



Bayer AG Financial Statements 2006



Cover picture

Invigorating drug discovery: following Bayer's successful acquisition of Schering AG, Berlin, Germany, the two companies' researchers have joined forces in the search for new drugs. The picture shows two Bayer Schering Pharma scientists – Dr. Ulrike Fuhrmann, formerly of Schering, and Dr. Thomas Krämer, formerly of Bayer Pharmaceuticals – meeting for an exchange of views. In the background is a laboratory at the research center in Wuppertal, Germany.

Corporate Structure

Bayer AG is the parent corporation of the Bayer Group and functions as a management holding company. The roles of the Bayer AG Board of Management (the Group Management Board) include deciding on the strategy of the Bayer Group, defining its business portfolio, conducting executive management and allocating resources. It is also responsible for financial management of the Bayer Group. It is supported in these tasks by the Corporate Center departments. Bayer AG also owns the real estate at the five German sites in Leverkusen, Dormagen, Krefeld-Uerdingen, Wuppertal-Elberfeld and Brunsbüttel. Facilities at these sites are leased to individual Group companies via Bayer Industry Services GmbH & Co. OHG.

The three subgroups – Bayer HealthCare, Bayer CropScience and Bayer MaterialScience – operate as independent entities within the Bayer Group. They have global responsibility for their business activities within the framework of the strategies, goals and directives defined by the Group Management Board. The Board of Management of each subgroup management company is responsible for the operational management of the respective subgroup. The subgroups are supported in their business operations by three service companies – Bayer Industry Services, Bayer Business Services and Bayer Technology Services – which offer their services primarily to companies in the Bayer Group, but also to external customers. The management companies of the subgroups and service companies were hived down from Bayer AG in 2002 and 2003.

The report on business developments given in the following refers to the annual financial statements of Bayer AG prepared in accordance with German commercial accounting law.

Acquisition and Financing of Bayer Schering Pharma AG

During 2006 our wholly owned subsidiary Bayer Schering GmbH (formerly Dritte BV GmbH) acquired 96.2 percent of the voting capital of Schering AG, Berlin, Germany. A domination and profit and loss transfer agreement between Bayer Schering GmbH and Schering AG was entered in the commercial register on October 27, 2006. Schering AG has since been renamed Bayer Schering Pharma AG. The name change was entered in the commercial register on December 29, 2006. 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 of 2006. The Extraordinary Stockholders' Meeting of Bayer Schering Pharma AG on January 17, 2007 resolved to effect a squeeze-out of the remaining minority stockholders.

Bayer Schering GmbH spent €16.2 billion in 2006 for the acquisition of Schering. This amount was provided by Bayer AG, with €3.0 billion coming from a capital increase and €13.2 billion from an intragroup loan. Bayer AG raised €1.2 billion of the necessary financing by issuing new shares, and €11.1 billion through borrowings. These figures

refer to the status of the financing as of December 31, 2006. The remaining amount of €3.9 billion was paid out of existing liquid assets. The loan capital comprised €3.1 billion from the issuance of three bonds, €5.7 billion from a syndicated loan and €2.3 billion borrowed from the Bayer Group company Bayer Capital Corporation B.V., Netherlands, which in turn had placed a mandatory convertible bond on the capital market.

Sales and Earnings Performance

Net sales were almost unchanged from the previous year at €196 million (2005: €197 million). €114 million (2005: €123 million) of this relates to revenues from the leasing of real estate at the German sites to the management companies of the subgroups and to the service companies. The remaining revenues of €82 million (2005: €74 million) resulted from the rendering of other services, almost exclusively to Bayer Group companies. With minor exceptions, the sales revenues were generated in Germany.

The cost of goods sold totaled €146 million (2005: €134 million), including €64 million relating to leased real estate, especially depreciation of leased property, and €82 million relating to other revenues. After deducting the cost of goods sold, gross profit amounted to €50 million (2005: €63 million), which was 26 percent (2005: 32 percent) of net sales and fell €13 million short of the prior-year figure.

The operating result decreased by €107 million to minus €149 million (2005: minus €42 million), mainly because the previous year's operating result was boosted by a positive balance of one-time factors that did not recur in 2006. For example, in 2005 the sale of real estate used by LANXESS at Bayer's German sites to LANXESS Deutschland GmbH generated one-time income of €201 million. After an allocation of €66 million to the special item with an equity component, €135 million of this income was reflected in earnings. At the same time, 2005 earnings were diminished by expenses of €18 million in connection with the spin-off and stock market listing of LANXESS.

The non-operating result – which is comprised of income and losses from investments in affiliated companies, interest income and expense and other non-operating income and expenses – increased by €730 million to €1,449 million (2005: €719 million).

Income from investments in affiliated companies increased substantially to €2,035 million, a rise of €1,204 million compared with the previous year. This was principally attributable to profits transferred from subsidiaries in Germany. In 2006 a total net amount of €2,104 million was transferred to Bayer AG under profit and loss transfer agreements, compared with €628 million in the previous year. Bayer MaterialScience AG increased its earnings contribution to €509 million (2005: €150 million) thanks to an improvement in business. Bayer CropScience AG transferred €942 million (2005: €27 million) to Bayer AG. The increase of €915 million was attributable to foreign dividend income. Bayer HealthCare AG's contribution was €343 million (2005: €368 million), a reduction of €25 million. Bayer Chemicals AG realized a gain of €330 million on the divestment of its 49.9 percent interest in GE Bayer Silicones GmbH & Co. KG, enabling it to transfer total income of €368 million (2005: €12 million) to Bayer AG. Bayer Schering GmbH transferred an initial loss of €256 million, principally due to financing expenses for the acquisition of the shares of Bayer Schering Pharma AG. Other companies contributed a net total

of €198 million (2005: €71 million) to income. While the amount transferred from German companies with profit and loss transfer agreements was significantly higher than in the previous year, dividends and expected income from partnerships were down considerably from the previous year, to a net total of €14 million (2005: €223 million). Income from investments in affiliated companies was also diminished by €87 million in losses (2005: €6 million in losses) on divestments of affiliated companies. Write-downs of investments in affiliated companies amounting to €14 million in 2005 were partially offset by valuation write-backs of €4 million in 2006.

Interest expense increased due to the acquisition of Bayer Schering Pharma AG and the capital raising to fund it. Net interest expense was €475 million, compared with €199 million in 2005. While interest expense rose €571 million, interest income did not increase as steeply, improving by just €295 million. The increase in interest expense was principally due to intragroup loans (€240 million), interest-rate swaps (€145 million), bank loans (€143 million) and bonds (€32 million). The increase of €181 million in interest income was principally attributable to intragroup loans, especially the loan to Bayer Schering GmbH, while €99 million resulted from interest-rate swaps.

Net other non-operating expense of €111 million was recorded, compared with net other non-operating income of €87 million in 2005. This was mainly due to a net exchange loss of €51 million, compared with the net exchange gain of €90 million recorded in the previous year. Earnings were also held back by the cost of financing the Schering acquisition. Bank charges for bonds and commitment fees for loans came to €60 million (2005: €10 million) and expenses for the capital increase in July 2006 amounted to €14 million. In the previous year, the main item of miscellaneous non-operating income/expense was a gain of €29 million from the repurchase by LANXESS AG of a mandatory convertible bond that had been issued to Bayer. Also included here is the annual interest portion of personnel-related provisions. After pro-rated allocation to the subgroups and service companies hived down from Bayer AG in 2002 and 2003, these expenses came to €4 million in 2006 (2005: €31 million).

Pre-tax income, the sum of the operating and non-operating results, advanced by €623 million in fiscal 2006 to €1,300 million (2005: €677 million). After deducting income taxes of €50 million (2005: €64 million), net income of €1,250 million remained (2005: €613 million). Of this amount, €486 million was allocated to other retained earnings and a balance sheet profit of €764 million was recognized.

Proposal for Distribution of the Profit

The Board of Management and Supervisory Board will propose to the Annual Stockholders' Meeting on April 27, 2007 that the balance sheet profit of €764 million be used to pay a dividend of €1.00 (2005: €0.95) per share (764,341,920 shares) on the capital stock of €1,957 million entitled to the dividend for 2006.

Asset and Capital Structure

The acquisition of a majority interest in Bayer Schering Pharma AG was the main factor influencing changes in Bayer AG's asset and capital structure in 2006. Total assets increased by a substantial €16.7 billion, or 61.8 percent, to €43.6 billion (2005: €26.9 billion).

Around 40 percent of this increase was due to noncurrent assets, which grew by €6.7 billion, or 36.7 percent, to €24.9 billion (2005: €18.2 billion). The growth in noncurrent assets related entirely to investments in affiliated companies, which increased by €6,493 million through capital increases at subsidiaries against cash contributions. Of this amount, €3,444 million related to Zweite K-W-A Beteiligungsgesellschaft mbH and €3,001 million to Bayer Schering GmbH, which used these funds to finance the acquisition of shares in Bayer Schering Pharma AG. Other additions to noncurrent assets resulted from intragroup acquisitions of shares, with €161 million relating to shares in Bayer SAS, France, and €42 million to shares in Bayer S.A., Venezuela. The total carrying amount of investments in affiliated companies at December 31, 2006 was €22.2 billion (2005: €15.5 billion), accounting for 51 percent (2005: 58 percent) of total assets. This remains a very high percentage, reflecting Bayer AG's special function as the parent company of the Bayer Group. Other noncurrent assets were virtually unchanged from the previous year. Property, plant and equipment and intangible assets were €24 million below the previous year's figure, while other investments decreased by €2 million.

Current assets increased sharply by €10.0 billion during the year to €18.7 billion (2005: €8.7 billion) and accounted for 60 percent of the growth in total assets. This rise was largely due to a €11.0 billion increase in intragroup loans granted. Bayer Schering GmbH alone received loans totaling €13.2 billion, which it used to purchase 96.2 percent of the shares of Bayer Schering Pharma AG. A receivable of €3,442 million from Zweite K-W-A Beteiligungsgesellschaft mbH recorded in the previous year has now been used for a capital increase at this company and thus is no longer recognized here.

As far as other assets are concerned, tax receivables decreased by €234 million while accrued interest increased by €221 million.

Cash and securities decreased by €1.0 billion, or 35.8 percent, to €1.7 billion, with bank balances accounting for €1,163 million (2005: €2,481 million) and securities for €575 million (2005: €226 million). The bank balances include an amount of €710 million deposited as guarantee for the cash compensation to be paid to minority stockholders of Bayer Schering Pharma AG as part of the squeeze-out process. Also included here is an amount of €89 million (2005: €253 million) to settle civil claims for compensation relating

to unlawful collusion on prices for rubber, polyester polyols and urethanes in the United States and Canada. Bayer has placed this amount into an escrow account administered in the U.S. pending the acceptance or judicial confirmation of the settlements offered. The securities recognized in 2006, temporarily stated as current assets, comprise investments in certain Schering group companies that are held for onward sale to other companies in the Bayer Group. The securities reflected in 2005 comprised shares of segregated funds.

Of the total assets of €43.6 billion (2005: €26.9 billion) recorded in the balance sheet, €34.1 billion (2005: €19.1 billion), or 78 percent (2005: 71 percent), was debt-financed. Of the latter amount, provisions accounted for €2.9 billion (2005: €3.2 billion) and other liabilities for €31.2 billion (2005: €15.9 billion).

Provisions declined by €257 million or 8.1 percent during the year to €2,929 million. Of the provisions of €286 million recorded in the previous year in connection with civil claims for compensation in the United States and Canada relating to antitrust violations in the areas of rubber, polyester polyols and urethanes, €210 million was utilized and a new allocation of €62 million was made. These provisions now amount to €138 million. Provisions of €45 million set up in the previous year for liabilities relating to antitrust proceedings of the E.U. Commission in the same matter were fully utilized, and a further €3 million in provisions was recorded. Provisions for impending losses from currency translations decreased by €63 million to €4 million (2005: €67 million). There was also a decrease in provisions for the anticipated assumption of losses from subsidiaries. These amounted to €18 million, compared with €57 million in the previous year. By contrast, provisions for income taxes increased by €23 million. Provisions for pensions and other post-employment benefits amounted to €2,498 million (2005: €2,503 million) and remained the largest item of provisions. They also include pension obligations to retirees and former employees with vested pension rights whose employment with the business and service areas since hived down to separate legal entities terminated prior to July 1, 2002.

Other liabilities increased substantially compared with the previous year to €31.2 billion (2005: €15.9 billion). The increase of €15.3 billion, or 96.1 percent, was caused by the increased financing requirements in connection with the acquisition of the majority interest in Bayer Schering Pharma AG. Three new bonds were issued in 2006: two Euro-bonds with face values of €1.6 billion and €1.0 billion, and a Sterling bond in the nominal amount of GBP 350 million (€517 million). A further €5.7 billion was borrowed from banks. The remainder was financed through intragroup loans, including €2.3 billion from Bayer Capital Corporation B.V., Netherlands, refinanced through the issuance of a mandatory convertible bond and made available as a loan to Bayer AG. Overall, liabilities to subsidiaries increased by €6.6 billion to €16.2 billion.

As of December 31, 2006 Bayer AG had total financial debt of €31.9 billion, comprising €17.6 billion payable to Group companies and €14.3 billion to third parties. After deducting liquid assets of €1.2 billion, net debt was €30.7 billion.

