

# Bayer AG

## Financial Statements 2003



# Financial Statements

of Bayer AG for 2003

## Management Report of Bayer AG

### Hive-down of business operations and transformation of Bayer AG into a management holding company

The Annual Stockholders' Meeting of April 26, 2002 having already approved the basic reorganization of the Bayer Group and the hive-down of the CropScience business area with retroactive effect from January 1, 2002, the stockholders of Bayer AG at the annual meeting on April 25, 2003 approved the plan that the business and service areas not yet hived down should also be placed into legally independent companies. Accordingly, the hive-down of HealthCare and Technology Services was undertaken with retroactive effect from January 1, 2003, while Chemicals gained legal independence retroactively effective July 1, 2003 and MaterialScience (formerly Polymers), Industry Services and Business Services retroactively effective October 1, 2003. This completes the transformation of Bayer AG into a management holding company without business operations of its own. The business responsibilities and operational management now lie with the respective new companies. Control and profit transfer agreements have been concluded with those of the new entities that are corporations. The service area Industry Services was placed into a general partnership.

### Sales and earnings performance

In 2003, Bayer AG's sales and earnings performance was again affected by the continuing weakness of the economy on the one hand and by the reorganization of the Bayer Group and efficiency improvement measures on the other hand. The economic recovery that set in during the third quarter of 2003 in many industrialized countries was only modest in the euro zone. Demand in Germany remained particularly weak and economic growth was unsatisfactory overall.

Against this economic backdrop, Bayer AG achieved sales of €5.2 billion in 2003, which was €4.3 billion less than in the previous year. This decline was primarily due to the hive-downs. Sales of the HealthCare business area are no longer included at all, while those of the Chemicals and MaterialScience business areas are only included prior to the respective hive-down dates July 1 and October 1. Based on the 2003 structure, Bayer AG would have had sales in 2002 of €5.5 billion; adjusted for the hive-downs, therefore, sales declined by €0.3 billion.

This was because the Chemicals and MaterialScience business areas, which continued to operate as units of Bayer AG until the above hive-down dates, saw their sales (prior to intracompany eliminations) decline by €0.2 billion and €0.8 billion, respectively, in a negative business environment. This effect was partially offset by an increase of €0.4 billion in sales of the service areas, which in turn resulted mainly from a higher invoiced volume of business conducted with the entities hived down from Bayer AG.

From a regional point of view, Europe remained by far the biggest market for Bayer AG, with an 82 percent share of sales (compared to 72 percent in the previous year). Customers in Germany accounted for 45 percent (2002: 33 percent), while those in the rest of Europe accounted for 37 percent (2002: 39 percent) of the total. Asia/Pacific accounted for 9 percent of sales (2002: 12 percent), while North America accounted for 4 percent (2002: 10 percent) and Latin America/Africa/Middle East for 5 percent (2002: 6 percent).

As in the previous year, the operating result was negative, at minus €74 million (compared to minus €88 million in 2002). In both Chemicals and MaterialScience the decline in sales impaired earnings, with cost-saving measures unable to compensate. By contrast, the service areas posted a slight improvement up to the date of their hive-downs.

The non-operating result fell by €1,343 million, or 104 percent, year on year, to minus €50 million (2002: €1,293 million). Under the existing profit transfer agreements and the new agreements concluded during the year, Bayer AG had to assume losses of €857 million on aggregate after receiving income of €116 million in 2002. Of the losses in 2003, companies that were newly created in 2002 and 2003 through hive-downs from Bayer AG accounted for €880 million, of which €263 million resulted from write-downs of noncurrent assets of Bayer Chemicals AG and Bayer MaterialScience AG. Dividend payments by other affiliated companies increased to €1,329 million, compared to €252 million in 2002. Gains from the sale of investments in affiliated companies were considerably lower, at €40 million, including €31 million that resulted from the divestment of our 50 percent interest in the PolymerLatex group to Soros Private Equity Investors. Divestment gains in the previous year amounted to €1,400 million, including €931 million from the sale of the Haarmann & Reimer group and €358 million from the sale of our interest in Baywoge GmbH. Earnings were diminished in 2003 by charges of €310 million (2002: €1 million) resulting from translations of foreign currency items, and derivative financial instruments used to hedge them. Under German

accounting regulations, these charges could not be offset against corresponding exchange gains. Positive contributions to the non-operating result came from a €50 million reduction in net interest expense and from a €41 million higher gain on sales of interest rate swaps than in the previous year. As a result of hive-downs, the charge to the non-operating result of Bayer AG resulting from the interest portion of personnel provisions decreased from the previous year. After allocations to Group companies it amounted to €117 million, compared to €227 million in 2002.

Bayer AG recorded a pre-tax loss for 2003 of €124 million. After €61 million in income tax expense, the company posted a net loss of €185 million. Due to a €550 million allocation from retained earnings, the balance sheet profit amounted to €365 million.

### Proposal for distribution of the profit

The Board of Management and the Supervisory Board will propose to the Annual Stockholders' Meeting on April 30, 2004 that the balance sheet profit of €365 million be used to pay a dividend of €0.50 per share (730,341,920 shares) on the capital stock of €1,870 million entitled to the dividend for 2003.

### Asset and capital structure

Total assets of Bayer AG increased in 2003 by €0.6 billion, or 2 percent, to €25.8 billion. The figure was affected not only by changes in the businesses that remained with Bayer AG but also by asset retirements related to the hive-downs.

The placement of business and service areas into legally separate entities resulted in the transfer of €6.2 billion in assets and €4.8 billion in liabilities to the new companies in 2003 and a corresponding increase in the carrying amounts of these companies in the Bayer AG balance sheet.

Non-current assets declined by €481 million to €17.8 billion in 2003 as a result of the hive-downs, and now account for 69 percent of total assets. Adjusted for the hive-downs, non-current assets grew by €1,077 million, or 7 percent. This was due entirely to an increase in investments, whereas all intangible assets and all but €485 million of property, plant and equipment have been retired from the balance sheet of Bayer AG and are now recognized in the balance sheets of the new business area and service companies. The €1,127 million increase in investments resulted mainly from capital increases at Bayer Corporation, United States (€441 million) and Bayer CropScience AG (€400 million), as well as from the intragroup acquisition of 75 percent of the shares of Bayer Hispania, S.A., Spain (€494 million). Additions also included a €30 million vendor note from Soros Private Equity Investors – which acquired the PolymerLatex group – and profit-participating capital for the company pension fund (Bayer Pensionskasse, €50 million). These amounts were partially offset by a €250 million retirement from the sale of the EQT vendor note to Bayer Inc., Canada, and a €75 million write-down of the equity interest in U.S.-based CuraGen Corporation.

Current assets of Bayer AG, at €8.0 billion including deferred charges, account for 31 percent of total assets. Following the hive-downs, current assets consist mainly of €6,295 million in receivables (2002: €5,283 million) – including €5,661 million from subsidiaries – as well as €114 million in marketable securities (2002: €12 million) and €1,547 million in cash and cash equivalents (2002: €412 million). Current assets grew by €1,080 million, or by €4,298 million if adjusted for the hive-downs. Of the hive-down-adjusted increase, a higher intragroup allocation of funds accounts for an increase of €2,963 million, while cash and cash equivalents grew by €1,135 million and marketable securities rose by €102 million.

Liabilities grew by €1.4 billion to €17.3 billion. Adjusted for the hive-downs, the increase amounted to €6.2 billion.

