.0 billion, compared with 1.0 billion in the previous year. Of this amount, 486 million represented future payments under financial leases (596 million in 2005).

Our financial commitment for orders placed under purchase agreements relating to planned or ongoing capital expenditure projects totaled 507 million in 2006. We expect to pay the majority of this amount in 2007. In 2005, this figure was 294 million, and in 2004, 142 million.

Under collective agreements on part-time work arrangements for certain older employees, we have to accept applications for such arrangements from a certain quota of the work force. Other financial obligations that may arise from such work arrangements in the future cannot be quantified, since the quota has already been exceeded.

In addition, we have entered into research agreements with a number of third parties. Under these agreements, we have agreed to fund various research projects or to assume other commitments. Our payments under these agreements are typically based on the achievement of certain milestones or the fulfillment of other specific conditions by our research partners. In 2006, the total amount of these commitments was 956 million, compared to 562 million in 2005. For details on milestone payments see Note 31 to our consolidated financial statements appearing elsewhere in this annual report on Form 20-F. For details on lines of credit see Note 27 to our consolidated financial statements appearing elsewhere in this annual report on Form 20-F.

Borrowings

Our consolidated financial statements reflect borrowings as financial obligations , which include debentures, liabilities to banks, liabilities under lease agreements, liabilities from the issuance of promissory notes, commercial paper and other financial obligations. We have no restrictions in the use of our borrowing. See the tables under *Commitments Contractual Obligations and Commercial Commitments* above for a summary of our current financial obligations. See also Note 27 to our consolidated financial statements appearing elsewhere in this annual report on Form 20-F.

Funding and Treasury Policies

We are exposed to interest rate risk. We are also exposed to currency-related risks such as transaction exchange rate and translation risk. To hedge our risks, we primarily use over-the-counter derivative instruments, particularly forward foreign exchange contracts, foreign exchange option contracts, interest rate swaps, interest and principal currency swaps and interest rate option contracts.

Interest rate risk applies mainly to receivables and payables with maturities of over one year. We primarily use interest rate swaps to convert a portion of our fixed rate borrowings into, in effect, floating rate borrowings. The bonds issued under our EMTN program make up the largest portion of our fixed rate borrowings. See also Note 27 to our consolidated financial statements. In a normal interest rate environment, short-term interest rates are lower than long-term interest rates. Thus, floating rate debt generally leads to lower interest costs in the long run. Short-term interest rate hedging contracts (excluding principal currency swaps) totaled a nominal amount of 4.1 billion in 2006, 0.4 billion in 2005 and 0.1 billion in 2004. In 2006, hedges maturing in more than one year represented a nominal amount of 7.5 billion, in 2005, 10.9 billion and in 2004, 5.7 billion. The cash and cash equivalents that we held on December 31, 2006 were mainly denominated in euro.

Because a substantial portion of Bayer s assets, liabilities, sales and earnings are denominated in currencies other than euro zone currency, we have translation exposure to fluctuations in the values of these currencies relative to the euro. Since these effects do not have an impact on our cash flows, we do not hedge these risks resulting from currency fluctuations.

We also face transaction risk when our businesses generate revenue in one currency but incur costs relating to that revenue in a different currency. We hedge a portion of our transaction currency risk through the use of derivative financial instruments, particularly forward foreign exchange contracts, currency swaps, currency options and interest and principal currency swaps. Our Corporate Treasury department has the central responsibility for managing our currency exposures and using currency derivatives. We establish the maturity dates of hedging contracts according to the anticipated cash flows of the Bayer Group. Our policy is to use a mixture of instruments depending upon our view of market conditions based on fundamental and technical analysis. Our Board of Management has provided clear guidance on how to limit and monitor cash flow risks that result from this approach. As of December 31, 2006, we had entered into forward foreign exchange contracts, currency swaps, currency swaps and interest and principal currency swaps with a total notional value of 12.1 billion.

For more information on, including quantification of, these risks, and our policies in managing them, see Item 11, *Quantitative and Qualitative Disclosures about Market Risk.*

Inflation, Seasonality and Cyclicality

Inflation has not had a material effect on our operating results in recent years. Seasonality does not materially affect our business as a whole. However, several of our individual business lines are subject to seasonal effects. In addition, a number of our business groups are subject to cyclicality, either directly or because of the effect of cyclicality on their customers businesses. See the descriptions of our various business segments in Item 4, *Information on the Company* for a discussion of those businesses subject to seasonal or cyclical effects.

RESEARCH AND DEVELOPMENT

The following table sets forth our total research and development expenditures for our continuing businesses during the last three full years.

	2004	Change from Previous Year	2005	Change from Previous Year	2006
		(%)	(Euros in millions)	(%)	
Research and development expenditures:					
Bayer HealthCare	878	(5.0)	834	71.0	1,426
Bayer CropScience	679	(2.2)	664	(7.5)	614
Bayer MaterialScience	199	7.5	214	6.1	227
Reconciliation	16	6.3	17	76.5	30
Total from Continuing Operations	1,772	(2.4)	1,729	32.9	2,297
As a percentage of sales	8.5		7.0		7.9

We typically allocate the largest portion of our research and development expenses to our HealthCare businesses, primarily in the Pharmaceuticals segment. In 2006, Pharmaceuticals accounted for 54.7 percent of our total research and development spending, mainly due to the inclusion of the acquired business of Schering AG, Germany (2005: 39.3 percent; 2004: 41.8 percent). The Schering business is only reflected in 2006 research and development expenses as of June 23, 2006.

For a more detailed discussion of our research and development activities and policies, see the descriptions of each business group s research and development activities in Item 4, *Information on the Company Business*. We discuss our patents and other intellectual property protection in Item 4, *Information on the Company Business Intellectual Property Protection*.

BASIS OF PRESENTATION

We prepared the consolidated financial statements that appear elsewhere in this annual report on Form 20-F in accordance with IFRS. See Note 41 to our consolidated financial statements for a reconciliation of the significant differences between IFRS and U.S. GAAP.

Effects of new accounting pronouncements

Accounting standards applied for the first time in 2006

IFRS

For description of the IFRS accounting standards, which were applied for the first time in 2006, refer to Note 3 to our consolidated financial statements appearing elsewhere in this annual report on Form 20-F.

U.S. GAAP

In September 2006, the FASB issued Statement of Financial Accounting Standards No. 158 (Employers Accounting for Defined Benefit Pension and Other Post-Retirement Plans), an amendment of FASB Statements No. 87, 88, 106, and 132R. This standard will require employers to fully recognize the obligations associated

with single-employer defined benefit pension, retiree healthcare and other post-retirement plans in their financial statements. In detail SFAS No. 158 requires an employer to recognize in its statement of financial position an asset for a plan s overfunded status or a liability for a plan s underfunded status, to measure a plan s assets and its obligations that determine its funded status as of the end of the employer s fiscal year (with limited exceptions) and to recognize changes in the funded status of a defined benefit post-retirement plan in the year in which the changes occur. Those changes will be reported in comprehensive income of a business entity until they are amortized as a component of net periodic benefit cost. The adjustments to adopt SFAS No. 158 were recorded as a component of accumulated other comprehensive income.

The impact due to the adoption of SFAS No. 158 as of December 31, 2006 is summarized in the following table:

	(Euros in millions)
U.S. GAAP equity at December 31, 2006 prior to adoption of SFAS No. 158	12,512
Adoption of SFAS No. 158 recognition of actuarial gains/ losses	(3,350)
Adoption of SFAS No. 158 prior service cost	131
Adoption of SFAS No. 158 reversal of additional minimum liability	2,667
Deferred taxes on the entries above	221
U.S. GAAP equity at December 31, 2006 after adoption of SFAS No. 158	12,181

Newly issued accounting standards

IFRS

For description of newly issued IFRS accounting standards refer to Note 3 to our consolidated financial statements appearing elsewhere in this annual report on Form 20-F.

U.S. GAAP

In June 2006, the Financial Accounting Standards Board (FASB) issued FASB Interpretation No. 48 (Accounting for Uncertainty in Income Taxes) (FIN 48), which is an interpretation of FASB Statement No. 109 (Accounting for Income Taxes). FIN 48 prescribes a recognition threshold and measurement attribute for the financial statement for recognition and measurement of a tax position taken or expected to be taken in a tax return.

The evaluation of a tax position in accordance with this interpretation firstly requires the determination whether it is more likely than not that a tax position will be sustained upon examination, based on the technical merits of the position and secondly the position is measured to determine the amount of benefit to recognize in the financial statements. The interpretation also provides guidance on derecognition, classification, interest and penalties, disclosure, and transition. FIN 48 is effective in fiscal years beginning after December 15, 2006. The provisions of FIN 48 are to be applied to all tax positions upon initial adoption, with the cumulative effect adjustment reported as an adjustment to the opening balance of retained earnings. The Bayer Group is currently evaluating the impact the standard will have on the Group s financial position, results of operations or cash flows.

In September 2006, the FASB issued Statement of Financial Accounting Standards No. 157 (Fair Value Measurements) (FAS 157). FAS 157 defines fair value, establishes a framework for measuring fair value in generally accepted accounting principles, and expands disclosures about fair value measurements. FAS 157 will apply whenever another standard requires (or permits) assets or liabilities to be measured at fair value. The standard does not expand the use of fair value to any new circumstances. FAS 157 is effective for financial statements issued for financial years beginning after November 15, 2007. The Bayer Group is currently evaluating the impact the standard will have on the Group s financial position, results of operations or cash flows.

Item 6. ***Directors, Senior Management and Employees***

Directors and Senior Management

In accordance with the German Stock Corporation Act (*Aktiengesetz*), Bayer AG has both a Board of Management (*Vorstand*) and a Supervisory Board (*Aufsichtsrat*). The Board of Management is responsible for the management of our business; the Supervisory Board supervises the Board of Management and appoints its members. The two boards are separate, and no individual may simultaneously be a member of both boards.

Both the members of the Board of Management and the members of the Supervisory Board owe a duty of loyalty and care to Bayer AG. In exercising their duties, the applicable standard of care is that of a diligent and prudent businessperson. Both the members of the Board of Management and the members of the Supervisory Board must take into account a broad range of considerations when making decisions, including the interests of Bayer AG and its stockholders as well as of our employees and creditors.

The members of the Board of Management and the Supervisory Board may be held personally liable to Bayer AG for breaches of their duties of loyalty and care. Bayer AG must bring an action for breach of duty against the Board of Management or Supervisory Board upon a resolution of the stockholders passed at a Stockholders Meeting by a simple majority of votes cast. Furthermore, minority shareholders representing at least 1 percent of the company s share capital or shares with a nominal value of 100,000 can file an application in court requesting an action to be admitted against members of either of the company s boards on behalf of the company or in their own name.

With the exception of stockholders of companies that (unlike Bayer AG) are under the control of another company, individual stockholders of German companies cannot sue directors on behalf of the company in a manner analogous to a stockholder s derivative action under U.S. law. Under German law, directors may be liable for breach of duty to stockholders (as opposed to a duty to the company itself) only where a breach of duty to the company also constitutes a breach of a statutory provision enacted specifically for the protection of stockholders. As a practical matter, stockholders are able to assert liability against directors for breaches of this sort only in unusual circumstances.

Board of Management

The Board of Management is responsible for managing the business of Bayer AG in accordance with the German Stock Corporation Act and Bayer AG s Articles of Association. It also represents Bayer AG in its dealings with third parties and in court. According to the Articles of Association, the Board of Management consists of a minimum of two members. The Supervisory Board determines the number of and appoints the members of the Board of Management. Members of the Board of Management are appointed for a maximum term of five years and are eligible for reappointment after the completion of their term in office.

Bayer AG is legally represented by two members of the Board of Management acting together, or by one member of the Board of Management together with a person possessing a special power of attorney (*Prokura*).

The Board of Management must report regularly to the Supervisory Board, particularly on proposed business policy and strategy, on profitability and on the current business of Bayer AG, as well as on any exceptional matters that may arise from time to time. If not otherwise required by law, the Board of Management decides with a simple majority of the votes cast. In case of deadlock, the vote of the chairperson is the relevant vote.

Under certain circumstances, such as a serious breach of duty or a vote of no confidence by the stockholders in an Annual Stockholders Meeting, a member of the Board of Management may be removed by the Supervisory Board prior to the expiration of his/her term. A member of the Board of Management may not deal with, or vote on, matters relating to proposals, arrangements or contracts between him/herself and Bayer AG.

Individual members of the Board of Management serve as representatives with primary responsibility for our various corporate functions and as representatives for the various geographic regions in which we operate.

The following table shows the members of our current Board of Management as well as members who resigned in the course of the financial year 2006, their ages, positions and the years in which their current terms expire.

Name and Age	Position	Current Term Expires
Werner Wenning (60)	Chairman	2010
Dr. Udo Oels (63)[(a)]	Member	2006
Klaus Kühn (55)	Member	2012
Dr. Richard Pott (53)	Member	2012
Dr. Wolfgang Plischke (55)[(b)]	Member	2009

(a) Until April 28, 2006.

(b) As of March 1, 2006.

Werner Wenning became chairman of our Board of Management in April 2002. He has served on the Board since 1997. Prior to becoming chairman, he served as chief financial officer and was a member of the Corporate Coordination and Human Resources Committees. From 1996 until he joined the Board in 1997, Mr. Wenning was head of Corporate Planning and Controlling. In addition to his responsibilities on the Board, he is the chairman of the supervisory board of Bayer Schering Pharma AG, Berlin, Germany and a member of the supervisory board of Henkel KGaA.

Dr. Udo Oels joined the Board of Management in 1996. Prior to his resignation he was responsible on a Group level for innovation, technology and environment. In addition to his responsibilities on the Board, he was chairman of the supervisory board of Bayer Technology Services and of Bayer Industry Services as well as a member of the supervisory board of Bayer Chemicals AG. He still is a member of the supervisory board of ThyssenKrupp Services AG.

Klaus Kühn is Bayer s chief financial officer. Prior to joining the Board in May 2002, Mr. Kühn was head of Bayer s Finance function. Prior to that appointment, he oversaw the spin-off of Bayer s former Agfa division. Before joining Bayer in 1998, Mr. Kühn worked with Schering AG, Berlin, Germany most recently as head of finance. In addition to his responsibilities on the Board, he is chairman of the supervisory boards of Bayer CropScience AG and Bayer Business Services GmbH and a member of the supervisory board of Bayer Schering Pharma AG (formerly named Schering AG).

Dr. Richard Pott joined the Board in May 2002. He had previously served as General Manager of our Specialty Products business group. Before assuming responsibility for Specialty Products, he served Bayer in a number of positions, most recently as head of the Strategic Planning Department and then as head of Corporate Planning and Controlling. Dr. Pott oversees strategy and human resources and serves as *Arbeitsdirektor* (that member of the Board responsible for personnel and social issues within the company). In addition to his responsibilities on the Board, he is the chairman of the supervisory boards of each of Bayer HealthCare AG and Bayer Industry Services GmbH & Co. OHG (member of the latter since May 1, 2006). Until April 30, 2006, he was the chairman of the supervisory board of Bayer MaterialScience AG.

Dr. Wolfgang Plischke joined the Board in March 2006. Prior to joining the Board, he was the General Manager of our previous Pharmaceuticals division since January 2002 and a member of the Bayer HealthCare Executive Committee responsible for that division since July 2002. Before becoming the General Manager of our previous Pharmaceuticals division, he had served as head of that division in North America and had been a member of the Executive Committee of Bayer Corporation since 2000. He started his career in 1980 with Bayer s subsidiary Miles Diagnostics. In addition to his responsibility on the Board, he became the chairman of the supervisory boards of Bayer Technology Services and of Bayer MaterialScience AG shortly after joining both boards as a member on May 1, 2006.

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Supervisory Board

Under the German Stock Corporation Act, the German Co-Determination Act (*Mitbestimmungsgesetz*) of 1976 and our Articles of Association, the Supervisory Board consists of 20 members. The principal function of the Supervisory Board is to supervise the Board of Management and to appoint its members. The Supervisory Board oversees our business policy, corporate planning and strategy. It also approves the annual budget and the financial statements of Bayer AG and of the Bayer Group. The Supervisory Board may not make management decisions, but the Board of Management s Standard Operating Procedures (*Geschäftsordnung*) may require the prior consent of the Supervisory Board for specified transactions above a specified threshold, including:

the acquisition or disposition of assets;

the acquisition, disposition or encumbrance of real property;

the acquisition or disposition of Company shares; and

the issuance of bonds, entering into credit agreements, or grant of guarantees, sureties (*Bürgschaften*) and loans, except to subsidiaries.

Our stockholders elect ten members of the Supervisory Board at the Annual Stockholders Meeting. Pursuant to the Co-Determination Act of 1976, our employees elect the remaining ten members. The term of a Supervisory Board member expires at the end of the Annual Stockholders Meeting in which the stockholders discharge Supervisory Board members for the fourth fiscal year following the year in which the member was elected. There is no compulsory retirement age for members of the Supervisory Board. However, in accordance with the German Corporate Governance Code, Supervisory Board members are encouraged to retire at the Annual Stockholders Meeting following the member s 72nd birthday.

Any member of the Supervisory Board elected by the stockholders at the Annual Stockholders Meeting may be removed by a vote of at least three quarters of the votes cast by the stockholders in such meeting. Any member elected by the employees may be removed by a majority of three quarters of the votes cast by the employees. Unless otherwise required by law or by the Articles of Association of Bayer AG, resolutions of the Supervisory Board are passed by simple majority of the votes cast. According to the Articles of Association, in the case of a deadlock, a second vote is held in which the chairman of the Supervisory Board is entitled to one additional vote. In order to constitute a quorum, at least half of the total members of the Supervisory Board must participate in the voting.

The following table shows the current members of our Supervisory Board as well as members of the Supervisory Board who left the Supervisory Board in the course of the financial year 2006, their principal occupations, the year in which they were first elected or appointed and memberships they hold on the supervisory boards of other companies. Employee representatives are identified by an asterisk.

Name	Position	Principal Occupation	First Elected	Membership on other Supervisory Boards
Dr. Manfred Schneider	Chairman	Former chairman of the Management Board	2002	Allianz SE, DaimlerChrysler AG, Linde AG, Metro AG, RWE AG, TUI AG
*Thomas de Win[(1)]	Vice Chairman	Chairman of the Bayer Central Works Council, Leverkusen	2002	Bayer MaterialScience AG
Dr. Paul Achleitner	Member	Member of the management board, Allianz SE	2002	Allianz Deutschland AG, Allianz Global Investors AG, Allianz Lebensversicherungs-AG, Allianz Elementar Versicherungs-AG,

Allianz Elementar
Lebensversicherungs-AG,
RWE AG

Name	Position	Principal Occupation	First Elected	Membership on other Supervisory Boards
Dr. Josef Ackermann	Member	Chairman of the management board, Deutsche Bank AG	2002	Deutsche Lufthansa AG, Linde AG, Siemens AG
*Andreas Becker[2]	Member	Chairman of the Works Council of H.C. Starck	2005	H.C. Starck GmbH
*Willy Beumann[3]	Member	Chairman of the Works Council, Wuppertal Site	2007	Bayer HealthCare AG
*Karl-Josef Ellrich	Member	Chairman of the Works Council, Dormagen Site, Chairman of the Bayer Group Works Council, Leverkusen	2000	Bayer CropScience AG
*Dr. Thomas Fischer	Member	Head of Process and Plant Safety, Bayer MaterialScience	2005	Bayer MaterialScience AG
*Erhard Gipperich[4]	Vice Chairman	Chairman of the Group and Central Works Councils of Bayer AG, Leverkusen	1998	
*Peter Hausmann[5]	Member	North Rhine District Secretary of the German Mine, Chemical and Power Workers Union	2006	Procter & Gamble Manufacturing GmbH
*Thomas Hellmuth	Member	Agricultural Engineer	2002	
Prof. Dr.-Ing. e.h. Hans-Olaf Henkel	Member	Honorary professor of the University of Mannheim	2002	Continental AG, DaimlerChrysler Aerospace AG, EPG AG, SMS GmbH, Brambles Industries Ltd., Orange SA, Ringier AG
*Reiner Hoffmann[6]	Member	Deputy Secretary of the European Trade Union Confederation (ETUC)	2006	Sasol Germany GmbH
*Gregor Jüsten[7]	Member	Member of the Works Councils, Leverkusen Site	2006	
Dr. rer. pol. Klaus Kleinfeld	Member	Chairman of the management board, Siemens AG	2005	Alcoa Inc., Citigroup Inc.
Dr. h.c. Martin Kohlhaussen	Member	Chairman of the supervisory board, Commerzbank AG	1992	Hochtief AG, ThyssenKrupp AG, Schering AG (until September 13, 2006)
John Christian Kornblum	Member	Chairman of Lazard & Co.	2002	Motorola Inc., ThyssenKrupp Technologies AG
*Petra Kronen	Member	Chairwoman of the Works Council,	2000	Bayer MaterialScience AG

		Uerdingen Site		
*Hubertus Schmoldt	Member	Chairman of German Mine, Chemical and Power Workers Union	1995	Deutsche BP AG, DOW Olefinverbund GmbH, E.ON AG, RAG AG, RAG Coal International
*Dieter Schulte[8]	Member	Former Chairman of German Unions Federation	1997	

Name	Position	Principal Occupation	First Elected	Membership on other Supervisory Boards
Dr.-Ing. Ekkehard D. Schulz	Member	Chairman of the management board, ThyssenKrupp AG	2005	AXA Konzern AG, Commerzbank AG, Deutsche Bahn AG, MAN AG, RAG AG, RAG Beteiligungs-AG, RWE AG, ThyssenKrupp Services AG, ThyssenKrupp Elevator AG, ThyssenKrupp Technologies AG
Dr.-Ing. e.h. Jürgen Weber	Member	Chairman of the supervisory board, Deutsche Lufthansa AG	2003	Allianz Lebensversicherungs-AG, Deutsche Bank AG, Deutsche Post AG, Voith AG, LP Holding GmbH, Tetra Laval Group, Willi Bogner GmbH & Co. KGaA
*Siegfried Wendlandt[9]	Member	North Rhine District Secretary of German Mine, Chemical and Power Workers Union	2001	
Prof. Dr. Dr. h.c. Ernst-Ludwig Winnacker	Member	Secretary General of the European Research Council (ERC)	1997	MediGene AG, KWS Saat AG, Wacker Chemie AG

(1) Vice Chairman of the Supervisory Board since March 2, 2006.

(2) Resigned February 1, 2007.

(3) First elected February 20, 2007.

(4) Resigned January 31, 2006; Vice Chairman until resignation.

(5) First elected April 28, 2006.

(6) First elected October 11, 2006.

(7) Elected February 1, 2006.

(8) Resigned September 18, 2006.

(9) Resigned April 28, 2006.

Supervisory Board Committees

Currently, the Supervisory Board has the following committees:

The Presidium was established pursuant to § 27 (3) of the Co-Determination Act and consists of the chairman and vice chairman of the Supervisory Board, as well as of one stockholder representative and one employee representative. It serves as our mediation committee (*Vermittlungsausschuss*) with respect to nominations to the Board of Management. The purpose of this committee is to nominate persons for election to the Board of Management by a simple majority of the votes of the Supervisory Board in the event that the Supervisory Board is unable to appoint members of the Board of Management with the votes of at least a two thirds majority of the Supervisory Board. Pursuant to § 9 (2) of the Standard Operating Procedures (*Geschäftsordnung*) of the Supervisory Board, the Presidium also prepares the general meetings of the full Supervisory Board. The current members of the Presidium are Mr. Schneider (chairman), Mr. Achleitner, Mr. de Win (since March 2, 2006, succeeding Mr. Gipperich who resigned January 31, 2006) and Mr. Schmoldt.

The personnel committee (*Personalausschuss*) was established pursuant to § 10 of the Standard Operating Procedures of the Supervisory Board. The personnel committee consists of four members of the Supervisory Board. The chairman of the Supervisory Board acts as chairman of the personnel committee. The main responsibility of the personnel committee is the determination of the salary and further conditions of the employment of Board of Management members, the legal representation of the

Company in affairs with Board of Management members pursuant to § 112 of the German Stock Corporation Act, the approval of agreements with Supervisory Board members pursuant to § 114 of the German Stock Corporation Act and the approval of loans granted to Supervisory Board and Board of Management members and other persons pursuant to § 89 and § 115 of the German Stock Corporation Act. The current members of the personnel committee are Mr. Schneider (chairman), Mr. Kohlhaussen, Mr. Ellrich and Ms. Kronen.

The audit committee (*Prüfungsausschuss*) was established pursuant to § 11 of the Standard Operating Procedures of the Supervisory Board. The audit committee consists of six members of the Supervisory Board. The main responsibilities of the audit committee are oversight of financial accounting, risk management, the preparation of the resolutions of the Supervisory Board with respect to the annual financial statements, the review of all non-audit services to be performed by the independent auditor, oversight over the independent auditors including scope of services, fees and schedules, the direct receipt of the audit reports, and the direct receipt of reports of accounting irregularities. The current members of the audit committee are Mr. Kohlhaussen (chairman), Mr. Schneider, Mr. Fischer, Mr. Henkel, Mr. Hausmann (as of April 29, 2006, succeeding Mr. Wendlandt who was a member until April 28, 2006) and Mr. de Win.

The committee relating to issues in connection with the takeover and integration of Schering AG, Berlin, Germany (*Schering Ausschuss*) was established pursuant to § 8 of the Standard Operating Procedures of the Supervisory Board. The Schering committee consists of four members of the Supervisory Board. Its main responsibilities are the oversight of the tender offer for all shares including shares represented by American Depositary Shares (ADS) in Schering as well as decisions relating to the financing or refinancing of the takeover. The Schering committee was established on March 23, 2006. The current members of the Schering committee are Mr. Schneider, Mr. Schmoldt, Mr. Schulz and Mr. de Win.

Share Ownership

Because the shares of Bayer AG are in bearer form, we cannot obtain precise information as to their holders. To the best of our knowledge, however, no member of the Supervisory Board or the Board of Management beneficially owns shares of Bayer AG totaling one percent or more of all outstanding shares.

Compensation

Board of Management

The members of the Board of Management receive a base salary and a fixed supplement (both aggregated under the term fixed salary), remuneration in kind and other benefits, and variable compensation. The variable compensation comprises a variable bonus and the possible payments from the participation in long-term stock-based compensation programs. Since 2005, the variable bonus for a given year is tied to the attainment of the Group target based on EBITDA, which we define as operating result plus depreciation and amortization. For the year 2006, the variable bonus is calculated partly according to the Group s EBITDA margin before special items adjusted to exclude the impact of a number of what we regard as special effects for this purpose (such as gains of divestitures, impairment charges, expenses relating to the strategic reorientation of our businesses and other material unusual effects), and partly according to the average target attainment of the HealthCare, CropScience and MaterialScience subgroups. The latter is based mainly on the subgroups target attainment concerning EBITDA, adjusted to exclude the impact of unusual effects, as well as on a qualitative appraisal in relation to the market and competitors.

The directly effected remuneration of members of the Board of Management in 2006 amounted to 8,143,822 (2005: 7,064,828), comprising 2,260,400 (2005: 1,985,580) in base salaries and 1,096,556 (2005: 837,073) in fixed supplements, 4,644,475 (2005: 4,085,754) in variable bonuses plus 142,391 (2005: 156,421) of remuneration in kind and other benefits. Remuneration in kind mainly consists of the value assigned by German taxation guidelines to certain benefits in kind such as for example the use of a company car. Other benefits include, for example, reimbursements for preventive medical checkups.

Members of the Board of Management were permitted to participate in a cash-settlement-based stock option program, offered through the year 2004, if they placed their personal investment in Bayer Stock in a special deposit account. As part of this old program, a total of 25,290 stock options with a fair value of 1,806,718 were outstanding as of December 31, 2006.

Since 2005, the members of the Board of Management have participated in the long-term stock-based compensation program *Aspire I* (2005 and 2006 tranches). Participation in this program is linked to membership of a Group Leadership Circle, not to the contract of service as a member of the Board of Management. Further details of this program are presented in *Employee Stock-Based Compensation Programs Long-term incentive program for members of the Board of Management and other senior executives* (*Aspire I*).

The entitlements earned in 2006 relate to the 2006 part of the respective three-year-performance period 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 2006 are shown separately. They result from the upward trend in the price of Bayer stock in 2006. Additionally, the fair value of the stock-based compensation as of the grant date is given separately.

The table below shows the remuneration components of those individuals that were members of our Board of Management in the course of 2006. In 2006, the remuneration of our chief financial officer was raised in recognition of the special tasks of such a position.

Remuneration of the Members of the Board of Management

	Werner Wenning	Klaus Kühn	Dr. Udo Oels[a]	Dr. Wolfgang Plischke[b]	Dr. Richard Pott	Total
			(In Euros)			
Base salary	748,872	412,236	343,526	343,530	412,236	2,260,400
Fixed supplement	325,132	316,366	142,205	142,206	170,647	1,096,556
Variable bonus	1,525,086	1,034,615	567,335	689,745	827,694	4,644,475
Remuneration in kind and other benefits	47,926	35,571	9,594	18,163	31,137	142,391
Directly effected remuneration	**2,647,016**	**1,798,788**	**1,062,660**	**1,193,644**	**1,441,714**	**8,143,822**
Stock-based compensation						
Entitlements earned in 2006	820,514	480,609	538,181	193,188	461,939	2,494,431
Change in value of entitlements earned prior to 2006	339,733	229,617	104,125	66,262	164,952	904,689

(a) Until April 28, 2006.

(b) Since March 1, 2006.

In 2005, the remuneration components of those individuals that were members of our Board of Management in the course of 2006 were as following:

	Werner Wenning	Klaus Kühn	Dr. Udo Oels[a]	Dr. Wolfgang Plischke[b]	Dr. Richard Pott	Total

			(In Euros)		
Base salary	748,872	412,236	412,236	412,236	1,985,580
Fixed supplement	325,132	170,647	170,647	170,647	837,073
Variable bonus	1,554,615	843,713	843,713	843,713	4,085,754
Remuneration in kind and other benefits	40,169	35,266	41,942	39,044	156,421
Directly effected remuneration	**2,668,788**	**1,461,862**	**1,468,538**	**1,465,640**	**7,064,828**
Stock-based compensation					
Entitlements earned in 2005	495,504	285,748	285,748	284,248	1,351,248
Change in value of entitlements earned prior to 2005	169,289	99,693	99,693	98,055	466,730

(a) Until April 28, 2006.

(b) Since March 1, 2006.

The fair value of the stock-based compensation as of the grant dates for the 2006 and 2005 Aspire program, respectively, is shown in the following table. The entitlements earned in 2006 under the 2006 and 2005 Aspire program are included in the preceding tables under Stock-based compensation: Entitlements earned in 2006 and Stock-based compensation: Entitlements earned in 2005 .

	Werner Wenning	Klaus Kühn	Dr. Udo Oels[a]	Dr. Wolfgang Plischke[b]	Dr. Richard Pott	Total
			(In Euros)			
Fair value as of grant date of options granted under the Aspire program						
in 2006	268,113	181,886	40,419	117,597	145,509	753,524
in 2005	253,636	137,652	137,652		137,652	666,592

[a] Until April 28, 2006.

[b] Since March 1, 2006.

Pension provisions for the current members of the Board of Management amounted to 29,564,478 (2005: 32,218,996). Active 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 at 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.

We currently pay former and retired members of the Board of Management a monthly pension equal to 80 percent of the last monthly fixed 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 amounts are in addition to any amounts they receive as a result of their participation in the Bayer pension plan described below. See *Employee Pension Plan.*

Current service cost for pension entitlements in 2006 and 2005 of those individuals that were members of our Board of Management in the course of 2006 were as following:

	Werner Wenning	Klaus Kühn	Dr. Udo Oels[a]	Dr. Wolfgang Plischke[b]	Dr. Richard Pott	Total
			(In Euros)			
Current service cost for pension entitlements earned						
in 2006	398,564	1,651,294		1,644,517	233,284	3,927,659
in 2005	311,158	420,046			186,600	917,804

[a] Until April 28, 2006.

[b] Since March 1, 2006.

For active Board of Management members a general severance indemnity clause, with the following main elements applies:

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 in the absence of grounds for termination without notice, he will receive a monthly allowance in an amount of 80 percent of his last monthly fixed salary for a period of 60 months from the date of expiration of his service contract less any period for which the Board of Management member was released from his duties on full pay.

If, in the event of a change of control of our company, the service contract is terminated within 12 months thereafter by mutual consent, due to its expiration, or voluntarily by the Board of Management member in certain circumstances such as a change of strategy the Board of Management member will receive a monthly allowance in an amount of 80 percent of his last monthly fixed salary for a period of 60 months from the date of termination of his service contract, not counting any period for which he was released from his duties on full pay.

Pension entitlements are based on the final target pension level. If the member of the Board of Management has not already reached his final target pension level, his pension entitlement will be supplemented up to this level.

Emoluments to retired members of the Board of Management and their surviving dependents amounted to 10,924,768 (2005: 10,323,009). Pension provisions for former members of the Board of Management and their surviving dependents amounted to 117,866,846 (2005: 115,972,457).

As of December 31, 2006, no loans to members of the Board of Management were outstanding, nor any repayments of such loans occurred during the year.

Supervisory Board

The remuneration of the members of the Supervisory Board is determined in accordance with Article 12 (most recently amended at the Annual Stockholders Meeting on April 29, 2005) of the Articles of Association of Bayer AG. In addition to reimbursing expenses incurred in connection with the exercise of their office, the company pays to each member of the Supervisory Board a fixed remuneration of 60,000 per year and a variable remuneration that is tied to the gross cash flow as reported in the consolidated financial statements of the Bayer Group for the recent fiscal year. For every 50 million or part thereof by which the gross cash flow exceeds 3.1 billion, a variable remuneration of 2,000 per year is paid to each Supervisory Board member. However, in total the variable remuneration per Supervisory Board member may not exceed 30,000 per year.

In accordance with the German Corporate Governance Codex, however, the amount of remuneration reflects such special functions as the Chairman and the Vice Chairman of the Supervisory Board, as well as the membership in Supervisory Board committees. The Chairman receives three times, the Vice Chairman one-and-a-half times the fixed and variable remuneration of the other members of the Supervisory Board detailed above. The fixed and variable remuneration of members who are also members of a Supervisory Board committee is increased by one quarter of the fixed and variable remuneration detailed above, and that of members who also chair a committee is increased by a further quarter. Regardless of special functions and committee membership however, in total, the fixed and variable remuneration of any Supervisory Board member may not exceed three times the fixed and variable remuneration described in the preceding paragraph. Supervisory Board members who have been members of the Supervisory Board or of one of its committees for only a part of the fiscal year receive the applicable remuneration on a pro rata basis.

No members of the Supervisory Board received any compensation or other benefits for personally-performed services, especially consultancy or agency 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.

As of December 31, 2006, no loans to members of the Supervisory Board were outstanding, nor any repayments of such loans occurred during the year.

The following table shows the remuneration paid to individuals that were members of the Supervisory Board in the course of 2006. Employee representatives, who receive salaries from us unrelated to their service on the Supervisory Board, are identified by an asterisk. The aggregate amount of the salaries the employee representatives received in 2006 in their capacities other than as members of the Supervisory Board is 647,813. Employee

representatives, who do not receive salaries from us unrelated to their service on the Supervisory Board, are identified by two asterisks.

Remuneration of the Members of the Supervisory Board

	Fixed Remuneration	Variable Remuneration	Totals
		(In Euros)	
Dr. Paul Achleitner	75,000.00	37.500,00	112,500.00
Dr. Josef Ackermann	60,000.00	30,000.00	90,000.00
*Andreas Becker[1]	60,000.00	30,000.00	90,000.00
*Karl-Josef Ellrich	75,000.00	37,500.00	112,500.00
*Dr. Thomas Fischer	75,000.00	37,500.00	112,500.00
*Erhard Gipperich[2]	8,917.81	4,458.91	13,376.72
**Peter Hausmann[3]	50,958.90	25,479.45	76,438.35
*Thomas Hellmuth	60,000.00	30,000.00	90,000.00
Prof. Dr.-Ing. e.h. Hans-Olaf Henkel	75,000.00	37,500.00	112,500.00
**Reiner Hoffmann[4]	13,479.45	6,739.73	20,219.18
*Gregor Jüsten[5]	54,904.11	27,452.05	82,356.16
Dr. rer. pol. Klaus Kleinfeld	60,000.00	30,000.00	90,000.00
Dr. h.c. Martin Kohlhaussen	105,000.00	52,500.00	157,500.00
John Christian Kornblum	60,000.00	30,000.00	90,000.00
*Petra Kronen	75,000.00	37,500.00	112,500.00
**Hubertus Schmoldt	86,671.23	43,335.62	130,006.85
Dr. Manfred Schneider	180,000.00	90,000.00	270,000.00
**Dieter Schulte[6]	42,904.11	21,452.05	64,356.16
Dr.-Ing. Ekkehard D. Schulz	71,671.23	35,835.62	107,506.85
Dr.-Ing. e.h. Jürgen Weber	60,000.00	30,000.00	90,000.00
**Siegfried Wendlandt[7]	24,246.58	12,123.29	36,369.87
*Thomas de Win	124,273.97	62,136.99	186,410.96
Prof. Dr. Dr. h.c. Ernst-Ludwig Winnacker	60,000.00	30,000.00	90,000.00

(1) Resigned February 1, 2007.