Stockholders' equity was €1.7 billion higher than at the start of the year. €1,182 million of this comprises the proceeds of the capital increase carried out on July 6, 2006, when €34 million new shares were placed with German and international institutional investors by an accelerated bookbuilding process. The issue price of the new shares, which carry

full dividend entitlement for 2006, was €34.75. The capital stock thus increased by €87 million and capital reserves by €1,095 million. Net income boosted the capital stock by €1,250 million (2005: €613 million), while €694 million was disbursed to pay the dividend for 2005. Despite the increase in stockholders' equity, the equity ratio declined by 7.0 percentage points to 21.8 percent (2005: 28.8 percent) due to the growth in total assets from €26.9 billion to €43.6 billion.

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

The capital stock of Bayer AG amounts to €1,956,715,315.20 (2005: €1,869,675,115.20) and is divided into 764,341,920 (2005: €730,341,920) no-par bearer shares. Each share confers one voting right.

We have received the following notifications of direct and indirect holdings of shares in Bayer AG that exceed 10 percent of the capital stock:

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

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

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

Pursuant to Section 179, Paragraph 1 of the German Stock Corporation Act, amendments to the Articles of Incorporation require a resolution of the Stockholders' Meeting.

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

The Annual Stockholders' Meeting of Bayer AG on April 28, 2006 resolved to revoke the existing Authorized Capital and create new Authorized Capital (Authorized Capital I and Authorized Capital II) and adopted the necessary amendments to the Articles of Incorporation. With the approval of the Supervisory Board and until April 27, 2011, the Board of Management may use the Authorized Capital I to increase the capital stock by up to a total of €465 million. The issue of new shares may take place in exchange for cash and/or contributions in kind, but capital increases in exchange for contributions in kind may not exceed a total of €370 million. If the Authorized Capital I is used to issue shares in return for cash contributions, stockholders must normally be granted subscription rights. With the approval of the Supervisory Board and until April 27, 2011, the Board of Management is also authorized to increase the capital by up to €186 million in one or more installments by issuing shares out of the Authorized Capital II in exchange for cash contributions. The stockholders must be granted subscription rights. However, the Board of Management is authorized, with the approval of the Supervisory Board, to exclude subscription rights for stockholders provided the capital increase out of the Authorized Capital II does not exceed 10 percent of the capital stock existing at the time this authorization becomes effective or the time this authorization is exercised. Following the capital increase on July 6, 2006, the Authorized Capital II is currently €98.96 million.

Conditional capital of €186.88 million, corresponding to 73,000,000 shares, exists to service the conversion rights under a mandatory convertible bond issued by Bayer Capital Corporation B.V., Netherlands, on April 6, 2006. Further, the Annual Stockholders' Meeting on April 28, 2006 authorized the Board of Management to purchase and sell company shares representing up to 10 percent of the capital stock. This authorization expires on October 27, 2007.

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

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

Finally, the terms of the €3 billion in notes issued by Bayer AG in 2006 under its multi-currency Euro Medium Term Note program also contain a change of control clause. Holders of these notes have the right to demand the redemption of their notes by Bayer AG in the event of a change of control if Bayer AG's credit rating is downgraded within 120 days after such change of control becomes effective.

The following arrangements have been made for the members of the Board of Management of Bayer AG in the event of a takeover offer:

In the event of a change of control and termination of a Board of Management member's service contract within 12 months thereafter – whether by mutual consent, through expiration of the contract or through its voluntary termination by the member in certain circumstances, such as a change in strategy – the member would receive a monthly bridging allowance amounting to 80 percent of his last monthly fixed salary for a period of 60 months, not counting any period for which he is released from his duties on full pay. His pension entitlement is based on the final target pension level. If this has not already been reached by the date of the change of control, his pension entitlement will be supplemented up to this level.

There are no comparable arrangements for employees.

Employees

Bayer AG had 603 (2005: 560) employees on December 31, 2006, 43 more than in previous year. However, personnel expenses declined by €12 million to €94 million (2005: €106 million). After adjusting for one-time pension expenses of €19 million in 2005, personnel expenses were €7 million higher.

Compensation Report

Board of Management

The members of the Board of Management receive a fixed salary, composed of a base salary and a fixed supplement. Additionally, remuneration in kind and other benefits, and variable compensation are granted. The variable compensation comprises a variable bonus and the possible payments resulting from participation in long-term stock-based compensation programs. Since 2005, the variable bonus for a given year is tied to the attainment of the Group target based on EBITDA. For the year 2006, the variable bonus is calculated partly according to the Group's EBITDA margin before special items, and partly according to the average target attainment of the HealthCare, CropScience and Material-Science subgroups. The latter is based mainly on the subgroups' target attainment measured by EBITDA before special items as well as on a qualitative appraisal in relation to the market and competitors.

The direct remuneration of members of the Board of Management in 2006 amounted to €8,143,822 (2005: €7,064,828), comprising €2,260,400 (2005: €1,985,580) in base salaries and €1,096,556 (2005: €837,073) in fixed supplements, €4,644,475 (2005: €4,085,754) in variable bonuses plus €142,391 (2005: €156,421) of remuneration in kind and other benefits. Remuneration in kind mainly consists of values assigned to certain benefits in kind in accordance with German taxation guidelines, such as on the use of company cars.

Members of the Board of Management were permitted to participate in a cash-settlement-based stock option program, offered through 2004, if they placed their personal investment in Bayer stock in a special deposit account. Under this previous program, a total of 25,290 instruments with a fair value of €1,806,718 remained outstanding as of December 31, 2006.

Since 2005, the members of the Board of Management have participated in the long-term stock-based compensation program Aspire I (2005 and 2006 tranches). Participation in this program is linked to membership of a Group Leadership Circle, not to the contract of service as a member of the Board of Management. Further details of this program are presented in Note [11] "Stock-based compensation."

The entitlements earned in 2006 relate to the 2006 parts of the respective three-year performance periods of the long-term stock-based compensation programs granted in current and previous years. The changes in the value of previously existing entitlements under long-term stock-based compensation programs that were earned prior to 2006 are shown separately. They result from the upward trend in the price of Bayer stock in 2006. Additionally, the fair value of the stock-based compensation as of the grant date in 2006 is given separately.

The table below shows the remuneration components of those individual members of our Board of Management who actively served in the course of 2006. In 2006, the remuneration of our chief financial officer was raised to recognize the special tasks of this position.

		Werner Wenning	Klaus Kühn	Udo Oels ¹	Wolfgang Plischke ²	Richard Pott	Total
€							
Base salary	2006	748,872	412,236	343,526	343,530	412,236	2,260,400
	2005	748,872	412,236	412,236	-	412,236	1,985,580
Fixed supplement	2006	325,132	316,366	142,205	142,206	170,647	1,096,556
	2005	325,132	170,647	170,647	-	170,647	837,073
Variable bonus	2006	1,525,086	1,034,615	567,335	689,745	827,694	4,644,475
	2005	1,554,615	843,713	843,713	-	843,713	4,085,754
Remuneration in kind and other benefits	2006	47,926	35,571	9,594	18,163	31,137	142,391
	2005	40,169	35,266	41,942	-	39,044	156,421
Directly effected remuneration	2006	2,647,016	1,798,788	1,062,660	1,193,644	1,441,714	8,143,822
	2005	2,668,788	1,461,862	1,468,538	-	1,465,640	7,064,828
Stock-based compensation entitlements earned in the respective year	2006	820,514	480,609	538,181	193,188	461,939	2,494,431
	2005	495,504	285,748	285,748	-	284,248	1,351,248
Change in value of existing entitlements	2006	339,733	229,617	104,125	66,262	164,952	904,689
	2005	169,289	99,693	99,693	-	98,055	466,730

¹until April 28, 2006

²effective March 1, 2006

The fair value of the stock-based compensation as of the grant dates for 2006 and 2005, respectively, is shown in the following table. The entitlements earned in 2006 under the 2006 and 2005 stock-based compensation are included in the preceding table under "Stock-based compensation entitlements earned in the respective year."

		Werner Wenning	Klaus Kühn	Udo Oels ¹	Wolfgang Plischke ²	Richard Pott	Total
€							
Fair value of newly granted stock-based compensation as of grant date	2006	268,113	181,886	40,419	117,597	145,509	753,524
	2005	253,636	137,652	137,652	-	137,652	666,592

¹until April 28, 2006

²effective March 1, 2006

Pension provisions for the current members of the Board of Management amounted to €22,974,049 (2005: €25,091,901). Active members of the Board of Management are entitled to receive a pension from the age of 60 in an annual amount equal to at least 30 percent of the last yearly fixed salary. This percentage increases depending on years of service as a Board of Management member and, according to the inception of the respective service contract, is capped between 60 and 80 percent. We refer to the maximum such percentage a member of the Board of Management can reach as his final target pension level. We currently pay former and retired members of the Board of Management a monthly pension equal to 80 percent of the last monthly base salary received while in service. The pensions paid to former members of the Board of Management or their widows are normally reassessed every three years and adjusted taking into account the development of consumer prices. These amounts are in addition to any amounts they receive as a result of their participation in the Bayer pension plan (Bayer Pensionskasse). The current service cost for pension entitlements of those individual members of our Board of Management who actively served in the course of 2006 was as follows:

		Werner Wenning	Klaus Kühn	Udo Oels ¹	Wolfgang Plischke ²	Richard Pott	Total
€							
Current service cost for pension entitlements earned in the respective year	2006	206,271	1,246,070	-	447,654	83,592	1,983,587
	2005	2,123,098	760,160	378,783	-	633,615	3,895,656

¹ until April 28, 2006

² effective March 1, 2006

For active Board of Management members a general severance indemnity clause, with the following main elements applies:

If a member of the Board of Management is not offered a new service contract upon expiration of his existing service contract because he is not reappointed to the Board of Management, or if the member is removed from the Board of Management in the absence of grounds for termination without notice, he will receive a monthly bridging allowance amounting to 80 percent of his last monthly fixed salary for a period of 60 months from the date of expiration of his service contract less the period for which the Board of Management member was released from his duties on full pay. Special arrangements apply in the event of a change of control. For details see page 10.

Emoluments to retired members of the Board of Management and their surviving dependents amounted to €10,924,768 (2005: €10,323,009). Pension provisions for former members of the Board of Management and their surviving dependents amounted to €97,243,586 (2005: €91,129,996).

There were no loans to members of the Board of Management outstanding as of December 31, 2006, nor any repayments of such loans during the year.

Supervisory Board

The compensation of the Supervisory Board is based on the provisions of the Articles of Incorporation, the current version of which was adopted by the stockholders at the Annual Stockholders' Meeting on April 29, 2005. This provides that, in addition to reimbursement of their expenses, each member of the Supervisory Board receives fixed

annual remuneration of €60,000 and a variable annual remuneration component. The variable remuneration component is based on corporate performance in terms of the gross cash flow reported in the Group financial statements for the fiscal year. The members of the Supervisory Board receive €2,000 for every €50,000,000 or part thereof by which the gross cash flow exceeds €3,100,000,000, but the variable component for each member may not exceed €30,000. In accordance with the provisions of the German Corporate Governance Code, additional remuneration is paid to the Chairman and Vice Chairman of the Supervisory Board and for chairing and membership of committees. The Chairman of the Supervisory Board receives three times the basic remuneration, while the Vice Chairman receives one-and-a-half times the basic remuneration. Members of the Supervisory Board who are also members of a committee receive an additional one quarter of the amount, with those chairing a committee receiving a further quarter. However, no member of the Supervisory Board may receive total remuneration exceeding three times the basic remuneration. If changes are made to the Supervisory Board and its committees during the fiscal year, members receive remuneration on a pro-rated basis. No remuneration or benefits were paid for personal services, in particular, the provision of consultancy or intermediary services. The Company has purchased insurance for the members of the Supervisory Board to cover their legal liability arising from their service on the Supervisory Board.

Remuneration of the Supervisory Board of Bayer AG for 2006	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 Schmoltdt	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

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

There were no loans to members of the Supervisory Board outstanding as of December 31, 2006, nor any repayments of such loans during the year.

Risk Report

Risk management

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

The management of opportunities and risks in the Bayer Group is an integral part of the Group-wide corporate governance system, not the task of one particular organizational unit. Key elements of the risk management system are the planning and controlling process, Group regulations and the reporting system. In regular conferences the company's results and its potential opportunities and risks are discussed, and targets and necessary actions are agreed upon. In addition, the Bayer Group has implemented the requirements of section 404 of the Sarbanes-Oxley Act regarding the system of internal controls.

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

To counter risks arising from legal or other requirements, we make our decisions and engineer our business processes on the basis of comprehensive legal advice provided both by our own experts and by acknowledged external specialists

We have purchased insurance coverage – where it is available on economically acceptable terms – in order to minimize the financial impact of possible compensation claims. The level of this coverage is continuously re-examined.

Overall business risks

Pharmaceutical product prices are subject to regulatory controls in many markets. Some governments intervene directly in setting prices. In addition, in some markets major purchasers of pharmaceutical products have the economic power to exert substantial pressure on prices. Price controls limit the financial benefits of growth in the pharmaceutical segment and the introduction of new products.

Sales of our crop protection products are particularly subject to weather conditions and fluctuations in crop prices. In addition, the increasing use of plant biotechnology could reduce market demand for some of our agrochemical products.

The performance of our MaterialScience subgroup is affected by cyclicity of the industries in which they operate. Low periods in the business cycles are characterized by decreasing demand and excess capacity, leading to price pressure and intense competition. This may result in volatile operating margins across the business cycle and to operating losses in these businesses. Expectations of growth, especially in Asian economies, encourage producers to increase their production capacities. Future growth in demand may not be sufficient to absorb those capacity additions without significant downward pressure on prices.