Provisions increased by €221 million, or 7.4 percent, chiefly due to a €295 million allocation to provisions for exchange rate risks. This amount was partially offset by a €76 million decrease in provisions for pensions and other post-employment benefits.

Liabilities – including deferred income – rose by €5,995 million, or 74 percent, to €14,121 million, when adjusted for the hive-downs. The increase resulted mainly from a €5,710 million increase in the intragroup allocation of funds, which stood at €8,286 million at year end. The increase in liabilities to subsidiaries indicates the special role of Bayer AG as the Group's financing company. Also related to this is the €2,963 million increase in receivables from affiliated companies, to €5,661 million; on aggregate, liabilities to Bayer Group companies increased by €2,747 million. Other changes in liabilities relate to commitments from the utilization of commercial paper and European Medium Term Notes, which increased by a total of €324 million, and loans to suppliers, which declined by €61 million.

Stockholders' equity declined by €0.8 billion, mainly due to the €657 million dividend payment for 2002 and the €185 million net loss recorded in 2003. Equity coverage of total assets fell from 37.1 percent to 33.0 percent due to the decline in stockholders' equity coupled with an increase in total assets.

## Employees

Due to Bayer AG's transformation into a management holding company and the related hive-down of business operations into legally independent companies, the number of employees dropped from 36,010 at the beginning of the year to 590 on December 31, 2003. The average number of employees for 2003 amounted to 19,398, a decline of 17,147, or 46.9 percent, compared to 2002. Personnel expenses fell by €1,050 million, or 44.6 percent, to €1,302 million. The ratio of personnel expenses to net sales remained steady year on year at 25 percent.

As in the previous year, the variable income component for non-managerial employees for 2003 is calculated on the basis of the gross cash flow before special items. As shown in

the cash flow statement on page 12, the gross cash flow for Bayer AG before special items amounted to €110 million. Since this figure only contains the amounts for the hived-down areas up to their respective hive-down dates, the gross cash flows of the new business area and service companies must be added. They totaled €454 million. The combined gross cash flow of Bayer AG and the hived-down companies thus amounted to €564 million before special items, an improvement of €230 million, or 69 percent, over the previous year's gross cash flow of €334 million.

### Research and development

Bayer AG spent €202 million on research and development in 2003, which was €1,086 million, or 84.3 percent, less than in the previous year. The decline was mainly due to the hive-down of the HealthCare business area with effect from January 1, 2003, the research costs of which are now borne by Bayer HealthCare AG. The research expenses remaining with Bayer AG in 2003 resulted almost entirely from activities of the Chemicals and MaterialScience business areas until their hive-downs from Bayer AG on July 1 and October 1, respectively. R&D expenses amounted to €37 million for Chemicals and €164 million for MaterialScience. Since October 1, 2003, research activities have been conducted exclusively by the operating business area and service companies. Bayer AG therefore ceased to incur costs for research and development as of that date.

### Risk management

As the parent of a global Group of companies, Bayer AG is exposed to a wide variety of risks in the course of its worldwide activities. In line with our corporate responsibility to deal adequately with risks, our goal is to identify as early and as fully as possible the potential risks associated with our activities, assess the possible consequences of their materialization and take suitable measures to mitigate them. The identification and assessment of these risks are crucial to the company's commercial success.

The various processes and instruments used, depending on the respective risk profile, are constantly being improved, supplemented and optimized in line with statutory requirements and the expectations of Bayer's management. Effective risk management ensures the efficient use of these processes and instruments.

Risk management is an integral part of all decisions and business processes. The management structure, the planning system, and the reporting and information systems, in particular, form the basis for the organizational integration of risk management into business processes.

Reporting plays a central role in monitoring the economic risks of our everyday business, as it ensures that the business developments are described according to uniform guidelines. In addition to the data on which external reports are based, internal reports are produced each month to ensure that the Board of Management and the various management levels

are fully alerted to possible risks in a timely fashion. Accounting and controlling functions support these activities and work to increase the responsiveness and efficiency of the reporting system. To ensure that the risk management system is functional at all times, we employ monitoring and control mechanisms based on established standard software. These mechanisms are the subject of continuous improvement and are adjusted immediately to changes in circumstances.

Possible risks are identified and documented with respect to their quantitative and qualitative effects and the likelihood of their occurrence so that precautionary measures can be taken.

The internal audit department regularly examines the risk management system's efficiency and functionality. The German Law on Corporate Supervision and Transparency (KonTraG) requires our external auditors to periodically evaluate our risk management system. The Board of Management and the Supervisory Board are regularly briefed on the results of this evaluation.

Increased risks currently result from litigation commenced in the United States following the voluntary withdrawal of the statin Lipobay/Baycol from the market and the voluntary cessation in the marketing of products containing PPA. Without acknowledging any liability, the company had settled 2,224 Baycol cases in the United States as of March 5, 2004, resulting in settlement payments totaling approximately US\$ 842 million. As of that date, 9,948 cases were pending in the U.S. Where facts have been developed in the course of the litigation, it so far appears that the vast majority of plaintiffs did not suffer serious side-effects. Should the U.S. plaintiffs in the Baycol litigation or in the phenylpropanolamine (PPA) product liability litigation substantially prevail despite the existing meritorious defenses, it is possible that Bayer could face payments that exceed its insurance coverage. The same is true should an unexpectedly sharp increase in settlement cases occur in the Baycol litigation. Due to the considerable uncertainty associated with these proceedings, it is currently not possible to more accurately estimate potential liability. For this reason, provisions for any amount by which liability in this regard might exceed insurance coverage have not presently been made. Depending on the progress of the litigation, we will continue to regularly reconsider the need to establish provisions, which may have a negative effect on financial results. PPA, which was widely used as an active ingredient in appetite suppressants and cough-and-cold medications by many manufacturers, was voluntarily replaced by Bayer and other producers in the U.S. after a recommendation in 2000 by the U.S. Food and Drug Administration.

In negotiations with the insurance companies concerning the Lipobay/Baycol litigation, a final agreement has been reached with the majority of the insurers. The insurers had previously proceeded only on a provisional basis under a customary reservation of rights. The insurers that are parties to this agreement have now withdrawn the reservations of rights. Thus, Bayer expects the insurance coverage for Lipobay/Baycol to be approximately US\$1.2 billion. In consideration of expenses already

incurred and quantifiable expenses expected to be incurred in this connection in the future, a €300 million charge has been taken to the operating result of the Bayer Group.

Risks also exist because Bayer AG and some of its domestic and foreign affiliated companies are the subject of investigations by the E.U. Commission and the U.S. and Canadian antitrust authorities for alleged anticompetitive conduct involving products of the former Rubber Business Group. The effects of these proceedings and their eventual conclusion cannot be predicted at this time. Civil actions are also pending in the United States in connection herewith.

Business risks also include those pertaining to acquisitions, capital expenditures and research and development activities. These future-oriented activities are vital to the continued existence of the Group, yet they also harbor risks because of the related uncertainties. We control and mitigate operating risks by exercising due diligence prior to such activities and by tracking their progress. For example, we investigate whether budgets can be adhered to, whether original forecasts can be met, and whether additional financial or technological risks are likely to emerge.

The future success of our business depends in no small measure on the dedication, motivation and skills of our employees. We must be capable at all times of attracting suitably qualified technical and managerial personnel, successfully integrating them into our operations and ensuring that they stay with us over the long term.

