BAYER AKTIENGESELLSCHAFT
Form 6-K
March 16, 2007

**Table of Contents**

**SECURITIES AND EXCHANGE COMMISSION**
**Washington, D.C. 20549**
**Form 6-K**
**REPORT OF FOREIGN PRIVATE ISSUER**
**PURSUANT TO RULE 13a-16 OR 15d-16**
**OF THE SECURITIES EXCHANGE ACT OF 1934**
For the month of March 2007
**Bayer Aktiengesellschaft**
**Bayer Corporation***
(Translation of registrant s name into English)
Bayerwerk, Gebaeude W11
Kaiser-Wilhelm-Allee
51368 Leverkusen
Germany
(Address of principal executive offices)

Indicate by check mark whether the registrant files or will file annual reports under cover of Form 20-F or Form 40-F.

Form 20-F X Form 40-F ___

Indicate by check mark if the registrant is submitting the Form 6-K in paper as permitted by Regulation S-T Rule 101 (b)(1): N/A

Indicate by check mark if the registrant is submitting the Form 6-K in paper as permitted by Regulation S-T Rule 101 (b)(7): N/A

Indicate by check mark whether, by furnishing the information contained in this form, the registrant is also thereby furnishing the information to the Commission pursuant to Rule 12g3-2(b) under the Securities Exchange Act of 1934.

Yes ___ No X

If Yes is marked, indicate below the file number assigned to the registrant in connection with Rule 12g3-2(b): N/A

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

Table of Contents

**Science For A Better Life**
Bayer Annual Report 2006

**Table of Contents**

**Bayer: Science For A Better Life**

... is more than a corporate slogan. It s a call to action. A truly ambitious goal. A claim that demands to be vindicated every day, and that essentially means one thing: striving for improvement. The images on the opening pages of this Annual Report contain impressive examples of how the inventor company Bayer justifies that claim with products and services that enhance the quality of life. But research never stops. The company s scientists are constantly on the track of innovations to address future challenges. And it is this that defines the fascination of Bayer.

**Table of Contents**

Bayer Group Key Data

| | 2005 million | **2006** million | Change % |
|---|---|---|---|
| **Bayer Group** | | | |
| Net sales | 24,701 | 28,956 | +17.2 |
| EBITDA[1] | 4,122 | 4,675 | +13.4 |
| EBITDA before special items | 4,602 | 5,584 | +21.3 |
| EBIT[2] | 2,514 | 2,762 | +9.9 |
| EBIT before special items | 3,047 | 3,479 | +14.2 |
| Income before income taxes | 1,912 | 1,980 | +3.6 |
| Net income | 1,597 | 1,683 | +5.4 |
| Earnings per share ( [3]) | 2.19 | 2.22 | +1.4 |
| Gross cash flow[4] | 3,114 | 3,913 | +25.7 |
| Net cash flow[5] | 3,227 | 3,928 | +21.7 |
| Capital expenditures | 1,210 | 1,739 | +43.7 |
| Research and development expenses | 1,729 | 2,297 | +32.9 |
| Dividend per Bayer AG share ( ) | 0.95 | 1.00 | +5.3 |
| **Bayer HealthCare** | | | |
| Net external sales | 7,996 | 11,724 | +46.6 |
| EBITDA[1] | 1,280 | 1,947 | +52.1 |
| EBITDA before special items | 1,487 | 2,613 | +75.7 |
| EBIT[2] | 923 | 1,313 | +42.3 |
| EBIT before special items | 1,177 | 1,715 | +45.7 |
| Gross cash flow[4] | 923 | 1,720 | +86.3 |
| Net cash flow[5] | 1,087 | 1,526 | +40.4 |

| | | | |
|---|---|---|---|
| Capital expenditures | 225 | 576 | +156.0 |
| **Bayer CropScience** | | | |
| Net external sales | 5,896 | 5,700 | -3.3 |
| EBITDA[1] | 1,284 | 1,166 | -9.2 |
| EBITDA before special items | 1,273 | 1,204 | -5.4 |
| EBIT[2] | 690 | 584 | -15.4 |
| EBIT before special items | 685 | 641 | -6.4 |
| Gross cash flow[4] | 964 | 900 | -6.6 |
| Net cash flow[5] | 904 | 898 | -0.7 |
| Capital expenditures | 201 | 197 | -2.0 |
| **Bayer MaterialScience** | | | |
| Net external sales | 9,446 | 10,161 | +7.6 |
| EBITDA[1] | 1,721 | 1,499 | -12.9 |
| EBITDA before special items | 1,764 | 1,677 | -4.9 |
| EBIT[2] | 1,250 | 992 | -20.6 |
| EBIT before special items | 1,293 | 1,210 | -6.4 |
| Gross cash flow[4] | 1,254 | 1,166 | -7.0 |
| Net cash flow[5] | 1,337 | 1,281 | -4.2 |
| Capital expenditures | 642 | 753 | +17.3 |

2005 figures restated

1 EBITDA = EBIT plus amortization of intangible assets and depreciation of property, plant and equipment. EBITDA, EBITDA before special items and EBITDA margin are not

defined in the International Financial Reporting Standards and should therefore be regarded only as supplementary information. The company considers underlying EBITDA to be a more suitable indicator of operating performance since it is not affected by depreciation, amortization, write-downs/write-backs or special items. The company also believes that this indicator gives readers a clearer picture of the results of operations and ensures greater comparability of data over time. The underlying EBITDA margin is calculated by dividing underlying EBITDA by sales.

[2] EBIT as shown in the income statement.

[3] Earnings per share as defined in IAS 33 = net income divided by the average number of shares. For details see Note [16] to the financial statements. For details on core earnings per share see page 25.

[4] Gross cash flow = income after taxes from continuing operations plus income taxes, plus/minus non-operating result, minus income taxes paid, plus depreciation, amortization and

write-downs, minus write-backs, plus/minus changes in pension provisions, minus gains/plus losses on retirements of noncurrent assets, plus non-cash effects of the remeasurement of acquired assets. The change in pension provisions includes the elimination of non-cash components of the operating result. It also contains benefit payments during the year. For details see Note [25].

5 Net cash flow = cash flow from operating activities according to IAS 7

**Table of Contents**

**Bayer**

Bayer AG defines common values, goals and strategies for the entire Group. The subgroups and service companies operate independently, led by the management holding company. The Corporate Center supports the Group Management Board in its task of strategic leadership.

**Bayer HealthCare**

Bayer HealthCare is among the world s foremost innovators in the field of pharmaceutical and medical products. This subgroup s mission is to research, develop, manufacture and market innovative products that improve the health of people and animals throughout the world.

**Bayer CropScience**

Bayer CropScience, with its highly effective products, pioneering innovations and keen customer focus, holds global leadership positions in crop protection and non-agricultural pest control. The company also has major activities in seeds and crop plants with genetically optimized properties.

**Bayer MaterialScience**

Bayer MaterialScience is a renowned supplier of high-performance materials such as polycarbonates and polyurethanes, and innovative system solutions such as coatings, for a wide range of everyday uses. Products holding leading positions on the world market account for a large proportion of its sales.

**Bayer Business Services**

Bayer Business Services is the Bayer Group s international competence center for it-based services. The focus of this company s offering is on integrated services in the core areas of it infrastructure and applications, procurement and logistics, human resources and management services, and finance and accounting.

**Bayer Technology Services**

Bayer Technology Services is engaged in process development and in process and plant engineering, construction and optimization. As the technological backbone of the Bayer Group worldwide, this service company offers integrated solutions throughout the life cycles of facilities, processes and products.

**Bayer Industry Services**

Bayer Industry Services offers services for the chemical industry including utility supply, waste management, infrastructure, safety, security, technical services, analytics and vocational training. This service company a joint venture between Bayer and lanxess operates Bayer s chemical parks at Leverkusen, Dormagen and Krefeld-Uerdingen in Germany.

**Table of Contents**

Working to Create Value through Innovation and Growth

**Bayer is a global enterprise with core competencies in the fields of health care, nutrition and high-tech materials. Our products and services are designed to benefit people and improve their quality of life. At the same time we want to create value through innovation, growth and high earning power.**

We are firmly aligned to our mission statement   Bayer: Science For A Better Life   and continue to optimize our portfolio, concentrating our activities in three high-potential, efficient subgroups with largely independent operations: HealthCare, CropScience and MaterialScience, supported by three service companies. Our operating companies provide us with access to major global growth markets.

As an inventor company, we plan to continue setting trends in research-intensive areas. Innovation is the foundation for competitiveness and growth, and thus for our company s success in the future.

Our expertise and our products are helping to diagnose, alleviate or cure diseases, improving the quality and adequacy of the global food supply, and contributing significantly to an active, modern lifestyle. All these aspects define the fascination of Bayer.

We are committed to the principles of sustainable development, and to our role as a socially and ethically responsible corporate citizen. For us, there is a clear link between technical and economic expertise and corporate social responsibility. This, in turn, we define as our responsibility to work for the benefit of humankind, become socially involved and make a lasting contribution to sustainable development. At Bayer, we regard economy, ecology and social commitment as objectives of equal rank.

We seek to retain society s confidence through performance, flexibility and open communication as we work in pursuit of our overriding goals: to steadily create corporate value and generate high value-added for the benefit of our stockholders, our employees and the community in every country in which we operate.

**Table of Contents**

Bayer HealthCare: Innovative drugs for heart and circulation

Bayer HealthCare is particularly dedicated to combating cardiovascular disease, the world s number one cause of death. Apart from its innovative medicines, the company also focuses on new diagnostic techniques. It recently developed and brought to market Vasovist®, an innovative contrast medium for comprehensive vascular diagnosis. A promising drug candidate for the future is rivaroxaban, an anticoagulant for the prevention and treatment of life-threatening conditions such as stroke, thrombosis and pulmonary embolism.

These two examples demonstrate how Bayer HealthCare fulfills its role as a global health care company. This holds true over its entire range of products: from the wonder drug Aspirin® through innovative anti-cancer drugs and contraceptives to cutting-edge diagnostic techniques and animal health products.

**Table of Contents**

Bayer CropScience: Better seed for tomorrow s harvests

Bayer CropScience has improved the oil profile of the canola plant so that the oil s naturally healthy mix of fatty acids is maintained even upon heating. The company s seed not only ensures a better-quality product but also raises yields. The high-yielding canola is a promising source of biofuel as well.

The innovative capability of the scientists at Bayer CropScience has already led to numerous milestones and continues to do so in conventional crop protection, as it does in the areas of biotechnology and seed development.

**Table of Contents**

Bayer MaterialScience: Toward a shining future

Materials for visions for Bayer MaterialScience this is both a claim and a commitment. One example is high-tech films. These are found everywhere: instrument panels, cellphone displays, forgery-proof identity cards. And in the future they ll be able to shine around corners too.

Scientists at Bayer MaterialScience came up with an electroluminescent film that lights up when an electric current is applied even when the film is bent, rolled or folded. Development of this exciting new material has been entrusted to start-up company lyttron Technology, a subsidiary of Bayer MaterialScience.

For designers this is undoubtedly a dream come true. And for Bayer MaterialScience one of the world s largest manufacturers of high-tech polymers it s another milestone in customer-oriented innovation. This company s portfolio also includes polyurethane and polycarbonate products, along with materials for coatings, adhesives, insulating materials and sealants. With this spectrum of activities, the company has one overriding goal: to continually enhance the quality of life.

Table of Contents



**Chairman s Letter/Board of Management**



**Report of the Supervisory Board/Corporate Governance Report**



**Investor Information**



**Management Report**



**Consolidated Financial Statements of the Bayer Group**

**Consolidated Financial Statements of the Bayer Group**



**Notes to the Consolidated Financial Statements of the Bayer Group**



**Further Information**

---

Table of Contents

**Bayer Annual Report 2006** **Chairman s Letter 3**

Schering acquisition crowns a strong year

Dear Stockholders:

We look back with satisfaction on an eventful and successful 2006 a landmark year for Bayer, both strategically and operationally. Our employees around the world have good reason to be proud of last year s accomplishments:

- By acquiring Schering, Berlin, Germany, in what was the largest corporate transaction in Bayer s history, we further optimized our product portfolio and successfully continued the Group s realignment.
- We increased sales considerably, and operating performance ( ebit and ebitda before special items) was at an all-time high.
- In China, we inaugurated production facilities representing Bayer s largest-ever capital expenditure project outside Germany.

The year s outstanding event was our acquisition of Schering AG for approximately 17 billion. The Schering business ideally complements our existing pharmaceutical activities, and the new Bayer Schering Pharma AG is among the world s leading suppliers of specialty pharmaceuticals. Our attractive product portfolio and well-stocked research and development pipeline offer excellent prospects for future success. We are convinced that Bayer Schering Pharma will strengthen our HealthCare business and with it the entire Bayer Group for the long term.

The integration process is proceeding as planned. We are well on track to achieve the communicated synergy goal of 700 million annually by 2009.

The Schering acquisition is founded on a balanced financing package of cash, borrowings and equity transactions. In addition to the mandatory convertible bond issued in March, we successfully placed 34 million new Bayer shares, worth 1.2 billion, in July.

We continued to focus our portfolio by divesting the diagnostics business and the subsidiaries H.C. Starck and Wolff Walsrode. The substantial proceeds of these transactions will help to reduce debt.

We also scored considerable success in our business operations:

- Sales rose 17 percent to 29 billion. Adjusted for currency fluctuations, the effect of the Schering acquisition and other portfolio changes, growth amounted to 5 percent.
- ebitda before special items climbed by 21 percent from the prior year, to 5.6 billion. That gave us an underlying ebitda margin of 19.3 percent, in line with our earnings guidance for 2006.
- ebit before special items moved ahead 14 percent to a record high of 3.5 billion, while ebit after special items advanced by 10 percent to 2.8 billion.

Table of Contents



Of course we want you, our stockholders, to benefit from our economic success. We therefore propose to raise the dividend for 2006 by 5 percent to 1.00 per share.