The early identification of economic trends or regulatory changes forms a particularly important part of our business management. Our analyses of the global economy and forecasts of medium-term economic development are documented in detail on a quarterly basis and used to support operational business planning.

Product development risks

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

Our life science segments are subject to particularly strict regulatory regimes. Increasing regulatory requirements, such as those governing clinical or (eco-)toxicological trials, may increase product development costs and the time it takes to bring new products to market.

Adverse effects of our products that may be discovered after regulatory approval or registration despite thorough prior testing may lead to a partial or complete withdrawal from the market, due either to regulatory actions or our voluntary decision to stop marketing a product.

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

Patent risks

We are involved in lawsuits to enforce patent rights in our products. In particular, generic drug manufacturers may seek marketing approval for pharmaceutical products currently under patent protection by challenging the validity or enforceability of a patent. We may also be required to defend ourselves against charges of infringement of patent or proprietary rights of third parties.

When one of our patents expires, or if a patent defense is unsuccessful, we are likely to face increased competition from generic products entering the market.

To minimize the risk of infringement of our patents, our legal department regularly reviews the patents situation in conjunction with the relevant functional departments and watches for potential patent infringement attempts by other companies so that legal action can be taken if necessary.

Procurement market risks

Our MaterialScience subgroup uses significant amounts of petrochemical raw materials and energy in its manufacturing processes. The prices of raw materials and energy vary with market conditions and may be highly volatile. There have been in the past, and may be in the future, periods during which we are not able to pass along the full amounts of any cost increases to our customers.

We purchase strategic raw materials on the basis of long-term contracts with multiple suppliers wherever possible. Supply agreements are centrally negotiated to achieve more favorable prices and supply terms for the Group as a whole.

Operational risks

Production at some of our manufacturing facilities could be adversely affected by occurrences such as technical failures or disruptions to raw material deliveries. In particular, our biological products business employs complicated production processes that are more likely to experience disruption. For this reason all production processes and material inputs are tested continuously by the relevant functional departments.

The Bayer Group is increasingly dependent on information technology systems to support business processes as well as internal and external communications. Despite all technical precautions, any significant disruption of these systems may result in loss of data and/or impairment of production and business processes.

From time to time, we acquire all or a portion of an established business and combine it with our existing business units. Integration of existing and newly acquired businesses requires difficult decisions, e.g. regarding staffing levels and reengineering of business processes, which are critical for a successful integration of the acquired business and realization of planned synergies. All such acquisitions are supported by integration teams.

Furthermore, in the European Union a new regulation on chemicals (Registration, Evaluation, Authorization of Chemicals, REACH) was adopted in December 2006 and becomes effective in June 2007. It could trigger a significant increase in administration and in the testing and assessment of all chemicals used, leading to increased costs and reduced operating margins for some products. The subgroups have launched REACH implementation projects to coordinate the implementation and avoid or reduce disadvantages for the business.

Product and environmental risks

Bayer's operations are subject to the operating risks associated with chemical manufacturing, including risks relating to the packaging, storage and transportation of raw materials, products and wastes. These operating risks have the potential to cause personal injury, property damage and/or environmental contamination, and may result in the shut-down of affected facilities.

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

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

Exchange rate risks

As a global enterprise, the Bayer Group conducts a significant portion of its operations in foreign currencies. We guard against exchange rate risks by financing our business in local currencies and by hedging with derivative financial instruments that are employed solely for this purpose in line with the respective risk assessments and relevant detailed guidelines. See Note [34] for explanations on the use of derivative financial instruments.

Risk to pension obligations from capital market developments

Plan assets to cover future pension obligations are comprised of equity, fixed-income instruments, property and other assets. Declining capital returns can have a negative impact on the funding status of our plans. Therefore, additional contributions to the plans could be necessary in order to cover future pension obligations. Additionally, changes in demographic or biometric assumptions (e.g. mortality rates) could also have a negative impact on the funding status. To minimize this risk we are increasingly offering defined-contribution pension plans to our employees.

Legal risks

As a global company with a diverse business portfolio, the Bayer Group (including Bayer Schering Pharma AG, which previously was named Schering AG) is exposed to numerous legal risks, particularly in the areas of product liability, competition and antitrust law, patent disputes, tax assessments, and environmental matters. The outcome of any current or future proceedings cannot be predicted with certainty. It is therefore possible that legal or regulatory judgments could give rise to expenses that are not covered, or not fully covered, by insurers' compensation payments and could significantly affect our revenues and earnings.

Legal proceedings currently considered to involve material risks are outlined below. The litigation referred to does not necessarily represent an exhaustive list.

Lipobay/Baycol

As of February 12, 2007, the number of Lipobay/Baycol cases pending against Bayer worldwide was approximately 1,870 (approximately 1,810 of them in the United States, including several class actions). As of February 12, 2007, Bayer had settled 3,152 Lipobay/Baycol cases worldwide without acknowledging any liability and resulting in settlement payments of approximately US\$ 1,159 million. Bayer will continue to offer fair compensation to people who experienced serious side effects while taking Lipobay/Baycol, on a voluntary basis and without concession of liability. In the United States, five cases have been tried to date, all of which were found in Bayer's favor.

After more than five years of litigation we are currently aware of fewer than 20 pending cases in the United States that in our opinion hold a potential for settlement, although we cannot rule out the possibility that additional cases involving serious side effects from Lipobay/Baycol may come to our attention. In addition, there could be further settlements of cases outside of the United States.

In the fiscal year 2006, Bayer recorded a €35 million charge to the operating result in respect of settlements already concluded or expected to be concluded and anticipated defense costs.

Since the existing insurance coverage is exhausted, it is possible – depending on the future progress of the litigation – that Bayer could face further payments that are not covered by the accounting measures already taken. We will regularly review the possibility of further accounting measures depending on the progress of the litigation.

A group of stockholders has filed a class-action lawsuit claiming damages against Bayer AG and Bayer Corporation and two current and certain former managers. The suit alleges that Bayer violated U.S. securities laws by making misleading statements, prior to the withdrawal of Lipobay/Baycol from the market, about the product's commercial prospects and, after its withdrawal, about the related potential financial liability. In 2005 the court dismissed with prejudice the claims of non-U.S. purchasers of Bayer AG stock on non-U.S. exchanges. Bayer believes it has meritorious defenses and will defend itself vigorously.

Cipro®

39 putative class action lawsuits, one individual lawsuit and one consumer protection group lawsuit (which has been dismissed) against Bayer involving the medication Cipro® have been filed since July 2000 in the United States. The plaintiffs are suing Bayer and other companies also named as defendants, alleging that a settlement to end patent litigation reached in 1997 between Bayer and Barr Laboratories, Inc. violated antitrust regulations. The plaintiffs claim the alleged violation prevented the marketing of generic ciprofloxacin as of 1997. In particular, they are seeking triple damages under U.S. law. After the settlement with Barr the patent was the subject of a successful re-examination by the U.S. Patent and Trademark Office and of successful defenses in U.S. federal courts. It has since expired.

All the actions pending in federal court were consolidated in federal district court in New York in a multidistrict litigation (MDL) proceeding. In 2005 the court had granted Bayer's motion for summary judgment and dismissed all of plaintiffs' claims in the MDL proceeding. The plaintiffs are appealing this decision. Further cases are pending before various state courts. Bayer believes that it has meritorious defenses and intends to defend itself vigorously.

Rubber, polyester polyols, urethane*Proceedings involving product lines of the former Rubber Business Group*

A number of investigations and proceedings by the respective authorities in the U.S., Canada and the E.U. concerning alleged anticompetitive conduct involving certain products in the rubber field have been resolved, while others remain pending. In the United States, Bayer AG has paid fines in two cases on the basis of agreements reached with the U.S. Department of Justice. In December 2005, the E.U. Commission imposed a fine of €58.9 million for antitrust violations in the area of rubber chemicals. The respective amount was paid at the end of March 2006. In July and August 2006 the U.S. Department of Justice, the E.U. Commission and the CCB notified Bayer AG that they had closed the respective EPDM proceedings. In November 2006 the E.U. Commission closed the proceeding related to BR/ESBR by imposing fines against several companies and granting full amnesty to Bayer.

Numerous civil claims for damages including class actions are pending in the United States, and proposed class proceedings in Canada, against Bayer AG and certain of its subsidiaries as well as other companies. The lawsuits involve rubber chemicals, EPDM, NBR and polychloroprene rubber (CR). Bayer has reached agreement to settle the bulk of the U.S. actions. The majority of these agreements have received court approval. These settlements do not resolve all of the pending civil litigation with respect to the aforementioned products, nor do they preclude the bringing of additional claims. However, as previously reported, Bayer has settled the actions which management believes to be material. In addition, a putative class action against Bayer AG and certain of its subsidiaries, as well as other companies, recently has been filed alleging claims of anticompetitive activities involving two additional rubber products, polybutadiene rubber (BR) and styrene butadiene rubber (SBR). Respective litigation in Europe is likely.

Proceedings involving polyester polyols, urethanes and urethane chemicals

In Canada an investigation is pending against Bayer for alleged anticompetitive conduct relating to adipic-based polyester polyols. In the United States, Bayer Corporation paid a fine on the basis of an agreement reached with the U.S. Department of Justice in 2004.

A number of civil claims for damages including class actions have been filed in the United States against Bayer involving allegations of unlawful collusion on prices for certain polyester polyol, urethanes and urethane chemicals product lines. Similar actions are pending in Canada with respect to polyester polyols.

Bayer has reached agreements or agreements in principle to settle certain of the U.S. actions. These agreements or agreements in principle partly remain subject to court approval. These settlements do not resolve all of the pending civil litigations with respect to the aforementioned products, nor do they preclude the bringing of additional claims.

Proceedings involving polyether polyols and other precursors for urethane end-use products

Bayer has been named as a defendant in multiple putative class action lawsuits in the United States and Canada involving allegations of price fixing for, inter alia, polyether polyols and certain other precursors for urethane end-use products. In the United States Bayer has settled with a class of direct purchasers of polyether polyols, MDI and TDI (and related systems) representing approximately 75 percent of the direct purchasers, which settlement has been approved by the court. The remaining direct purchasers opted out of this settlement and have the right to bring their own actions. To date no such actions have been brought. In Canada, the class action lawsuit on behalf of direct and indirect purchasers of polyether polyols, MDI and TDI (and related systems) continues. In February 2006 Bayer was served with a subpoena from the U.S. Department of Justice seeking information relating to the manufacture and sale of this product.

Impact of these antitrust proceedings on Bayer

Excluding the portion allocated to LANXESS, the provisions with respect to the described civil proceedings were reduced from €285 million in 2005 to €129 million as of December 31, 2006, due to settlement payments.

Bayer will continue to pursue settlements that in its view are warranted. In cases where settlement is not achievable, Bayer will continue to defend itself vigorously.

The financial risk associated with the proceedings described above, beyond the amounts already paid and the financial provisions already established, is currently not quantifiable due to the considerable uncertainty associated with these proceedings. Consequently, no provisions other than those described above have been established. The company expects that, in the course of the regulatory proceedings and civil damages suits, additional charges, which are currently not quantifiable, will become necessary.

Proceedings involving genetically modified rice

Since August 2006, Bayer CropScience LP is party to multiple lawsuits, including putative class actions, filed in U.S. federal and state courts by rice farmers and resellers. Plaintiffs allege that they have suffered economic losses after traces of the genetically modified rice event LLRICE 601 were identified in samples of conventional long-grain rice grown in the U.S. This is alleged to have led to various commercial damages, including a decline in the commodity price for long-grain rice, costs associated with restrictions on imports and exports, and costs to secure alternative supplies. All the actions pending in federal court were consolidated in December in federal district court in Missouri in a multidistrict litigation (MDL) proceeding.

After technological development, LLRICE 601 had been further tested in cooperation with third parties, including a breeding research institute in the U.S. However, it was never selected for commercialization. The U.S. Department of Agriculture and the U.S. Food and Drug Administration have stated that LLRICE 601 does not pose a health risk and is safe for use in food and feed and for the environment. In November 2006, the USDA advised that it had deregulated LLRICE 601. The USDA is conducting an investigation in an effort to determine how LLRICE 601 became present in commercial rice grown in the United States.

Bayer believes it has meritorious defenses and intends to continue to defend itself vigorously. Due to the considerable uncertainty associated with these proceedings, it is currently not possible to estimate potential liability.

Proceedings involving oral contraceptives

Yasmin®: In April 2005, Bayer Schering Pharma filed an ANDA IV suit against Barr Pharmaceuticals Inc. and Barr Laboratories Inc. in U.S. federal court alleging patent infringement by Barr for the intended generic version of Bayer Schering Pharma's Yasmin® oral contraceptive product in the United States. In June 2005 Barr filed its counterclaim seeking to invalidate Bayer Schering Pharma's patent. This lawsuit is currently in the discovery phase.

YAZ®: In January 2007, Schering received notice from Barr Laboratories, Inc. that it has filed an ANDA IV application with the U.S. FDA seeking approval of a generic version of Schering's YAZ® oral contraceptive product. Barr will be prohibited from marketing its generic version until after expiry in March 2009 of the exclusivity period for marketing granted by FDA.

Bayer highly values its Yasmin® and YAZ® oral contraceptive products and is deeply committed to continuing its leadership position in oral contraception.