(2) Resigned January 31, 2006.

(3) First elected on April 28, 2006.

(4) First elected on October 11, 2006.

(5) First elected February 1, 2006.

(6) Resigned September 18, 2006.

(7) Resigned April 28, 2006.

Employee Stock-Based Compensation Programs

Stock-based compensation in the Bayer Group is granted primarily under standard programs and also on an individual agreement basis.

Individual agreements enable the company to link remuneration components to stock price or future stock price trends. Awards under such agreements may be contingent upon the attainment of agreed targets, or they may be based solely on length of service.

Standard programs exist for different groups of employees. The program offered to members of the Board of Management and other senior executives from 2001 through 2004 was essentially a stock option program with variable stock-based awards. This program provides for cash payments. Middle managers were offered a stock incentive program, while other groups of employees were offered a stock participation program.

A stock-based compensation program for top and middle management, known as Aspire , was introduced in 2005. It comprises two variants, which are described below. For other managers and non-managerial employees, a stock participation program has been offered since 2005, under which Bayer subsidizes employee purchases of shares in the company.

As with other remuneration systems involving cash settlement, awards to be made under the stock-based programs are covered by provisions in the amount of the fair value of the obligations existing as of the date of the financial statements vis-à-vis the respective employee group. Adjustments to provisions relating to all existing stock-based compensation programs are recognized in the income statement.

The table below shows the change in provisions for the various programs:

	Stock Option program	Stock Incentive program	Stock Participation program	Aspire I	Aspire II	Total
			(Euros in millions)			
December 31, 2005	13	3	11	11	23	61
Additions	7	2	5	22	29	65
Utilization	(7)	(2)	(4)	(4)	(8)	(25)
Reversal	0	0	0	0	0	0
Reclassification to current liabilities				(2)	(5)	(7)
Currency effects				(1)	(1)	(2)
December 31, 2006	13	3	12	26	38	92

Total expenses for stock-based compensation programs in 2006 were 65 million (2005: 51 million), including 51 million (2005: 34 million) for the Aspire programs and 4 million in subsidies for the 2006 short-term stock participation program (2005: 2 million in subsidies for the 2005 short-term stock participation program).

In 2006, provisions of 8 million were recorded in the financial statements at the fair value of obligations entered into under individual stock-based compensation agreements. The obligations were measured in the same way as those incurred under the standard programs. Expenses for individual stock-based compensation agreements in 2006 were 6 million (2005: 4 million).

The fair value of obligations under the standard stock-based compensation programs and individual agreements has been calculated using the Monte Carlo simulation method and the following key parameters:

	2005	2006
Dividend yield	2.27%	2.29%
Risk-free interest rate	2.92%	3.83%
Volatility of Bayer stock	38.00%	21.52%
Volatility of the EURO STOXX 50[sm]	19.55%	13.14%
Correlation between Bayer stock price and the EURO		

STOXX 50[sm]	0.56	0.61

The expected exercise period is three to five years.

Long-term incentive program for members of the Board of Management and other senior executives (Aspire I)

To participate in Aspire I, members of the Board of Management and other senior executives are required to purchase a certain number of Bayer shares determined on the basis of specific guidelines and to retain them for the full term of the program.

A percentage of their annual base salary is defined as a target for variable payments (Aspire target opportunity). Depending on the performance of Bayer stock, both in absolute terms and relative to the EURO STOXX 50sm benchmark index, participants are granted an award of between 0 percent and 200 percent of their individual target opportunity.

Participants may ask for their Aspire award to be paid out in cash immediately at the end of the three-year performance period, or they may convert it into performance units . These can then be redeemed within a two-year exercise period for a cash payment that depends on the Bayer stock price on the exercise date.

Long-term incentive program for middle management (Aspire II)

A variant of the Aspire program with the following modifications is offered to middle management:

No personal investment in Bayer shares is required.

The amount of the award in relation to the employee s personal Aspire target opportunity is based entirely on the absolute performance of Bayer stock during the performance period.

The award varies between 0 percent and 150 percent of the Aspire target opportunity.

This variant of the Aspire program is not linked to the EURO STOXX 50sm index.

Stock Participation Program (2006) for other managers and non-managerial employees

Under this program, Bayer offered employees the opportunity to purchase shares at a discount of 15 percent from the lowest stock price for the day (*Tagestiefstkurs*) of August 15, 2006. Employees could invest an amount of up to 10 percent of their annual base salary, but not more than 5,000.

The shares purchased under the 2006 Stock Participation Program must be held in a special deposit account and may not be sold prior to December 31, 2007. In 2006, employees acquired a total of 474,003 Bayer shares under the 2006 Stock Participation Program, leading to additional compensation expenses in an amount of 3 million.

Bayer Industry Services GmbH & Co. OHG (BIS), held by Bayer AG (60 percent) and by LANXESS (40 percent), offered a different stock participation program. BIS offered its managers and non-managerial employees the opportunity to purchase Bayer shares and LANXESS shares in a ratio of 3:2, at a discount of 50 percent from the lowest stock price for the day (*Tagestiefstkurs*) of August 14, 2006. The total discounted purchase of shares purchased by any one manager or non-managerial employee under this stock participation program was capped at an amount ranging between 600 and 2,000, depending on the contract level of that manager or non-managerial employee. The total granted discount per manager or non-managerial employee ranged between 300 and 1,000.

The shares purchased under the BIS stock participation program must be held in a special deposit account and may not be sold prior to December 31, 2008. In 2006, BIS managers and non-managerial employees acquired a total of 34,512 Bayer shares under the BIS stock participation program, leading to an additional compensation expense for us in an amount of 1 million.

Stock-based compensation programs 2000-2004

The stock-based compensation programs offered to the different employee groups in 2000 through 2004 were all similar in their respective structures. Provisions for the obligations under these programs are recorded in the balance sheet and recognized in the income statement at fair value. Entitlement to awards under these programs is conditioned on retention of the Bayer stock designated under the program for a certain time period.

The following table shows the programs applicable through December 31, 2004:

	Stock Option program	Stock Incentive program	Stock Participation program
Year of issue	2001-2004	2000-2004	2000-2004
Original term in years	5	10	10
Retention period/distribution date in years from issue date	3	2/6/10	2/6/10
Reference price	0	0	0
Performance criteria	Yes	Yes	No

Stock Option Program (2001-2004)

A maximum personal investment in Bayer stock was defined for each Board of Management member or other senior executive who wished to participate in the Stock Option Program.

The Stock Option Program contains a three-year retention condition. The retention period is followed by a two-year exercise period, after which any option rights not exercised expire. Eligibility to exercise option rights and the award to which the holder is entitled depend on the absolute and relative performance of Bayer stock.

For the tranches issued in 2001-2002, every participant received one option for every 20 shares of their personal investments placed in a special account. Each option originally could reach a maximum value of 200 shares during the term of the tranche, depending on the performance of Bayer stock, both in absolute terms and relative to the EURO STOXX 50SM index.

For the tranches issued in 2003 and 2004, participants received up to three options per share for every share of their personal investments placed in the special account. For each option, a cash payment equivalent to the market price of one Bayer share and an outperformance premium are awarded at the exercise date subject to the attainment of certain performance and outperformance targets, respectively.

None of the stock options issued under the 2001 tranche, which expired on May 15, 2006, were exercised. Stock options under the 2002 and 2003 tranches where partially exercised and are currently still exercisable. As of December 31, 2006, their intrinsic value was 4 million.

Stock Incentive Program (2000-2004)

To participate in this program, each participant was required to deposit shares with a maximum aggregate value of 50 percent of his or her performance-related bonus for the preceding fiscal year. The incentive award depends on the number of Bayer shares deposited at the launch of each tranche and the overall performance of Bayer stock. The Stock Incentive Program differed from the Stock Option Program in that participants were permitted to sell their shares during the term of the program, although any shares sold did not count for purposes of calculating the incentive awards on subsequent distribution dates. The Stock Incentive Program runs for a ten-year period, during which there are three incentive payment dates.

Incentive payments under the program are only made if Bayer stock has outperformed the EURO STOXX 50SM index on the respective incentive payment dates. For every ten Bayer shares originally placed in their special account and retained until the incentive payment date, participants receive payments equal to the value of two shares after two years, the value of four shares after six years and the value of additional four shares after ten years.

Stock Participation Program (2000-2004)

Under the Stock Participation Program, only half as many shares as under the Stock Incentive Program are awarded per ten shares deposited, but the award is not conditioned on any performance criteria.

Employee Pension Plan

Employees who enter into employment with Bayer AG or its group management companies on or after January 1, 2005, become members of the BayerPLUS pension plan and must join Bayer AG s new pension fund Rheinische Pensionskasse (*RPK*), a mutual insurance company. As a member of the *RPK*, an employee makes a mandatory monthly contribution of 2 percent of his or her monthly contribution-eligible income (up to the threshold (*Beitragsbemessungsgrenze*) for the statutory pension insurance (*gesetzliche Rentenversicherung*), which for 2006 was a salary of 5,250 per month or 63,000 per year) to the pension fund. These contributions are withheld from the employee s salary. Bayer AG and its group management companies match the employee s contribution. Upon retirement, the employee is entitled to receive a monthly basic pension payment (*Grundrente*) from the *RPK* calculated on the basis of contributions made multiplied by an age factor based on actuarial principles and including a guaranteed interest rate of 2.75 percent. Entitlements under this basic pension plan vest immediately. If the *RPK* generates a surplus, the pension benefits paid will rise accordingly.

Employees who entered into employment with Bayer AG or its group management companies on or after January 1, 2005 and whose annual contribution-eligible income exceeds the statutory pension insurance threshold are entitled to receive an additional monthly pension payment (*Zusatzrente*) from a supplementary pension plan, for which book reserves are included in the balance sheet. Under this plan, entitlements are calculated in the same manner as under the *RPK*. Bayer AG and its group management companies make a mandatory notional contribution of 6 percent of that portion of the employee s income exceeding the statutory pension insurance threshold (contribution-eligible income for purposes of the supplementary pension plan) into the supplementary pension plan. In addition, Bayer matches any contributions made by the employee into the supplementary pension plan. The employee may make a contribution of up to 9 percent of that employee s contribution-eligible income for purposes of the supplementary pension plan. Entitlements based on employer contributions vest after a period of five years. Entitlements based under the supplementary pension plan on an employee s own contributions vest immediately.

Employees who entered into employment with Bayer AG or its group management companies before January 1, 2005 became members of the old pension plan (which is no longer open to new members) and joined the *Bayer-Pensionskasse*. As a member of the *Bayer-Pensionskasse*, an employee also makes a mandatory monthly contribution of 2 percent of his or her monthly contribution-eligible income (up to the statutory pension insurance threshold). Employees whose annual contribution-eligible income exceeds the annual statutory pension insurance threshold are entitled to receive an additional monthly pension payment (*Zusatzrente*) with respect to that excess (up to an annual contribution-eligible income of 111,000), for which book reserves are included in the balance sheet. Starting on January 1, 2006, the portion of the employees contribution-eligible income in excess of 111,000 is treated in the same manner as is contribution-eligible income of new employees that exceeds the statutory pension insurance threshold.

Key senior managers in leadership positions essential for the Group (*i.e.*, who shape the future of the Group as a whole) are assigned to so-called Group Leadership Circles (GLC). A manager s assignment to a GLC depends on his/her position and his/her reporting relationship at Group level. Members of the Board of Management are assigned to GLC I. (Their pension entitlements are discussed in *Compensation.*) For GLC II and GLC III members (*i.e.*, members of our senior management), who are appointed after March 18, 2005, a new pension contract applies in addition to their entitlements under the pension plans described above: Bayer AG matches the employee s contributions (up to 9 percent of the respective contribution-eligible income) at a 200 percent (GLC III) or 300 percent (GLC II) level. These benefits are also financed by book reserves. The pension contracts of GLC members appointed prior to that date remain unchanged on a defined benefit basis.

These changes for the German employees reflect the process of moving from Defined Benefit to Defined Contribution plans. The Bayer Group started this process in the 1990s and today Bayer has introduced Defined Contribution plans for new employees in all major countries. In the United States several of Bayer s current Defined Benefit plans were replaced with a pure Defined Contribution plan effective January 1, 2006. Pension entitlements under the modified Defined Benefit plans were determined as of December 31, 2005 and frozen. For further information, please refer to Note 25 to the consolidated financial statements appearing elsewhere in this annual report on Form 20-F.

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Employees

The following tables set forth the average number of employees* in continuing operations during 2004, 2005 and 2006 by area of primary activity and an approximate breakdown of employees as of December 31, 2004, 2005 and 2006 by geographical region:

	Employees* by Activity Average For				
	2004	Change from Previous Year (%)	2005	Change from Previous Year (%)	2006
Technology/ Manufacturing	42,282	(1.24)	41,757	7.95	45,076
Marketing	23,689	4.36	24,723	25.79	31,098
Administration	7,850	(1.03)	7,769	29.54	10,064
Research and development	8,532	(4.77)	8,125	27.46	10,356
Total	82,353	(0.02)	82,374	17.26	96,594

	Breakdown by Region As of December 31,				
	2004	Change from Previous Year (%)	2005	Change from Previous Year (%)	2006
Europe	44,483	1.56	45,179	26.70	57,241
North America	14,900	(12.08)	13,100	31.30	17,200
Asia/ Pacific	11,500	14.78	13,200	31.06	17,300
Latin America/ Africa/ Middle East	9,600	10.42	10,600	29.25	13,700
Corporate	517	0.77	521	7.29	559

* Starting with the second quarter of 2006, the number of employees was converted to fulltime equivalents, which means part-time employees are included in proportion of their contractual working hours. This presentation improves the comparability of personnel expenses and employee numbers.

Labor Relations

The union-organized employees at our German sites belong to several unions, the most important of which is IG BCE, the German Mining, Chemical and Energy Industrial Union. We do not negotiate collective bargaining agreements directly with these unions to cover our employees. Instead, in accordance with German practice, unions negotiate agreements with industry-wide employers associations, in our case, the German Chemical Industry Association.

In Germany, employers associations and unions typically negotiate collective bargaining agreements annually. However, collective bargaining agreements may be entered into for longer terms. A German collective bargaining agreement governs the employment of all employees up to a certain level of responsibility organized in the relevant union. At Bayer, even the employees in those employee groups governed by collective bargaining agreements who are not union members are granted rights under the collective bargaining agreements by means of reference in the individual agreements.

The current agreement covering our employees has a term of 19 months and began in June 2005. Negotiations for a new agreement started at the beginning of 2007 but are not concluded yet. Depending on the outcome of those negotiations, applicable regulations may be implemented retroactively from January 2007. It grants employees a salary increase of 2.7 percent over the previous collectively-agreed monthly salary (*monatliches Tarifentgelt*) for the term of the agreement. In addition, it grants employees a lump-sum payment amounting to a certain percentage of the previous monthly collectively-agreed salary. The percentage varies between 24 and 32 percent, depending on work schedules and shift. For Bayer AG, its group management companies (except for Bayer Industry Services) and the majority of Bayer AG s German affiliates, the lump-sum

payment under the current agreement was made in 2005. For Bayer Industry Services the lump-sum payment was made in February 2006.

There are 13 pay grades, based on job description, for our employees in positions governed by collective bargaining agreements. Our management employees, who have individual employment or service contracts, are organized in six contract levels. The Chemical Industry has a union for academics (*Verband der Angestellten Akademiker* (VAA)). Apart from a specific collective bargaining agreement for young entry level academics, management contracts at Bayer are not subject to collective bargaining agreements.

Each Bayer site in Germany has a works council (*Betriebsrat*), elected by all non-managerial employees. Members serve a four-year term. The last elections took place in April, 2006. The works councils facilitate communications between management and staff at the site level. A joint works council (*Gesamtbetriebsrat*) serves a similar purpose at the company-wide level and the same applies to the Group works council (*Konzernbetriebsrat*) at Group level, Germany-wide. The rights and responsibilities of works councils are set forth in the German Works Council Constitution Act (*Betriebsverfassungsgesetz*). Within the given framework of laws and collective bargaining agreements, works councils have participatory rights on site and company level with respect to managing staff-related issues as well as working conditions such as:

working hours (namely, beginning and end of daily working hours);

vacation guidelines;

social services (*e.g.*, subsidized cafeterias); and

distribution guidelines for performance-related bonuses.

A works council has generally no authority, however, to negotiate with an employer on wage and salary compensation or other issues included or typically included in collective bargaining agreements between employers associations and unions, unless the relevant collective bargaining agreement provides otherwise. Under German labor law, employees may not legitimately strike during the term of the collective bargaining agreements. The provisions of the applicable collective bargaining agreements determine whether the right to strike in request of issues not covered by the applicable collective bargaining agreements is also excluded during such term. Works councils generally have no legal authority to call a work stoppage. On the European level, we put in practice a customized procedure for information and consultation of employee representatives based on a voluntary agreement between Bayer AG and the Group works council (*Europaforum*).

Associated with restructuring measures within the Bayer Group, on November 7, 2003, the Board of Management and the employee representative members of the Supervisory Board agreed on principles for the extension of the existing agreement with the joint works council dated December 12, 2000 for safeguarding employment at several of our major German sites, taking effect January 1, 2004. Collective agreements with the competent representative bodies were signed June 30, 2004 and July 1, 2004 respectively. Under these principles, an act of solidarity by all employees at German Bayer locations allows us to maintain 1,000 full time equivalent (FTE) positions more than previously planned. By reducing performance-related variable income of all employees of German sites covered by the agreement by up to 10 percent, personnel costs for temporarily-unassigned employees are covered. On the basis of these options for cost cuts, we agreed that we would not, except in exceptional circumstances, lay off employees at our Leverkusen, Dormagen, Krefeld-Uerdingen, Elberfeld and Brunsbüttel sites for operational reasons before December 31, 2007. If exceptional circumstances arise that are beyond our control and lead to an overcapacity of employees, we have agreed to negotiate with the joint works council in order to find a solution that will serve the interests of the company and the employees to the greatest possible extent. In accordance with the agreements, performance-related variable income for 2006 was reduced by 1.4 percent.

Item 7. ***Major Shareholders and Related Party Transactions***

Major Shareholders

Under our Articles of Association, each of our ordinary shares represents one vote. Major shareholders do not have different voting rights.

Under the German Securities Trading Act (*Wertpapierhandelsgesetz; WpHG*), holders of voting securities of a listed German company must notify that company of the level of their holding whenever it reaches, exceeds or falls below specified thresholds. Until and throughout the financial year 2006 these thresholds were 5, 10, 25, 50 and 75 percent of the company s outstanding voting securities. As of the financial year 2007 these thresholds are 3, 5, 10, 15, 20, 25, 30, 50 and 75 percent of the company s outstanding voting securities.

The Capital Group Companies, Inc. has notified us pursuant to Section 21, Paragraph 1 of the German Securities Trading Act that since September 19, 2006, it has held 10.0179 percent of the voting rights (representing 76,571,057 ordinary shares) in our company 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, Sentence 2 and Sentence 3 of the German Securities Trading Act. Section 22, Paragraph 1, Sentence 2 and 3 provides that voting rights held by a subsidiary of the notifying company are attributable to the notifying company.

The Capital Research and Management Company, which according to our information is a subsidiary of Capital Group Companies, Inc. has notified us that since November 8, 2006, it has held 10.0852 percent of the voting rights (representing 77,085,721 ordinary shares) in our company 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. We are unable to determine on the basis of these notifications or otherwise, the total percentage of voting rights in our company held by Capital Group Companies, Inc. and Capital Research and Management Company taken together.

Based on these notifications and any notifications we have received pursuant to section 21(1) of the German Securities Trading Act through February 28, 2007, as of that date we are not aware of any other shareholder holding five percent or more of our outstanding shares.

U.S. shareholders can hold our shares either directly or indirectly through our sponsored American Depositary Receipt (ADR) program with The Bank of New York as depositary. Because our shares are in bearer form, we cannot obtain precise information as to the identity of shareholders or the distribution of our shares among them. From time to time, however, we conduct surveys, using the assistance of shareholder identification service providers. The results of these surveys are based on an analysis of regulatory filings of institutions with assets under management and known propensity to invest in European equities and the chemical and pharmaceutical sectors, cross-referenced with information provided by third parties and ourselves. Our last such survey measured our worldwide shareholder structure as of October 2006 and identified 61 percent (468,129,135 shares) of our total shares outstanding. Due largely to the greater difficulty inherent in learning details about shareholdings by individuals, substantially all of the shareholders identified in the survey were institutions. Of the 468,129,135 shares identified in this survey, 37.9 percent were held by institutions located in the United States (based on domicile of the shareholder), 27.0 percent were held by institutions located in Germany and 20.8 percent were held by institutions located in the United Kingdom. The rest of the shares identified in this survey were held by institutions in Switzerland, France and other countries, mainly in Europe. We believe that the major part of the 39 percent of our shares for which owners were not identified in this survey are held by retail shareholders located all over the world, but predominantly in Germany. Therefore, the regional percentages of the total outstanding shares could be different from the results of the above survey.

Furthermore, while we cannot obtain precise information as to the identity (and location) of the beneficial owners of the shares held in our ADR program, the records of the depositary under our ADR program show that as of February 28, 2007 there were 1,721 registered holders of our American Depositary Shares (ADSs). We assume that these ADSs are owned by persons resident in the United States. The ADSs are listed on the New York Stock Exchange and each ADS represents one ordinary share. As of February 28, 2007 the ADS holders collectively held 38,632,945 ADSs, or approximately 5.1 percent of our total outstanding share capital.

To our knowledge, we are not directly or indirectly owned or controlled by another corporation, by any government, or by any other natural or legal person severally or jointly, and there are no arrangements which may result in a change of control. See also Item 6, *Directors, Senior Management and Employees Share Ownership.*

Related Party Transactions

In the ordinary course of business, we purchase materials, supplies and services from numerous companies throughout the world. Members of Bayer AG s Supervisory Board are affiliated with some of these companies. We conduct our transactions with such companies on an arm s length basis. We do not consider the amounts involved in such transactions to be material to our business and believe that these amounts are not material to the business of the companies involved.

During our most recent full fiscal year and through the date of this annual report on Form 20-F, we have not been involved in, and we do not currently anticipate becoming involved in, any transactions that are material to us or any of our related parties and that are unusual in their nature or conditions. We have not made any outstanding loans to or for the benefit of:

- enterprises that, directly or indirectly, control or are controlled by, or are under common control with, us (except at arm s length conditions in the ordinary course of business);
- enterprises in which we have significant influence or which have significant influence over us (except at arm s length conditions in the ordinary course of business);
- shareholders beneficially owning a 10 percent or greater interest in our voting power;
- key management personnel; or
- enterprises in which persons described above own, directly or indirectly, a substantial interest in the voting power.

Interests of Experts and Counsel

Not applicable.

Item 8. *Financial Information*

Consolidated Financial Statements and Other Financial Information

See Item 18, *Financial Statements.*

Legal Proceedings

Bayer is involved in a number of legal proceedings. As a global company active in a wide range of life sciences and chemical activities, Bayer may in the ordinary course of business become involved in proceedings relating to such matters as:

- product liability;
- competition and antitrust;
- patent validity and infringement;
- tax assessments; and
- past waste disposal practices and release of chemicals into the environment.

The following discussion, although not an exhaustive list of claims or proceedings in which Bayer AG or its subsidiaries are involved, nevertheless describes what Bayer believes to be the most significant of those claims and proceedings. Subsequent developments in any pending matter, as well as additional claims that may arise from time to time, including additional claims similar to those described below, could become significant to

Bayer. References to Bayer include claims or proceedings to which Bayer AG and/or one or more of its subsidiaries is a party. Bayer subsidiaries include Schering AG, Berlin, Germany (now known as Bayer Schering Pharma AG) and its subsidiaries, although matters historically involving the products, operations or activities of Schering are discussed separately below. (Please note that Bayer Schering Pharma AG and Schering-Plough Corporation, New Jersey, are unaffiliated companies that have been totally independent of each other for many years. The names Bayer Schering Pharma or Schering as used in this annual report on Form 20-F always refer to Bayer Schering Pharma AG, Berlin, Germany, or its predecessor, Schering AG, Berlin, Germany, respectively.)

Bayer cannot predict with certainty the outcome of any proceedings in which Bayer is or may become involved. An adverse decision in a lawsuit seeking damages from Bayer, or Bayer s decision to settle certain cases, could result in monetary payments to the plaintiff and other costs and expenses. If Bayer loses a case in which Bayer seeks to enforce its patent rights or in which Bayer has been accused of infringing another company s patent rights, Bayer will sustain a loss of future revenue if Bayer no longer can sell the product covered by the patent or command prices for the affected products that reflect the exclusivity conferred by the patent. While payments and other costs and expenses Bayer might have to bear as a result of these actions are covered by insurance in some circumstances, the coverage under some of these insurance policies has (as indicated below) been exhausted, and other payments may not be covered by Bayer s insurance policies in full or at all. Accordingly, each of the legal proceedings described in the following discussion could be significant to Bayer, and the payments, costs and expenses above those already incurred or accrued could have a material adverse effect on Bayer s results of operations, financial position or cash flows.

Product liability proceedings

Lipobay/ Baycol litigation

In August 2001 Bayer voluntarily ceased marketing the anticholesterol product cerivastatin (marketed in the United States and Canada under the trade name *Baycol*) in response to reports of serious side effects in some patients. Claims for compensation have been made against Bayer in several countries. Many lawsuits were filed, primarily in the United States and Canada. It is possible that additional lawsuits may be filed in the United States and elsewhere.

U.S. litigation. As of February 12, 2007, approximately 1,810 lawsuits remain pending in the United States in both federal and state courts against Bayer, including putative class actions. At one time, more than 14,000 lawsuits were pending.

The actions in the United States have been based primarily on theories of product liability, consumer fraud, predatory pricing and unjust enrichment. These lawsuits seek remedies including compensatory and punitive damages, disgorgement of funds received from the marketing and sale of *Baycol* and the establishment of a trust fund to finance the medical monitoring of former *Baycol* users. Five U.S. cases have been tried to date to final judgment, all of which resulted in verdicts in Bayer s favor.

Cases remain pending in the federal district court in Minnesota and in multiple states. All cases are on behalf of individual plaintiffs, except in Oklahoma and Illinois, where class actions on behalf of multiple plaintiffs have been approved. Additional cases seeking class certification remain pending. Certification of a class is unrelated to a determination of Bayer s liability.

In January 2004, Bayer Corporation received a subpoena for documents principally relating to *Baycol* from the Defense Criminal Investigative Service of the U.S. Department of Defense Inspector General followed by a related subpoena issued by the U.S. Attorney for New Jersey in February 2006. The U.S. Attorney for New Jersey subsequently advised Bayer that Bayer did not need to respond to this subpoena. Prior to the withdrawal of *Baycol,* Bayer had a contract with the Department to provide it with a supply of *Baycol*. The investigation is a joint Department of Defense/ Food and Drug Administration inquiry relating to *Baycol*. Bayer is not aware of any charges or complaints filed in connection with this inquiry. Bayer believes it acted responsibly and fulfilled its responsibilities to the U.S. government, and has cooperated in the investigation, including by providing the information requested. Local governmental authorities in several European countries also initiated criminal

proceedings in connection with the withdrawal of *Baycol*. The majority of these proceedings have been dismissed.

Since April 2004, Bayer also has received civil investigative demands from 30 states seeking documents regarding the marketing of *Baycol*. In January 2007, Bayer agreed, without any admission of fault, to pay a total of $8 million to settle civil allegations made by the attorneys general of these 30 states that Bayer failed to adequately disclose to consumers safety risks associated with *Baycol*. Bayer also entered into a consent decree wherein it agreed to publicly register Bayer-sponsored clinical studies for Bayer products approved for marketing in the United States in accordance with the International Committee of Medical Journal Editors guidelines and to post information regarding those studies on the Internet.

Litigation in other countries. As of February 12, 2007, approximately 60 actions remain pending against Bayer companies in other countries, including class actions in Canada for residents of all Canadian provinces, except for Québec, who claim personal injury from *Baycol* other than rhabdomyolysis. In November 2006, these class actions were consolidated and will proceed in Manitoba. Separately, in 2004, Bayer entered into settlement agreements covering Canadian residents who allegedly contracted rhabdomyolysis. The deadline for filing claims under the 2004 settlement agreements lapsed in November 2006.

Impact of cerivastatin litigation on Bayer. Without acknowledging any liability, during 2006 Bayer settled an additional 69 cases worldwide resulting in agreements to pay settlements of approximately U.S. $11.7 million. In the United States, approximately 4,000 additional cases were dismissed without payment during 2006. As of February 12, 2007, Bayer has settled a total of 3,152 cases worldwide resulting in aggregate settlement payments of approximately U.S. $1,159 million. Bayer will continue, on a voluntary basis and without concession of liability, to offer fair compensation to people who experienced serious side effects while taking cerivastatin. After more than five years of litigation Bayer is currently aware of fewer than 20 cases in the United States that in Bayer s opinion hold a potential for settlement, although Bayer cannot rule out the possibility that additional cases involving serious side effects from cerivastatin may come to Bayer s attention. In cases where an examination of the facts indicates that cerivastatin played no part in the patient s medical situation, or where a settlement is not achieved, Bayer will continue to defend itself vigorously. Bayer believes it has meritorious defenses in these actions.

Following a 2003 agreement reached with the majority of the insurers in the cerivastatin litigation, Bayer began establishing provisions reflecting an excess of expected payments including defense costs over the expected insurance coverage. Additional charges of 43 million and 22.2 million to the operating result were recorded in 2005 and 2006, respectively, each in respect of settlements already concluded or expected to be concluded and anticipated defense costs.

Due to the considerable uncertainty associated with the cerivastatin litigation, it is currently not possible to estimate the potential liability. Since the existing insurance coverage is exhausted, Bayer could incur further costs that are not covered by the provisions already established. Bayer will regularly review the necessity of further provisions and related charges to the operating result as the cerivastatin litigation proceeds.

In the United States, Bayer co-promoted *Baycol* with SmithKline Beecham Corporation. SmithKline Beecham Corporation and Bayer have signed an allocation agreement under which SmithKline Beecham has agreed to pay five percent of all settlements and compensatory damage judgments arising out of actions based on the sale or distribution of *Baycol* in the United States, with each party responsible for paying its own attorneys fees.

HIV/ HCV related actions

Since the 1980 s, Bayer, as well as other fractionators of plasma products, has been involved in lawsuits alleging that hemophiliacs became infected with the human immunodeficiency virus (HIV) and/or the hepatitis C virus (HCV) by using allegedly infected clotting factor concentrates derived from human plasma. All of the early HIV-related cases have been resolved except for two which remain pending in Argentina and three which are pending in Japan. In October 2006, an additional HIV-related case was filed in Taiwan. In 2003, a putative class action against Bayer and other manufacturers was filed in the United States on behalf of U.S. residents claiming

compensation for HCV infections and non-U.S. residents claiming compensation for HIV and/or HCV infections. The court denied the plaintiffs motion to certify a class. Since 2003, U.S. and non-U.S. residents have filed additional cases, involving multiple plaintiffs, against Bayer and other manufacturers, claiming compensation for HIV and/or HCV infections allegedly acquired through blood plasma products manufactured in the United States. All of these matters have been filed in or transferred to federal district court in Illinois for coordinated proceedings. In January 2006, the court granted defendants motion, on the basis of *forum non conveniens*, to dismiss the claims of the eight residents of the United Kingdom who are plaintiffs in one of the cases. Plaintiffs appealed this ruling, and we are awaiting the decision of the United States Court of Appeals for the Seventh Circuit.

Bayer believes that it has meritorious defenses in the HIV/ HCV litigation and intends to continue to defend itself vigorously. Due to the considerable uncertainty associated with these proceedings, it is currently not possible to estimate potential liability and Bayer has and will regularly consider the need to establish provisions as the proceedings continue.

Phenylpropanolamine (PPA) litigation

In late 2000, Bayer voluntarily discontinued marketing over-the-counter cough and cold remedies containing the decongestant phenylpropanolamine (PPA) in the United States in response to a recommendation from the FDA that manufacturers voluntarily discontinue marketing products containing PPA. The FDA issued this recommendation after one epidemiological study suggested a possible association between PPA and hemorrhagic stroke.

As of February 12, 2007, 79 lawsuits remained pending in U.S. federal and state courts against Bayer. To date, three state cases have proceeded to trial. Two have resulted in defense verdicts for Bayer. In one case, the plaintiff was awarded damages of U.S. $400,000. This case was settled in July 2005 while on appeal.

Bayer believes it has meritorious defenses in these actions and intends to continue to defend itself vigorously. As of February 12, 2007, Bayer had settled 383 cases resulting in payments of approximately U.S. $57.2 million, without acknowledging any liability. Bayer will continue, on a voluntary basis and without concession of liability, to offer fair compensation to people who suffered hemorrhagic stroke while taking a Bayer product containing PPA. Bayer recorded a charge to the operating result in the total amount of 62 million in 2005. In 2006, this amount was reduced by 15 million due to an anticipated reduction in future PPA-related litigation charges. Such charges were for settlements already concluded or expected to be concluded, and defense costs which exceed the amount of existing insurance coverage.

Given the number and nature of the outstanding cases, management believes this matter no longer involves a material risk to Bayer and, absent a significant adverse development, will no longer report on its status.

Thimerosal litigation

Bayer Corporation remains a defendant in eight lawsuits filed in various state and U.S. federal courts by or on behalf of persons alleging injuries from the use of Bayer products containing thimerosal, specifically immunoglobulin therapies. In the second quarter of 2006, one case involving immunoglobulin therapy was dismissed. Other cases involving thimerosal in over-the-counter nasal spray products also have been dismissed. Given the number and nature of the remaining outstanding cases, management believes the Thimerosal product liability cases no longer involve a material risk to Bayer and, absent a significant adverse development, will no longer report on the status of these cases.

Isocyanate litigation

Bayer is a defendant in three Alabama state court isocyanate cases. Collectively the cases involve the claims of more than 1,600 plaintiffs who allege personal injuries (primarily respiratory) caused by exposure to diphenylmethane diisocyanate (MDI) from products supplied by Bayer and other co-defendants. The products were used in underground coal mines in Alabama where the plaintiffs worked. Bayer s co-defendants include two other MDI manufacturers, several distributors and contracting companies that used MDI-containing products in

those mines. Plaintiffs assert claims of negligence, wantonness, outrage, failure to warn, misrepresentation, concealment, breach of warranties and conspiracy. Punitive damages are sought. In April 2006, the trial court entered an order sanctioning Bayer for allegedly failing to properly respond to discovery, and entered a default judgment holding Bayer liable for damages if proven at trial. Following an appeal by Bayer, the Alabama Supreme Court in July 2006 directed the trial court to vacate its orders, and those orders subsequently were vacated.

Bayer is a defendant in a purported class action filed in federal district court in Alabama. Bayer s co-defendants include isocyanate trade associations, MDI manufacturers, several distributors and contracting companies that used MDI-containing products in the underground coal mines where plaintiffs worked. The case was filed by fifteen individual plaintiffs on behalf of themselves and a class of all similarly situated coal miners in the United States seeking redress for alleged personal injuries, declaratory and injunctive relief as a result of their alleged exposure. Plaintiffs likewise allege that they are entitled to medical monitoring for injuries that may manifest themselves in the future as a result of past MDI exposure.

Bayer believes it has meritorious defenses in these actions and intends to continue to defend itself vigorously. Due to the considerable uncertainty associated with these proceedings, it is currently not possible to estimate potential liability.