Our good business performance is also reflected in the value of Bayer stock. The share price rose above 40 in 2006 for the first time in five years. Last year alone, our market capitalization grew by 20 percent to more than 31 billion. We will do all we can to ensure that this encouraging performance continues in the future.

Our success greatly depends on the skills and the dedication of more than 100,000 Bayer employees throughout the world, whom I would expressly like to thank on behalf of the entire Board of Management. Without their support, we could not have accomplished so much over the past year. We continue to rely on their high commitment and motivation.

Now let us look at the performance of the subgroups.

Sales of Bayer HealthCare rose considerably, thanks to the Schering acquisition and above-market growth in all divisions. We successfully introduced new products to the market and boosted the potential of existing products through expanded registrations.

Table of Contents



Including Schering s sales prior to the acquisition date as well gave Bayer Schering Pharma total pro forma sales of more than 10 billion for 2006 a very substantial revenue base.

Together with the Consumer Care, Diabetes Care and Animal Health divisions, which all hold leading international positions and also performed impressively last year, HealthCare will account for nearly 50 percent of Bayer Group sales in the future. As you can see, these activities are growing quickly and profitably.

Bayer CropScience stood up comparatively well to difficult market conditions in 2006. Our conventional crop protection business in particular had to contend with adverse weather conditions, heightening competition from generic products and the increasing cultivation of genetically modified crops. The company is implementing a new cost structure program to sustainably improve earnings. Innovation and growth prospects at Bayer CropScience are closely linked to the major opportunities presented by plant biotechnology. I for one believe that biotechnology is one of the most important technologies of the 21st century and it will be of fundamental value to Bayer CropScience in mastering future challenges.

At Bayer MaterialScience, sales again developed well and earnings almost matched the high level of the previous year. Margins were squeezed primarily by the sharp rise in petrochemical feedstock and energy costs, along with unplanned production interruptions.

In polycarbonates we achieved a special milestone in 2006 , becoming the world s number one supplier. This means Bayer is now the global leader in both polyurethanes and poly-carbonates.

In China we are implementing our biggest capital expenditure project to date outside Germany, with a volume of approximately US$ 1.8 billion through 2009. By building the facilities at the Bayer Integrated Site in Shanghai, Bayer MaterialScience has laid the foundation for further growth in the highly promising Asia-Pacific region, and China in particular.

We remain confident for 2007 and aim to boost Group sales by more than 10 percent. Adjusted for portfolio and currency effects, business should expand by about 5 percent. We plan to increase underlying ebitda by more than 10 percent as well, and also slightly improve our underlying ebitda margin.

Yet apart from the kind of corporate success that can be expressed in terms of sales and earnings, another aspect is very important to me. Our products are of great value to humankind and contribute substantially to improving the quality of life. They extend the health of people and animals, help ensure the quality and adequacy of food supplies, make cars safer, improve home living and contribute to climate protection. Thus the achievements of our employees are in evidence everywhere.

Table of Contents



Our products save lives, improve conditions and are indispensable to many people. That is enormously motivating and a source of great satisfaction and pride.

In 2006 we also ran more than 300 activities that testify to our corporate social responsibility, ranging from training for young environmentalists around the world through programs for school students and talented scientists to the development of health care plans and projects to ease social hardship.

Bayer is mindful of its social responsibilities and is particularly committed to the principle of sustainability. We are a strong advocate of responsible corporate governance and business ethics, and we require strict observance of our corporate compliance program.

This year again, we want to live up to our mission statement Bayer: Science For A Better Life. And I m already sure we can succeed not least because we can count on an exceptionally dedicated workforce. An example is the response to our new Triple-i initiative (inspiration, ideas, innovation), which is helping to strengthen the innovation culture throughout the Bayer Group. Employees around the world had already submitted more than 1,900 business ideas by the end of 2006. Many of these proposals show how Bayer could help to solve problems in the future by developing new lines of business that are in keeping with our mission statement.

We believe one of our most important tasks is not just to ensure a strong current performance, but at the same time to create the conditions for long-term success. Last year we took a major stride in that direction in the interest of the company, our employees and, of course, our stockholders.

In closing, I would like to thank you on behalf of the Board of Management for your trust and your support. We will do everything in our power to live up to the expectations placed in us for 2007.

Sincerely,

/s/ Werner Wennig

Werner Wenning

Chairman of the Board of Management of Bayer AG

Board of Management

**WERNER WENNING**

Chairman of the Bayer AG Board of Management since April 2002. Born in 1946, Werner Wenning joined the company in 1966 as a commercial trainee. He held a number of positions with Bayer in Germany and abroad, serving as managing director of Bayer subsidiaries in Peru and Spain and later as Head of the Corporate Planning and Controlling Division. Wenning was appointed to the Board of Management as Chief Financial Officer in February 1997. Since September 2005 he has also been President of the German Chemical Industry Association.

**KLAUS KüHN**

Chief Financial Officer and responsible for the Europe region. Born in 1952, Klaus Kühn studied mathematics and physics at the Technical University of Berlin, Germany, gaining a mathematics degree in 1978. He also studied in the United States, where he obtained a Master of Business Administration. Kühn joined Bayer AG in 1998 as Head of the Finance Section, and shortly afterwards was made Head of the Group Finance Division. He was appointed to the Bayer AG Board of Management in May 2002.

**DR. WOLFGANG PLISCHKE**

Responsible for Innovation, Technology and Environment and the Asia-Pacific region. Born in 1951, Wolfgang Plischke studied biology at the University of Hohenheim, Germany. After gaining his Ph.D., Plischke began his career with Bayer in 1980, first joining the subsidiary Miles Diagnostics. After holding a number of positions in Germany and abroad, he became Head of the Pharmaceuticals Business Group in North America in 2000, and two years later took over responsibility for the Pharmaceuticals Business Group of Bayer AG. Plischke was appointed to the Bayer AG Board of Management in March 2006.

**DR. RICHARD POTT**

The member responsible for Strategy and Human Resources and the Americas, Africa and Middle East regions, Dr. Richard Pott is also Bayer AG s Labor Director. Born in 1953, Richard Pott studied physics at the University of Cologne, Germany, where he obtained his Ph.D. In 1984 he joined the company s Central Research Division. After holding various positions in the Corporate Staff Division he became Head of the former Specialty Products Business Group in 1999. Pott was appointed to the Bayer AG Board of Management in May 2002.

Table of Contents



Report of the Supervisory Board

Dear Stockholders:

During 2006 the Supervisory Board monitored the conduct of the company s business and acted in an advisory capacity. We performed these functions on the basis of detailed written and oral reports received from the Board of Management. In addition, the Chairman of the Supervisory Board and the Chairman of the Board of Management maintained a constant exchange of information and ideas. In this way the Supervisory Board was kept continuously informed about the company s intended business strategy, corporate planning (including financial, investment and human resources planning), earnings performance, the state of the business and the situation in the company and the Group as a whole.

The documents relating to Board of Management decisions or actions which by law or under the articles of incorporation or the rules of procedure required the approval of the Supervisory Board were inspected by the Supervisory Board at its plenary meetings, sometimes after preparatory work by the committees. In certain cases the Supervisory Board gave its approval on the basis of documents circulated to its members. The meetings of the Supervisory Board were regularly attended by the members of the Board of Management. The Supervisory Board was involved in decisions of material importance to the company. We discussed at length the business trends described in the reports from the Board of Management and the prospects for the development of the Bayer Group as a whole, the individual organizational units and the principal affiliated companies in Germany and abroad. During 2006 there were six plenary meetings of the Supervisory Board. On several further occasions, decisions relating to specific acquisition or divestiture projects were made after circulation of documents to the members. No member of the Supervisory Board attended fewer than half of the meetings.

**Principal topics discussed by the Supervisory Board**

A major focus of the Supervisory Board s deliberations in 2006 was the acquisition of Schering AG (now Bayer Schering Pharma AG). At an extraordinary meeting on March 23, 2006, the Supervisory Board considered the acquisition project and consented to the submission of a takeover offer.

The Supervisory Board also discussed and resolved upon measures to finance this project through debt and equity issuances and divestments of subsidiaries. This included the conclusion of agreements on a bridge financing and a syndicated loan of 7 billion each and an equity raising of up to 4 billion.

The Supervisory Board formed a committee from among its members to which decision-making powers in connection with the Schering AG acquisition project and certain related financing measures were transferred to the extent legally permissible, in order to allow a rapid response to new developments. The members elected to this committee were Manfred Schneider, Hubertus Schmoldt, Ekkehard Schulz and Thomas de Win.

Table of Contents



The Board of Management reported in detail at the Supervisory Board meetings about the steps necessary to integrate Bayer Schering Pharma AG, including the conclusion of a domination and profit and loss transfer agreement and the squeeze-out of outside stockholders and transfer of their shares to the principal stockholder.

At an extraordinary meeting on June 29, 2006, the Supervisory Board consented to the sale of the global diagnostics business to Siemens. The Board of Management presented status reports on other projects to develop the Group s portfolio, such as the sale of the subsidiaries Wolff Walsrode and H.C. Starck and the interest in GE Bayer Silicones, and the acquisition of the consumer care business of Topsun. These projects received the Supervisory Board s approval.

At the meeting in December 2006, the Board of Management presented its operational, financial and balance sheet planning for the years 2007 through 2009, which was the subject of detailed discussion.

Table of Contents



**Work of the committees**

The Presidial Committee of the Supervisory Board, acting on authorizations given by the plenary meeting, made decisions at four telephone conferences relating to the issuance of a bond under the existing emtn program in May 2006 and the capital increase out of authorized capital in July 2006. The Presidial Committee did not need to convene during 2006 in its capacity as the mediation committee pursuant to Section 27, Paragraph 3 of the German Codetermination Act.

The Audit Committee met four times during the year, concerning itself in particular with the company s and the Group s financial reporting, including the annual report to the u.s. Securities and Exchange Commission on Form 20-f. Another area of focus was the Group s risk management system. The Audit Committee solicited and discussed verbal reports from the Head of Corporate Auditing and the Group Compliance Officer. The Audit Committee also set the budget for the services of the external auditor and discussed with the auditor the main areas of the audit for the 2006 fiscal year. It also discussed measures to implement various requirements of the u.s. Sarbanes-Oxley Act including, in particular, the submission of an assessment, attested to by the auditor, regarding the internal controls over financial reporting introduced in the Group pursuant to Section 404 of the Sarbanes-Oxley Act. The auditor was present at all the meetings of the Audit Committee, reporting in detail on the audit work and auditor review of interim financial statements.

The Human Resources Committee convened on two occasions. It dealt with matters relating to the remuneration of the Board of Management and with the renewal of the contracts of Werner Wenning, Klaus Kühn and Richard Pott.

The committee formed in connection with the Schering AG acquisition project held five telephone conferences and made decisions. It considered the conditions for the purchase of shares, compensation offers to stockholders, and the issuance of a mandatory convertible bond in April 2006 as part of the related financing package.

The meetings and decisions of the committees were prepared on the basis of reports and other information provided by the Board of Management, whose members regularly attended the committee meetings. Reports on the committee meetings were presented at the plenary meetings of the Supervisory Board.

**Corporate governance**

The Supervisory Board dealt with the ongoing development of corporate governance at Bayer, taking into account the amendments made to the German Corporate Governance Code in June 2006. In December 2006 the Board of Management and the Supervisory Board issued a new Declaration of Conformity, which is also contained in the Corporate Governance Report on page 19 forming part of this Annual Report.

At its meeting in December 2006, the Supervisory Board reviewed the efficiency of its own work and came to a positive conclusion.

Table of Contents



**Financial statements and audits**

The financial statements and management report of Bayer AG were drawn up according to the requirements of the German Commercial Code, while the consolidated financial statements and management report of the Bayer Group were prepared according to the principles of the International Financial Reporting Standards (ifrs).

The financial statements of Bayer AG, the consolidated financial statements of the Bayer Group, the management report of Bayer AG and the management report of the Bayer Group have been examined by the auditor, PricewaterhouseCoopers Aktiengesellschaft, Wirtschaftsprüfungsgesellschaft, Essen. The conduct of the audit is explained in the Independent Auditor s Report. The auditor finds that Bayer has complied with the requirements of the German Commercial Code and the International Financial Reporting Standards, respectively, and issues an unqualified opinion on the financial statements of Bayer AG and the consolidated financial statements of the Bayer Group. The financial statements and management report of Bayer AG, the consolidated financial statements and management report of the Bayer Group, and the audit reports were submitted to all members of the Supervisory Board. They were discussed in detail by the Audit Committee and at a plenary meeting of the Supervisory Board. The auditor submitted a report on both occasions and was present during the discussions.

We examined the financial statements and management report of Bayer AG, the proposal for distribution of the profit, and the consolidated financial statements and management report of the Bayer Group. We found no objections, thus we concur with the result of the audit. We have approved the financial statements of Bayer AG and the consolidated financial statements of the Bayer Group prepared by the Board of Management. The financial statements of Bayer AG are thus confirmed. We are in agreement with the management reports of Bayer AG and the Bayer Group and, in particular, with the assessment of the future development of the enterprise. We also concur with the dividend policy and the decisions concerning earnings retention by the company. We assent to the proposal for distribution of the profit, which provides for payment of a dividend of 1.00 per share.

**Information pursuant to Section 289, Paragraph 4 and Section 315, Paragraph 4 of the German Commercial Code**

At its meeting on March 12, 2007, the Supervisory Board considered the information, and the report thereon, provided in the management report pursuant to Section 289, Paragraph 4 and Section 315, Paragraph 4 of the German Commercial Code. Reference is hereby made to this information, and the report thereon, to be found in the management report on page 56 ff., which the Supervisory Board has reviewed and with which it fully concurs.

The Supervisory Board would like to thank the Board of Management and all employees for their dedication and hard work in 2006.