Proceedings involving propylene oxide

In May 2006 a U.S. arbitration panel issued a final award in favor of Lyondell Chemical Co. in respect of a dispute with Bayer over interpretation of their Joint Venture Agreement for the manufacture of propylene oxide. Bayer is seeking to vacate the final award, while Lyondell is seeking to confirm the award as well as obtain pre-award interest. Bayer has established appropriate provisions in this regard. In addition to seeking to vacate the final award, in January 2007 Bayer filed suit against Lyondell in a U.S. court of justice seeking equitable reformation of an agreement and restitution of certain monies paid or, as a result of the final award, allegedly owing by Bayer to Lyondell in connection with the panel award.

Bayer has separately notified Lyondell of its claim in connection with Lyondell's affiliate to compensate Bayer for using certain quantities of propylene oxide from Bayer's share of capacity under the Joint Venture. This dispute is proceeding to binding arbitration.

Proceedings involving syringe injectors and related products

In November 1998, Liebel-Flarsheim Company and its parent, Mallinckrodt, Inc., filed suit against Bayer Schering Pharma's Medrad subsidiary alleging that some of Medrad's front load syringe injections infringe four patents held by Liebel-Flarsheim. In October 2005, the court ruled in favor of Medrad. The ruling stated that the Medrad products would have infringed the patents of Liebel-Flarsheim if those patents were valid, but then held all four of those patents to be invalid. Each party is appealing the material portions of the ruling unfavorable to it. In September 2004 Liebel-Flarsheim Company and its parent, Mallinckrodt, Inc., filed a second suit alleging that a further product of Medrad infringes the same group of four patents. Based on the October 2005 decision in the first case the court also dismissed this case in October 2005, but again each party appealed the material portions of the ruling unfavorable to it.

The plaintiffs in these cases have also filed two additional declaratory judgment actions against Medrad. Medrad separately has brought suit against Liebel-Flarsheim alleging that a Liebel-Flarsheim MR syringe injector infringes a patent held by Medrad.

Bayer believes it has meritorious arguments in all proceedings and intends to defend itself vigorously against any claim raised.

Patent and contractual disputes

In the U.S. Abbott has commenced a lawsuit against Bayer and another party alleging infringement of two of Abbott's patents relating to blood glucose monitoring devices. This also relates to Ascensia® Contour® Systems which are supplied by a Japanese manufacturer. The manufacturer is contractually obligated to indemnify Bayer against the potential liability with respect to this claim, as well as defense costs, and management expects Bayer to be reimbursed for a substantial portion of all such costs and liability, if any.

Limagrain Genetics Corporation has filed suit against Bayer – as legal successor to Rhône-Poulenc – for indemnity against liabilities to third parties arising from breach of contract.

In another dispute, Bayer has filed suit against several companies in the U.S. alleging patent infringement in connection with moxifloxacin. These companies are defending the action, claiming, among other things, that the patents are invalid and not enforceable.

Bayer believes it has meritorious defenses in these patent and contractual disputes and will defend itself vigorously.

Product liability and other litigation

Legal risks also arise from product liability lawsuits other than those concerning Lipobay/Baycol. Numerous actions are pending against Bayer seeking damages for plaintiffs resident outside of the United States who claim to have become infected with HIV or HCV (hepatitis C virus) through blood plasma products. Further actions have been filed by U.S. residents who claim to have become infected with HCV.

Bayer, together with other manufacturers, wholesalers and users, is a defendant in Alabama, United States, in cases seeking damages, including one U.S.-wide putative class action, for personal injuries alleging health damages through exposure to diphenylmethane diisocyanate (MDI) used in coal mines.

Bayer, like a number of other pharmaceutical companies in the United States, has several lawsuits pending against it in which plaintiffs, including states, are seeking damages, punitive damages and/or disgorgement of profits, alleging manipulation in the reporting of wholesale prices and/or best prices.

The shareholder resolution on the domination and profit and loss transfer agreement between Bayer Schering Pharma AG and Bayer Schering GmbH passed at the Extraordinary Stockholder's Meeting held on September 13, 2006 is subject to legal challenges. Dissenting stockholders are seeking to have the stockholder resolution set aside or to have it declared null and void. Several stockholders have indicated proceedings asking the court to review the adequacy of the costs compensation (Abfindung) and of the guaranteed dividend (Ausgleich). Bayer Schering GmbH has commenced special proceedings (Freigabeverfahren) to obtain a judgment that the stockholder actions do not prevent registration of the domination and profit and loss transfer agreement and that any defects of the stockholder resolution do not affect the validity of the registration. One stockholder has brought a suit in Berlin seeking to have registration of the agreement in the Commercial Register removed (Amtslöschungsverfahren).

A further risk may arise from asbestos litigation in the United States. In the majority of these cases, the plaintiffs allege that Bayer and co-defendants employed third parties on their sites in past decades without providing them with sufficient warnings or protection against the known dangers of asbestos. One Bayer affiliate in the United States is the legal successor to companies that sold asbestos products until 1976. Should liability be established, Union Carbide has to completely indemnify Bayer.

Bayer, among others, is named as a defendant in a putative nationwide class action pending in federal court in North Carolina, United States, which alleges violations of antitrust laws in the marketing of a certain pest control product (Premise®).

Bayer believes it has meritorious defenses in these product liability and other proceedings and will defend itself vigorously.

Liability considerations following the LANXESS spin-off

The liability situation following the spin-off of the LANXESS subgroup is governed by both statutory and contractual provisions. Under the German Transformation Act, all entities that are parties to a spin-off are jointly and severally liable for obligations of the transferor entity that are established prior to the spin-off date. Bayer AG and LANXESS AG are thus jointly and severally liable for a time period of 5 years for all obligations of Bayer AG that existed on January 28, 2005.

Assessment of the overall risk situation

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

We expect global economic growth to remain well above the long-term average in 2007, though it will probably lose a little of its current momentum. At present, leading indicators are pointing to a temporary dip in growth rates in some industrialized countries. However, we anticipate that the cyclical slowdown in the United States will only moderately impact the global economy. Robust growth in other regions, such as Europe and the emerging markets of Asia and Latin America, is likely to offset the weaker growth in the United States. Even though we assume that the strong global uptrend will be maintained overall, we believe risks to the global economy lie particularly in the emerging trend toward protectionism and the continued global economic imbalances. Moreover, oil price trends are difficult to forecast.

We further improved the Bayer Group's earning power in 2006. With record highs for underlying EBIT and EBITDA, an underlying EBITDA margin of 19.3 percent (calculated on Group sales) and currency- and portfolio-adjusted sales growth of 5.2 percent, we achieved our operations targets for 2006. We are confident that by building on this foundation we can continue to enhance our operating performance.

In 2007, we 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.

As the holding company for the Bayer Group, Bayer AG derives most of its income from its subsidiaries. The principal operating subsidiaries in Germany transfer their earnings directly to Bayer AG under profit and loss transfer agreements. Bayer AG also receives dividend income. Against a background of ongoing performance improvement in the Group, we expect that by appropriate dividend management we will derive sufficient income from our subsidiaries and affiliates to cover Bayer AG's operating costs as a holding company, service the borrowings associated with the Schering acquisition and, in the medium term, reduce our debt. Moreover, our goal for 2007 is once again to report a level of net income with which we can allow stockholders to share appropriately in the company's success while at the same time strengthening reserves.

Subsequent Events

The divestment of Bayer's diagnostics business to Siemens for €4.3 billion which was agreed in June 2006, was completed in January 2007. After taxes the Group received about €3.6 billion in divestiture proceeds, which was used to reduce external financial debt, including that of Bayer AG.

The Extraordinary Stockholders' Meeting of Bayer Schering Pharma AG resolved on January 17, 2007, by a majority of 99.62 percent of the votes cast, to effect a squeeze-out of the remaining minority stockholders. Thus the shares still held by minority stockholders will be transferred to the main stockholder, Bayer Schering GmbH, in return for cash compensation of €98.98 per share.

We have audited the annual financial statements – comprising the balance sheet, income statement and notes – together with the accounting system, and the management report of Bayer Aktiengesellschaft, Leverkusen, Germany, for the financial year from January 1 to December 31, 2006. The maintenance of the books and records and the preparation of the annual financial statements and management report in accordance with German commercial law are the responsibility of the Board of Management of Bayer AG. Our responsibility is to express an opinion on the annual financial statements, together with the accounting system, and the management report based on our audit.

We conducted our audit of the annual financial statements in accordance with § 317 HGB (Handelsgesetzbuch – German Commercial Code) and German generally accepted standards for the audit of financial statements promulgated by the Institut der Wirtschaftsprüfer in Deutschland (IDW). Those standards require that we plan and perform the audit such that misstatements materially affecting the presentation of the net assets, financial position and results of operations in the annual financial statements in accordance with German generally accepted accounting principles and in the management report are detected with reasonable assurance. Knowledge of the business activities and the economic and legal environment of the Company and evaluations of possible misstatements are taken into account in the determination of audit procedures. The effectiveness of the accounting-related internal control system and the evidence supporting the disclosures in the books and records, the annual financial statements and the management report are examined primarily on a test basis within the framework of the audit. The audit includes assessing the accounting principles used and significant estimates made by the Company's Board of Management, as well as evaluating the overall presentation of the annual financial statements and management report. We believe that our audit provides a reasonable basis for our opinion.

Our audit has not led to any reservations.

In our opinion based on the findings of our audit the annual financial statements comply with the legal requirements and give a true and fair view of the net assets, financial position and results of operations of the Company in accordance with German generally accepted accounting principles. The management report is consistent with the financial statements and as a whole provides a suitable view of the Company's position and suitably presents the opportunities and risks of future development.

Essen, March 8, 2007

PricewaterhouseCoopers
Aktiengesellschaft
Wirtschaftsprüfungsgesellschaft

P. Albrecht
Wirtschaftsprüfer

V. Linke
Wirtschaftsprüfer

Statements of Income

Bayer AG
Financial Statements
2006

	Note	2005	2006
€ million			
Net sales	[1]	197	196
Cost of goods sold		(134)	(146)
Gross profit		63	50
Selling expenses		(21)	(20)
General administration expenses		(194)	(174)
Other operating income	[2]	216	95
Other operating expenses	[3]	(106)	(100)
Operating result		(42)	(149)
Income from investments in affiliated companies – net	[4]	831	2,035
Interest expense – net	[5]	(199)	(475)
Other non-operating income – net	[6]	87	(111)
Non-operating result		719	1,449
Income before income taxes		677	1,300
Income taxes	[7]	(64)	(50)
Net income		613	1,250
Allocation (to) from retained earnings		81	(486)
Balance sheet profit		694	764

	Note	Dec. 31, 2005	Dec. 31, 2006
€ million			
Assets			
Noncurrent assets			
Intangible assets	[14]	35	32
Property, plant and equipment	[15]	396	375
Investments	[16]	17,758	24,464
		18,189	24,871
Current assets			
Receivables and other assets			
Trade accounts receivable	[17]	20	31
Receivables from subsidiaries		5,119	16,099
Other assets	[18]	854	798
	[19]	5,993	16,928
Marketable securities	[20]	226	575
Cash and cash equivalents	[21]	2,481	1,163
		8,700	18,666
Deferred charges	[22]	46	44
		26,935	43,581
Stockholders' equity and liabilities			
Stockholders' equity			
	[23]		
Capital stock		1,870	1,957
Capital reserves		2,942	4,037
Other retained earnings		2,245	2,731
Balance sheet profit		694	764
		7,751	9,489
Special item with an equity component	[24]	112	11
Provisions			
Provisions for pensions and other post-employment benefits	[25]	2,503	2,498
Other provisions	[26]	683	431
		3,186	2,929
Other liabilities			
Bonds and notes	[27]	5,793	8,574
Liabilities to banks		27	5,722
Trade accounts payable	[28]	25	35
Payables to subsidiaries	[29]	9,547	16,179
Miscellaneous liabilities	[30]	492	640
	[31]	15,884	31,150
Deferred income		2	2
		26,935	43,581

Notes to the Financial Statements

Accounting Policies

The financial statements of Bayer AG are prepared in accordance with the German Commercial Code (Handelsgesetzbuch) and Stock Corporation Act (Aktiengesetz).

Certain income statement and balance sheet items are combined for the sake of clarity, as explained in the Notes.

The income statement is drawn up by the cost-of-sales method. Non-operating income and expenses whose disclosure is not covered by a mandatory item are stated under other non-operating income or expenses.

A Declaration of Conformity with the German Corporate Governance Code has been issued pursuant to Article 161 of the German Stock Corporation Act and made available to stockholders.

Recognition and Valuation Principles

Intangible assets that have been acquired are recognized at cost and amortized on a straight-line basis over their estimated useful lives.

Property, plant and equipment is carried at the cost of acquisition or construction. Assets subject to depletion are depreciated. Write-downs are made for any declines in value that go beyond the depletion reflected in depreciation. Low-value assets are depreciated in full in the year of acquisition. Where permitted under the tax laws, depreciation is made by the declining-balance method at the highest rates possible, switching to the straight-line method as soon as this leads to higher depreciation.

Useful Life of Property, Plant and Equipment

Factory, commercial and residential buildings	25 to 50 years
Outdoor infrastructure	10 to 20 years
Plant installations	7 to 20 years
Vehicles	5 years
Computer equipment	3 to 4 years
Furniture and fixtures	4 to 10 years

The cost of construction of self-constructed property, plant and equipment comprises the direct cost of materials, direct manufacturing expenses, appropriate allocations of material and manufacturing overheads, and an appropriate share of the depreciation of assets used in construction.

