BAYER AKTIENGESELLSCHAFT
Form 20-F
March 06, 2006

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As filed with the Securities and Exchange Commission on March 6, 2006

UNITED STATES SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549

Form 20-F

(Mark One)

o **REGISTRATION STATEMENT PURSUANT TO SECTION 12(b) OR 12(g) OF THE SECURITIES EXCHANGE ACT OF 1934**

OR

þ **ANNUAL REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**
For the fiscal year ended December 31, 2005.

OR

o **TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**

OR

o **SHELL COMPANY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**
Date of event requiring this shell company report....

For the transition period from _____ to _____
Commission file number 001-16829
BAYER AKTIENGESELLSCHAFT
(Exact name of Registrant as specified in its charter)
BAYER CORPORATION*
(Translation of Registrant s name into English)
Federal Republic of Germany
(Jurisdiction of incorporation or organization)
Bayerwerk, Gebäude W11
Kaiser-Wilhelm-Allee
51368 Leverkusen, GERMANY
(Address of principal executive offices)

Securities registered or to be registered pursuant to Section 12(b) of the Act.

Title of Each Class:	**Name of Each Exchange on Which Registered:**
American Depositary Shares representing Bayer AG ordinary shares of no par value	New York Stock Exchange
Bayer AG ordinary shares of no par value	New York Stock Exchange**

Securities registered or to be registered pursuant to Section 12(g) of the Act.

None

(Title of class)

Securities for which there is a reporting obligation pursuant to Section 15(d) of the Act.

None

(Title of class)

Indicate the number of outstanding shares of each of the issuer s classes of capital or common stock as of the close of the period covered by the annual report.

As of December 31, 2005, 730,341,920 ordinary shares, of no par value, of Bayer AG were outstanding.

Indicate by check mark if the registrant is a well-known seasoned issuer, as defined in Rule 405 of the Securities Act.

Yes þ No o

If this report is an annual or transition report, indicate by check mark if the registrant is not required to file reports pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934.

Yes o No þ

Note Checking the box above will not relieve any registrant required to file reports pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934 from their obligations under those Sections.

Indicate by check mark whether the Registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days.

Yes þ No o Not applicable o.

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, or a non-accelerated filer. See definition of accelerated filer and large accelerated filer in Rule 12b-2 of the Exchange Act. (Check one):

þ Large accelerated filer o Accelerated filer o Non-accelerated filer

Indicate by check mark which financial statement item the registrant has elected to follow:

Item 17 o Item 18 þ

If this is an annual report, indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act).

Yes o No þ

(APPLICABLE ONLY TO ISSUERS INVOLVED IN BANKRUPTCY PROCEEDINGS DURING THE PAST FIVE YEARS)

Indicate by check mark whether the registrant has filed all documents and reports required to be filed by Sections 12, 13 or 15(d) of the Securities Exchange Act of 1934 subsequent to the distribution of securities under a plan confirmed by a court.

Yes o No o

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

** Not for trading, but only in connection with the registration of American Depositary Shares.

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Defined Terms and Conventions

Bayer AG is a corporation organized under the laws of the Federal Republic of Germany. As used in this annual report on Form 20-F, unless otherwise specified or required by the context, the term Company , Bayer or Bayer AG refers to Bayer AG and the terms we , us and our refer to Bayer AG and, as applicable, Bayer AG and its consolidated subsidiaries.

Due to rounding, numbers presented throughout this document may not add up precisely to the totals we provide and percentages may not precisely reflect the absolute figures.

Forward-Looking Information

This annual report on Form 20-F contains forward-looking statements that reflect our plans and expectations. As these statements are based on current plans, estimates and projections, you should not place undue reliance on them. We generally identify forward-looking statements with words such as expects , intends , anticipates , plans , believes estimates and similar expressions.

Forward-looking statements involve known and unknown risks, uncertainties and other factors. We caution you that a number of important factors may cause our actual results, performance, achievements or financial position to be materially different from any results, performance, achievements or financial position expressed or implied by forward-looking statements. These factors include, but are not limited to:

- cyclicality in our industries;
- reduced demand for older products in response to advances in technology;
- increasingly stringent regulatory controls;
- increased raw materials prices;
- the expiration of patent protections;
- environmental liabilities and compliance costs;
- failure to compete successfully, integrate acquired companies or develop new products and technologies;
- risks from hazardous materials;
- litigation and product liability claims; and
- fluctuations in currency exchange rates.