Leverkusen, March 2007

For the Supervisory Board

/s/ Manfred Schneider

Dr. Manfred Schneider

Chairman

Bayer again in compliance with the German Corporate Governance Code*

**Bayer has always placed great importance on responsible corporate governance and will continue to do so. Last year the company renewed its declaration that it is in full compliance with the recommendations of the German Corporate Governance Code.**

In 2006 the Board of Management and Supervisory Board again addressed the question of code compliance, particularly in light of the new recommendations issued on June 12. The resulting Declaration of Conformity (see page 19 ) was published in December 2006 and posted on Bayer s website along with previous declarations.

**Supervisory Board: oversight and control functions**

The role of the 20-member Supervisory Board is to oversee and advise the Board of Management. Under the German Codetermination Act, half the members of the Supervisory Board are elected by the stockholders, and half by the company s employees. The Supervisory Board is directly involved in decisions on matters of fundamental importance to the company and confers with the Board of Management on the company s strategic alignment. It also holds regular discussions with the Board of Management on the company s business strategy and status of its implementation.

The Chairman of the Supervisory Board coordinates its work and presides over the meetings. Through regular discussions with the Board of Management, the Supervisory Board is kept constantly informed of business policy, corporate planning and strategy. The annual budget and the consolidated financial statements of Bayer AG and the Bayer Group are submitted to the Supervisory Board to obtain its approval, which must also take the auditors report into account. Details are provided in the Report of the Supervisory Board on page 10 ff. of this Annual Report. The committees set up by the Supervisory Board operate in compliance with the German Stock Corporation Act, the German Corporate Governance Code, the u.s. Sarbanes-Oxley Act and the rules of the New York Stock Exchange.

The committees of the Supervisory Board are as follows:

**Presidial Committee:** This comprises two stockholder representatives and two employee representatives. Its main task is to serve as the mediation committee pursuant to the German Codetermination Act. It submits proposals to the Supervisory Board on the appointment of members of the Board of Management if the necessary two-thirds majority is not achieved in the first vote at a plenary meeting. The Supervisory Board has also delegated certain decision-making powers relating to capital measures to the Presidial Committee.

* report pursuant to Section 3.10 of the German Corporate Governance Code

www.bayer.com
> Bayer Group
> Corporate Governance

**Audit Committee:** The Audit Committee, comprising three stockholder representatives and three employee representatives, meets four times a year. Its tasks include examining the company s internal and external accounting and the quarterly reports and annual financial statements prepared by the Board of Management. On the basis of the auditors report on the annual financial statements, the Audit Committee submits proposals concerning their approval by the full Supervisory Board. The Audit Committee also oversees the company s internal control system along with the procedures used to identify, track and manage risk, and monitors compliance with laws and statutory regulations. The company s Corporate Auditing department reports regularly to the Audit Committee, which also is responsible for the company s relationship with the external auditors. The Audit Committee prepares the awarding of the audit contract to the audit firm appointed by the Annual Stockholders Meeting, suggests areas of focus for the audit and determines the auditors remuneration. It also monitors the independence, qualifications, rotation and efficiency of the auditors.

The Supervisory Board of Bayer AG has designated Dr. Manfred Schneider as an Audit Committee Financial Expert pursuant to the Sarbanes-Oxley Act.

**Human Resources Committee:** On this committee, too, there is parity of representation between stockholders and employees. It consists of the Chairman of the Supervisory Board, one other stockholder representative and two employee representatives. The Human Resources Committee prepares the personnel decisions to be made by the Supervisory Board. In particular, it concludes service contracts with the members of the Board of Management on behalf of the Supervisory Board. It also provides advice on long-term succession planning for the Board of Management.

**Bayer Schering Pharma Committee:** The Supervisory Board formed a committee from among its members to which decision-making powers in connection with the Schering AG acquisition project and certain related financing measures were transferred to the extent legally permissible, in order to allow a rapid response to new developments.

**Compensation report**

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

In accordance with the provisions of the German Corporate Governance Code, additional remuneration is paid to the Chairman and Vice Chairman of the Supervisory Board and for chairing and membership of committees. The Chairman of the Supervisory Board receives three times the basic remuneration, while the Vice Chairman receives one-and-a-half times the basic remuneration. Members of the Supervisory Board who are also members of a committee receive an additional one quarter of the amount, with those chairing a committee receiving a further quarter. However, no member of the Supervisory Board may receive total remuneration exceeding three times the basic remuneration. If changes are made to the Supervisory Board and its committees during the fiscal year, members receive remuneration on a pro-rated basis. The following table shows the remuneration of individual members of the Supervisory Board for fiscal 2006. No remuneration or benefits were paid for personal services, in particular, the provision of consultancy or intermediary services.

| **Remuneration of the Members of the Supervisory Board** | Fixed Remuneration | Variable Remuneration | **Total** |
|---|---|---|---|
| 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 | 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 | 8,917.81 | 4,458.91 | 13,376.72 |
| Peter Hausmann | 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 | 13,479.45 | 6,739.73 | 20,219.18 |
| Gregor Jüsten | 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 (Chairman) | 180,000.00 | 90,000.00 | 270,000.00 |
| Dieter Schulte | 42,904.11 | 21,452.05 | 64,356.16 |
| Dr.-Ing. Ekkehard D. Schulz | 71,671.23 | 35,835.62 | 107,506.85 |
| Dipl.-Ing. Dr.-Ing. e. h. Jürgen Weber | 60,000.00 | 30,000.00 | 90,000.00 |
| Siegfried Wendlandt | 24,246.58 | 12,123.29 | 36,369.87 |
| Thomas de Win (Vice Chairman) | 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 |

Legislation on the disclosure of the compensation paid to members of the Board of Management came into force in Germany during the fiscal year. It specifies where such compensation is to be disclosed and the content of individual disclosures. In accordance with the provisions of this law, the compensation of the Board of Management is presented and published uniformly in a compensation report in the management reports of Bayer AG and the Bayer Group. To avoid dual presentation of the data, this Corporate Governance Report explicitly adopts, and makes reference to, the presentation in the management reports of Bayer AG and the Bayer Group (see page 76 ff.). This also applies to the description of stock option programs for the Board of Management (see page 76 ff.) and employees (see Note [26.1] to the financial statements (page 177 ff.).

**Personal liability in place of a deductible**

With regard to the recommendation in the German Corporate Governance Code that a deductible be agreed for any d&o (directors and officers liability) insurance, the company s d&o insurance does not cover intentional breach of duty and thus there is no deductible.

Instead, personal declarations have been given by the members of the Board of Management and Supervisory Board that, should they cause damage to the company or third parties through gross negligence (by German standards) in the performance of their duties, they undertake to pay for such damage up to the equivalent of half their total annual remuneration for the year in which such damage occurs. The members of the Supervisory Board undertake to pay for such damage, if caused by them, up to the equivalent of the variable portion of their respective annual remuneration as Supervisory Board members for the relevant year.

**Disclosure of securities transactions by members of the Supervisory Board and Board of Management**

To comply with Section 15a of the German Securities Trading Act, members of the Board of Management and Supervisory Board and their close relatives are required to disclose all transactions involving the purchase or sale of Bayer stock where such transactions total 5,000 or more in a calendar year. Bayer publishes details of such transactions immediately on its website and also notifies the German Financial Supervisory Authority accordingly. No reportable securities transactions were made in fiscal 2006 .

According to information filed with the company by members of the Board of Management and Supervisory Board, their total holdings of Bayer stock and related financial instruments amounted to less than 1 percent of the issued stock on the closing date for the financial statements.

**Systematic monitoring of all business activities**

Bayer has an internal control system in place to ensure early identification of any business or financial risks and enable it to manage such risks so as to minimize any impact on the achievement of its commercial objectives. The control system is designed to ensure timely and accurate accounting for all business processes and the constant availability of reliable data on the company s financial position. Where acquisitions are made during a fiscal year, we aim to bring the acquired units internal control systems into line with those of the Bayer Group as quickly as possible. However, the control and risk management system cannot protect the company from all business risks. In particular, it cannot provide absolute protection against losses or fraudulent actions.

**Corporate Compliance Program**

Our corporate activity is governed by national and local laws and statutes that place a range of obligations on the Bayer Group and its employees throughout the world. Bayer manages its business responsibly in compliance with the statutory and regulatory requirements of the countries in which it operates.

The Board of Management has also issued guidelines to support legal compliance. These are summarized in the Program for Legal Compliance and Corporate Responsibility at Bayer (Corporate Compliance Program), which contains binding rules on complying with international trade law, adhering to the principle of fair competition and concluding contracts with business partners on fair terms.

To avoid conflicts of interest, every employee is required to separate corporate and private interests. The program also lays down clear rules for employee integrity toward the company and the responsible handling of insider information. Compliance Committees have been established at Bayer AG and each of its subgroups and service companies. Each Compliance Committee includes at least one legal counsel.

The role of these committees is to initiate and monitor systematic, business-specific training and other measures necessary to ensure implementation of the Corporate Compliance Program. They are also responsible for investigating any suspected violations of the Corporate Compliance Program and, if necessary, taking steps to rectify them. All Compliance Committees report at least once a year to a coordination committee chaired by the Chief Financial Officer on any violations notified to them, the investigations carried out and their outcomes, and any corrective or disciplinary action taken. They also report on the systematic training and implementation measures they have initiated to foster compliance.

All Bayer employees are required to immediately report any violations of the Compliance Program. In Germany, a telephone hotline to a law firm has been set up to allow this to be done anonymously.

**Common values and leadership principles**

The mission statement published in 2004 supplements the Corporate Compliance Program and sets out the principles underlying Bayer s corporate strategy. It outlines the foundation of our corporate philosophy and activity to stockholders, customers, employees and the general public. Common values and leadership principles are considered essential for every employee s daily work. The values include a will to succeed; a passion for our stakeholders; integrity, openness and honesty; respect for people and nature; and the sustainability of our actions. The assessment of managers performance on the basis of defined leadership principles helps to ensure adherence to these values throughout the enterprise.

**Detailed reporting**

To maximize transparency, we provide regular and timely information on the company s position and significant changes in business activities for stockholders, financial analysts, stockholders associations, the media and the general public. Bayer complies with the recommendations of the Corporate Governance Code by publishing reports on business trends, earnings and the Group s financial position four times a year. The annual consolidated financial statements of the Bayer Group are published within 90 days following the end of the fiscal year. In addition to the annual report, quarterly reports, news conferences and analysts meetings, Bayer publishes the reports on Form 20-f (annual report) and Form 6-k (e.g. quarterly report) as required by the u.s. Securities and Exchange Commission (sec). Bayer also uses the Internet as a platform for timely disclosure of information, including details of the dates of major publications and events such as the annual and quarterly reports and the Annual Stockholders Meeting.

In line with the principle of fair disclosure, we provide the same information to all stockholders and all main target groups. All significant new facts are disclosed immediately. Stockholders also have timely access to the information that Bayer publishes in foreign countries in compliance with local stock market regulations.

In addition to our regular reporting, we issue ad-hoc statements on developments that might not otherwise become publicly known but have the potential to materially affect the price of Bayer stock.

**Investor protection in compliance with the Sarbanes-Oxley Act**

Since Bayer stock is listed on the New York Stock Exchange (nyse), the Bayer Group also has to comply with certain u.s. capital market laws, including the rules of the u.s. stock exchange regulator, the Securities and Exchange Commission (sec) , and the Sarbanes-Oxley Act adopted in 2002. Section 404 of the Sarbanes-Oxley Act requires companies to establish and maintain a system of internal controls over financial reporting to protect investors and maintain their confidence in corporate accounting, management and oversight.

At the end of 2003, Bayer initiated a Group-wide project to implement an internal control system for financial reporting in order to ensure compliance with Section 404 (Management Assessment of Internal Controls) of the Sarbanes-Oxley Act. The main focus of this project was to ensure uniform Group-wide procedures to document material business processes, identify risks affecting financial reporting, audit the effectiveness of internal controls and perform a central assessment of the internal control system for the Bayer Group. Compliance with Section 404 of the Sarbanes-Oxley Act resulted in a substantial increase in the documentation and auditing workload in 2006.

www.investor.bayer.com
> Events
> Calendar

Table of Contents



A separate department was established at the holding company in 2005 to define and introduce Group-wide standards for the internal control system (ics) and to coordinate and monitor their implementation at Group companies. A system applied throughout the Group ensures uniform and audit-proof documentation and archiving of all ics -relevant business processes, together with the associated risks and controls. The management assesses the effectiveness of the controls during the year. The findings are documented and presented transparently at Group level in a central it system. These data are the basis for the central assessment of the Group s internal control system at year end.

The management of Group companies holds local responsibility for ensuring and overseeing compliance with Section 404 of the Sarbanes-Oxley Act. That includes in particular providing guidance and support for line functions on establishing, maintaining and upgrading their internal control systems to align them with Group-wide ics standards. Many companies in the Bayer Group have appointed ics managers to support local management in these tasks.

The Bayer Group s internal control system is designed to enable the Board of Management and senior executives to assess the reliability of financial reporting with a sufficient degree of assurance. As of December 31, 2006, the Board of Management and senior executives assessed the effectiveness of the internal control system on the basis of the coso framework (Committee of Sponsoring Organizations of the Treadway Commission) for internal control systems. With reference to these criteria, the Board of Management established that as of December 31, 2006, the Bayer Group had an effective system of internal controls over financial reporting.

**Declaration by the Board of Management and the Supervisory Board of Bayer AG concerning the German Corporate Governance Code (June 12, 2006 version) pursuant to Section 161 of the German Stock Corporation Act ***

Under section 161 of the German Stock Corporation Act, the Board of Management and the Supervisory Board of Bayer AG are required to issue an annual declaration that the company has been, and is, in compliance with the recommendations of the Government Commission on the German Corporate Governance Code as published by the Federal Ministry of Justice in the official section of the electronic Federal Gazette (Bundesanzeiger), or to advise of any recommendations that have not been, or are not being, applied. The declaration pursuant to section 161 of the Stock Corporation Act shall be available to shareholders at all times. An annual declaration was last issued in December 2005.