Investments in subsidiaries and affiliated companies are carried at cost, less write-downs for any decline in value that is expected to be permanent. Write-downs made in previous years are written back if the reasons for them no longer apply. However, such write-backs must not cause the carrying amount to exceed the cost of acquisition.

Loans receivable that are interest-free or bear low rates of interest are carried at present value; other loans receivable are carried at nominal value.

Receivables and other assets are stated at nominal value, less any necessary write-downs for amounts unlikely to be recovered.

Marketable securities are shown at the lower of cost or market as of the closing date.

Where the redemption value of liabilities exceeds their issue price, the difference is capitalized and amortized over the term of the liabilities.

Allocations to the special item with an equity component are made at the amounts permitted for tax purposes where tax recognition is subject to their inclusion in the accounting balance sheet.

Provisions for pensions and other post-employment benefits are computed by the actuarial method that takes tax regulations into consideration, based on a statutory discount factor of 6 percent and the reference tables published by Prof. Klaus Heubeck in 2005 (2005 G).

Other provisions are established to cover all foreseeable risks and uncertain liabilities, based on reasonable estimates of such commitments as of the closing date. Provisions for expenses pursuant to Article 249, Paragraph 2 of the German Commercial Code are not established.

Other liabilities are carried at nominal or redemption value, whichever is higher. Regular future obligations are recorded at present value calculated using a suitable discount rate that reflects the company's financial commitments.

Foreign currency receivables and liabilities, forward rate agreements and other currency derivatives are recognized using the limited mark-to-market method. For this purpose, foreign currency receivables and payables are valued using spot rates on the reporting date and the fair value of currency derivatives on the reporting date is determined. Unrealized gains and losses are then offset in each currency. Provisions are set up for any net unrealized losses; net unrealized gains are not recognized. The actual receivables and payables are translated using the exchange rate at which they are originally recorded.

Cash and cash equivalents and bank balances held in foreign currencies are translated at the rate on the reporting date.

Contingent liabilities arising from sureties and debt guarantees, and amounts pledged as security for other parties' liabilities, are shown at the amounts equivalent to the loans or commitments actually outstanding as of the closing date.

(1) Net sales

Sales comprise €114 million (2005: €123 million) from the leasing of real estate belonging to Bayer AG and €82 million (2005: €74 million) from the provision of certain services.

Sales of Bayer AG in 2006 amounted to €195 million. As in 2005 (€193 million), Germany accounted for almost all of the total.

(2) Other operating income

	2005	2006
€ million		
Gains from retirements of noncurrent assets	206	1
Reversals of unutilized provisions	3	3
Reversals of the special item with an equity component	-	90
Miscellaneous income	7	1
	216	95

Effective January 29, 2005, Bayer AG sold the real estate used by LANXESS at the sites in Leverkusen, Dormagen, Krefeld-Uerdingen and Brunsbüttel in Germany to LANXESS Deutschland GmbH. In this connection a €201 million gain was recorded in 2005.

The revenues from sideline operations are offset against the corresponding cost of goods sold to more clearly reflect the earnings position. These operations broke even in 2006 whereas in 2005 the company reported net operating income of €3 million from sideline operations.

(3) Other operating expenses

Other operating expenses include allocations to provisions, write-downs of accounts receivable and various accrued expenses. €18 million of the other operating expenses in 2005 was incurred in connection with the carve-out of LANXESS AG and preparations for its stock market listing.

Of the special item with an equity component set up pursuant to Section 6b of the German Income Tax Act, the entire amount of €90 million was offset in 2006 against the cost of acquisition or construction of new assets, resulting in an expense of €90 million. This expense is balanced by income of the same amount – reflected in other operating income – from the reversal of the special item. In 2005, the setting-up of a special item with an equity component led to an expense of €66 million.

(4) Income (loss) from investments in affiliated companies – net

31

	2005	2006
€ million		
Dividends and similar income	223	14
of which €14 million (2005: €223 million) from subsidiaries		
Income from profit and loss transfer agreements with subsidiaries	744	2,402
Expenses from profit and loss transfer agreements with subsidiaries	(116)	(298)
Write-downs of investments in affiliated companies	(14)	-
Write-backs of investments in affiliated companies	-	4
Gains from the sale of investments in affiliated companies	2	-
Losses from the sale of investments in affiliated companies	(8)	(87)
	831	2,035

The write-downs of investments in affiliated companies in 2005 included €10 million for CuraGen Corporation, U.S.A., and €4 million for Bayer Middle East Ltd., Egypt. In 2006, a write-back of €3 million was made for the investment in CuraGen as a result of a corresponding rise in value.

€81 million, and thus the largest single item contributing to the losses from the sale of investments in affiliated companies in 2006, relates to the intra-Group sale of shares in Bayer CropScience Ltda., Brazil. The largest single item in the losses from the sale of investments in affiliated companies in 2005 comprised €7 million relating to the divestment of LANXESS India Private Limited, India, to LANXESS Deutschland GmbH.

(5) Interest expense – net

	2005	2006
€ million		
Income from other securities and loans included in investments	4	5
Other interest and similar income	670	964
of which €417 million (2005: €236 million) from subsidiaries		
Interest and similar expenses	(873)	(1,444)
of which €448 million (2005: €208 million) to subsidiaries		
	(199)	(475)

(6) Other non-operating income (expense) – net

	2005	2006
€ million		
Interest portion of the allocation to personnel-related provisions	(146)	(188)
Interest portion of the allocation to personnel-related provisions assigned to subsidiaries	115	184
Miscellaneous non-operating expenses	(12)	(133)
Miscellaneous non-operating income	130	26
	87	(111)

The interest portion of allocations to personnel-related provisions, calculated on the basis of actuarial assumptions, was assigned proportionately to the subsidiaries hived down from Bayer AG in 2002 and 2003. This was agreed with these subsidiaries in the respective hive-down and transfer agreements and relates to retirees whose pensions continue to be paid by Bayer AG and to former employees with vested pension rights.

€74 million of the miscellaneous non-operating expenses relate to bank charges, mainly in connection with financing of the acquisition of Schering, Berlin, Germany. They comprise €38 million for the issuance of bonds and €14 million relating to the capital increase in July 2006. In 2005, bank charges of €10 million were incurred in connection with the issue of a €1.3 billion hybrid bond.

Miscellaneous non-operating expenses also include the impact of currency translations. This comprises realized exchange gains and losses and those effects of the valuation of foreign currency receivables and payables and currency derivatives that are to be recognized in the balance sheet. This resulted in a net expense of €51 million in 2006. In 2005 the company recorded a net exchange gain of €90 million in miscellaneous non-operating income.

In 2005 miscellaneous non-operating income also included a gain of €29 million from the repurchase by LANXESS AG of the mandatory bond with a nominal value of €200 million issued in 2004.

(7) Income taxes

The taxes reflected here are corporate income tax, trade tax, the solidarity surcharge and income taxes paid outside Germany.

(8) Other taxes

Other taxes are included in the cost of goods sold, selling expenses or general administration expenses wherever they can be allocated to these categories on the basis of accountability. In other cases they are assigned to other operating expenses. Other taxes for 2006 amount to €9 million (2005: €9 million).

(9) Cost of materials

	2005	2006
€ million		
Expenses for raw materials, supplies and goods purchased for resale	3	7
Expenses for purchased services	31	24
	34	31

(10) Personnel expenses/employees

	2005	2006
€ million		
Wages and salaries	72	78
Social expenses	7	7
Pension expenses	27	9
	106	94

The personnel expenses shown here do not contain the interest portion of the allocation to personnel-related provisions, which is included in the non-operating result as other non-operating expense. These personnel-related provisions are mainly for employee pensions.

The average number of employees at Bayer AG was 582 (2005: 554).

(11) Stock-based compensation

Bayer AG has offered its employees collective stock-based compensation programs as additional compensation components since 2000. Different programs are offered to different groups of employees.

The program offered to members of the Board of Management and other senior executives from 2000 through 2004 was essentially a stock option program with variable stock-based awards. This program provides for cash payments. Middle managers and other groups of employees were offered a stock incentive program or a stock participation program, respectively.

A new stock-based compensation program for members of the Board of Management and other senior managers, known as “Aspire”, was introduced in 2005. It comprises two variants. For other managers and non-managerial employees, a different type of stock participation program has been offered since 2005, under which Bayer subsidizes employee purchases of shares in Bayer AG.

Provisions are recorded for all obligations existing under the stock-based compensation programs at the reporting date. The amount of such provisions is based on the fair value of the obligations and the proportion of the total duration of the respective program that has elapsed since its introduction. Allocations to provisions are expensed.

The fair value of obligations under the stock-based compensation programs has been calculated by the Monte Carlo simulation method using the following key parameters:

	2005	2006
%		
Dividend yield	2,27	2,29
Risk-free interest rate	2,92	3,83
Volatility of Bayer stock	38,00	21,52
Volatility of the Dow Jones EURO STOXX 50 SM	19,55	13,14
Correlation between Bayer stock price and the Dow Jones EURO STOXX 50 SM	0,56	0,61

Aspire I (2005 – 2006)

To participate in Aspire I, members of the Board of Management and other senior executives are required to purchase a certain number of Bayer shares that is predetermined according to specific guidelines and to retain them for the full term of the program. A percentage of the executive's annual base salary – based on his/her position – is defined as a target for variable payments ("Aspire target opportunity"). Depending on the performance of Bayer stock, both in absolute terms and relative to the EURO STOXX 50SM benchmark index during a three-year performance period, participants are granted an award of up to 200 percent of their individual Aspire target opportunity. They may ask for this to be paid out in cash or to be converted into "performance units". These can be redeemed within a two-year exercise period for a cash payment that depends on the Bayer stock price on the exercise date.

Aspire II (2005 – 2006)

Other senior managers are offered Aspire II, a variant of Aspire I which does not require a personal investment in Bayer shares. Moreover, the amount of the award is based entirely on the absolute performance of Bayer stock. The maximum award is 150 percent of each manager's Aspire target opportunity.

Stock Participation Program (2005 – 2006)

Under this program Bayer offers eligible employees the opportunity to purchase shares in Bayer at a discount. The discount is set separately each year. In 2006 it was 15 percent. Employees can invest up to 10 percent of their annual base salary, but not more than €5,000. The shares purchased must be held in a special deposit account and may not be sold prior to the end of the defined retention period, which expires on December 31, 2007 for shares purchased in 2006.

Stock Option Program (2000 – 2004)

The stock option programs for members of the Board of Management and other senior executives, which run for five-year periods, are also subject to a three-year retention condition, followed by a two-year exercise period. Stock options that have not been exercised by the end of the exercise period either expire (2000-2002 tranches) or are exercised at the end of the period on behalf of the employee (2003-2004 tranches). The right to exercise the options and the cash payment to which each participant is entitled depend on the absolute performance of Bayer stock and its performance relative to the Dow Jones EURO STOXX 50SM.

The maximum personal investment in Bayer stock eligible for the program was set individually for each participant at the start of each tranche, according to his/her position. This determined the number of options allocated to them. For the tranches issued in 2000 to 2002, every participant received one option for every 20 shares placed in a special account. This entitled them to a cash payment equivalent to up to 200 shares at the end of the exercise period. For the tranches issued in 2003 and 2004 participants received up to three options per share held as a personal investment. For each option, a cash payment – equivalent to the market price of one Bayer share – and an outperformance premium are awarded at the exercise date, subject to the attainment of certain performance and outperformance targets.

The stock options issued under the 2002 and 2003 tranches can currently be exercised. Options issued under the 2000 and 2001 tranches have either been exercised or have expired.

Stock Incentive Program (2000 – 2004)

Participants in this program receive a cash payment equivalent to a defined number of Bayer shares on certain dates during the ten-year duration of this program. For every ten shares held in a special account (personal investment), they receive two shares after two years and a further four shares after six and ten years respectively. To qualify for these payments, they must still hold the personal investment on the incentive payment dates and the percentage rise in the price of Bayer stock by the payment date must be above the performance of the Dow Jones EURO STOXX 50SM since the start of the program. The Stock Incentive Program differs from the Stock Option Program in that participants may sell their shares during the term of the program. However, the shares sold do not qualify for incentive payments on subsequent distribution dates. The number of shares that each employee could transfer to the program was based on their performance-related bonus for the preceding fiscal year.

Stock Participation Program (2000 – 2004)

The structure of this program is similar to the Stock Incentive Program. However, the incentive payments are based exclusively on the period for which employees hold their personal investment in Bayer shares. Incentive payments are half those allocated under the Stock Incentive Program. After two years, participants are entitled to a cash payment equivalent to the price of one Bayer share for every ten shares held. After six and again after ten years they are entitled to payments equivalent to the value of two Bayer shares.

Bayer AG spent €10 million (2005: €6 million) on stock-based compensation programs. This amount is reflected in personnel expenses. Provisions for these programs amounted to €9 million as of December 31, 2006 (2005: €6 million).

(12) Valuation write-downs, depreciation for tax purposes

In 2006 no write-downs were made to reflect declines in value that were expected to be permanent. Write-downs of €14 million on financial assets were made in the previous year. No depreciation was undertaken specifically for tax purposes in either 2006 or 2005.

(13) Effects of valuation adjustments made for tax purposes

The net income for 2006 was increased by €22 million (2005: reduced by €77 million) as a result of accelerated depreciation for tax purposes and the net effect of allocations to, and partial reversals of, the special item with an equity component. The higher income taxes that will be incurred as a result of these valuation adjustments will be spread over a maximum of 33 years and therefore will not materially affect net income for the individual years.

