Bayer AG
Financial Statements 2007

Cover picture

Climate change also presents Bayer scientists with new challenges, for example in agriculture. Our cover picture shows farmer Tony Beck (left) and Bayer CropScience employee Kyle Gross checking the quality of flowering canola plants in Australia.

Management Report

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 CURRENTA 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 Business Services, Bayer Technology Services and CURRENTA – which offer their services primarily to companies in the Bayer Group, but also to external customers.

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.

Restructuring

Following the acquisition in 2006 of a 96.24 percent interest in Bayer Schering Pharma AG by Bayer Schering GmbH, a wholly owned subsidiary of Bayer AG, Bayer's interest in this company was increased by 0.08 percent to 96.32 percent in 2007. At an Extraordinary Stockholders' Meeting of Bayer Schering Pharma AG on January 17, 2007, it was resolved to effect a squeeze-out of the remaining minority stockholders in return for cash compensation. Moreover, pursuant to the domination and profit and loss transfer agreement concluded and entered in the commercial register in the previous year, Bayer Schering Pharma AG transferred its profits to Bayer AG via Bayer Schering GmbH for the first time in 2007.

The sale of the Diagnostics business to Siemens was closed on January 2, 2007 and the acquisition of Wolff Walsrode by The Dow Chemical Company was completed on June 30, 2007. Bayer AG was indirectly involved in both transactions through one of its German subsidiaries. As a consequence of profit and loss transfer agreements, the divestment of these operations had an impact on the earnings, cash flows and thus also the debt of Bayer AG.

Sales and Earnings Performance

Net sales of Bayer AG in 2007 amounted to €242 million (2006: €196 million). Of the total, €114 million 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 through CURRENTA GmbH & Co. OHG, while €128 million (2006: €82 million) results from the rendering of other services, almost exclusively to Bayer Group companies. The rise of €46 million compared with the previous year is essentially due to intragroup charges for project costs in connection with divestments completed during 2007. Germany accounted for €219 million of net sales.

The cost of goods sold came to €195 million (2006: €146 million), including €55 million relating to leased real estate, especially depreciation of leased property, and €140 million relating to other revenues. After deducting the cost of goods sold, gross profit amounted to €47 million (2006: €50 million), which was 19 percent (2006: 26 percent) of net sales and €3 million below the prior-year figure.

Bayer AG incurred an operating loss of €179 million in 2007, €30 million more than in the previous year (€149 million), in the performance of its tasks as a management holding company for the Bayer Group. This was principally attributable to higher personnel expenses, along with one-time expenses of €13 million resulting from a settlement of stockholders' claims for compensation in connection with alleged violations of U.S. capital market regulations.

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 €855 million to €2,304 million (2006: €1,449 million).

This was chiefly due to a €995 million improvement in income from investments in affiliated companies to €3,030 million (2006: €2,035 million).

Of the income from investments in affiliated companies, €2,841 million was attributable to amounts transferred from subsidiaries in Germany under profit and loss transfer agreements. This was €737 million more than in 2006 (€2,104 million). The profit transferred to Bayer AG by Bayer Gesellschaft für Beteiligungen mbH increased by €1,463 million to €1,624 million (2006: €161 million), mainly due to an intragroup share transaction. Bayer Schering GmbH also increased its income to €811 million (2006: loss of €256 million). This company holds the majority interest in Bayer Schering Pharma AG acquired in the previous year. In addition to financing expenses for the purchase of that interest, in 2007 this company's earnings included for the first time a profit of €1,381 million transferred to it by Bayer Schering Pharma AG. Bayer HealthCare AG also contributed higher earnings of €1,087 million (2006: €343 million), principally due to an improvement in its operating result and a gain of €589 million from the sale of shares in connection with the divestment of the diagnostics business to Siemens. Bayer CropScience AG, which transferred a profit of €942 million in the previous year, recorded a loss of €1,098 million in 2007, mainly due to €2,445 million in write-downs of investments in affiliated companies. Of this amount, €912 million was related to or the result of dividend payments. Even after offsetting this amount, the write-downs of investments in affiliated companies nevertheless had a €1,533 million negative impact on the earnings of Bayer CropScience AG. By contrast, the company's operating result improved significantly from the previous year. Bayer Chemicals AG, which no longer has any operating business, reported income of €330 million from the sale of its 49.9 % interest in GE Bayer Silicones GmbH & Co. KG in 2006 and was thus able to transfer a total profit of €368 million for that year. In 2007, however, Bayer Chemicals AG had to transfer a loss of €47 million, including a loss of €7 million from the divestiture of its interest in Wolff Walsrode AG. The income contribution from Bayer MaterialScience AG decreased by €72 million to €437 million, compared with €509 million in 2006. The decline was due to lower income from its investments in affiliated companies; the operating result was €121 million higher than in the previous year, chiefly as a result of one-time factors. The net amount of income from other subsidiaries with profit and loss transfer agreements was €27 million (2006: €37 million).

Apart from the increase in the net amount transferred by German companies with profit and loss transfer agreements, dividends and income from partnerships also improved to €245 million (2006: €14 million). Nearly the whole of this amount came from foreign subsidiaries. The largest individual contributions comprised €143 million from Bayer Inc., Canada, €28 million from Bayer de México, S.A. de C.V., €23 million from Bayer New Zealand Limited and €16 million from Bayer Korea Ltd.

Income from investments in affiliated companies included gains of €13 million from the sale of such investments (2006: loss of €87 million). At the same time, it was diminished by write-downs of investments in affiliated companies totaling €69 million (2006: write-backs of €4 million), comprising €60 million for Bayer Technology Services GmbH and €9 million for CuraGen Corporation, U.S.A.

Bayer AG's net interest expense rose by €269 million year-on-year to €744 million (2006: €475 million). Net debt, which increased substantially in 2006 due to the financing of the Schering acquisition, was €30.7 billion at the start of the year, but was reduced by €1.6 billion to €29.1 billion during the year. Net interest expense nevertheless increased because the cost of servicing the higher debt was incurred for the full year, whereas in 2006 it increased only with the successive acquisition of shares in Bayer Schering Pharma AG, starting in June.

While interest expense increased by a substantial €540 million to €1,984 million, interest income only rose by €271 million to €1,240 million. The increase in interest expense was entirely to due intragroup loans, which rose by €589 million, while interest on bank loans dropped by €23 million and that on other liabilities by €26 million. Of the increase in interest income, €329 million came from intragroup loans and €31 million from balances with banks. By contrast, interest income from interest-rate swaps decreased by €76 million and that from other receivables by €13 million.

The balance of other non-operating income and expense was positive in 2007 at €18 million, following a negative balance of €111 million in 2006. The improvement was principally due to currency translations. Following a net exchange loss of €51 million in 2006, a net exchange gain of €33 million was registered in 2007. A profit of €19 million, €13 million more than in the previous year, was generated by the sale of some of the share options purchased to hedge price risks in connection with the company's stock-based compensation programs. Moreover, the previous year's result was diminished by bank charges totaling €74 million in connection with the financing of the Schering acquisition, whereas no comparable expenses were incurred in 2007. The balance of other non-operating income and expense for 2007 was, however, hampered by a write-down of €29 million on an intragroup loan. 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 €6 million in 2007 (2006: €4 million).

Pre-tax income, the sum of the operating and non-operating results, advanced by €825 million in fiscal 2007 to €2,125 million (2006: €1,300 million). Income taxes also increased to €197 million, compared with €50 million in the previous year. This reflects the higher taxable income and the fact that since the start of 2007, major domestic companies in the Schering group have been included among those forming a single tax entity with Bayer AG, which therefore is now responsible for the payment of income tax on their earnings. After deducting taxes, net income of €1,928 million remained (2006: €1,250 million). Of this amount, €896 million was allocated to other retained earnings and a balance sheet profit of €1,032 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 25, 2008 that the balance sheet profit of €1,032 million be used to pay a dividend of €1.35 (2006: €1.00) per share (764,341,920 shares) on the capital stock of €1,957 million entitled to the dividend for 2007.

Asset and Capital Structure

Total assets of Bayer AG decreased by €1.7 billion or 4.0 percent to €41.9 billion (2006: €43.6 billion). While noncurrent assets grew by €0.7 billion, current assets declined by €2.4 billion.

The increase in noncurrent assets to €25.6 billion (2006: €24.9 billion) was entirely due to an increase in investments in affiliated companies, which rose by €1.8 billion to €24.0 billion (2006: €22.2 billion) and now account for around 57 percent (2006: 51 percent) of total assets. This high percentage reflects Bayer AG's special function as the parent company of the Bayer Group. In 2007, €1,526 million was spent on the intragroup acquisition of Bayer CropScience GmbH from Bayer CropScience Holding SA, France. After this transaction, Bayer CropScience GmbH was merged into Bayer CropScience AG. A capital increase at Bayer Holding Japan LLC added €251 million to investments in affiliated companies. The other changes in this item totaled €4 million. Other financial assets were impacted by the repayment by Bayer CropScience AG of a €1,050 million loan. Property, plant and equipment and intangible assets were just €23 million below the previous year.

Current assets were €16.3 billion at December 31, 2007, compared with €18.7 billion at the start of the year. The total decline of €2.4 billion relates to all balance sheet items to various degrees. Receivables from Group companies declined by €1.3 billion to €14.8 billion (2006: €16.1 billion). Other assets diminished by €377 million from €798 million in 2006 to €421 million in 2007, mainly due to a reduction of €360 million in accrued interest. There was also a reduction in securities and cash, which at €971 million (2006: €1,738 million) were €767 million down from the start of the year. This item mainly comprises balances with banks amounting to €968 million (2006: €1,163 million), including €60 million (2006: €89 million) to settle civil claims for compensation in the United States and Canada. Bayer has placed this amount in an escrow account administered in the United States. In 2006 bank balances also included €710 million for cash compensation payments to minority stockholders of Schering as part of the ongoing squeeze-out process. As of December 31, 2007 this guarantee – now amounting to €696 million – was provided by Bayer Antwerpen Comm. V, Belgium, a subsidiary of Bayer AG. Securities of €3 million comprise investment fund units held in trust for Bayer AG by Bayer Pension Trust to guarantee pension obligations to employees of Bayer AG. In the previous year, securities included shares in companies of the Schering group held temporarily, which have since been sold on to other companies in the Bayer Group.

Of the total assets of €41.9 billion (2006: €43.6 billion) recorded in the balance sheet, €31.2 billion (2006: €34.1 billion) or 75 percent (2006: 78 percent), was debt-financed. Of the latter amount, provisions accounted for €3.0 billion (2006: €2.9 billion) and other liabilities for €28.2 billion (2006: €31.2 billion).