The Board of Management and the Supervisory Board declared in July 2006 that Section 7.1.2. Sentence 3 of the Code, according to which interim reports are to be publicly accessible within 45 days of the end of the reporting period, would not be complied with for the interim reports as of June 30, 2006 or September 30, 2006 because of the additional workload involved in including Schering AG and its subsidiaries in the consolidated financial statements of the Bayer Group.

With respect to the past, the following declaration refers to the June 2, 2005 version of the Code. With respect to present and future corporate governance practices at Bayer AG, the following declaration refers to the recommendations in the June 12, 2006 version of the Code.

The Board of Management and the Supervisory Board of Bayer AG hereby declare that the company is in compliance with the recommendations of the Government Commission on the German Corporate Governance Code as published by the Federal Ministry of Justice in the official section of the electronic Federal Gazette and has been in compliance except as stated in the supplementary declaration of July 2006 since issuance of the last declaration of conformity in December 2005.

Leverkusen, December 2006

| | | |
|---|---|---|
| For the Board of Management: | | For the Supervisory Board: |
| Wenning | Kühn | Dr. Schneider |

* This is an English

translation of a German document. The German document is the official and controlling version, and this English translation in no event modifies, interprets or limits the official German version.

Table of Contents



Acquisition of Schering gives Bayer stock further impetus

**Bayer stock continued to appreciate in 2006, posting an overall performance of 18.3 percent. Investor interest focused on the acquisition of Schering. Dividend rises to  1.00 per share.**

**2006: a volatile stock market year ends on a positive note**

The German equity market proved volatile in fiscal 2006. The dax initially continued on the previous year s upward path. However, concern about inflation and interest rates in the United States triggered a global market downtrend in May and June, with substantial falls in some stocks. Sound corporate profits and buoyant mergers and acquisitions activity revived investor confidence at the start of the second half and ushered in a new rally. The dax ended the year up 22.0 percent at 6,597 points.

**Performance of Bayer stock exceeds 18 percent**

Bayer stock again developed very well, its price gaining 15.2 percent on the year. Including the dividend of  0.95 per share paid in 2006, our stock achieved a performance of 18.3 percent. This was only just below the dax s performance but slightly above the Dow Jones euro stoxx 50$^{sm}$ index, in which Bayer is also included.

During the year the share price was driven mainly by factors relating to our acquisition of Schering, Berlin, Germany. The announcement on March 23, 2006 of our intention to acquire Schering triggered a period of turbulent trading in Bayer stock, with a very high turnover at times. The tide turned in mid-June 2006, when it became increasingly clear that our public takeover offer would succeed, and Bayer shares went on from there to gain over 30 percent by year-end.

A  1.2 billion capital increase as part of the financing of this acquisition raised the number of shares in issue by 34 million to 764.34 million. Market capitalization increased by a total of  5.3 billion (+20.5 percent) on the year, to 31.1 billion.

This capital increase and the effect of the  2.3 billion mandatory convertible bond launched in April 2006 have to be taken into account in calculating earnings per share for fiscal 2006. In computing earnings per share, ordinary shares to be issued when the conversion rights from this bond issue are exercised have to be counted together with already issued shares, so basic and diluted earnings per share are identical. Details on the calculation of earnings per share are given on page 152.

Table of Contents



| Bayer Stock Data | | 2005 | 2006 |
|---|---|---|---|
| Earnings per share | | 2.19 | 2.22 |
| Core earnings per share[1] | | 2.84 | 3.24 |
| Cash flow per share | | 4.26 | 5.12 |
| Equity per share | | 15.28 | 16.81 |
| Dividend per share | | 0.95 | 1.00 |
| Year-end price[2] | | 35.29 | 40.66 |
| High for the year[2] | | 35.92 | 40.92 |
| Low for the year[2] | | 22.02 | 30.56 |
| Total dividend payment | million | 694 | 764 |
| Shares entitled to the dividend (Dec. 31) | million | 730.34 | 764.34 |
| Market capitalization (Dec. 31) | billion | 25.8 | 31.1 |
| Average daily trading volume | million | 4.1 | 5.6 |
| Price/earnings ratio[2] | | 16.1 | 18.3 |
| Price/cash flow ratio[2] | | 8.3 | 7.9 |
| Dividend yield | % | 2.7 | 2.5 |

1 For details on the calculation of core earnings per share, see page 25.

2 XETRA closing prices; Source: Bloomberg

**Proposed dividend of 1.00 per share**

The Board of Management and Supervisory Board will propose to the Annual Stockholders Meeting that that the dividend be raised by 5.3 percent to 1.00 per share. The higher per-share amount and the larger number of shares due to the capital increase boost the payout by 10.1 percent to 764 million. The dividend yield calculated on the year-end price amounts to 2.5 percent.

Despite the substantial expenditures for the Schering acquisition, this dividend is intended to ensure that stockholders participate in the success Bayer experienced in 2006 and demonstrate the confidence of the Board of Management and Supervisory Board in the Group s future development.

**Debt issues support financing of Schering acquisition**

Bayer s borrowings generally take the form of bond issues under the company s European Medium Term Notes (emtn) program. The larger Bayer AG bonds launched under this program are included in the major bond indices in light of their benchmark issue volumes and their liquidity. In addition, the Group issues innovative, separately documented debenture types and u.s. bonds under Rule 144a.

In 2006 Bayer offered investors several attractive issues. As part of the financing package for the Schering acquisition, a 2.3 billion mandatory convertible bond was issued by Bayer Capital Corp. in April 2006 and placed with institutional investors. This subordinated bond, which is guaranteed by Bayer AG, has a coupon of 6.625% . It was the largest mandatory convertible bond placement in Europe to date. Investors may convert the bond into shares of Bayer AG during the term of the bond, which runs until June 2009. If they have not done so by then, the bond will automatically convert into shares. Because of its structure, the rating agencies Moody s and Standard & Poor s treat the mandatory convertible bond entirely as equity and do not regard it as debt for credit rating purposes. For information on Bayer s credit rating, see section on financial strategy on page 52.

Table of Contents



In May 2006 Bayer AG issued three bonds under its emtn program, again to help finance the acquisition of Schering. The first is a three-year floating rate note in a nominal amount of 1.6 billion which bears interest at 0.225 percent above the 3-month Euribor rate. The second is a 1 billion issue with a seven-year term and a coupon of 4.5 percent. The third, a sterling (gbp) issue, has a coupon of 5.625 percent and a maturity of 13 years. In December 2006 Bayer utilized the very favorable capital market conditions to increase this issue by gbp 100 million to a total of gbp 350 million, giving Bayer s first-ever sterling bond benchmark volume and appealing to investors in a further currency zone. The issue was fully swapped into euros.

The hybrid bond in the nominal amount of 1.3 billion issued in 2005 was reclassified by Standard & Poor s as a result of a change to that agency s rating methodology. In computing debt indicators, s&p now treats 50 percent of this issue as equity and 50 percent as debt. Moody s continues to treat 75 percent as equity.

**Investor relations activities focus on the acquisition**

Investors interest in 2006 centered on the acquisition of Schering. Bayer s management and investor relations team met with analysts and investors at roadshows and investor conferences on nearly 60 days.

The principal topics addressed at these meetings, apart from the strategic reasons for acquiring Schering, were the late-stage projects in Bayer s pharmaceuticals development pipeline, the restructuring of CropScience, trends on the polymers markets and the impact of the Schering acquisition on Bayer s credit rating.

An innovative conference format entitled Meet Management, which was introduced in May, proved especially attractive. Representatives of the investment community were invited to Leverkusen for intensive small-group discussions with members of the management boards of our holding company and subgroups about the performance of the Bayer Group and its subsidiaries.

We also set up a hotline on the Schering acquisition to give private investors full and timely information on matters relating to the tender of their shares. The Internet was used as an additional information channel, particularly to reach individual stockholders. Wherever practicable, all conference calls and meetings are streamed live on the Internet to ensure their accessibility to all interested parties.

www.investor.bayer.com

Table of Contents



**Calculation of core earnings per share**

Earnings per share according to ifrs are affected by the purchase price allocation (see page 136 ff.) and other special factors. To enhance comparability, we also determine core net income from continuing operations after elimination of the amortization of intangible assets, asset write-downs (including any impairment losses), special items in ebitda and extraordinary factors affecting income from investments in affiliated companies (such as divestment gains or write-downs), including the related tax effects.

The calculation of earnings per share in accordance with ifrs is explained in the notes to the financial statements on page 152. Adjusted core net income, core earnings per share and core ebit are not defined in the International Financial Reporting Standards. Therefore they should be regarded as supplementary information rather than stand-alone indicators.

| **Calculation of Core EBIT and Core Earnings per Share** | **2005** | **2006** |
|---|---|---|
| million | | |
| **EBIT as per income statement** | **2,514** | **2,762** |
| Amortization and write-downs of intangible assets | 550 | 734 |
| Write-downs of property, plant and equipment | 55 | 107 |
| Special items (other than write-downs) | 480 | 909 |
| **Core EBIT** | **3,599** | **4,512** |
| Non-operating result (as per income statement) | (602) | (782) |
| Extraordinary income/loss from investments in affiliated companies | | (236) |
| Income taxes (as per income statement) | (538) | (454) |
| Tax adjustment | (386) | (531) |
| Income after taxes attributable to minority interest (as per income statement) | 2 | (12) |
| **Core net income from continuing operations** | **2,075** | **2,497** |
| Financing expenses for the mandatory convertible bond, net of tax effects | | 72 |
| **Adjusted core net income** | **2,075** | **2,569** |
| Shares | | |
| **Weighted average number of issued ordinary shares*** | **730,341,920** | **746,456,988** |
| Potential shares to be issued upon conversion of the mandatory convertible bond | | 45,300,595 |
| **Adjusted weighted average total number of issued and potential** | | |

| | | |
|---|---|---|
| **ordinary shares** | **730,341,920** | **791,757,583** |
| **Core earnings per share from continuing operations ( )** | **2.84** | **3.24** |

* including new shares from the capital increase on a pro-rated basis

2006 a record year for Bayer

**Pharmaceuticals business decisively strengthened**

Sales up 17 percent to 29 billion

Operating performance at an all-time high

ebitda before special items climbs 21 percent to 5.6 billion

ebit before special items advances 14 percent to 3.5 billion

Group net income rises 5 percent to 1.7 billion

Earning power expected to further improve in 2007

**Overview of Sales, Earnings and Financial Position**

Bayer had a very successful year in 2006, both operationally and strategically. In June, we decisively strengthened our pharmaceuticals business with the acquisition of Schering AG, Berlin, Germany. This is the most significant corporate transaction in Bayer s history and gives us leading market positions in specialty pharmaceuticals. We successfully implemented our divestiture program with the sale of our Diagnostics Division and the H.C. Starck and Wolff Walsrode activities.

We improved the performance data of our businesses, in some cases substantially, compared to the previous year. Sales of the Bayer Group grew 17.2 percent to 29.0 billion, from 24.7 billion in 2005. The total for 2006 includes 3.1 billion in revenues from the Schering business in the period from June 23, 2006. Adjusted for currency and portfolio effects, Group sales rose by 5.2 percent, with HealthCare and MaterialScience up 10.0 and 7.2 percent, respectively, and CropScience down 2.3 percent, from the prior year.

| **Change in Sales** % | **2005** | **2006** |
|---|---|---|
| Volumes | 0 | +5 |
| Prices | +7 | 0 |
| Exchange rates | +1 | 0 |
| Portfolio changes | +10 | +12 |

ebitda before special items rose by 21.3 percent to the record level of 5,584 million, from 4,602 million in 2005, yielding an underlying ebitda margin of 19.3 percent in line with our 2006 target. HealthCare saw a 75.7 percent jump in earnings, with ebitda before special items advancing to 2,613 million, from 1,487 million in 2005. The increase was due to a 774 million contribution from the acquired business of Schering AG, Germany, and gratifying business development in all divisions. CropScience posted underlying ebitda of 1,204 million, a decline of 5.4 percent in difficult market conditions. Here, cost savings partially offset a price- and volume-related squeeze on margins. MaterialScience

Table of Contents



**Bayer Group Quarterly Sales in 2006**
million

**HealthCare Quarterly Sales in 2006**
million

**CropScience Quarterly Sales in 2006**
million

**MaterialScience Quarterly Sales in 2006**
million

earnings nearly equaled the previous year s outstanding level, with underlying ebitda falling just 4.9 percent to 1,677 million. However, earnings were diminished by a sharp increase in raw material costs and by unscheduled production interruptions in the fourth quarter.

Bayer Group ebit before special items, boosted by a 178 million contribution from the Schering business, climbed by 14.2 percent to a record high of 3,479 million, from 3,047 million in 2005.

ebit in 2006 was diminished by net special charges of 717 million, compared with 533 million in the prior year. Of the net special charges for 2006, HealthCare accounted for 402 million, CropScience for 57 million and MaterialScience for 218 million. Special charges of 273 million (net) were related to the acquisition and integration of Schering AG, Germany, 200 million (2005 : 109 million) to restructuring, 172 million (net) (2005: 451 million) to litigation, and 72 million (net) (2005: 27 million net gain) to other effects.

ebit after special items improved by 9.9 percent to 2,762 million, from 2,514 million in 2005.

After a non-operating result of minus 782 million ( 2005: minus 602 million), pre-tax income was 1,980 million (2005: 1,912 million). The non-operating result contained a 236 million gain from the sale of our 49.9 percent interest in GE Bayer Silicones and net interest expense of 728 million (2005: 338 million), including 370 million in interest expense for the immediate financing of the Schering AG acquisition. After tax expense of 454 million (2005: 538 million), income after taxes from continuing operations rose to 1,526 million (2005: 1,374 million). The reduction in tax expense was due primarily to one-time income due to increased usability of tax loss carryforwards. Including the result of discontinued operations and after minority stockholders interest, net income of the Bayer Group improved to 1,683 million (2005: 1,597 million). Earnings per share came to 2.22 (2005: 2.19).

Gross cash flow increased by 799 million to 3,913 million (2005: 3,114 million) due to the gratifying growth in business and the inclusion of Schering AG, Germany. Net cash flow advanced by 21.7 percent to 3,928 million. The total net cash flow including discontinued operations was 4,203 million.