Hormone Replacement Therapies product litigation

Schering is one of several pharmaceutical companies named as defendants in lawsuits filed in various U.S. federal and state courts and at various times since July 2003 by plaintiffs who used hormone replacement therapy (HRT) products. Currently, 28 plaintiffs allege injury, including breast cancer, ovarian cancer, stroke and pulmonary embolism, as a result of their use of Schering HRT products. Cases involving 24 of these plaintiffs have been consolidated in Federal multi-district litigation involving similar cases against other manufacturers of HRT products. Four cases are pending in state courts. Various trials have been and are being conducted involving other manufacturers, with findings both in favor of and against the manufacturer defendants. To date, none of the cases involving Schering have been tried. Schering intends to vigorously defend the cases pending against it, and continues to monitor developments in the cases involving these other manufacturers. Due to the considerable uncertainly associated with these proceedings, it is currently not possible to estimate potential liability.

Antitrust proceedings

Proceedings involving former rubber-related lines of business

Government investigations. Bayer is or has been the subject of criminal and civil investigations conducted by the Antitrust Division of the U.S. Department of Justice (DOJ), the Directorate General for Competition of the European Commission (EC), and the Canadian Competition Bureau (CCB) (collectively, the Competition Authorities). The Competition Authorities are or were investigating potential violations of their respective antitrust or competition laws involving certain of Bayer s former rubber-related lines of business.

Since September 2002, the DOJ has undertaken criminal grand jury investigations of potential antitrust violations involving Bayer s former rubber chemicals, ethylene propylene diene monomer (EPDM) synthetic rubber, and acrylonitrile butadiene rubber (NBR) synthetic rubber lines of business. To settle charges related to allegations that its former rubber chemicals business unit engaged in anti-competitive activities between 1995 and 2001, Bayer AG pleaded guilty and paid a fine of U.S. $66 million. To settle charges related to allegations that its former NBR business unit engaged in anti-competitive activities between May and December 2002, Bayer AG pleaded guilty and paid a fine of U.S. $4.7 million. The two agreements resolve all criminal charges against Bayer in the United States for activities related to its former rubber chemicals and NBR businesses. The DOJ closed its investigation into potential antitrust violations involving EPDM in July 2006.

The CCB has also undertaken criminal investigations of potential violations of Canadian competition laws involving Bayer s former rubber chemicals, EPDM and NBR lines of business. Bayer is in the process of negotiating settlement agreements with the CCB that would resolve all charges in Canada related to allegations

that its former rubber chemicals and NBR business units engaged in anti-competitive activities between 1995 and 2001 and between May and December 2002, respectively. The CCB closed its investigation into potential antitrust violations involving EPDM in August 2006.

The DOJ and the CCB have also launched criminal investigations of possible anti-competitive behavior involving a further product attributable to the former rubber-related lines of business. The DOJ and the CCB have granted conditional amnesty from the imposition of criminal liability in connection with these investigations. Conditional amnesty requires continued cooperation by Bayer.

The EC has been conducting investigations of and initiated respective proceedings regarding potential violations of European competition laws involving Bayer s former rubber chemicals, EPDM and NBR lines of business. In December 2005, the EC imposed on Bayer, and in March 2006 Bayer paid, a fine of 58.9 million in concluding the rubber chemicals proceeding. The EC investigation into potential antitrust violations involving NBR remains ongoing. The EC closed its investigation into potential competition law violations involving EPDM in July 2006. Bayer is cooperating with the EC and the antitrust authorities of certain member states of the EU with respect to their investigations of possible anti-competitive behavior involving several additional products attributable to Bayer s former rubber-related lines of business. The EC and certain member state authorities have granted conditional amnesty from the imposition of fines in connection with the investigations involving these additional products. Conditional amnesty requires continued cooperation by Bayer. In November 2006, the EC closed the proceeding related to Butadiene Rubber and Emulsion-Styrene-Butadiene Rubber by imposing fines against several companies and granting full amnesty to Bayer. Bayer was not required to pay a fine in connection with this proceeding.

Civil litigation. Bayer has been named, among others, as a defendant in multiple putative class action lawsuits in various state courts in the United States and as a defendant in lawsuits including multiple putative class actions pending before various federal courts in the United States. The actions involve rubber chemicals, EPDM, NBR and polychloroprene rubber (CR). In the state court actions, the plaintiffs have alleged violations based on the defendants purported participation in a conspiracy to fix prices and seek damages as indirect purchasers of the allegedly affected products. In the federal court actions, the plaintiffs have alleged the defendants participation in a conspiracy to fix the prices and/or to allocate markets and customers for the sale of the allegedly affected products and seek damages as direct purchasers of those products. Bayer has reached agreements or agreements in principle to settle the majority of these court actions. The federal rubber chemicals, EPDM, NBR and CR settlements, and a number of the state rubber chemicals, EPDM, NBR and CR settlements, have received final court approval. Other settlement agreements must still be finalized, and then are subject to court approval. The foregoing settlements do not resolve all of the pending civil litigation with respect to the aforementioned products, nor do they preclude the bringing of additional claims.

In addition, Bayer recently has been named, but not served, in a complaint filed in the Western District of Pennsylvania on behalf of putative classes of direct purchasers of Butadiene Rubber and Styrene-Butadiene Rubber alleging a conspiracy to fix prices. Civil litigation in Europe is likely.

Bayer also has been named, among others, as a defendant in multiple putative class action lawsuits in three Canadian provinces. The actions involve rubber chemicals, EPDM, NBR and CR. In the Canadian actions, the plaintiffs have alleged violations based on the defendants alleged participation in a conspiracy to fix prices, and the Canadian plaintiffs seek damages as direct and indirect purchasers of the allegedly affected products. These proceedings are at various stages, and no class has been certified.

Proceedings involving polyester polyols, urethanes and urethane chemicals

Government investigation. Bayer Corporation was the subject of a criminal antitrust investigation by the DOJ involving allegations that it had engaged in anti-competitive activities from February 1998 through December 2002 with respect to adipic-based polyester polyols. Under the terms of a September 2004 settlement agreement with the DOJ, Bayer Corporation pleaded guilty and paid a fine of U.S. $33 million. The agreement resolves all criminal charges against Bayer Corporation in the United States for activities related to its adipic-based polyester polyols business. The CCB in Canada is conducting a similar investigation. Bayer is in the process of negotiating a settlement agreement with the CCB that would resolve all charges in Canada related to

allegations that its adipic-based polyester polyols business unit engaged in anti-competitive activities from February 1998 through December 2002.

Civil litigation. Bayer has been named, among others, as a defendant in multiple putative class action lawsuits in various state courts in the United States and as a defendant in multiple putative class action lawsuits which have been consolidated in federal district court in Kansas, involving allegations of price fixing with respect to polyester polyols and/or urethanes and urethane chemicals. Plaintiffs in the federal court actions seek damages on behalf of direct purchasers of polyester polyols and related polyurethane systems, while plaintiffs in the state court actions seek damages on behalf of indirect purchasers of products that contain urethanes and urethane chemicals. These cases are at various preliminary stages. Bayer has received final court approval of its agreement to settle all of the federal direct purchaser class action cases relating to polyester polyols (and related systems). The foregoing settlement does not resolve all the pending civil litigation with respect to the aforementioned products, nor does it preclude the bringing of additional claims.

Bayer also has been named, among others, as a defendant in putative class action lawsuits involving polyester polyols in two Canadian courts, involving allegations of a price fixing conspiracy. The Canadian plaintiffs seek damages on behalf of a class of direct and indirect purchasers of the allegedly affected products. These cases are at various preliminary stages, and no class has been certified.

Proceedings involving polyether polyols and other precursors for urethane end-use products

Government investigation. On February 16, 2006, Bayer Corporation was served with a subpoena by the DOJ seeking information relating to the manufacture and sale of methylene diphenyl diisocyanate (MDI), toluene diisocyanate (TDI) and polyether polyols and related systems. Bayer Corporation is cooperating with the DOJ in connection with the subpoena.

Civil litigation. Bayer has also been named, among others, as a defendant in multiple putative class action lawsuits which have been consolidated in federal district court in Kansas, involving allegations of price fixing of, *inter alia*, polyether polyols and certain other precursors for urethane end-use products. Bayer has received final court approval of its agreement to settle all of the federal direct purchaser class action cases relating to polyether polyols, MDI and TDI (and related systems). Approximately 25 percent of the direct purchaser plaintiffs opted out of the class settlement and reserved thereby the right to independently bring an individual action in their own name to recover damages they allegedly suffered. To date no such actions have been brought.

Bayer also has been named, among others, as a defendant in two putative class action lawsuits pending in Quebec and Ontario, respectively, involving allegations of price fixing of, *inter alia*, polyether polyols and certain other precursors for urethane end-use products. These matters are at an early stage, and no class has been certified.

Impact of rubber-related and urethane-related antitrust proceedings on Bayer

Excluding the portion allocated to LANXESS, provisions in the amount of 129 million and 285 million were accounted for as of December 31, 2006 and 2005, respectively, in respect of the previously described civil proceedings. Bayer currently has a provision of 10 million in respect of the rubber-related antitrust proceedings in Europe, although a reliable estimate cannot be made as to the actual amount of any additional losses or fines.

These provisions taken may not be sufficient to cover the ultimate outcome of the above-described matters. The amount of provisions established for civil claims was based on the expected payments under the settlement agreements or agreements in principle described above. In the case of settlements in civil matters which have been asserted as class actions, members of the putative classes have the right to opt out of the class, meaning that they elect not to participate in the settlement. Plaintiffs that opt out are not bound by the terms of the settlement and have the right to independently bring individual actions in their own names to recover damages they allegedly suffered.

Bayer has and will continue to pursue settlements that in its view are warranted, including with plaintiffs that elect or have elected to opt out of the class action proceedings. In cases where settlement is not achievable, Bayer will continue to defend itself vigorously.

The financial risk associated with the rubber-related and urethane-related antitrust proceedings described above beyond the amounts already paid and the financial provisions already established is currently not quantifiable due to the considerable uncertainty associated with these proceedings. Consequently, no provisions other than those described above have been established. The Company expects that, in the course of the regulatory proceedings and civil damages suits, additional charges, which are currently not quantifiable, will become necessary.

Additionally, Bayer and its former affiliate LANXESS AG entered into a master agreement, dated September 22, 2004, pursuant to which the parties, among other things, apportion between them liability for certain of the antitrust proceedings described above.

Proceedings involving Ciprofloxacin

In January 1997, Bayer settled a patent infringement suit it brought in the United States against Barr Laboratories, Inc. This suit had arisen when Barr filed an Abbreviated New Drug Application (ANDA) (IV) seeking regulatory approval of a generic form of Bayer s ciprofloxacin anti-infective product, which Bayer sells in the United States under the trademark *Cipro*®. Shortly after settling this suit, Bayer applied to the U.S. Patent and Trademark Office for re-examination of its patent. The Patent and Trademark Office reissued the patent in February 1999. In addition, Bayer s *Cipro*® patent was the subject of additional patent invalidity challenges litigated in the U.S. federal district courts and in each instance, the validity of Bayer s patent was upheld. The patent expired in December 2003.

Since July 2000, Bayer has been named as one of several defendants in 39 putative class action lawsuits, one individual lawsuit and one consumer protection group lawsuit (which has since been dismissed) filed in a number of state and federal courts in the United States. The plaintiffs in these suits allege that they are direct or indirect purchasers of *Cipro*® who were damaged because Bayer s settlement of the Barr ANDA (IV) litigation prevented generic manufacturers from selling a generic version of *Cipro*®. The plaintiffs allege that the settlement violated various federal antitrust and state business, antitrust, unfair trade practices, and consumer protection statutes, and seek treble damages and injunctive relief. The Barr settlement is also the subject of an antitrust investigation by the U.S. Federal Trade Commission and a number of state attorneys general.

All the actions pending in federal court were consolidated in federal district court in New York in a multidistrict litigation (MDL) proceeding. In May 2004, Bayer moved for summary judgment on all of plaintiffs antitrust claims in the consolidated cases brought by direct purchaser and indirect purchaser plaintiffs pending in that court, including certain plaintiffs claims related to Bayer s actions during the prosecution of the *Cipro*® patent in the U.S. Patent and Trademark Office and its enforcement against third party infringers. Bayer also moved to dismiss those plaintiffs patent-related claims on grounds that these claims do not state a claim for relief under the antitrust laws. The direct purchaser plaintiffs filed a cross-motion seeking summary judgment on certain liability issues. In March 2005, the court entered summary judgment in favor of Bayer and dismissed all of plaintiffs claims in the MDL proceeding. Plaintiffs appealed this ruling, and a decision by the U.S. Court of Appeal for the Second Circuit is pending.

The remaining lawsuits consist of a class action lawsuit brought on behalf of indirect purchasers in California state court, as well as putative class action lawsuits in Florida, New York, Kansas, Tennessee and Wisconsin. The New York and Wisconsin cases were dismissed by the trial courts and plaintiffs appealed the dismissals. On December 13, 2005, the New York intermediate appellate court affirmed dismissal of the New York class action suit. On January 19, 2006, plaintiffs moved for leave to appeal that decision to the New York Court of Appeals. On May 9, 2006, the Wisconsin Court of Appeals reinstated the Wisconsin case. On June 8, 2006, Bayer petitioned the Wisconsin Supreme Court for review of the Court of Appeals decision. The Supreme Court s decision is pending. The California and Kansas cases have been stayed. Bayer Corporation filed an answer in the Florida state court action, and there has been no subsequent activity in that case. A motion to dismiss is pending in the Tennessee state court proceeding.

These cases may involve joint and several liability among the defendants, in the aggregate allege substantial unquantified damages and also seek treble and punitive damages and penalties. Due to the considerable uncertainty associated with these proceedings, it is currently not possible to estimate potential liability. However,

Bayer believes that it have meritorious defenses to the above-described proceedings and intends to continue to defend itself vigorously. Bayer will regularly consider the need to establish provisions as the proceedings continue.

Proceedings involving Premise®

Bayer is named as a defendant in a putative nationwide class action pending in federal court in North Carolina. Plaintiffs allege that Bayer conspired with intermediaries to fix the price at which those intermediaries resold the Bayer product *Premise®* to pest control operators. In November, 2006, plaintiffs voluntarily withdrew their further claim that Bayer conspired with BASF Corporation to utilize an agency system for distributing *Premise®* (and BASF s termiticide) in violation of the Sherman Act.

Plaintiffs assert that they are entitled to recover on behalf of the proposed class a total amount in excess of U.S. $200 million (subject to trebling and the addition of plaintiffs attorneys fees, under the antitrust laws). Bayer believes that it has meritorious defenses in the proceedings involving *Premise®* and intends to continue to defend itself vigorously. Due to the considerable uncertainty associated with these proceedings, it is currently not possible to estimate potential liability.

Average wholesale price manipulation proceedings

Sixty-two pending lawsuits allege that a number of pharmaceutical companies, including Bayer, manipulated the average wholesale price (AWP) and/or Medicaid best price of their products resulting in overcharges to Medicare beneficiaries, Medicaid recipients, state governmental health programs, private health plans and privately insured patients. These suits generally seek damages, treble damages, disgorgement of profits, restitution and attorney s fees. Some of these purported class actions allege injury to patients or payors. However, no class has yet been certified against Bayer. In addition, suits have been filed by the attorneys general of eight states as well as the City of New York and numerous New York counties. These suits generally seek to recover for excess costs incurred by the governmental entities and their constituents as a result of the alleged overcharges. Discovery is proceeding.

The claims of five states have been dismissed, in whole or in part, based on Bayer s settlement of earlier AWP litigation. Bayer believes that it has meritorious defenses in the remaining actions and intends to continue to defend itself vigorously. Due to the considerable uncertainty associated with these proceedings, it is currently not possible to estimate potential liability. Bayer will regularly consider the need to establish provisions as the proceedings continue.

Patent validity challenges and infringement proceedings

Proceedings involving Moxifloxacin

In February 2004, Bayer received a notice letter pursuant to the Hatch-Waxman Act from the generic manufacturers Dr. Reddy s Laboratories, Ltd. and Dr. Reddy s Laboratories, Inc. stating that they had filed an ANDA with the U.S. FDA seeking regulatory marketing approval for allegedly bioequivalent versions of *Avelox®*, Bayer s respiratory tract anti-infective, prior to the expiration of one or more patents covering *Avelox®* and/or its use. Dr. Reddy s sought the approval for its generic product prior to the expiration of three Bayer patents protecting the active ingredient of *Avelox®*, moxifloxacin, which expire on December 8, 2011, March 4, 2014, and December 5, 2016, respectively. Bayer filed a patent infringement suit against Dr. Reddy s Laboratories, Ltd. and Dr. Reddy s Laboratories Inc. in the United States District Court for the District of Delaware alleging infringement of the first two U.S. patents listed above. Dr. Reddy s alleged that the patents are invalid, not infringed and unenforceable.

A trial was held in August 2006. Dr. Reddy s has stipulated that its proposed generic product would infringe certain of the patent claims in each of the patents which Bayer is asserting in this case. A decision is pending. If the court rules that the patents are invalid or unenforceable, the FDA may grant approval immediately. If, on the other hand, the court rules that the patents are not invalid or unenforceable, and the ruling takes place before the FDA 30-month stay expires, the FDA may not grant final approval until the original patents have expired. The

court has extended the expiration of the 30-month stay until October 21, 2007. Bayer believes that it has meritorious claims and defenses in this action and intends to defend Bayer s patents vigorously.

Bayer received separate notice letters from two other generic manufacturers, each stating that it had filed an ANDA seeking regulatory marketing approval for a generic version of *Avelox*®. Each sought approval of its generic product to be effective after the first two Bayer patents listed above had expired but prior to the expiration of the third patent listed above. Bayer has not filed actions against either manufacturer.

On February 24, 2006, Bayer received a notice letter pursuant to the Hatch-Waxman Act from generic manufacturer Teva Pharmaceuticals USA, Inc., stating that it had filed an Abbreviated New Drug Application (ANDA) with the FDA seeking regulatory marketing approval for allegedly bioequivalent versions of *Vigamox*®, an ophthalmic preparation of Bayer s anti-infective compound moxifloxacin sold by Alcon Laboratories Inc. under license from Bayer, prior to the expiration of one or more patents covering moxifloxacin, and/or its use. The relevant Bayer patents expire on December 8, 2011 and March 4, 2014. On April 5, 2006, Bayer HealthCare AG, Alcon, Inc. and Alcon Manufacturing, Ltd. filed a patent infringement suit against Teva in the U.S. District Court for the District of Delaware. Teva has answered alleging invalidity and non-infringement. A trial date has been set for February 28, 2008. The two Bayer patents are the same as those involved in the suit against Dr. Reddy s Laboratories, Ltd. and Dr. Reddy s Laboratories, Inc. above. Bayer believes it has meritorious claims and defenses in this action and intends to defend Bayer s patents vigorously.

Proceedings involving Kogenate®

As previously reported, since 2003 Bayer had been party to several lawsuits involving two affiliates of Aventis, A. Nattermann & Cie GmbH and Aventis Behring LLC. The suits related to certain Aventis patents which Bayer allegedly uses or infringes in its manufacture and distribution of a recombinant factor VIII product sold by Bayer as *Kogenate*® and a related agreement whereby Bayer supplies the finished recombinant factor VIII product to Aventis. In February 2007, the parties settled both disputes in full. In connection with this settlement, Bayer extended the term of its supply agreement with Aventis through 2017, and Bayer was granted a license to intellectual property related to formulations of recombinant Factor VIII.

Proceeding involving blood glucose monitors

In August 2005, Abbott commenced a lawsuit in a federal district court in California against Bayer and Roche Diagnostics alleging infringement of two of Abbott s U.S. patents relating to blood glucose monitoring devices. The Bayer product originally accused of infringing the Abbott patents is the *Ascensia® Contour®* system, which is supplied to Bayer by Matsushita. Matsushita is contractually obligated to indemnify Bayer against the potential liability with respect to this claim, as well as defense costs, and management expects Bayer to be reimbursed by Matsushita for a substantial portion of all such costs and liability, if any. Abbott subsequently added claims of infringement of one of the Abbott patents against Bayer s DEX and Autodisc system. The cost of the defense and liability, if any, will be borne by Bayer, without indemnification by Matsushita, as these products were designed and manufactured by Bayer. Bayer believes that it has meritorious defenses against these claims and intends to continue to defend itself vigorously. Due to the considerable uncertainty associated with this proceeding, it is currently not possible to estimate potential liability.

Versant® Diagnostic Assays related actions

In two separate lawsuits, filed in federal court in 2004 and 2005, respectively, Gen-Probe Inc. alleged that Bayer, through the marketing and sale of certain *Versant*® assays for the detection of hepatitis C and HIV-related viruses, willfully infringed certain patents owned by Gen-Probe. Gen-Probe sought recovery of an unspecified amount in damages, which could have been subject to enhancement to up to three times the amount of any actual damages found or assessed, as well as injunctive relief. In June 2006, Bayer and Gen-Probe resolved their patent litigation, with Bayer obligated to pay up to U.S. $31.7 million, U.S. $5 million of which was paid upon signing of the definitive settlement agreement, U.S. $10.3 million of which was paid in January 2007 and the balance of which may come due in 2008 as royalties for future use of the patented technologies. Bayer sold the products utilizing the patented technologies to Siemens Medical Solutions Diagnostics as part of Bayer s divestiture of its

Diagnostics division. Bayer remains liable for the 2008 royalty payment should Siemens continue on or after January 1, 2008 to make, import or sell these products. In conjunction with the patent settlement, Gen-Probe and Bayer also resolved their separate arbitration relating to their collaboration for viral products. Neither party will be required to make payment to the other as a result of this separate resolution.

Proceedings involving syringe injectors and related products

Continuing a dispute over the manufacturing, marketing and sale of syringe injectors, in September 2004, Liebel-Flarsheim Company and its parents, Mallinckrodt, Inc., and Tyco Healthcare Group LP filed suit against Schering AG s Medrad subsidiary alleging that some of Medrad s front load syringe injectors infringe four patents held by Liebel-Flarsheim. This suit involves the same four patents that Liebel-Flarsheim et. al., in a 1998 lawsuit, had alleged several other Medrad front load injectors infringed. In October 2005, the court ruled that the Medrad products at issue in the 1998 case would have infringed the patents of Liebel-Flarsheim if those patents were valid, but then held all four of those patents to be invalid for purposes of both the 1998 and 2004 lawsuits. Each party is appealing the material portions of the ruling unfavorable to it.

The Tyco plaintiffs in these cases have also filed two additional declaratory judgment actions against Medrad. The first seeks to invalidate patents covering certain Medrad CT syringe injectors or alternatively establish that Liebel-Flarsheim s competing CT syringe injector does not infringe Medrad s patents. The second action, filed in November 2006, seeks to invalidate other medical imaging or scanning device patents held by Medrad. This latter lawsuit also alleges antitrust violations by Medrad, claiming Medrad improperly enforced a patent which it allegedly obtained from the Patent Office through fraud. Medrad separately has brought suit against Liebel-Flarsheim alleging that a Liebel-Flarsheim MR syringe injector infringes a patent held by Medrad.

Bayer believes that it has meritorious defenses against these claims and intends to continue to defend itself vigorously. Due to the considerable uncertainty associated with these proceedings, it is currently not possible to estimate potential liability.

Proceedings involving oral contraceptives

In April 2005, Schering filed an ANDA IV suit against Barr Pharmaceuticals, Inc. and Barr Laboratories, Inc. in U.S. federal court alleging patent infringement by Barr for its generic version of Schering s *Yasmin*® oral contraceptive product in the USA. In June, 2005, Barr filed its counterclaims seeking to invalidate Schering s patent. Schering is vigorously pursuing its claims and contesting the counterclaims of Barr. This lawsuit is currently in the discovery phase.

In January 2007, Schering received notice from Barr Laboratories, Inc. that it has filed an ANDA IV application with the U.S. FDA seeking approval of a generic version of Schering s *YAZ*® oral contraceptive product. Barr will be prohibited from marketing its generic version until after expiry in March 2009 of the three-year exclusivity period for marketing granted by the FDA.

The Company highly values its *Yasmin*® and *YAZ*® oral contraceptive products and is deeply committed to continuing its leadership position in oral contraception.

Betaseron® supply related actions

In October 2006, Schering filed a complaint in state court in California against Novartis relating to matters arising out of a 1993 agreement with the former Chiron Corporation (now part of Novartis) associated with Chiron s contract manufacture and supply of Schering s *Betaseron*® multiple sclerosis product and related rights which would allow Schering to license an additional facility to manufacture and supply *Betaseron*® in the United States. In December 2006, the parties signed a non-binding settlement term sheet outlining the terms on which they have agreed in principle to settle these matters. They have also agreed to stay the lawsuit while negotiations on definitive agreements are continuing.

Securities litigation

Bayer AG and Bayer Corporation, along with two of their current or former officers, have been named as defendants in a class action lawsuit pending in the U.S. District Court for the Southern District of New York. The lawsuit alleges violations of the U.S. securities laws and asserts that the defendants made false and misleading statements and omissions with respect to the commercial prospects, safety and efficacy of Bayer s cerivastatin anticholesterol products and with respect to the extent of the potential product liability exposure following Bayer s voluntary decision to cease marketing and to withdraw these products in August 2001. Plaintiffs sought unspecified damages on behalf of a class of all persons who purchased Bayer AG stock (including Bayer AG American Depositary Receipts) between August 4, 2000 and February 21, 2003 at allegedly inflated prices. On September 14, 2005, the court dismissed with prejudice the claims of non-U.S. purchasers of Bayer AG stock on non-U.S. exchanges. On February 24, 2006, the court certified a class of all persons who during the period from August 4, 2000 through and including February 21, 2003 either (a) purchased Bayer AG shares on the U.S. over the counter market or purchased ADRs on the New York Stock Exchange, regardless of the purchaser s country of residence at the time of the purchase; or (b) purchased Bayer AG shares or ADRs on any other stock exchange, and the purchaser was a resident or citizen of the United States at the time of purchase. Bayer believes that it has meritorious defenses in this action and intends to continue to defend itself vigorously. Due to the considerable uncertainty associated with this proceeding, it is currently not possible to estimate potential liability.

Schering AG shareholder litigation

The shareholder resolution on the Domination and Profit and Loss Transfer Agreement between Bayer Schering Pharma AG, Germany (formerly named Schering AG) and Bayer Schering GmbH, passed at the Extraordinary General Meeting of Bayer Schering Pharma AG held on September 13, 2006, is subject to legal challenges by dissenting unaffiliated Bayer Schering Pharma AG shareholders. The plaintiffs are seeking to have the shareholder resolution set aside or to have it declared null and void (*Anfechtungs- und Nichtigkeitsklagen*). These actions are based on alleged violations of procedural and substantive requirements and of shareholder information rights.

Bayer Schering Pharma AG has commenced special proceedings (*Freigabeverfahren*) to obtain a legally final judgment stating that the shareholder actions do not prevent registration of the Domination and Profit and Loss Transfer Agreement and that any defects of the shareholder resolution do not affect the validity of the registration.

Further, shareholders have made a motion in a local Berlin court seeking to have the registration of the Domination and Profit and Loss Transfer Agreement in the Commercial Register removed (*Amtslöschungsverfahren*) based on an alleged abuse of discretion by the competent court which entered the Domination and Profit and Loss Transfer Agreement in the Commercial Register in October 2006.

Several shareholders have initiated special court proceedings (*Spruchverfahren*) with the Berlin District Court asking the court to review the adequacy of the cash compensation (*Abfindung*) and of the guaranteed dividend (*Ausgleich*) offered under the Domination and Profit and Loss Transfer Agreement. Should the court find in favor of the shareholders it could increase the amount of the adequate cash compensation and the guaranteed dividend required to be paid under the Domination and Profit and Loss Transfer Agreement to all unaffiliated shareholders, including those who previously tendered their shares pursuant to the original cash compensation offer.

Bayer believes that it has meritorious defenses in these actions and intends to continue to defend itself vigorously. Due to the considerable uncertainty associated with these proceedings, it is currently not possible to estimate potential liability or the impact of an unfavorable outcome.

On January 17, 2007, the Extraordinary General Meeting of Bayer Schering Pharma AG passed a resolution on the transfer of shares of the unaffiliated shareholders in Bayer Schering Pharma AG to Bayer Schering GmbH as the main shareholder in exchange for adequate cash compensation (squeeze-out). If this resolution on the transfer of shares is registered into the Commercial Register prior to a legally final decision on the actions directed against the resolution on the Domination and Profit and Loss Transfer Agreement, the respective plaintiff

under the actions will not lose his/her standing to sue according to the case law of the Federal Court of Justice (*Bundesgerichtshof*) if that individual has a legal interest in continuing the action in that specific case. The shareholder resolution passed at the Extraordinary General Meeting of Bayer Schering Pharma AG held on January 17, 2007, is subject to legal challenges by dissenting unaffiliated Bayer Schering Pharma AG shareholders. The plaintiffs are seeking to have the shareholder resolution set aside or to have it declared null and void (*Anfechtungs- und Nichtigkeitsklagen*).

Asbestos litigation

Bayer is a defendant in asbestos cases in the United States which allege that Bayer, along with other premises defendants, employed contractors at industrial sites where they were exposed to asbestos and were injured. Plaintiffs contend that Bayer failed to warn or protect them from the known hazards of asbestos during the 1960s, 1970s and 1980s. The majority of cases are pending in West Virginia and Texas.

A Bayer subsidiary in the United States also is the legal successor to entities that sold asbestos-containing products from the 1940s until 1976 and is named as a defendant in asbestos-related litigation. Bayer is and has been fully indemnified for its costs with respect to this litigation by Union Carbide. Union Carbide continues to accept Bayer s tender of these cases, and it defends and settles them in Bayer s name, in its own name and in the name of the several predecessor companies to Bayer.

Bayer believes that it has meritorious defenses in these actions and intends to continue to defend itself vigorously. Without acknowledging any liability, Bayer has settled a number of these cases in the past. Bayer may, on a case-by-case basis, settle additional cases for reasonable amounts when, in Bayer s judgment, settlement is economically feasible given the risks and costs inherent in the litigation. Bayer has made what Bayer believes to be appropriate provisions in light of Bayer s experience in handling these cases.

Other commercial proceedings

Lyondell Arbitration

As previously reported, an arbitration panel in May 2006 issued a final award in favor of Lyondell Chemical Co. in respect of a dispute with Bayer over interpretation of their joint venture agreements for the manufacture of propylene oxide. Bayer is seeking to vacate the final award in federal court, while Lyondell is seeking to confirm the award as well as obtain pre-award interest. Bayer has established provisions in this regard that we believe at this stage of the proceeding to be appropriate. Additionally, Bayer will regularly review the need to establish provisions consistent with the arbitration ruling and continuing business operations. In addition to seeking to vacate the final award, in January 2007, Bayer filed suit against Lyondell in the Delaware State Court of Chancery, seeking equitable reformation of one of the license agreements relating to the joint venture and restitution of certain monies paid or, as a result of the final award, allegedly owing by Bayer to Lyondell under that license agreement.

Bayer separately has notified Lyondell of its claim in connection with Lyondell s failure to compensate Bayer for taking approximately 351 million pounds of propylene oxide from Bayer s share of capacity under the joint venture. This dispute is proceeding to binding arbitration.

Proceedings involving Limagrain Genetics Corporation

In July 2004, Bayer, as successor in interest to Rhone Poulenc Inc., was served with a Notice of Arbitration by Limagrain Genetics Corporation, Inc. Limagrain was seeking indemnification from Bayer for liability Limagrain had incurred to a third party, Midwest Oilseeds. This proposed liability arose from a judgment entered against Limagrain, and upheld on appeal, for an alleged breach of a 1986 contract to which Midwest Oilseeds and a former business unit of Rhone Poulenc Inc. were parties. Limagrain sought indemnification for more than U.S. $60 million. A binding arbitration proceeding between Limagrain and Bayer was held in October 2005, and the arbitration panel in March 2006 denied all of Limagrain s claims. In a parallel proceeding in France, Limagrain has sued Bayer, as successor in interest to Rhone Poulenc Agrochimie SA, to recover the judgment

amount Limagrain is obligated to pay Midwest Oilseeds. Bayer believes that it has meritorious defenses to this action and intends to continue to defend itself vigorously.

Proceedings involving genetically modified rice

Since August 2006, Bayer CropScience LP is party to multiple lawsuits, including putative class actions, filed in U.S. federal and state courts by rice farmers and resellers. Plaintiffs allege that they have suffered economic losses after traces of the genetically modified rice event LLRICE601 were identified in samples of conventional long-grain rice grown in the United States. This is alleged to have led to various commercial damages, including a decline in the commodity price for long-grain rice, costs associated with restrictions on imports and exports, and costs to secure alternative supplies. In December, the Judicial Panel on Multidistrict Litigation entered an order establishing a single pretrial proceeding in the U.S. District Court for the Eastern District of Missouri for all federal cases involving LLRICE601.

After development, LLRICE601 had been further tested in cooperation with third parties, including a breeding institute in the United States. However, it was never selected for commercialization. The U.S. Department of Agriculture and the U.S. Food and Drug Administration have stated that LLRICE601 does not pose a health risk and is safe for use in food and feed and for the environment. In November 2006, the USDA advised that it had deregulated LLRICE601. The USDA is conducting an investigation in an effort to determine how LLRICE601 became present in commercial rice grown in the United States.

Bayer believes it has meritorious defenses and intends to continue to defend itself vigorously. Due to the considerable uncertainty associated with these proceedings, it is currently not possible to estimate potential liability.

Overtime wage claims

During the past year, Bayer Corporation, as well as other major employers within the pharmaceuticals industry, has been named in lawsuits alleging that pharmaceutical sales representatives were improperly classified as exempt employees under state and federal wage and hour laws and, therefore, were improperly denied overtime pay and other benefits such as meal and rest periods. Two putative class and collective actions were filed against Bayer Corporation and Bayer Pharmaceuticals Corporation in federal district courts in California, and those actions have been consolidated in one proceeding in the United States District Court for the Central District of California. The complaints seek back overtime pay and statutory damages, penalties, interest, and attorneys fees, and some claims purport to have been filed on behalf of a nationwide class of sales representatives. The proceeding is at a preliminary stage. Bayer believes it has meritorious defenses and intends to vigorously defend this action. Due to the considerable uncertainty associated with these proceedings, it is currently not possible to estimate potential liability.

Dividend Policy and Liquidation Proceeds

Our stockholders may declare dividends at an ordinary Annual Stockholders Meeting, which must be held within the first eight months of each fiscal year.

Under German law, Bayer AG may pay dividends only from balance sheet profits reflected in its unconsolidated financial statements (as opposed to the consolidated financial statements of the Bayer Group), as adopted and approved by the Board of Management and the Supervisory Board. In determining the balance sheet profits that may be distributed as dividends, the Board of Management may under German law and the provisions of our Articles of Association allocate to other retained earnings (*andere Gewinnrücklagen*) the net income of Bayer AG for the fiscal year that remains after deducting amounts to be allocated to legal and statutory reserves (*gesetzliche Rücklagen*) and losses carried forward. More than 50 percent of the net income may be allocated to other retained earnings only if such retained earnings would then not exceed 50 percent of our capital stock. The Board of Management may also increase balance sheet profits when preparing the financial statements with funds withdrawn from retained earnings.

Our stockholders, in their resolution on the appropriation of balance sheet profits, may carry forward balance sheet profits in part or in full and may allocate additional amounts to retained earnings. Profits carried forward will be automatically incorporated in the balance sheet profits of the next fiscal year and may be used in their entirety to pay dividends in the next fiscal year. Amounts allocated to the retained earnings are available for dividends only if and to the extent the retained earnings have been dissolved by the Board of Management when preparing the financial statements, thereby increasing the balance sheet profits.

Dividends approved at an ordinary Annual Stockholders Meeting are payable promptly after the meeting, unless otherwise decided at the meeting. Because all of Bayer AG s shares are in book-entry form represented by a global certificate deposited with Clearstream Banking AG in Frankfurt am Main, Germany, stockholders receive dividends through Clearstream for credit to their deposit accounts. Additionally, the ordinary Annual Stockholders Meeting may decide to distribute the balance sheet profit partly or in total to the stockholders by way of distribution in kind.

We expect to continue to pay dividends, although we can give no assurance as to the payment of a dividend for any particular year or as to the particular amounts that we may pay from year to year.