(14) Intangible assets

	Acquired con- cessions, industrial prop- erty rights, similar rights and assets, and licenses there- under	Advance payments	Total
€ million			
Gross carrying amounts, Dec. 31, 2005	38	1	39
Transfers	1	(1)	-
Gross carrying amounts, Dec. 31, 2006	39	-	39
Accumulated amortization and write-downs, Dec. 31, 2005	4	-	4
Amortization and write-downs in 2006	3	-	3
Accumulated amortization and write-downs, Dec. 31, 2006	7	-	7
Net carrying amounts Dec. 31, 2006	32	-	32
Net carrying amounts Dec. 31, 2005	34	1	35

(15) Property, plant and equipment

	Land and buildings	Furniture, fix- tures and other equip- ment	Construction in progress and advance payments to vendors and contractors	Total
€ million				
Gross carrying amounts, Dec. 31, 2005	2,027	11	14	2,052
Capital expenditures	90	1	3	94
Retirements	(35)	(3)	-	(38)
Transfers	10	4	(14)	-
Gross carrying amounts, Dec. 31, 2006	2,092	13	3	2,108
Accumulated depreciation and write-downs, Dec. 31, 2005	1,647	9	-	1,656
Depreciation and write-downs in 2006	113	1	-	114
Retirements	(34)	(3)	-	(37)
Accumulated depreciation and write-downs, Dec. 31, 2006	1,726	7	-	1,733
Net carrying amounts Dec. 31, 2006	366	6	3	375
Net carrying amounts Dec. 31, 2005	380	2	14	396

(16) Investments

	Investments in subsid- iaries	Loans to subsidiaries	Investments in other affiliated companies	Loans to other affiliated companies	Other loans	Total
€ million						
Gross carrying amounts, Dec. 31, 2005	15,498	2,100	178	2	160	17,938
Additions	6,872	-	-	-	-	6,872
Retirements	(168)	-	-	-	(2)	(170)
Gross carrying amounts, Dec. 31, 2006	22,202	2,100	178	2	158	24,640
Accumulated write-downs, Dec. 31, 2005	9	-	166	1	4	180
Write-backs	-	-	(4)	-	-	(4)
Accumulated write-downs, Dec. 31, 2006	9	-	162	1	4	176
Net carrying amounts Dec. 31, 2006	22,193	2,100	16	1	154	24,464
Net carrying amounts Dec. 31, 2005	15,489	2,100	12	1	156	17,758

Capital increases against cash contributions at subsidiaries account for €6,493 million of the additions to investments in subsidiaries. This includes €3,444 million for Zweite K-W-A Beteiligungsgesellschaft mbH and €3,001 million for Bayer Schering GmbH (formerly Dritte BV GmbH), which used these funds to finance the acquisition of shares in Bayer Schering Pharma AG (formerly Schering AG).

Purchases of shares in companies accounted for €304 million of the additions to investments. €161 million relates to Bayer SAS, France, €81 million to Bayer CropScience Ltda., Brazil, and €42 million to Bayer S.A., Venezuela. All of these transactions were purchases from other Group companies.

Additions of €75 million relate to the transfer of investments in subsidiaries to other subsidiaries. These were offset by an equal amount of retirements.

The other retirements of investments in subsidiaries comprised €81 million resulting from the sale of Bayer CropScience Ltda, Brazil, within the Bayer Group and the withdrawal of €12 million in capital from Bayer Industry Services GmbH & Co. OHG.

The write-backs of investments in other affiliated companies totaling €4 million mainly comprise €3 million for CuraGen Corporation, U.S.A.

A separate list of Bayer AG's direct and indirect holdings can be obtained from the company's headquarters and will be published in the electronic version of the German Federal Gazette.

(17) Trade accounts receivable

	Dec. 31, 2005	Dec. 31, 2006
€ million		
Accounts receivable from subsidiaries	17	29
Accounts receivable from other customers	3	2
	20	31

(18) Other assets

The other assets totaling €798 million (2005: €854 million) mainly consist of €589 million (2005: €368 million) in accrued interest, €71 million (2005: €302 million) in claims for tax refunds and €76 million (2005: €59 million) in premiums paid to conclude options transactions. Also included are a large number of other items such as payroll receivables, current receivables from loans, advance payments and amounts that cannot yet be invoiced.

(19) Receivables and other assets maturing in more than one year

The total receivables and other assets amounting to €16,928 million (2005: €5,993 million) include €172 million (2005: €223 million) due in more than one year. Of this, €91 million (2005: €163 million) comprises receivables from subsidiaries and €81 million (2005: €60 million) comprises other assets.

(20) Securities

Securities comprise shares in three subsidiaries acquired by Bayer AG in December 2006 as part of the integration of Schering with a view to their onward sale within the Bayer Group. Other securities in 2005 consisted mainly of units of special investment funds.

(21) Cash and cash equivalents

Under a resolution adopted at the Extraordinary Stockholders' Meeting of Bayer Schering Pharma AG (formerly Schering AG) on January 17, 2007, Bayer Schering GmbH, a subsidiary of Bayer AG and majority stockholder of Bayer Schering Pharma AG, is mandated to acquire the shares held by the minority stockholders of Bayer Schering Pharma AG through a squeeze-out in return for payment of compensation in cash. Bayer AG has deposited a corresponding sum as security for this transaction. This amounted to €710 million as of December 31, 2006 and is included in bank balances.

Cash and cash equivalents also includes €89 million (2005: €253 million) to settle civil law compensation claims relating to antitrust violations in the fields of rubber, polyester polyols and urethanes in the United States and Canada. Bayer has placed this amount in an escrow account administered in the U.S. pending acceptance or judicial confirmation of the settlements offered.

(22) Deferred charges

Deferred charges as of December 31, 2006 include unamortized discounts totaling €32 million pertaining to bonds issued by Bayer AG between 2002 and 2006. The amount of €30 million recognized at the beginning of the year was diminished during the year by amortization of €7 million and increased by €9 million pertaining to bonds issued in 2006.

The remaining deferred charges are prepaid premiums for business insurance and prepaid rental and leasing charges.

(23) Capital stock

The capital stock changed as follows in 2006:

	Dec. 31, 2005	Dividend for 2005	Net income	Capital increase	Dec. 31, 2006
€ million					
Capital stock	1,870			87	1,957
Capital reserves	2,942			1,095	4,037
Other retained earnings	2,245		486		2,731
Balance sheet profit	694	(694)	764		764
	7,751	(694)	1,250	1,182	9,489

The capital stock of Bayer AG totals €1,956,715,315.20 (2005: €1,869,675,315.20) and is divided into 764,341,920 (2005: 730,341,920) no-par bearer shares. Each share confers one voting right. On July 6, 2006, 34 million new shares were placed with German and international institutional investors by means of an accelerated bookbuilding process. This capital increase raised around €1,182 million. The issue price of the new shares, which carry full entitlement to the dividend for fiscal 2006, was €34.75. The related 4.7 percent cash increase in the company's capital stock was approved by the Supervisory Board and implemented on the basis of the authorization granted by the Annual Stockholders' Meeting on April 28, 2006 (Authorized Capital II).

Authorized capital of €465 million was approved by the Annual Stockholders' Meeting on April 28, 2006. It expires on April 27, 2011. It can be used to increase the capital stock by issuing new no-par bearer shares against cash contributions or contributions in kind, but capital increases against contributions in kind may not exceed a total of €370 million (Authorized Capital I). Stockholders must normally be granted subscription rights. However, subject to the approval of the Supervisory Board, the Board of Management is

authorized to exclude subscription rights for the stockholders with respect to any excess shares remaining after rights have been allocated (fractional amounts) and also to the extent necessary to grant subscription rights for new shares to holders of convertible bonds or bonds with attached warrants or mandatory convertible bonds issued by Bayer AG or its Group companies, who would be entitled to subscription rights upon exercise of the conversion rights or warrants. In addition the Board of Management is authorized to exclude stockholders' subscription rights, subject to the approval of the Supervisory Board, in cases where an increase in capital against contributions in kind is carried out for the purpose of acquiring companies, parts of companies, participating interests in companies or other assets.

Further authorized capital was also approved by the Annual Stockholders' Meeting on April 28, 2006. The Board of Management is authorized until April 27, 2011 to increase the capital stock, subject to the approval of the Supervisory Board, by up to a total of €186 million in one or more installments by issuing new no-par bearer shares against cash contributions (Authorized Capital II). Of this amount, €87.04 million was used for the capital increase effected on July 6, 2006. The remaining Authorized Capital II thus stood at €98.96 million on the balance sheet date. Under the resolution adopted by the Annual Stockholders' Meeting, stockholders must normally be granted subscription rights. However, the Board of Management is authorized to exclude subscription rights for stockholders with respect to one or more capital increases out of the Authorized Capital II, subject to the approval of the Supervisory Board, provided that such capital increase does not exceed 10 percent of the capital stock existing at the time this authorization becomes effective or the time this authorization is exercised, for purposes of issuing new shares against cash contributions at a price that is not significantly below the market price of shares in the company that are already listed on the stock exchange at the time the issue price is finally determined. Shares acquired on the basis of an authorization of the Stockholders' Meeting and sold pursuant to Article 71, Paragraph 1, No. 8, Sentence 5 of the German Stock Corporation Act in conjunction with Article 186, Paragraph 3, Sentence 4 of the German Stock Corporation Act during the term of this authorization shall count toward the above 10 percent limit. Shares issued or to be issued to service bonds with conversion rights, attached warrants or mandatory conversion rights shall also count toward this limit where such bonds were issued during the term of this authorization and stockholders' subscription rights were excluded by application of Article 186, Paragraph 3, Sentence 4 of the German Stock Corporation Act.

Conditional capital of €186.88 million, corresponding to 73,000,000 shares, exists to service the conversion rights contained in a mandatory convertible bond issued by Bayer Capital Corporation B.V., Netherlands, on April 6, 2006.

Regarding the information pursuant to Section 160, Paragraph 1, No. 8 of the German Stock Corporation Act concerning shareholdings in Bayer AG that have been notified pursuant to Section 21, Paragraph 1 of the German Securities Trading Act, reference is made to the respective commentaries in the management report.

(24) Special item with an equity component

The €11 million special item with an equity component comprises the remaining one-third of the difference between pension commitments computed as of December 31, 2005 using the life expectancy tables published in 1998 and the lower pension obligations as of the same date calculated using the new life expectancy tables published in 2005. As instructed in a letter from the German Federal Finance Ministry dated December 16, 2005, two-thirds of this amount was allocated to the special item with an equity component in 2005 to be released to income in two equal installments in 2006 and 2007.

In 2005 the special item with an equity component also included an amount of €90 million from the sale of land and buildings that was allocated to this item under Article 6b of the Income Tax Act. €66 million of this related to divestments in 2005, while €24 million pertained to divestments made prior to 2005. This entire amount was removed from the special item in 2006 and transferred to newly acquired buildings.

(25) Provisions for pensions and other post-employment benefits

This item includes provisions for current and future pension entitlements.

It also includes commitments to former employees of the business areas and service companies hived down into separate legal entities and former employees who retired before July 1, 2002 or who left the company before this date and have vested pension rights. The respective companies reimburse Bayer AG for these expenses.

This item also includes commitments entered into under early retirement agreements.

(26) Other provisions

	Dec. 31, 2005	Dec. 31, 2006
€ million		
Provisions for taxes	173	196
Miscellaneous provisions	510	235
	683	431

Miscellaneous provisions include amounts for environmental protection measures, vacations, part-time working by older employees, annual bonuses, long-service awards to employees, the costs of preparing and auditing the annual financial statements, expenses for the anticipated assumption of losses from affiliated companies and other uncertain liabilities. It also includes anticipated losses, for example on foreign exchange derivatives.

As of December 31, 2006, provisions of €138 million (2005: €286 million) existed for commitments in the United States and Canada arising from compensation claims relating to antitrust violations in the fields of rubber, polyester polyols and urethanes. There was also a provision of €3 million (2005: €45 million) for obligations arising out of antitrust proceedings instituted by the E.U. Commission.

(27) Bonds and notes

	Nominal value	Stated rate %	Effective rate %	Dec. 31, 2005	Dec. 31, 2006
				€ million	€ million
Eurobonds 2002/2007	€ 2,137 million	5.375	5.515	2,137	2,137
Eurobonds 2002/2012	€ 2,000 million	6.000	6.075	2,000	2,000
Eurobonds 2006/2013	€ 1,000 million	4.500	4.621	-	1,000
Eurobonds 2006/2009	€ 1,600 million	floating	floating	-	1,600
Sterling bonds 2006/2018	GBP 250 million	5.625	5.774	-	369
Sterling bonds 2006/2018 (second tranche)	GBP 100 million	5.625	5.541	-	148
Hybrid bond 2005/2105	€ 1,300 million	5.000*	5.155	1,300	1,300
Bonds 2003/2006 private placement	€ 250 million	floating	floating	250	-
Bonds 2004/2006 private placement	€ 50 million	floating	floating	50	-
Bonds 2004/2008 private placement	€ 20 million	3.490	3.502	20	20
Bonds 2005/2006 private placement	JPY 5 billion	0.160	0.160	36	-
				5,793	8,574

* fixed interest rate until 2015, floating rate thereafter

In July 2005 Bayer AG issued a 100-year subordinated hybrid bond with an issue volume of €1.3 billion. This issue matures in 2105 and has a fixed coupon of 5 percent in the first ten years. Thereafter, interest is calculated quarterly at a floating rate (3-month EURIBOR plus 280 basis points). After the first 10 years, Bayer AG has a quarterly option to redeem the bonds at face value. The issue price was 98.812 percent and interest is paid in arrears.