Net debt amounted to 17.5 billion at December 31, 2006, compared to 5.5 billion at the end of 2005. Thus, despite the purchase price of approximately 17 billion for Schering AG, net debt rose by only 12 billion, taking into account the Schering shares not yet acquired and an advance payment of 0.4 billion received on the sale of the Diagnostics Division. The purchase price payments received at the beginning of 2007 for Diagnostics and H.C. Starck, along with the expected proceeds from the divestiture of Wolff Walsrode, are intended to contribute to a further substantial reduction in net debt during 2007.

**Bayer Group Quarterly EBITDA Before Special Items in 2006**
million

**HealthCare Quarterly EBITDA Before Special Items in 2006**
million

**CropScience Quarterly EBITDA Before Special Items in 2006**
million

**MaterialScience Quarterly EBITDA Before Special Items in 2006**
million

Table of Contents



We also had a successful **fourth quarter**. Thanks to strong business gains in HealthCare, Group sales moved ahead 25.1 percent to 8.0 billion, of which Schering, Berlin, Germany, accounted for 1.5 billion. Adjusted for currency and portfolio effects, Group sales rose by 5.7 percent, with business expanding by 10.6 percent at HealthCare and 7.4 percent at MaterialScience. Currency- and portfolio-adjusted sales of CropScience were at the previous year s level (+0.4 percent), with business at a low level in Brazil.

Underlying **ebitda** in the fourth quarter climbed by 34.3 percent year on year, to 1,258 million, including a 352 million contribution from the Schering business. There was again a pleasing improvement in EBITDA performance of all the HealthCare divisions in the fourth quarter, while earnings of MaterialScience and CropScience declined. **ebit** before special items amounted to 622 million, against 553 million in the same period of 2005. Net special charges came to 416 million, with Bayer HealthCare accounting for most of these items. EBIT after special items came in at 206 million (Q4 2005: 129 million). Including tax income of 130 million, Group net income was 311 million (Q4 2005: 46 million). Earnings per share for the quarter were 0.41 (Q4 2005: 0.06). Net cash flow advanced 26.3 percent to 1,493 million (Q4 2005: 1,182 million). The total net cash flow including discontinued operations was 1,578 million (Q4 2005: 1,309 million).

**Operating Environment in 2006**

The dynamic pace of **global economic growth** established in 2005 continued into 2006, although the upswing slowed somewhat during the course of the year. Economic expansion nonetheless remained remarkably robust and became much more broadly based. The positive economic trend spurred the employment markets of the major industrialized countries, boosting private consumption. Growth in the emerging economies remained basically robust throughout the year.

The economy of the **United States** showed very good growth in the first quarter, but weakened markedly as the year progressed due to tighter monetary policy and higher energy prices. Although dampened by the weakness of the real estate market, private consumption remained the u.s. economy s primary growth engine, with a substantial year-on-year increase. Industry investment also trended very well through the fall of the year thanks to healthy corporate earnings and high capacity utilization, but slowed toward year end.

In **Europe**, the upswing gained considerable steam, especially in the first half. The strong recovery in Germany, in particular, stimulated the economies of the other e.u. member states, and the euro zone economy has since gathered significant momentum. On top of robust foreign demand, firmer domestic demand also contributed increasingly to economic growth in this region. Private consumption expanded far more strongly than in previous years, thanks primarily to fuller employment. In addition, corporate investment activity picked up during the year thanks to higher capacity utilization and continuing good financing conditions.

In **Japan** the economy continued to expand, even if the pace of growth temporarily weakened in the summer. Buoyed by the sharp depreciation of the yen, exports rose rapidly and helped to stimulate the economy, but domestic demand proved to be the real growth

Table of Contents



engine. The improvement in the employment market spurred private consumption, although consumer sentiment deteriorated considerably in the second half. With capacity utilization at a high level, order books well filled and corporate earnings strong, companies were more willing to invest, thereby propping up the economy. By contrast, government spending declined markedly.

The emerging economies in **Asia** continued their robust expansion in the wake of strong global economic growth, albeit at a slower pace in the second half. These countries benefited particularly from high export demand from China, Japan and the United States, while private consumption showed a slight decline almost throughout the region. A general increase in interest rates dampened corporate investment activity. Despite government efforts to check the pace of expansion, the **Chinese** economy again showed rapid growth, which continued to be driven by domestic demand. Investment posted a double-digit increase and private consumption boomed. Exports again grew strongly in addition, despite the slight appreciation of the yuan.

The economy remained strong in most countries of **Latin America** thanks to robust domestic demand and the sharp rise in raw material prices in the first half of 2006, which benefited the raw material exporters. Private consumer demand rose considerably, spurred by higher real incomes. The region s economy is thus increasingly broadly based. The Mexican economy evolved better than expected during the year, with high crude oil prices and continuing steady demand from the United States resulting in stable growth despite political turbulence. Argentina and Venezuela also developed well, but had to contend with high inflation rates. The only exception to this favorable overall picture was Brazil, where growth was comparatively moderate.

The **prescription medicines market** posted stable growth of more than 6 percent in 2006, although the pace of expansion was down slightly compared to the prior year. Trends varied greatly by region and product segment. In North America, the u.s. pharmaceuticals market recovered, expanding slightly faster than the average, as was already the case in Canada. The major u.s. companies saw sales of some blockbuster drugs fall dramatically due to numerous patent expirations, but these declines were offset by significant gains for cancer drugs and other specialty pharmaceuticals. Europe continued to suffer from the health care policy environment, with the result that below-average growth was recorded in all countries. Cardiovascular products and antibiotics, in particular, showed a very weak trend, while cancer drugs posted double-digit growth rates. The Japanese market stagnated due to the government s biennial price cuts, which took place in April. Emerging markets such as Brazil, Mexico and China made particularly large contributions to the overall expansion in the sector. In these markets, unlike those of the highly industrialized countries, growth was strongest in the traditional primary care segments such as cardiovascular risk management and metabolic disorders.

The **crop protection market** weakened in 2006 due to adverse weather conditions in the major agricultural regions and the weakness of the Brazilian farming economy. Agriculture was additionally hampered by high energy and fertilizer prices. The North and Latin American markets, in particular, recorded sharp declines, though in Latin America there was some improvement toward the end of the year. The European market held steady year on year after conditions improved in the second half. The Asian market as a whole trended slightly downward. In China, however, rising demand and the switch to modern chemical products led to strong growth.

The three major industry sectors relevant to Bayer MaterialScience registered good to above-average growth in 2006. The expansion of the **automotive industry** in 2006 was spurred by strong growth in Asia particularly in China and India and also in Japan, which is still the region s largest producer. By contrast, the automotive sector shrank in western Europe and North America, the regions where there is high replacement demand. The decline in western Europe was partly the result of a shift in production toward eastern Europe and the Middle East. The slump in car sales in the United States particularly impacted the big three u.s. producers, which failed to respond to the growing demand for more fuel-efficient vehicles.

The global **construction industry** posted growth of 3 percent in 2006 , thanks to the positive trend not only in Asia and Latin America, but also in eastern Europe, Africa and the Middle East. On the heels of market weakness in recent years, there was a gratifying performance in western Europe, due partly to the turnaround in Germany. In the u.s. residential construction stagnated, while the non-residential segment showed good growth.

The **electrical and electronics sector** again proved the most dynamic of the three, driven by brisk demand for capital equipment in areas such as automation technology, along with innovative products for the consumer electronics and communications technology markets. All regions contributed significantly to this industry s expansion in 2006, led by China with double-digit increases.

**Changes in Corporate Structure**

Since June 23, 2006, we have held a majority of the shares of Schering AG, Berlin, Germany, and therefore have included Schering in our consolidated financial statements as of that date. The names Bayer Schering Pharma or Schering as used in this Annual Report always refer to Bayer Schering Pharma AG, Berlin, Germany, or its predecessor, Schering AG, Berlin, Germany, respectively. The reference to Bayer Schering Pharma AG or Schering AG also includes business conducted by affiliated entities in countries outside Germany. Bayer Schering Pharma AG and Schering-Plough Corporation, New Jersey, are unaffiliated companies that have been totally independent of each other for many years. On October 27, 2006, the domination and profit and loss transfer agreement between Bayer Schering GmbH and Schering AG was entered in the commercial register. The renaming of Schering AG to Bayer Schering Pharma AG took effect on December 29, 2006. As of December 31, 2006, our interest in the voting capital of Bayer Schering Pharma AG amounted to 96.2 percent. The 95 percent majority required to squeeze out the minority stockholders in return for cash compensation pursuant to Sections 327a through 327f of the German Stock Corporation Act was exceeded in the third quarter. The Extraordinary Stockholders Meeting on January 17, 2007, resolved to effect a squeeze-out of the remaining minority stockholders of Bayer Schering Pharma AG.

The sale of the Diagnostics Division of Bayer HealthCare to Siemens, announced in the second quarter of 2006, was closed in January 2007. The divestment of H.C. Starck to Advent International and The Carlyle Group was completed in February 2007. The transfer of our Wolff Walsrode activities to The Dow Chemical Company is planned for the second quarter of 2007. These three businesses are recognized as discontinued operations.

**Table of Contents**



To ensure comparability between reporting periods, the following table provides a reconciliation of Bayer s sales and earnings data in the corporate structure existing at the beginning of 2006 to those in the new structure in place on December 31, 2006.

| **Bayer Key Data for the Previous and Current Corporate Structures** | Bayer excl. Schering, incl. Discontinued Operations | | Schering AG, Germany [1] | | Operations Reported as Discontinued as of 2006 [4] | | Continuing Operations incl. Schering [1] | |
|---|---|---|---|---|---|---|---|---|
| million | 2005 | **2006** | 2005 | **2006** | 2005 | **2006** | 2005 | **2006** |
| Sales | 27,383 | 28,719 | | 3,082 | 2,682 | 2,845 | 24,701 | 28,956 |
| EBITDA[2] | 4,647 | 4,986 | | 151 | 525 | 462 | 4,122 | 4,675 |
| EBITDA before special items | 5,082 | 5,291 | | 774 | 480 | 481 | 4,602 | 5,584 |
| EBITDA margin before special items | 18.6% | 18.4% | | 25.1% | 17.9% | 16.9% | 18.6% | 19.3% |
| EBIT [2] | 2,812 | 3,179[3] | | (119) | 298 | 298[3] | 2,514 | 2,762 |
| EBIT before special items | 3,300 | 3,635[3] | | 178 | 253 | 334[3] | 3,047 | 3,479 |

1 Schering AG business for the period June 23 December 31, 2006

2 For definition see Bayer Group Key Data table on front flap

3 For a year-on-year comparison of data, it should be borne in mind that depreciation and amortization for

the Diagnostics Division only took place for the first half of 2006. According to International Financial Reporting Standards, depreciation and amortization must cease from the date on which operations are classified as discontinued.

[4] Diagnostics, H.C. Starck, Wolff Walsrode

**Calculation of ebit(da) before special items for the Schering AG business**

The purchase price paid for Schering AG, Germany, was allocated among the acquired assets and assumed liabilities in accordance with the International Financial Reporting Standards (ifrs) (see also Note [7.2] to the consolidated financial statements).

One of the effects of the preliminary purchase price allocation is an upward revaluation or step-up of the acquired inventories and noncurrent assets. The greater part of the noncurrent asset step-up relates to assets used for production. Depreciation of the step-up amount results in a long-term increase in the cost of production of goods manufactured after the acquisition date. The work-down of the inventory step-up as the acquired inventories are sold off results in charges to earnings in the short term.

To ensure comparability with future earnings data, the expected long-term effects of the step-up are reflected in ebit and ebitda before special items, whereas temporary, non-cash effects of the purchase price allocation are eliminated. Special items in ebit and ebitda for 2006 include 84 million and 429 million, respectively, in charges resulting from the purchase price allocation.

**Performance by Subgroup and Segment**

Our business activities are grouped into the HealthCare, CropScience and Material-Science subgroups. The following changes apply compared to the 2005 Annual Report: as of the first quarter of 2006, the Pharmaceuticals, Biological Products segment was renamed Pharmaceuticals. As of the second quarter of 2006 , this segment also includes the acquired Schering AG business. Also since the second quarter of 2006 , the Diagnostics Division has been reported in the financial statements of the Bayer Group as a discontinued operation. At the same time, the former Consumer Care and Animal Health segments were grouped together with the Diabetes Care Division to form the new segment Consumer Health.

Furthermore, the H.C. Starck and Wolff Walsrode activities of Bayer MaterialScience are reported in the 2006 financial statements of the Bayer Group as discontinued operations. The commentaries in this report relate exclusively to continuing operations, except where specific reference is made to discontinued operations or to a total value (total). The 2005 data are restated accordingly.

| **Sales by Subgroup and Segment** | 2005 million | 2005 share of Group % | **2006** million | 2006 share of Group % |
|---|---|---|---|---|
| **HealthCare** | **7,996** | **32** | **11,724** | **40** |
| Pharmaceuticals | 4,067 | 16 | 7,478 | 26 |
| Consumer Health | 3,929 | 16 | 4,246 | 14 |
| **CropScience** | **5,896** | **24** | **5,700** | **20** |
| Crop Protection | 4,874 | 20 | 4,644 | 16 |
| Environmental Science, BioScience | 1,022 | 4 | 1,056 | 4 |
| **MaterialScience** | **9,446** | **38** | **10,161** | **35** |
| Materials | 2,837 | 11 | 2,925 | 10 |
| Systems | 6,609 | 27 | 7,236 | 25 |
| **Reconciliation** | **1,363** | **6** | **1,371** | **5** |
| **Continuing operations** | **24,701** | **100** | **28,956** | **100** |

2005 figures restated

Table of Contents



## Bayer HealthCare

| Bayer HealthCare | 2005 million | **2006** million | Change % |
|---|---|---|---|
| **Sales** | **7,996** | **11,724** | **+46.6** |
| **EBITDA[1]** | **1,280** | **1,947** | **+52.1** |
| *Special items* | *(207)* | *(666)* | |
| *EBITDA before special items [2]* | *1,487* | *2,613* | *+75.7* |
| EBITDA margin before special items | 18.6% | 22.3% | |
| **EBIT[1]** | **923** | **1,313** | **+42.3** |
| *Special items* | *(254)* | *(402)* | |
| *EBIT before special items [2]* | *1,177* | *1,715* | *+45.7* |
| **Gross cash flow [1]** | **923** | **1,720** | **+86.3** |
| **Net cash flow [1]** | **1,087** | **1,526** | **+40.4** |

2005 figures restated

1 for definition see Bayer Group Key Data on front flap

2 for definition see page 33

**Sales** of **Bayer HealthCare** in 2006 rose by 46.6 percent, or 3,728 million, to 11,724 million. The acquisition of Schering AG, Berlin, Germany, contributed 3,082 million to this figure. Currency- and portfolio-adjusted sales climbed by 10.0 percent. All divisions outperformed the market in terms of sales growth.