Apart from liquidation as a result of insolvency proceedings, Bayer AG may be liquidated only with the affirmative vote of the majority of the votes cast, and with at least three-quarters of the share capital present or represented at the stockholders meeting actually voting on the resolution to liquidate. In accordance with the German Stock Corporation Act, upon a liquidation of Bayer AG, any liquidation proceeds remaining after paying off all of Bayer AG s liabilities would be distributed among the stockholders in proportion to the total number of shares held by each stockholder.

See also Item 3, *Key Information Dividends.*

Significant Changes

Except as discussed elsewhere in this annual report on Form 20-F, no significant change has occurred since the date of the annual financial statements included in this annual report on Form 20-F.

Item 9. *The Listing*

Listing Details and Markets

American Depositary Shares (ADSs), each representing one of our ordinary shares, are listed on the New York Stock Exchange and trade under the symbol BAY . The depositary for the ADSs is The Bank of New York.

The principal trading market for our ordinary shares is the Frankfurt Stock Exchange. Our shares are traded on Xetra, the computerized trading system integrated into the Frankfurt Stock Exchange and operated by Deutsche Börse AG, in addition to being traded on the auction market (floor) of the Frankfurt Stock Exchange. Our shares are also listed on the other German stock exchanges, including Berlin-Bremen, Düsseldorf, Hamburg, Hanover, Stuttgart and Munich. In addition, our shares are listed on the Barcelona, Madrid, London, Zurich and Tokyo Stock Exchanges.

The table below sets forth, for the periods indicated, the reported high and low closing prices for our shares on the Frankfurt Stock Exchange (Xetra, Source: Bloomberg) and our ADSs on the New York Stock Exchange.

	Frankfurt Stock Exchange [b]		New York Stock Exchange [b]	
	High	Low	High	Low
	(In euros)		(In dollars)	
2002[a]	38.22	16.35	36.00	17.30
2003	22.09	9.63	29.41	11.24
2004	23.83	18.26	34.12	23.52
2005:				
First quarter	26.82	22.02	35.61	30.84
Second quarter	28.62	24.79	34.94	31.16
Third quarter	30.84	26.78	38.50	31.85
Fourth quarter	35.92	27.86	42.87	33.70
Full year 2005	35.92	22.02	42.87	30.84
2006:				
First quarter	36.37	31.70	44.31	37.60
Second quarter	36.75	30.56	47.73	38.05
Third quarter	40.20	35.32	51.40	44.34
Fourth quarter	40.92	38.83	54.00	49.37
Full year 2006	40.92	30.56	54.00	37.60
Previous six months				
September 2006	40.20	37.83	51.07	47.89
October 2006	40.80	39.20	52.09	49.37
November 2006	40.45	38.93	52.62	50.24
December 2006	40.92	38.83	54.00	51.58
January 2007	45.20	40.20	59.18	52.05
February 2007	45.56	43.47	60.00	56.72

[a] From January 24, 2002 for New York Stock Exchange.

[b] The spin-off of LANXESS from Bayer became legally effective on January 28, 2005 and trading in the shares of LANXESS on the Frankfurt Stock Exchange commenced on January 31, 2005. Since January 31, 2005, Bayer shares have been traded ex LANXESS on the Frankfurt Stock Exchange and since February 8, 2005, Bayer ADSs have been traded ex LANXESS on the New York Stock Exchange. The Bayer share prices presented here for the Frankfurt Stock Exchange (Xetra) have been retroactively adjusted by Bloomberg in October 2006. The Bayer ADS prices presented here for the New York Stock Exchange have not been retroactively adjusted for the spin-off.

On February 28, 2007 the closing sales price per Bayer AG ordinary share on Xetra was 43.47 and per Bayer AG ADS on the New York Stock Exchange was U.S. $57.50.

The average daily volume of Bayer shares traded on the German Stock Exchanges (Xetra and floors) for the years 2006, 2005 and 2004 was 5,610,944, 4,138,431 and 3,931,299 respectively. The average daily trading volume of Bayer ADSs on the New York Stock Exchange in 2006, 2005 and 2004 was 190,818, 110,548 and 134,025, respectively.

Item 10. ***Additional Information***

Memorandum and Articles of Association

In the following section we describe the material provisions of our Articles of Association and German law to the extent that they affect the rights of our stockholders. This description is only a summary and does not provide a complete description of all relevant provisions. An English translation of our Articles of Association is filed as Exhibit 1.1 to this annual report on Form 20-F.

Registration

We are registered in the Commercial Register (*Handelsregister*) maintained by the local court (*Amtsgericht*) in Cologne, Germany, under the registration number HRB 48248. Copies of our Articles of Association may be obtained from the Commercial Register.

Object and Purposes

According to Article 2 of our Articles of Association, our object and purpose is manufacturing, marketing and other industrial activities or provision of services in the fields of health care, agriculture, polymers and chemicals.

Members of the Board of Management and the Supervisory Board

Typically, neither the members of the Board of Management nor members of the Supervisory Board may vote on matters in which they have a material interest. Particularly, it is not permissible for the members of either of our boards to vote on compensation for themselves or any members of their body. Pursuant to the German Stock Corporation Act (*Aktiengesetz*), the compensation of Management Board members is determined by the Supervisory Board. Our stockholders have resolved to specify the amount of compensation of Supervisory Board members in our Articles of Association. Any increase or decrease of the Supervisory Board members compensation requires a further stockholders resolution.

Pursuant to the German Stock Corporation Act, a Supervisory Board member may not receive a loan from Bayer AG unless approved by the Supervisory Board. A member of the Board of Management may only receive a loan from us upon prior approval by the Supervisory Board.

There is no compulsory retirement age for members of the Supervisory Board. However, in accordance with the German Corporate Governance Code, Supervisory Board members are encouraged to retire at the Annual Stockholders Meeting following the member s 72nd birthday.

There is no share ownership requirement for the members of either our Board of Management or Supervisory Board.

Like most German companies, Bayer does not stagger the terms of office of the members of its Supervisory Board.

Rights, Preferences and Restrictions Attaching to our Shares

Information Rights

The principal means by which our stockholders may obtain information on our company is through our audited annual financial statements (*Jahresabschluss*), a report prepared by our Board of Management discussing these financial statements, certain risk factors and business trends (*Lagebericht*), a report by our Supervisory Board and a recommendation by our Board of Management regarding the distribution of our earnings. We are required to make these materials available for inspection at our principal offices starting on the date when the Annual Stockholders Meeting is convened. In addition, each shareholder is entitled to receive a copy of these materials upon request.

Furthermore, each stockholder attending a stockholders meeting is entitled to ask certain types of questions, which members of our Board of Management, who are required to attend the meeting, are obliged to answer. By contrast, our stockholders have no right to inspect the books and records of our company.

Dividend Rights and Other Distributions

In accordance with the German Stock Corporation Act, the record date for determining which holders of our shares are entitled to the payment of dividends, if any, or other distributions, whether in cash, stock or property, is the date of the Annual Stockholders Meeting at which such dividends or other distributions are declared. For a summary of our stockholders dividend rights, please see Item 8, *Financial Information Dividend Policy and Liquidation Proceeds.*

Voting Rights

Our stockholders vote at stockholders meetings. By contrast, German corporate law does not allow stockholders to approve matters by written consent in lieu of a meeting.

Each share entitles its holder to cast one vote at stockholders meetings. In certain cases, a stockholders right to cast a vote is excluded. Stockholders may pass resolutions at a general stockholders meeting by a simple majority of the votes cast, unless a greater majority is required by law or by our Articles of Association. Neither the German Stock Corporation Act nor our Articles of Association provide for minimum quorum requirements for passing resolutions at stockholders meetings. The German Stock Corporation Act requires that significant resolutions (*i.e.*, those relating to amendments to our Articles of Association, capital increases and decreases, exclusion of stockholder pre-emptive rights, the dissolution of our company, mergers or consolidations, the transfer of substantially all of our assets, and certain other significant matters) be passed with the affirmative vote of the majority of the votes cast, and with at least three-quarters of the share capital present or represented at the stockholders meeting actually voting on such resolution.

Neither German law nor our Articles of Association restrict the rights of our domestic, non-resident or foreign stockholders to hold or vote their shares.

Liquidation Rights

In case we are liquidated, any liquidation proceeds remaining after our liabilities have been paid off are distributed among our stockholders in proportion to the number of shares held by them.

Pre-emptive Rights

Under the German Stock Corporation Act, each stockholder of a corporation generally has a pre-emptive right (*Bezugsrecht*). Pre-emptive rights are preferential rights to subscribe for issues by the corporation of new shares, securities convertible into shares, securities with warrants to purchase shares, or instruments granting a profit participation right. The proportional share of the issue to which the shareholder may subscribe is equal to the proportional share of existing capital of the corporation that the shareholder holds. Subscription rights are freely transferable and may be traded on the German stock exchanges during the exercise period for these rights. When authorizing a capital increase and a new issue of shares, our stockholders may exclude pre-emptive rights, in whole or in part. In addition, when creating authorized capital, stockholders may authorize the Board of Management to exclude the pre-emptive rights attaching to any shares issued pursuant to the authorized capital. In addition to having to be approved by the stockholders meeting, any exclusion or restriction of pre-emptive rights requires a justification, which our Board of Management has to set forth in a written report to our stockholders. If our Board of Management increases our share capital, it may exclude pre-emptive rights in accordance with Article 4 of our Articles of Association.

Derivative suits

Under the German Stock Corporation Act, individual stockholders are generally not entitled to bring derivative actions on behalf of or in the interest of our company if a member of our Board of Management or

Supervisory Board violates his or her fiduciary duties. Stockholders by a majority of the votes cast at a stockholders meeting, however, may demand that an action be brought by the Board of Management or the Supervisory Board against a member who has allegedly violated his or her duties. In addition, the stockholders meeting or stockholders representing at least 10 percent of the company s share capital or shares with a nominal value of 1,000,000, may appoint special representatives to bring such action.

However, on November 1, 2005, the German Stock Corporation Act was amended to facilitate derivative suits by individual stockholders. Under the new law, minority stockholders representing at least one percent of the company s share capital or shares with a nominal value of 100,000 may now file an application in court requesting that an action be admitted against a member of either of the company s board of management or supervisory board on behalf of the company in their own name. The court must admit such stockholders derivative suit if, among other things, there are facts that justify a suspicion that the board members harmed the company through actions conducted in bad faith or a fundamental violation of the law or the Articles of Association, and an enforcement of the claims would not be against the prevailing interests of the company. Furthermore, the minority shareholders must show that they have first demanded from the company that action be brought and that such demand has been futile.

Stockholders Meetings Convocation and Participation

A stockholders meeting may be called by the Board of Management or by stockholders who, in the aggregate, hold at least 5 percent of our share capital. In addition, if required in our interest, the Supervisory Board must call a stockholders meeting. Stockholders holding in the aggregate at least 500,000, or at least 5 percent of our share capital, may require that particular items be placed on the agenda of a stockholders meeting. The Annual Stockholders Meeting must be held within the first eight months of each fiscal year and is called by the Board of Management, upon receipt of the Supervisory Board s report on our annual financial statements.

Under our Articles of Association, in order to be eligible to attend and vote at an Annual Stockholders Meeting, a stockholder must register its participation with us by the end of the seventh day prior to the day of the Annual Stockholders Meeting, including proof of ownership of our stock as of the 21st day prior to the Annual Stockholders Meeting.

We are required to publish a notice of each ordinary or extraordinary stockholders meeting in the electronic Federal Gazette (*elektronischer Bundesanzeiger*) at least thirty days prior to the deadline for stockholders registration for the stockholders meeting. In addition, we are required to publish a notice in one national, authorized stock exchange journal.

Repurchase of Shares

We may not repurchase our own shares unless so authorized by a resolution duly adopted by our stockholders at a general stockholders meeting or in other very limited circumstances set forth in the German Stock Corporation Act, including for example in order to satisfy obligations under employee stock participation plans. Any repurchase is subject to various restrictions and conditions relating to, among other things, the manner and timing of such purchase. Any stockholders resolution that authorizes us to repurchase shares may not be in effect for a period longer than 18 months. The German Stock Corporation Act limits share repurchases to 10 percent of our share capital. Any resale of repurchased shares must be effected on a stock exchange or in a manner that treats all stockholders equally, unless otherwise approved by the stockholders at the stockholders meeting that authorized the repurchase of the shares.

On April 28, 2006, our stockholders authorized our Board of Management to repurchase our own shares representing up to 10 percent of our outstanding share capital in one or more steps on or before October 27, 2007. The repurchase may be effected for various purposes, including to fulfill option rights held by our executives or employees, or executives or employees of our subsidiaries, on the basis of our stock option programs.

Anti-takeover Defenses

The German Takeover Act (*Wertpapiererwerbs- und Übernahmegesetz*), which came into effect on January 1, 2002, provides that, while a tender offer for the shares of a company is underway, the company s management board may not take any action that may have the effect of thwarting the success of the tender offer. Certain defenses, however, are permitted. In particular, the company s management board may: (i) search for a white knight (*i.e.*, a third party that is willing to make a tender offer for the shares); (ii) perform any acts that a diligent and conscientious manager would perform in the absence of a tender offer; and (iii) perform any acts that have been approved by the company s supervisory board. In addition, the German Takeover Act permits the stockholders meeting of the company, provided no tender offer is currently underway, to authorize the company s management board to take any actions that may have the effect of frustrating the success of a future tender offer, so long as the authorization is sufficiently specific and falls within the competence of the stockholders meeting. Any such authorization may remain in effect for a maximum of 18 months. On July 26, 2006 the German Takeover Act was amended in the course of implementing the E.U. takeover directive. Pursuant to the takeover directive, companies may implement further restrictions, such as the invalidity of certain shareholder agreements or pre-emption rights vis-à-vis the bidder in the course of takeover offers, by amending their articles of association. We have not amended our articles of association in this way.

Disclosure Requirements

For a description of disclosure requirements pursuant to Section 21 of the German Securities Trading Act (*Wertpapierhandelsgesetz*), please refer to Item 7, *Major Shareholders and Related Party Transactions Major Shareholders.*

The German Securities Trading Act further requires the reporting of dealings by certain persons carrying managerial responsibilities and other persons close to them. Members of our Board of Management and members of our Supervisory Board must notify both us and the German Federal Financial Supervisory Authority of any acquisitions and sales of our shares or financial instruments linked to our shares in writing within five business days. Transactions are exempt from the notification obligations if the value of the shares or related financial instruments acquired or sold does not exceed in the aggregate 5,000 per calendar year. This obligation also applies to certain relatives of our board members, particularly, spouses, dependent children and other relatives who have been living in the same household for at least one year. In addition, we must publish on our website all notifications we have thus received, keep them posted for a period of at least one month and send proof of such publication to the German Federal Financial Supervisory Authority.

In addition, the German Takeover Act provides that a person who has acquired 30 percent or more of the voting rights of an issuer whose securities are admitted for trading on a German stock exchange is deemed to have gained control of the issuer and is required to publish this fact and to launch a public tender offer for the outstanding shares.

Material contracts

Relating to LANXESS

Bayer AG (Bayer) and LANXESS AG (LANXESS) are party to a spin-off and acquisition agreement dated September 22, 2004, which sets forth the assets and liabilities, including in particular the entire equity interest in LANXESS GmbH, transferred by Bayer to LANXESS by way of a spin-off pursuant to section 123 (2) No. 1 of the German Transformation Act (*Umwandlungsgesetz*). The spin-off, which took retroactive economic effect as of July 1, 2004, became legally effective upon its registration in the Commercial Register (*Handelsregister*) for Bayer at the Local Court of Cologne (*Amtsgericht Köln*) on January 28, 2005. Pursuant to the spin-off and acquisition agreement, all of LANXESS no par value ordinary bearer shares were granted to the stockholders of Bayer in the ratio of one LANXESS share for every ten Bayer shares.

Bayer and LANXESS also entered into a master agreement, dated September 22, 2004, pursuant to which Bayer and LANXESS agreed on measures to ensure the formation of the LANXESS subgroup as well as on provisions for the general apportionment of liability as between the parties and special provisions relating to the

apportionment of product liability, liability for environmental contamination and liability for antitrust proceedings, in each case arising under administrative, civil and criminal proceedings and settlements thereof. The rules on general apportionment of liability provide that Bayer is to indemnify LANXESS and its affiliates with respect to liabilities of Bayer or its affiliates arising by statute or by application of common law and which were not allocated to LANXESS. In the area of environmental contamination, liability is essentially established based on the contamination of the properties used by the relevant party or its affiliates on July 1, 2004, subject to a ceiling on the liability of LANXESS and its affiliates of 350 million. Bayer is responsible for any claims asserted against LANXESS and its affiliates to the extent to which such claims in total exceed the ceiling. With respect to antitrust proceedings, each party has agreed generally to bear all liability that relates to those antitrust violations committed by it. With respect to products sold by the former Rubber business group, Bayer generally assumed 70 percent of liabilities arising from antitrust proceedings and LANXESS assumed 30 percent. LANXESS total liability arising from antitrust proceedings with respect to products sold by the former Rubber business group is generally limited to 100 million. Bayer is responsible for any expenses in excess of this limit incurred by LANXESS and its affiliates arising out of or in connection with these proceedings. Finally, Bayer and LANXESS will generally be liable for any claims arising out of or in connection with defective products that the respective party or its affiliates introduced to the market prior to January 28, 2005.

Relating to the Schering AG acquisition

On March 23, 2006, Bayer AG, as borrower, entered into an unsecured Syndicated Facilities Agreement for an amount of 7,000 million. Funds received under the Syndicated Facilities Agreement may only be used for the purpose of financing or refinancing the acquisition of the shares of Schering AG, Berlin, Germany, including shares represented by American Depositary Receipts, pursuant to the terms of the cash offer we made for Schering and a subsequent squeeze-out and any costs, fees and expenses associated therewith. The syndicated facility is divided into two tranches in the amounts of 3,000 million (Facility A) and 4,000 million (Facility B). The Syndicated Facilities Agreement contains standard covenants, such as negative pledge and information covenants. The facility was filed as an exhibit to the Schedule TO (Tender Offer) filed with the SEC on April 13, 2006. The term of Facility A is 364 days, with an extension option of up to one additional year, and the initial term of the Facility B is five years, in each case from the date of the execution of the Syndicated Facilities Agreement. The interest rate of the Facility A equals the EURIBOR reference rate plus a margin of 0.35 percent, and the interest rate of the Facility B equals the EURIBOR reference rate plus a margin of 0.40 percent. After December 31, 2006, the margin will be variable. Depending on Bayer AG s credit rating, the margin may vary between 0.20 percent and 0.60 percent for Facility A and between 0.25 percent and 0.65 percent for Facility B. Under the Syndicated Facility Agreement, there was 4,000 million under Facility B outstanding as of the date of publication of this annual report on Form 20-F. Under the Facility A, as of December 31, 2006, 1,700 million was outstanding, which was repaid in full on January 10, 2007.

For more information on the financing of Schering AG s acquisition refer to Item 5, *Operating and Financial Review and Prospects Liquidity and Capital Resources 2004, 2005 and 2006.*

Exchange controls

There are currently no German foreign exchange control restrictions on the payment of dividends on the shares or the conduct of our operations.

Taxation

The following is a discussion of the material U.S. federal income and German tax consequences to you as a Qualified Holder of Bayer AG shares. This discussion is based upon existing U.S. federal income and German tax law, including legislation, regulations, administrative rulings and court decisions, as in effect on the date of this annual report on Form 20-F, all of which are subject to change, possibly with retroactive effect.

For the purposes of this discussion, you are a Qualified Holder if you are the beneficial owner of ordinary Bayer AG shares and (1) are a resident of the United States for purposes of the Convention Between the United States of America and the Federal Republic of Germany for the Avoidance of Double Taxation and the Prevention

of Fiscal Evasion with Respect to Taxes on Income and Capital, as amended (the Income Tax Treaty), which generally includes an individual U.S. resident, a corporation created or organized under the laws of the United States, any state thereof or the District of Columbia and a partnership, estate or trust, to the extent its income is subject to taxation in the United States as the income of a U.S. resident, either in its hands or in the hands of its partners or beneficiaries, (2) do not hold Bayer AG shares as part of the business property of a permanent establishment located in Germany or as part of a fixed base located in Germany and used for the performance of independent personal services and (3) if you are not an individual, are not subject to the limitation on benefits restrictions in the Income Tax Treaty. This discussion assumes that you hold Bayer AG shares as capital assets. This discussion does not address all aspects of U.S. federal income and German taxation that may be relevant to you in light of your particular circumstances. For example, this discussion does not apply to Qualified Holders whose shares were acquired pursuant to the exercise of an employee share option or otherwise as compensation or who are subject to special treatment under U.S. federal income tax laws such as financial institutions, insurance companies, tax-exempt organizations, holders of 10 percent or more of Bayer AG shares, broker-dealers in securities or currencies, persons that hold Bayer AG shares as part of a hedging or a conversion transaction or as a position in a straddle , and persons whose functional currency is other than the U.S. dollar. This discussion also does not address any aspects of state, local or non-U.S. (other than certain German) tax law. If a partnership holds Bayer AG shares, the tax treatment of a partner generally will depend upon the status of the partner and the activities of the partnership. If a Qualified Holder is a partner in a partnership that holds Bayer AG shares, the Holder is urged to consult its own tax advisor regarding the specific tax consequences of the purchase, ownership and disposition of the Bayer AG shares.

In general, for U.S. federal income tax purposes, if you are a Qualified Holder of ADRs evidencing ADSs, you will be treated as the owner of the Bayer AG shares represented by such ADSs. Unless the context requires otherwise, all references in this section to Bayer shares are deemed to refer likewise to ADSs evidencing an ownership interest in Bayer AG shares.

We urge you to consult your tax advisor as to the U.S. federal income and German tax consequences of holding Bayer AG shares, including the particular facts and circumstances that may be unique to you, and as to any other tax consequences of holding Bayer AG shares.

Taxation of Dividends

We were required under German law to withhold tax on dividends in respect of the 2006 fiscal year in an amount equal to 20 percent of the gross amount paid to German resident and non-resident stockholders, and we will be required to so withhold on dividends in respect of the 2007 fiscal year.

A surtax on the German withholding tax is currently levied on dividend distributions paid by a German resident company. The rate of this surtax is 5.5 percent on the withholding tax due. The surtax will equal 1.1 percent (5.5 percent x 20 percent) of the gross dividend. This results in a total withholding tax rate on dividends of 21.1 percent.

As a Qualified Holder, you are eligible to receive a partial refund of the withholding tax (including surtax) under the Income Tax Treaty (subject to certain limitations), effectively reducing the withholding tax (including surtax) to 15 percent of the gross amount of the dividend. Thus, for each U.S. $100 of gross dividend paid by Bayer AG to you, the dividend will be subject to net German withholding tax (including surtax) of U.S. $15 under the Income Tax Treaty. The net cash received per U.S. $100 of gross dividend thus will be U.S. $85.

For U.S. federal income tax purposes, the gross amount of dividends paid on your Bayer AG shares, without reduction for German withholding tax, will be included in your gross income on the date the dividends are received or treated as received by you, translating dividends paid in euros into U.S. dollars using the exchange rate in effect on that date. Subject to certain exceptions for short-term and hedged positions, the U.S. dollar amount of dividends paid on your Bayer AG shares generally will be subject to U.S. taxation at a maximum rate of 15 percent in respect of dividends received before January 1, 2011 if you are an individual and the dividends are qualified dividends . Dividends that we pay generally will be treated as qualified dividends if we were not, in the year prior to the year in which the dividend was paid, and are not, in the year in which the dividend is paid, a passive foreign investment company (PFIC). Based on our audited financial statements and relevant market

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and shareholder data, we believe that we were not treated as a PFIC for U.S. federal income tax purposes with respect to our 2006 taxable year. In addition, based on our audited financial statements and current expectations regarding the value and nature of our assets, the sources and nature of our income, and relevant market data, we do not anticipate becoming a PFIC for our 2007 taxable year. However, whether we in fact are classified as a PFIC is a factual matter that must be determined annually at the close of each taxable year. Therefore, there can be no certainty as to our actual PFIC status in any particular year until the close of the taxable year in question.

If dividends paid in euros are converted into U.S. dollars on the date you receive or are treated as receiving them, you generally should not be required to recognize foreign currency gain or loss in respect of such dividend. You will not be entitled to the dividends received deduction with respect to any dividends we pay.

German tax withheld from dividends will be treated, up to the 15 percent rate provided under the Income Tax Treaty, as a foreign income tax that, subject to generally applicable limitations under U.S. tax law, is eligible for credit against your U.S. federal income tax liability, or, if you have elected to deduct such taxes, generally may be deducted in computing your taxable income for U.S. federal income tax purposes.

Refund Procedures

To claim the refund reflecting the reduction of the German withholding tax from 20 percent to 15 percent and the refund of the 5.5 percent German surtax, when applicable, you must submit (either directly, or, as described below, through our U.S. transfer agent or the Depository Trust Company) a claim for refund to the German tax authorities, with the original bank voucher (or a certified copy thereof) issued by the paying entity documenting the tax withheld within four years from the end of the calendar year in which the dividend is received. Claims for refunds are made on a special form, which must be filed with the German tax authorities at the following address: Bundeszentralamt für Steuern, An der Küppe 1, 53225 Bonn, Germany. A refund claim form may be obtained from the German tax authorities at the same address as where applications are filed, from the Embassy of the Federal Republic of Germany, 4645 Reservoir Road, N.W., Washington, D.C. 20007-1998 or from the Office of International Operations, Internal Revenue Service, 1325 K Street, N.W., Washington, D.C. 20225, Attention: Taxpayer Service Division.

You also must submit to the German tax authorities certification of your United States residency (IRS Form 6166). You generally can obtain this certification by filing a request for certification on IRS Form 8802, along with a user fee, with the Internal Revenue Service, P.O. Box 42530, Philadelphia, PA 19101-2530. You should consult your tax advisor and the instructions for IRS Form 8802 for further details regarding how to obtain this certification.

Our U.S. transfer agent will perform administrative functions necessary to claim the refund reflecting the reduction in German withholding tax from 20 percent to 15 percent and the refund of the 5.5 percent German surtax, when applicable, for you. However, these arrangements may be amended or revoked at any time in the future. Under the current procedure, the U.S. transfer agent will prepare the German claim for refund forms on your behalf and file them with the German tax authorities. In order for the U.S. transfer agent to file the claim for refund forms, the U.S. transfer agent will prepare and mail to you, and will ask that you sign and return to the U.S. transfer agent, (1) a statement authorizing the U.S. transfer agent to perform these procedures and agreeing that the German tax authorities may inform the Internal Revenue Service of any refunds of German taxes and (2) a written authorization to remit the refund of withholding to an account other than yours. The U.S. transfer agent will also require certification of your United States residency (IRS Form 6166). The U.S. transfer agent will attach the signed statement, the IRS Form 6166 and the documentation issued by the paying agency documenting the dividend paid and the tax withheld to the claim for refund form and file them with the German tax authorities.

A simplified refund procedure will be available to you if your Bayer AG shares are registered with brokers participating in the Depository Trust Company. Under this simplified refund procedure, the Depository Trust Company will provide the German tax authorities with electronic certification of your U.S. taxpayer status based on information it receives from its broker participants, and will claim a refund on your behalf. If approved by the German tax authorities, a similar simplified refund procedure may also be implemented by the U.S. transfer agent in the future. Under such a simplified refund procedure, following each dividend payment, the U.S. transfer agent

would file a claim for refund automatically on your behalf if you have instructed the U.S. transfer agent in writing to file on your behalf.

The German tax authorities will issue refunds denominated in euros. The refunds will be issued in the name of the U.S. transfer agent or the Depository Trust Company, as the case may be, which will then convert the refunds to dollars and make corresponding refund payments to you or your broker. This broker, in turn, will remit corresponding refund amounts to you.

If you receive a refund attributable to reduced withholding taxes under the Income Tax Treaty, you may be required to recognize foreign currency gain or loss for U.S. federal income tax purposes, which will be treated as ordinary income or loss for such purposes, to the extent that the U.S. dollar value of the refund received or treated as received by you differs from the U.S. dollar equivalent of the refund on the date the dividend on which such withholding taxes were imposed was received or treated as received by you.

Taxation of Capital Gains

Under the Income Tax Treaty, you will not be liable for German tax on capital gains realized or accrued on the sale or other disposition of Bayer AG shares.

Upon a sale or other disposition of Bayer AG shares, you will recognize capital gain or loss for U.S. federal income tax purposes equal to the difference between the U.S. dollar value of the amount realized and your U.S. dollar adjusted tax basis in the Bayer AG shares. This gain or loss generally will be U.S. source gain or loss, and will be treated as long-term capital gain or loss if your holding period in the Bayer AG shares exceeds one year. The net amount of long-term capital gain recognized by an individual U.S. holder before January 1, 2011 is generally subject to a taxation at a maximum rate of 15 percent. The deductibility of capital losses is subject to significant limitations.

German Gift and Inheritance Taxes

The Convention between the United States of America and the Federal Republic of Germany for the Avoidance of Double Taxation with Respect to Taxes on Estates, Inheritances and Gifts, as amended (the Estate Tax Treaty), provides that an individual whose domicile is determined to be in the United States for purposes, of such treaty will not be subject to German inheritance and gift tax (the equivalent of the U.S. federal estate and gift tax) on the individual s death or making of a gift unless the Bayer AG shares (1) are part of the business property of a permanent establishment located in Germany or (2) are part of the assets of a fixed base of an individual located in Germany and used for the performance of independent personal services. An individual s domicile in the United States, however, does not prevent imposition of German inheritance and gift tax with respect to an heir, donee or other beneficiary who is domiciled in Germany at the time the individual died or the gift was made.

The Estate Tax Treaty also provides a credit against U.S. federal estate and gift tax liability for the amount of inheritance and gift tax paid in Germany, subject to certain limitations, in a case where the shares are subject both to German inheritance or gift tax and U.S. federal estate or gift tax.

German Capital Tax (Vermögensteuer)

The Income Tax Treaty provides that you will not be subject to German capital tax (*Vermögensteuer*) with respect to the Bayer AG shares. As a result of a judicial decision, the German capital tax (*Vermögensteuer*) presently is not imposed.

Other German Taxes

There are no German transfer, stamp or other similar taxes that would apply to you upon receipt, purchase, holding or sale of Bayer AG shares.

U.S. Information Reporting and Backup Withholding

Dividends on Bayer AG shares and payments of the proceeds of a sale of Bayer AG shares paid within the United States or through certain U.S.-related financial intermediaries are subject to information reporting and may be subject to backup withholding unless you (1) are a corporation or other exempt recipient or (2) provide a taxpayer identification number and certify that no loss of exemption from backup withholding has occurred. U.S. persons who are required to establish their exempt status generally must file IRS Form W-9 (Request for Taxpayer Identification Number and Certification). Non-U.S. holders generally will not be subject to U.S. information reporting or backup withholding. However, these holders may be required to provide certification of non-U.S. status (generally on IRS Form W-8BEN) in connection with payments received in the United States or through certain U.S.-related financial intermediaries.

Backup withholding is not an additional tax. Amounts withheld as backup withholding may be credited against your U.S. federal income tax liability. You may obtain a refund of any excess amounts withheld under the backup withholding rules by filing the appropriate claim for refund with the Internal Revenue Service and furnishing any required information.

Documents on display

You can inspect the documents concerning Bayer AG mentioned in this annual report during normal business hours at Bayer AG s headquarters at the Bayerwerk, 51368 Leverkusen, Germany, as well as at the headquarters of Bayer AG s U.S. subsidiary, Bayer Corporation, 100 Bayer Road, Pittsburgh, PA 15205-9741.

Significant Differences in Corporate Governance Practices

For a description of the significant ways in which our corporate governance practices differ from those followed by U.S. companies under the listing standards of the New York Stock Exchange, please refer to our website at http://www.bayer.com/en/ German-Corporate-Governance-Practices.aspx. (Reference to this uniform resource locator or URL is made as an inactive textual reference for informational purposes only. The information found at this website is not incorporated by reference into this document.)

Item 11. ***Quantitative and Qualitative Disclosures about Market Risk***

Market Risk

The global nature of our business exposes our operations, financial results and cash flows to a number of risks, including those listed below.

Currency exchange rate fluctuations. We are exposed to fluctuations between the euro and other major world currencies. The majority of our currency fluctuation risks are between the euro and the U.S. dollar, between the euro and the Japanese yen and between the euro and the Canadian dollar.

Interest rate fluctuations. We are exposed to changes in interest rates. Our primary interest rate exposure is to fluctuations in short- and long-term European and U.S. interest rates.

Credit risk. We are exposed to credit risk with respect to the counterparties in our transactions.

Raw material, commodity and energy price fluctuations. We are exposed to possible increases in raw material, commodity and energy prices. We may not be able to pass any such increases on to our customers.

Any of these risks could harm our operating results and financial condition.

From time to time, we enter into hedging arrangements to mitigate our exposure to currency, interest and commodity price risks. Our primary tools for hedging financial risks are over-the-counter derivative instruments, particularly forward foreign exchange contracts, foreign exchange option contracts, interest rate swaps and interest and principal currency swaps, interest rate options, commodity price swaps and commodity price options. As a matter of policy, we enter into these transactions only with counterparties of high credit standing. We have

established uniform guidelines and internal controls for the use of these derivatives. We use these instruments only to economically hedge risks arising from our business operations and from related investments and financing transactions. We do not use derivatives for speculative purposes. A portion of our transactions hedge anticipated risks from currency exchange and raw material price fluctuations but do not qualify for hedge accounting under IFRS and U.S. GAAP. Such transactions are monitored closely and require authorization by our head of finance, our risk committee (consisting of the head of Finance and the heads of the major divisions within Finance) or the Board of Management. Our Board of Management has provided us with loss limits for all derivative transactions that do not qualify for hedge accounting under IFRS and U.S. GAAP and do not hedge other balance sheet items. All other derivative transactions are either limited by volume or by hedging degree. For example, we have a loss limit for the commodity hedges we use to reduce volatility in future cash flows from anticipated raw material purchases but which do not qualify for hedge accounting.

Sensitivity Analysis

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 foreign exchange rates shift in which the euro depreciates against all currencies by 10 percent;

a simultaneous, parallel 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 of the interest rate yield curves in all currencies.

We use our business experience, 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 our managers, stockholders, employees, suppliers and customers to appreciate an approximation of the effect changing market conditions could have on our business. Additionally, it allows our management after becoming aware of the impact of immediate and substantial changes to take the necessary steps to address such risks.

Sensitivity analysis is subject to material limitations, consisting of the following:

The risk-mitigating effects caused by correlation and diversification among different currencies, commodity prices and interest rate areas or between these different risk exposures are not taken into account. This may lead to an overestimation of risk, since a simultaneous adverse shift in all currencies, commodity prices and yield curves is highly unlikely.

Unlike other more complex risk modeling concepts, it applies only two shifts (up or down) in each risk category with the direction causing the adverse outcome chosen. While it is possible to apply more sophisticated risk measurement techniques, it is our view that sensitivity analysis gives decision makers in our non-financial businesses a sufficient warning of potential losses. We may apply further detailed analyses using the specific facts of a given situation to determine if appropriate corrective actions are needed.

Sensitivity analyses offer a snapshot of exposures at and between specific dates in time. However, there is continuous change in the Other Than Trading Portfolio. For example, positions are continually being opened and closed, assets and liabilities mature and new interest rates take effect. We accept this limitation and whenever we believe that more current information is required, produce either updated sensitivity analyses or utilize other management reporting options to understand in detail the effects of changing market conditions.

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Sensitivity analyses do not provide an answer to the question of how long a sharp rise or fall of market rates will continue. Accordingly, we develop our own market direction projections and obtain other professional predictions that we then use in our financial planning and in modeling earnings impacts.

We continually refine our risk measurement and reporting procedures, including a periodic re-examination of the underlying assumptions and parameters utilized. Compared to the last fiscal year, several portfolio changes have led to a change in our market risk exposure. In particular the acquisition of Schering AG, Berlin, Germany and the divestment of our Diagnostics division and H.C. Starck changed the composition of our exposure to fluctuations of foreign exchange rates and interest rates as compared with the periods prior to these transactions, as described below.

The sensitivity analyses included in the risk sections below present the hypothetical loss in cash flows of financial instruments and derivative financial instruments that we held as of December 31, 2006 and 2005. These instruments were subject to changes in foreign exchange rates, commodity prices and interest rates. The range of sensitivities that we chose for these analyses reflects our view of changes reasonably possible over a one-year period.

Interest Rate Risk

Interest rate risk is the possibility that the total return (all changes in fair value and interest rate performance) of a financial instrument will change due to movements in market rates of interest. This risk primarily affects debt with maturities of more than one year. Items with these long maturities are not of material significance to our operations, but are relevant to our financial obligations.