A discussion of these and other factors that may affect our actual results, performance, achievements or financial position is contained in Item 3, *Key Information Risk Factors,* the various Strategy sections in Item 4, *Information on the Company,* Item 5, *Operating and Financial Review and Prospects* and elsewhere in this annual report.

Forward-looking statements speak only as of the date they are made, and we undertake no obligation to update publicly any of them in light of new information or future events.

Enforceability of Civil Liabilities under U.S. Federal Securities Laws

We are a German corporation. All of our directors and executive officers are residents of Germany. A substantial portion of our assets and those of such individuals is located outside the United States.

As a result, although a multilateral treaty to which both Germany and the United States are party guarantees service of writs and other legal documents in civil cases if the current address of the defendant is known, it may be difficult or impossible for you to effect service of process upon these persons from within the United States.

Also, because these persons and assets are outside the United States, it may be difficult for you to enforce judgments against them in the United States, even if these judgments are of U.S. courts and are based on the civil

liability provisions of the U.S. securities laws.

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If you wish to execute the judgment of a foreign court in Germany, you must first obtain from a German court an order for execution (*Vollstreckungsurteil*). A German court may grant an order to execute a U.S. court judgment with respect to civil liability under the U.S. federal securities laws if that judgment is final as a matter of U.S. law. In granting the order, the German court will not enquire whether the U.S. judgment was, as a matter of U.S. law, correct. However, the German court must refuse to grant the order if:

the U.S. court lacked jurisdiction, as determined under German law;

the person against whom the judgment was obtained did not receive service of process adequate to permit a proper defense, did not otherwise acquiesce in the original action and raises the lack of service of process as a defense against the grant of the execution order;

the judgment would conflict with the final judgment of a German court or with the final judgment of another foreign court that is recognizable under German law;

recognition of the judgment would violate an important principle of German law, especially basic constitutional rights; or

there is a lack of reciprocity between Germany and the jurisdiction whose court rendered the original judgment.

You should be aware that German courts hold certain elements of some U.S. court judgments, for example, punitive damages, to violate important principles of German law. Judgments for ordinary compensatory damages are generally enforceable, unless in an individual case one of the reasons described above would forbid enforcement.

If you bring an original action before a German court based on the provisions of the U.S. securities laws and the court agrees to take jurisdiction over the case, the court will decide the matter in accordance with the applicable U.S. laws, to the extent that these do not violate important principles of German law. However, the court may refuse to accept jurisdiction if another action is pending before a U.S. or other foreign court in the same matter. Furthermore, the court might decide that, for a lawsuit brought by a U.S. resident under U.S. law against a defendant that, like Bayer, has a significant presence in the United States, a U.S. court would be the more proper forum.

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PART I

Item 1. ***Identity of Directors, Senior Management and Advisors***

Directors and Senior Management

Not applicable.

Item 2. ***Offer Statistics and Expected Timetable***

Not applicable.

Item 3. ***Key Information***

Selected Financial Data

We derived the following selected financial data for each of the years in the five-year period ended December 31, 2005 from our consolidated financial statements. We have prepared our consolidated financial statements in accordance with International Financial Reporting Standards, or IFRS and, where indicated, in accordance with U.S. Generally Accepted Accounting Standards, or U.S. GAAP. Since 2002, IFRS is the term for the entire body of accounting standards issued by the International Accounting Standards Board (IASB), replacing the earlier International Accounting Standards, or IAS. Individual accounting standards that the IASB issued prior to this change in terminology continue to use the prefix IAS . Note 44 to our consolidated financial statements included in Item 18 of this annual report on Form 20-F describes the reconciliation of significant differences between IFRS and U.S. GAAP.

In this annual report we have translated certain euro amounts into U.S. dollar amounts at the rate of $1.1842 = 1.00, the noon buying rate of the Federal Reserve Bank of New York on December 31, 2005. We have translated these amounts solely for your convenience, and you should not assume that, on that or any other date, one could have converted these amounts of euros into dollars at that or any other exchange rate.