Although total provisions increased by €100 million, those for pensions and other post-employment benefits were almost unchanged at €2,501 million (2006: €2,498 million). These also include pension obligations to retirees and former employees with vested pension rights whose employment with the business and service areas hived down to separate legal entities in 2002 and 2003 was terminated prior to July 1, 2002. Provisions for taxes increased by €102 million to €298 million. Moreover, provisions of €54 million – €50 million more than in the previous year – are recorded for pending losses from currency translations. As of December 31, 2007, provisions of €62 million for commitments in the United States and Canada arising from civil compensation claims relating to antitrust violations in the fields of rubber, polyester polyols and urethanes had been utilized and a further €4 million had been allocated to these provisions, which now amount to €80 million. The provisions set up in connection with antitrust proceedings instituted by the E.U. Commission in the same matter were increased by €19 million to €22 million. In 2006, a provision of €18 million was recorded for the assumption of losses incurred by CURRENTA GmbH & Co. OHG, formerly Bayer Industry Services GmbH & Co. OHG. Since this company is expected to report a profit for 2007, no such provision was recorded in 2007.

Other liabilities decreased by €3.0 billion compared with the start of the year to €28.2 billion. External financial debt was reduced by a total of €6.1 billion, partly through scheduled repayment of a bond issued in 2002, which was reflected in the previous year's financial statements at a value of €2,137 million. In addition, bank loans totaling €4,455 million were repaid. New issues under the Multi-Currency Medium Term Note program comprised a floating-rate bond with a face value of €300 million maturing in 2010, and a €200 million bond with a 4.375 percent coupon, which matures in 2011. Total external financial debt was €8.2 billion at year-end 2007 (2006: €14.3 billion). In parallel with the reduction in external financial debt, intragroup liabilities increased by €3.2 billion. Other liabilities declined by €52 million, principally as a result of lower interest accruals.

Total financial debt as of December 31, 2007 was €30.1 billion (2006: €31.9 billion), comprising €21.9 billion payable to Group companies and €8.2 billion payable to third parties. After deduction of liquid assets of €1.0 billion (2006: €1.2 billion) net debt was €29.1 billion (2006: 30.7 billion). It should be noted that out of liquid assets, €60 million is set aside in an escrow account administered in the U.S. to settle civil claims for compensation in the U.S. and Canada.

Stockholders' equity was €1.2 billion higher than at the end of 2006. Net income boosted stockholders' equity by €1,928 million (2006: €1,250 million), while €764 million (2006: €694 million) was disbursed to pay the dividend for 2006. As a result of the increase in stockholders' equity and the concurrent reduction in total assets, the equity ratio increased by 3.7 percentage points to 25.5 percent (2006: 21.8 percent).

Employees

Bayer AG had 659 (2006: 603) employees on December 31, 2007, 56 more than a year before. Included are 42 employees who were transferred to Bayer AG at the start of 2007 from CURRENTA GmbH & Co. OHG (at that time known as Bayer Industry Services GmbH & Co. OHG) as a result of various transfers of undertaking. Personnel expenses increased by €19 million to €113 million (2006: €94 million), mainly as a result of the increase in headcount and also because of higher costs for the stock-based compensation programs.

Information Required Under Takeover Law

Information pursuant to Section 289, Paragraph 4 of the German Commercial Code in conjunction with Section 120 Paragraph 3 Sentence 2 of the German Stock Corporation Act

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

We received no notifications in 2007 of direct and indirect holdings of shares in Bayer AG that exceed 10 percent of the capital stock. The following notifications were received in 2006:

The Capital Group Companies, Inc., U.S.A., 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, 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 on the first ballot. If no such majority is achieved, the appointment may be approved pursuant to Section 31, Paragraph 3 of the Codetermination Act on a second ballot by a simple majority of the votes of the members of the Supervisory Board. 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, the Supervisory Board may appoint one member to be Chairman of the Board of Management pursuant to Section 84, Paragraph 2 of the German Stock Corporation Act or Section 6, Paragraph 1 of the Articles of Incorporation.

Under 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 provisions of the Articles of Incorporation relating to Authorized Capital I and Authorized Capital II are entered in the commercial register of Bayer AG. 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 26, 2012, the Board of Management is also authorized to increase the capital by up to €195 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.

Conditional capital of €186.88 million, corresponding to 73 million 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 27, 2007 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 26, 2008.

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. This credit facility had been reduced to €1.25 billion as of December 31, 2007.

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 pursuant to Section 29, Paragraph 1 of the German Securities Acquisition and Takeover Act (WpÜG) or a mandatory offer pursuant to Section 35, Paragraph 1 of that Act, 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 €3.6 billion in notes issued by Bayer AG in 2006 and 2007 under its multicurrency European 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 severance indemnity clause for the members of the Group Management Board described in the Compensation Report is currently supplemented by a change of control clause, which only takes effect if a change of control results in the termination of a Group Management Board member's service contract and his leaving the Bayer Group prior to his 60th birthday. The potential benefits are the same as under the severance indemnity clause except that, if the contract of a member of the Group Management Board terminates on or before his 55th birthday the monthly bridging allowance may be paid for 60 months, though not beyond his 60th birthday, provided that he does not take up another position on comparable terms before then. The exact amount of the monthly payments, which are intended to offset any difference in remuneration, depend on the remuneration received elsewhere.

Compensation of the Board of Management

The compensation of the Board of Management basically comprises four components: a fixed annual salary, a short-term incentive award on a yearly basis in relation to a target amount, a long-term incentive award for a three-year period in relation to a target amount, and a company pension plan conferring pension entitlements that increase with years of service. Remuneration in kind and other benefits are also provided, such as the use of a company car for private purposes or reimbursement of the cost of health screening examinations.

The fixed salary consists of two parts: a base salary and a fixed supplement. The short-term incentive award for 2007 is calculated partly according to the Group's EBITDA margin before special items, and partly according to the weighted average target attainment of the HealthCare, CropScience and MaterialScience 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. In addition, the variable bonus for 2007 includes a special one-time individual bonus linked to outstanding achievements in connection with the restructuring of the Bayer Group.

The directly effected remuneration of members of the Board of Management in 2007 (fixed salaries, short-term incentives and remuneration in kind) amounted to €8,882,552 (2006: €8,143,822), comprising €1,985,580 (2006: €2,260,400) in base salaries and €982,792 (2006: €1,096,556) in fixed supplements, €5,768,862 (2006: €4,644,475) in short-term incentive payments as well as €145,318 (2006: €142,391) of remuneration in kind and other benefits. Remuneration in kind mainly consists of values assigned to remuneration in kind and other benefits in accordance with German taxation guidelines.

The long-term incentive evolved in the following way: Through 2004, members of the Board of Management were permitted to participate in a cash-settlement-based stock option program. The last of the options were exercised in 2007, therefore no further claims existed under this program as of December 31, 2007.

Since 2005, the members of the Board of Management have participated in the long-term stock-based compensation program Aspire I (2005, 2006 and 2007 tranches). Further details of this program are provided under "Stock-based compensation" in Note [11] to the financial statements.

The entitlements earned in 2007 relate to the 2007 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 2007 are shown separately. They result from the upward trend in the price of Bayer stock in 2007. Additionally, the fair value of the stock-based compensation as of the grant date in 2007 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 2007.

€		Werner Wenning	Klaus Kühn	Udo Oels[1]	Wolfgang Plischke[2]	Richard Pott	**Total**
Base salary	2007	748,872	412,236	-	412,236	412,236	1,985,580
	2006	748,872	412,236	343,526	343,530	412,236	2,260,400
Fixed supplement	2007	325,132	316,366	-	170,647	170,647	982,792
	2006	325,132	316,366	142,205	142,206	170,647	1,096,556
Short-term incentive	2007	2,168,878	1,379,994	-	1,109,995	1,109,995	5,768,862
	2006	1,525,086	1,034,615	567,335	689,745	827,694	4,644,475
Remuneration in kind and other benefits	2007	51,104	35,769	-	25,208	33,237	145,318
	2006	47,926	35,571	9,594	18,163	31,137	142,391
Directly effected remuneration	**2007**	**3,293,986**	**2,144,365**	**-**	**1,718,086**	**1,726,115**	**8,882,552**
	2006	2,647,016	1,798,788	1,062,660	1,193,644	1,441,714	8,143,822
Long-term incentive (stock-based compensation entitlements earned in the respective year)	2007	1,149,675	698,890	-	358,924	631,618	2,839,107
	2006	820,514	480,609	538,181	193,188	461,939	2,494,431
Change in value of existing entitlements	2007	889,725	510,121	-	100,950	491,935	1,992,731
	2006	339,733	229,617	104,125	66,262	164,952	904,689

[1] member of the Board of Management until April 28, 2006
[2] member of the Board of Management effective March 1, 2006

The fair value of the stock-based compensation as of the grant dates for 2007 and 2006 is shown in the following table.

€		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	2007	299,173	202,957	-	162,366	162,366	826,862
	2006	268,113	181,886	40,419	117,597	145,509	753,524

[1] member of the Board of Management until April 28, 2006
[2] member of the Board of Management effective March 1, 2006

The fair value of the entitlements to newly granted stock-based compensation already earned in the respective year is included in the preceding table under “Long-term incentive.”

The current 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. Pension provisions for the current members of the Board of Management amounted to €25,836,386 (2006: €22,974,049).

The current service cost for the pension entitlements of the members of the Board of Management 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	2007	-	728,918	-	585,280	375,751	1,689,949
	2006	206,271	1,246,070	-	447,654	83,592	1,983,587

[1] member of the Board of Management until April 28, 2006
[2] member of the Board of Management effective March 1, 2006

For active Board of Management members a general severance indemnity clause applies if the service contract is terminated at the company's instigation prior to a member's 60th birthday. The basic principles according to this clause are as follows:

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 prematurely during the term of his contract 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 he was released from his duties on full pay or otherwise compensated. (If he were removed during the term of his contract, he would also receive the payment due for the rest of the term, though this would be reduced to the amount of his annual fixed salary plus the target amount for the short-term incentive payment for at least twelve months). His earnings from any new employment elsewhere would be offset against the bridging allowance. In the case of premature termination at the instigation of the company, further years of service might be credited under certain circumstances for the purpose of computing his Board of Management pension entitlement, though not beyond his 60th birthday. Special supplementary arrangements apply in the event of a change of control; for details see page 10.