**ebitda** of the subgroup before special items advanced by 75.7 percent to 2,613 million (2005: 1,487 million), with the Schering business accounting for 774 million. **ebit** before special items rose by 538 million to 1,715 million (2005: 1,177 million). The net special charges of 402 million resulted primarily from expenses relating to the Schering integration. ebit of Bayer HealthCare moved ahead by 390 million, or 42.3 percent, to 1,313 million.

**Pharmaceuticals**

**Sales** of our **Pharmaceuticals** segment climbed by 83.9 percent to 7,478 million (2005: 4,067 million). This figure contains sales of 3,082 million due to the inclusion of the Schering AG business. Adjusted for currency and portfolio changes, business expanded by 11.5 percent. This encouraging growth in sales was particularly attributable to our Primary Care and Oncology business units.

The 2006 sales figures include the acquired business of Schering AG as of June 23, 2006. The Bayer Group financial statements do not include Schering AG results for the previous years. The commentaries given below on business developments related to the acquired Schering AG products 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 AG. We refer to those figures as pro forma.

Sales of the Primary Care business unit rose by 9.2 percent in 2006, to 3,091 million. This increase was due particularly to higher sales of Levitra® (+20.8 percent), Aspirin® Cardio (+18.1 percent) and Avalox®/Avelox® (+8.8 percent). Sales were additionally boosted by the inclusion of the blood pressure treatments Pritor® and PritorPlus®, for which we acquired the marketing rights for certain European countries from GlaxoSmith-Kline in January 2006. Sales from the acquired Schering AG andrology business 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®.

Table of Contents



Performance by Subgroup and Segment

In our Women s Health business unit, which focuses on contraception, we achieved sales of 1,320 million. The main growth drivers were the oral contraceptives in the Yasmin®/ yaz®/Yasminelle® product line, pro forma sales of which were up by 35.5 percent in 2006. The fda has since expanded the registration for yaz®, which is thus the first and only oral contraceptive approved to effectively treat the emotional and physical symptoms of pre-menstrual dysphoric disorder as well as acne in women. Pro-forma sales of our intra-uterine system Mirena® also advanced by a pleasing 23.9 percent.

Sales of the Diagnostic Imaging business unit came to 697 million. Pro forma 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 sales of this product in numerous countries in the first quarter of 2007. Medrad, which markets application technologies for contrast agents worldwide, grew pro forma sales by a pleasing 13.1 percent.

Sales of the Specialized Therapeutics business unit amounted to 678 million. Pro forma business with our top product Betaferon®/Betaseron® to treat multiple sclerosis (ms) expanded by 14.3 percent. The fda has expanded marketing authorization for Betaseron® so that it can now also be used to treat patients who have first clinical symptoms and diagnostic features consistent with ms.

Sales of the Hematology/Cardiology business unit receded by 4.9 percent to 1,142 million. The effects of terminating our plasma distribution in Canada at the end of March 2006 and markedly lower sales of Trasylol® (-33.5 percent) were nearly offset by the pleasing growth in sales of Kogenate® (+18.7 percent). Two separate observational studies reported on a possible correlation between the administration of Trasylol® (aprotinin), our product for use during open-heart surgery, and severe renal dysfunction and vasoconstriction (myocardial infarction and stroke). A follow-up study to one of them reported on a possible correlation between administration of this product and increased long-term mortality. Based on our study data and many years of experience with Trasylol®, Bayer believes that this product is a safe and effective medicine when used correctly. We are currently cooperating closely with the relevant regulatory authorities to resolve the questions that have arisen.

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

The Dermatology (Intendis) business unit had sales of 118 million. The unit s two bestselling products, Skinoren® (+17.1 percent pro forma) and Advantan® (+10.6 percent pro forma) developed particularly well.

| **Pharmaceuticals** | **2005** million | **2006** million | **Change** % |
|---|---|---|---|
| **Sales** | **4,067** | **7,478** | **+83.9** |
| Primary Care | 2,831 | 3,091 | +9.2 |
| Women s Health | | 1,320 | |
| Diagnostic Imaging (including Medrad) | | 697 | |
| Specialized Therapeutics | | 678 | |
| Hematology/Cardiology | 1,201 | 1,142 | -4.9 |
| Oncology | 35 | 432 | |
| Dermatology (Intendis) | | 118 | |
| **EBITDA[1]** | **663** | **1,051** | **+58.5** |
| *Special items* | *(108)* | *(635)* | |
| *EBITDA before special items[2]* | *771* | *1,686* | *+118.7* |
| EBITDA margin before special items | 19.0% | 22.5% | |
| **EBIT[1]** | **475** | **563** | **+18.5** |
| *Special items* | *(140)* | *(371)* | |
| *EBIT before special items[2]* | *615* | *934* | *+51.9* |
| **Gross cash flow[1]** | **449** | **1,086** | **+141.9** |
| **Net cash flow[1]** | **481** | **1,053** | **+118.9** |

2005 figures restated

Data for the acquired Schering AG business are reflected for the period June 23 December 31, 2006.

1 for definition see Bayer Group Key Data on front flap

2 for definition see also page 33

| **Best-Selling Pharmaceutical Products** | **2005** million | **2006** million | **Change** % |
|---|---|---|---|
| Betaferon®/Betaseron®* (Specialized Therapeutics) | | 535 | |
| Yasmin®/YAZ®/Yasminelle®* (Women s Health) | | 451 | |
| Kogenate® (Hematology/Cardiology) | 663 | 787 | +18.7 |
| Adalat® (Primary Care) | 659 | 657 | -0.3 |
| Cipro®/Ciprobay® (Primary Care) | 525 | 513 | -2.3 |
| Avalox®/Avelox® (Primary Care) | 364 | 396 | +8.8 |
| Levitra® (Primary Care) | 260 | 314 | +20.8 |
| Mirena®* (Women s Health) | | 166 | |
| Magnevist® * (Diagnostic Imaging) | | 171 | |
| Glucobay® (Primary Care) | 295 | 308 | +4.4 |
| **Total** | **2,766** | **4,298** | **+55.4** |
| Proportion of Pharmaceutical sales | 68% | 57% | |

Products are ranked by fourth-quarter sales.

* acquired Schering AG product (sales included for the period June 23 December 31, 2006).

| **Best-Selling Schering AG Products (pro forma, unaudited)** | **2005** million | **2006** million | **Change** % |
|---|---|---|---|
| Betaferon®/Betaseron® | 867 | 991 | +14.3 |
| Yasmin®/YAZ®/Yasminelle® | 586 | 794 | +35.5 |
| Magnevist® | 328 | 323 | -1.5 |
| Mirena® | 243 | 301 | +23.9 |

Performance by Subgroup and Segment

**ebitda** of the **Pharmaceuticals** segment before special items advanced by 118.7 percent to 1,686 million (2005: 771 million), with the business acquired from Schering AG in June 2006 accounting for 774 million. When adjusted for portfolio effects, earnings rose by 141 million, due especially to a gratifying sales performance by Kogenate®, Levitra® and Avalox®/Avelox®. **ebit** before special items rose by 319 million, or 51.9 percent, to 934 million. The net special charges of 371 million in the Pharmaceuticals segment resulted chiefly from expenses for the integration of Schering AG, including a special gain of 74 million from the sale of an office building. ebit moved ahead by 88 million, or 18.5 percent, to 563 million.

**Consumer Health**

All divisions contributed to the gratifying performance of our **Consumer Health** segment, **sales** of which improved by 8.1 percent to 4,246 million. Adjusted for currency and portfolio effects, sales rose by 8.4 percent.

Business in the Consumer Care Division expanded by 7.5 percent to 2,531 million. Among our top products, Aleve® (+27.5 percent), Bepanthen®/Bepanthol® (+14.9 percent) and Canesten® (+11.7 percent) posted the largest sales gains.

There was a significant increase in sales of our Diabetes Care Division, where business improved by 12.8 percent to 810 million thanks mainly to the strong performance of our blood glucose monitoring system Ascensia® Contour® (+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 pleasing performance of our Advantage® product line, where business was up 10.4 percent, and the continued market introduction of Profender®.

**ebitda** of the **Consumer Health** segment before special items grew by 211 million, or 29.5 percent, to 927 million. This increase was attributable to positive sales development and reduced production costs. ebit before special items advanced by 39.0 percent to 781 million. Earnings for 2006 were diminished by special charges totaling 31 million (2005: 114 million), the main items being expenses for the integration of the Roche consumer health business, which is largely completed, and restructuring activities in the United States. After special items, ebit improved by 67.4 percent to 750 million.

The strong growth in sales led to an increase in current assets, particularly inventories and receivables, diminishing net cash flow from 606 million in the prior year to 473 million in 2006.

| Consumer Health | 2005 million | 2006 million | Change % |
|---|---|---|---|
| **Sales** | **3,929** | **4,246** | **+8.1** |
| Consumer Care | 2,355 | 2,531 | +7.5 |
| Diabetes Care | 718 | 810 | +12.8 |
| Animal Health | 856 | 905 | +5.7 |
| **EBITDA*** | **617** | **896** | **+45.2** |
| *Special items* | *(99)* | *(31)* | |
| *EBITDA before special items* | *716* | *927* | *+29.5* |
| EBITDA margin before special items | 18.2% | 21.8% | |
| **EBIT*** | **448** | **750** | **+67.4** |
| *Special items* | *(114)* | *(31)* | |
| *EBIT before special items* | *562* | *781* | *+39.0* |
| **Gross cash flow *** | **474** | **634** | **+33.8** |
| **Net cash flow *** | **606** | **473** | **-21.9** |

2005 figures restated

* for definition see Bayer Group Key Data on front flap

| Best-Selling Consumer Health Products | 2005 million | 2006 million | Change % |
|---|---|---|---|
| Ascensia® product line (Diabetes Care) | 701 | 788 | +12.4 |
| Aspirin® * (Consumer Care) | 453 | 465 | +2.6 |
| Advantage®/Advantix® (Animal Health) | 249 | 275 | +10.4 |
| Aleve®/ naproxen (Consumer Care) | 178 | 227 | +27.5 |

| | | | |
|---|---|---|---|
| Canesten® (Consumer Care) | 145 | 162 | +11.7 |
| Baytril® (Animal Health) | 163 | 162 | -0.6 |
| Bepanthen ®/ Bepanthol® (Consumer Care) | 114 | 131 | +14.9 |
| Supradyn® (Consumer Care) | 125 | 130 | +4.0 |
| One-A-Day® (Consumer Care) | 118 | 124 | +5.1 |
| Alka-Seltzer® (Consumer Care) | 95 | 101 | +6.3 |
| **Total** | **2,341** | **2,565** | **+9.6** |
| Proportion of Consumer Health sales | 60% | 60% | |

* total Aspirin® sales = 674 million (2005: 630 million), including Aspirin® Cardio, which is reflected in sales of the Pharmaceuticals segment

Table of Contents



Performance by Subgroup and Segment
Bayer CropScience

| **Bayer CropScience** | **2005** million | **2006** million | **Change** % |
|---|---|---|---|
| **Sales** | **5,896** | **5,700** | **-3.3** |
| **EBITDA*** | **1,284** | **1,166** | **-9.2** |
| *Special items* | *11* | *(38)* | |
| *EBITDA before special items* | *1,273* | *1,204* | *-5.4* |
| EBITDA margin before special items | 21.6% | 21.1% | |
| **EBIT*** | **690** | **584** | **-15.4** |
| *Special items* | *5* | *(57)* | |
| *EBIT before special items* | *685* | *641* | *-6.4* |
| **Gross cash flow*** | **964** | **900** | **-6.6** |
| **Net cash flow*** | **904** | **898** | **-0.7** |

* for definition see Bayer Group Key Data on front flap

| **Best-Selling Bayer CropScience Products *** | **2005** million | **2006** million | **Change** % |
|---|---|---|---|
| Confidor®/Gaucho®/Admire®/Merit® (Insecticides/Seed Treatment/Environmental Science) | 587 | 564 | -3.9 |
| Folicur®/Raxil® (Fungicides/Seed Treatment) | 339 | 276 | -18.6 |
| Basta®/Liberty® (Herbicides) | 219 | 229 | +4.6 |
| Puma® (Herbicides) | 205 | 196 | -4.4 |
| Decis®/K-Othrine® (Insecticides/Environmental Science) | 159 | 183 | +15.1 |
| Flint®/Stratego®/Sphere® (Fungicides) | 193 | 181 | -6.2 |
| Atlantis® (Herbicides) | 142 | 169 | +19.0 |

| | | | |
|---|---|---|---|
| Proline® (Fungicides) | 91 | 144 | +58.2 |
| Poncho® (Seed Treatment) | 110 | 127 | +15.5 |
| Betanal® (Herbicides) | 128 | 120 | -6.3 |
| **Total** | **2,173** | **2,189** | **+0.7** |
| Proportion of Bayer CropScience sales | 37% | 38% | |

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

**Sales** of **Bayer CropScience** in 2006 came in at 5,700 million, down just 3.3 percent in a declining crop protection market. With selling prices in Brazil pegged to the u.s. dollar, the sharp appreciation of the local currency led to a decline in sales. Adjusted for this effect and for currency and portfolio changes, business at CropScience shrank by 2.3 percent.