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The financial information presented below is only a summary. You should read it together with the consolidated financial statements included in Item 18.

Consolidated Income Statement Data

	Year ended December 31,					
	2001	**2002**	**2003**	**2004**	**2005**	**2005**
						$
	(In millions, except per share data)					
IFRS:						
Net sales (continuing operations)	21,981	22,283	22,417	23,278	27,383	32,427
Operating result (continuing operations)	1,518	815	575	1,875	2,812	3,330
Non-operating result[(1)]	(467)	(423)	(708)	(653)	(613)	(726)
Income before income taxes[(1)]	1,051	392	(133)	1,222	2,199	2,604
Income taxes[(1)]	(173)	5	84	(473)	(641)	(759)
Income after taxes[(1)]	878	397	(49)	749	1,558	1,845
Income after taxes from discontinued operations[(1)]	50	681	(1,242)	(67)	37	44
Income after taxes total[(1)]	928	1,078	(1,291)	682	1,595	1,889
Minority stockholders interest	4	(3)	(12)	3	2	2
Net income	932	1,075	(1,303)	685	1,597	1,891
Average number of shares in issue	730	730	730	730	730	730
Operating result from continuing operations per share[(1)]	2.08	1.12	0.79	2.57	3.85	4.56
Basic net income/loss per share[(1)]	1.28	1.47	(1.78)	0.94	2.19	2.59
Diluted net income/loss per share[(1)]	1.28	1.47	(1.78)	0.94	2.19	2.59
Dividends per share[(1)]	0.90	0.90	0.50	0.55	N/A[(2)]	N/A[(2)]
U.S. GAAP:						
Net income	800	1,277	(1,445)	653	1,327	1,571
Basic and diluted net income per share	1.10	1.75	(1.98)	0.89	1.82	2.15

(1) Prior year data have been restated for these items due to adoption of new IFRS accounting standards. For more details, see Notes 2, 3 and 28 to the consolidated financial statements appearing elsewhere in this annual report.

(2) The dividend payment for 2005 has not yet been decided on. Our Supervisory Board has accepted our Board of Management s proposal to recommend at our Annual Stockholders Meeting a dividend for 2005 of 0.95 per share, for a total dividend of 694 million.

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Consolidated Balance Sheet Data

	Year ended December 31,					
	2001	2002	2003	2004	2005	2005
						$
	(In millions, except per share data)					
IFRS:						
Total Assets[1]	36,868	40,966	37,516	37,588	36,722	43,486
Stockholders equity[1]	16,916	14,666	11,290	10,943	11,157	13,212
Liabilities[1]	19,952	26,300	26,226	26,645	25,565	30,274
of which noncurrent financial obligations	2,981	7,228	7,288	7,025	7,185	8,508
U.S. GAAP:						
Stockholders equity	18,300	16,734	13,325	13,046	12,347	14,621
Total assets	37,831	42,668	38,012	38,496	38,133	45,157

(1) Prior year data have been restated for these items due to adoption of new IFRS accounting standards. For more details, see Notes 2, 3 and 28 to the consolidated financial statements appearing elsewhere in this annual report.

Dividends

The following table indicates the dividends per share paid from 2003 to 2005. Stockholders who are U.S. residents should be aware that they will be subject to German withholding tax on dividends received. See Item 10, *Additional Information Taxation*.

	2003	2004	2005
Total dividend (in millions)	365	402	N/A[1]
Dividend per share ( )	0.50	0.55	N/A[1]
Dividend per share ($)	0.57	0.68	N/A[1]

(1) The dividend payment for 2005 has not yet been decided on. Our Supervisory Board has accepted our Board of Management s proposal to recommend at our Annual Stockholders Meeting a dividend for 2005 of 0.95 per share, for a total dividend of 694 million.

See also Item 8, *Financial Information Dividend Policy and Liquidation Proceeds.*

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Exchange Rate Data

The following table shows, for the periods and dates indicated, the exchange rate of the U.S. dollar to the euro based on the noon buying rate of the Federal Reserve Bank of New York. Fluctuations in the exchange rate between the euro and the U.S. dollar will affect the market price of the shares and the ADSs, the U.S. dollar amount received by holders of shares and the ADSs on conversion by the Depositary of any cash dividends paid in euro and the U.S. dollar translation of our results of operations and financial condition.