We sometimes make loans to employees. Although a small proportion of these loans are interest-free, they generally bear interest at market-oriented, fixed rates. More than three quarters of our loans to employees have terms of over five years. All of these loans are real estate related, many of them secured by real estate. None of these loans were provided to any of the members of our Board of Management.

Derivative financial instruments

Derivative financial instruments are our main method of interest rate hedging. We use interest rate swaps to convert a portion of our fixed rate borrowings into, in effect, floating rate debt. We do this because, in a normal interest rate environment, short-term interest rates are lower than long-term interest rates. Thus, floating debt leads to lower interest costs in the long-run. The derivatives we use to hedge interest rate risk are primarily over-the-counter instruments, particularly interest rate swaps and, in rare cases, options. Our Corporate Treasury department has central responsibility for managing our interest rate exposures and using interest rate derivatives. Our Board of Management has provided clear guidance on how to limit and monitor cash flow risks that result from this approach.

The notional amount of these derivatives is the total nominal value of the underlying transactions. The fair value of these derivatives is their repurchase value, based on quoted prices or, in the case of contracts not publicly traded, their values as determined by standard methods, as of a given closing date. The table below shows the notional amount and fair value of the interest rate derivatives we held as of December 31, 2006 and 2005; the fair values quoted disregard any compensating movements in the values of the underlying transactions.

	Notional Amount As of December 31,		**Fair Value As of December 31,**	
	2005	**2006**	**2005**	**2006**
		(Euros in millions)		
Interest rate hedging contracts	11,327	11,633	109	(47)

At December 31, 2006, the notional amount of our short-term interest rate hedging contracts (including interest rate swaps and options) totaled 4.1 billion (2005: 0.4 billion); those maturing after more than one year totaled 7.5 billion (2005: 10.9 billion). Our divestments of the Diagnostics division and H.C. Starck in early 2007, led to a reduction in the level of interest rate risk compared to the level at the end of 2006 as we used most

of the net proceeds from these disposals to reduce debt. We do not anticipate any further significant change in the level of interest rate risk with respect to our current business operations during 2007.

Sensitivity Analysis

Financial debt including derivatives amounted to 19,616 million as of December 31, 2006, compared to 8,764 million as of December 31, 2005. The increase was due to the acquisition of the business of Schering AG, Berlin, Germany. For the calculation of debt and details on the Schering acquisition, see Item 5, *Operating and Financial Review and Prospects Liquidity and Capital Resources 2004, 2005 and 2006 Development of net debt*. Based on our floating interest rate debt position at year-end 2006, a hypothetical increase of 100 basis points, or one percent per year, of the interest rates applicable to our debt denominated in all currencies (holding currency rates constant), effective beginning January 1, 2007, would have resulted in an increase in our interest expense for the year ended December 31, 2006 of 124 million (2006 (based on year-end 2005 debt levels): 39.7 million). Had the divestments in January 2007 occurred as of December 31, 2006, this increase would have been reduced to 78 million.

Currency Risk

Because we conduct our operations in many currencies, we face a variety of risks associated with fluctuations in the relative values of these currencies. The primary currencies with respect to which we have material exchange rate risk are the U.S. dollar, Japanese yen and the Canadian dollar. In general, appreciation of the euro in relation to another currency has an adverse effect on our reported revenues and results, and depreciation of the euro has a positive effect. Since we are not including anticipated cash flows in our sensitivity analysis, the main impact of an adverse change results from derivatives used to hedge our anticipated exposure in foreign currencies. We therefore apply an adverse change in currencies where the euro depreciates against all other currencies by 10 percent.

Transaction Risk

We face transaction risk when our businesses generate revenue in one currency but incur costs relating to that revenue in a different currency. For example, an increase in the value of the U.S. dollar relative to the euro will increase the euro value of Bayer s sales and earnings made in the dollar zone and increase the competitiveness of its products produced in Europe against products exported from the United States. Because we enter into foreign exchange transactions for a significant portion of our contracted and forecasted operational foreign exchange exposures, we believe that a significant increase or decrease in the exchange rate of the euro relative to other major world currencies would not, in the short term, materially affect our future cash flows. Over time, however, to the extent that we cannot reflect these exchange rate movements in the pricing of our products in local currency, they could harm our cash flows.

Translation Risk

Many of the companies of the Bayer Group are located outside the euro zone. Because the euro is our financial reporting currency, we translate the financial statements of these subsidiaries into euro for inclusion in our consolidated financial statements. Period-to-period changes in the average exchange rate for a particular country s currency can significantly affect the translation into euro of both revenues and operating income denominated in that currency. Unlike the effect of exchange rate fluctuations on transaction exposure, the effect of exchange rate translation exposure does not affect our local currency cash flows. See Note 30 to the consolidated financial statements appearing elsewhere in this annual report on Form 20-F.

Outside the euro zone, we hold significant assets, liabilities and operations denominated in local currencies, most importantly the U.S. dollar. Although we regularly assess and evaluate the long-term currency risk inherent in these investments, we generally undertake foreign exchange hedge transactions addressing this type of risk only when we are considering withdrawal from a specific venture and repatriating the funds that our withdrawal generates. However, we reflect effects from currency fluctuations on the translation of net asset amounts into euro in our equity position.

The translation effects of currency fluctuations had no measurable effects on our sales in 2006, compared to an increase in our sales of 0.3 billion in 2005 and a decrease of 0.9 billion in 2004.

Derivative financial instruments

To mitigate the impact of currency exchange fluctuations, we regularly assess our transaction exposure to currency risks and hedge a portion of those risks with derivative financial instruments. Our Corporate Treasury department has central responsibility for managing our currency exposures and using currency derivatives. Our Board of Management has provided clear guidance on how to limit and monitor cash flow risks that result from this approach.

We relate the maturity dates of hedging contracts to the anticipated cash flows of the Bayer Group. Our policy is generally to use forward hedges and in some cases options depending upon our view of market conditions based on fundamental and technical analysis.

The table below shows the notional amounts and fair values of the currency derivatives we held as of December 31, 2006 and 2005. We have included interest and principal currency swaps in this presentation since they are primarily used to hedge currency risks.

	Notional Amount As of December 31,		**Fair Value As of December 31,**	
	2005	**2006**	**2005**	**2006**
		(Euros in millions)		
Forward exchange contracts, currency swaps and interest and principal currency swaps	5,532	11,990	(115)	98
Currency options	169	76	(2)	1

At December 31, 2006, we estimated that our aggregate annual direct net transaction risk from sales and purchases in foreign currencies was approximately 3.1 billion, which consisted primarily of U.S. dollars (U.S. $3.1 billion), Japanese yen (¥50 billion) and Canadian dollars (CAN $535 million). We do not anticipate a significant change in these levels of risk with respect to our current business operations during 2007. The increase in risk compared to December 31, 2005 (2.5 billion) is mainly related to the acquisition of the business of Schering AG, Germany and divestments of H.C. Starck and our Diagnostics division.

Sensitivity Analysis

We applied a hypothetical adverse change of 10 percent in foreign currency exchange rates, where the U.S. dollar, Japanese yen and Canadian dollar simultaneously strengthened against the euro using the year-end exchange rates of these currencies as a basis. The estimated hypothetical loss in cash flows of derivative and non-derivative financial instruments as of December 31, 2006 would be 156 million (2005: 85 million). Of these 156 million, 111 million are related to the U.S. dollar, 15 million to the Japanese yen and 30 million to other currencies. 157 million of the estimated hypothetical loss in cash flow of 156 million resulted from derivatives used to hedge our anticipated exposure in foreign currencies. These transactions typically qualify for hedge accounting. The offsetting position of 1 million is attributable to an unhedged position from accounts receivable. The impact of foreign currency exchange rate fluctuations on our anticipated sales in foreign currencies is not included in this calculation.

Credit Risk

Credit risk is the possibility that the value of our assets may become impaired if counterparties cannot meet their obligations in transactions involving financial instruments. Since we do not conclude master netting arrangements with our customers, the total of the amounts recognized in assets represents our maximum exposure to credit risk.

Raw Materials, Commodity and Energy Price Risks

We operate in markets in which economic cyclicality often affects raw material and product prices. Fluctuations in prices and availability of raw materials, commodities and energies affect major parts of our business. In order to secure our supply of raw materials, we are party to long-term supply contracts, buy additional quantities on the spot markets, and enter into swap agreements to manage our supply/demand as needed. The most important of our raw materials and energies affected by price fluctuations are:

Benzene;

Phenol;

Acetone;

Propylene oxide;

Ethylene;

Toluene;

Electric power; and

Steam.

As these products are derived from crude oil, naphtha and natural gas, their prices are affected by the volatility in the markets for these underlying basic feedstocks. Sometimes, however, their prices are decoupled from those for the underlying basic feedstocks and instead driven by the global supply and demand in the markets for these derivative products.

We typically use the following measures to avoid and manage pricing risk in purchasing raw materials and energies:

coverage of recurrent requirements with long-term contracts to reduce the price volatility of purchases on the spot markets;

incorporating pricing formulas linked to economic indices and pre-products into our contracts, rather than using published prices;

stock-keeping, flexibility in supply sources and, wherever possible, other alternative production plants to limit risks from raw material availability (only applicable to raw materials); and

hedging.

Derivative financial instruments

Facing increasing volatility in commodity and energy markets, we started a price risk management program in 2003 designed to reduce the variability of our expenditures for energy and commodity purchases by entering into financial swaps, collars and options on the over-the-counter markets. The gas and steam contracts for our major European sites are linked to liquidly traded fuel oil and European natural gas indices; the U.S. contracts are based on U.S. natural gas indices. The majority of the hedges for these contracts qualify for hedge accounting under IFRS and U.S. GAAP. Our commodity hedges for petrochemical purchases are typically linked to crude oil and naphtha, which are all feedstock to the production process of the raw materials our production depends on. These contracts are treated as trading instruments for accounting purposes.

The strategy for economically hedging energy and commodity price risks is based on contracts with a maturity of up to three years. Our procurement departments have central responsibility for managing our raw material, commodity and energy price risks. All financial derivatives which are not directly executed with suppliers in conjunction with

purchasing agreements are executed and managed by our Corporate Treasury department. Our Board of Management has provided clear guidance on how to limit and monitor cash flow risks that result from this approach.

The notional amount of these derivatives is the nominal value of the underlying transactions. The fair value of these derivatives is their repurchase value, based on quoted prices or, in the case of contracts not publicly traded, their values as determined by standard methods, as of a given closing date. The table below shows the notional amount and fair value of the financial derivatives we held as of December 31, 2006 and 2005; the fair values quoted disregard any compensating movements in the values of the underlying transactions.

	Notional Amount As of December 31,		Fair Value As of December 31,	
	2005	2006	2005	2006
	(Euros in millions)			
Commodity hedging contracts	416	323	85	(73)
Commodity option hedging contracts	49	66	(13)	(15)

At December 31, 2006, the notional amount of our commodity and energy hedging contracts totaled 389 million (2005: 465 million). We do not anticipate a significant change in the level of commodity and energy price risk with respect to our current business operations during 2007.

Sensitivity Analysis

We applied a hypothetical adverse change of 20 percent in commodity and energy prices, where all prices simultaneously decrease. The estimated hypothetical loss in cash flows of derivative financial instruments as of December 31, 2006 would be 36 million (2005: 66 million).

Item 12. ***Description of Securities Other Than Equity Securities***

Not applicable.

PART II

Item 13. ***Defaults, Dividend Arrearages and Delinquencies***

None.

Item 14. ***Material Modifications to the Rights of Security Holders and Use of Proceeds***

None.

Item 15. ***Controls and Procedures***

Disclosure Controls and Procedures

Bayer AG management, with the participation of Bayer AG s chief executive officer (CEO) and chief financial officer (CFO), have conducted an evaluation of the effectiveness of the design and operation of the Company s disclosure controls and procedures as of December 31, 2006 and have concluded that, as of such date, the Company s disclosure controls and procedures were effective to provide reasonable assurance that information required to be disclosed by us in the reports we file or submit under the Securities Exchange Act of 1934, as amended, is recorded, processed, summarized and reported, within the time periods specified in the applicable rules and forms, and that it is accumulated and communicated to our management, including our chief executive officer and chief financial officer, as appropriate to allow timely decisions regarding required disclosure.

There are inherent limitations to the effectiveness of any system of disclosure controls and procedures, no matter how well designed, such as the possibility of human error and the circumvention or overriding of the controls and procedures. Therefore, even those systems determined to be effective may not prevent or detect misstatements and can provide only reasonable assurance of achieving their control objectives. In addition, any determination of effectiveness of controls is not a projection of any effectiveness of those controls to future periods, as those controls may become inadequate because of changes in conditions, or the degree of compliance with the policies or procedures may deteriorate.

Report of Bayer AG s Management on Internal Control over Financial Reporting

Bayer AG management is responsible for establishing and maintaining adequate internal control over financial reporting.

Bayer AG management, with the participation of Bayer AG s chief executive officer (CEO) and chief financial officer (CFO), has conducted an evaluation of the effectiveness of the Company s internal control over financial reporting as of December 31, 2006. In conducting this evaluation, it used the criteria established in the Internal Control Integrated Framework issued by the Committee of Sponsoring Organizations of the Treadway Commission (COSO) and Control Objectives for Information and related Technology (COBIT). Based on our evaluation under these criteria, management has concluded that, as of December 31, 2006, the Bayer Group s internal control over financial reporting is effective to provide reasonable assurance regarding the reliability of financial reporting and the preparation and fair presentation of our published consolidated financial statements.

Bayer AG management has excluded the acquired Schering AG business from its evaluation of internal control over financial reporting as of December 31, 2006 because it was acquired by Bayer in June 2006. The total assets and total revenues of the acquired Schering AG business represent approximately 9 percent, or 5 billion (total assets excluding amount resulting from the purchase price allocation) and 11 percent, or 3.1 billion, respectively of the related consolidated financial statements amounts as of, and for the year ended, December 31, 2006.

The management evaluation of the effectiveness of internal control over financial reporting as of December 31, 2006 has been audited by PricewaterhouseCoopers AG, Essen (PwC), an independent registered public accounting firm, as stated in their report which is included under Item 18 on page F-2.

Because of its inherent limitations, internal control over financial reporting may not prevent or detect misstatements. Projections of any evaluation of effectiveness to future periods are subject to risk that controls may become inadequate because of changes in conditions, or that the degree of compliance with the policies or procedures may deteriorate.

Attestation of the Registered Public Accounting Firm

See report of PwC, an independent registered public accounting firm, included under Item 18 on page F-2.

Changes in Internal Control over Financial Reporting

There has been no change in our internal control over financial reporting during 2006 that has materially affected, or is reasonably likely to materially affect, our internal control over financial reporting.

Item 16. ***[Reserved]***

Item 16A. ***Audit Committee Financial Expert***

Our Supervisory Board has determined that Dr. Schneider is an audit committee financial expert, as that term is defined in Item 16A(b) of Form 20-F.

Item 16B. ***Code of Ethics***

We have adopted a code of ethics, as that term is defined by Item 16B(b) of Form 20-F, that is applicable to all of our employees, including our chief executive officer, chief financial officer and chief accounting officer. Our code of ethics is available on our website at http://www.bayer.com/bayer-group/corporate-compliance/page1134.htm. (Reference to this uniform resource locator or URL is made as an inactive textual reference for informational purposes only. The information found at this website is not incorporated by reference into this document.)

Item 16C. ***Principal Accountant Fees and Services***

Independent Auditor Fees

Fees billed to the Company for professional services by its principal accountant, PricewaterhouseCoopers, during the fiscal years 2004, 2005 and 2006 were as follows:

Type of fees	**2004**	**2005**	**2006**
	(Euros in millions)		
Audit fees	18	16	26
Audit-related fees	8	5	4
Tax fees	1	1	1
Fees for other services	*	1	7
Total	27	23	38

* All other fees amounted to less than 500,000 in 2004.

The audit-related services PricewaterhouseCoopers provided related to acquisition/disposition due diligence, audits of financial carve-out statements, reviews of Bayer s information system unrelated to audit and audits of employee benefit plans. No services falling under the *de minimis* exception of paragraph (c)(7)(i)(c) of Rule 2-01 of Regulation S-X were provided to the Company by PricewaterhouseCoopers in 2004, 2005 and 2006.

Audit Committee Pre-Approval Policies

All services provided by our auditor and companies affiliated with our auditor must be pre-approved by the audit committee of our Supervisory Board (*Aufsichtsrat*). The annual contract conditions and fees relating to the audit of the financial statements of the Bayer Group and Bayer AG must be approved by the audit committee on a case-by-case basis. Other services may be pre-approved by the audit committee within the authorities the audit committee has adopted; if they fall outside these authorities, they require case-by-case approval. Our policies for these pre-approvals grant authority to management to engage our auditor and companies affiliated with our auditor for:

Audit services up to an annual aggregate, which was 18 million in 2004, 16 million in 2005 and 26 million in 2006 for Bayer Group and Bayer AG and which include the audit of the consolidated financial statements of Bayer and its affiliates; services necessary to provide audit opinions; services in connection with the submission of reports to the SEC; attest services for reports prepared on Bayer s internal control system and review of Bayer s information systems; accounting and disclosure advice in connection with the annual audit; and audit services relating to the audit of restated prior-year figures, if any.

Audit-related services, which include acquisition/disposition due diligence; audits of material companies acquired or to be acquired, of carve-out statements relating to acquisitions or dispositions, of closing balances for dispositions and of employee benefit plans; procedures necessary to meet finance, accounting or other regulatory reporting requirements; advice on internal control systems; reviews of Bayer s information systems unrelated to audit; assistance in interpreting SEC requirements; and evaluation of risk management.

Tax advisory services, provided that the auditor or affiliate does not act as a representative of Bayer and did not recommend the transaction to which the tax advisory services relate; these include tax planning and advice; assistance with tax compliance; reviewing tax declarations; assistance in tax audits and appeals; and tax appraisals.

Other services, which include other risk management advice; audits of valuations performed by other advisors; analysis or review of business plans or planning processes (but not design or implementation thereof); and other financial related advice.

Pre-approval for the audit-related services, tax advisory services and other services categories is only valid if these services together aggregate below 66 percent of the annual budget set for audit services. Any requests for services to be provided by the auditor or an affiliate must be made through Bayer s accounting department, which will, if necessary, prepare the individual approval applications. The accounting department also notifies the audit committee of services provided pursuant to the pre-approval policies, monitors the pre-approval budget, notifies the chairman of the audit committee once the 66 percent pre-approval threshold has been reached and maintains records of all services provided by the auditor and its affiliates.

Item 16D. ***Exemptions from the Listing Standards for Audit Committees***

We rely on the exemption afforded by Rule 10A-3(b)(1)(iv)(C) under the Securities Exchange Act of 1934, as amended. We believe that such reliance does not materially adversely affect the ability of our audit committee to act independently or to satisfy the other requirements of Rule 10A-3.

Item 16E. ***Purchases of Equity Securities by the Issuer and Affiliated Purchasers***

The following table sets forth certain information concerning purchases by us of Bayer AG ordinary shares of no par value during 2006:

Period (2006)	Total Number of Shares Purchased[(a)]	Average Price Paid per Share in Euro[(b)]	Total Number of Shares Purchased as Part of Publicly Announced Plans or Programs	Maximum Number (or Approximate Dollar Value) of Shares (or Units) that May Yet Be Purchased Under the Plans or Programs
January	22,773	37.01	[N/A]	[N/A]
February	30,570	34.41	[N/A]	[N/A]
March	35,293	34.27	[N/A]	[N/A]
April	50,496	33.62	[N/A]	[N/A]
May	53,487	36.90	[N/A]	[N/A]
June	136,619	34.48	[N/A]	[N/A]
July	26,989	35.71	[N/A]	[N/A]
August	27,207	38.48	[N/A]	[N/A]
September	38,472	38.52	[N/A]	[N/A]
October	532,391	40.79	[N/A]	[N/A]
November	24,817	40.10	[N/A]	[N/A]
December	23,618	40.59	[N/A]	[N/A]

(a) Relates to purchases of Bayer AG ordinary shares of no par value made by Bayer or Bayer s US subsidiaries to accommodate its employee stock participation programs in Germany and the United States. Purchases made by Bayer under the remaining employee stock participation programs represent an amount that is immaterial in the aggregate. Our Board of Management is authorized until October 27, 2007 to purchase Bayer AG ordinary shares representing up to 10 percent of Bayer s capital stock, including for the purpose of accommodating Bayer s Stock Participation Program. For further information on our Stock Participation Program, see Item 6, *Directors, Senior Management and Employees Compensation Employee Stock-Based Compensation Program.*

(b) Average price paid per share includes commissions.

As of December 31, 2006 none of our subsidiaries owned any Bayer AG ordinary shares.

PART III

Item 17. ***Financial Statements***

We have responded to Item 18 in lieu of responding to this item.

Item 18. ***Financial Statements***

See pages F-1 through F-139, incorporated herein by reference.

Item 19. ***Exhibits***

Documents filed as exhibits to this annual report on Form 20-F:

Exhibit 1.1	Articles of Association (*Satzung*) of Bayer AG, as amended to date, in English translation.
Exhibit 2.1	The total amount of long-term debt securities Bayer AG authorized under any instrument does not exceed 10 percent of the total assets of the Company. Bayer AG agrees to furnish to the Securities and Exchange Commission, upon its request, a copy of any instrument defining the rights of holders of long-term debt of Bayer AG or its subsidiaries for which consolidated or unconsolidated financial statements are required to be filed.
Exhibit 4.1	Spin-Off and Acquisition Agreement, dated September 22, 2004, between Bayer AG and LANXESS AG, in English translation, incorporated by reference to Exhibit 4.1 to Bayer AG s Annual Report on Form 20-F for the Year Ended December 31, 2004.
Exhibit 4.2	Master Agreement, dated September 22, 2004, between Bayer AG and LANXESS AG, in English translation, incorporated by reference to Exhibit 4.2 to Bayer AG s Annual Report on Form 20-F for the Year Ended December 31, 2004.
Exhibit 4.3	7,000,000,000 Syndicated Facilities Agreement, dated 23 March 2006, by and among Bayer AG; Citigroup Global Markets Limited and Credit Suisse International, as Mandated Lead Arrangers; Citigroup Global Markets Limited and Credit Suisse International, as Bookrunners; and Citibank International plc, as Facility Agent, incorporated by reference to the Schedule TO filed by Bayer AG on April 13, 2006.
Exhibit 8.1	Significant subsidiaries as of the end of the year covered by this report as defined in rule 1-02(w) of Regulation S-X: See Item 4, *Information on the Company Organizational Structure*.
Exhibit 12.1	Certification of the Principal Executive Officer pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.
Exhibit 12.2	Certification of the Principal Financial Officer pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.
Exhibit 13.1	Certification in accordance with 18 U.S.C. § 1350 as adopted by § 906 of the Sarbanes-Oxley Act of 2002.

SIGNATURES

The registrant hereby certifies that it meets all of the requirements for filing on Form 20-F and that it has duly caused and authorized the undersigned to sign this annual report on its behalf.

BAYER AG

/s/ Werner Wenning

Name: Werner Wenning

Title: Chairman of the Board of Management

/s/ Dr. Roland Hartwig

Name: Dr. Roland Hartwig
Title: General Counsel
Date: March 15, 2007

BAYER GROUP
Index to Consolidated Financial Statements

Report of Independent Registered Public Accounting Firm

To the Board of Directors
and Stockholders of Bayer AG

We have completed an integrated audit of Bayer AG s consolidated financial statements and of its internal control over financial reporting as of December 31, 2006 and audits of its 2005 and 2004 consolidated financial statements in accordance with International Auditing Standards and standards of the Public Company Accounting Oversight Board (United States). Our opinions on the Bayer AG 2006, 2005 and 2004 financial statements and on its internal control over financial reporting of 2006, based on our audits, are presented below.

Consolidated financial statements

We have audited the consolidated financial statements (comprising consolidated balance sheets, statements of income, statements of cash flows, statements of recognized income and expense and notes) of Bayer AG as of December 31, 2006 and 2005 and for each of the three years in the period ended December 31, 2006. These consolidated financial statements are the responsibility of the Board of Directors and management. Our responsibility is to express an opinion on these consolidated financial statements based on our audits.

We conducted our audits in accordance with International Standards on Auditing and the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the consolidated financial statements are free of material misstatement. An audit of consolidated financial statements includes examining, on a test basis, evidence supporting the amounts and disclosures in the consolidated financial statements, assessing the accounting principles used and significant estimates made by management, and evaluating the overall consolidated financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the consolidated financial statements present fairly, in all material respects, the financial position of Bayer AG and its subsidiaries at December 31, 2006 and 2005, and the results of its operations and its cash flows for each of the three years in the period ended December 31, 2006 in accordance with International Financial Reporting Standards (IFRS).

IFRS vary in certain significant respects from accounting principles generally accepted in the United States of America and as allowed by Item 18 of Form 20-F. Information relating to the nature and effect of such differences is presented in Note [41] to the consolidated financial statements.

Internal control over financial reporting

Also in our opinion, management s assessment, included in Item 15, *Controls and Procedures Report of Bayer AG s Management on Internal Control over Financial Reporting*, that Bayer AG maintained effective internal control over financial reporting as of December 31, 2006 based on criteria established in Internal Control Integrated Framework issued by the Committee of Sponsoring Organizations of the Treadway Commission (COSO) and Control Objectives for Information and related Technology (COBIT), is fairly stated, in all material respects, based on those criteria. Furthermore, in our opinion, the Company maintained, in all material respects, effective internal control over financial reporting as of December 31, 2006 based on criteria established in Internal Control Integrated Framework issued by the Committee of Sponsoring Organizations of the Treadway Commission (COSO) and Control Objectives for Information and related Technology (COBIT). Bayer AG s Board of Directors and management are responsible for maintaining effective internal control over financial reporting and management is responsible for the assessment of the effectiveness of internal control over financial reporting. Our responsibility is to express opinions on management s assessment and on the effectiveness of the Company s internal control over financial reporting based on our audit. We conducted our audit of internal control over financial reporting in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether effective internal control over financial reporting was maintained in all material respects. An audit of internal control over financial reporting includes obtaining an understanding of internal control over financial reporting, evaluating management s assessment, testing and evaluating the design

and operating effectiveness of internal control, and performing such other procedures as we consider necessary in the circumstances. We believe that our audit provides a reasonable basis for our opinions.

A company s internal control over financial reporting is a process designed to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles. A company s internal control over financial reporting includes those policies and procedures that (i) pertain to the maintenance of records that, in reasonable detail, accurately and fairly reflect the transactions and dispositions of the assets of the company; (ii) provide reasonable assurance that transactions are recorded as necessary to permit preparation of financial statements in accordance with generally accepted accounting principles, and that receipts and expenditures of the company are being made only in accordance with authorizations of management and directors of the company; and (iii) provide reasonable assurance regarding prevention or timely detection of unauthorized acquisition, use, or disposition of the company s assets that could have a material effect on the financial statements.

Because of its inherent limitations, internal control over financial reporting may not prevent or detect misstatements. Also, projections of any evaluation of effectiveness to future periods are subject to the risk that controls may become inadequate because of changes in conditions, or that the degree of compliance with the policies or procedures may deteriorate.

As described in Item 15, *Controls and Procedures Report of Bayer AG s Management on Internal Control over Financial Reporting*, Management has excluded the acquired Schering AG business from its assessment of internal control over financial reporting as of December 31, 2006 because Schering AG was acquired by Bayer AG in a business combination during 2006. We have also excluded the acquired Schering AG business from our audit of internal controls over financial reporting. The total assets and total revenues of the acquired Schering AG business represent approximately 9 percent or 5 billion (total assets excluding amount resulting from purchase price allocation) and 11 percent or 3.1 billion, respectively, of the related consolidated financial statement amounts as of and for the year ended December 31, 2006.

Essen, Germany
March 14, 2007
PricewaterhouseCoopers
Aktiengesellschaft
Wirtschaftsprüfungsgesellschaft

/s/ ALBRECHT	/s/ LINKE
P. Albrecht Wirtschaftsprüfer (German Public Accountant)	V. Linke Wirtschaftsprüfer (German Public Accountant)

Bayer Group
Consolidated Statements of Income

	Note	2004	2005	2006
			(million)	
Net sales	[8]	20,925	24,701	28,956
Cost of goods sold		(11,086)	(13,412)	(15,275)
Gross profit		9,839	11,289	13,681
Selling expenses	[9]	(4,783)	(5,247)	(6,534)
Research and development expenses		(1,772)	(1,729)	(2,297)
General administration expenses		(1,285)	(1,307)	(1,599)
Other operating income	[10]	802	775	730
Other operating expenses	[11]	(1,144)	(1,267)	(1,219)
Operating result		1,657	2,514	2,762
Equity-method loss	[13.1]	(139)	(10)	(25)
Non-operating income		483	632	931
Non-operating expenses		(976)	(1,224)	(1,688)
Non-operating result	[13]	(632)	(602)	(782)
Income before income taxes		1,025	1,912	1,980
Income taxes	[14]	(401)	(538)	(454)
Income from continuing operations after taxes		624	1,374	1,526
Income from discontinued operations after taxes	[7.2]	58	221	169
Income after taxes		682	1,595	1,695
of which attributable to minority interest	[15]	(3)	(2)	12
of which attributable to Bayer AG stockholders (net income)		685	1,597	1,683
Earnings per share ( )				
From continuing operations	[16]			
Basic*		0.86	1.88	2.00
Diluted*		0.86	1.88	2.00
From continuing and discontinued operations	[16]			

Basic*	0.94	2.19	2.22
Diluted*	0.94	2.19	2.22

2004 and 2005 figures restated

* The ordinary shares to be issued upon conversion of the mandatory convertible bond are treated as already issued shares.

Bayer Group
Consolidated Balance Sheets

	Note	Dec. 31, 2005	Dec. 31, 2006
		(million)	
Noncurrent assets			
Goodwill	[17]	2,623	8,227
Other intangible assets	[17]	5,065	15,807
Property, plant and equipment	[18]	8,321	8,867
Investments in associates	[19]	795	532
Other financial assets	[20]	1,429	1,094
Other receivables	[21]	199	165
Deferred taxes	[14]	1,698	1,205
		20,130	35,897
Current assets			
Inventories	[22]	5,504	6,153
Trade accounts receivable	[23]	5,204	5,802
Other financial assets	[20]	447	401
Other receivables	[21]	1,421	1,217
Claims for tax refunds		726	581
Cash and cash equivalents	[36]	3,290	2,915
Assets held for sale and discontinued operations	[7.2]		2,925
		16,592	19,994
Assets		36,722	55,891
Stockholders equity	[24]		
Capital stock of Bayer AG		1,870	1,957
Capital reserves of Bayer AG		2,942	4,028
Other reserves		6,265	6,782
		11,077	12,767
Equity attributable to minority interest		80	84
		11,157	12,851
Noncurrent liabilities			
Provisions for pensions and other post-employment benefits	[25]	7,174	6,543
Other provisions	[26]	1,340	1,464
Financial liabilities	[27]	7,185	14,723
Other liabilities	[29]	516	449
Deferred taxes	[14]	280	4,346
		16,495	27,525

Current liabilities			
Other provisions	[26]	3,009	3,765
Financial liabilities	[27]	1,767	5,078
Trade accounts payable	[28]	1,974	2,369
Tax liabilities		304	400
Other liabilities	[29]	2,016	3,055
Liabilities directly related to assets held for sale and discontinued operations	[7.2]		848
		9,070	15,515
Stockholders equity and liabilities		36,722	55,891

Bayer Group
Consolidated Statements of Cash Flows

	Note	2004	2005	2006
			(million)	
Income after taxes from continuing operations		624	1,374	1,526
Income taxes		401	538	454
Non-operating result		632	602	782
Income taxes paid		(407)	(463)	(763)
Depreciation and amortization		1,729	1,608	1,913
Change in pension provisions		(393)	(501)	(295)
(Gains) losses on retirements of noncurrent assets		(35)	(44)	(133)
Non-cash effects of the remeasurement of acquired assets (inventory work-down)				429
Operating cash flow before changes in net working capital (gross operating cash flow)		2,551	3,114	3,913
Decrease (increase) in inventories		(365)	(130)	(155)
Decrease (increase) in trade accounts receivable		(359)	211	(201)
(Decrease) increase in trade accounts payable		(13)	(117)	130
Changes in other working capital, other non-cash items		145	149	241
Net cash provided by (used in) operating activities (net cash flow, continuing operations)	[33]	1,959	3,227	3,928
Net cash provided by (used in) operating activities (net cash flow, discontinued operations)	[7.2]	491	275	275
Net cash provided by (used in) operating activities (net cash flow, total)		2,450	3,502	4,203
Cash outflows for additions to property, plant, equipment and intangible assets		(1,251)	(1,389)	(1,876)
Cash inflows from sales of property, plant, equipment and other assets		124	105	185
Cash inflows from divestitures		76	293	489
Cash inflows from noncurrent financial assets		90	1,189	850
Cash outflows for acquisitions less acquired cash		(358)	(2,188)	(15,351)
Interest and dividends received		400	451	686
Cash inflows (outflows) from current financial assets		105	(202)	287
Net cash provided by (used in) investing activities (total)	[34]	(814)	(1,741)	(14,730)
Capital contributions		10		1,174
Bayer AG dividend, dividend payments to minority stockholders, reimbursements of advance capital gains tax payments		(559)	(440)	(535)
Issuances of debt		1,393	2,005	13,931

Retirements of debt		(881)	(2,659)	(3,216)
Interest paid		(724)	(787)	(1,155)
Net cash provided by (used in) financing activities (total)	[35]	(761)	(1,881)	10,199
Change in cash and cash equivalents due to business activities (total)		875	(120)	(328)
Cash and cash equivalents at beginning of year		2,734	3,570	3,290
Change in cash and cash equivalents due to changes in scope of consolidation		6	(196)	(2)
Change in cash and cash equivalents due to exchange rate movements		(45)	36	(45)
Cash and cash equivalents at end of year	[36]	3,570	3,290	2,915

2004 and 2005 figures restated

Bayer Group
Consolidated Statements of Recognized Income and Expense

	Dec. 31, 2004	Dec. 31, 2005	Dec. 31, 2006
		(million)	
Changes in fair values of derivatives designated as hedges, recognized in stockholders equity	64	(15)	(59)
Changes in fair values of derivatives designated as hedges, recognized in the income statement	*4*	*3*	*11*
Changes in fair values of available-for-sale financial assets, recognized in stockholders equity	12	9	(7)
Changes in fair values of available-for-sale financial assets, recognized in the income statement	*(6)*		
Revaluation surplus (IFRS 3)	66		
Changes in actuarial gains (losses) relating to pensions and other post-employment benefits, recognized in stockholders equity	(740)	(1,207)	448
Exchange differences on translation of operations outside the euro zone	(304)	857	(725)
Deferred taxes on valuation adjustments, recognized directly in stockholders equity	251	470	(148)
Deferred taxes on valuation adjustments, removed from stockholders equity and recognized in the income statement	*(2)*		*3*
Valuation adjustments recognized directly in stockholders equity	(655)	117	(477)
Income after taxes	682	1,595	1,695
Total income and expense recognized in the financial statements	27	1,712	1,218
of which attributable to minority interest	(3)	6	7
of which attributable to Bayer AG stockholders	30	1,706	1,211

Notes to the Consolidated Financial Statements of the Bayer Group

[1] Key Data by Business Segment and Region

Key Data by Business Segment

	HealthCare				CropScience			
	Pharmaceuticals		Consumer Health		Crop Protection		Environmental Science, BioScience	
Business Segments	**2005**	**2006**	**2005**	**2006**	**2005**	**2006**	**2005**	**2006**
					(million)			
Net sales (external)	4,067	7,478	3,929	4,246	4,874	4,644	1,022	1,056
Change	2.7%	83.9%	41.6%	8.1%	(1.7)%	(4.7)%	3.3%	3.3%
Change currency adjusted	1.7%	84.5%	40.3%	8.5%	(4.3)%	(5.2)%	2.1%	3.7%
Intersegment sales	58	51	21	7	70	59	13	6
Other operating income	48	224	48	39	226	186	35	20
Operating result	475	563	448	750	532	384	158	200
Operating cash flow before changes in net working capital (gross operating cash flow)	449	1,086	474	634	762	691	202	209
Capital invested	2,501	18,253	3,498	3,477	7,372	7,203	1,477	1,403
CFRoI	18.7%	10.5%	13.3%	18.2%	10.7%	9.5%	13.8%	14.5%
Net cash flow	481	1,053	606	473	699	748	205	150
Equity-method income (loss)								
Equity-method investments	4							
Total assets	3,489	25,860	4,622	4,372	8,836	7,712	1,591	1,444
Capital expenditures	142	476	83	100	175	156	26	41
Amortization and depreciation	188	488	169	146	494	505	100	77
Liabilities	2,086	3,451	1,366	1,154	2,668	2,088	369	311
Research and development expenses	680	1,257	154	169	548	500	116	114
Number of employees (as of Dec. 31)	16,800	40,000	11,400	11,400	15,800	15,000	2,700	2,900