**ebitda** before special items was down by 69 million, or 5.4 percent, in 2006 to 1,204 million. The savings achieved through cost structure and efficiency improvement programs partly compensated for the squeeze on margins brought about by price erosion, lower volumes and adverse currency effects. **ebit** before special items was down 44 million, or 6.4 percent, from the previous year to 641 million in 2006, hampered by special charges connected with the restructuring program initiated in summer 2006 . These charges were only partially offset by non-recurring income from the divestment of a family of mature herbicide products. After special items, ebit for 2006 amounted to 584 million (2005: 690 million).

## Crop Protection

**Sales** in the **Crop Protection** segment declined by 4.7 percent to 4,644 million, from 4,874 million in 2005. With selling prices in Brazil pegged to the u.s. dollar, the sharp appreciation of the local currency led to a decline in sales. Adjusted for this effect and for currency and portfolio changes, business in this segment shrank by 3.5 percent.

Fiscal 2006 was marked by adverse weather conditions in major agricultural markets, a difficult business environment in Brazil, heightening pressure on prices from generic products and an increasing trend toward genetically modified crops. The resulting decline in sales was partially offset by the successful marketing of innovative active ingredients introduced over the past few years. Sales of products containing these new ingredients, which have been introduced in core markets since 2000, achieved the 2006 target of 1 billion. Contributing to this performance were our cereal herbicide Atlantis®, the seed treatment Poncho® and the cereal fungicide Proline®. Including our Flint® fungicide, four of our recent market introductions were among our ten best-selling products.

Sales of our Insecticides business unit fell by 7.0 percent overall, to 1,219 million (2005: 1,311 million). The decline was attributable to the adverse market environment in Brazil, unfavorable regional weather conditions, increasing competition from generics and the absence of business in certain mature insecticide products that have been divested. Business with insecticides in China, however, developed well. Global sales of our new ketoenols Oberon® and Envidor® posted significant increases.

Sales of the Fungicides business unit receded 3.8 percent to 1,200 million. One reason for the decrease was the prolonged drought in Australia, the United States and parts of Europe, which led to a decrease in fungal infestation. 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.

| **Crop Protection** | **2005** | **2006** | **Change** |
|---|---|---|---|
| | million | million | % |
| **Sales** | **4,874** | **4,644** | **-4.7** |
| Insecticides | 1,311 | 1,219 | -7.0 |
| Fungicides | 1,248 | 1,200 | -3.8 |
| Herbicides | 1,840 | 1,758 | -4.5 |
| Seed Treatment | 475 | 467 | -1.7 |
| **EBITDA*** | **1,026** | **889** | **-13.4** |
| *Special items* | *12* | *(38)* | |
| *EBITDA before special items* | *1,014* | *927* | *-8.6* |
| EBITDA margin before special items | 20.8% | 20.0% | |
| **EBIT*** | **532** | **384** | **-27.8** |
| *Special items* | *7* | *(57)* | |
| *EBIT before special items* | *525* | *441* | *-16.0* |

| | | | |
|---|---|---|---|
| **Gross cash flow*** | **762** | **691** | **-9.3** |
| **Net cash flow*** | **699** | **748** | **+7.0** |

* for definition see Bayer Group Key Data on front flap

Performance by Subgroup and Segment

In the Herbicides business unit, sales dropped by 4.5 percent to 1,758 million, from 1,840 million in 2005. 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 very strongly in the market, further strengthening our position as one of the leading suppliers of cereal herbicides. Business with our herbicides Basta® and Liberty® moved ahead.

Sales of our Seed Treatment business unit dipped by 1.7 percent to 467 million. Adjusted for portfolio effects, however, sales were slightly above the prior year. Business with 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 e.u. sugar market reform.

**ebitda** before special items for the **Crop Protection** business decreased to 927 million. The price-related decline in margins was partly offset by savings achieved through our cost structure and efficiency improvement programs.

**ebit** before special items fell by 16.0 percent to 441 million. After net special charges of 57 million, ebit for 2006 came in at 384 million, down from 532 million in the previous year.

**Environmental Science, BioScience**

| **Environmental Science, BioScience** | **2005** million | **2006** million | **Change** % |
|---|---|---|---|
| **Sales** | **1,022** | **1,056** | **+3.3** |
| Environmental Science | 694 | 714 | +2.9 |
| BioScience | 328 | 342 | +4.3 |
| **EBITDA*** | **258** | **277** | **+7.4** |
| *Special items* | *(1)* | *0* | |
| *EBITDA before special items* | *259* | *277* | *+6.9* |
| EBITDA margin before special items | 25.3% | 26.2% | |
| **EBIT*** | **158** | **200** | **+26.6** |
| *Special items* | *(2)* | *0* | |
| *EBIT before special items* | *160* | *200* | *+25.0* |
| **Gross cash flow*** | **202** | **209** | **+3.5** |
| **Net cash flow*** | **205** | **150** | **-26.8** |

* for definition see Bayer Group Key Data on front flap

**Sales** of the **Environmental Science, BioScience** segment rose by 3.3 percent in 2006 to 1,056 million, or by 3.7 percent when adjusted for currency and portfolio changes.

The Environmental Science unit saw business expand by 2.9 percent to 714 million, from 694 million in 2005, in light of strong sales gains by our products for professional users.

BioScience increased sales by 4.3 percent to 342 million, thanks mainly to buoyant sales of vegetable and canola seed products.

Table of Contents



**ebitda** for Environmental Science, BioScience before special items rose by  277 million, or 6.9 percent, thanks to the growth in business. Costs savings in Environmental Science also had a positive effect. **ebit** before special items advanced by 25.0 percent from the prior year to  200 million. ebit after special items rose by 26.6 percent.
Due to an increase in working capital, net cash flow dropped to  150 million, from  205 million in the previous year.

**Bayer MaterialScience**

| **Bayer MaterialScience** | **2005** | **2006** | **Change** |
|---|---|---|---|
| | million | million | % |
| **Sales** | **9,446** | **10,161** | **+7.6** |
| **EBITDA*** | **1,721** | **1,499** | **-12.9** |
| *Special items* | *(43)* | *(178)* | |
| *EBITDA before special items* | *1,764* | *1,677* | *-4.9* |
| EBITDA margin before special items | 18.7% | 16.5% | |
| **EBIT*** | **1,250** | **992** | **-20.6** |
| *Special items* | *(43)* | *(218)* | |
| *EBIT before special items* | *1,293* | *1,210* | *-6.4* |
| **Gross cash flow*** | **1,254** | **1,166** | **-7.0** |
| **Net cash flow*** | **1,337** | **1,281** | **-4.2** |

2005 figures restated

* for definition see Bayer Group Key Data on front flap

The upward business trend at **Bayer MaterialScience** continued in 2006 , with **sales** advancing a further 7.6 percent from the previous year s high level to  10,161 million, or by 7.2 percent when adjusted for currency and portfolio effects. This encouraging growth in business was due primarily to higher volumes in all business units, while selling prices rose slightly on average.

**ebitda** before special items almost matched the previous year s level, dipping just 4.9 percent to  1,677 million. Substantial price hikes for petrochemical feedstocks, especially in the second half, were offset by volume growth and price increases, but fourth-quarter earnings were held back by a temporary loss of production in Krefeld-Uerdingen, Germany. In addition, the expansion of our sales organization in the growth market of Asia and expenses for the start-up of our production facilities in China led to an increase in costs.

**ebit** before special items dropped by  83 million, or 6.4 percent, to  1,210 million. Special charges amounted to  218 million, including  153 million in litigation-related expenses. The prior-year figure contained net special charges of  43 million. ebit after special items was down by  258 million, or 20.6 percent, to  992 million.

Performance by Subgroup and Segment

**Materials**

Our **Materials** segment saw **sales** rise by 3.1 percent in 2006, to 2,925 million. Adjusted for currency and portfolio changes, the increase was 3.3 percent. Volumes in the Poly-carbonates business unit moved higher, particularly in Europe and Asia/Pacific, with sales up 2.8 percent over 2005 despite heavy pressure on prices. The Thermoplastic Poly-urethanes business unit grew sales by 6.8 percent, mainly as a result of higher volumes.

**ebitda** before special items fell by a substantial 30.7 percent in 2006 , to 448 million, as a result of a squeeze on margins caused by lower selling prices and rising raw material costs, which were not outweighed by the higher volumes. **ebit** before special items fell by 41.6 percent to 289 million, while ebit after special items dropped by 225 million to 289 million.

**Systems**

**Sales** of the **Systems** segment climbed by 9.5 percent year on year to 7,236 million, or by 8.9 percent when adjusted for currency and portfolio effects. This expansion was attributable to both selling price and volume increases in all business units.

**ebitda** before special items in 2006 advanced by 9.9 percent to 1,229 million, with selling price increases and higher volumes more than compensating for the rise in raw material costs. **ebit** before special items climbed by 123 million, or 15.4 percent, to 921 million. ebit of the Systems segment was hampered by special charges of 218 million, resulting primarily from an arbitration proceeding in the United States relating to the production of propylene oxide. Other special charges were incurred in connection with pending antitrust proceedings and the restructuring of our u.s. sites in New Martinsville, West Virginia, and Baytown, Texas. After special items, ebit declined by 33 million, or 4.5 percent, to 703 million.

| **Materials** | **2005** million | **2006** million | **Change** % |
| --- | --- | --- | --- |
| **Sales** | **2,837** | **2,925** | **+3.1** |
| Polycarbonates | 2,645 | 2,720 | +2.8 |
| Thermoplastic Polyurethanes | 192 | 205 | +6.8 |
| **EBITDA*** | **665** | **448** | **-32.6** |
| *Special items* | *19* | *0* | |
| *EBITDA before special items* | *646* | *448* | *-30.7* |
| EBITDA margin before special items | 22.8% | 15.3% | |
| **EBIT*** | **514** | **289** | **-43.8** |
| *Special items* | *19* | *0* | |
| *EBIT before special items* | *495* | *289* | *-41.6* |
| **Gross cash flow*** | **473** | **364** | **-23.0** |
| **Net cash flow*** | **466** | **324** | **-30.5** |

2005 figures restated

* for definition see Bayer Group Key Data on front flap

| **Systems** | **2005** million | **2006** million | **Change** % |
| --- | --- | --- | --- |
| **Sales** | **6,609** | **7,236** | **+9.5** |
| Polyurethanes | 4,792 | 5,182 | +8.1 |
| Coatings, Adhesives, Sealants | 1,330 | 1,488 | +11.9 |
| Inorganic Basic Chemicals | 380 | 403 | +6.1 |
| Other | 107 | 163 | +52.3 |

| | | | |
|---|---|---|---|
| **EBITDA*** | **1,056** | **1,051** | **-0.5** |
| *Special items* | *(62)* | *(178)* | |
| *EBITDA before special items* | *1,118* | *1,229* | *+9.9* |
| EBITDA margin before special items | 16.9% | 17.0% | |
| **EBIT*** | **736** | **703** | **-4.5** |
| *Special items* | *(62)* | *(218)* | |
| *EBIT before special items* | *798* | *921* | *+15.4* |
| **Gross cash flow*** | **781** | **802** | **+2.7** |
| **Net cash flow*** | **871** | **957** | **+9.9** |

* for definition see Bayer Group Key Data on front flap

Table of Contents



**Performance by Region**

In 2006 Bayer s global business expanded by 4,255 million, or 17.2 percent, to 28,956 million. Adjusted for shifts in exchange rates, sales rose by 17.4 percent.

The largest increase in absolute terms was achieved in the **Europe** region, where sales climbed by 17.5 percent to 12,652 million. Portfolio-adjusted sales in Europe expanded by 5.1 percent, driven by HealthCare and MaterialScience. Sales of the CropScience subgroup remained steady at the previous year s level due to unfavorable weather conditions, particularly in southern Europe. Sales in Germany grew 17.7 percent to 4,525 million, or by 7.9 percent when adjusted for portfolio effects.

Sales in **North America** advanced by 19.8 percent in 2006, to 7,779 million. Adjusted for portfolio effects, the increase came to 5.9 percent. In this region too, improvements were recorded by HealthCare, thanks to strong sales in the Consumer Health segment, as well as by MaterialScience in the Polyurethanes business unit and in Coatings, Adhesives, Sealants. In the Crop Protection segment, on the other hand, sales declined due to adverse weather patterns and increasing cultivation of genetically modified crops.

In the **Asia/Pacific** and **Latin America/Africa/Middle East** regions, sales rose by 13.2 percent and 16.5 percent, respectively. Notably, sales in Greater China advanced by a gratifying 24.1 percent from the previous year, to 1.5 billion. Portfolio-adjusted sales in the two regions advanced by 3.7 and 4.3 percent, respectively, thanks to growth in HealthCare and MaterialScience. However, CropScience sales in the Latin America/Africa/ Middle East region receded by 9.1 percent due to the difficult market environment in Brazil, but dipped by only 1.0 percent in the Asia/Pacific region when adjusted for currency effects.