Year	Period End	Average	High	Low
		(U.S. dollar per euro)		
2001	0.8901	0.8909	0.9535	0.8370
2002	1.0485	0.9454	1.0485	0.8594
2003	1.2597	1.1321	1.2597	1.0361
2004	1.3538	1.2438	1.3625	1.1801
2005	1.1842	1.2449	1.3476	1.1667

Previous six months	High	Low
	(U.S. dollar per euro)	
September 2005	1.2538	1.2011
October 2005	1.2148	1.1914
November 2005	1.2067	1.1667
December 2005	1.2041	1.1699
January 2006	1.2287	1.1980
February 2006	1.2100	1.1860

The exchange rate of the U.S. dollar to the euro based on the noon buying rate of the Federal Reserve Bank of New York on February 28, 2006 was $1.1925 = 1.00. In this annual report, we have translated certain euro amounts into U.S. dollar amounts at the rate of $1.1842 = 1.00, the noon buying rate of the Federal Reserve Bank of New York on December 31, 2005.

Risk Factors

An investment in our shares or ADSs involves a significant degree of risk. You should carefully consider these risk factors and the other information in this annual report on Form 20-F before deciding to invest in our shares or ADSs. The risks described below are the ones we consider material. However, they are not the only ones that may exist. Additional risks not known to us or that we consider immaterial may also have an impact on our business operations. The occurrence of any of these events could seriously harm our business, operating results and financial condition. In that case, the trading price of our shares or ADSs could decline and you could lose all or part of your investment.

Cyclicality may reduce our operating margins or cause operating losses

Several of the industries in which Bayer operates are cyclical. This applies particularly to our Materials and Systems segments. Typically, increased demand during peaks in the business cycle in these industries leads producers to increase their production capacity. Although peaks in the business cycle have been characterized by increased selling prices and higher operating margins, in the past these capacity increases have led to excess capacities because they have exceeded demand growth. Low periods in the business cycles are then characterized by decreasing prices and excess capacity. These factors lead to volatile operating margins and may result in operating losses for Bayer.

Excess capacities can affect our operating results especially with respect to those commodity businesses that are characterized by slow market growth. We believe that some areas of the isocyanate business, in particular, face slow growth in demand together with substantial excess production capacity. Excess capacity in polycarbonates has declined but continues to affect the structure of the polycarbonates market.

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Future growth in demand may not be sufficient to absorb current excess capacity or future capacity additions without significant downward pressure on prices and adverse effects on our operating results.

The agriculture sector is particularly subject to seasonal and weather factors and fluctuations in crop prices, which may have a negative influence on our business results. As climate conditions and market prices for agricultural products change, the demand for our agricultural products generally also changes. For example, a drought will often reduce demand for our fungicides products.

Failure to develop new products and production technologies may harm our competitive position

Bayer s operating results significantly depend on the development of commercially viable new products and production technologies. We devote substantial resources to research and development. Because of the lengthy development process, technological challenges and intense competition, we cannot assure you that any of the products we are currently developing, or may begin to develop in the future, will become market-ready or achieve commercial success. For these reasons, we may be unable to meet our expectations and targets with respect to products we are currently developing, particularly in our Pharmaceuticals; Crop Protection and Environmental Science, BioScience segments. Our competitive position and operating results could be harmed, if we are unsuccessful in developing new products and production processes in the future or if our ability to generate sufficient levels of sales through investments in new products and expenditures on research and development declines.

Competitive pressure from new agrochemical compounds that achieve similar or improved results with better ecotoxicological profiles and smaller doses may reduce the sales of our existing products. The growing importance of plant biotechnology in the crop protection field could reduce market demand for some of our agrochemical products and, to the extent that our competitors supply those biotechnological products, could lead to declines in our revenues.