There were no loans to members of the Board of Management outstanding as of December 31, 2007, nor any repayments of such loans during the year.

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 benefits are in addition to any amounts they receive under previous employee pension arrangements. The pensions paid to retired members of the Board of Management and their surviving dependents amounted to €10,997,016 (2006: €10,924,768). Pension provisions for former members of the Board of Management and their surviving dependents amounted to €101,143,534 (2006: €97,243,586).

Compensation of the 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 Members of the Supervisory Board	Fixed Remuneration	Variable Remuneration	**Total**
€			
Dr. Paul Achleitner	79,356.16	39,678.08	119,034.24
Dr. Josef Ackermann	19,232.88	9,616.44	28,849.32
Andreas Becker	5,260.27	2,630.14	7,890.41
Willy Beumann	51,780.82	25,890.41	77,671.23
Dr. Clemens Börsig	40,931.51	20,465.75	61,397.26
Karl-Josef Ellrich	75,000.00	37,500.00	112,500.00
Dr.-Ing. Thomas Fischer	75,000.00	37,500.00	112,500.00
Peter Hausmann	75,000.00	37,500.00	112,500.00
Thomas Hellmuth	19,232.88	9,616.44	28,849.32
Prof. Dr.-Ing. e.h. Hans-Olaf Henkel	75,000.00	37,500.00	112,500.00
Reiner Hoffmann	60,000.00	30,000.00	90,000.00
Gregor Jüsten	19,232.88	9,616.44	28,849.32
Dr. rer. pol. Klaus Kleinfeld	60,000.00	30,000.00	90,000.00
Dr. h.c. Martin Kohlhaussen	33,657.54	16,828.77	50,486.31
John Christian Kornblum	19,232.88	9,616.44	28,849.32
André Krejcik	40,931.51	20,465.75	61,397.26
Petra Kronen	75,000.00	37,500.00	112,500.00
Dr. rer. nat. Helmut Panke	40,931.51	20,465.75	61,397.26
Hubertus Schmoldt	85,684.93	42,842.47	128,527.40
Dr. Manfred Schneider	180,000.00	90,000.00	270,000.00
Dr.-Ing. Ekkehard D. Schulz	70,684.93	35,342.47	106,027.40
Dr. Klaus Sturany	61,397.26	30,698.63	92,095.89
Dipl.-Ing. Dr.-Ing. e.h. Jürgen Weber	70,232.88	35,116.44	105,349.32
Thomas de Win	130,684.93	65,342.47	196,027.40
Prof. Dr. Dr. h.c. Ernst-Ludwig Winnacker	60,000.00	30,000.00	90,000.00
Oliver Zühlke	40,931.51	20,465.75	61,397.26

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 €686,661 (2006: €647,813).

There were no loans to members of the Supervisory Board outstanding as of December 31, 2007, nor any repayments of such loans during the year.

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 and thus at Bayer AG as the holding company 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.

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.

Business risks

As the parent of a global group of companies with a heterogeneous business portfolio, Bayer AG is exposed to a wide variety of risks in the course of its business activities. These may directly impact Bayer AG, but can also affect it indirectly through its subsidiaries. Bayer AG has concluded profit and loss transfer agreements with all major German subsidiaries so that, to that extent, the financial consequences of business risks have a direct impact on the financial position and results of operations of Bayer AG.

Material business risks may arise from the operations of our subsidiaries. For example, a large number of pharmaceutical products are exposed to state price control mechanisms. We also have to compete with generics suppliers. Sales of our crop protection products are subject, among other things, to weather conditions. Finally, the performance of our MaterialScience subgroup is affected by the cyclical nature of the industries in which it operates. The early identification of statutory and business developments and active portfolio management play an important part in the management of the company. 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.

As a research-based company, Bayer's competitive position is dependent to a significant extent on the development of commercially viable products and production technologies. We therefore allocate considerable sums to research and development. To ensure 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. Our products are exposed to a risk of infringement of patent rights after market launch. In collaboration with the respective operating units, our patents department regularly monitors the patent situation and identifies possible infringements of our patents so that it can take legal action where necessary.

Other risks arise from the increasingly demanding regulatory requirements imposed on the development, manufacture and marketing of many products. 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. Special projects are established to coordinate the implementation of new regulations and endeavor to minimize any disadvantages to the company.

To avoid production risks and their implications, for example risks to people and the environment, the risk of production stoppages and the interruption of operations, all steps in the production chain and the materials used are constantly monitored by our specialists. 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.

Alongside these risks, there are additional risks that are not explicitly mentioned here but which are inseparable from all business activity. A more detailed risk report can be found in the consolidated management report for the Bayer Group.

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 scope and level of this coverage is continuously re-examined.

Management of financial and commodity price risks

As a global enterprise, Bayer is exposed in the normal course of business to credit risk, liquidity risk and various market risks that could materially affect its net assets, financial position and results of operations.

It is company policy to use derivative financial instruments to minimize or eliminate the risks associated with operating activities and the resulting financing requirements. Derivative financial instruments are used almost exclusively to hedge booked or forecasted transactions. The use of derivative financial instruments is subject to strict internal controls based on centrally defined mechanisms and uniform guidelines. The derivatives used are mainly over-the-counter instruments, particularly forward exchange contracts, currency option contracts, interest rate swaps, cross-currency interest-rate swaps, commodity swaps and commodity option contracts concluded with banks. We set counterparty limits for such banks depending on their creditworthiness.

The various risks associated with financial instruments are outlined below together with the relevant risk management systems.

Credit risk

In the Bayer Group credit risk arises from the possibility of the value of its receivables or other financial assets being impaired because counterparties cannot meet their payment or other performance obligations. Since the Bayer Group does not conclude master netting arrangements with its customers, the total amounts recognized in assets represent the maximum exposure to credit risk.

Bayer has a standardized process in place to effectively manage the credit risk from trade receivables. Regular creditworthiness analysis takes place in relation to exposures; these receivables are partially secured. Credit limits are generally set for all customers. All credit limits for debtors where total risk exposure is €10 million or more are evaluated by operational credit management and also submitted to the company’s Central Financial Risk Committee.

To minimize credit risk from transactions with financial assets and instruments, such transactions are only conducted with counterparties of first-class credit standing. For any other counterparties, pre-determined risk limits based on a methodological model are observed.

Country risks relating to trade receivables and intra-Group loans are continuously monitored, systematically evaluated and centrally managed.

Liquidity risk

Liquidity risk, i.e. the risk of not being able to fulfill current or future payment obligations because insufficient cash is available, is centrally managed in the Bayer Group. Sufficient liquid assets are held to meet all of the Group's payment obligations when they fall due, thereby ensuring solvency at all times. Such payment obligations take the form of both operating cash flows and changes in current financial liabilities and are derived from our liquidity planning. In addition, a reserve is maintained for unbudgeted shortfalls in cash receipts or unexpected disbursements. For this purpose, budget deviation analyses are performed on the basis of historical time series, adjusted for variations in business structure. The liquidity reserve is then determined which, with a defined probability, will cover a negative deviation from planned cash flows. The size of this reserve is regularly reviewed and adjusted as necessary to current conditions. Liquid assets are kept mainly in the form of overnight and term deposits. Furthermore, credit facilities with banks are available.

Market risk

Market risk is the risk that the fair value or future cash flows of a financial instrument could fluctuate due to variations in market prices. Market risks include currency risk, interest-rate risk and other price risks, especially commodity price risk.

Sensitivity analysis is a widely used risk measurement tool that allows our management to make judgments regarding the potential loss in future earnings, fair values or cash flows of market-risk-sensitive instruments resulting from one or more selected hypothetical changes in interest rates, foreign currency exchange rates, commodity prices and other relevant market rates or prices over a selected period of time. We use sensitivity analysis because it provides reasonable risk estimates using straightforward assumptions (for example, an increase in interest rates).

We use market information and additional analytics to manage our risk exposure and mitigate the limitations of our sensitivity analysis. We have found sensitivity analysis to be a useful tool in achieving some of our specific risk management objectives. Sensitivity analysis offers an easy-to-understand risk exposure estimate that allows an approximation of the effect changing market conditions could have on our business. Additionally, it allows our management to take the necessary steps to address such risks.

We continually refine our risk measurement and reporting procedures. This includes periodically re-examining the underlying assumptions and parameters utilized.

Currency risk

Since the Bayer Group conducts a significant portion of its operations outside the euro currency zone, fluctuations in currency exchange rates can materially affect earnings. Currency risk from financial instruments exists with respect to receivables, payables, cash and cash equivalents that are not denominated in a company's functional currency. In the Bayer Group this risk is particularly significant for the U.S. dollar, the Japanese yen and the Canadian dollar.

Currency risks are identified, analyzed and managed centrally and systematically. The scope of hedging is evaluated regularly and defined in a corporate directive. The booked foreign currency exposure from operating items as well as from financial positions, i.e. receivables and payables, is normally fully hedged.

The anticipated foreign currency exposure from forecasted transactions in the next 12 months is hedged on a basis agreed between the Group Management Board, the central finance department and the operating units. A significant proportion of contractual and foreseeable currency risks is hedged, mainly through forward exchange contracts and currency options.

The Board of Management has provided clear guidance on how to limit and monitor cash flow risks that result from this approach.

Interest-rate risk

The Bayer Group's interest-rate risk arises primarily from financial assets and liabilities with maturities exceeding one year. In the case of fixed-rate financial instruments, such as fixed-rate bonds, the risk of fluctuations in capital-market interest rates results in a fair-value risk because the fair values fluctuate as a function of interest rates. In the case of floating-rate instruments a cash flow risk exists because interest payments could increase in the future.

Interest rate risk is analyzed centrally in the Bayer Group and managed by the central finance department using a mix of fixed-rate and floating-rate instruments defined by the management and subject to regular review. Derivatives – mainly interest-rate swaps, cross-currency interest-rate swaps and interest options – are employed to preserve the target structure of the portfolio.

Other price risks (especially commodity price risks)

The Bayer Group requires significant quantities of petrochemical feedstocks and energy for its various production processes. The prices of these inputs may fluctuate considerably depending on market conditions. As in the past, there will be times when it is not possible for us to pass on increased raw material costs to customers through price adjustments. This applies particularly to our MaterialScience business.

A commodity price risk therefore exists, which can impact net assets, financial position and results of operations. We have addressed this risk by concluding long-term contracts with multiple suppliers. In addition, derivatives are employed where possible to hedge against commodity price risks by smoothing variations in income-statement items due to changes in commodity prices – and the resulting changes in stockholders' equity – over the long term. The procurement departments of the subgroups are responsible for managing these price risks on the basis of internal, centrally issued directives and limits, which are subject to constant review.