**Sales by Region and Segment (by market)**

| Europe | | | North America | | | | Asia/Pacific | | | | Latin America/Africa/Middle East | | | | |
|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|
| **2006** | % | adj. % | 2005 | **2006** | % | adj. | 2005 | **2006** | % | adj. % | 2005 | **2006** | % | adj. % | |
| **4,737** | **+48.4** | **+48.3** | **2,450** | **3,689** | **+50.6** | **+50.5** | **1,201** | **1,649** | **+37.3** | **+40.9** | **1,153** | **1,649** | **+43.0** | **+44.6** | |
| 3,046 | +90.4 | +90.2 | 1,129 | 2,226 | +97.2 | +96.6 | 900 | 1,313 | +45.9 | +50.5 | 438 | 893 | +103.9 | +105.7 | |
| 1,691 | +6.2 | +6.3 | 1,321 | 1,463 | +10.7 | +11.1 | 301 | 336 | +11.6 | +12.1 | 715 | 756 | +5.7 | +7.3 | |
| **2,251** | **+0.4** | **+0.3** | **1,528** | **1,457** | **-4.6** | **-5.1** | **933** | **907** | **-2.8** | **-1.0** | **1,194** | **1,085** | **-9.1** | **-11.4** | |
| 1,909 | +0.4 | +0.2 | 1,076 | 996 | -7.4 | -8.1 | 811 | 772 | -4.8 | -3.1 | 1,086 | 967 | -11.0 | -13.5 | |
| 342 | +0.6 | +0.5 | 452 | 461 | +2.0 | +2.1 | 122 | 135 | +10.7 | +13.2 | 108 | 118 | +9.3 | +9.9 | |
| **4,402** | **+7.4** | **+7.4** | **2,500** | **2,622** | **+4.9** | **+5.4** | **1,887** | **2,007** | **+6.4** | **+7.2** | **961** | **1,130** | **+17.6** | **+16.8** | |
| 1,100 | +3.5 | +3.4 | 609 | 599 | -1.6 | -1.0 | 908 | 947 | +4.3 | +4.9 | 257 | 279 | +8.6 | +8.8 | |
| 3,302 | +8.8 | +8.8 | 1,891 | 2,023 | +7.0 | +7.5 | 979 | 1,060 | +8.3 | +9.3 | 704 | 851 | +20.9 | +19.8 | |
| **12,652** | **+17.5** | **+17.4** | **6,496** | **7,779** | **+19.8** | **+19.9** | **4,073** | **4,610** | **+13.2** | **+15.0** | **3,361** | **3,915** | **+16.5** | **+16.0** | **2** |

2005 figures restated

adj.= currency-adjusted

## Value Management

*Our goal is to steadily increase Bayer s enterprise value and generate high value-added for the benefit of our stockholders, our employees and society as a whole in every country in which we do business.*

Werner Wenning, Chairman of the Board of Management of Bayer AG

### Cash value added-based system

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

### Calculating the cost of capital

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

To take into account the different risk and return profiles of our principal businesses, we calculate the cost of capital after taxes for each of our subgroups. In 2006 this was 7.5 percent (2005: 8.0 percent) for Bayer HealthCare, 7.0 percent (2005 : 6.5 percent) for Bayer CropScience and 6.5 percent (2005: 6.0 percent) for Bayer MaterialScience. The minimum return required for the Bayer Group as a whole was 7.0 percent ( 2005 : 7.0 percent).

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

The gcf, as published in our cash flow statement, is the measure of our internal financing capability. Bayer has chosen this parameter because it is relatively free of accounting influences and thus a more meaningful performance indicator. The profitability of the Group and of its individual business entities is measured by the cash flow return on investment (cfroi). This is the ratio of the gcf to the capital invested (ci). The ci can be derived from the balance sheet and basically comprises the property, plant and equipment and intangible assets required for operations stated at cost of acquisition or construction - plus working capital, less interest-free liabilities (such as short-term provisions). To allow for fluctuations during the year, the cfroi is computed on the basis of the average ci for the respective year.

Taking into account the costs of capital and of reproducing depletable assets, we determine the gcf hurdle. If the gcf hurdle is equaled or exceeded, the required return on equity and debt plus the cost of asset reproduction has been earned. The cfroi hurdle for 2006 was 10.0 percent, while the corresponding gcf hurdle was 3,188 million.

Actual gcf came in at 3,913 million, exceeding the hurdle by a substantial 22.7 percent. Thus in 2006 we earned our entire capital and asset reproduction costs, and the positive cva of 725 million shows we created additional value. Given the previous year s cva of 746 million, the Bayer Group therefore achieved a delta cva of minus 21 million. With a cfroi of 12.1 percent in 2006 (2005: 12.5 percent), we thus almost equaled the previous year s record level despite the acquisition-related increase in the capital invested.

The HealthCare and MaterialScience subgroups exceeded their target returns including asset reproduction. The cfroi for HealthCare declined from 15.5 percent in the previous year to 12.4 percent, due to the increase in capital invested associated with the Schering AG acquisition and also because of integration-related charges. MaterialScience achieved a cfroi of 15.6 percent (2005: 17.8 percent). The figure for CropScience dipped from 11.2 percent in the prior year to 10.3 percent in 2006 .

| **Value Management Indicators by Subgroup** | HealthCare | | CropScience | | MaterialScience | | Bayer Group | |
|---|---|---|---|---|---|---|---|---|
| million | 2005 | **2006** | 2005 | **2006** | 2005 | **2006** | 2005 | **2006** |
| Gross cash flow hurdle (GCF hurdle) | 690 | 1,536 | 935 | 1,000 | 610 | 649 | 2,368 | 3,188 |
| Gross cash flow* (GCF) | 923 | 1,720 | 964 | 900 | 1,254 | 1,166 | 3,114 | 3,913 |
| Cash value added (CVA) | 233 | 184 | 29 | (100) | 644 | 517 | 746 | 725 |
| Cash fl ow return on investment (CFROI) | 15.5% | 12.4% | 11.2% | 10.3% | 17.8% | 15.6% | 12.5% | 12.1% |
| Average capital invested (ACI) | 5,955 | 13,865 | 8,618 | 8,728 | 7,054 | 7,489 | 24,893 | 32,276 |

2005 figures restated

* for definition see Bayer Group Key Data on front flap

Table of Contents



## Liquidity and Capital Resources

### Operating cash flow

Gross cash flow in 2006 amounted to 3,913 million, up 25.7 percent from the previous year ( 3,114 million). The increase was mainly the result of the strong business performance in HealthCare and the inclusion of Schering AG, Berlin, Germany. Higher tax payments had a negative effect. Earnings for 2005 contained tax-free gains of 238 million from changes in our company pension plans, while in 2006 the charges resulting from the revaluation of acquired assets of Schering AG were not tax-deductible.

Net cash flow from continuing operations rose by 21.7 percent, or 701 million including 483 million from the Schering business to 3,928 million (2005: 3,227 million).

### Investing cash flow

There was a net cash outflow of 14.7 billion for investing activities in 2006, compared to a 1.7 billion inflow in the previous year. This was chiefly attributable to disbursements totaling 15.2 billion for the Schering AG acquisition, including the purchase price payments for 96.2 percent of Bayer Schering Pharma AG shares as of December 31, 2006, less approximately 1 billion in acquired cash. We also acquired biotech company Icon Genetics and 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 AG. Depreciation of property, plant and equipment came to 1,086 million, and amortization of intangible assets to 1,000 million.

Capital expenditures for property, plant, equipment and intangible assets included 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 near Shanghai, China. In September 2006 we inaugurated at that site a world-scale polycarbonate production facility with an initial capacity of 100,000 tons per year, a plant for the manufacture of the polyurethane raw materials monomeric and polymeric Mdi (diphenylmethane diisocyanate) from crude Mdi with an annual capacity of 80,000 tons, and a production unit for hexamethylene diisocyanate with a planned initial capacity of 30,000 tons.

Receipts from sales of property, plant, equipment and other assets totaled 185 million (2005: 105 million), while the proceeds of divestitures amounted to 489 million (2005: 293 million). At the end of 2006 we received an initial payment of 395 million related to the sale of our Diagnostics business; this transaction closed at the beginning of 2007.

Receipts from noncurrent financial assets came to 850 million, compared to 1,189 million in 2005. This figure primarily included the sale of our 49.9 percent interest in GE Bayer Silicones to the other partner General Electric and the repayment of a loan made to the chemical company Symrise. This loan had been granted to the company that purchased the Haarmann & Reimer group from Bayer in 2002.

Table of Contents



In the previous year, expenditures for acquisitions mainly comprised a payment of about 1.9 billion for the consumer health business of Roche. Receipts related to noncurrent financial assets in that year came to 1.2 billion, resulting primarily from the scheduled repayment of loans by lanxess and the expiration of derivatives. The 293 million cash inflow from divestitures in 2005 consisted largely of the proceeds from the sale of the u.s. plasma business.

| **Bayer Group Summary Cash Flow Statements** million | **2005** | **2006** |
|---|---|---|
| **Gross cash flow*** | **3,114** | **3,913** |
| Changes in working capital/other non-cash items | 113 | 15 |
| **Net cash provided by (used in) operating activities (net cash flow), continuing operations** | **3,227** | **3,928** |
| Net cash provided by (used in) operating activities (net cash flow), discontinued operations | 275 | 275 |
| **Net cash provided by (used in) operating activities (net cash flow), (total)** | **3,502** | **4,203** |
| **Net cash provided by (used in) investing activities (total)** | **(1,741)** | **(14.730)** |
| **Net cash provided by (used in) financing activities (total)** | **(1,881)** | **10,199** |
| **Change in cash and cash equivalents due to business activities (total)** | **(120)** | **(328)** |
| **Cash and cash equivalents at beginning of year** | **3.570** | **3,290** |
| Change due to exchange rate movements and to changes in scope of consolidation | (160) | (47) |
| **Cash and cash equivalents at end of year** | **3,290** | **2,915** |

2005 figures restated

* for definition see Bayer Group Key Data on front flap

**Financing cash flow**

Financing activities resulted in a net cash inflow in 2006 of 10.2 billion (2005: outflow of 1.9 billion), which was chiefly due to net borrowings of 10.7 billion in connection with the financing of the Schering AG acquisition. The proceeds from the placement of 34 million new shares amounted to 1.2 billion. For details of the financing, see the table headed Principal Financing Measures for the Schering AG Acquisition on the next page.

Cash outflows for dividend payments less the 176 million refund of advance capital gains tax payments made on intragroup dividends in 2004 amounted to 535 million (2005: 440 million), while interest payments rose to 1,155 million (2005: 787 million) primarily as a result of borrowings made to finance the Schering AG acquisition.

As of December 31, 2006 the Bayer Group had cash and cash equivalents of 2,915 million, including 799 million held in escrow accounts. The latter amount comprises 710 million transferred to a guarantee account following the decision to squeeze out Bayer Schering Pharma AG s remaining minority stockholders, and 89 million (2005: 253 million) earmarked exclusively for payments relating to civil law settlements in antitrust proceedings. In view of the restriction on its use, the liquidity held in escrow accounts was not deducted when calculating net debt.

Table of Contents



**Net debt**

| **Net Debt** million | **Dec. 31, 2005** | **Dec. 31, 2006** |
|---|---|---|
| Noncurrent financial liabilities as per balance sheets (including derivatives) | 7,185 | 14,723 |
| of which mandatory convertible bond | | 2,276 |
| of which hybrid bond | 1,268 | 1,247 |
| Current financial liabilities as per balance sheets (including derivatives) | 1,767 | 5,078 |
| - Derivative receivables | 188 | 185 |
| **Financial liabilities** | **8,764** | **19,616** |
| - Cash and cash equivalents* | 3,037 | 2,116 |
| - Available-for-sale financial assets | 233 | 27 |
| **Net debt from continuing operations** | **5,494** | **17,473** |
| Net debt from discontinued operations | 0 | 66 |
| **Net debt (total)** | **5,494** | **17,539** |

* In view of the restriction on its use, the 799 million liquidity in escrow accounts was not deducted when calculating net debt. December 31, 2006: 2,116 million = 2,915 million 799 million (December 31, 2005: 3,037 million = 3,290 million

253 million)

Net debt rose to 17.5 billion as of December 31, 2006, due mainly to the financing of the Schering AG acquisition. The disbursements for this acquisition in 2006 totaled 16.3 billion. From Schering AG we assumed financial liabilities of 0.2 billion and acquired liquid assets of 1.0 billion. The following table shows the components of the acquisition financing package and their status at year end.

| **Principal Financing Measures for the Schering AG Acquisition** billion | **June 30, 2006** | **Dec. 31, 2006** |
|---|---|---|
| **Credit utilization:** | | |
| Bridge financing ( 7 billion facility) | 0.6 | 0 |
| Syndicated loan ( 7 billion facility) | 7.0 | 5.7 |
| of which with a one-year term | 3.0 | 1.7 |
| **Bond issues:** | | |
| 3-year floating-rate Eurobond | 1.6 | 1.6 |
| 7-year fixed-rate Eurobond | 1.0 | 1.0 |
| 12-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 purchase price for the acquired shares of Schering AG was financed mainly with liquid assets.
As well as fully redeeming the bridge financing, we had also paid down the syndicated 7 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.

Liquidity and Capital Resources

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. Moody s and Standard & Poor s treat 75 percent and 50 percent, respectively, of the hybrid bond as equity. Both rating agencies consider the mandatory convertible bond wholly as equity. Unlike conventional borrowings, the hybrid bond thus has only a limited effect on the Group s rating-specific debt indicators, while the mandatory convertible bond has no effect. We raised an additional 1.2 billion through the successful placement of 34 million new shares. Along with the placing of the 2.3 billion mandatory convertible bond, this completed the equity raising announced in connection with the Schering AG acquisition. The total 3.5 billion thus raised is below the 4 billion limit originally set.

In January 2007, we sold the diagnostics business to Siemens for 4.3 billion. The difference compared with the price of 4.2 billion announced in July 2006 results mainly from the transfer of higher working capital. 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 sold H.C. Starck to Advent International and The Carlyle Group. The transaction value of approximately 1.2 billion comprises a cash component of more than 0.7 billion and the assumption of financial liabilities and personnel-related commitments totaling some 0.5 billion. This sale 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 Wolff Walsrode to The Dow Chemical Company, to reduce net debt.

**Financial 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 bring about a sustained increase in corporate value and ensure the Group s creditworthiness and liquidity. That means reducing our cost of capital, improving our financing cash flow, optimizing our capital structure and effectively managing risk.

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. The short-term ratings are a-2 (Standard & Poor s) and p-2 (Moody s). These investment-grade ratings evidence a continuing high level of 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 reduce net debt.

We generally pursue a prudent debt management strategy aimed at ensuring flexibility, drawing on a balanced financing portfolio. 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.