In May 2006 Bayer AG launched three further bond issues under its multi-currency European Medium Term Note (EMTN) program as part of the financing of the Schering acquisition. The first of these was a three-year floating rate note in a nominal amount of €1,600 million which bears interest at 0.225 percent about the 3-month Euribor rate. The second issue, in an amount of €1,000 million, has a coupon of 4.5 percent and matures in seven years. A third bond, denominated in sterling (GBP), with a face value of GBP 250 million was also issued, followed later by a second tranche of GBP 100 million. This bond has a coupon of 5.625 percent and matures in 2018. The entire issue has been swapped into euros.

(28) Trade accounts payable

	Dec. 31, 2005	Dec. 31, 2006
€ million		
Payables to subsidiaries	9	25
Payables to other suppliers	16	10
	25	35

(29) Payables to subsidiaries

The payables to subsidiaries mainly comprise loans and overnight funds invested at Bayer AG by subsidiaries.

(30) Miscellaneous liabilities

Miscellaneous liabilities are amounts due to third parties and comprise €541 million (2005: €395 million) in accrued interest and €76 million (2005: €51 million) in premiums received on options. This item also includes €6 million (2005: €11 million) in short-term capital investments and €5 million (2005: €5 million) in employees' income and church taxes held for paying over to the authorities.

(31) Further information on other liabilities

The other liabilities are due as follows:

€ million	Dec. 31, 2005			Dec. 31, 2006		
	Maturing in 2006	Maturing in 2007-2010	Maturing after 2010	Maturing in 2007	Maturing in 2008-2011	Maturing after 2011
Debentures	336	2,157	3,300	2,137	1,620	4,817
Liabilities to banks	5	16	6	1,705	4,013	4
Trade accounts payable	25	-	-	35	-	-
Payables to subsidiaries	9,512	11	24	13,821	2,300	58
Miscellaneous liabilities	445	24	23	567	2	71
	10,323	2,208	3,353	18,265	7,935	4,950

The miscellaneous liabilities as of December 31, 2006 include €543 million (2005: €397 million) in liabilities that only arose from a legal viewpoint after year-end. They are almost exclusively accrued interest liabilities.

(32) Contingent liabilities

Contingent liabilities include sureties of €15 million (2005: €10 million), including €9 million (2005: €4 million) for subsidiaries.

Bayer AG has also assumed debt guarantees and issued letters of comfort totaling €4,125 million (2005: €2,032 million) to other Group companies.

	Dec. 31, 2005		Dec. 31, 2006	
	Nominal amount	€ million	Nominal amount	€ million
Sureties				
Bayer Capital Corporation B.V., Netherlands				
Mandatory convertible bond	-	-	EUR 2,300 million	2,300
Bayer (China) Limited, China				
Liabilities to banks	USD 70 million	59	USD 70 million	53
Bayer Polymers (Shanghai) Co., Ltd., China				
Liabilities to banks	CNY 952 million	100	CNY 1,770 million	172
Bayer Corporation Holding, U.S.A.				
3.750% EMTN Notes, maturing in 2009	EUR 460 million	460	EUR 460 million	460
7.125% Notes, maturing in 2015	USD 200 million	169	USD 200 million	152
6.650% Notes, maturing in 2028	USD 350 million	297	USD 350 million	266
6.200% Puttable Reset Securities (PURS SM , maturing at the latest in 2028)	USD 250 million	212	USD 250 million	190
Global Commercial Paper Program	USD 205 million	174	-	-
Sale-and-lease-back agreements Pass Through Trust	USD 209 million	177	USD 209 million	120
Guarantees for other Group companies		35		51
Letters of comfort		349		361
		2,032		4,125

Bayer AG bears joint and several liability under Article 133 of the German Transformation Act for the liabilities of the business and service areas transferred to legally separate entities in 2002 and 2003 where such liabilities relate to the period prior to the transfers. The same applies to the liabilities of LANXESS AG, which was spun off effective July 1, 2004. Liability continues for five years from the effective dates of the respective transfers. The Spin-Off and Acquisition Agreement specifies that Bayer AG and LANXESS AG shall release the other party from those liabilities each has assumed as principal debtor under that Agreement. Bayer AG and LANXESS AG also signed a master agreement covering the apportionment of general liability and of specific liability for environmental contamination, antitrust violations and product liability.

(33) Other financial commitments

In addition to provisions, other liabilities and contingent liabilities, there are also other financial commitments.

Minimum non-discounted future payments relating to operating leases total €133 million (2005: €237 million), of which €79 million (2005: €174 million) relates to lease and rental agreements with subsidiaries. In 2006 these related exclusively to Bayer Industry Services GmbH & Co. OHG. In the previous year they also comprised payments to the two real estate companies KG III Augusta and Gigas through which the Agricultural Center in Monheim was financed in the past. The lease agreements with these two companies were prematurely terminated at year end 2006. The commitments under lease and rental agreements are due as follows:

€ million	
2007	20
2008	17
2009	16
2010	16
2011	15
After 2011	49
	133

(34) Derivative financial instruments

In the course of its business, Bayer AG is exposed to foreign exchange, interest rate and price risks, which it hedges largely through derivative financial instruments. It mainly uses over-the-counter (OTC) instruments, particularly forward rate contracts, currency options, interest rate options, interest rate swaps, cross-currency interest rate swaps, and stock options. These instruments are employed according to uniform guidelines and are subject to strict internal controls. Their use is generally confined to the hedging of the operating business and of the related investments and financing transactions. In addition, interest options and interest swaps are used to achieve the defined benchmarks for interest rates. In the commodities markets Bayer AG concludes derivatives agreements with external counterparties to hedge raw material and energy prices on behalf of Group companies.

The main objective of using derivative financial instruments is to reduce fluctuations in cash flows and earnings associated with changes in interest rates, foreign exchange rates, equity prices and market prices.

There is a risk that the value of derivative financial instruments could change as a result of fluctuations in underlying parameters such as exchange rates, interest rates or share prices. Where derivatives are designated as hedges, possible declines in their value due to falling prices are offset by corresponding increases in the value of the hedged contracts.

Where derivatives have a positive fair value, a credit or default risk arises from the fact that the counterparties may not be able to meet their obligations. To minimize this risk, all transactions are executed only with banks of impeccable credit standing. We also impose limits on the volume of business in derivative financial instruments transacted with individual parties.

The notional amount of financial derivative contracts concluded with external counterparties was €21.3 billion on December 31, 2006 (2005: €16.0 billion). Back-to-back derivatives contracts in a notional amount of €3.4 billion (2005: €3.8 billion) were concluded with Group companies. The notional amounts of derivative financial derivatives totaled €24.7 billion (2005: €19.8 billion) on the closing date and were comprised as follows:

€ million	Notional amount		Fair value		Carrying amount	
	Dec. 31, 2005	Dec. 31, 2006	Dec. 31, 2005	Dec. 31, 2006	Dec. 31, 2005	Dec. 31, 2006
Forward rate contracts						
positive fair values	3,375	5,733	77	98		
negative fair values	3,498	6,353	(142)	(81)		
	6,873	12,086	(65)	17	(67)	(4)
Cross-currency interest rate swaps						
positive fair values	614	453	58	10		
negative fair values	593	676	(56)	(12)		
	1,207	1,129	2	(2)	0	0
Interest swaps						
positive fair values	6,215	4,850	172	105		
negative fair values	3,742	5,034	(56)	(143)		
	9,957	9,884	116	(38)	0	0
Interest options						
positive fair values	500	500	2	4		
negative fair values	500	500	(1)	(1)		
	1,000	1,000	1	3	1	2
Share options						
positive fair values	88	79	30	26		
negative fair values	-	5	-	(1)		
	88	84	30	25	16	12
Commodity contracts						
positive fair values	314	251	452	340		
negative fair values	314	251	(452)	(340)		
	628	502	0	0	0	0
	19,753	24,685	84	5	(50)	10

To hedge currency risks Bayer AG mainly uses forward rate agreements, currency options and cross-currency interest rate swaps.

Hedging is focused on financial exposure. To hedge the currency risk arising from receivables and liabilities at Group companies relating to business activities, contracts in a notional amount of €8.0 billion (2005: €3.6 billion) were concluded with external counterparties. Back-to-back transactions with Group companies total €1.9 billion (2005: €2.3 billion). These transactions have a net positive fair value of €16 million (2005: net negative fair value of €62 million).

To hedge planned transactions in foreign currencies, Bayer AG has concluded forward rate agreements and currency options with a notional value of €1.3 billion (2005: €1.0 billion) with external counterparties. Back-to-back agreements of the same amount are concluded with Group companies. The positive and negative fair values of these transactions therefore cancel each other out.

Cross-currency interest rate swaps in a nominal amount of €0.5 billion were used to hedge interest and foreign exchange risks arising from the GBP bonds issued in 2006. They have a net negative fair value of €2 million.

Other forward rate agreements in a nominal amount of €0.2 billion (2005: €0.1 billion) have a net positive fair value of €1 million (2005: net negative fair value of €1 million).

Interest rate swaps are mainly used to hedge the interest risk relating to Eurobonds issued by Bayer AG. The notional amount of these derivatives is €5.6 billion (2005: €5.3 billion) and they have a net negative fair value of €118 million (2005: positive fair value of €3 million).

Further interest swaps with a notional value of €4.3 billion (2005: €4.2 billion) have now been economically closed out. They have a net positive fair value of €80 million (2005: €113 million).

The interest-rate swaps with a notional value of €0.4 billion concluded in the previous year to manage interest rates and achieve interest-rate benchmarks no longer existed on December 31, 2006.

Caps were also used to manage interest rates. The premiums paid on these interest options have been capitalized and options received have been recognized as liabilities. Their notional value is €1 billion as in the previous year. They have a net positive fair value of €3 million (2005: €1 million).

Bayer AG and other Group companies have established a variety of stock programs for their employees, all of which run for several years. These programs entail the issue of free shares in Bayer AG or equivalent cash payments to employees upon the fulfillment of specific criteria. One condition is that employees must make a personal investment in Bayer shares which must be retained throughout the program. Employees lose their right to free shares once they sell the personal investment. Bayer AG has acquired stock purchase options to hedge the risk of fluctuations in the purchase price of the shares to be distributed free to participants in this program. These are closed out through call and put options if the actual period for which these personal investments are retained differs from the expected retention pattern. The stock purchase options had a net fair value of €25 million on December 31, 2006 (2005: €30 million).

The external commodity futures and options contracts were passed on to group companies on reciprocal terms. The results of such transactions through year end were mutually offsetting. The remaining open contracts were measured on the basis of closed positions, so no income was derived in this case either.

The fair value of derivative financial instruments is derived from the price at which they are quoted or traded. If no market price is available, the value is determined using capital market pricing models.

Currency derivatives, in other words forward rate agreements, currency options and cross-currency interest rate swaps, are recognized using the limited mark-to-market method. For this purpose, currency derivatives used for hedging purposes are valued at fair value on the reporting date and the underlying foreign currency receivables and payables are valued using spot rates on the reporting date. The resultant unrealized gains and losses in each currency are then netted. Provisions totaling €4 million (2005: €67 million) have been established for any net unrealized losses resulting from this valuation method. These are recognized under other provisions. Net unrealized gains are not recognized.

Wherever possible, interest swaps were valued in closed positions with the corresponding underlyings, so no unrealized gains or losses had to be recognized.

The interest rate swaps and cross-currency interest rate swaps used to hedge bonds are not reflected in the financial statements prepared in accordance with commercial law.

Interest options are capitalized at the lower of cost or market value and recognized as liabilities using the higher of cost or market value. As of December 31, 2006, capitalized interest options totaled €3 million (2005: €2 million). Interest option liabilities totaled €1 million (2005: €1 million). They are recognized in the balance sheet in other assets and miscellaneous liabilities respectively.

Put and call options on shares are also reflected in other assets and miscellaneous liabilities. They are valued at the higher or lower, respectively, of cost or market prices. As of December 31, 2006 the net value of stock options was €12 million (2005: €16 million).

(35) Audit fees

The following fees for the services of the auditor of the financial statements, PricewaterhouseCoopers Aktiengesellschaft Wirtschaftsprüfungsgesellschaft, are recognized as expenses:

	2005	2006
€ million		
Financial statement auditing	2.2	8.6
Audit-related services and other audit work	2.9	2.3
Other services	0.8	0.1
	5.9	11.0

The fees for the auditing of financial statements mainly comprise those for the audits of the financial statements of Bayer AG and the consolidated financial statements of the Bayer Group. Fees for audit-related services and other audit work primarily relate to audits of the internal control system, including project audits in connection with the implementation of new IT systems, and auditor review of interim financial statements.

(36) Total remuneration of the Board of Management and the Supervisory Board and loans

The total direct remuneration of active members of the Board of Management in 2006 amounted to €8,143,822 (2005: €7,064,828). It comprised the following components:

	2005	2006
€		
Base salary	1,985,580	2,260,400
Fixed supplement	837,073	1,096,556
Variable bonus	4,085,754	4,644,475
Remuneration in kind and other benefits	156,421	142,391
Total direct remuneration	7,064,828	8,143,822

In addition the members of Board of Management participate in long-term stock-based compensation programs. The entitlements earned in 2006 under the long-term stock-

based compensation programs granted in current and previous years are shown in the table below. The changes in the value of entitlements earned prior to 2006 are shown separately.