Commodity swaps and commodity options, in particular, are employed to hedge changes in the prices of energy, especially gas, and of crude oil, naphtha and benzene feedstocks. These instruments are also used in the case of long-term, fixed-price supply contracts.

The derivative financial instruments used by Bayer AG to mitigate the risk of changes in exchange rates, interest rates and commodity prices are described in Note [34] (Derivative financial instruments) to the financial statements.

Legal risks

As a global company with a diverse business portfolio, Bayer 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 legal proceedings referred to do not necessarily represent an exhaustive list. The risks described are those to which Bayer AG is exposed either directly, or indirectly through subsidiaries with which it has profit and loss transfer agreements. Further legal risks existing in the Bayer Group are described in the notes to the consolidated financial statements of the Bayer Group.

Lipobay/Baycol: As of February 1, 2008, approximately 335 Lipobay/Baycol cases remain pending against Bayer worldwide (approximately 295 of them in the United States, including class actions claiming economic loss, medical monitoring, and personal injury, one of which has been certified). We are currently aware of fewer than five pending cases in the United States that in our opinion meet our criteria for potential settlement. Based on the information currently available, Bayer has taken accounting measures for anticipated defense costs in the consolidated financial statements of the Group.

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.

In connection with Lipobay/Baycol, a class-action lawsuit claiming damages from Bayer was filed by shareholders. The suit alleges that Bayer made misleading statements, prior to the product's withdrawal 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 has reached an agreement in principle with the remaining plaintiffs to settle the litigation on a class-wide basis for a payment by Bayer of a total of US$ 18.5 million, subject to conclusion of a final settlement agreement and court approval.

Magnevist®: As of February 1, 2008, Bayer has been served in a total of 29 lawsuits in the United States involving the gadolinium-based contrast agent Magnevist®. Three other manufacturers of gadolinium-based contrast agents in the United States also have been named party to the same or similar lawsuits. Additional cases are anticipated.

In the lawsuits, plaintiffs allege that patients developed nephrogenic systemic fibrosis (NSF) as a result of the use of Magnevist® during medical imaging procedures. NSF is a rare, severe condition that can be debilitating and in some cases fatal. Plaintiffs seek compensatory and punitive damages under theories of strict liability and negligence and/or breach of warranty, claiming that the product is defective and unreasonably dangerous, that Bayer knew or should have known of the risks associated with Magnevist®, and has failed to disclose or adequately warn its users.

The proceedings are still at an early stage. A motion is pending to create a multi-district litigation (MDL) proceeding for common pre-trial management of all cases pending in federal courts. Bayer believes that it has meritorious defenses and intends to defend itself vigorously. Based on the information currently available, Bayer has taken accounting measures for anticipated defense costs in the consolidated financial statements of the Group.

Trasylol® (Aprotinin) is a drug approved for use in managing bleeding in patients undergoing coronary artery bypass graft surgery. As of February 1, 2008, there were 46 lawsuits pending in the United States served upon Bayer on behalf of persons alleging personal injuries, including renal failure and death, from the use of Trasylol®. Plaintiffs seek compensatory and punitive damages, claiming that Bayer knew or should have known of these risks and is liable for having failed to disclose or adequately warn users of Trasylol®. Additional cases are anticipated.

In 2006 and 2007 observational studies reported on a possible correlation between the administration of Trasylol® and severe renal dysfunction, myocardial infarction, stroke and an increase in mortality. In November, 2007 Bayer temporarily suspended worldwide marketing of Trasylol® after preliminary results from an independent clinical study in Canada raised concerns about a possible increased risk of mortality in patients who had received Trasylol®. The marketing suspension will remain in effect until the final results from the Canadian study have been analyzed and the benefit-risk assessment for Trasylol® can be re-evaluated together with the health authorities. In some countries, including the United States, Trasylol® continues to be available to certain surgical patients with an established medical need. We are closely cooperating with health authorities to resolve the questions that have arisen.

Bayer believes it has meritorious defenses and intends to defend itself vigorously. Based on the information currently available, Bayer has taken accounting measures for anticipated defense costs in the consolidated financial statements of the Group.

Competition law proceedings

Cipro®: 39 putative class action lawsuits and one individual lawsuit against Bayer involving the medication Cipro® are pending in the United States. These matters first arose in July 2000. 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 dismissed all of plaintiffs' claims in the MDL proceeding. The plaintiffs have appealed this decision. Further cases are pending before various state courts. Bayer believes that it has meritorious defenses and intends to defend itself vigorously.

Antitrust proceedings in connection with polymers

All proceedings by authorities reported in the past relating to rubber, polyester polyols, polyether polyols, urethanes, urethane chemicals and other primary products for urethane end products in which fines were expected have since been terminated. Most recently, a fine of €28.87 million was imposed by the E.U. Commission upon Bayer for antitrust violations relating to nitrile butadiene rubber.

In addition, subject to few exceptions, all North American civil lawsuits for damages relating thereto have been settled. Bayer no longer considers the remaining risks to be material. However, there is a possibility that further lawsuits may be filed.

In Europe, the E.U. Commission imposed fines upon Bayer or granted Bayer full amnesty in antitrust investigations concerning the products rubber chemicals, butadiene rubber, styrene butadiene rubber, polychloroprene rubber and nitrile butadiene rubber. Bayer is expecting civil antitrust lawsuits for damages to be filed concerning these products.

A new class action alleging antitrust violations in connection with certain rubber products was filed recently in Australia. The proceeding is still at a very early stage.

The financial risk from the Australian litigation and the litigation expected in Europe cannot currently be quantified. Therefore, Bayer is unable to take any accounting measures in this regard.

Antitrust proceedings in connection with over-the-counter drugs in Germany
The German Federal Cartel Office *(Bundeskartellamt)* has instituted an inquiry against Bayer Vital GmbH questioning the manner in which Bayer extended discounts to its pharmacy customers. Bayer is cooperating with the Bundeskartellamt in its investigation.

Proceedings involving genetically modified rice
Since August 2006, Bayer CropScience LP has been 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 genetically modified rice 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 2006 in federal district court in Missouri in a multidistrict litigation (MDL) proceeding, and plaintiffs recently asked that court to certify a class action.

In development of the genetically modified rice, field testing was conducted in cooperation with third parties, including a breeding research institute in the U.S. The genetically modified rice was never commercialized.

The USDA and the FDA have stated that the genetically modified rice does not present a health risk and is safe for use in food and feed and for the environment. Additionally, in October 2007, the USDA released its report concerning its investigation into how the genetically modified rice entered the commercial rice supply. The USDA was unable to determine a cause and indicated it would not pursue any enforcement actions against Bayer CropScience or any other party.

Bayer believes it has meritorious defenses in these actions and intends to continue to defend itself vigorously. Bayer has taken accounting measures in the consolidated financial statements of the Group for anticipated defense costs based on the information currently available.

Proceedings involving oral contraceptives

Yasmin®: In April 2005, Bayer Schering Pharma filed suit against Barr Pharmaceuticals Inc. and Barr Laboratories Inc. in U.S. federal court alleging patent infringement by Barr for its 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. Barr conceded that the marketing of a generic version of Yasmin® would infringe Bayer's patent, therefore the proceedings now relate solely to the question of the validity of the patent. Trial of the matter began on November 15, 2007 and ended on December 4, 2007. Bayer is awaiting a court decision.

YAZ®: In January 2007, Bayer Schering Pharma received notice from Barr Laboratories, Inc. that it has filed an ANDA paragraph IV application with the U.S. FDA seeking approval of a generic version of Bayer Schering Pharma's YAZ® oral contraceptive product. In October 2007 Bayer Schering Pharma received notice that Watson Laboratories Inc. also had filed an ANDA paragraph IV application with the U.S. FDA seeking approval of a generic version of Bayer Schering Pharma's YAZ® oral contraceptive product. Both applications claim that Bayer Schering Pharma's patents are invalid and/or that the respective generic product does not infringe them. Bayer has filed a patent infringement suit against Watson claiming, inter alia, that Bayer´s ´531 patent has been infringed. Bayer´s ´531 patent is also at issue in the patent infringement suit against Barr, mentioned in the previous paragraph, relating to the Yasmin® oral contraceptive. Bayer Schering Pharma retains FDA marketing exclusivity for YAZ® as an oral contraceptive until March 2009.

The Yasmin® and YAZ® oral contraceptive products are very important to the business. Bayer is deeply committed to maintaining its leadership in oral contraception and intends to continue to vigorously defend its position.

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. Subsequently, Bayer sought to vacate the final award. Lyondell seeks to confirm such award and obtain pre-award interest. On March 20, 2007, the Texas District Court denied Bayer´s motion to vacate, confirmed in part the final award and ordered additional discovery. Bayer has established appropriate provisions for the entire matter in the consolidated financial statements of the Group.

In addition, in January 2007, Bayer filed suit against Lyondell in the U.S. 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 Bayer´s claim to compensation for use by Lyondell´s affiliate of certain quantities of propylene oxide from Bayer's share of capacity under the Joint Venture.

Proceedings concerning the registration of the domination and profit and loss transfer agreement with Bayer Schering Pharma AG

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. Bayer Schering Pharma AG 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. In May 2007 the District Court of Berlin *(Landgericht Berlin)* dismissed all of the stockholders´ actions and approved Bayer Schering Pharma AG´s application in the aforementioned special proceedings. Meanwhile, both proceedings are pending before the High Court of Berlin *(Kammergericht Berlin)*. Several stockholders have initiated a valuation proceeding *(Spruchverfahren)* seeking to have reviewed the adequacy of the compensation *(Abfindung)* and of the guaranteed dividend *(Ausgleich)* provided for in the domination and profit and loss transfer agreement. This proceeding is pending before the District Court of Berlin *(Landgericht Berlin)* as the court of first instance. One stockholder has brought a suit in Berlin, Germany, seeking to have registration of the domination and profit and loss transfer agreement in the Commercial Register removed *(Amtslöschungsverfahren)*. The Local Court of Berlin-Charlottenburg *(Amtsgericht Berlin-Charlottenburg)* has dismissed such suit. The stockholder has appealed to the District Court of Berlin *(Landgericht Berlin)*, which dismissed the appeal on November 22, 2007. The further appeal brought is pending before the High Court of Berlin *(Kammergericht Berlin)*.

Bayer believes it has meritorious defenses in this case also, and intends to continue to 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 five years for all obligations of Bayer AG that existed on January 28, 2005.

