Bayer

Report by the Board of Management pursuant to §§ 221 para. 4 sentence 2, 186 para. 4 sentence 2 German Stock Corporations Act

The proposed authorizations for the issuance of bonds with warrants or convertible bonds, profit sharing rights or profit participation bonds or a combination of these instruments (the "Bonds") in a total nominal amount, based on the clause on crediting the issuances against each other, of up to EUR 6 billion as well as on creating the corresponding conditional capital of in each case up to EUR 195,584,000 are intended to expand the possibilities described in more detail below for Bayer AG to finance its activities and to give the Board of Management with the consent of the Supervisory Board an opportunity in the interests of the Company for flexible and quick financing upon the occurrence of advantageous conditions in the capital market.

The reason why two authorizations on issuing bonds are provided for is that recently there have been several decisions by the courts under which, contrary to the previous general practice, the determination of a minimum price in a convertible bond covered by conditional capital is supposedly not permitted. According to these court decisions, it instead should be necessary to provide for a specific conversion or option price or a formula for calculating it. This results in a considerable loss of flexibility, and the possibility of reacting to market developments occurring up to 5 years after the original grant of authorization when issuing the bonds is limited. By granting two authorizations, the Company obtains the possibility of being able to decide at the time of issuing the bonds about the authorization with the conditions which better correspond to the then predominant market conditions in order to be able to achieve better conditions for the financing.

The two authorizations for the issuance of bonds are independent of each other and are being submitted separately for a vote. The volume of the two authorizations, however, is limited in such a manner that under both authorizations together, Bonds with a maximum aggregate amount of up to EUR 6 billion can be issued.

Authorization I and Conditional Capital 2008 I (agenda item 5)

The shareholders as a general rule have the statutory subscription right for bonds which are tied to option rights or conversion rights (§ 221 para. 4 in conjunction with § 186 para. 1 AktG). In order to facilitate the handling, it is intended to make use of the possibility of issuing the bonds to a credit institution or a syndicate of credit institutions with the obligation to offer the bonds to the shareholders in accordance with their subscription rights (indirect subscription right within the meaning of § 186 para. 5 AktG).

The exclusion of the subscription right for remainder amounts makes it possible to use the requested authorization with rounded amounts. This facilitates the handling of the subscription right for the shareholders. The exclusion of the subscription right for the benefit of holders of already issued conversion rights and option rights or conversion obligations or obligations to exercise option rights has the advantage that the conversion price or option price for the already issued conversion rights or option rights or conversion obligations or obligations to exercise options does not have to be reduced and, thus, in total a greater amount of funds can be raised. Both instances of excluding the subscription right, therefore, are in the interests of the Company and its shareholders.

The Board of Management is further authorized with the consent of the Supervisory Board to completely exclude the subscription right of the shareholders if the issuance of the bonds tied to option rights or conversion rights or obligations to exercise option rights or conversion obligations leads to an exchange price which does not materially fall below the fair market value of these bonds. This gives the Company the opportunity to exploit advantageous market situations on very short notice and quickly and to achieve better conditions when setting the interest rate and the issuing price for the bonds by being able to do so reacting quickly to the market. Setting conditions close to market and a smooth placement would not be possible if the subscription right were retained. Although § 186 para. 2 AktG permits publication of the subscription price (and thus the conditions for these bonds) by the third to the last day of the subscription period, in light of the frequently observed volatility in the stock markets, there still exists a market risk for several days which leads to precautionary discounts when setting the conditions of the bonds and, thus, does not permit close to market conditions. The existence of a subscription right also endangers the successful placement with third parties or involves additional expenses due to the uncertainty of whether the subscription right will be exercised. Finally, when granting a subscription right, a Company cannot react on short notice to beneficial or disadvantageous market conditions if a subscription right has been granted because of the length of the period for exercising the subscription right, and the Company is instead subject to a downturn in the price of the stock during the period for exercising the subscription right which can lead to a disadvantageous procurement of equity capital for the Company.