With this goal in mind, we offer our employees internal education and training opportunities, as well as performance-oriented remuneration systems. To ensure that our employees act responsibly from both a professional and a legal point of view within their respective fields of work, we have promulgated a worldwide legal compliance program. Supported by thorough training, this behavioral code obligates employees to observe the relevant laws and regulations. Complying with the rules at all times and monitoring the way employees handle risks are among the basic duties of all managers and supervisors throughout the Group. Binding guidelines, instructions and manuals are distributed throughout the enterprise to help ensure that our employees act consistently and safely.

In addition to the risks described above, further risks could exist for our business that we currently are unaware of or regard as negligible.

### Outlook

In the future, Bayer aims to focus more closely on its strengths in the fields of health care, nutrition and high-tech materials. The Board of Management and the Supervisory Board of Bayer AG have therefore decided to adjust the Group's structure and business alignment accordingly. It is planned to place the Chemicals business (except H.C. Starck and Wolff Walsrode) and parts of the MaterialScience subgroup that are no longer regarded as core businesses into an independent company named Lanxess which is to be divested by 2005 at the latest. The other activities of the MaterialScience and Chemicals subgroups are to be

combined in the new Bayer MaterialScience subgroup. The goal is to strengthen the competitiveness of the fast-growing, innovation-driven businesses in the HealthCare, CropScience and MaterialScience subgroups by concentrating on the special needs of these businesses.

Bayer is thus specializing in businesses that harbor significant potential for growth, value creation and innovation. Such businesses require more sophisticated structures and a substantial level of investment. Businesses that do not fit this profile are better served by being placed in an environment in which they can deploy their own management resources to the full and create the structures they need. The strategic focus on core competencies should enable Bayer to increase investment in growth businesses and innovative technologies. This in turn will allow the company to play a leading role in these attractive markets and expand its existing strong positions. As well as optimizing the allocation of resources in this way, we will press ahead with our cost-saving and efficiency-improvement programs in order to boost our success and thus increase Bayer's corporate value over the long term.

We expect sales of the Bayer Group to decline slightly in 2004 against the background of the measures undertaken and a projected slight improvement in economic conditions. If our planning assumptions for the various businesses prove to be correct over the course of the year, we believe we can increase EBIT before special items by more than 10 percent. Earnings of Bayer AG will be determined partly by the expenses it incurs in performing its functions as a management holding company, and primarily by the income it receives under profit transfer agreements and in the form of dividends from its subsidiaries.

### Subsequent events

No events of special importance have occurred since the end of the 2003 fiscal year.

## Independent Auditors' Report

We have audited the financial statements – including the accounting – of Bayer AG as well as the management report for the financial year from January 1 through December 31, 2003. The accounting, the financial statements and the management report prepared according to the German accounting regulations are the responsibility of the Board of Management of Bayer AG. Our responsibility is to express an opinion, based on our audit, to these financial statements – including the accounting – and to the management report.

We conducted our audit pursuant to Article 317 of the German Commercial Code, and also in compliance with the German principles for the auditing of financial statements promulgated by the Institut der Wirtschaftsprüfer (IDW) (German Institute of Certified Public Accountants). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether there are misstatements or violations with material implications on the financial statements, having regard to generally accepted accounting principles, or on the true and fair view of the net worth, financial position and results of operations provided by the management report. In defining the scope of the audit, knowledge of the company's business and the economic and statutory environment of the company are considered, as well as any anticipations of possible errors. The effectiveness of internal monitoring procedures and evidence supporting the amounts in the accounting and the disclosures in the financial statements and the management report are examined, primarily on a test basis. The scope of the audit also includes assessing the accounting principles used and significant estimates made by the Board of Management, as well as evaluating the overall presentation of the financial statements and the management report. We believe that our audit provides a reasonable basis for our opinion.

Our audit gave rise to no objections.

In our opinion, based on our audit, the financial statements, prepared in accordance with generally accepted accounting principles, give a true and fair view of the net worth, financial position, results of operations and cash flows of Bayer AG. The management report provides, on the whole, a fair understanding of Bayer AG's position and adequately presents the risks related to its future development.

Without qualifying our opinion we refer to the lawsuits associated with the withdrawal of the Lipobay/Baycol drug described in the Annual Report. Those lawsuits may result in material liability risks. Due to the unique trial situation in the United States of America it is currently not possible – even in consideration of the cases settled so far – to quantify the liability risks and to assess whether these risks exceed the existing insurance coverage. Hence, a provision did not have to be set up.

Essen, March 6, 2004 / March 11, 2004

PwC Deutsche Revision  
Aktiengesellschaft  
Wirtschaftsprüfungsgesellschaft

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## Bayer AG Statements of Income

€ million

	Note	2002	2003
<b>Net sales</b>	[1]	<b>9,513</b>	<b>5,224</b>
Cost of goods sold		(6,771)	(4,204)
<b>Gross profit</b>		<b>2,742</b>	<b>1,020</b>
Selling expenses		(1,245)	(573)
Research and development expenses		(1,288)	(202)
General administration expenses		(464)	(306)
Other operating income	[2]	465	122
Other operating expenses	[3]	(298)	(135)
<b>Operating result</b>		<b>(88)</b>	<b>(74)</b>
Income from investments in affiliated companies – net	[4]	1,698	437
Interest expenses – net	[5]	(178)	(128)
Other non-operating expense – net	[6]	(227)	(359)
<b>Non-operating result</b>		<b>1,293</b>	<b>(50)</b>
<b>Income (loss) before income taxes</b>		<b>1,205</b>	<b>(124)</b>
Income taxes	[7]	(43)	(61)
<b>Net income (loss)</b>		<b>1,162</b>	<b>(185)</b>
Allocation (to) from retained earnings		(505)	550
<b>Balance sheet profit</b>		<b>657</b>	<b>365</b>

# Bayer AG Balance Sheets

€ million

	Note	Dec. 31, 2002	Dec. 31, 2003
<b>Assets</b>			
<b>Noncurrent assets</b>			
Intangible assets	[14]	271	0
Property, plant and equipment	[15]	2,269	485
Investments	[16]	15,760	17,334
		<b>18,300</b>	<b>17,819</b>
<b>Current assets</b>			
Inventories	[17]	1,138	0
Receivables and other assets			
Trade accounts receivable	[18]	1,295	30
Receivables from subsidiaries	[19]	3,368	5,661
Other receivables and other assets	[20]	620	604
	[21]	<b>5,283</b>	<b>6,295</b>
Marktable securities	[22]	12	114
Cash and cash equivalents		412	1,547
		<b>6,845</b>	<b>7,956</b>
<b>Deferred charges</b>	[23]	<b>93</b>	<b>62</b>
		<b>25,238</b>	<b>25,837</b>
<b>Stockholders' equity and liabilities</b>			
<b>Stockholders' equity</b>			
Capital stock	[24]	1,870	1,870
Capital reserves		2,942	2,942
Retained earnings	[25]	3,840	3,290
Balance sheet profit		657	365
		<b>9,309</b>	<b>8,467</b>
<b>Special item with an equity component</b>	[26]	<b>85</b>	<b>86</b>
<b>Provisions</b>			
Provisions for pensions and other post-employment benefits	[27]	3,627	2,591
Other provisions	[28]	983	572
		<b>4,610</b>	<b>3,163</b>
<b>Other liabilities</b>			
Debentures	[29]	5,000	5,000
Liabilities to banks		40	37
Trade accounts payable	[30]	743	36
Payables to subsidiaries	[31]	4,747	8,286
Miscellaneous liabilities	[32]	600	757
	[33]	<b>11,130</b>	<b>14,116</b>
<b>Deferred income</b>		<b>104</b>	<b>5</b>
		<b>25,238</b>	<b>25,837</b>