Assessment of the overall risk situation

Compared to the previous year, there was no significant change in the overall risk situation of Bayer AG and the subsidiaries with which it has profit and transfer agreements. The overall risk assessment is based on a consolidated view of all significant individual risks. At present, no indication of risks have been identified that individually or in combination could endanger the continued existence of the company.

Outlook

We currently expect the global economy to go on expanding in 2008. The pace of growth will decline somewhat compared with 2007, yet remain satisfactory overall in light of healthy business conditions in Europe and the continuing dynamic development of the emerging countries. We anticipate that the world economy will more or less sustain its present growth trend, with the economic weakness in the United States being partially offset by continuing strong growth in the emerging markets. However, there is an increased risk particularly from possible negative repercussions of the ongoing financial crisis for the real economy or in the event of further increases in oil and raw material prices.

We aim to continue growing the business in 2008 and anticipate that we can raise Bayer Group sales by about 5 percent on a currency-adjusted basis. We also expect to further increase Group EBITDA before special items and improve the operating margin, in anticipation of a gratifying earnings trend for HealthCare and CropScience along with a difficult market environment for MaterialScience.

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 as well as to service and gradually reduce our financial debt. Moreover, our goal for 2008 is once again to report a level of net income that enables us to allow stockholders to share appropriately in the company's success while at the same time strengthening retained earnings.

Subsequent Events

There were no events of particular significance between the closing date and the preparation of this report.

Auditor's Report

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, 2007. 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, February 25, 2008

PricewaterhouseCoopers
Aktiengesellschaft
Wirtschaftsprüfungsgesellschaft

(Armin Slotta)	(Volker Linke)
Wirtschaftsprüfer	Wirtschaftsprüfer

Statements of Income

€ million	Note	2006	2007
Net sales	[1]	**196**	**242**
Cost of goods sold		(146)	(195)
Gross profit		**50**	**47**
Selling expenses		(20)	(27)
General administration expenses		(174)	(197)
Other operating income	[2]	95	18
Other operating expenses	[3]	(100)	(20)
Operating result		**(149)**	**(179)**
Income from investments in affiliated companies – net	[4]	2,035	3,030
Interest expense – net	[5]	(475)	(744)
Other non-operating income (expense) – net	[6]	(111)	18
Non-operating result		**1,449**	**2,304**
Income before income taxes		**1,300**	**2,125**
Income taxes	[7]	(50)	(197)
Net income		**1,250**	**1,928**
Allocation to retained earnings		(486)	(896)
Balance sheet profit		**764**	**1,032**

Balance Sheets

€ million	Note	Dec. 31, 2006	Dec. 31, 2007
Assets			
Noncurrent assets			
Intangible assets	[14]	32	28
Property, plant and equipment	[15]	375	356
Investments	[16]	24,464	25,195
		24,871	**25,579**
Current assets			
Receivables and other assets			
Trade accounts receivable	[17]	31	25
Receivables from subsidiaries		16,099	14,828
Other assets	[18]	798	421
	[19]	**16,928**	**15,274**
Marketable securities	[20]	575	3
Cash and cash equivalents	[21]	1,163	968
		18,666	**16,245**
Deferred charges	[22]	**44**	**29**
		43,581	**41,853**
Stockholders' equity and liabilities			
Stockholders' equity	[23]		
Capital stock		1,957	1,957
Capital reserves		4,037	4,037
Other retained earnings		2,731	3,627
Balance sheet profit		764	1,032
		9,489	**10,653**
Special item with an equity component	[24]	**11**	**4**
Provisions			
Provisions for pensions and other post-employment benefits	[25]	2,498	2,501
Other provisions	[26]	431	528
		2,929	**3,029**
Other liabilities			
Bonds and notes	[27]	8,574	6,937
Liabilities to banks		5,722	1,267
Trade accounts payable	[28]	35	36
Payables to subsidiaries	[29]	16,179	19,337
Miscellaneous liabilities	[30]	640	588
	[31]	**31,150**	**28,165**
Deferred income		**2**	**2**
		43,581	**41,853**

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.

Notes to the Statements of Income

(1) Net sales

Sales comprise €114 million (2006: €114 million) from the leasing of real estate belonging to Bayer AG and €128 million (2006: €82 million) from the provision of certain services.

Germany accounted for €219 million (2006: €195 million) of the total and other countries for €23 million (2006: €1 million).

(2) Other operating income

Other operating income comprises:

€ million	2006	**2007**
Gains from retirements of noncurrent assets	1	6
Reversals of unutilized provisions	3	5
Reversals of the special item with an equity component	90	-
Miscellaneous income	1	7
	95	**18**

(3) Other operating expenses

Other operating expenses include write-downs and derecognition of accounts receivable, bank charges, donations and various accrued expenses.

The other operating expenses for 2007 also include €13 million which Bayer AG has undertaken to pay to settle claims for compensation from stockholders resulting from alleged infringement of U.S. capital market regulations.

Allocations to the special item with an equity component set up pursuant to Section 6b of the German Income Tax Act amounted to €6 million (2006: €0 million).

In 2006, €90 million of the special item with an equity component was offset against the cost of acquisition or construction or newly acquired or constructed assets. The resulting expense of €90 million was balanced by income of the same amount - reflected in other operating income – from the reversal of the special item.

(4) Income from investments in affiliated companies – net

€ million	2006	**2007**
Dividends and similar income of which €245 million (2006: €14 million) from subsidiaries	14	245
Income from profit and loss transfer agreements with subsidiaries	2,402	4,041
Expenses from profit and loss transfer agreements with subsidiaries	(298)	(1,200)
Write-downs of investments in affiliated companies	-	(69)
Write-backs of investments in affiliated companies	4	-
Gains from the sale of investments in affiliated companies	-	13
Losses from the sale of investments in affiliated companies	(87)	-
	2,035	**3,030**

The Management Report contains details of the composition and development of dividend income from investments in affiliated companies and profits and losses resulting from profit and loss transfer agreements.

The write-downs of investments in affiliated companies totaling €69 million in 2007 include €60 million for Bayer Technology Services GmbH and €9 million for CuraGen Corporation, U.S.A. The write-backs of investments in affiliated companies of €4 million recognized in 2006 include €3 million for CuraGen Corporation, U.S.A.

The €13 million gains from the sale of investments in affiliated companies resulted from the spin-off of the diagnostics operations of Bayer Sp.z.o.o., Poland, and their subsequent sale to Siemens. The losses from the sale of such investments amounting to €81 million in the previous year essentially comprised the intragroup sale of shares in Bayer CropScience Ltda., Brazil.

(5) Interest expense – net

€ million	2006	**2007**
Income from other securities and loans included in investments	5	7
Other interest and similar income of which €746 million (2006: €417 million) from subsidiaries	964	1,233
Interest and similar expenses of which €1,037 million (2006: €448 million) to subsidiaries	(1,444)	(1,984)
	(475)	**(744)**

The changes in net interest expense are explained in the Management Report.

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

€ million	2006	**2007**
Interest portion of the allocation to personnel-related provisions	(188)	(190)
Interest portion of the allocation to personnel-related provisions assigned to subsidiaries	184	184
Miscellaneous non-operating expenses	(133)	(32)
Miscellaneous non-operating income	26	56
	(111)	**18**

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.

The miscellaneous non-operating expenses for 2007 principally comprise a write-down of €29 million on a loan with a debtor warrant clause granted to Bayer AB, Sweden, to strengthen its capital. In 2006 this item contained bank charges amounting to €74 million, mainly in connection with the acquisition of Schering, Berlin, Germany. They comprised €38 million for the issuance of bonds, €22 million for the provision of credit lines and €14 million relating to the capital increase in July 2006. Miscellaneous expenses for 2006 also included a loss of €51 million on currency translations.

In 2007 currency translation generated a gain of €33 million, which is recognized as miscellaneous financial income. This comprises both 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. Miscellaneous non-operating income also includes gains of €19 million from the sale and exercise of share options which are used to hedge the price risk relating to the company's stock-based compensation programs.

(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 totaled €10 million in 2007 (2006: €9 million).

(9) Cost of materials

€ million	2006	2007
Expenses for raw materials, supplies and goods purchased for resale	7	4
Expenses for purchased services	24	27
	31	**31**

(10) Personnel expenses/employees

€ million	2006	2007
Wages and salaries	78	97
Social expenses	7	7
Pension expenses	9	9
	94	**113**

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 646 (2006: 582).

(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, other senior executives and middle 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:

%	2006	**2007**
Dividend yield	2.29	1.91
Risk-free interest rate	3.83	4.06
Volatility of Bayer stock	21.52	22.19
Volatility of the Dow Jones EURO STOXX 50℠	13.14	13.83
Correlation between Bayer stock price and the Dow Jones EURO STOXX 50℠	0.61	0.54

Aspire I (2005–2007)

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 Dow Jones EURO STOXX 50℠ 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 (2005–2007)
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 (2005–2007)
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 2007 it was 15 percent, as in the previous year. Employees could invest up to 10 percent of their annual base salary in 2007 (2006: 10 percent), but not more than €5,000 or €7,500 depending on their position in the company (2006: maximum investment of €5,000 for all eligible employees). The shares purchased must be held in a special securities account and may not be sold prior to the end of the defined retention period, which expires on December 31 of the following year.

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 50℠.

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 their 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 2003 and 2004 tranches can currently be exercised. Options issued under the 2000 to 2002 tranches have either been exercised or have expired.

Stock Incentive Program (2000–2004)
Participants in this program receive a defined number of Bayer shares or an equivalent cash payment, depending on the tranche, on certain dates during the ten-year duration of the program. For every ten shares held in a special account (personal investment), they receive two shares or equivalent cash payment after two years, and a further four shares or equivalent cash payment 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 receive one Bayer share for every ten shares held. After six and again after ten years they are entitled to receive two Bayer shares. Participants are granted either actual shares or their cash equivalent, depending on the tranche.

Bayer AG spent €17 million (2006: €10 million) on stock-based compensation programs. This amount is reflected in personnel expenses. Provisions for these programs amounted to €15 million as of December 31, 2007 (2006: €9 million).

(12) Valuation write-downs, depreciation for tax purposes
In 2007 write-downs of €69 million (2006: €0) were made to reflect declines in the value of financial assets that were expected to be permanent. No depreciation was undertaken specifically for tax purposes in either 2007 or 2006.

(13) Effects of valuation adjustments made for tax purposes
The net income for 2007 was increased by €18 million (2006: €22 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 2007 and prior years. 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.