	MaterialScience							
	Materials		Systems		Reconciliation		Continuing Operations	
Business Segments	**2005**	**2006**	**2005**	**2006**	**2005**	**2006**	**2005**	**2006**
					(million)			

Net sales (external)	2,837	2,925	6,609	7,236	1,363	1,371	24,701	28,956
Change	28.0%	3.1%	23.6%	9.5%			18.0%	17.2%
Change currency adjusted	27.4%	3.4%	22.8%	9.7%			16.7%	17.4%
Intersegment sales	14	25	142	138	(318)	(286)		
Other operating income	14	17	41	66	363	178	775	730
Operating result	514	289	736	703	(349)	(127)	2,514	2,762
Operating cash flow before changes in net working capital (gross operating cash flow)	473	364	781	802	(27)	127	3,114	3,913
Capital invested	2,706	2,789	4,791	4,691	2,848	1,541	25,193	39,357
CFRoI	19.0%	13.2%	17.1%	16.9%			12.5%	12.1%
Net cash flow	466	324	871	957	(101)	223	3,227	3,928
Equity-method income (loss)	37	29	(47)	(54)			(10)	(25)
Equity-method investments	208	28	580	504			792	532
Total assets	2,770	2,742	5,125	4,745	7,493	6,091	33,926	52,966
Capital expenditures	304	282	338	471	142	213	1,210	1,739
Amortization and depreciation	151	159	320	348	186	190	1,608	1,913
Liabilities	610	597	1,632	1,681	15,970	32,910	24,701	42,192
Research and development expenses	70	76	144	151	17	30	1,729	2,297
Number of employees (as of Dec. 31)	4,700	5,000	9,400	9,900	21,800	21,800	82,600	106,000

Notes to the Consolidated Financial Statements of the Bayer Group (Continued)

Key Data by Business Segment

	HealthCare				CropScience			
	Pharmaceuticals		Consumer Health		Crop Protection		Environmental Science, BioScience	
Business Segments	**2004**	**2005**	**2004**	**2005**	**2004**	**2005**	**2004**	**2005**
				(million)				
Net sales (external)	3,961	4,067	2,775	3,929	4,957	4,874	989	1,022
Change	(9.4)%	2.7%	(1.5)%	41.6%	3.2%	(1.7)%	2.7%	3.3%
Change currency adjusted	(5.9)%	1.7%	4.1%	40.3%	7.0%	(4.3)%	7.5%	2.1%
Intersegment sales	38	58	18	21	71	70	7	13
Other operating income	129	48	38	48	146	226	37	35
Operating result	399	475	448	448	386	532	106	158
Operating cash flow before changes in net working capital (gross operating cash flow)	386	449	352	474	739	762	154	202
Capital invested	2,305	2,501	1,390	3,498	6,932	7,372	1,454	1,477
CFRoI	16.8%	18.7%	24.8%	13.3%	10.9%	10.7%	10.6%	13.8%
Net cash flow	261	481	546	606	637	699	141	205
Equity-method income (loss)								
Equity-method investments	4	4						
Total assets	4,052	3,489	2,289	4,622	9,117	8,836	1,703	1,591
Capital expenditures	115	142	71	83	181	175	28	26
Amortization and depreciation	174	188	113	169	592	494	135	100
Liabilities	2,138	2,086	968	1,366	2,450	2,668	360	369
Research and development expenses	740	680	138	154	571	548	108	116
Number of employees (as of Dec. 31)	18,400	16,800	8,300	11,400	16,400	15,800	2,800	2,700

	MaterialScience							
	Materials		Systems		Reconciliation		Continuing Operations	
Business Segments	**2004**	**2005**	**2004**	**2005**	**2004**	**2005**	**2004**	**2005**
				(million)				
Net sales (external)	2,217	2,837	5,349	6,609	677	1,363	20,925	24,701

Change	17.3%	28.0%	14.4%	23.6%			3.5%	18.0%
Change currency adjusted	23.2%	27.4%	18.8%	22.8%			7.7%	16.7%
Intersegment sales	13	14	116	142	(263)	(318)		
Other operating income	22	14	106	41	324	363	802	775
Operating result	184	514	348	736	(214)	(349)	1,657	2,514
Operating cash flow before changes in net working capital (gross operating cash flow)	271	473	484	781	165	(27)	2,551	3,114
Capital invested	2,267	2,706	4,344	4,791	3,684	2,848	22,376	25,193
CFRoI	11.9%	19.0%	9.8%	17.1%			10.8%	12.5%
Net cash flow	152	466	289	871	(67)	(101)	1,959	3,227
Equity-method income (loss)	4	37	(131)	(47)	(12)		(139)	(10)
Equity-method investments	176	208	562	580			742	792
Total assets	2,513	2,770	4,724	5,125	5,796	7,493	30,194	33,926
Capital expenditures	106	304	185	338	135	142	821	1,210
Amortization and depreciation	168	151	326	320	221	186	1,729	1,608
Liabilities	511	610	1,475	1,632	15,608	15,970	23,510	24,701
Research and development expenses	60	70	139	144	16	17	1,772	1,729
Number of employees (as of Dec. 31)	4,400	4,700	8,900	9,400	21,800	21,800	81,000	82,600

Notes to the Consolidated Financial Statements of the Bayer Group (Continued)

Key Data by Business Region

	Europe			North America			Asia/Pacific			Latin America/ Africa/Middle East		
ns	**2004**	**2005**	**2006**	**2004**	**2005**	**2006**	**2004**	**2005**	**2006**	**2004**	**2005**	**20**
						(million)						
les nal) by	8,751	10,771	12,652	5,790	6,496	7,779	3,509	4,073	4,610	2,875	3,361	3
nge	7.2%	23.1%	17.5%	(8.1)%	12.2%	19.8%	9.4%	16.1%	13.2%	12.7%	16.9%	
nge cy ed	7.2%	22.9%	17.4%		11.3%	19.9%	15.1%	15.2%	15.0%	19.1%	10.5%	
les nal) by f origin	9,531	11,655	13,696	5,807	6,492	7,776	3,306	3,931	4,410	2,281	2,623	3
nge	7.7%	22.3%	17.5%	(8.0)%	11.8%	19.8%	9.8%	18.9%	12.2%	11.6%	15.0%	
nge cy ed	7.7%	22.1%	17.5%	0.1%	10.9%	19.9%	15.9%	18.0%	14.0%	19.2%	6.9%	
gional	3,129	3,536	4,315	1,303	1,485	1,795	142	176	210	114	172	
operating e	570	397	474	116	227	98	57	49	46	59	102	
ing	889	1,167	1,581	281	767	821	323	436	296	395	310	
ing cash efore es in net g capital												
ng cash	1,374	1,557	2,495	611	978	1,016	336	431	335	340	265	
-method e (loss)	(39)	6	1	(100)	(17)	(27)		1	1			
-method ments	429	440	232	307	345	297	2	3	3	4	4	
ssets	17,784	18,939	37,255	6,707	7,145	7,881	2,483	3,589	3,965	1,830	2,351	2
l ditures	460	497	777	193	244	398	122	380	472	46	89	
ization iation	1,073	980	1,201	434	419	459	117	99	138	43	56	
ties	15,566	17,091	29,985	5,122	4,779	4,928	946	1,047	1,463	733	992	1
ch and pment	1,286	1,193	1,639	398	445	551	68	66	80	20	25	

es
er of
yees (as
. 31) 45,000 45,700 57,800 14,900 13,100 17,200 11,500 13,200 17,300 9,600 10,600 13

	Reconciliation			Continuing Operations		
Regions	**2004**	**2005**	**2006**	**2004**	**2005**	**2006**
				(million)		
Net sales (external) by market				20,925	24,701	28,956
Change				3.5%	18.0%	17.2%
Change currency adjusted				7.7%	16.7%	17.4%
Net sales (external) by point of origin				20,925	24,701	28,956
Change				3.5%	18.0%	17.2%
Change currency adjusted				7.7%	16.7%	17.4%
Interregional sales	(4,688)	(5,369)	(6,548)			
Other operating income				802	775	730
Operating result	(231)	(166)	(140)	1,657	2,514	2,762
Operating cash flow before changes in net working capital (gross operating cash flow)	(110)	(117)	(116)	2,551	3,114	3,913
Equity-method income (loss)				(139)	(10)	(25)
Equity-method investments				742	792	532
Total assets	1,390	1,902	1,365	30,194	33,926	52,966
Capital expenditures				821	1,210	1,739
Amortization and depreciation	62	54	47	1,729	1,608	1,913
Liabilities	1,143	792	4,767	23,510	24,701	42,192
Research and development expenses				1,772	1,729	2,297
Number of employees (as of Dec. 31)				81,000	82,600	106,000

Notes to the Consolidated Financial Statements of the Bayer Group (Continued)

[2] General information

The consolidated financial statements of the Bayer Group as of December 31, 2006 have been prepared pursuant to Section 315a of the German Commercial Code according to the International Financial Reporting Standards (IFRS) of the International Accounting Standards Board (IASB), London, which are recognized by the European Union, and the Interpretations of the International Financial Reporting Interpretations Committee (IFRIC), in effect at the closing date.

Bayer Aktiengesellschaft (Bayer AG) is a global enterprise based in Germany. Its business activities in the fields of health care, nutrition and high-tech materials are divided among the Bayer HealthCare, Bayer CropScience and Bayer MaterialScience subgroups, respectively. The activities of the various segments are outlined in Note [6].

A Declaration of Conformity with the German Corporate Governance Code has been issued pursuant to Section 161 of the German Stock Corporation Act and made available to stockholders.

The Board of Management of Bayer AG approved the consolidated financial statements of the Bayer Group on February 27, 2007 for submission to the company s Supervisory Board. They were submitted to the Audit Committee of the Supervisory Board on March 8, 2007 and approved by the Supervisory Board at its meeting on March 12, 2007.

The financial statements of the consolidated companies are prepared according to uniform recognition and valuation principles. Valuation adjustments made for tax reasons are not reflected in the Group statements. The financial statements of the individual consolidated companies are prepared as of the closing date for the Group statements.

The Group financial statements are based on the principle of the historical cost of acquisition, construction or production, with the exception of certain items such as available-for-sale financial assets and derivative financial instruments, which are reflected at fair value.

The consolidated financial statements of the Bayer Group are drawn up in euros ( ). Amounts are stated in millions of euros (million) except where otherwise indicated.

The income statement is prepared using the cost-of-sales method, in which expenses are classified according to their function as cost of goods sold, selling expenses, research and development expenses, general administration expenses or other operating expenses.

In the income statement and balance sheet, certain items are combined for the sake of clarity and explained in the Notes. Assets and liabilities are classified by maturity. They are classified as current if they mature within one year or are held for sale, and as noncurrent if they remain in the Bayer Group for more than one year. Trade accounts receivable and payable, claims for tax refunds, tax liabilities and inventories are always presented as current items, deferred tax assets and liabilities as noncurrent items.

In compliance with IFRS 5 (Non-current Assets Held for Sale and Discontinued Operations), a distinction was made in 2006 between continuing operations and discontinued operations or assets held for sale. The discontinued operations are recognized as separate line items in the balance sheet for fiscal 2006 and in the income and cash flow statements for 2004, 2005 and 2006. Depreciation of noncurrent assets allocable to discontinued operations ceased when the respective divestiture was announced. All data in these Notes refer to continuing operations, except where otherwise indicated. Discontinued operations are described in Note [7.2].

Changes in recognition and valuation principles are explained in the Notes. The retrospective application of new or revised standards requires except as otherwise provided in the respective standard that earnings for the preceding year and the opening balance sheet for the reporting year be restated as if the new recognition and valuation principles had been applied in the past. The financial statements as of December 31, 2005 and 2004 have therefore been restated in line with the new and revised standards applied by the Bayer Group as of January 1, 2006.

Notes to the Consolidated Financial Statements of the Bayer Group (Continued)

[3] Effects of new accounting pronouncements

Accounting standards applied for the first time in 2006

In 2006 the following accounting standards and interpretations had to be applied for the first time. None of the following standards had a material impact on the Group s net assets, financial position, results of operations or earnings per share in the current period.

In August 2005, the IASB issued amendments to IAS 39 (Financial Instruments: Recognition and Measurement) and IFRS 4 (Insurance Contracts). The amendments are intended to insure that issuers of financial guarantee contracts include the resulting liabilities in their balance sheet. The amendments define a financial guarantee contract as a contract that requires the issuer to make specified payments to reimburse the holder for a loss it incurs because a specified debtor fails to make payment when due in accordance with the original or modified terms of a debt instrument. The amendment is to be applied for annual periods beginning on or after January 1, 2006.

In December 2004, the IFRIC issued the interpretation IFRIC 5 (Rights to Interests Arising From Decommissioning, Restoration and Environmental Rehabilitation Funds), which specifies the accounting treatment of cash reimbursements from funds set up to cover costs of waste disposal, environmental remediation and similar commitments. IFRIC 5 is to be applied for annual periods beginning on or after January 1, 2006. The interpretation is not relevant for the Bayer Group since it does not participate in such funds.

In September 2005, the IFRIC issued IFRIC 6 (Liabilities arising from Participating in a Specific Market Waste Electrical and Electronic Equipment). IFRIC 6 clarifies when certain producers of electrical goods will need to recognize a liability for the cost of waste management relating to the decommissioning of waste electrical and electronic equipment (historical waste) supplied to private households. The amendment is to be applied for annual periods beginning on or after December 1, 2005.

In November 2005, the IFRIC issued IFRIC 7 (Applying the Restatement Approach under IAS 29 Financial Reporting in Hyperinflationary Economies). IFRIC 7 clarifies how comparative amounts in financial statements should be restated when an entity s functional currency becomes hyperinflationary. IFRIC agreed that when hyperinflationary status is reached, an entity must restate its financial statements as though the economy had always been hyperinflationary. In addition, IFRIC 7 also provides guidance on how deferred tax items in the opening balance sheet should be restated.

In March 2006, the IFRIC issued IFRIC 9 (Reassessment of Embedded Derivatives). The interpretation addresses the timing of when a contract must be assessed to determine if an embedded derivative exists that needs to be separated and fair valued. The IFRIC concluded that the assessment has to be carried out only when the entity first enters into the contract. A subsequent reassessment is prohibited unless there is a change in terms of the contract that significantly modifies the cash flows.

Newly issued accounting standards

In July 2006, the IFRIC issued IFRIC 10 (Interim Financial Reporting and Impairment). This interpretation addresses the interaction between the requirements of IAS 34 (Interim Financial Reporting) and the recognition of impairment losses on goodwill under IAS 36 (Impairment of Assets) and investments in equity instruments as well as financial assets carried at cost under IAS 39 (Financial Instruments: Recognition and Measurement). The IFRIC concluded that where an entity has recognized an impairment loss in an interim period in respect of goodwill or an investment in either an equity instrument or a financial asset carried at cost, that impairment must not be reversed in subsequent interim financial statements or in annual financial statements. IFRIC 10 is to be applied for annual periods beginning on or after November 1, 2006. The Bayer Group does not believe that the application of this interpretation will have a material impact on the Group s financial position, results of operations or cash flows.

Notes to the Consolidated Financial Statements of the Bayer Group (Continued)

In November 2006, the IFRIC issued IFRIC 11 (IFRS 2 Group and Treasury Share Transactions). The interpretation addresses how to apply IFRS 2 (Share-based Payment) to accounting for share-based payment arrangements involving an entity s own equity instruments. It also provides guidance on whether share-based payment arrangements, in which suppliers of goods or services of an entity are provided with equity instruments of the entity s parent, should be accounted for as cash-settled or equity-settled in the entity s financial statements. IFRIC 11 is to be applied for annual periods beginning on or after March 1, 2007. The Bayer Group is currently evaluating the impact that application of the interpretation may have on the Group s financial position, results of operation or cash flows.

In November 2006, the IFRIC issued IFRIC 12 (Service Concession Arrangements). Service concessions are arrangements whereby a government or other public-sector entity grants contracts for the supply of public services such as roads, airports, prisons and energy and water supply and distribution facilities to private-sector operators. IFRIC 12 is to be applied for annual periods beginning on or after January 1, 2008. The Bayer Group does not believe that the application of this interpretation will have a material impact on the Group s financial position, results of operations or cash flows.

In August 2005, the IASB issued the new standard IFRS 7 (Financial Instruments: Disclosures), which is to be applied for annual periods beginning on or after January 1, 2007. This standard specifies the information on financial instruments that is to be provided in the notes to the financial statements. IFRS 7 provides for financial instruments to be grouped into certain categories and specific disclosures to be made for each category, including the significance of the instruments and the nature and extent of the risks associated with them. The new standard will affect the nature and modality of financial instrument disclosures in the financial statements of the Bayer Group, but not the recognition or measurement of the instruments.

[4] Basic principles of the consolidated financial statements

[4.1] Scope of consolidation and consolidation methods

The consolidated financial statements include those companies in which Bayer AG directly or indirectly has a majority of the voting rights (subsidiaries) or from which it is able to derive the greater part of the economic benefit and bears the greater part of the risk by virtue of its power to govern corporate financial and operating policies, generally through an ownership interest greater than 50 percent. Inclusion of such companies accounts in the consolidated financial statements begins when Bayer AG starts to exercise control over the company and ceases when it is no longer able to do so.

However, associates in which Bayer AG exerts significant influence, generally through an ownership interest between 20 and 50 percent, are accounted for by the equity method. The cost of acquisition of an associate is adjusted annually by the percentage of any change in its stockholders equity corresponding to Bayer s percentage interest in the company. Any goodwill arising from the first-time inclusion of companies at equity is accounted for in the same way as goodwill relating to fully consolidated companies. Bayer s share of changes in these companies stockholders equities that are recognized in their income statements including write-downs of goodwill are recognized in the Bayer Group consolidated income statement in the non-operating result. Intercompany profits and losses for these companies were not material in either 2006 or 2005. Further details of the companies included at equity in the Group financial statements are given in Note [19].

Subsidiaries that do not have a material impact on net assets or results of operations, either individually or in aggregate, are not consolidated. Further details of changes in the scope of consolidation and the individual companies consolidated are given in Note [7.1].

Capital consolidation is performed according to IAS 27 (Consolidated and Separate Financial Statements) by offsetting the net carrying amounts of subsidiaries in the balance sheet against their underlying equity as valued at the respective acquisition dates. The identifiable assets and liabilities (including contingent liabilities) of subsidiaries and joint ventures are included at their fair values in proportion to Bayer s interest. Remaining differences are recognized as goodwill.

Notes to the Consolidated Financial Statements of the Bayer Group (Continued)

Intragroup sales, profits, losses, income, expenses, receivables and payables are eliminated.

Deferred taxes are recognized for temporary differences related to consolidation entries.

Joint ventures are included by proportionate consolidation according to the same principles.

[4.2] Foreign currency translation

In the financial statements of the individual consolidated companies, foreign currency receivables and payables are translated at closing rates, irrespective of whether they are exchange-hedged. Derivative financial instruments are stated at fair value.

The majority of consolidated companies outside the euro zone are to be regarded as foreign entities since they are financially, economically and organizationally autonomous. Their functional currencies according to IAS 21 (The Effects of Changes in Foreign Exchange Rates) are thus the respective local currencies.

The assets and liabilities of foreign companies at the start and end of the year are translated at closing rates. All changes occurring during the year and all income and expense items are translated at average rates for the year. Components of stockholders equity are translated at the historical exchange rates prevailing at the respective dates of their first-time recognition in Group equity.

The differences between the resulting amounts and those obtained by translating at closing rates are reflected in other comprehensive income and stated separately in the tables in the Notes under Exchange differences on translation of operations outside the euro zone or Exchange differences. When a company is deconsolidated, exchange differences recognized in stockholders equity are removed from equity and recognized in the income statement.

Acquisition-related goodwill and remeasurement amounts arising at companies outside the euro zone are translated at the closing rate on the acquisition date.

The exchange rates for major currencies against the euro varied as follows:

		Closing rate			Average rate		
		2004	2005	2006	2004	2005	2006
			(1)			(1)	
Argentina	ARS	4.05	3.57	4.04	3.66	3.64	3.86
Brazil	BRL	3.62	2.76	2.82	3.64	3.04	2.73
U.K.	GBP	0.71	0.69	0.67	0.68	0.68	0.68
Japan	JPY	139.65	138.90	156.93	134.40	136.86	146.04
Canada	CAD	1.64	1.37	1.53	1.62	1.51	1.42
Mexico	MXN	15.23	12.59	14.27	14.04	13.58	13.69
Switzerland	CHF	1.54	1.56	1.61	1.54	1.55	1.57
U.S.A.	USD	1.36	1.18	1.32	1.24	1.24	1.26

[4.3] Basic recognition and valuation principles

Net sales and other operating income

Sales are recognized upon transfer of risk or rendering of services to third parties if it is sufficiently probable that the transaction s economic benefit to the company will actually be realized, and are reported net of sales taxes and rebates.

Where sales of products or services involve the provision of multiple elements which may contain different remuneration arrangements such as prepayments, milestone payments etc. for example research and development alliances and co-promotion agreements they are assessed to determine whether separate delivery of the individual elements of such arrangements comprises more than one unit of accounting. The delivered elements

Notes to the Consolidated Financial Statements of the Bayer Group (Continued)

are separated if (a) they have value to the customer on a stand-alone basis, (b) there is objective and reliable evidence of the fair value of the undelivered element(s) and (c) if the arrangement includes a general right of return relative to the delivered element(s), delivery or performance of the undelivered element(s) is considered probable and is substantially in the control of the company. If all three criteria are fulfilled, the appropriate revenue recognition convention is then applied to each separate accounting unit.

Allocations to provisions for rebates to customers are recognized in the period in which the related sales are recorded. These amounts are deducted from net sales. Payments relating to the sale or outlicensing of technologies or technological expertise once the respective agreements have become effective are immediately recognized in income if all rights relating to the technologies and all obligations resulting from them have been relinquished under the contract terms and Bayer has no continuing obligation to perform under the agreement. However, if rights to the technologies continue to exist or obligations resulting from them have yet to be fulfilled, the payments received are recorded in line with the actual circumstances.

Contractually agreed upfront payments and similar non-refundable payments received under these agreements are recorded as deferred revenue and recognized in income over the estimated performance period stipulated in the agreement. Non-refundable milestone payments received that are linked to the achievement of significant and substantive technological or regulatory hurdles in the research and development process, pursuant to collaborative agreements, are recognized as revenue upon the achievement of the specified milestone. Revenues such as license fees, rentals, interest income or dividends are recognized according to the same principles.

Research and development expenses

A substantial proportion of the Bayer Group s financial resources is invested in research and development. In addition to in-house research and development activities, especially in the health care business, various research and development collaborations and alliances are maintained with third parties involving the provision of funding and/or payments for the achievement of performance milestones.

For accounting purposes, research expenses are defined as costs incurred for current or planned investigations undertaken with the prospect of gaining new scientific or technical knowledge and understanding. Development expenses are defined as costs incurred for the application of research findings or specialist knowledge to production, production methods, services or goods prior to the commencement of commercial production or use.

According to IAS 38 (Intangible Assets), research costs cannot be capitalized; development costs must be capitalized if, and only if, specific, narrowly defined conditions are fulfilled. Development costs must be capitalized if it is sufficiently certain that the future economic benefits to the company will also cover the respective development costs. Since development projects are often subject to regulatory approval procedures and other uncertainties, the conditions for the capitalization of costs incurred before receipt of approvals are not normally satisfied.

With respect to costs incurred in collaborations and alliances with third parties, considerable judgment is involved in assessing whether milestone-based payments simply reflect the funding of research, in which case expensing is always required, or whether, by making a milestone payment, an asset is acquired. In the latter case, the relevant costs are capitalized.

The following costs in particular, by their very nature, constitute research and development expenses: the appropriate allocations of direct personnel and material costs and related overheads for internal or external application technology, engineering and other departments that provide the respective services; costs for experimental and pilot facilities (including depreciation of buildings or parts of buildings used for research or development purposes); costs for clinical research; regular costs for the utilization of third parties patents for research and development purposes; other taxes related to research facilities; and fees for the filing and registration of self-generated patents that are not capitalized.

Notes to the Consolidated Financial Statements of the Bayer Group (Continued)

The Bayer Group capitalizes the costs incurred in the application development phase of in-house software development. These costs are amortized over the useful life of the software from the date it is placed in service.

Goodwill and other intangible assets

Acquired intangible assets with the exception of goodwill and other assets with indefinite useful lives are recognized at cost and generally amortized by the straight-line method over a period of 3 to 30 years, depending on their estimated useful lives. Write-downs are made for impairment losses. They are written back if the reasons for the previous write-downs no longer apply. However, such write-backs must not cause the carrying amount to exceed the cost of acquisition. Amortization for 2006 has been allocated to the respective functional cost items.

Since January 1, 2005, goodwill, including that arising on acquisitions, has not been amortized. In accordance with IFRS 3 (Business Combinations) and the related revised versions of IAS 36 (Impairment of Assets) and IAS 38 (Intangible Assets), goodwill, including that arising on acquisitions, is no longer amortized, but in common with other intangible assets with indefinite useful lives tested annually for possible impairment. This is done more frequently if events or changes in circumstances indicate a possible impairment. Further details of the annual impairment test for goodwill are given in Note [4.5].

Property, plant and equipment

Property, plant and equipment is carried at the cost of acquisition or construction and where subject to depletion depreciated over its estimated useful life or written down if its value falls below its net carrying amount (impairment loss).

The cost of acquisition comprises the acquisition price, ancillary costs and subsequent acquisition costs less any reduction received on the acquisition price. Where an obligation exists to dismantle or remove the asset or restore a site to its former condition at the end of the asset s useful life, the estimated cost of such dismantlement, removal or restoration is added to the asset s cost of acquisition and a corresponding provision is recognized. The cost of self-constructed property, plant and equipment comprises the direct cost of materials, direct manufacturing expenses, appropriate allocations of material and manufacturing overheads.

If the construction phase of property, plant or equipment extends over a long period, the interest incurred on borrowed capital up to the date of completion is capitalized as part of the cost of acquisition or construction in accordance with IAS 23 (Borrowing Costs).

Expenses for the repair of property, plant and equipment, such as ongoing maintenance costs, are normally charged to income. The cost of acquisition or construction is capitalized retroactively if the expenses related to the asset will result in future economic benefits.

Property, plant and equipment is depreciated by the straight-line method, except where depreciation based on actual depletion is more appropriate. Depreciation for the year is allocated to the respective functional cost items.

If an asset s value falls below its net carrying amount, the latter is reduced accordingly. In compliance with IAS 36 (Impairment of Assets), such impairment losses are measured by comparing the carrying amounts to the discounted cash flows expected to be generated by the respective assets. They are written back if the reasons for the previous write-downs no longer apply. However, such write-backs must not cause the carrying amount to exceed the cost of acquisition. Further details of impairment testing procedures are given in Note [4.5].

When assets are sold, closed down, or scrapped, the difference between the net proceeds and the net carrying amount of the assets is recognized as a gain or loss in other operating income or expenses, respectively.

Notes to the Consolidated Financial Statements of the Bayer Group (Continued)

The following depreciation periods, based on the estimated useful lives of the respective assets, are applied throughout the Group:

Buildings	20 to 50 years
Outdoor infrastructure	10 to 20 years
Plant installations	6 to 20 years
Machinery and equipment	6 to 12 years
Laboratory and research facilities	3 to 5 years
Storage tanks and pipelines	10 to 20 years
Vehicles	4 to 8 years
Computer equipment	3 to 5 years
Furniture and fixtures	4 to 10 years

In accordance with IAS 17 (Leases), assets leased on terms equivalent to financing a purchase by a long-term loan (finance leases) are capitalized at the lower of their fair value or the present value of the minimum lease payments at the date of addition. The leased assets are depreciated over their estimated useful lives except where subsequent transfer of title is uncertain, in which case they are depreciated over their estimated useful lives or the respective lease terms, whichever are shorter.

Financial assets

Financial assets comprise receivables, acquired equity and debt instruments, cash and cash equivalents and derivative financial instruments with positive fair values.

They are classified as financial assets and accounted for in compliance with IAS 39 (Financial Instruments: Recognition and Measurement), which specifies that financial assets must be recognized in the consolidated financial statements if the Bayer Group has a contractual right to receive cash or another financial asset from another entity. Regular way purchases and sales of financial assets are posted on the settlement date. Financial assets are initially recognized at fair value plus transaction costs. The transaction costs incurred for the purchase of financial assets held at fair value through profit or loss are expensed immediately. Interest-free or low-interest receivables are initially reflected at the net present value of the expected future cash flows. For purposes of subsequent measurement, financial assets are allocated to the following categories:

Financial assets held at fair value through profit or loss comprise those financial assets that are held for trading. This category comprises receivables from forward commodity contracts and receivables from other derivative financial instruments, which are included in other financial assets, except where hedge accounting is used. Changes in the fair value of financial assets in this category are recognized in the income statement when the increase or decrease in value occurs.

Loans and receivables are non-derivative financial assets that are not quoted in an active market. They are carried at amortized cost. This category comprises trade accounts receivable, the financial receivables and loans included in other financial assets, the additional financial receivables and loans reflected in miscellaneous receivables, and cash and cash equivalents. Interest income from items assigned to this category is determined using the effective interest method, insofar as such items are not classified as current receivables and the effect of discounting interest is not material.

Held-to-maturity financial assets are non-derivative financial assets, with fixed or determinable payments, that are to be held for a fixed period of time. They are accounted for at amortized cost using the effective interest method. Held-to-maturity financial investments are recognized in other financial assets.

Available-for-sale financial assets are those non-derivative financial assets that are not assigned to any of the above categories. In particular, they comprise equity instruments recognized at fair value and debt instruments not to be held to maturity, which are included in other financial assets. Changes in the fair

Notes to the Consolidated Financial Statements of the Bayer Group (Continued)

value of available-for-sale financial assets are recognized in stockholders equity and not released to the income statement until the assets are sold or impaired. Where possible, a fair value for equity and debt securities is derived from market data. Financial assets for which no market price is available and whose fair value cannot be reliably estimated are carried at amortized cost.

If there are substantial, objective indications that loans and receivables, held-to-maturity financial assets or available-for-sale financial assets are impaired, their carrying amount is compared to the present value of the expected future cash flows, discounted by the current market rate of return on a comparable financial asset. If an impairment is confirmed, they are written down by the difference between the two amounts. Indications of impairment include the fact that a company has been making an operating loss for several years, a reduction in market value, a significant deterioration in credit standing, material breach of contract, a high probability of insolvency or other financial restructuring of the debtor, or the disappearance of an active market for the asset.

Previous write-downs are written back if the reasons for them no longer apply. However, such write-backs must not cause the carrying amount to exceed the cost of acquisition. No write-backs are made for available-for-sale equity instruments.

Financial assets are derecognized when the contractual rights to receive the cash flows from the financial assets expire or the financial assets are transferred, together with all material risks and benefits.

The management of financial and commodity price risks and, in particular, the accounting treatment of derivative financial instruments and hedging relationships involving them, are explained in more detail in Note [30].

Inventories

In accordance with IAS 2 (Inventories), inventories encompass assets (finished goods and goods purchased for resale) that are held for sale in the ordinary course of business, that are in the process of production for such sale (work in process) or that take the form of materials or supplies to be consumed in the production process or in the rendering of services (raw materials and supplies). Inventories are recognized at the lower of acquisition or production cost calculated by the weighted-average method and fair value less costs to sell, which is the realizable sale proceeds under normal business conditions less estimated production costs and selling expenses.

Taxes

Income taxes comprise all taxes levied on the Group s taxable income. The remaining taxes, such as property, electricity and other energy taxes, are included in the cost of goods sold or in selling, research and development or general administration expenses.

In compliance with IAS 12 (Income Taxes), deferred taxes are calculated for temporary differences between the carrying amounts of assets and liabilities in the IFRS balance sheet and the balance sheet drawn up for tax purposes, for consolidation measures, and for tax loss carryforwards likely to be realizable.

Deferred tax assets relating to deductible temporary differences and tax loss carryforwards are recognized to the extent that it is sufficiently probable that taxable income will be available in the future to enable the tax loss carryforwards to be utilized.

Deferred taxes are calculated at the rates which on the basis of the statutory regulations in force, or already enacted in relation to future periods, as of the closing date are expected to apply in the individual countries at the time of realization. Where legally permitted, deferred tax assets and deferred tax liabilities are offset if they relate to income taxes levied by the same taxation authority.

Provisions

Provisions are recognized for obligations arising from past events that will probably give rise to a future outflow of resources, provided that a reliable estimate can be made of the amount of the obligation.

Notes to the Consolidated Financial Statements of the Bayer Group (Continued)

The accounting and valuation principles for pension and other post-employment benefit obligations are outlined in Note [25].

Other provisions are measured in accordance with IAS 37 (Provisions, Contingent Liabilities and Contingent Assets) and, where appropriate, IAS 19 (Employee Benefits), using the best estimate of the extent of the expenditure that would be required to meet the present obligation as of the reporting date. Where the cash outflow to settle an obligation is not expected to occur until after one year, the provision is recognized at the present value of the expected cash outflow. Reimbursement receivables from third parties are capitalized separately if their realization is virtually certain.

If the projected obligation declines as a result of a change in the estimate, the provision is reversed by the corresponding amount and the resulting income recognized in the operating expense item(s) in which the original charge was recognized.

Personnel commitments mainly include annual bonus payments, vacation entitlements, service awards and other personnel costs. Reimbursements to be received from the German authorities under the senior part-time work program are recorded as receivables and recognized in income as soon as the criteria for such reimbursements are fulfilled. Sales-related commitments mainly relate to the granting of rebates or discounts, acceptance of product returns, and obligations regarding services already received but not yet invoiced.

Litigation and administrative proceedings are evaluated on a case-by-case basis considering the available information, including that from legal counsel, to assess potential outcomes. Where it is considered probable that a future obligation will result in an outflow of resources, a provision is recorded in the amount of the present value of the expected cash outflows if these can be reliably estimated. These provisions cover the estimated payments to plaintiffs, court fees, attorney costs and the cost of potential settlements. Further details of legal risks are given in Note [32].

Financial liabilities

Financial liabilities comprise primary financial liabilities and negative fair values of derivative financial instruments.

Primary financial liabilities are recognized in the balance sheet if the Bayer Group has a contractual obligation to transfer cash or other financial assets to another party. Initial recognition is at the fair value of the consideration received or the value of payments received less any transaction costs. In subsequent periods, primary financial liabilities are measured at amortized cost using the effective interest method. Liabilities relating to finance leases are carried at the present value of the minimum future lease payments.

Derivative financial instruments are carried at fair value through profit or loss unless hedge accounting is used. Negative fair values of derivative financial instruments are included in financial liabilities or other liabilities.

Financial liabilities are derecognized when the contractual obligation is discharged, canceled or expires.

The management of financial and commodity price risks and, in particular, the accounting treatment of derivative financial instruments and hedging relationships involving them, are explained in more detail in Note [30].

Under IAS 32 (Financial Instruments: Presentation), financial instruments are only classified as equity if no contractual obligation exists to repay the capital or deliver other financial assets to the issuer. Where a third party holding a (minority) interest in a consolidated subsidiary is contractually entitled to terminate its participation and at the same time claim repayment of its capital contribution, such capital is recognized as a liability in the Group statements even if it is classified as equity in the respective jurisdiction. The redeemable capital of a minority stockholder is recognized at the amount of such stockholder s pro-rata share of the subsidiary s net assets.

Notes to the Consolidated Financial Statements of the Bayer Group (Continued)

Other receivables and liabilities

Accrued items, advance payments and non-financial assets and liabilities are carried at amortized cost. They are amortized to income by the straight-line method or according to performance of the underlying transaction.