# Bayer AG Statements of Cash Flows

€ million

	Note	2002	2003
Operating result		(88)	(74)
Income taxes (operating activities)		(35)	(61)
Depreciation and amortization		638	277
Change in long-term provisions		(67)	(32)
Gains on retirements of noncurrent assets		(146)	0
Exceptional items included in gross cash flow		(100)	0
<b>Gross cash flow before exceptional items</b>		<b>202</b>	<b>110</b>
<b>Gross cash flow</b>		<b>302</b>	<b>110</b>
Decrease (increase) in inventories		(14)	15
Increase in trade accounts receivable		(106)	(85)
Increase (decrease) in trade accounts payable		37	(135)
Change in other working capital		(113)	337
<b>Net cash provided by operating activities</b>	<b>[36]</b>	<b>106</b>	<b>242</b>
Cash outflows for additions to intangible assets, property, plant and equipment		(654)	(234)
Cash inflows from sales of intangible assets, property, plant and equipment		195	12
Cash outflows for additions to investments		(6,824)	(3,891)
Cash inflows from sales of investments		2,261	651
Acquisitions and divestitures		1,678	0
Cash inflows (outflows) from marketable securities		4	(96)
Interest and dividends received		779	1,418
Income taxes (non-operating activities)		(8)	0
<b>Net cash used in investing activities</b>	<b>[37]</b>	<b>(2,569)</b>	<b>(2,140)</b>
Bayer AG dividend		(657)	(657)
Issuances of debt		5,656	5,857
Retirements of debt		(2,112)	(1,513)
Interest paid		(387)	(654)
<b>Net cash provided by financing activities</b>	<b>[38]</b>	<b>2,500</b>	<b>3,033</b>
<b>Change in cash and cash equivalents</b>		<b>37</b>	<b>1,135</b>
Cash and cash equivalents at beginning of year		375	412
<b>Cash and cash equivalents at end of year</b>		<b>412</b>	<b>1,547</b>

# Notes to the Financial Statements of Bayer AG

## Transformation into a management holding company

Following the carve-out of the CropScience business area in 2002, the remaining business and service areas of Bayer AG were hived down into legally separate companies in 2003. The HealthCare business area and Technology Services were hived down effective January 1, 2003, followed on July 1, 2003 by the Chemicals business area. The MaterialScience business area (formerly known as Polymers), Industry Services and Business Services were hived down effective October 1, 2003. Thus the resolution adopted at the Annual Stockholders' Meeting in April 2002 on the reorganization of the Bayer Group has now been fully implemented. The legal entity Bayer AG is thereby transformed into a management holding company without business operations of its own.

As a consequence of the hive-downs, the balance sheet of Bayer AG as of December 31, 2003 no longer contains the assets and liabilities allocable or allocated to the business and service areas. To enhance comparability, the notes to each item state which amount recognized for the previous year relates to the operations that remained with Bayer AG or which to the operations that were hived down. Accordingly, inasmuch as the income statement and the statement of cash flows of Bayer AG include the operations of the business and service areas only until the date on which their transfer to a separate legal entity became effective, the figures contained therein are not comparable to the prior-year figures.

## 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. Research and development expenses are shown separately in view of their special importance in the chemical industry.

Non-operating income and expenses whose disclosure is not covered by a mandatory item are stated under miscellaneous non-operating income or expenses.

Under Article 161 of the Stock Corporation Act (Aktiengesetz), companies must declare the extent to which they comply with the German Corporate Governance Code. This Declaration of Conformity has been issued and made available to the 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 fully depreciated 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
Machinery and apparatus	generally		10	years
Laboratory and research facilities			5	years
Storage tanks and pipelines	12	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 in other affiliated companies are carried at cost, less write-downs for any decline in value that is expected to be permanent.

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.

Inventories are valued as follows: raw materials, supplies and goods purchased for resale, at the average cost of acquisition; work in process and finished goods, at the cost of production. The latter 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 for production. Write-downs are made where necessary to the market or fair value.

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

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

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

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.

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 maintenance are set up for maintenance work that has been deferred until the first three months of the following year. 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.

Foreign currency receivables and payables are translated at the rates at which they were initially recorded or at the current year's closing rates, whichever yield the lower amounts for receivables or the higher amounts for payables. Foreign currency receivables and payables that are hedged are translated at the hedged rates.

Deferred taxes and deferred income are stated separately for the first time. In 2002 they were included in other assets and other miscellaneous liabilities. The prior-year figures for these items have been restated accordingly.

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.

## Notes to the Statements of Income

**[1] Net sales**

Sales declined by €4.3 billion compared with 2002, to €5.2 billion. It should be noted here that during fiscal 2003 all remaining operating businesses were hived down from Bayer AG into legally independent companies. The HealthCare business area and Technology Services were hived down effective January 1, 2003, followed on July 1, 2003 by the Chemicals business area. The hive-down of the MaterialScience business area and of Business Services and Industry Services took place with effect from October 1, 2003. Accordingly, the sales recognized for Bayer AG contain the sales of the Chemicals business area for the first half of the year and the sales reported by MaterialScience, Business Services and Industry Services for the first nine months of 2003. On the basis of the 2003 structures, the comparable sales in 2002 would have been €5.5 billion. Adjusted for the hive-downs, sales thus declined by €0.3 billion.

The breakdown by regions and business areas is as follows:

**Sales by Region**

€ million	2002	2003
Germany	3,165	2,344
Other European countries	3,724	1,921
North America	992	219
Asia/Pacific	1,095	486
Latin America/Africa/Middle East	537	254
	<b>9,513</b>	<b>5,224</b>

**Sales by Business Area**

€ million	2002	2003
HealthCare	2,497	–
MaterialScience	4,606	3,285
Chemicals	2,198	1,076
Other	1,055	1,065
Elimination of sales between business areas	(843)	(202)
	<b>9,513</b>	<b>5,224</b>

The sales for each business area shown in the above table include intracompany sales to other business areas. A reconciliation to the total sales of Bayer AG is given in the last line.

**[2] Other operating income**

€ million	2002	2003
Income from sideline operations	23	–
Gains from retirements of noncurrent assets	155	1
Income from the sale of trademarks and know-how	154	20
Income from reversals of unutilized provisions	77	43
Miscellaneous income	56	58
	<b>465</b>	<b>122</b>

The cost of goods sold incurred for sideline operations is offset against the corresponding revenues to more clearly reflect the earnings position. In fiscal 2002 this resulted in net operating income of €23 million, while in fiscal 2003 the net result was an expense of €16 million, which is recognized in other operating expenses.

Of the 2002 income from retirements of noncurrent assets, €140 million related to the sale of company-owned housing units to Baywoge GmbH.

The 2002 income from the sale of trademarks and know-how comprised €127 million from the sale of the household insecticides business of the Consumer Care Division to SC Johnson.