Notes to the Balance Sheets

(14) Intangible assets

€ million	Acquired concessions, industrial property rights, similar rights and assets, and licenses thereunder	Total
Gross carrying amounts, Dec. 31, 2006	39	39
Gross carrying amounts, Dec. 31, 2007	**39**	**39**
Accumulated amortization and write-downs, Dec. 31, 2006	7	7
Amortization and write-downs in 2007	4	4
Accumulated amortization and write-downs, Dec. 31, 2007	**11**	**11**
Net carrying amounts, Dec. 31, 2007	**28**	**28**
Net carrying amounts, Dec. 31, 2006	32	32

(15) Property, plant and equipment

€ million	Land and buildings	Furniture, fixtures and other equipment	Construction in progress and advance payments to vendors and contractors	Total
Gross carrying amounts, Dec. 31, 2006	2,092	13	3	2,108
Capital expenditures	5	1	5	11
Retirements	(13)	(1)	-	(14)
Transfers	2	-	(2)	-
Gross carrying amounts, Dec. 31, 2007	**2,086**	**13**	**6**	**2,105**
Accumulated depreciation and write-downs, Dec. 31, 2006	1,726	7	-	1,733
Depreciation and write-downs in 2007	28	1	-	29
Retirements	(11)	(2)	-	(13)
Accumulated depreciation and write-downs, Dec. 31, 2007	**1,743**	**6**	**-**	**1,749**
Net carrying amounts, Dec. 31, 2007	**343**	**7**	**6**	**356**
Net carrying amounts, Dec. 31, 2006	366	6	3	375

(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, 2006	22,202	2,100	178	2	158	24,640
Additions	3,414	-	1	-	-	3,415
Retirements	(1,565)	(1,050)	-	-	(1)	(2,616)
Gross carrying amounts, Dec. 31, 2007	**24,051**	**1,050**	**179**	**2**	**157**	**25,439**
Accumulated write-downs, Dec. 31, 2006	9	-	162	1	4	176
Write-downs in 2007	60	-	9	-	-	69
Write-backs	-	-	-	-	(1)	(1)
Accumulated write-downs, Dec. 31, 2007	**69**	**-**	**171**	**1**	**3**	**244**
Net carrying amounts, Dec. 31, 2007	**23,982**	**1,050**	**8**	**1**	**154**	**25,195**
Net carrying amounts, Dec. 31, 2006	22,193	2,100	16	1	154	24,464

Additions to investments in subsidiaries comprise €1,526 million for the intra-group acquisition of Bayer CropScience GmbH, €251 million for a capital incrase at Bayer Holding Japan LLC and €76 million for other acquisitions and capital increases. The remaining additions of €1,561 million comprise the transfer of investments between subsidiaries and mergers of Group companies. From a commercial viewpoint these do not comprise additions: they are offset by retirements of the same amount for the subsidiaries merged or transferred. Retirements of the carrying amount of investments include €4 million relating to the sale of shares in connection with the divestment of the diagnostics business to Siemens.

The write-downs of investments in subsidiaries totaling €60 million relate entirely to Bayer Technology Services GmbH.

Retirements of €1,050 million from loans to subsidiaries relate to the repayment of a loan granted to Bayer CropScience AG in 2002 to finance the acquisition of Aventis CropScience.

The write-downs of investments in other affiliated companies relate to 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

€ million	Dec. 31, 2006	**Dec. 31, 2007**
Accounts receivable from subsidiaries	29	23
Accounts receivable from other customers	2	2
	31	**25**

(18) Other assets

The other assets totaling €421 million (2006: €798 million) mainly consist of €229 million (2006: €589 million) in accrued interest, €75 million (2006: €71 million) in claims for tax refunds and €69 million (2006: €76 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 amounted to €15,274 million (2006: €16,928 million) include €143 million (2006: €172 million) due in more than one year. Of this, €72 million (2006: €91 million) comprises receivables from subsidiaries and €71 million (2006: €81 million) comprises other assets.

(20) Securities

To secure the pension obligations of Bayer AG and other Group companies, funds were transferred to Bayer Pension Trust e.V. under a contractual trust arrangement (CTA) for the first time in 2007. As of December 31, 207 these funds, together with the interest earned in 2007, amounted to €3 million. Almost all of this amount is invested in investment funds and recognized under securities. These funds may only be used for the defined purpose. Under German commercial law, they still have to be reflected in the annual financial statements of Bayer AG.

In 2006 securities comprised 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, which was completed in 2007.

(21) Cash and cash equivalents

Under a resolution adopted at the Extraordinary Stockholders' Meeting of Bayer Schering Pharma 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. In 2006 Bayer AG deposited €710 million as security for this transaction. This was included in bank balances. Effective December 31, 2007 this security amounting to €696 million was provided by Bayer Antwerpen Comm. V, Belgium, a subsidiary of Bayer AG.

Cash and cash equivalents as of December 31, 2007 also includes €60 million (2006: €89 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, 2007 include unamortized discounts totaling €27 million pertaining to bonds issued by Bayer AG between 2002 and 2007. The amount of €32 million recognized at the beginning of the year was diminished during the year by amortization of €6 million and increased by €1 million in additions.

The remaining deferred charges are prepaid premiums for business insurance and other accrued charges.

(23) Capital stock

The capital stock changed as follows in 2007:

€ million	Dec. 31, 2006	Dividend for 2006	Net income	**Dec. 31, 2007**
Capital stock	1,957			1,957
Capital reserves	4,037			4,037
Other retained earnings	2,731		896	3,627
Balance sheet profit	764	(764)	1,032	1,032
	9,489	**(764)**	**1,928**	**10,653**

The capital stock of Bayer AG totals €1,956,715,315.20 – as in the previous year – and is divided into 764,341,920 no-par bearer shares. Each share confers one voting right.

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 and/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 approved by the Annual Stockholders' Meeting on April 27, 2007. The Board of Management is authorized until April 26, 2012 to increase the capital stock, subject to the approval of the Supervisory Board, by up to a total of €195 million in one or more installments by issuing new no-par bearer shares against cash contributions (Authorized Capital II). 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 under a mandatory convertible bond issued by Bayer Capital Corporation B.V., Netherlands, on April 6, 2006.

In 2007 we did not receive any notifications of direct and indirect holdings of shares in Bayer AG that exceed 10 percent of the capital stock: The following notifications were received in 2006:

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.

(24) Special item with an equity component

The €4 million special item with an equity component comprises gains from the sale of land and buildings in 2007, which have been allocated to this item in accordance with Section 6b of the German Income Tax Act (EStG).

The €11 million special item with an equity component recognized in 2006 comprised 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 and released to income in two equal installments in 2006 and 2007. As of December 31, 2007, there is thus no equity component for this item.

(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

€ million	Dec. 31, 2006	**Dec. 31, 2007**
Provisions for taxes	196	298
Miscellaneous provisions	235	230
	431	**528**

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, 2007, provisions of €80 million (2006: €138 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 €22 million (2006: €3 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, 2006	**Dec. 31, 2007**
		%	%	€ million	€ million
Eurobonds 2002/2007	€2,137 million	5.375	5.515	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	1,000
Eurobonds 2006/2009	€1,600 million	floating	floating	1,600	1,600
Eurobonds 2006/2018	GBP 250 million	5.625	5.774	369	369
Eurobonds 2006/2018 (increase)	GBP 100 million	5.625	5.541	148	148
Hybrid bond 2005/2105	€1,300 million	5.000*	5.155	1,300	1,300
Eurobonds 2004/2008 private placement	€20 million	3.490	3.502	20	20
Eurobonds 2007/2010 private placement	€300 million	floating	floating	-	300
Eurobonds 2007/2011 private placement	€200 million	4.375	4.464	-	200
				8,574	**6,937**

* Fixed interest rate until 2015, floating rate thereafter

In April 2007, Bayer AG issued a floating rate bond with a maturity of three years and a face value of €300 million under the EMTN program. The coupon is the three-month Euribor rate plus 10 basis points. Further, Bayer AG issued a four-year bond with a face value of €200 million and a coupon of 4.375 percent under the same program.

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 above the 3-month Euribor rate. The second issue, which has a face value of €1,000 million, has a coupon of 4.5 percent and a maturity of seven years. A third bond, denominated in sterling (GBP) was also issued with a face value of GBP 250 million. A second tranche of GBP 100 million was issued in the same year. 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

€ million	Dec. 31, 2006	Dec. 31, 2007
Payables to subsidiaries	25	26
Payables to other suppliers	10	10
	35	**36**

(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 €457 million (2006: €541 million) in accrued interest and €75 million (2006: €76 million) in premiums received on options. This item also includes €14 million (2006: €6 million) in short-term capital investments and €7 million (2006: €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:

	Dec. 31, 2006			Dec. 31, 2007		
€ million	Maturing in 2007	Maturing in 2008-2011	Maturing after 2011	Maturing in 2008	Maturing in 2009-2012	Maturing after 2012
Debentures	2,137	1,620	4,817	20	4,100	2,817
Liabilities to banks	1,705	4,013	4	6	1,260	1
Trade accounts payable	35	-	-	36	-	-
Payables to subsidiaries	13,821	2,300	58	16,980	2,357	-
Miscellaneous liabilities	567	2	71	514	73	1
	18,265	**7,935**	**4,950**	**17,556**	**7,790**	**2,819**

The miscellaneous liabilities as of December 31, 2007 include €458 million (2006: 543 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 (2006: €15 million), including €4 million (2006: €9 million) for subsidiaries.

Bayer AG has also assumed debt guarantees and issued letters of comfort totaling €5,060 million (2006: €4,125 million) to other Group companies.