In accordance with IAS 20 (Accounting for Government Grants and Disclosure of Government Assistance), grants and subsidies that serve to promote investment are reflected in the balance sheet under other liabilities and amortized to income over the useful lives of the respective assets.

[4.4] Cash flow statement

The cash flow statement shows how the liquidity of the Bayer Group was affected by the inflow and outflow of cash and cash equivalents during the year. The effects of changes in the scope of consolidation are eliminated. Cash flows are classified by operating, investing and financing activities in accordance with IAS 7 (Cash Flow Statements). The cash and cash equivalents shown in the balance sheet comprise cash, checks, balances with banks and securities with original maturities of up to three months.

The amounts reported by consolidated companies outside the euro zone are translated at average exchange rates for the year, with the exception of cash and cash equivalents, which are translated at closing rates as in the balance sheet. The effect of changes in exchange rates on cash and cash equivalents is shown separately.

Cash and cash equivalents contain the proceeds from the divestiture of discontinued operations and cash inflows from these operations prior to divestiture. In principle, therefore, the statement of cash flows must account for all cash inflows and outflows for both continuing and discontinued operations. However, IFRS 5 (Non-current Assets Held for Sale and Discontinued Operations) specifies that cash flows from operating, investing and financing activities be classified by continuing and discontinued operations. The discontinued operations shares of the cash flows from operating, investing and financing activities are stated separately in Note [7.2].

In both the balance sheet and the income statement, however, the amounts corresponding to the components of the net operating cash flow are shown for continuing operations only. This is the case, for example, with the amounts of inventories, receivables and payables recognized in the balance sheet that determine the changes in working capital shown in the cash flow statement. The income after taxes from continuing operations that is recognized in the income statement forms the starting-point for the cash flow statement. To ensure that the presentation of operating activities in the cash flow statement is consistent with the income statement and balance sheet, the net operating cash flow from continuing operations is therefore stated first on the face of the cash flow statement. The total net operating cash flow from discontinued operations is shown in the next line, by analogy with the presentation of income after taxes in the income statement. The cash flows from continuing and discontinued operations are added together to give the net operating cash flow for the entire business.

[4.5] Procedure used in global impairment testing and its impact

In accordance with IFRS 3 (Business Combinations) and the related revised versions of IAS 36 (Impairment of Assets) and IAS 38 (Intangible Assets), goodwill and other intangible assets with indefinite useful lives are no longer amortized but tested regularly for impairment.

Where goodwill or other indefinite-lived intangible assets allocated to a cash-generating unit are not likely to generate identifiable future economic benefits independently of other assets, they must be tested for impairment annually, or more frequently if events or changes in circumstances indicate a possible impairment. This involves comparing the residual carrying amount of each cash-generating unit to the recoverable amount, which is the higher of the cash-generating unit s fair value less costs to sell and its value in use. In the Bayer Group, the strategic business entities the financial reporting levels below the segments are defined as the cash-generating units.

Where the carrying amount of a cash-generating unit exceeds the recoverable amount, an impairment loss is recognized for the difference. First, the goodwill of the relevant strategic business entity is written down

Notes to the Consolidated Financial Statements of the Bayer Group (Continued)

accordingly. Any remaining impairment loss is allocated among the other assets of the strategic business entity in proportion to their net carrying amounts. This value adjustment is recognized in the income statement under other operating expenses.

The recoverable amount is determined from the present value of future cash flows, based on continuing use of the asset by the strategic business entity and its retirement at the end of its useful life. The cash flow forecasts are derived from the current long-term planning for the Bayer Group.

Bayer calculates the total cost of capital on the basis of the debt/equity ratio using the weighted average cost of capital (WACC) formula. The cost of equity corresponds to the return expected by stockholders, while the cost of debt is based on the conditions on which the company can obtain long-term financing. Both components are derived from capital market information.

To allow for the different risk and return profiles of the principal businesses, the after-tax cost of capital is calculated separately for each of the subgroups. The discount rates used are 7.6 percent (2005: 7.4 percent) for HealthCare, 7.9 percent (2005: 8.0 percent) for CropScience and 7.3 percent (2005: 7.0 percent) for MaterialScience.

[5] Critical accounting policies

The preparation of the financial statements for the Bayer Group requires the use of estimates and assumptions. These affect the classification and valuation of assets, liabilities, income, expenses and contingent liabilities. Estimates and assumptions mainly relate to the useful life of noncurrent assets, the discounted cash flows used in impairment testing and the establishment of provisions for litigation, pensions and other benefits, taxes, environmental protection, inventory valuations, sales allowances, product liability and guarantees. Estimates are based on historical experience and other assumptions that are considered reasonable under the circumstances. Actual values may vary from the estimates. The estimates and the assumptions are continually reviewed.

To enhance the information content of the estimates, certain provisions that could have a material effect on the financial position and results of operations of the Group are selected and tested for their sensitivity to changes in the underlying parameters. To reflect uncertainty about the likelihood of the assumed events actually occurring, the impact of a 5 percent change in the probability of occurrence is examined in each case. For long-term interest-bearing provisions, the impact of a 1 percent change in the interest rate used is analyzed. Analysis has not shown other provisions to be materially sensitive. The interest sensitivity of pension obligations is discussed in Note [25].

Critical accounting and valuation policies and methods are those that are both most important to the portrayal of the Bayer Group s financial position, results of operations and cash flows, and that require the application of difficult, subjective and complex judgments, often as a result of the need to make estimates about the effects of matters that are inherently uncertain and may change in subsequent periods. The critical accounting policies that we disclose will not necessarily result in material changes to our financial statements in any given period but rather contain a potential for material change. The main accounting and valuation policies used by the Bayer Group are outlined in Note [4.3]. While not all of the significant accounting policies require difficult, subjective or complex judgments, the Company considers that the following accounting policies should be considered critical accounting policies.

Intangible assets and property, plant and equipment

As discussed in Notes [17] and [18] at December 31, 2006 the Bayer Group had intangible assets with a net carrying amount of 24,034 million including goodwill of 8,227 million, and property, plant and equipment with a net carrying amount of 8,867 million. Intangible assets with finite useful lives and property, plant and equipment are amortized over their estimated useful lives. The estimated useful lives are based on estimates of the period during which the assets will generate revenue.

Notes to the Consolidated Financial Statements of the Bayer Group (Continued)

Intangible assets with finite useful lives and property, plant and equipment are tested for impairment whenever events or changes in circumstances indicate that the carrying amount of the assets may no longer be recoverable. Goodwill and intangible assets with indefinite useful lives must be tested annually for impairment. In compliance with IAS 36 (Impairment of Assets), impairment losses are measured by comparing the carrying amounts to the discounted cash flows expected to be generated by the respective assets. Where it is not possible to estimate the impairment loss for an individual asset, the loss is assessed on the basis of the discounted cash flow for the cash-generating unit to which the asset belongs. Estimating the discounted future cash flows involves significant assumptions, especially regarding future sales prices, sales volumes and costs. The discounting process is also based on assumptions and estimations relating to business-specific costs of capital, which in turn are based on country risks, credit risks as well as additional risks resulting from the volatility of the respective line of business. The present value of future cash flows measures an asset s value based on our continuing use of the asset and its retirement at the end of its useful life. Further information on the procedure for impairment testing and the residual carrying amounts of goodwill at the balance sheet date is presented in Note [4.5] and Note [17].

To illustrate the Bayer Group s impairment loss measurement on a segment level, if the actual present value of future cash flows were 10 percent lower than the anticipated present value, the net carrying amount of goodwill in the Crop Protection segment would have to be impaired by 146 million. In the Systems segment, the net carrying amounts would have to be impaired by 42 million. We have focused our analysis on the Crop Protection and Systems segments because we believe that these are the only of our segments where impairments of goodwill and other intangibles under the assumptions described above are reasonably likely to have a material adverse effect on the results of operations of the respective segments. If the weighted average cost of capital used for the impairment test were increased by 10 percent, assets of the Crop Protection and Systems segment would have to be impaired by 85 million or 34 million, respectively. In quantifying our sensitivity analysis, we modeled a 10 percent decline as a negative change up to this magnitude is in our view reasonably likely. We do not now believe that greater changes are reasonably likely given our experiences in the Crop Protection and System segments.

Applying these policies, we recognized impairment charges in each of the years 2006, 2005 and 2004. The following table sets forth these charges based on their allocation to our continuing businesses and our discontinued operations.

	2004	2005	2006
		(million)	
Impairment charges (continuing businesses)	26	77	172
Impairment charges (discontinued operations)	63		18
Total impairment charges	89	77	190

In 2004 and 2005, we recognized impairment charges largely as a result of our decisions to close or relocate several facilities and sites within our continuing businesses as part of our strategic reorientation and focus on our core businesses.

The impairment charges within discontinued operations 2004 related to the sale of our plasma business (24 million in 2004) and the spin-off of the former LANXESS segment (39 million in 2004). We recorded an additional 24 million impairment charge related to this business in 2004 based on price negotiations with the purchaser. We updated our cash flow assumptions for the LANXESS businesses as a result of sustained pressure on its margins resulting from adverse foreign exchange rates, ongoing consolidation in customers in the industries LANXESS served, overcapacities in certain market segments and an increase in competition, particularly from Asian suppliers. We recognized an additional 39 million in impairment charges for the spun off LANXESS businesses in 2004 due to further revisions of the economic assumptions within the strategic business entities Performance Chemicals,

Engineering Plastics and Chemical Intermediates.

Notes to the Consolidated Financial Statements of the Bayer Group (Continued)

Impairment charges and write-downs on tangible assets in 2005 originated especially from our decision to shut down or to relocate different production facilities and sites in the United States in our continuing businesses (33 million). Also, in 2005 capitalized marketing rights for our product, Viadur®, were impaired by 15 million. We revised this estimate in 2006 and wrote off the remaining intangible asset of 19 million.

Impairment charges and write-downs in 2006 were predominantly due to further restructurings of our sites in the United States (14 million), partly related to acquisitions, as well as changes in plans for the expansion of our chlorine alkali facilities in Baytown, Texas (31 million). In addition, restructuring efforts pursued in the year 2006 within the Bayer CropScience subgroup and the Bayer Industrial Services GmbH & Co. OHG resulted in impairment charges and write-downs on tangible assets of 19 million and 30 million, respectively. In 2006 the capitalized costs of an acquired development project for the product alfimeprase within the Bayer HealthCare subgroup were impaired by 41 million. Within discontinued operations an impairment charge was recognized within the H.C. Starck group for its Battery business in Canada (17 million).

Although we believe that our estimates of the relevant expected useful lives, our assumptions concerning the macroeconomic environment and developments in the industries in which the Bayer Group operates, and our estimations of the discounted future cash flows, are appropriate, changes in assumptions or circumstances could require changes in the analysis. This could lead to additional impairment charges in the future or to valuation write-backs should the trends expected reverse.

Research and development

In addition to the in-house research and development activities, various research and development collaborations and alliances are maintained with third parties. These collaborations and alliances involve provision of funding and/or payments for the achievement of performance milestones. All research costs are expensed as incurred. Since development projects are subject to regulatory approval procedures and other uncertainties, the conditions for the capitalization of development costs incurred with respect to in-house research and development activities before receipt of regulatory approvals are not satisfied, and these costs are also expensed as incurred. With respect to costs incurred in collaborations and alliances with third parties, under IAS 38 (revised), which entered into effect on January 1, 2005, milestone payments relating to acquired assets in development must be capitalized to the extent that they are related to the acquisition of the related technology rights, even if uncertainties exist as to whether the research and development will ultimately be successful in producing a saleable product. If research and development collaborations are embedded in contracts for a strategic alliance, considerable judgment is involved in determining whether milestone-based payments reflect the funding of research and development or if they are related to the acquisition of an underlying compound or other rights. Factors considered in reaching this determination are (a) the nature of the payment, for example whether it is related to regulatory approval, a sales target or outsourced research and development activities, and (b) the relative fair values of the planned research and development activities compared to the total value of the payment.

Net sales

We recognize revenue for product sales and the rendering of services when:

the significant risks and rewards of ownership of the goods are transferred to the customer,

the company retains neither continuing managerial involvement to the degree usually associated with ownership nor effective control over the goods sold,

the amount of revenue and costs incurred or to be incurred can be measured reliably, and

it is probable that the economic benefits associated with the transaction will flow to the company.

At the time revenue is recognized, we also record estimates for revenue deductions including cash discounts, rebates and product returns. Also, we record revenues net of items we collect on behalf of third parties, such as

Notes to the Consolidated Financial Statements of the Bayer Group (Continued)

sales taxes and goods and service taxes. We report our net sales after deducting all sales deductions from our gross revenue.

The majority of our sales deductions are subject to formula-based determination using factors such as a fixed percentage of the sales volume or gross sales proceeds. Accordingly, estimates related to sales deductions are predominantly based on historical experience, specific contractual terms and future expectations of our sales development in each of our business segments. We believe that assumptions other than those that we discuss are not reasonably likely to occur or not applicable to our business. We estimate the potential for future variability in provisions for anticipated sales deductions to be insignificant with respect to our reported operating results. We have not made adjustments to our provisions for rebates, cash discounts or returns for sales made in prior periods that were material in relation to our income before income taxes in any of the periods covered by the financial statements included in this annual report.

Provisions for rebates were 1.6 percent of our total net sales in 2006 (2005: 1.4 percent; 2004: 1.5 percent). In addition to rebates, we offer cash discounts for prompt payment in some countries. Our provisions for cash discounts were less than 0.1 percent of total net sales as of December 31, 2006, 2005 and 2004.

We deduct provisions for returned defective goods or related to contractual arrangements to return saleable products on the date of sale or at the time when the amount of future returns can be reasonably estimated. If future product returns cannot be reasonably estimated and are significant to the sale transaction, both the recognition of revenues and of the related cost of sales are deferred until an estimate may reasonably be made or when the right to return the goods has expired. Provisions for product returns were 0.1 percent of total net sales in 2006 (2005: 0.3 percent; 2004: 0.3 percent).

Some of the Bayer Group s revenues are generated from licensing agreements under which third parties are granted rights to certain of our products and technologies. Upfront payments and similar non-refundable payments received under these agreements are recorded as other liabilities and recognized in income over the estimated performance period stipulated in the agreement. Milestone payments linked to the achievement of a significant and substantive technical/regulatory hurdle in the research and development process, pursuant to collaborative agreements, are recognized as revenue upon the achievement of the specified milestone. Revenues are also derived from research and development collaborations and co-promotion agreements. Such agreements may consist of multiple elements and provide for varying consideration terms, such as upfront, milestone and similar payments, which may be complex and require significant analysis by management in order to separate individual revenue components and recognize them on the most appropriate dates. This may have to be done partially on the basis of assumptions.

Pensions and other post-employment benefits

Group companies provide retirement benefits for most of their employees, either directly or by contributing to independently-administered funds. The way these benefits are provided varies according to the legal, fiscal and economic conditions of each country, the benefits generally being based on the employees remuneration and years of service. The obligations relate both to existing retirees pensions and to pension entitlements of future retirees. Group companies provide retirement benefits under defined contribution and/or defined benefit plans. In the case of defined contribution plans, the company pays contributions to publicly or privately administered pension insurance plans on a mandatory, contractual or voluntary basis. Once the contributions have been paid, the company has no further payment obligations. All other retirement benefit systems are defined benefit plans, which may be either unfunded, *i.e.*, financed by provisions (accruals), or funded, *i.e.*, financed through pension funds. Statistical and actuarial methods are used to anticipate future events in calculating the expenses and liabilities related to the plans. These calculations include assumptions about the discount rate, expected return on plan assets and rate of future compensation increases.

The interest rate used to discount post-employment benefit obligations to present value is derived from the yields of senior, high-quality corporate bonds in the respective country at the balance sheet date. These generally include AA-rated securities. The discount rate is based on the yield of a portfolio of bonds whose weighted

Notes to the Consolidated Financial Statements of the Bayer Group (Continued)

residual maturities approximately correspond to the duration necessary to cover the entire benefit obligation. If AA-rated corporate bonds of equal duration are not available, a discount rate equivalent to the effective interest rate for government bonds at the balance sheet date is used instead but increased by about 0.5 to 1.0 percentage point since corporate bonds generally provide higher yields by virtue of their risk structure.

Determination of the discount rate is also based on a bond portfolio corresponding to the expected cash outflows from the pension plans. The average return of this bond portfolio serves as benchmark when determining the discount rate.

The assumption for the expected return-on-assets reflects a long-term global capital market return that corresponds to the duration of the pension obligation, and a diversified investment strategy. The investment policy of Bayer Pensionskasse is geared toward regulatory compliance and toward maintaining the risk structure corresponding to the benefit obligations. To this end, Bayer Pensionskasse has developed a strategic target portfolio commensurate with the risk profile. This investment strategy focuses principally on stringent management of downside risks rather than on maximizing absolute returns. In other countries, too, the key criteria for the funds investment strategies are the structure of the benefit obligations and the risk profile. Other determinants are risk diversification, portfolio efficiency and a country-specific and global risk/return profile capable of ensuring payment of all future benefits. The expected return is applied to the fair market value of plan assets at each year end.

Statistical information such as withdrawal and mortality rates is also used in estimating the expenses and liabilities under the plans. Because of changing market and economic conditions, the expenses and liabilities actually arising under the plans in the future may differ materially from the estimates made on the basis of these actuarial assumptions. The plan assets are partially comprised of equity and fixed-income instruments. Therefore, declining returns on equity markets and markets for fixed-income instruments could necessitate additional contributions to the plans in order to cover future pension obligations. Also, higher or lower withdrawal rates or longer or shorter life of participants may have an impact on the amount of pension income or expense recorded in the future.

On December 31, 2006, the present value of our defined benefit obligations for pensions and other post-employment benefits payable under defined benefit plans was 16,708 million. Note [25] contains an analysis of the sensitivities of our defined benefit obligation to a 0.5 percent increase or decrease in any of our discount rate, projected remuneration increases and projected future benefit increases and the effects on our results of operations in which these changes would result. It also sets forth the changes in our accumulated actuarial losses related to changes in these actuarial parameters.

Environmental provisions

The business of the Bayer Group is subject to a variety of laws and regulations in the jurisdictions in which it operates or maintains properties. Provisions for expenses that may be incurred in complying with such laws and regulations are set aside if environmental inquiries or remediation measures are probable, the costs can be reliably estimated and no future benefits are expected from such measures. Our provisions for environmental protection measures amounted to 262 million on December 31, 2006 and 279 million on December 31, 2005.

It is difficult to estimate the future costs of environmental protection and remediation because of many uncertainties, particularly with regard to the status of laws, regulations and the information available about conditions in the various countries and at the individual sites. Significant factors in estimating the costs include previous experiences in similar cases, the conclusions in expert opinions we obtain regarding our environmental programs, current costs and new developments affecting costs, management s interpretation of current environmental laws and regulations, the number and financial position of third parties that may become obligated to participate in any remediation costs on the basis of joint liability, and the remediation methods which are likely to be deployed. Changes in these assumptions could impact future reported results. Subject to these factors, but taking into consideration experience gained to date regarding environmental matters of a similar nature, we

Notes to the Consolidated Financial Statements of the Bayer Group (Continued)

believe our provisions to be adequate based upon currently available information. There were no significant changes in our assumptions or estimates that impacted our statements of income in 2004, 2005 or 2006.

However, given the inherent difficulties in estimating liabilities in the businesses in which we operate, especially those for which the risk of environmental damage is relatively greater (CropScience and MaterialScience), it remains possible that material additional costs will be incurred beyond the amounts accrued. It is possible that final resolution of these matters may require expenditures to be made in excess of established provisions, over an extended period of time and in a range of amounts that cannot be reasonably estimated. Management nevertheless believes that such additional amounts, if any, would not have a material adverse effect on the Group s financial position or results of operations. Further information on environmental provisions can be found in Note [26.2].

Litigation provisions

As a global company with a diverse business portfolio, the Bayer Group is exposed to numerous legal risks, particularly in the areas of product liability, patent disputes, tax assessments, competition and antitrust law, and environmental matters. The outcome of the currently pending and future proceedings cannot be predicted with certainty. Thus, an adverse decision in a lawsuit could result in additional costs that are not covered, either wholly or partially, under insurance policies and that could significantly impact the business and results of operations of the Bayer Group. If the Bayer Group loses a case in which it seeks to enforce its patent rights, a decrease in future earnings could result as other manufacturers could be permitted to begin to market products that the Bayer Group or its predecessors had developed.

Litigation and other judicial proceedings as a rule raise difficult and complex legal issues and are subject to many uncertainties and complexities including, but not limited to, the facts and circumstances of each particular case, issues regarding the jurisdiction in which each suit is brought and differences in applicable law. Upon resolution of any pending legal matter, the Bayer Group may be forced to incur charges in excess of the presently established provisions and related insurance coverage. It is possible that the financial position, results of operations or cash flows of the Bayer Group could be materially affected by the unfavorable outcome of litigation. Litigation and administrative proceedings are evaluated on a case-by-case basis considering the available information, including that from legal counsel, to assess potential outcomes. Where it is considered probable that a future obligation will result in an outflow of resources, a provision is recorded in the amount of the present value of the expected cash outflows if these are deemed to be reliably measurable. These provisions cover the estimated payments to plaintiffs, court fees, attorney costs and the cost of potential settlements. We have in the past adjusted existing provisions as proceedings have continued, been settled or otherwise provided further information on which we could review the likelihood of outflows of resources and their measurability, and we expect to continue to do so in future periods.

During 2004, we recorded the following litigation related charges: 83 million in respect of fines paid in antitrust proceedings for rubber and urethane products, 47 million with respect to the Lipobay/ Baycol proceedings and 16 million with respect to the Phenylpropanolamine (PPA) proceedings.

During 2005, we had operating charges based on our expected payments totaling 336 million related to our rubber-and urethane-related antitrust proceedings, as well as charges in respect of our Lipobay/ Baycol proceedings (43 million) and our PPA proceedings (62 million).

Provisions for litigation-related expenses totaled 434 million on December 31, 2006. During 2006, we recorded 135 million other operating expenses on the basis of expected payments, which mainly relate to proceedings in connection with Lipobay/ Baycol (35 million), to patent infringement (24 million) and to proceedings in connection with former rubber product lines (51 million). Further details on legal risks and the related effects on our results of operations are contained in Note [41] as well as in Note [32].

Notes to the Consolidated Financial Statements of the Bayer Group (Continued)

Income taxes

To compute provisions for taxes, estimates have to be made. Estimates are also necessary to determine whether valuation allowances are required against deferred tax assets. These involve assessing the probabilities that deferred tax assets resulting from deductible temporary differences and tax losses can be utilized to offset taxable income.

Uncertainties exist with respect to the interpretation of complex tax regulations and the amount and timing of future taxable income. Given the wide range of international business relationships and the long-term nature and complexity of existing contractual agreements, differences arising between the actual results and the assumptions made, or future changes to such assumptions, could necessitate adjustments to tax income and expense in future periods. The Group establishes what it believes to be reasonable provisions for possible consequences of audits by the tax authorities of the respective countries. The amount of such provisions is based on various factors, such as experience with previous tax audits and differing interpretations of tax regulations by the taxable entity and the responsible tax authority. Such differences of interpretation may arise on a wide variety of issues depending on the conditions prevailing in the respective Group company s domicile. On December 31, 2006, net liabilities for current tax payments amounted to 908 million, and net deferred tax liabilities amounted to 3,141 million. We reversed provisions in our U.S. subsidiary totaling 104 million in 2005 that related to tax positions taken in periods that were closed with the Internal Revenue Service.

Further information on income taxes is provided in Note [14].

Acquisition accounting

We account for the acquired businesses using the purchase method of accounting which requires that the assets acquired and liabilities assumed be recorded at the date of acquisition at their respective fair values. The application of the purchase method requires certain estimates and assumptions especially concerning the determination of the fair values of the acquired intangible assets and property, plant and equipment as well as the liabilities assumed at the date of the acquisition. Moreover the useful lives of the acquired tangible and intangible assets have to be determined. The judgments made in the context of the purchase price allocation can materially impact our future results of operations. Accordingly, for significant acquisitions, we obtain assistance from third party valuation specialists. The valuations are based on information available at the acquisition date.

Significant judgments and assumptions made regarding the purchase price allocation in the course of the acquisition of Schering AG, Berlin, Germany included the following:

For intangible assets associated with products, product related technology, and qualified in-process research and development (IPR&D) we base our valuation on the expected future cash flows using the Multi-Period Excess Earnings approach. This method employs a discounted cash flow analysis using the present value of the estimated after-tax cash flows expected to be generated from the purchased intangible asset using risk adjusted discount rates and revenue forecasts as appropriate. The period of expected cash flows was based on the individual patent protection, taking into account the term of the product s main patent protection and essential extension of patent protection, as well as market entry of generics, considering sales, volume, prices, potential defense strategies and market development at patent expiry.

For the valuation of brands the Relief-from-Royalty method was applied which includes estimating the cost savings that result from the company s ownership of trademarks and licenses on which it does not have to pay royalties to a licensor. The intangible asset is then recognized at the present value of these savings. The brand-specific royalty rates were calculated using a product-specific scoring model. The corporate brands Schering and Medrad were assumed to have an unlimited life. (Please note that the rights to the name Schering in the United States and Canada do not belong to us but to Schering-Plough Corporation, New Jersey. Schering-Plough Corporation 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.) Product brands, however, were assumed to have limited lives depending on the respective products

Notes to the Consolidated Financial Statements of the Bayer Group (Continued)

life cycles. The expected amortization of these assets is determined on the basis of expected product-specific revenues.

The net carrying amount of acquired intangible assets after a step-up of 11,745 million resulting from the purchase price allocation was 12,042 million, as of June 23, 2006. This figure includes 1,191 million for IPR&D which relates to new compounds development as well as new versions of existing drugs. The valuation of acquired intangible assets is to a great extent based on anticipated cash flows. Nevertheless it is not impossible that actual outcomes vary significantly from such estimated future cash flows. In particular, the estimation of discounted cash flows of intangible assets under development and developed technologies is subject to highly sensitive assumptions, which are closely related to the nature of our pharmaceutical activities and whose changes may have material consequences such as:

Outcome of research and development activities regarding compound efficacy, results of clinical trails, etc.;

Probability of obtaining regulatory approval in several countries;

Long-term sales forecast;

Anticipation of selling price erosion rates after the end of patent protection due to generic competition in the market;

Behavior of competitors (launch of competing products, marketing initiatives, etc.).

Measures pursued in the course of restructuring efforts such as the closing of facilities or changes in the planned use of buildings, machinery or equipment may result in shortened useful lives or impairments.

For land acquired in general the comparison approach was based on the fair market values of properties situated in locations similar to those of the acquired properties and utilized for similar purposes. Unitary land values were derived from public or official sources and expert appraisals such as those made by advisory committees, contained in market reports or produced by local real estate agents. For buildings that could be leased, the income approach was predominantly applied, discounting projected rental charges.

For technical equipment and machinery as well as for other equipment the indirect cost approach was applied, utilizing replacement costs. These costs are depreciated on a straight-line basis over the assets economic useful life according to an age analysis. Utilization and condition of the related technical equipment and machinery were reflected by adjustments and deduction for obsolescence.

The valuation of the patented finished goods on stock at date of acquisition and work in process was based on the corresponding selling price less estimated costs of completion or estimated costs to make the sale.

The excess of the purchase price for Schering over the estimated fair values of the net assets acquired is recorded as goodwill amounting to 5,771 million, as of June 23, 2006. The step-ups have lead to an according deferred tax liability of 4,546 million, as of June 23, 2006, which will be amortized analogously to the amortization of the respective assets.

[6] Segment reporting

In accordance with IAS 14 (Segment Reporting), a breakdown of certain data in the financial statements is given by segment and geographical region. The segments and regions are the same as those used for internal reporting, allowing a reliable assessment of risks and returns. The aim is to provide users of the financial statements with information regarding the profitability and future prospects of the Group s various activities.

As of December 31, 2006 the Bayer Group comprised three subgroups with operations subdivided into divisions (HealthCare), business groups (CropScience) or business units (MaterialScience). Their activities are aggregated into the six reporting segments listed below according to economic characteristics, products, production processes, customer relationships and methods of distribution.

Notes to the Consolidated Financial Statements of the Bayer Group (Continued)

The subgroups activities are as follows:

Subgroup / Segment	Activities
HealthCare	
Pharmaceuticals	Development, production and marketing of prescription pharmaceuticals, such as for the treatment of hypertension, cardiovascular diseases, infectious diseases, cancer and multiple sclerosis, and for contraception
Consumer Health	Development, production and marketing of over-the-counter medications, diagnostic products, nutritional supplements for humans and animals, veterinary medicines and grooming products for animals
CropScience	
Crop Protection	Development, production and marketing of a comprehensive portfolio of fungicides, herbicides, insecticides and seed treatment products to meet a wide range of regional requirements
Environmental Science, BioScience	Development, production and marketing of a wide range of products for the green industry, garden care, non-agricultural pest and weed control, plant biotechnology, and conventional seeds
MaterialScience	
Materials	Development, production and marketing of high-quality plastics granules, sheets and films
Systems	Development, production and marketing of polyurethanes for a wide variety of applications and of coating and adhesive raw materials; production and marketing of inorganic basic chemicals

Effective January 1, 2006, the segment reporting for the Bayer Group was aligned to the new structure of the Bayer Group. It thus differs from the presentation used for fiscal 2005. The Pharmaceuticals, Biological Products segment was renamed Pharmaceuticals as of January 1, 2006, reflecting the divestment of our plasma business in the United States. The remaining activities of the former Biological Products division were integrated into the Bayer Schering Pharma division. The newly acquired business of Bayer Schering Pharma AG, Berlin, Germany, is included in the Pharmaceuticals segment along with our existing pharmaceuticals operations. The businesses of the Diabetes Care and Diagnostics divisions were previously combined for reporting purposes, while the Consumer Care and Animal Health divisions were reported as separate segments. Due to the agreed divestiture of the Diagnostics Division, the Diabetes Care division was combined with the Consumer Care and Animal Health divisions to form a new Consumer Health segment in the light of the similarities in their long-term financial performance and their common focus on products that can be promoted directly to consumers.

The segment table presents continuing operations only, and thus no longer includes the Diagnostics division or the Wolff Walsrode business or the H.C. Starck business. The prior-year figures have been restated accordingly. Details of the discontinued operations are given in Note [7.2].

The reconciliation eliminates intersegment items and reflects income, expenses, assets and liabilities not allocable to segments. These include in particular the Corporate Center, the service companies and sideline operations.

The segment data are calculated as follows:

The intersegment sales reflect intragroup transactions effected at transfer prices fixed on an arm s-length basis.

The operating cash flow before changes in net working capital (gross operating cash flow) comprises the income after taxes from continuing operations plus income taxes plus/minus non-operating result minus income taxes paid plus depreciation and amortization and write-downs, minus write-backs, plus/minus

Notes to the Consolidated Financial Statements of the Bayer Group (Continued)

changes in pension provisions, minus gains/plus losses on retirements of noncurrent assets, plus non-cash charges resulting from the remeasurement of acquired assets. The change in pension provisions includes the elimination of non-cash components of the income from continuing operations after taxes. It also contains benefit payments during the year.

The net cash flow is the cash flow from operating activities as defined in IAS 7 (Cash Flow Statements).

The capital invested comprises all assets serving the respective segment that are required to yield a return on their cost of acquisition. Noncurrent assets are included at cost of acquisition or construction throughout their useful lives because the calculation of cash flow return on investment (CFRoI) requires that depreciation and amortization be excluded. Interest-free liabilities are deducted. The capital invested is stated as of December 31.

The CFRoI is the ratio of the operating cash flow before changes in net working capital (gross operating cash flow) to the average capital invested for the year and is thus a measure of the return on capital employed.

The equity items reflect the earnings and carrying amounts of companies recognized at equity (associates). They are allocated to the segments where possible.

Details of capital expenditures, amortization and depreciation are as shown in the tables detailing changes in the Group s asset structure. The effects of the purchase price allocation for Bayer Schering Pharma AG, Germany are reflected in depreciation and amortization.

Since financial management of Group companies is carried out centrally by Bayer AG, financial liabilities are not allocated directly to the respective segments. Consequently, the liabilities shown for the individual segments do not include financial liabilities.

The number of employees is reported as full-time equivalents, with part-time employees included in proportion to their contractual working hours. The prior-year figures have been restated accordingly.

The table shows the regional breakdown of intangible assets and property, plant and equipment:

	2005	2006
	(million)	
Germany	5,758	21,235
Finland	1	1,503
France	1,311	1,200
United States	4,062	4,026
Others	4,877	4,937
	16,009	32,901

Notes to the Consolidated Financial Statements of the Bayer Group (Continued)

[7] Changes in the Bayer Group

[7.1] Scope of consolidation

	Germany	Other countries	Total
Bayer AG and consolidated companies			
December 31, 2005	54	229	283
Changes in the scope of consolidation	3	(6)	(3)
Additions	33	127	160
Retirements		(8)	(8)
December 31, 2006	**90**	**342**	**432**
Companies included at equity (associates)			
December 31, 2005	3	8	11
Changes in the scope of consolidation		(2)	(2)
Additions			
Retirements	(2)	(1)	(3)
December 31, 2006	**1**	**5**	**6**

The increase in the number of fully consolidated companies in 2006 is primarily due to the inclusion of 155 group companies of Bayer Schering Pharma AG since the second quarter.

Five joint ventures the same number as in the previous year are included by proportionate consolidation in compliance with IAS 31 (Interests in Joint Ventures). Excluded from consolidation are 103 subsidiaries that in aggregate are immaterial to the net worth, financial position and earnings of the Bayer Group; they account for less than 0.3 percent of Group sales, less than 0.7 percent of stockholders equity and less than 0.4 percent of total assets.

The effect of joint ventures on the Group balance sheet and income statement is as follows:

	2006 (**million**)
Current assets	21
Noncurrent assets	56
Current liabilities	(30)
Noncurrent liabilities	(9)
Net assets	38
Income	59
Expenses	(64)
Income (loss) after taxes	(5)

While six companies are accounted for by the equity method, 39 associates of minor importance are stated at cost less impairment charges.

A list of Bayer AG s direct and indirect holdings is published in the electronic version of the German Federal Gazette. It is also available directly from Bayer AG on request.