**[3] Other operating expenses**

Included in other operating expenses are those for allocations to provisions, write-downs of accounts receivable, losses on retirements of noncurrent assets, payments of damages, and donations. Allocations to the special item with an equity component pursuant to Article 6b of the German Income Tax Act (Einkommensteuergesetz) resulted in expenses of €1 million (2002: €85 million).

**[4] Income from investments in affiliated companies – net**

€ million	2002	2003
Dividends and similar income	252	1,329
<i>of which €1,327 million (2002: €246 million) from subsidiaries</i>		
Income from profit and loss transfer agreements	179	268
<i>of which €268 million (2002: €179 million) from subsidiaries</i>		
Expenses from loss transfer	(63)	(1,125)
<i>of which €1,125 million (2002: €63 million) to subsidiaries</i>		
Write-downs of investments in affiliated companies	(70)	(75)
Gains from the sale of investments in affiliated companies	1,400	40
	<b>1,698</b>	<b>437</b>

Dividends and similar income comprise €1,279 million (2002: €117 million) from domestic affiliates and €50 million (2002: €135 million) from foreign affiliates.

A write-down of €75 million on the investment in CuraGen Corporation, United States, was expensed in 2003. The prior-year figure principally comprised write-downs on three research alliances of the Pharmaceuticals Division.

The €40 million in gains from the sale of investments in affiliated companies consists mainly of €31 million from the sale of Bayer's interest in the PolymerLatex Group to Soros Private Equity Investors, United States. The main components of this item in 2002 were the €931 million gain from the sale of Haarmann & Reimer GmbH to EQT, €358 million from the divestment of 94.9 percent of the shares of Baywoge GmbH to TreuHandStelle, Essen, Germany, and €78 million from the disposal of the interest in P.T. Bayindo Investama, Indonesia, to SC Johnson.

#### [5] Interest expense – net

€ million	2002	2003
Income from other securities and loans included in investments	4	12
Other interest and similar income <i>of which €236 million (2002: €224 million) from subsidiaries</i>	418	526
Interest and similar expenses <i>of which €172 million (2002: €208 million) to subsidiaries</i>	(600)	(666)
	<b>(178)</b>	<b>(128)</b>

#### [6] Other non-operating expense – net

€ million	2002	2003
Interest portion of the allocation to personnel-related provisions	(227)	(193)
Miscellaneous non-operating expenses	(21)	(312)
Miscellaneous non-operating income	21	146
	<b>(227)</b>	<b>(359)</b>

Almost the entire amount of miscellaneous non-operating expenses consists of a €310 million exchange loss. The miscellaneous non-operating income of €146 million includes gains of €61 million from the sale of interest rate swaps. Further, it contains €76 million from the allocation of expenses relating to the interest portion of pension obligations. Under the hive-down agreements, these costs are allocated proportionately to the companies hived down from Bayer AG insofar as they relate to retirees whose pensions continue to be paid by Bayer AG or to former employees with vested pension rights.

#### [7] Income taxes

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

#### [8] Other taxes

Other taxes are included in the cost of goods sold, selling expenses, research and development 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 2003 total €80 million (2002: €46 million).

**[9] Cost of materials**

€ million	2002	2003
Expenses for raw materials, supplies and goods purchased for resale	3,177	2,016
Expenses for purchased services	370	124
	<b>3,547</b>	<b>2,140</b>

**[10] Personnel expenses**

€ million	2002	2003
Wages and salaries	1,884	1,013
Social expenses	332	193
Pension expenses	136	96
	<b>2,352</b>	<b>1,302</b>

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.

**[11] Number of employees**

The average number of employees at Bayer AG declined from 36,545 to 19,398. This was mainly due to the hive-downs effected in 2003. At year-end Bayer AG had 590 employees. The breakdown of employees by functional area was as follows:

	Average	Reporting date	
	2002	2003	31.12.2003
Manufacturing	23,696	12,723	–
Marketing	3,532	1,769	–
Research and development	5,201	1,107	–
General administration	4,116	3,799	590
	<b>36,545</b>	<b>19,398</b>	<b>590</b>

**[12] Valuation write-downs, depreciation for tax purposes**

In addition to scheduled amortization and depreciation, write-downs of property, plant and equipment totaling €11 million were made in 2003 (2002: €3 million) to reflect declines in value that went beyond the depletion reflected in depreciation. No depreciation was undertaken specifically for tax purposes in 2003. In 2002, the company took depreciation charges for tax purposes of €112 million under Article 6b of the German Income Tax Act, and €7 million under Article 35 of the Income Tax Regulations.

**[13] Effects of valuation adjustments made for tax purposes**

The net loss (2002: net income) for 2003 was diminished by €22 million (2002: €11 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 in 2003 and prior years. The higher income taxes that will be incurred as a result of these valuation adjustments will be spread over approximately 25 years and therefore will not materially affect net income for these individual years.

## Notes to the Balance Sheets

The CropScience business area was hived down from Bayer AG effective January 1, 2002. In fiscal 2003 the remaining business and service areas of Bayer AG were hived down into legally independent companies. The resulting retirements of noncurrent assets are shown separately. In the other items, these Notes state which of the prior-year amounts relate to business remaining with Bayer AG or which relate to the activities that have been hived down.

**[14] Intangible assets**

€ million	<b>Acquired concessions, industrial property rights and assets, and licenses thereunder</b>	<b>Advance payments</b>	<b>Total</b>
Gross carrying amounts, Dec. 31, 2002	466	15	481
Capital expenditures	3	1	4
Hive-downs	(473)	(5)	(478)
Other retirements	(4)	–	(4)
Transfers	11	(11)	–
<b>Gross carrying amounts, Dec. 31, 2003</b>	<b>3</b>	<b>–</b>	<b>3</b>
Accumulated amortization and write-downs, Dec. 31, 2002	210	–	210
Amortization and write-downs in 2003	24	–	24
Hive-downs	(229)	–	(229)
Other retirements	(2)	–	(2)
<b>Accumulated amortization and write-downs, Dec. 31, 2003</b>	<b>3</b>	<b>–</b>	<b>3</b>
<b>Net carrying amounts, Dec. 31, 2003</b>	<b>–</b>	<b>–</b>	<b>–</b>
Net carrying amounts, Dec. 31, 2002	256	15	271

## [15] Property, plant and equipment

€ million	Land and buildings	Machinery and technical equipment	Furniture, fixtures and other equipment	Construction in progress and advance payments to vendors and contractors	Total
Gross carrying amounts, Dec. 31, 2002	3,174	7,477	595	559	11,805
Capital expenditures	2	35	9	184	230
Hive-downs	(727)	(7,645)	(579)	(446)	(9,397)
Other retirements	(27)	(106)	(24)	(1)	(158)
Transfers	35	239	16	(290)	–
<b>Gross carrying amounts, Dec. 31, 2003</b>	<b>2,457</b>	<b>–</b>	<b>17</b>	<b>6</b>	<b>2,480</b>
Accumulated depreciation and write-downs, Dec. 31, 2002	2,595	6,430	511	–	9,536
Depreciation and write-downs in 2003	52	179	22	–	253
Hive-downs	(645)	(6,508)	(494)	–	(7,647)
Other retirements	(22)	(101)	(24)	–	(147)
<b>Accumulated depreciation and write-downs, Dec. 31, 2003</b>	<b>1,980</b>	<b>–</b>	<b>15</b>	<b>–</b>	<b>1,995</b>
<b>Net carrying amounts, Dec. 31, 2003</b>	<b>477</b>	<b>–</b>	<b>2</b>	<b>6</b>	<b>485</b>
Net carrying amounts, Dec. 31, 2002	579	1,047	84	559	2,269