	Dec. 31, 2006		**Dec. 31, 2007**	
	Nominal amount	€ million	**Nominal amount**	€ million
Sureties				
Bayer Capital Corporation B.V., Netherlands Mandatory convertible bond	EUR 2,300 million	2,300	EUR 2,300 million	2,300
Bayer (China) Limited, China Liabilities to banks	USD 70 million	53	USD 70 million	48
Bayer Corporation Holding, USA 3.750 % EMTN Notes, maturing in 2009	EUR 460 million	460	EUR 460 million	460
7.125 % Notes, maturing in 2015	USD 200 million	152	USD 200 million	136
6.650 % Notes, maturing in 2028	USD 350 million	266	USD 350 million	238
6.200 % Puttable Reset Securities (PURS^{SM}, maturing at the latest in 2028)	USD 250 million	190	USD 250 million	170
Sale-and-lease-back agreement Pass Through Trust	USD 209 million	120	USD 288 million	196
Bayer Holding Japan LLC, Japan 1.585 % EMTN Notes, maturing in 2010	-	-	JPY 10 billion	61
Floating rate EMTN Notes, maturing in 2012	-	-	JPY 30 billion	181
1.955 % EMTN Notes, maturing in 2012	-	-	JPY 15 billion	91
Bayer Polymers (Shanghai) Co. Ltd., China Liabilities to banks	CNY 1,770 million	172	CNY 2,427 million	226
Bayer Polyurethanes (Shanghai) Co. Ltd., China Liabilities to banks	-	-	CNY 3,871 million	360
Bayer Schering Pharma AG Liabilities to banks	-	-	EUR 179 million	179
Bayer Türk Kimya Sanayi Limited Sirketi, Turkey Liabilities to banks	-	-	EUR 55 Million	55
Guarantees for other Group companies		51		68
Letters of comfort		361		291
		4,125		**5,060**

Bayer AG bears joint and several liability under Article 133 of the German Transformation Act (UmwG) for the liabilities of the business and service areas transferred to legally separate entities in 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. Liabilities continue for five years from the effective date of the entry of the spin-off or transfer into the Commercial Register of Bayer AG. 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 €115 million (2006: €133 million), of which €65 million (2006: €79 million) relates to lease and rental agreements with subsidiaries, all of which have been concluded with CURRENTA GmbH & Co. OHG. The commitments under lease and rental agreements are due as follows:

€ million	
2008	19
2009	16
2010	13
2011	14
2012	16
After 2012	37
	115

(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, share 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 €14.6 billion on December 31, 2007 (2006: €21.3 billion). Back-to-back derivatives contracts in a notional amount of €4.5 billion (2006: €3.4 billion) were concluded with Group companies. The notional amounts of derivative financial derivatives totaled €19.1 billion (2006: €24.7 billion) on the closing date and were comprised as follows:

	Notional amount		Fair value		Carrying amount	
€ million	Dec. 31, 2006	**Dec. 31, 2007**	Dec. 31, 2006	**Dec. 31, 2007**	Dec. 31, 2006	**Dec. 31, 2007**
Forward rate contracts						
positive fair values	5,733	4,823	98	153		
negative fair values	6,353	4,897	(81)	(171)		
	12,086	9,720	17	(18)	(4)	(13)
Cross-currency interest rate swaps						
positive fair values	453	27	10	0		
negative fair values	676	504	(12)	(29)		
	1,129	531	(2)	(29)	0	0
Interest swaps						
positive fair values	4,850	2,773	105	93		
negative fair values	5,034	4,600	(143)	(183)		
	9,884	7,373	(38)	(90)	0	0
Interest options						
positive fair values	500	500	4	4		
negative fair values	500	500	(1)	0		
	1,000	1,000	3	4	2	2
Share options						
positive fair values	79	7	26	30		
negative fair values	5	0	(1)	(1)		
	84	7	25	29	12	6
Commodity contracts						
positive fair values	251	239	340	456		
negative fair values	251	239	(340)	(456)		
	502	478	0	0	0	0
	24,685	**19,109**	**5**	**(104)**	**10**	**(5)**

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 €4.0 billion (2006: €8.0 billion) were concluded with external counterparties. Back-to-back transactions with Group companies total €2.6 billion (2006: €1.9 billion). These transactions have a net positive fair value of €12 million (2006: €16 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, the same amount as in the previous year, with external counterparties. Back-to-back agreements of the about 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 with a notional value of €0.5 billion (2006: €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 €29 million (2006: €2 million).

Other forward rate agreements in a notional amount of €0.3 billion (2006: €0.2 billion) have a net positive fair value of €2 million (2006: €1 million). For the first time in 2007 these were offset by transactions with internal counterparties in a notional amount of €0.2 billion and a negative fair value of €32 million.

Interest swaps are used to hedge the interest risk relating to Eurobonds issued by Bayer AG. The notional amount of these derivatives is €1.6 billion (2006: €5.6 billion) and they have a net negative fair value of €62 million (2006: €118 million).

Further interest swaps with a notional value of €5.8 billion (2006: €4.3 billion) have now been economically closed out. They have a net negative fair value of €28 million (2006: net positive fair value of €80 million).

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 €4 million (2006: €3 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. They had a net fair value of €29 million on December 31, 2007 (2006: €25 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 values of derivative financial instruments are measured by the usual methods in light of the market data available at the measurement date. The following principles are applied:

- Currency contracts are measured individually at their forward rates on the balance sheet date. These depend on spot rates, including time spreads.
- The fair values of interest-rate swaps are determined by discounting expected future cash flows at market rates of interest over the remaining terms of the instruments. The fair values of interest-rate options are determined using a Black-Scholes model.
- The fair value of share options is determined either by the Black-Scholes method (for simple European options) or, in the case of more complex U.S. options, by conventional binomial methods.
- The fair value of forward commodity contracts is calculated from future price data obtained from the markets or from external data providers. Certain long-term commodity contracts to which fair values cannot be assigned are measured with the aid of valuation models based on internal fundamental data.

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 €13 million (2006: €4 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 or recognized as liabilities at the higher of cost or market value, respectively. As of December 31, 2007, capitalized interest options totaled €3 million (2006: €3 million). Interest option liabilities totaled €1 million (2006: €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, 2007 the net value of share options was €6 million (2006: €12 million).

(35) Audit fees

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

€ million	2006	**2007**
Financial statement auditing	8.6	5.0
Audit-related services and other audit work	2.3	1.9
Other services	0.1	0.1
	11.0	**7.0**

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 reviews of interim financial statements.

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

The total directly effected remuneration of the Board of Management in 2007 amounted to €8,882,552 (2006: €8,143,822) and comprises:

€	2006	2007
Base salary	2,260,400	1,985,580
Fixed supplement	1,096,556	982,792
Short-term incentive	4,644,475	5,768,862
Remuneration in kind and other benefits	142,391	145,318
Total direct remuneration	**8,143,822**	**8,882,552**

In addition, the members of Board of Management participate in long-term stock-based compensation programs. The entitlements earned in 2007 under the long-term stock-based compensation programs granted in current and previous years are shown separately in the table below. The changes in the value of entitlements earned prior to 2007 are also shown separately.

€	2006	2007
Long-term incentive (stock-based compensation entitlements earned in the respective year)	2,494,431	2,839,107
Change in value of existing entitlements	904,689	1,992,731

The fair value of the stock-based compensation as of the grant dates for 2007 is shown in the following table:

€	2006	2007
Fair value of newly granted stock-based compensation as of grant date	753,524	826,862

The fair value of the entitlements to newly granted stock-based compensation already earned in the respective year is included in the preceding table under “Long-term incentive.”

Expenses for pension entitlements granted to the members of the Board of Management serving in 2007 amounted to €1,689,949 (2006: €1,983,587). Pension provisions for the members of the Board of Management serving at year end amounted to €25,836,386 (2006: €22,974,049).

The pensions paid to retired members of the Board of Management and their surviving dependents amounted to €10,997,016 (2006: €10,924,768). Pension provisions for former members of the Board of Management and their surviving dependents amounting to €101,143,534 (2006: €97,243,586) are reflected in the balance sheet of Bayer AG.

The remuneration of the Supervisory Board amounted to €2,346,596 (2006: €2,337,041). Of this, variable components accounted for €782,199 (2006: €779,014).

There were no loans to members of the Board of Management or the Supervisory Board outstanding as of December 31, 2007, 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, which forms part of the Management Report.

Leverkusen, February 18, 2008
Bayer Aktiengesellschaft

The Board of Management

Proposal for Distribution of the Profit

The net income of Bayer AG in 2007 amounted to €1,928 million, of which €896 million was allocated to other retained earnings, giving a balance sheet profit of €1,032 million. We propose that this amount be used to pay a dividend of €1.35 per no-par share (764,341,920 shares) on the capital stock of €1,957 million entitled to the dividend for 2007.

Responsibility Statement

To the best of our knowledge, and in accordance with the applicable reporting principles, the financial statements give a true and fair view of the assets, liabilities, financial position and profit or loss of the company, and the management report includes a fair review of the development and performance of the business and the position of the company, together with a description of the principal opportunities and risks associated with the expected development of the company.

Leverkusen, February 18, 2008
Bayer Aktiengesellschaft

The Board of Management

Werner Wenning   Klaus Kühn   Dr. Wolfgang Plischke   Dr. Richard Pott

Report of the Supervisory Board

Dear stockholders:

During 2007 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 2007 there were five plenary meetings of the Supervisory Board. On two occasions, decisions were made after circulation of documents to the members. These related in one case to an acquisition project and in the other to the launch of a bond issue. No member of the Supervisory Board attended fewer than half of the meetings.

Elections to the Supervisory Board

In 2007, both the stockholder and the employee representatives on the Supervisory Board were elected for a term of five years. Three stockholder representatives, including a long-serving member, and two employee representatives did not stand for re-election, and new members were elected in their places.

Principal topics discussed by the Supervisory Board

At the focus of the Supervisory Board's deliberations were questions relating to the integration of Bayer Schering Pharma AG and the strategies of the Group as a whole and the subgroups. The September meeting of the Supervisory Board devoted special attention to the alignment of pharmaceutical research in the HealthCare subgroup and the pharmaceutical product pipeline. The same meeting also received reports concerning the delisting of Bayer shares from the New York Stock Exchange and the subsequent deregistration with the U.S. Securities and Exchange Commission (SEC).

At its meetings the Supervisory Board also discussed Bayer CropScience's acquisition of the U.S. cotton seed producer Stoneville, Bayer HealthCare's purchase of the Citracal product line from the U.S. company Mission Pharmacal, and the launch of a bond issue in Japan. Court proceedings and other litigations were dealt with at several meetings.

At the meeting in December 2007, the Board of Management presented its operational, financial and balance sheet planning for the years 2008 through 2010, which was the subject of detailed discussion.

Committees of the Supervisory Board

The Supervisory Board currently has the following committees:
Presidial Committee: This comprises two stockholder representatives and two employee representatives. The Presidial Committee serves primarily as the mediation committee pursuant to the German Codetermination Act. It has the task of submitting proposals to the Supervisory Board on the appointment of members of the Board of Management if the necessary two-thirds majority is not achieved in the first vote at a plenary meeting. Certain decision-making powers relating to capital measures have also been delegated to this committee.