Regulatory controls and changes in public policy may reduce the profitability of new or current products

We must comply with a broad range of regulatory controls on the testing, manufacturing and marketing of many of our products. In some countries, including the United States, regulatory controls have become increasingly demanding. We expect that this trend will continue and will expand to other countries, particularly those of the European Union (EU). A proposed EU chemicals policy could mandate a significant increase in the testing and assessment of all chemicals, leading to increased costs and reduced operating margins for these products. Although we have adopted measures to address these stricter regulations, such as increasing the efficiency of our internal research and development processes in order to reduce the impact of extended testing on time-to-market, stricter regulatory regimes could substantially delay our product development or restrict our marketing and sales.

Our Pharmaceuticals segment and our Consumer Care segment are subject to particularly strict regulatory regimes. Rising regulatory requirements, such as those governing clinical trials, may increase the cost of product development and the time it takes to bring new products to market, thus reducing the overall financial benefits from these products. Failure to achieve regulatory approval of new products in a timely manner or at all can mean that we do not recoup our research and development and/or commercial investment through sales of that product. We do not know when or whether any approvals from regulatory authorities will be received. Withdrawal by regulators of an approval previously granted can mean that the affected product ceases to generate revenue. This can occur even if regulators take action falling short of actual withdrawal or direct their action at products that do not require regulatory approval. In addition, in some cases we may voluntarily cease marketing a product even in the absence of regulatory action.

Pharmaceutical product prices are subject to controls or pressures in many markets. Some governments intervene directly in setting prices. In addition, in some markets major purchasers of pharmaceutical products (whether governmental agencies or private health care providers) have the economic power to exert substantial pressure on prices. Price controls limit the financial benefits of growth in the life sciences markets and the introduction of new products. We expect that price controls and pressures on pricing will remain or increase. Any increase may further limit or eliminate our financial benefits from the affected products.

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Changes in governmental agricultural policies could significantly change the structure of the overall market for agricultural products in affected countries in which we operate. A substantial change in the level of subsidies for agricultural commodities could negatively affect the level of agricultural production and the extent of the area under cultivation. As a consequence, existing markets could change with a corresponding negative impact on our CropScience subgroup s sales and operating results. As it is impossible at present to determine precisely what changes, if any, may occur, whether and when such changes will be implemented and the extent of their impact, close monitoring and analyses of the related political developments are necessary. We expect the operating result of our CropScience business to reflect the uncertainties of this industry.

See Item 4, *Information on the Company Governmental Regulation* for a more detailed discussion of the regulatory regimes to which we are subject.

Our operating margins may decrease if we are not be able to pass increased raw material prices on to customers or if prices for our products decrease faster than raw material prices

Significant variations in the cost and availability of raw materials and energy may reduce our operating results. We use significant amounts of petrochemical-based raw materials and aromatics (benzene, toluene) in manufacturing a wide variety of our products. We also purchase significant amounts of natural gas, coal and electricity to supply the energy required in our production processes. The prices and availability of these raw materials and energy vary with market conditions and may be highly volatile. There have been in the past, and may be in the future, periods during which we cannot pass raw material price increases on to customers. Even in periods during which raw material prices decrease, we may suffer decreasing operating profit margins if the prices of raw materials decrease more slowly than do the selling prices of our products. In the past, we have entered into hedging arrangements with respect to raw materials prices only to a limited extent. If the market for these hedging arrangements were to attain sufficient liquidity and we could obtain their protection at a reasonable cost, we would consider making more extensive use of these hedging instruments.

Shortages or disruptions of supplies to customers due to unplanned capacity decreases or shutdowns of production plants may reduce sales

Production at some of our manufacturing facilities or the supply of raw materials to them could be adversely affected by technical failures, strikes, natural disasters, regulatory rulings and other factors. Our biological products, in particular, generally face complicated production processes that are more subject to disruption than is the case with other processes and therefore pose increased risk of manufacturing problems, unplanned shutdowns and loss of products. Production capacities at one or more of our sites or major plants could therefore decline temporarily or over the long term. If the capacity of one or more material facilities is reduced or manufacture of material products is shut down for a prolonged period and we are unable to shift sufficient production to other plants or draw on our inventories, we can suffer declines in sales revenues and in our results, be exposed to damages claims and suffer reputational harm.