## [16] Investments

€ million	Investments in subsidiaries	Loans to subsidiaries	Investments in other affiliated companies	Loans to other affiliated companies	Other loans	Total
Gross carrying amounts, Dec. 31, 2002	12,811	2,103	627	–	319	15,860
Additions	2,840	–	4	–	80	2,924
Hive-downs	(443)	–	(363)	–	(44)	(850)
Other retirements	(93)	–	(73)	–	(259)	(425)
Transfers	–	(3)	–	3	–	–
<b>Gross carrying amounts, Dec. 31, 2003</b>	<b>15,115</b>	<b>2,100</b>	<b>195</b>	<b>3</b>	<b>96</b>	<b>17,509</b>
Accumulated write-downs, Dec. 31, 2002	4	2	88	–	6	100
Write-downs in 2003	–	–	75	–	–	75
Hive-downs	–	–	–	–	–	–
Other retirements	–	–	–	–	–	–
Transfers	–	(2)	–	2	–	–
<b>Accumulated write-downs, Dec. 31, 2003</b>	<b>4</b>	<b>–</b>	<b>163</b>	<b>2</b>	<b>6</b>	<b>175</b>
<b>Net carrying amounts, Dec. 31, 2003</b>	<b>15,111</b>	<b>2,100</b>	<b>32</b>	<b>1</b>	<b>90</b>	<b>17,334</b>
Net carrying amounts, Dec. 31, 2002	12,807	2,101	539	–	313	15,760

Additions to investments in subsidiaries include €1,359 million relating to the hive-downs of the business and service areas of Bayer AG into legally independent companies. Additions of €441 million, €400 million and €72 million arose from capital increases at Bayer Corporation in the United States, Bayer CropScience AG and Bayer (China) Ltd. A further €494 million was spent to acquire 75 percent of the shares in Bayer Hispania, S.A., Spain, from another Group company.

Additions to other loans totaling €80 million include €50 million in profit-participating capital granted to Bayer Pensionskasse and a €30 million vendor note to finance the acquiring third party's purchase of the PolymerLatex group. Nearly the entire amount of the retirements – €250 million – relates to the transfer of the vendor note granted to ISIS Vermögensverwaltungs-GmbH in connection with the sale of the Haarmann & Reimer group to another company in the Bayer Group.

Lists of Bayer AG's direct and indirect holdings have been included in the Commercial Register in Cologne.

#### [17] Inventories

€ million	Dec. 31, 2002	Dec. 31, 2002 (after hive-downs)	Dec. 31, 2003
Raw materials and supplies	269	4	–
Work in process, finished goods and goods purchased for resale	869	12	–
	<b>1,138</b>	<b>16</b>	<b>–</b>

Work in process and finished goods are grouped together in light of the production sequences characteristic of the chemical industry.

#### [18] Trade accounts receivable

€ million	Dec. 31, 2002	Dec. 31, 2002 (after hive-downs)	Dec. 31, 2003
Accounts receivable from subsidiaries	377	–	27
Accounts receivable from other affiliated companies	45	–	–
Accounts receivable from other customers	873	21	3
	<b>1,295</b>	<b>21</b>	<b>30</b>

#### [19] Receivables from subsidiaries

The total €3,368 million receivables from subsidiaries stated in the balance sheet as of December 31, 2002 included a €670 million receivable pertaining to the business and service areas hived down in 2003 and €2,698 million pertaining to Bayer AG (after the hive-downs).

**[20] Other receivables and other assets**

€ million	Dec. 31, 2002	Dec. 31, 2002 (after hive-downs)	Dec. 31, 2003
Receivables from other affiliated companies	55	54	11
Other assets	565	434	593
	<b>620</b>	<b>488</b>	<b>604</b>

The other assets as of December 31, 2003 include €252 million (2002: €213 million) that represents income earned in the fiscal year but not due to be received until after the closing date. This income consists mainly of accrued interest.

Further items reflected in other assets include claims for tax refunds, royalties and compensation, amounts for services rendered but not yet chargeable, payroll receivables, and advance payments.

**[21] Receivables and other assets maturing in more than one year**

The total receivables and other assets as of December 31, 2003, amounting to €6,295 million (2002: €5,283 million), include €78 million (2002: €49 million) due after 2004. Of this, €71 million comprises receivables from subsidiaries and €7 million comprises other assets.

**[22] Marketable securities**

The marketable securities include €100 million (2002: 0) invested in units of special investment funds, €10 million (2002: €10 million) in shares of short-term money market funds and €4 million (2002: €2 million) in shares of SolarWorld AG, Bonn.

**[23] Deferred charges**

Deferred charges as of December 31, 2003 include a discount of €32 million (2002: €40 million) relating to bonds issued in April 2002.

**[24] Capital stock**

The capital stock of Bayer AG amounts to €1,870 million, as in the previous year, and is divided into 730,341,920 no-par bearer shares of a single class.

Authorized capital totaling €250 million was approved by the Annual Stockholders' Meeting on April 26, 2002. It expires on April 26, 2007. The authorized capital can be used to increase the capital stock by issuing new shares against cash contributions. The Board of Management is authorized to exclude subscription rights with respect to €100 million of this authorized capital; however, in this case the issue price of the new shares must not be significantly below the market price. Exclusion of subscription rights for a further €150 million is only possible in specific cases.

Further authorized capital in the amount of €374 million was approved by the Annual Stockholders' Meeting on April 27, 2001. This authorized capital, which expires on April 27, 2006, can be used to increase the capital stock by issuing new shares against non-cash contributions. Subscription rights for existing stockholders are excluded.

Conditional capital of €83.2 million existed at December 31, 2003. This capital may only be utilized to the extent necessary to issue the requisite number of shares as and when conversion or subscription rights are exercised by the holders of convertible bonds or of warrants conferring subscription rights, respectively, that may be issued by Bayer AG or a wholly owned direct or indirect subsidiary through April 29, 2004.

#### [25] Retained earnings

Retained earnings consist solely of "other retained earnings" as referred to in the German Commercial Code.

#### [26] Special item with an equity component

The special item with an equity component for 2003 consists of gains from the sale of land and buildings allocated to this item under Article 6b of the Income Tax Act. €1 million was added to this item in 2003.

#### [27] Provisions for pensions and other post-employment benefits

This item includes provisions for current and future pension entitlements and for commitments entered into under early retirement agreements.

Out of the provisions for pensions and other post-employment benefits amounting to €3,627 million recognized as of December 31, 2002, €906 million related to employees of the business areas and service companies hived down during 2003.

#### [28] Other provisions

€ million	Dec. 31, 2002	Dec. 31, 2002 (after hive-downs)	Dec. 31, 2003
Provisions for taxes	132	132	186
Miscellaneous provisions	851	143	386
	<b>983</b>	<b>275</b>	<b>572</b>

Miscellaneous provisions include amounts for environmental protection measures, vacations, part-time working by older employees, annual bonuses, long-service awards to employees, discounts and other uncertain liabilities. It also includes anticipated losses, for example on currency and interest rate hedges.