Notes to the Consolidated Financial Statements of the Bayer Group (Continued)

The principal companies consolidated in the financial statements are listed in the following table:

Company Name and Place of Business	Bayer s Interest (%)
Germany	
Bayer Business Services GmbH, Leverkusen	100
Bayer CropScience AG, Monheim	100
Bayer CropScience Deutschland GmbH, Langenfeld	100
Bayer CropScience GmbH, Frankfurt	100
Bayer HealthCare AG, Leverkusen	100
Bayer Industry Services GmbH & Co. OHG, Leverkusen	60
Bayer MaterialScience AG, Leverkusen	100
Bayer Schering GmbH, Leverkusen	100
Bayer Schering Pharma AG, Berlin	96.2
Bayer Technology Services GmbH, Leverkusen	100
Bayer Vital GmbH, Leverkusen	100
Schering Deutschland GmbH, Berlin	100
Other European Countries	
Bayer Antwerpen Comm.V, Belgium	100
Bayer Biologicals S.r.l., Italy	100
Bayer Consumer Care AG, Switzerland	100
Bayer CropScience France S.A.S., France	100
Bayer CropScience Limited, U.K.	100
Bayer CropScience S.A., France	99.9
Bayer CropScience S.r.l., Italy	100
Bayer International S.A., Switzerland	99.7
Bayer Pharma SAS, France	99.9
Bayer Polyols S.N.C., France	100
Bayer Polyurethanes B.V., Netherlands	100
Bayer Public Limited Company, U.K.	100
Bayer S.p.A., Italy	100
Bayer SP.Z.O.O., Poland	100
Quimica Farmaceutica Bayer, S.A., Spain	100
North America	
Bayer Corporate and Business Services LLC, U.S.A.	100
Bayer CropScience Inc., Canada	100
Bayer CropScience LP, U.S.A.	100
Bayer HealthCare LLC, U.S.A.	100
Bayer Inc., Canada	100
Bayer MaterialScience LLC, U.S.A.	100
Bayer Pharmaceuticals Corporation, U.S.A.	100
BAYPO Limited Partnership, U.S.A.	100
Berlex Inc., U.S.A.	100
Medrad Inc., U.S.A.	100

Notes to the Consolidated Financial Statements of the Bayer Group (Continued)

Company Name and Place of Business	Bayer s Interest (%)
Asia/Pacific	
Bayer Australia Limited, Australia	99.9
Bayer CropScience K.K., Japan	100
Bayer HealthCare Co. Ltd., China	100
Bayer Korea Ltd., Republic of Korea	100
Bayer MaterialScience Limited, Hong Kong	100
Bayer MaterialScience Trading (Shanghai) Company Limited, China	100
Bayer Thai Company Limited, Thailand	99.9
Bayer Yakuhin, Ltd., Japan	100
Nihon Schering K.K., Japan	100
Sumika Bayer Urethane Co., Ltd., Japan	60
Latin America/ Africa/ Middle East	
Bayer (Proprietary) Limited, South Africa	100
Bayer de Mexico, S.A. de C.V., Mexico	100
Bayer S.A., Argentina	99.9
Bayer S.A., Brazil	99.9
Bayer Türk Kimya Sanayi Limited Sirketi, Turkey	100

Also included in the consolidated financial statements are the following material associates, which are accounted for by the equity method:

Company Name and Place of Business	Bayer s Interest (%)
Lyondell Bayer Manufacturing Maasvlakte VOF, Netherlands	50
Palthough Industries (1998) Ltd., Israel	25
PO JV, LP, U.S.A.	43.4
Polygal Plastics Industries Ltd., Israel	25.8

The following domestic subsidiaries availed themselves in 2006 of certain exemptions granted under Sections 264, paragraph 3 and 264 b, No. 4 of the German Commercial Code regarding the preparation, auditing and publication of financial statements:

Company Name	Place of Business
Bayer 04 Immobilien GmbH	Leverkusen
Bayer 04 Leverkusen Fußball GmbH	Leverkusen
Bayer 04 Mobilien GmbH	Leverkusen
Bayer Beteiligungsverwaltungsgesellschaft mbH	Leverkusen
Bayer Bitterfeld GmbH	Greppin
Bayer Business Services GmbH	Leverkusen
Bayer Chemicals AG	Leverkusen
Bayer CropScience AG	Monheim

Bayer Direct Services GmbH	Leverkusen
Bayer Gastronomie GmbH	Leverkusen
Bayer Gesellschaft für Beteiligungen mbH	Leverkusen
Bayer HealthCare AG	Leverkusen
Bayer Industry Services GmbH & Co. OHG	Leverkusen

Notes to the Consolidated Financial Statements of the Bayer Group (Continued)

Company Name	Place of Business
Bayer Innovation GmbH	Düsseldorf
Bayer Kaufhaus GmbH	Leverkusen
Bayer MaterialScience AG	Leverkusen
Bayer MaterialScience Customer Services GmbH	Leverkusen
Bayer Schering GmbH	Leverkusen
Bayer Technology Services GmbH	Leverkusen
Bayer Vital GmbH	Leverkusen
Bayfin GmbH	Leverkusen
Case Tech GmbH & Co. KG	Bomlitz
Chemion Logistik GmbH	Leverkusen
Drugofa GmbH	Köln
DYNEVO GmbH	Leverkusen
EPUREX Films GmbH & Co. KG	Bomlitz
Erste K-W-A Beteiligungsgesellschaft mbH	Leverkusen
Euroservices Bayer GmbH	Leverkusen
Generics Holding GmbH	Leverkusen
GeWoGe Gesellschaft für Wohnen und Gebäudemanagement mbH	Leverkusen
GP Grenzach Produktions GmbH	Grenzach
ICON Genetics GmbH	München
KVP Pharma+Veterinär-Produkte GmbH	Kiel
Probis GmbH	Bomlitz
Sportrechte Vermarktungs- und Verwertungs-GmbH & Co. oHG	Leverkusen
Travel Board GmbH	Leverkusen
Wolff Cellulosics GmbH & Co. KG	Bomlitz
Wolff Walsrode AG	Walsrode
Zweite K-W-A Beteiligungsgesellschaft mbH	Leverkusen

[7.2] Business combinations and other acquisitions; divestments and discontinued operations

Acquisitions are accounted for by the purchase method in accordance with IFRS 3 (Business Combinations), the results of the acquired businesses therefore being included in the consolidated financial statements as from the respective dates of acquisition. The purchase prices of acquisitions of companies domiciled outside the euro zone are translated at the exchange rates in effect at the respective dates of acquisition.

A total of 15,357 million was spent for acquisitions in 2006. The purchase prices of the acquired companies or businesses were settled in cash. Goodwill arising on these acquisitions totaled 5,804 million and is subject to an annual impairment test.

Acquisition of Schering AG, Berlin, Germany

In June 2006, the wholly owned subsidiary Bayer Schering GmbH (at that time Dritte BV GmbH) acquired a majority interest in Schering AG, Berlin, Germany, which is included in full in the consolidated financial statements of the Bayer Group as of June 23, 2006. On that date Bayer Schering GmbH held 87.99 percent of the voting capital of Schering AG. This was preceded by a public takeover offer issued to stockholders of Schering AG by Bayer Schering GmbH on April 13, 2006. The European Commission cleared the acquisition on May 24, 2006; approval from the U.S. antitrust authorities was granted on April 21, 2006.

Notes to the Consolidated Financial Statements of the Bayer Group (Continued)

On July 31, 2006, Bayer Schering GmbH and Schering AG, as a dependent company, concluded a domination and profit and loss transfer agreement, which was approved by an Extraordinary Stockholders Meeting of Schering AG on September 13, 2006. This agreement took effect on October 27, 2006 when it was entered in the commercial register for the headquarters of Schering AG. Schering AG was renamed Bayer Schering Pharma AG effective December 29, 2006.

By December 31, 2006, Bayer Schering GmbH had raised its holding in the voting capital of Bayer Schering Pharma AG to 96.24 percent through the addition of further shares. The shares in Bayer Schering Pharma AG were purchased in tranches involving total cash outflows of 16,271 million, less total acquisition-related cash and cash equivalents of 1,025 million. The ancillary costs of the acquisition amounted to about 71 million.

The Extraordinary Stockholders Meeting of Bayer Schering Pharma AG on January 17, 2007 resolved to squeeze-out the remaining minority stockholders. Pursuant to this resolution, the shares held by minority stockholders will be transferred to the majority stockholder Bayer Schering GmbH in return for cash compensation of 98.98 per share. Liabilities for anticipated cash compensation payments and guaranteed dividends to the minority stockholders raise the purchase price by 736 million to 17,007 million.

At the time they were acquired, the activities of Bayer Schering Pharma AG and its subsidiaries (referred to here collectively as Schering) focused on the areas of gynecology and andrology, diagnostic imaging, specialized therapeutics, oncology, and the dermatology business operated by the Intendis group.

In fiscal 2006, Schering contributed 3,082 million to Bayer Group sales. It had a net negative effect of 119 million on the operating result after integration and restructuring expenses of 179 million and charges of 551 million from the purchase price allocation. Income after taxes of the acquired business for the period since the date of first-time consolidation was minus 37 million.

If Schering had already been acquired effective January 1, 2006, the Bayer Group would have had sales of 31,689 million in 2006. Income after taxes would have amounted to 1,448 million, taking into account the effects of the revaluation of acquired assets and the financing costs for the full year. Earnings per share from continuing and discontinued operations would have been 1.90.

Notes to the Consolidated Financial Statements of the Bayer Group (Continued)

The purchase price allocation to the acquired assets and assumed liabilities at the date of acquisition is shown in the table. Including the acquired cash and cash equivalents and the ancillary acquisition costs, it resulted in the net cash outflow shown below:

	Net Carrying Amount at the Date of First-Time Consolidation	Fair-Value Adjustment	Net Carrying Amount After the Acquisition
		(million)	
Acquired assets and assumed liabilities			
Goodwill	364	5,407	5,771
Other intangible assets	297	11,745	12,042
Property, plant and equipment	1,123	453	1,576
Other noncurrent assets	233	(1)	232
Inventories	837	848	1,685
Other current assets	1,671		1,671
Cash and cash equivalents	1,025		1,025
Pensions and other post-employment benefits	(345)		(345)
Other provisions	(1,078)	(78)	(1,156)
Financial liabilities	(243)		(243)
Other liabilities	(690)		(690)
Deferred taxes	295	(4,841)	(4,546)
Net assets	3,489	13,533	17,022
Minority interests			(15)
Purchase price			17,007
of which are ancillary acquisition costs			*71*
Acquired cash and cash equivalents			1,025
Liabilities to minority stockholders			736
Net cash outflow for the acquisition			15,246

The fair-value adjustment reflects the differences between the previous net carrying amounts and the respective fair values in the acquirer s balance sheet at the date of acquisition.

The purchase price allocation reflects all information with respect to revaluation amounts calculated as of the date of acquisition, but has not yet been completed. Therefore, changes may yet be made in the allocation of the purchase price to the individual assets.

The goodwill remaining after the purchase price allocation is attributable to a number of factors. Apart from general synergies in administration processes and infrastructures, such factors also include significant cost savings in the R&D, marketing, sales, procurement and production functions. In addition, the acquisition strengthens the Bayer Group s global market position in the pharmaceuticals business.

Notes to the Consolidated Financial Statements of the Bayer Group (Continued)

The fair values of the acquired intangible assets are as follows:

	Fair value (million)
Company names	725
Product-related brand names	940
Product-related technologies	9,118
IPR&D projects	1,191
Software	68

Company names are not amortized as they have no definite useful life. Product-related brand names are amortized over average periods of 18 years. The projected average useful life is 14 years for product-related technologies and 16 years for IPR&D projects. The residual useful life of acquired property, plant and equipment carried at fair value is determined in accordance with the principles set forth in Note [4.3]. The amortization of the adjustment for first-time consolidation of inventories is based on inventory turnover of the respective products. The useful lives and amortization periods are reflected analogously in deferred taxes.

Other acquisitions

In addition to the acquisition of the majority of the shares of Bayer Schering Pharma AG, the following significant acquisitions were made in 2006:

Effective January 9, 2006 Bayer Innovation GmbH acquired the biotech company Icon Genetics AG, Munich, Germany. Icon Genetics discovers innovative methods for the development and use of engineered plants to produce therapeutically active substances. The purchase price was 18 million.

On July 6, 2006, Bayer HealthCare LLC, U.S.A., acquired Metrika Inc., Sunnyvale, California, for 57 million. Metrika manufactures and markets the A1CNow+ appliance to monitor long-term blood glucose levels in diabetics.

These and further smaller acquisitions affected the Group s assets and liabilities as of the dates of acquisition as shown in the table. Including acquired cash and cash equivalents, they resulted in the following net outflow:

	2006 (million)
Acquired assets and assumed liabilities	
Goodwill	33
Other intangible assets	75
Property, plant and equipment	6
Other assets	10
Cash and cash equivalents	1
Provisions	(1)
Financial liabilities	(1)
Other liabilities	(3)
Deferred taxes	(8)
Purchase price	112
of which are ancillary acquisition costs	
Cash and cash equivalents acquired	1

Net cash outflow for acquisitions	111

Notes to the Consolidated Financial Statements of the Bayer Group (Continued)

Acquisitions after the closing date

Between the closing date and the approval of the annual financial statements for publication, Bayer HealthCare AG, Leverkusen, acquired the over-the-counter cough and cold products portfolio of the Topsun Group, Shanghai, China. The purchase price is approximately 103 million plus contingent payments of around 19 million subject to fulfillment of certain performance criteria. The agreement also comprises the transfer of the Gaitianli manufacturing facility in Qidong and the national sales force, and has been submitted to the regulatory authorities for approval. Chief among the products to be acquired from Topsun is the market-leading White & Black® brand.

Further, in October 2006 Bayer MaterialScience agreed to acquire Taiwan s Ure-Tech Group, the largest producer of thermoplastic polyurethane (TPU) in the Asia-Pacific region.

The transfer of this business had not yet taken place by the date on which these financial statements were approved for publication.

Acquisitions in 2005

Since January 2005, the worldwide Roche consumer health business with non-prescription drugs and vitamins has been part of the Consumer Care division of Bayer HealthCare. The transaction includes the global consumer health activities of Roche, with the exception of Japan, including the five production sites in Grenzach, Germany; Gaillard, France; Pilar, Argentina; Casablanca, Morocco and Jakarta, Indonesia. Among the brands acquired are Aleve®, Bepanthen®, Redoxon®, Rennie® and Supradyn®. The merger puts Bayer among the largest global suppliers of prescription-free medicines.

The acquired business contributed in 2005 1,061 million to Group sales. Since the sales forces, distribution function and support functions such as controlling have been combined in the Group s legal entities, it is not practicable to separately identify an operating result of the former Roche business.

The acquisition price for the worldwide consumer health business of Roche, including the assumption of net financial liabilities, was approximately 2,338 million, including about 208 million for the purchase of the remaining 50 percent interest in the U.S. joint venture with Roche. This purchase was completed in 2004 in an economically and legally separate transaction. The acquisition of the remaining global business was accomplished in 2005 by way of a 2,130 million cash transfer, of which 200 was paid in advance at the end of 2004, and the assumption of some 46 million in net financial liabilities. The ancillary costs of the acquisition amounted to about 28 million.

The assets and goodwill acquired were as follows:

	(million)
Acquisition costs excluding assumption of debt	2,056
Ancillary acquisition costs	28
Purchase price	2,084
Fair value of acquired net assets	1,440
Goodwill	644

Goodwill is attributable to a number of factors, including significant synergies that the Bayer Group expects to achieve by acquiring the Roche OTC business. Apart from general administrative processes and infrastructure synergies, these comprise significant savings in sales and marketing costs, for example. The acquisition also strengthens the Bayer Group s global market position in the OTC sector. Of the 644 million in recognized goodwill, 183 million is tax-deductible.

Notes to the Consolidated Financial Statements of the Bayer Group (Continued)

The purchase price can be allocated among the acquired assets and assumed liabilities at the date of acquisition as follows:

	Net Carrying Amount Prior to the Acquisition	Fair Value Adjustments	Net Carrying Amount After the Acquisition
		(million)	
Acquired assets and assumed liabilities			
Other intangible assets		1,142	1,142
Goodwill		644	644
Property, plant and equipment	142	9	151
Inventories	97	57	154
Other current assets (excluding liquid assets)	255	9	264
Liquid assets	28		28
Pensions and other post-employment benefits	(25)		(25)
Other provisions	(9)		(9)
Financial liabilities	(74)		(74)
Other liabilities	(129)		(129)
Deferred taxes	6	(68)	(62)
Purchase price			2,084
of which are ancillary acquisition costs			*28*
Assumed net financial liabilities			(46)
Net cash outflow for the acquisition			2,130

The expected useful lives of the acquired intangible assets are as follows:

	Fair value	Useful life
	(million)	(years)
Trademarks	1,055	20-30
Marketing and customer-related rights	41	20-30
Software and technologies	46	5-8

In addition to the acquisition of the Roche consumer health business, the following significant acquisitions or other transactions were made in 2005:

In connection with the acquisition of Aventis CropScience Holding, S.A., France, in 2002, the antitrust authorities required Bayer to divest some of the operations acquired from Aventis. In this connection, the business with the active ingredient Fipronil was sold to BASF AG, Ludwigshafen, Germany, in 2003. On January 31, 2005, Bayer CropScience AG, Monheim, Germany, signed an agreement with BASF to license back the rights to this product for agricultural applications in certain countries outside of Europe and the United States, for 125 million.

On February 10, 2005, Bayer CropScience GmbH, Frankfurt am Main, Germany, and Bayer CropScience LP, Research Triangle Park, North Carolina, United States, acquired various intangible assets and the property, plant and equipment required for the production of cotton seeds from Associated Farmers Delinting, Inc., a regional cotton seed producer based in Littlefield, Texas, for 9 million.

On July 8, 2005, Bayer South East Asia Pte Ltd., Singapore, received marketing rights for the cardiovascular drug Zetia® to the value of 100 million under a co-marketing and distribution agreement with Schering-Plough.

Notes to the Consolidated Financial Statements of the Bayer Group (Continued)

(Bayer Schering Pharma AG and Schering-Plough Corporation, New Jersey, are unaffiliated companies that have been totally independent of each other for many years.)

Bayer MaterialScience LLC, Pittsburgh, Pennsylvania, acquired Polythane Systems, Inc. (PSI), Spring, Texas, on August 31, 2005, for 20 million. PSI is a leading American supplier of polyurethane spray foam systems for roof insulation.

The total net assets and goodwill acquired in the above acquisitions and transactions and a number of smaller ones is comprised as follows:

	(million)
Acquisition costs	276
Ancillary acquisition costs	
Purchase price	276
Fair value of acquired net assets	259
Goodwill	17

The acquisitions and other transactions affected the Group s assets and liabilities as of the dates of acquisition as follows:

	2005
	(million)
Acquired assets and assumed liabilities	
Other intangible assets	242
Goodwill	17
Property, plant and equipment	4
Other financial assets	3
Other current assets	10
Purchase price	276
of which are ancillary acquisition costs	
Assumed net financial liabilities	
Net cash outflow for the business combinations and other acquisitions	276

Divestitures

In 2006 the Bayer Group made the following significant divestitures, the proceeds of which totaled 525 million.

On November 30, 2006 Bayer sold its 49.9 percent interest in the GE Bayer Silicones joint venture to its partner General Electric. The sale of this interest generated proceeds of 431 million.

On April 3, 2006, Bayer Diagnostics Manufacturing Limited, Bridgend, U.K., divested its production facilities and activities to Kimball Electronics Wales Limited. The businesses divested comprise the manufacture of appliances for the Diagnostics and diabetes care market.

To strengthen the focus on its core business, the Bayer CropScience subgroup divested various active ingredients and related rights in its Crop Protection segment in 2006, including Asulam®, a herbicide that was marketed as Asulox® and Asilan®. Total proceeds of divestitures by Bayer CropScience in fiscal 2006 were 47 million.

Notes to the Consolidated Financial Statements of the Bayer Group (Continued)

The divestitures affected the Group s assets and liabilities as of the respective dates of divestiture as follows:

	2006 (million)
Divested assets and liabilities	
Goodwill	2
Other intangible assets	5
Property, plant and equipment	16
Financial assets	195
Inventories	26
Other assets and liabilities	
Net gain/loss on divestitures	281
Total sale price	525
Divested cash and cash equivalents	
Net cash inflow from the divestitures	525

The Bayer Group made the following significant divestitures, the proceeds of which totaled 87 million, in 2005:

The Bayer CropScience subgroup divested a number of activities in 2005 to strengthen the focus on its core business. These included Philagro Holding S.A., France, and EqSeeds Comercia de Sementes Ltda., Brazil. Bayer CropScience also divested the businesses with various active ingredients together with the related rights, including the acaricide and insecticide Amitraz, which it marketed as Mitac®. CropScience also sold its site in Hauxton, United Kingdom, in December 2005, and BCS S.A., France, divested its interest in Holdisa S.r.l., Italy. The selling prices of the operations divested by Bayer CropScience in fiscal 2005 totaled 80 million.

The remaining 7 million relates to several minor divestitures in the Bayer Group.

The divestitures affected the Group s assets and liabilities as of the respective dates of divestiture as follows:

	2005 (million)
Divested assets and liabilities	
Other intangible assets	5
Property, plant and equipment	13
Other financial assets	7
Other current assets	3
Pensions and other post-employment benefits	(7)
Other provisions	(1)
Net gain on divestitures	67
Total selling price	87
Net divested financial liabilities	
Net cash inflow from the divestitures	87

Discontinued operations

On June 29, 2006, Bayer AG concluded an agreement with Siemens AG on the sale of the Diagnostics business. This transaction closed on January 2, 2007.

Notes to the Consolidated Financial Statements of the Bayer Group (Continued)

On November 23, 2006 an agreement was concluded to divest the activities of the H.C. Starck Group, formerly assigned to the Materials segment, to a consortium of two financial investors, Advent International and The Carlyle Group. This business was transferred to the new owners on February 1, 2007.

An agreement was signed on December 18, 2006 to sell the companies of the Wolff Walsrode group, which operates principally in the field of cellulose chemistry, to The Dow Chemical Company, U.S.A. Wolff Walsrode also was formerly assigned to the Materials segment. Pending the approval of the antitrust authorities, the transfer of this business is expected to take place in the first half of 2007.

The Diagnostics activities, H.C. Starck and Wolff Walsrode are recognized as discontinued operations in 2006. The corresponding information is provided from the standpoint of the Bayer Group, not for the purpose of separately portraying either the discontinued operations or the remaining operations of Bayer.

On January 28, 2005 the spin-off of LANXESS from Bayer AG was entered in the commercial register and thus took legal effect. In March 2005, the plasma operations of the Bayer HealthCare subgroup in the United States were divested. The LANXESS and plasma operations were recognized as discontinued operations in 2005.

A breakdown of the results of discontinued operations is given below:

	LANXESS			Plasma business		
	2004	2005	2006	2004	2005	2006
	(million)			(million)		
Net sales	6,053	503		427	124	
Cost of goods sold	(4,635)	(345)		(309)	(91)	
Selling expenses	(846)	(62)		(56)	(14)	
Research and development expenses	(126)	(8)		(48)	(11)	
General administration expenses	(263)	(20)		(18)	(11)	
Other operating income (expenses) net	(105)	(6)		(93)	1	
Operating result	78	62		(97)	(2)	
Non-operating result	(84)	(4)				
Income (loss) before income taxes	(6)	58		(97)	(2)	
Income taxes	2	(20)		34	1	
Income (loss) after taxes	(4)	38		(63)	(1)	
of which:						
Current income (loss) (before taxes)	(6)	58		(7)	22	
Income taxes	2	(20)		3	(7)	
Current income (loss) (after taxes)	(4)	38		(4)	15	
Income (loss) from the sale (before taxes)				(90)	(24)	
Income taxes				31	8	
Income (loss) from the sale (after taxes)				(59)	(16)	

Notes to the Consolidated Financial Statements of the Bayer Group (Continued)

	Diagnostics			H.C. Starck		
	2004	**2005**	**2006**	**2004**	**2005**	**2006**
		(million)			**(million)**	
Net sales	1,322	1,433	1,526	703	920	985
Cost of goods sold	(577)	(652)	(660)	(535)	(738)	(806)
Selling expenses	(370)	(370)	(394)	(50)	(54)	(51)
Research and development expenses	(118)	(120)	(124)	(30)	(29)	(28)
General administration expenses	(95)	(95)	(94)	(20)	(22)	(32)
Other operating income (expenses) net	(53)	(17)	(51)	1	6	(13)
Operating result	109	179	203	69	83	55
Non-operating result		2	(1)	(14)	(10)	(5)
Income (loss) before income taxes	109	181	202	55	73	50
Income taxes	(38)	(63)	(85)	(21)	(27)	(18)
Income (loss) after taxes	71	118	117	34	46	32
of which:						
Current income (loss) (before taxes)	109	181	202	55	73	50
Income taxes	(38)	(63)	(85)	(21)	(27)	(18)
Current income (loss) (after taxes)	71	118	117	34	46	32
Income (loss) from the sale (before taxes)						
Income taxes						
Income (loss) from the sale (after taxes)						

Notes to the Consolidated Financial Statements of the Bayer Group (Continued)

	Wolff Walsrode			Total		
	2004	**2005**	**2006**	**2004**	**2005**	**2006**
		(million)			**(million)**	
Net sales	328	329	334	8,833	3,309	2,845
Cost of goods sold	(223)	(225)	(233)	(6,279)	(2,051)	(1,699)
Selling expenses	(37)	(42)	(45)	(1,359)	(542)	(490)
Research and development expenses	(7)	(8)	(8)	(329)	(176)	(160)
General administration expenses	(21)	(20)	(19)	(417)	(168)	(145)
Other operating income (expenses) net		2	11	(250)	(14)	(53)
Operating result	40	36	40	199	358	298
Non-operating result	(7)	(3)	(7)	(105)	(15)	(13)
Income (loss) before income taxes	33	33	33	94	343	285
Income taxes	(13)	(13)	(13)	(36)	(122)	(116)
Income (loss) after taxes	20	20	20	58	221	169
of which:						
Current income (loss) (before taxes)	33	33	33	184	367	285
Income taxes	(13)	(13)	(13)	(67)	(130)	(116)
Current income (loss) (after taxes)	20	20	20	117	237	169
Income (loss) from the sale (before taxes)				(90)	(24)	
Income taxes				31	8	
Income (loss) from the sale (after taxes)				(59)	(16)	

Notes to the Consolidated Financial Statements of the Bayer Group (Continued)

The separate asset and liability line items in the balance sheet reflect the following amounts pertaining to the discontinued operations as of December 31:

	Diagnostics		H.C. Starck	
	2005	2006	2005	2006
	(million)			
Noncurrent assets	822			391
Goodwill and other intangible assets	383			33
Property, plant and equipment	356			300
Other noncurrent assets	42			15
Deferred taxes	41			43
Current assets	700			676
Inventories	235			506
Trade accounts receivable	422			162
Other current assets	43			8
Assets held for sale and discontinued operations	1,522			1,067
Noncurrent liabilities	33			233
Provisions for pensions and other post-employment benefits	26			182
Other provisions				30
Financial liabilities				
Other noncurrent liabilities				
Deferred taxes	7			21
Current liabilities	299			125
Other provisions	100			20
Financial liabilities				58
Trade accounts payable	74			29
Other current liabilities	125			18
Liabilities directly related to assets held for sale and discontinued operations	332			358

Notes to the Consolidated Financial Statements of the Bayer Group (Continued)

	Wolff Walsrode		Total	
	2005	2006	2005	2006
		(million)		
Noncurrent assets		214		1,427
Goodwill and other intangible assets		8		424
Property, plant and equipment		194		850
Other noncurrent assets		2		59
Deferred taxes		10		94
Current assets		122		1,498
Inventories		61		802
Trade accounts receivable		53		637
Other current assets		8		59
Assets held for sale and discontinued operations		336		2,925
Noncurrent liabilities		115		381
Provisions for pensions and other post-employment benefits		89		297
Other provisions		7		37
Financial liabilities				
Other noncurrent liabilities				
Deferred taxes		19		47
Current liabilities		43		467
Other provisions		11		131
Financial liabilities		8		66
Trade accounts payable		16		119
Other current liabilities		8		151
Liabilities directly related to assets held for sale and discontinued operations		158		848

Notes to the Consolidated Financial Statements of the Bayer Group (Continued)

Discontinued operations affected the Group cash flow statements as follows:

	LANXESS			Plasma business			Diagnostics		
	2004	2005	2006	2004	2005	2006	2004	2005	2006
					(million)				
Net cash provided by (used in) operating activities	234	(80)		(46)	40		246	264	154
Net cash provided by (used in) investing activities	(253)	(19)		(30)	206		(93)	(97)	(107)
Net cash provided by (used in) financing activities	19	99		76	(246)		(153)	(167)	(47)
Change in cash and cash equivalents									

	H.C. Starck			Wolff Walsrode			Total		
	2004	2005	2006	2004	2005	2006	2004	2005	2006
					(million)				
Net cash provided by (used in) operating activities	(2)	10	78	59	41	43	491	275	275
Net cash provided by (used in) investing activities	(40)	(48)	(55)	(13)	(20)	(17)	(429)	22	(179)
Net cash provided by (used in) financing activities	42	38	(23)	(46)	(21)	(26)	(62)	(297)	(96)
Change in cash and cash equivalents									

Notes to the Statements of Income

[8] Net sales

Sales revenues are derived primarily from product deliveries. Total reported net sales increased by 4,255 million, or 17.2 percent, from 2005 to 28,956 million. While volumes increased by 1,145 million, or 4.7 percent, adverse shifts in exchange rates trimmed sales by 47 million, or 0.2 percent. Changes in selling prices contributed 132 million, or 0.5 percent, to the growth in business. Portfolio changes boosted sales by 3,025 million, or 12.2 percent.

Portfolio changes led to the following changes in sales compared with the previous year:

2006	**(million)**
Acquisitions	
Schering AG, Germany	3,082
Other	24

	3,106
Divestitures	
Cessation of plasma distribution in Canada (divested in 2005)	(100)
BCS active ingredients	(50)
	(150)
LANXESS sales revenues (January 1 31, 2005)	69
Net effect of portfolio changes	3,025

In 2005 total reported net sales increased by 3,776 million (+18.0 percent) from 2004, to 24,701 million. A 39 million (-0.2 percent) decrease in volume was offset by a 273 million (+1.3 percent) positive impact of shifts in exchange rates. Changes in selling prices contributed 1,472 million (+7.0 percent), to the growth in

Notes to the Consolidated Financial Statements of the Bayer Group (Continued)

business. Acquisitions boosted sales by 2,070 million (+9.9 percent). Acquisitions and divestitures during 2005 and 2004 affected the comparison between the two years sales figures by the following amounts:

2005	**(million)**
Acquisitions	
Roche Consumer Health business	1,061
Gustafson (remaining 50 percent acquired in 2004)	25
Other	7
	1,093
Divestitures	(4)
Net sales to LANXESS after the spin-off on January 31, 2005[(1)]	981
	981
Net effect of portfolio changes	2,070

(1) A trading relationship now exists between the Bayer Group and the LANXESS Group as separate enterprises following the spin-off of what was previously the LANXESS subgroup of Bayer. The relevant agreements are concluded on an arm s-length basis. Under these agreements, the Bayer Group supplies goods and services to the LANXESS Group. Some of the transactions relate to products, such as chlorine or caustic soda solution, that are supplied to LANXESS by the MaterialScience subgroup. Others are service transactions in the areas of IT systems development and application support, IT infrastructure, site services and engineering services. Prior to the spin-off, the resulting revenues were recorded as intragroup sales and eliminated in the consolidation.

Breakdowns of net sales by segments and by regions are given in the table in Note [1].

[9] Selling expenses

Selling expenses include 594 million in shipping and handling costs in 2006 (2005: 578 million; 2004: 532 million). They also include advertising and promotion costs, expensed in the period in which they are incurred. These costs amount to 1,484 million for 2006 (2005: 1,206 million; 2004: 947 million).

[10] Other operating income

	2004	**2005**	**2006**
		(million)	
Gains from sales of intangibles, property, plant and equipment and from divestitures	182	150	169
Write-backs of receivables and other assets	48	79	98
Reversals of unutilized provisions	60	25	55
Recognition of exchange rate hedges	72	105	120
Miscellaneous operating income	440	416	288
	802	775	730

Other operating income for 2006 includes 86 million in connection with the first-time consolidation of the group companies of Schering AG, Germany. Total other operating income is composed of a large number of individually immaterial items pertaining to subsidiaries. In the previous year it was decided to modify several of Bayer s largest pension plans in the United States, replacing defined-benefit plans with purely defined-contribution plans. This resulted in one-time income of 248 million in 2005, which was recognized in miscellaneous operating income. In fiscal 2004, income of 105 million was realized from a restructuring of global pension obligations.

Notes to the Consolidated Financial Statements of the Bayer Group (Continued)

[11] Other operating expenses

	2004	2005	2006
		(million)	
Amortization and write-downs of acquired goodwill	(166)		
Losses from sales of intangibles, property, plant and equipment and from divestitures	(126)	(126)	(31)
Write-downs of trade accounts receivable	(86)	(165)	(138)
Expenses related to significant legal risks	(149)	(451)	(205)
Recognition of exchange rate hedges	(76)	(58)	(126)
Miscellaneous operating expenses	(541)	(467)	(719)
	(1,144)	(1,267)	(1,219)

Other operating expenses for 2006 contain restructuring expenses of 408 million (2005: 162 million; 2004: 123 million), including 179 million in connection with integration of Schering AG. Further details of restructuring expenses are given in Note [26.3].

Other operating expenses for 2006 also include write-downs on development and marketing agreements for the drug alfimeprase and the product Viadur® totaling 60 million. Further details can be found in Note [17]. As a result of a change in the plan to expand the chlor-alkali production facilities in Baytown, Texas, a write-down of 31 million on facilities under construction is recorded under miscellaneous operating expenses, which also include a large number of individually immaterial items totaling 220 million pertaining to subsidiaries.

In the previous year, miscellaneous operating expenses included 106 million incurred in connection with the termination of the co-promotion agreement with GlaxoSmithKline for Levitra®.

[12] Personnel expenses/employees

	2004	2005	2006
		(million)	
Wages and salaries	4,347	4,309	5,216
Social expenses and expenses for pensions and other benefits	1,236	1,009	1,414
of which for defined-contribution pension plans	*272*	*320*	*392*
of which for defined-benefit pension plans	*143*	*38*	*198*
	5,583	5,318	6,630

Personnel expenses increased by 1,312 million to 6,630 million in 2006 (2005: 5,318 million; 2004: 5,583 million), with the first-time consolidation of the Schering AG group accounting for 805 million. Changes in exchange rates reduced personnel expenses by 23 million. In fiscal 2005 pension expenses were diminished by one-time income of 248 million resulting from the modification of pension plans in the United States.

Pension expense in fiscal 2004 was diminished by one-time income of 105 million resulting mainly from changes in the basic conditions for the plan covering health care costs in the United States. These changes require participating employees to assume a greater share of the costs through higher co-payments and proportionate contributions. In addition, a ceiling was introduced for the annual contributions payable by companies.

The personnel expenses shown here do not include the interest portion of personnel-related provisions (particularly pension provisions), which is included in the non-operating result as other non-operating expense (see Note [13.3]).

Notes to the Consolidated Financial Statements of the Bayer Group (Continued)

The average number of employees classified by corporate functions is shown in the table. Employees of the Schering AG group are included for the first time.

	2004	2005	2006
Marketing	23,689	24,723	31,098
Technology/ Manufacturing	42,282	41,757	45,076
Research and development	8,532	8,125	10,356
Administration	7,850	7,769	10,064
	82,353	82,374	96,594
of which trainees	*2,545*	*2,547*	*2,715*

The employees of joint ventures are included in the above figures in proportion to Bayer s interests in the respective companies. The total number of people employed by joint ventures in 2006 was 67 (2005: 62; 2004: 31).

As of 2006, the number of employees is reported as full-time equivalents, with part-time employees included in proportion to their contractual working hours. The prior-year figures have been restated accordingly.

[13] Non-operating result

The non-operating result was minus 782 million in 2006 (2005: minus 602 million; 2004: minus 632 million), comprising equity-method loss of 25 million (2005: 10 million; 2004: 139 million), non-operating expenses of 1,688 million (2005: 1,224; 2004: 976 million) and non-operating income of 931 million (2005: 632 million; 2004: 483 million). The total non-operating result is detailed in the categories income (loss) from investments in affiliated companies net, interest expense net and other non-operating expense net as provided below.

[13.1] Income (loss) from investments in affiliated companies net

	2004	2005	2006
		(million)	
Net loss from investments in associates (equity-method loss)	(139)	(10)	(25)
Expenses			
Write-downs of investments in affiliated companies	(11)	(27)	(20)
Losses from the sale of investments in affiliated companies	(4)		(12)
Income			
Dividends from affiliated companies and income from profit and loss transfer agreements		10	5
Gains from the sale of investments in affiliated companies	11	5	259
	(143)	(22)	207

The income from investments in affiliated companies mainly comprised an equity-method loss of 55 million (2005: 47 million; 2004: 131 million) from two production joint ventures with Lyondell and equity-method income of 28 million (2005: 35 million; 2004: equity-method loss of 8 million) received from GE Bayer Silicones prior to the sale of our interest. In addition, this divestiture contributed 236 million to income from investments in affiliated companies. For further details see Note [7.2].

Further details of the companies included at equity in the Group financial statements are given in Note [19].

Notes to the Consolidated Financial Statements of the Bayer Group (Continued)

[13.2] Interest expense net

	2004	2005	2006
		(million)	
Expenses			
Interest and similar expenses	(654)	(909)	(1,381)
Income			
Income from other financial assets	13	7	10
Other interest and similar income	414	564	643
	(227)	(338)	(728)

This item mainly comprises interest expense for financial liabilities, value adjustments relating to interest-rate hedging transactions, and interest income from investments. Interest expense of 370 million incurred for financing of the acquisition of Schering AG, Germany in 2006 is included here.

Finance leases are capitalized under property, plant and equipment in compliance with IAS 17 (Leases). The interest portion of the lease payments, amounting to 20 million (2005: 17 million; 2004: 20 million), is reflected in interest expense.

Interest expense incurred to finance the construction phase of major investment projects is not included here. Such interest expense, amounting in 2006 to 12 million (2005: 4 million; 2004: 3 million), is capitalized as part of the cost of acquisition or construction of the property, plant or equipment concerned, based on an average capitalization rate of 5 percent (2005: 4 percent; 2004: 4 percent).

[13.3] Other non-operating expense net

	2004	2005	2006
		(million)	
Expenses			