Litigation and administrative claims could harm our operating results and cash flows

We are involved in a number of legal proceedings and may become involved in additional legal proceedings. See Item 8, *Financial Information Legal Proceedings*. Each of these proceedings or potential proceedings could involve substantial claims for damages or other payments. These proceedings include claims alleging product liability, patent infringement proceedings, claims alleging breach of contract and claims alleging antitrust violations. If our opponents in these lawsuits obtain judgments against us or if we determine to settle any of these lawsuits, we could be required to pay substantial damages and related costs.

We are also plaintiff in lawsuits to enforce our patent rights in our products. If we are not successful in these actions, we would expect our revenue from these products to decline as generic competitors enter the market. In cases where we believe it appropriate, we have established provisions to cover potential litigation-related costs. Increased risks currently result from litigation commenced in the United States after we voluntarily withdrew *Lipobay/ Baycol* (cerivastatin) from the market, voluntarily stopped marketing products containing phenylpropa-

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nolamine (PPA), antitrust proceedings relating to our polymers business and antitrust proceedings associated with Bayer s ciprofloxacin anti-infective product, *Cipro®*.

Since the existing insurance coverage with respect to *Lipobay/ Baycol* and PPA 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 provisions already established. We will regularly review whether further accounting measures are necessary depending on the progress of the litigation. Please see also *Existing insurance coverage may turn out to be inadequate*.

Bayer expects that, in the course of the antitrust proceedings relating to our polymers business, additional charges, which are also currently not quantifiable, will become necessary. Please see Item 8, *Financial Information Legal Proceedings*, for a discussion of these proceedings.

Competition from generic pharmaceuticals after patent expiration may reduce market share and sales revenue

During the life of its patent related to the compound *per se*, a patented product is normally only subject to competition from alternative products. After a patent expires, the producer of the formerly patented product is likely to face increased competition from generic products entering the market. See Item 4, *Information on the Company Intellectual Property Protection*, for a discussion of the scheduled expiration dates of our significant patents.

In response to rising healthcare costs, many governments (including many U.S. states) and private health care providers, such as Health Maintenance Organizations (HMOs) in the United States, have instituted reimbursement schemes favoring less expensive generic pharmaceuticals over brand-name pharmaceuticals. We expect that the pressure for generic substitution will increase as a result of the implementation of the Medicare prescription drug benefit in 2006. Increased competition from generic products after patent expiration is likely to reduce market share and sales revenue of our formerly patented products.

The loss of patent protection or ineffective patent protection for marketed products may result in loss of sales to competing products

Generic drug manufacturers, particularly in the United States, may seek marketing approval for pharmaceutical or agricultural products currently under patent protection by attacking the validity or enforceability of a patent. If a generic manufacturer succeeds in voiding a patent protecting one of our products, that product could be exposed to generic competition before the expiration date of the patent. See Item 8, *Financial Information Legal Proceedings*, for a discussion of several important patent-related proceedings in which we are involved.

The extent of patent protection varies from country to country. In some of the countries in which we operate, patent protection may be significantly weaker than in the United States or the European Union. Piracy of patent-protected intellectual property has occurred in recent years, particularly in some Asian countries. In particular, these countries could facilitate competition within their markets from generic manufacturers who would otherwise be unable to introduce competing products for a number of years. We do not currently expect any proposed patent law modifications to affect us materially. Nevertheless, if a country in which we sell a substantial volume of an important product were to effectively invalidate our patent rights in that product, our revenues could suffer.

Failure to compete successfully or weak performance by our marketing partners may reduce our operating results

Bayer operates in highly competitive industries. Actions of our competitors could reduce our profitability and market share. In some commodity areas (especially within our Materials and Systems segments), we compete primarily on the basis of price and reliability of product and supply. All of our segments, however, also compete in specialty markets on the basis of product differentiation, innovation, quality and price. Significant product innovations, technical advances or the intensification of price competition by competitors could harm our operating results.

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We depend on third parties for the marketing of some of our products, most notably in our pharmaceutical business. Therefore, our operating performance is influenced by the quality of our partners marketing and sales performance.