**[29] Debentures**

In April 2002 Bayer AG launched two Eurobond issues under its €8 billion European Medium Term Notes (EMTN) program. One of these issues, in the nominal volume of €3,000 million, carries a 5 3/8 percent coupon and has a term of 5 years, maturing in 2007. Interest is paid annually for the preceding year. The issue price was 99.402 percent. The other Eurobond issue has a nominal volume of €2,000 million and a term of 10 years, so it matures in 2012. The bonds carry a 6 percent coupon. Again, all interest is paid annually for the preceding year. The issue price was 99.45 percent.

**[30] Trade accounts payable**

€ million	Dec. 31, 2002	Dec. 31, 2002 (after hive-downs)	Dec. 31, 2003
Accounts payable to subsidiaries	180	–	21
Accounts payable to other affiliated companies	17	–	–
Accounts payable to other suppliers	546	121	15
	<b>743</b>	<b>121</b>	<b>36</b>

**[31] Payables to subsidiaries**

The payables to subsidiaries amounting to €4,747 million stated in the balance sheet as of December 31, 2002 included €2,171 million pertaining to the business areas and services companies hived down in 2003 and payables of €2,576 million due to Bayer AG (after the hive-downs).

**[32] Miscellaneous liabilities**

€ million	Dec. 31, 2002	Dec. 31, 2002 (after hive-downs)	Dec. 31, 2003
Payables to other affiliated companies	1	–	–
Other miscellaneous liabilities	599	389	757
	<b>600</b>	<b>389</b>	<b>757</b>

The other miscellaneous liabilities as of December 31, 2003 include €17 million (2002: €71 million) in employees' income and church taxes. As of December 31, 2003 there were no liabilities relating to social insurance contributions (2002: €1 million).

The main items of other miscellaneous liabilities are €251 million (2002: €243 million) in accrued interest and €390 million (2002: €66 million) arising from the utilization of a commercial paper program. Also included here are short-term deposits pertaining to third parties and various amounts attributable to the fiscal year but not due to be paid until after the closing date. The prior-year figure also includes €30 million in advance payments received.

**[33] Further information on other liabilities**

The other liabilities are due as follows:

€ million	Dec. 31, 2002			Dec. 31, 2003		
	Maturing in 2003	Maturing in 2004– 2007	Maturing after 2007	Maturing in 2004	Maturing in 2005– 2008	Maturing after 2008
Debentures	–	3,000	2,000	–	3,000	2,000
Liabilities to banks	3	21	16	3	13	21
Trade accounts payable	743	–	–	36	–	–
Payables to subsidiaries	4,747	–	–	8,286	–	–
Payables to other affiliated companies	1	–	–	–	–	–
Other miscellaneous liabilities	597	2	–	757	–	–
	<b>6,091</b>	<b>3,023</b>	<b>2,016</b>	<b>9,082</b>	<b>3,013</b>	<b>2,021</b>

The total of other liabilities includes €253 million (2002: €331 million) representing amounts – mainly interest and payroll liabilities – attributable to the fiscal year but not due to be paid until after the closing date.

**[34] Contingent liabilities**

Contingent liabilities from sureties include €3 million (2002: €2 million) for subsidiaries. No security is now pledged for liabilities to third parties. In 2002 such security totaled €6 million and related to subsidiaries' liabilities to third parties.

Bayer AG guaranteed the CHF 400 million (€257 million) bond issue launched in April 2000 by its wholly owned subsidiary Bayer Ltd., Japan. The bonds, which carry a 3.75 percent coupon, mature in 2005. Similar guarantees were given to the creditors of USD 70 million (€55 million) in loans granted to Bayer (China) Ltd. and €65 million in loans granted to Bayer Capital Corporation, Netherlands.

Bayer AG has also guaranteed the following capital market instruments issued by Bayer Corporation, U.S.A.: USD 350 million (€277 million) of 6.65 % Notes due in 2028; USD 200 million (€158 million) of 7.125 % Notes due in 2015; USD 250 million (€198 million) of Puttable Reset Securities PURS<sup>SM</sup> due in 2028 at the latest; and USD 500 (€396 million) of Money Market Puttable Reset Securities (PURS) with a coupon of 4.45 % due in 2011. Utilization of the Global Commercial Paper Program of Bayer Corporation, which is guaranteed by Bayer AG, amounted to USD 577 million (€457 million) on December 31, 2003. In addition, a USD 468 million (€370 million) guarantee exists with respect to a lease agreement concluded by Bayer Corporation.

Further guarantees totaling €90 million (2002: €34 million) were given to the creditors of other Group companies. Bayer AG's contingent liabilities from debt guarantees thus total €2,323 million (2002: €1,688 million).

In addition to the commitments outlined above, Bayer AG bears joint and several liability under § 133 of the Companies' Reorganization Act for the liabilities of the business and service areas hived down to legally separate entities where such liabilities relate to the period prior to the hive-downs. Liability continues for five years from the effective dates of the respective hive-downs.

### [35] Other financial commitments

Other financial commitments include minimum future lease and rental payments of €247 million (2002: €278 million), of which €130 million (2002: €150 million) relates to lease and rental agreements with subsidiaries. The entire latter amount pertains to the two real-estate companies KG III Augusta and Gigas, through which the Agricultural Center in Monheim is financed. The commitments under lease and rental agreements mature as follows:

Maturing in	€ million
2004	20
2005	19
2006	19
2007	26
2008	28
after 2008	135
	<b>247</b>

Bayer AG has given an undertaking that it will provide Bayer Pensionskasse with profit-participating capital totaling €150 million which can be utilized by December 31, 2010 at the latest. Of this amount, €50 million was drawn in 2003, so the potential future obligation is €100 million.

In the years 2000 to 2003, all employees were offered opportunities to participate in stock compensation programs, with different programs for different employee groups. All participants have the opportunity to receive free Bayer AG shares or equivalent cash payments over a ten-year period depending on their initial personal investments in the stock, which must be retained for a certain time. The allocation of these benefits to senior executives also depends on internal and external performance criteria which, if achieved, would trigger the corresponding financial commitments.

## Notes to the Statements of Cash Flows

**[36] Net cash provided by operating activities**

The gross operating cash flow amounted to €110 million. This figure is computed, starting from the operating result of minus €74 million, by adding back expenses that do not result in cash disbursements and subtracting the income taxes attributable to the operating result. The net cash flow – after changes in working capital – amounted to €242 million.

**[37] Net cash used in investing activities**

Additions to intangible assets, property, plant and equipment in 2003 resulted in a cash outflow of €234 million, while additions to investments and capital increases amounted to €1,565 million. Included here is €494 million for the acquisition of 75 percent of the shares in Bayer Hispania, S.A., Spain, from another Group company, along with €441 million, €400 million and €72 million for capital increases at Bayer Corporation in the United States, Bayer CropScience AG and Bayer (China) Ltd., respectively. Loans, which were mainly granted to other companies in the Bayer Group, resulted in disbursements of €2,276 million, while a further €566 million was used to purchase marketable securities. In addition, profit-participating capital of €50 million was provided to Bayer Pensionskasse. Cash inflows of €12 million arose from the sale of property, plant and equipment, while €651 million came from the sale of investments and €470 million from the sale of marketable securities. Including cash inflows of €957 million in dividends and €461 million in interest, net cash used in investing activities amounted to €2,140 million.

**[38] Net cash provided by financing activities**

Net borrowings in 2003 amounted to €4,344 million, while dividend and interest payments came to €657 million and €654 million, respectively. Financing activities provided net cash of €3,033 million.