	2005	2006
€		
Stock-based compensation entitlements earned during the year	1,351,248	2,494,431
Change in value of stock-based compensation entitlements earned in prior years	466,730	904,689

The fair value of the stock-based compensation as of the grant dates for 2006 and 2005, respectively, is shown in the following table. The entitlements earned in 2006 under the 2006 and 2005 stock-based compensation are included in the preceding table under “entitlements earned during the year.”

	2005	2006
€		
Fair value of entitlements to stock-based compensation granted during the year at the time of granting	666,592	753,524

Expenses for pension entitlements granted to the members of the Board of Management serving in 2006 amounted to €1,983,587 (2005: €3,895,656). Pension provisions for the members of the Board of Management serving at year end amounted to €22,974,049 (2005: €25,091,901).

Emoluments to retired members of the Board of Management and their surviving dependents amounted to €10,924,768 (2005: €10,323,009). Pension provisions for these individuals, amounting to €97,243,586 (2005: €91,129,996) are reflected in the balance sheet of Bayer AG.

The remuneration of the Supervisory Board amounted to €2,337,041 (2005: €1,989,000). Of this, variable components accounted for €779,014 (2005: €459,000).

There were no loans to members of the Board of Management or the Supervisory Board outstanding as of December 31, 2006, nor any repayments of such loans during the year. Details of the remuneration of the Board of Management and Supervisory Board are set out in the compensation report of Bayer AG in the management report.

Proposal for Distribution of the Profit

The net income of Bayer AG in 2006 amounted to €1,250 million. €486 million was allocated to other retained earnings, giving a balance sheet profit of €764 million. We propose that this amount be used to pay a dividend of €1.00 per no-par share (764,341,920 shares) on the capital stock of €1,957 million entitled to the dividend for 2006.

Leverkusen, February 27, 2007
Bayer Aktiengesellschaft

The Board of Management

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.

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.

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 of the Bayer Group Annual Report.

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

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 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 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 8 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

A handwritten signature in blue ink, reading "Manfred Schneider". The signature is written in a cursive style with a large initial 'M' and a long, sweeping tail.

Dr. Manfred Schneider
Chairman

Supervisory Board and Board of Management

Supervisory Board

Hermann Josef Strenger

Honorary Chairman, Leverkusen

Members of the Supervisory Board hold or held offices as members of the supervisory board or a comparable supervising body of the corporations listed (as at December 31, 2006 or the date on which they ceased to be members of the Supervisory Board of Bayer AG):

Dr. Manfred Schneider

Chairman of the Supervisory Board, Leverkusen

* December 21, 1938

Allianz SE (until October 31, 2006)

DaimlerChrysler AG

Linde AG (Chairman)

Metro AG

RWE AG

TUI AG

Thomas de Win

Vice Chairman of the Supervisory Board (effective March 2, 2006);

Chairman of the Bayer Central Works Council, Leverkusen

* November 21, 1958

Bayer MaterialScience AG

Dr. Paul Achleitner

Member of the Board of Management of Allianz SE, Munich

* September 28, 1956

Allianz Deutschland AG

Allianz Elementar

Lebensversicherungs-AG (Chairman)

Allianz Elementar

Versicherungs-AG (Chairman)

Allianz Global Investors AG

Allianz Lebensversicherungs-AG

RWE AG

Dr. Josef Ackermann

Chairman of the Board of Managing Directors of Deutsche Bank AG,

Frankfurt am Main

* February 7, 1948

Deutsche Lufthansa AG

(until June 30, 2006)

Linde AG (until June 30, 2006)

Siemens AG

Andreas Becker

(until February 1, 2007)

Chairman of the Works Council of

H.C. Starck, Laufenburg

* March 1, 1959

H.C. Starck GmbH (until June 30, 2006)

Willy Beumann

(effective February 20, 2007)

Chairman of the Works Council of the Wuppertal site of Bayer AG

* April 12, 1956

Bayer HealthCare AG

Karl-Josef Ellrich

Chairman of the Dormagen Works Council of Bayer AG; Chairman of the Bayer Group Works Council (effective February 10, 2006), Leverkusen

* October 5, 1949

Bayer CropScience AG

Dr. Thomas Fischer

Graduate Engineer, Dormagen

* August 27, 1955

Bayer MaterialScience AG

Erhard Gipperich

(until January 31, 2006)

Former Vice Chairman of the Supervisory Board;

Former Chairman of the Bayer Central and Group Works Councils, Leverkusen

* April 30, 1942

Peter Hausmann

(effective April 28, 2006)
 North Rhine District Secretary of the
 German Mine, Chemical and
 Power Workers' Union, Düsseldorf
 * February 13, 1954
 Procter & Gamble Manufacturing GmbH

Thomas Hellmuth

Agricultural Engineer, Langenfeld
 * May 29, 1956

Prof. Dr.-Ing. e. h. Hans-Olaf Henkel

Honorary Professor at the University of
 Mannheim, Berlin
 * March 14, 1940
 Brambles Industries Ltd.
 Continental AG
 DaimlerChrysler Aerospace AG
 EPG AG (effective May 22, 2006)
 Orange SA
 Ringier AG
 SMS GmbH

Reiner Hoffmann

(effective October 11, 2006)
 Deputy General Secretary of the European
 Trade Union Confederation (ETUC),
 Brussels
 * May 30, 1955
 SASOL Germany GmbH

Gregor Jüsten

(effective February 1, 2006)
 Chemical Production Technician, Member
 of the Leverkusen Works Council of Bayer
 * December 13, 1948

Dr. rer. pol. Klaus Kleinfeld

President and Chief Executive Officer
 of Siemens AG, Munich
 * November 6, 1957
 Alcoa Inc.
 Citigroup Inc.

Dr. h. c. Martin Kohlhaussen

Chairman of the Supervisory Board of
 Commerzbank AG, Frankfurt am Main
 * November 6, 1935
 Hochtief AG (Chairman)
 Schering AG (until September 13, 2006)
 ThyssenKrupp AG

John Christian Kornblum

Chairman of Lazard & Co. GmbH, Berlin
 * February 6, 1943
 Motorola Inc.
 ThyssenKrupp Technologies AG (until
 November 30, 2006)

Petra Kronen

Chairwoman of the Uerdingen Works
 Council of Bayer AG
 * August 22, 1964
 Bayer MaterialScience AG

Hubertus Schmoltdt

Chairman of the German Mine, Chemical
 and Power Workers' Union, Hannover
 * January 14, 1945
 Deutsche BP AG
 DOW Olefinverbund GmbH
 E.ON AG
 RAG AG
 RAG Coal International

Dieter Schulte

(until September 18, 2006)
 Former Chairman of the German Unions
 Federation, Duisburg
 * January 13, 1940

Dr.-Ing. Ekkehard D. Schulz

Chairman of the Executive Board of
 ThyssenKrupp AG, Düsseldorf
 * July 24, 1941
 AXA Konzern AG
 Commerzbank AG (until March 31, 2006)
 Deutsche Bahn AG (until June 30, 2006)
 MAN AG (Chairman)

Standing committees of the Supervisory Board of Bayer AG as at December 31, 2006

Presidial Committee/Mediation Committee	Schneider (Chairman), Achleitner, Schmoltdt, de Win
Audit Committee	Kohlhaussen (Chairman), Fischer, Hausmann, Henkel, Schneider, de Win
Human Resources Committee	Schneider (Chairman), Ellrich, Kohlhaussen, Kronen

RAG AG (Vice Chairman)
RAG Beteiligungs-AG (Vice Chairman
effective September 14, 2006)
RWE AG (effective April 13, 2006)
ThyssenKrupp Elevator AG (Chairman)
ThyssenKrupp Services AG (Chairman)
ThyssenKrupp Technologies AG
(Chairman effective October 1, 2006)

Dipl.-Ing. Dr.-Ing. e. h. Jürgen Weber
Chairman of the Supervisory Board of
Deutsche Lufthansa AG,
Frankfurt am Main
* October 17, 1941
Allianz Lebensversicherungs-AG
Deutsche Bank AG
Deutsche Post AG (Chairman)
LP Holding GmbH (Chairman)
Tetra Laval Group
Voith AG
Willi Bogner GmbH & Co. KGaA
(effective May 31, 2006)

Siegfried Wendlandt
(until April 28, 2006)
Former North Rhine District Secretary of
the German Mine, Chemical and Power
Workers' Union, Düsseldorf
* July 27, 1947

Prof. Dr. Dr. h. c. Ernst-Ludwig Winnacker
Former President of the German Research
Foundation, Bonn; Secretary General of
the European Research Council (ERC),
Brussels
* July 26, 1941
KWS Saat AG
Medigene AG (Chairman)
Wacker Chemie AG

Board of Management

Members of the Board of Management
hold or held offices as members of the
supervisory board or a comparable super-
vising body of the corporations listed
(as at December 31, 2006):

Werner Wenning
Chairman of the Board of Management
* October 21, 1946
Bayer Schering Pharma AG (Chairman,
effective September 14, 2006)
Henkel KGaA

Klaus Kühn
* February 11, 1952
Bayer Business Services GmbH
(Chairman)
Bayer CropScience AG (Chairman)
Bayer Schering Pharma AG (effective
September 14, 2006)

Dr. Wolfgang Plischke
(effective March 1, 2006)
* September 15, 1951
Bayer MaterialScience AG
(Chairman, effective May 1, 2006)
Bayer Technology Services GmbH
(Chairman, effective May 1, 2006)

Dr. Udo Oels
(until April 28, 2006)
* January 2, 1944

Dr. Richard Pott
Labor Director
* May 11, 1953
Bayer HealthCare AG (Chairman)
Bayer Industry Services Geschäfts-
führungs-GmbH
(Chairman, effective May 1, 2006)
Bayer MaterialScience AG (Chairman,
until April 30, 2006)

Publisher

Bayer AG, 51368 Leverkusen, Germany

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English edition

Bayer Industry Services GmbH & Co. OHG

Central Language Service

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Date of publication

March 15, 2007

Bayer on the Internet

www.bayer.com

ISSN 0343/1975

The financial statements and management report of Bayer AG for the 2006 fiscal year are published in the electronic version of the German Federal Gazette (Bundesanzeiger) and filed in the Commercial Register of the Local Court of Cologne.

Forward-Looking Statements

These financial statements contain forward-looking statements. These statements use words like “believes,” “assumes,” “expects” or similar formulations. Various known and unknown risks, uncertainties and other factors could lead to material differences between the actual future results, financial situation, assets, development or performance of our company and those either expressed or implied by these statements. These factors include, among other things:

- downturns in the business cycle of the industries in which we compete;
- new regulations, or changes to existing regulations, that increase our operating costs or otherwise reduce our profitability;
- increases in the price of our raw materials, especially if we are unable to pass these costs along to customers;
- loss or reduction of patent protection for our products;
- liabilities, especially those incurred as a result of environmental laws or product liability litigation;
- fluctuation in international currency exchange rates as well as changes in the general economic climate; and
- other factors identified in these financial statements.

These factors include those discussed in our public reports filed with the Frankfurt Stock Exchange and with the U.S. Securities and Exchange Commission (including our Form 20-F). In view of these uncertainties, we caution readers not to place undue reliance on these forward-looking statements. We assume no liability whatsoever to update these forward-looking statements or to conform them to future events or developments.

Important Information from Bayer AG:

This is neither an offer to purchase nor a solicitation of an offer to sell shares or American depository shares of Bayer Schering Pharma AG (formerly Schering AG). Bayer Schering GmbH (formerly Dritte BV GmbH) filed a tender offer statement with the U.S. Securities and Exchange Commission (SEC) with respect to the mandatory compensation offer on November 30, 2006, the time of commencement of the mandatory compensation offer. Simultaneously Bayer Schering Pharma AG (formerly Schering AG) filed a solicitation/recommendation statement on Schedule 14D-9 with the SEC with respect to the mandatory compensation offer. Investors and holders of shares and American depository shares of Bayer Schering Pharma AG (formerly Schering AG) are strongly advised to read the tender offer statement and other relevant documents regarding the mandatory compensation offer that have been filed or will be filed with the SEC because they contain important information. Investors and holders of shares and American depository shares of Bayer Schering Pharma AG (formerly Schering AG) will be able to receive these documents free of charge at the SEC's website (www.sec.gov), or at the website www.bayer.com.

These documents and information contain forward-looking statements based on assumptions and forecasts made by Bayer Group management as of the respective dates of such documents. Various known and unknown risks, uncertainties and other factors could lead to material differences between the actual future results, financial situation, development or performance of the Bayer Group and/or Bayer Schering Pharma AG (formerly Schering AG) and the estimates contained in these documents and to differences between actions taken by the Bayer Group with respect to its investment in Bayer Schering Pharma AG (formerly Schering AG) and the intentions described in these documents. These factors include those discussed in reports filed with the Frankfurt Stock Exchange and in our reports filed with the U.S. Securities and Exchange Commission (including on Form 20-F). All forward-looking statements in these documents are made as of the dates thereof, based on information available to us as of the dates thereof. Except as otherwise required by law, we assume no obligation to update or revise any forward-looking statement to reflect new information, events or circumstances after the applicable dates thereof.

The names “Bayer Schering Pharma” or “Schering” as used in this publication always refer to Bayer Schering Pharma AG, Berlin, Germany, or its predecessor, Schering AG, Berlin, Germany, respectively.