In this event of a complete exclusion of the subscription right, the provision in § 186 para. 3 sentence 4 AktG applies accordingly pursuant to § 221 para. 4 sentence 2 AktG. The limit regulated there for excluding subscription rights of 10 % of the share capital must be complied with in the content of the resolution. The volume of the maximum amount of conditional capital for securing the option rights or conversion rights or obligations to exercise options or conversion obligations should be less than 10 % of the current share capital. A corresponding requirement in the resolution on the Authorization also makes sure that the 10 % limit is not exceeded in the event of a reduction of capital because the authorization for excluding the subscription right expressly cannot exceed 10 % of the share capital, either at the time the authorization takes effect or at the time of exercise of the existing authorization, whichever is less. The above mentioned 10 % limit applies both to new shares which are issued from this authorized capital subject to exclusion of the subscription right under § 186 para. 3 sentence 4 AktG during the term of this authorization up to the issuance of the bonds with warrants and/or conversion rights or obligations to exercise options or conversion obligations issued under § 186 para 3 sentence 4 AktG as well as to those shares which are acquired on the basis of the authorization of the Annual Stockholders' Meeting dated April 25, 2008 and are sold pursuant to § 71 para. 1 no. 8 sentence 5 in conjunction with § 186 para. 3 sentence 4 AktG up to the issuance without subscription rights of bonds with warrants and/or conversion rights or with the obligation to exercise options or with conversion obligations under § 186 para. 3 sentence 4 AktG subject to exclusion of the subscription right, as well as to those shares which are issued upon exercise of option rights and/or conversion rights or as a result of obligations to exercise options or to convert resulting from bonds issued without subscription rights on the basis of the authorization of the Annual Stockholders' Meeting dated April 25, 2008 under agenda item 6 pursuant to § 186 para. 3 sentence 4 AktG to the extent that these bonds have been issued up to the issuance under exclusion of subscription rights pursuant to § 186 para. 3 sentence 4 AktG of bonds with warrants and/or conversion rights or obligations to exercise options or conversion obligations under the authorization of the Annual Stockholders' Meeting dated April 25, 2008 under agenda item 5.

§ 186 para. 3 sentence 4 AktG also means that the issuing price cannot materially be less than the price on the exchange. This is intended to make sure that no material economic dilution of the value of the shares occurs. Whether such a dilutive effect occurs upon issuing bonds with warrants or conversion rights or with obligations to exercise options or conversion obligations under exclusion of the subscription right occurs can be determined by calculating the hypothetical exchange price of the bonds in accordance with recognized methods, especially financial mathematical methods, and comparing them with the issuing price. If after a proper examination, this issuing price is not materially below the hypothetical price on the exchange at the time of issuing the bonds, an exclusion of the subscription rights based on an immaterial shortfall is permissible under the intent and purpose of the regulation § 186 para. 3 sentence 4 AktG. Therefore, the resolution does not provide that the Board of Management must come to the conclusion upon the proper examination prior to issuing the bonds with warrants or conversion rights or with obligations to exercise options or conversion obligations that the contemplated issuing price does not lead to any material dilution of the value of the shares. Thus, the calculatory fair market value of a subscription right is reduced to virtually 0 so that the shareholders cannot incur any material economic disadvantage as a result of excluding the subscription right. Independent of this examination by the Board of Management, it is ensured that the conditions will be set in a manner that is fair compared to the market and, thus, a material dilution in value in the case of carrying out the book-building procedure will be avoided. Under this procedure, the bonds are issued at a fixed issuing price, but individual terms and conditions of the bonds (e.g. interest rate and, if appropriate, term) are fixed on the basis of the purchase offers made by investors so that the overall value of the bond is determined close to market. All of this makes sure that no material dilution of the value of the shares can occur as a result of excluding the subscription right.

In addition, the shareholders have the possibility to maintain their portion in the share capital of the Company even after the exercise of conversion rights or option rights or the realization of the obligation to exercise options or conversion obligations at any time by purchasing shares on the exchange. Compared to this, the authorization to exclude subscription rights makes it possible for the Company to set conditions close to market while having the greatest possible security with regard to the ability to place the bonds with third parties and to exploit advantageous market situations on short notice.

To the extent that profit sharing rights or profit participation bonds without option rights or conversion rights or obligations to exercise options or conversion obligations are issued, the Board of Management is authorized with the consent of the Supervisory Board to completely exclude the subscription right of the shareholders if these profit sharing rights or profit participation bonds are structured in a manner similar to obligations, i. e. if they do not establish membership rights in the Company, do not grant any participation in proceeds of liquidation and if the amount of interest is not calculated on the basis of the amount of the annual profit, the balance sheet profit or the dividend. Furthermore, the interest rate and the issuing price for the profit sharing rights and the profit participation bonds must correspond to current market conditions at the time they are issued. If the stated prerequisites have been satisfied, no disadvantages arise for the shareholders as a result of excluding the subscription right because the profit sharing rights or the profit participation bonds do not establish any membership rights and also do not grant any participation in proceeds of liquidation or in the profits of the Company.

Authorization II and conditional capital 2008 II (Agenda item 6)

The Authorization proposed under agenda item 6 together with the conditional capital is identical in content to the Authorization together with conditional capital proposed under agenda item 5, except for the requirements for setting the conversion price or the option price.

In order to avoid repetition, therefore, reference is made to the discussion in this Report on agenda item 5. This applies accordingly also for the reasoning for the possibilities to exclude the subscription right when issuing the Bonds under agenda item 6 which is justified on the same grounds under agenda item 5.

Leverkusen, February 26, 2008
Bayer Aktiengesellschaft

The Board of Management