Audit Committee: The Audit Committee, comprising three stockholder representatives and three employee representatives, meets four times a year. Its tasks include examining the company's financial reporting along with the quarterly and annual financial statements prepared by the Board of Management. On the basis of the auditor's report on the audit of the annual financial statements, the Audit Committee submits the proposal for their confirmation by the full Supervisory Board.

The Audit Committee also oversees the company's internal control system along with the procedures used to identify, track and manage risk, and monitors compliance with laws and statutory regulations. In accordance with the amendments to the Corporate Governance Code adopted during 2007, the Audit Committee is also responsible for compliance issues and discusses new developments in this area at each of its meetings.

The company's Corporate Auditing department reports regularly to the Audit Committee, which also is responsible for the company's relationship with the external auditor. The Audit Committee prepares the awarding of the audit contract to the audit firm appointed by the Annual Stockholders' Meeting, suggests areas of focus for the audit and determines the auditor's remuneration. It also monitors the independence, qualifications, rotation and efficiency of the auditor.

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

Nominations Committee: At the September meeting of the Supervisory Board, a Nominations Committee was established in line with the recommendation in the German Corporate Governance Code of June 2007 to carry out preparatory work when an election of stockholder representatives to the Supervisory Board is to be held. It suggests suitable candidates for the Supervisory Board to propose to the Annual Stockholders' Meeting for election. The Nominations Committee comprises the Chairman of the Supervisory Board and the other stockholder representative on the Presidial Committee.

The **Bayer Schering Pharma AG Acquisition Project Committee** was dissolved in September 2007 as it had completed the tasks entrusted to it.

Work of the committees

The Presidial Committee of the Supervisory Board was not required to convene in 2007 in its capacity as the Mediation Committee under Section 27 Paragraph 3 of the German Codetermination Act, nor did it need to resolve on any other matters.

The Audit Committee met four times during the year, concerning itself in particular with the company’s and the Group’s financial reporting. Other areas of focus were the Group’s risk management system, the internal control system and compliance issues. 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 2007 fiscal year. The auditor was present at all the meetings of the Audit Committee, reporting in detail on the audit work and the auditor’s review of the interim financial statements.

The Human Resources Committee convened on two occasions. It dealt mainly with matters relating to the remuneration of the Board of Management and questions relating to the pensions of former members of the Board of Management.

The previously formed Bayer Schering Pharma AG Acquisition Project Committee, dissolved in September 2007, and the newly formed Nominations Committee did not convene in 2007.

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 2007. In December 2007 the Board of Management and the Supervisory Board issued a new Declaration of Conformity, which is also reproduced in the Corporate Governance chapter of this Annual Report.

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 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 €1.35 per share.

The Supervisory Board would like to thank the Board of Management and all employees for their dedication and hard work in 2007.

Leverkusen, February 2008
For the Supervisory Board

Dr. Manfred Schneider
Chairman

Supervisory Board and Board of Management

Supervisory Board

Hermann Josef Strenger
Honorary Chairman, Leverkusen

Members of the Supervisory Board held offices as members of the supervisory board or a comparable supervising body of the corporations listed (as at December 31, 2007 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
Daimler AG
Linde AG (Chairman)
Metro AG
RWE AG
TUI AG

Thomas de Win
Vice Chairman of the Supervisory Board, Leverkusen;
Chairman of the Bayer Central Works Council
* 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 Investment Bank (Vice Chairman)
Allianz Lebensversicherungs-AG
RWE AG

Dr. Josef Ackermann
(until April 27, 2007)
Chairman of the Board of Managing Directors of Deutsche Bank AG, Frankfurt am Main
* February 7, 1948
Siemens AG

Andreas Becker
(until February 1, 2007)
Chairman of the Works Council of H. C. Starck, Laufenburg
* March 1, 1959

Willy Beumann
(effective February 20, 2007)
Chairman of the Works Council of the Wuppertal site of Bayer AG
* April 12, 1956
Bayer HealthCare AG

Dr. Clemens Börsig
(effective April 27, 2007)
Chairman of the Supervisory Board of Deutsche Bank AG, Frankfurt am Main
* July 27, 1948
Daimler AG (effective April 4, 2007)
Deutsche Bank AG (Chairman)
Deutsche Lufthansa AG
Foreign & Colonial Eurotrust PLC (until December 13, 2007)
Linde AG

Karl-Josef Ellrich
Chairman of the Dormagen Works Council of Bayer AG;
Chairman of the Bayer Group Works Council
* October 5, 1949
Bayer CropScience AG

Dr.-Ing. Thomas Fischer
Chairman of the Group Managerial Employees' Committee of Bayer AG
* August 27, 1955
Bayer MaterialScience AG

Peter Hausmann
North Rhine District Secretary of the German Mining, Chemical and Energy Industrial Union, Düsseldorf
* February 13, 1954
Evonik Services GmbH

Thomas Hellmuth
(until April 27, 2007)
Agricultural Engineer, Langenfeld
* May 29, 1956

Prof. Dr.-Ing. e.h. Hans-Olaf Henkel
Honorary Professor at the University of Mannheim, Mannheim
* March 14, 1940
Brambles Industries Ltd.
(until November 15, 2007)
Continental AG
Daimler Luft- und Raumfahrt Holding AG
EPG AG
Orange SA (until February 2, 2007)
Ringier AG
SMS GmbH

Reiner Hoffmann
Deputy General Secretary of the European Trade Union Confederation (ETUC), Brussels
* May 30, 1955
SASOL Germany GmbH

Gregor Jüsten
(until April 27, 2007)
Chemical Production Technician, Member of the Leverkusen Works Council of Bayer
* December 13, 1948

Dr. rer. pol. Klaus Kleinfeld
Chief Operating Officer of ALCOA Inc., New York, USA
* November 6, 1957
Citigroup Inc. (until August 2007)

Dr. h.c. Martin Kohlhaussen
(until April 27, 2007)
Chairman of the Supervisory Board of Commerzbank AG, Frankfurt am Main
* November 6, 1935
Hochtief AG (Chairman)
ThyssenKrupp AG

John Christian Kornblum
(until April 27, 2007)
Senior Advisor at Nörr Stiefenhofer Lutz, Berlin
* February 6, 1943
Motorola GmbH

André Krejcik
(effective April 27, 2007)
Member of the Works Council of Bayer Schering Pharma AG
* February 17, 1969

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

Dr. rer. nat. Helmut Panke
(effective April 27, 2007)
Former Chairman of the Board of Management of BMW AG, Munich
* August 31, 1946
Microsoft Corporation
UBS AG

Hubertus Schmoldt
Chairman of the German Mining, Chemical and Energy Industrial Union, Hannover
* January 14, 1945
Deutsche BP AG
DOW Olefinverbund GmbH
E.ON AG
RAG AG

Standing committees of the Supervisory Board of Bayer AG as at December 31, 2007	
Presidial Committee/Mediation Committee	Schneider (Chairman), Achleitner, Schmoldt, de Win
Audit Committee	Sturany (Chairman), Fischer, Hausmann, Henkel, Schneider, de Win
Human Resources Committee	Schneider (Chairman), Ellrich, Kronen, Weber
Nominations Committee	Schneider (Chairman), Achleitner

Dr.-Ing. Ekkehard D. Schulz
Chairman of the Executive Board of ThyssenKrupp AG, Duisburg/Essen
* July 24, 1941
AXA Konzern AG
MAN AG (Chairman until May 10, 2007, Vice Chairman effective May 11, 2007)
RAG AG (Vice Chairman) (until November 30, 2007)
RAG Beteiligungs-AG (Vice Chairman) (until November 30, 2007)
RWE AG
ThyssenKrupp Elevator AG (Chairman) (until August 31, 2007)
ThyssenKrupp Services AG (Chairman)
ThyssenKrupp Steel AG (Chairman) (effective September 1, 2007)
ThyssenKrupp Technologies AG (Chairman)

Dr. Klaus Sturany
(effective April 27, 2007)
Member of the Board of Management of RWE AG, Essen (until April 30, 2007)
* October 23, 1946
Commerzbank AG
Hannover Rückversicherung AG
Heidelberger Druckmaschinen AG
Österreichische Industrieholding AG

Dipl.-Ing. Dr.-Ing. e.h. Jürgen Weber
Chairman of the Supervisory Board of Deutsche Lufthansa AG, Köln
* October 17, 1941
Allianz Lebensversicherungs-AG
Deutsche Bank AG
Deutsche Post AG (Chairman)
LP Holding GmbH (Chairman)
Tetra Laval Group
Voith AG
Willy Bogner GmbH & Co. KGaA

Prof. Dr. Dr. h.c. Ernst-Ludwig Winnacker
Special Adviser to the European Commission, Brussels
* July 26, 1941
KWS Saat AG (until December 13, 2007)
Medigene AG (Chairman)
Wacker Chemie AG

Oliver Zühlke
(effective April 27, 2007)
Vice Chairman of the Works Council of Bayer AG
* December 11, 1968
Bayer HealthCare AG

Board of Management

Members of the Board of Management held offices as members of the supervisory board or a comparable supervising body of the corporations listed (as at December 31, 2007):

Werner Wenning
Chairman of the Board of Management
* October 21, 1946
Bayer Schering Pharma AG (Chairman)
Evonik Industries AG (effective December 3, 2007)
Henkel KGaA

Klaus Kühn
* February 11, 1952
Bayer Business Services GmbH (Chairman)
Bayer CropScience AG (Chairman)
Bayer Schering Pharma AG
Symrise AG (effective July 16, 2007)

Dr. Wolfgang Plischke
* September 15, 1951
ARK Therapeutics, Non-Executive Director
Bayer Innovation GmbH (Chairman of the Shareholders' Committee)
Bayer MaterialScience AG (Chairman)
Bayer Technology Services GmbH (Chairman)
Bayern LB, Economic Advisory Board

Dr. Richard Pott
Labor Director
* May 11, 1953
Bayer HealthCare AG (Chairman)
Currenta Geschäftsführungs-GmbH (formerly Bayer Industry Services Geschäftsführungs-GmbH) (Chairman)

Masthead

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This publication contains forward-looking statements based on current assumptions and forecasts made by Bayer Group or subgroup management. Various known and unknown risks, uncertainties and other factors could lead to material differences between the actual assets, financial position, earnings, development or performance of the company and the estimates given here. These factors include those discussed in Bayer's public reports, which are available on the Bayer website at www.bayer.com. The company assumes no liability whatsoever to update these forward-looking statements or to conform them to future events or developments.

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This is neither an offer to purchase nor a solicitation of an offer to sell shares or American depositary 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 depositary 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 depositary 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

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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.