### Total remuneration of the Board of Management and the Supervisory Board; advances and loans

The remuneration of the Board of Management for 2003 amounted to €4,590,646 (2002: €5,700,737). Emoluments to retired members of the Board of Management and their surviving dependents amounted to €10,184,254 (2002: €14,383,353).

Pension provisions for these individuals, amounting to €93,375,261 (2002: €97,452,418) are reflected in the balance sheet.

The remuneration of the Supervisory Board amounted to €752,250 (2002: €1,293,750).

There were no loans to members of the Board of Management or the Supervisory Board outstanding as of December 31, 2003, nor any repayments of such loans during the year.

### Proposal for Distribution of the Profit

The financial statements of Bayer AG show a balance sheet profit of €365 million. We propose that this amount be used to pay a dividend of €0.50 per no-par share on the capital stock of €1,870 million entitled to the dividend for 2003.

Leverkusen, March 11, 2004

Bayer Aktiengesellschaft

The Board of Management

# Supervisory Board and Board of Management

## Supervisory Board

### Hermann Josef Strenger

Honorary Chairman, Leverkusen

Members of the Supervisory Board – in addition to performing individual supervising functions at companies affiliated to those in which they hold legal offices – hold or held offices as members of the supervisory board or a comparable supervising body of the corporations listed (as at December 31, 2003 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

\* Dec. 21, 1938

Allianz AG

DaimlerChrysler AG

Linde AG (Chairman)

Metro AG

RWE AG

TUI AG

### Erhard Gipperich

Vice Chairman of the Supervisory Board; Chairman of the Group and Central Works Councils of Bayer AG, Leverkusen

\* April 30, 1942

THS GmbH

### Dr. Paul Achleitner

Member of the Board of Management of Allianz AG, Munich

\* Sept. 28, 1956

Allianz Immobilien GmbH (Chairman)

Allianz Dresdner Asset Management GmbH (ADAM)

MAN AG

RWE AG

ÖIAG

### Dr. Josef Ackermann

Spokesman of the Board of Managing Directors and Chairman of the Group Executive Committee of Deutsche Bank AG, Frankfurt am Main

\* Feb. 7, 1948

Linde AG

Deutsche Lufthansa AG

(effective June 2003)

Siemens AG (effective January 2003)

Stora Enso Oyj (until March 2003)

### Karl-Josef Ellrich

Chairman of the Works Council, Dormagen site

\* Oct. 5, 1949

Bayer CropScience AG

(effective February 2003)

### Thomas Hellmuth

Agricultural Engineer, Langenfeld

\* May 29, 1956

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

President of the Leibniz Association, Berlin

\* March 14, 1940

Continental AG

Deutsche Industriebank AG (IKB)

DaimlerChrysler Aerospace AG

SMS AG

Ringier AG

Orange SA

### Dr. h.c. Martin Kohlhausen

Chairman of the Supervisory Board of Commerzbank AG, Frankfurt am Main

\* Nov. 6, 1935

Heraeus Holding GmbH

Hochtief AG

Infineon Technologies AG

Schering AG

ThyssenKrupp AG

Verlagsgruppe Georg von Holtzbrinck GmbH

### John Christian Kornblum

Chairman of Bankhaus Lazard, Berlin

\* Feb. 6, 1943

ThyssenKrupp Technologies AG

### Petra Kronen

Chairman of the Works Council, Uerdingen site

\* Aug. 22, 1964

### Dr. Heinrich von Pierer

President and Chief Executive Officer of Siemens AG, Munich

\* Jan. 26, 1941

Hochtief AG

Münchener Rückversicherungs-Gesellschaft AG

Volkswagen AG

Committees of the Supervisory Board of Bayer AG	
<b>Presidial Committee/ Mediation Committee</b>	Schneider (Chairman), Gipperich, von Pierer, Schmoltdt
<b>Audit Committee</b>	Kohlhaussen (Chairman), Henkel, Schenk, Schneider, Wendlandt, de Win
<b>Human Resources Committee</b>	Schneider (Chairman), Ellrich, Kohlhaussen, Kronen

**Dr. Wolfgang Reitzle**

(until April 25, 2003)  
Chairman of the Executive Board of  
Linde AG, Wiesbaden  
\* March 7, 1949  
*Allianz Lebensversicherungs-AG*

**Wolfgang Schenk**

Graduate Engineer, Leverkusen  
\* Sept. 24, 1953  
Bayer CropScience AG  
(effective February 2003)

**Hubertus Schmoltdt**

Chairman of the German Mine, Chemical  
and Power Workers' Union, Hannover  
\* Jan. 14, 1945  
*BHW AG*  
*BP AG*  
*DOW Olefinverbund GmbH*  
*e.on AG*

**Dieter Schulte**

Former Chairman of the German Unions  
Federation, Duisburg  
\* Jan. 13, 1940  
*ThyssenKrupp AG (until January 2004)*

**Dipl.-Ing. Dr.-Ing. e.h. Jürgen Weber**

(effective April 25, 2003)  
Chairman of the Supervisory Board of  
Deutsche Lufthansa AG, Frankfurt am Main  
\* Oct. 17, 1941  
*Allianz Lebensversicherungs-AG*  
*Deutsche Bank AG (effective June 2003)*  
*Deutsche Post AG (effective July 2003)*  
*Thomas Cook AG (Chairman)*  
*Voith AG (effective June 2003)*  
*Loyalty Partner GmbH*  
*Tetra Laval Group (effective July 2003)*

**Siegfried Wendlandt**

North Rhine District Secretary of the  
German Mine, Chemical and Power  
Workers' Union, Düsseldorf  
\* July 27, 1947  
*Rütgers AG*  
*HTTropplast AG*

**Reinhard Wendt**

Printer, Walsrode  
\* March 6, 1945  
*Wolff Walsrode AG*

**Thomas de Win**

Commercial Clerk, Cologne  
\* Nov. 21, 1958

**Prof. Dr. Dr. h.c. Ernst-Ludwig Winnacker**

President of the German Research  
Association, Bonn  
\* July 26, 1941  
*MEDIGENE AG (Chairman)*  
*KWS Saat AG*

**Dr. Hermann Wunderlich**

Former Vice Chairman of the Company's  
Board of Management, Odenthal  
\* April 29, 1932  
*Freudenberg & Co.*

## Board of Management

Members of the Board of Management –  
in addition to performing individual  
supervising functions at companies  
affiliated to those in which they hold legal  
offices – hold or held offices as members  
of the supervisory board or a comparable  
supervising body of the corporations  
listed (as at December 31, 2003 or the date  
on which they ceased to be members of  
the Board of Management):

**Werner Wenning**

Chairman of the Board of Management  
\* Oct. 21, 1946  
*Gerling-Konzern Versicherungs-  
Beteiligungs-AG*  
*Henkel KGaA*

**Klaus Kühn**

\* Feb. 11, 1952  
Bayer CropScience AG  
(Chairman effective June 2003)

**Dr. Udo Oels**

\* Jan. 2, 1944  
Bayer Chemicals AG  
(effective December 2003)  
*ThyssenKrupp Services AG*  
(effective December 2003)

**Dr. Richard Pott**

\* May 11, 1953  
Bayer HealthCare AG  
(effective December 2003)

**Werner Spinner**

\* Oct. 30, 1948  
(until February 2003)



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**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, 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.

The financial statements and management report of Bayer AG for 2003 are published in the Bundesanzeiger and have been included in the Commercial Register in Cologne.