Our transactions relating to LANXESS expose us to continuing liability

As announced in November 2003, Bayer combined its former Bayer Chemicals segment (except for Wolff Walsrode and H.C. Starck) with parts of its former Bayer Polymers business to form the LANXESS subgroup with economic effect from July 1, 2004 as part of its portfolio realignment. LANXESS AG became a legally independent company on January 28, 2005, when its spin-off was registered in the Commercial Register (Handelsregister) for Bayer AG at the Local Court of Cologne (Amtsgericht Köln), Germany.

Our liability for prior obligations of the LANXESS subgroup following its spin-off 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 all obligations of Bayer AG that existed on January 28, 2005. The company to which the respective obligations were not assigned under the Spin-Off and Acquisition Agreement, dated September 22, 2004, between Bayer AG and LANXESS AG ceases to be liable for such obligations after a five-year period.

Under the Master Agreement between Bayer AG and LANXESS AG of the same date, each of Bayer AG and LANXESS AG agreed to release the other party from those liabilities each has assumed as principal debtor under the Spin-Off and Acquisition Agreement. The Master Agreement contains provisions for the general apportionment of liability as well as special provisions relating to the apportionment of product liability and of liability for environmental contamination and antitrust violations between Bayer AG and LANXESS AG. The Master Agreement applies to all activities of Bayer AG and LANXESS AG units throughout the world, subject to certain conditions for the United States. For a description of these agreements, please see Item 10, *Additional Information Material Contracts*.

We may bear expenses in the future relating to liabilities of the former LANXESS subgroup under the German Transformation Act or pursuant to the Spin-Off and Acquisition Agreement or the Master Agreement. These could have a material adverse effect on our financial condition and results of operations.

Risks from the handling of hazardous materials could negatively impact our operating results

Bayer s operations are subject to the operating risks associated with pharmaceutical and chemical manufacturing, including the related risks associated with storage and transportation of raw materials, products and wastes. These risks include, among other things, the following hazards:

pipeline and storage tank leaks and ruptures;

fires and explosions;

malfunction and operational failure; and

releases, discharges or disposal of toxic and/or hazardous substances resulting from these or other causes.

These operating risks have the potential to cause personal injury, property damage and environmental contamination, and may result in the shutdown of affected facilities and in business interruption and the imposition of civil or criminal penalties, and negatively impact the reputation of the company. The occurrence of any of these events may significantly reduce the productivity and profitability of the affected manufacturing facility and harm our operating results. Furthermore, our property damage, business interruption and casualty insurance policies may not be adequate to cover fully all potential hazards incidental to our business.

For more detailed information on environmental issues, see Item 4, *Information on the Company Business Governmental Regulation*.

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Environmental liabilities and compliance costs may have a significant negative effect on our operating results

The environmental laws of various jurisdictions impose actual and potential obligations on Bayer to remediate contaminated sites. These obligations may relate to sites:

- that we currently own or operate;
- that we formerly owned or operated;
- where we disposed of waste from our operations;
- where external toll manufacturers operate or operated; or
- where property owned by third parties was contaminated by the emission or spill of contaminants for which we bear responsibility.

The costs of these environmental remediation obligations could significantly reduce our operating results. In particular, our accruals for these obligations may be insufficient if the assumptions underlying these accruals prove incorrect or if we are held responsible for additional, currently undiscovered, contamination. See Item 4, *Information on the Company Governmental Regulation*.

Furthermore, Bayer is or may become involved in claims, lawsuits and administrative proceedings relating to environmental matters. An adverse outcome in any of these might have a significant negative impact on our operating results and reputation.

Stricter health, safety and environmental laws and regulations as well as enforcement policies could result in substantial liabilities and costs to Bayer and could subject our handling, manufacturing, use, reuse or disposal of substances or pollutants to more rigorous scrutiny than is currently the case. Consequently, compliance with these laws and regulations could result in significant capital expenditures and expenses as well as liabilities, thereby harming our business and operating results.

Existing insurance coverage may turn out to be inadequate

We seek to cover foreseeable risks through insurance coverage. Such insurance coverage, however, may not fully cover the risks to which the company is exposed. This can be the case with respect to insurance covering legal and administrative claims, as discussed above, as well as with respect to insurance covering other risks. For certain risks, adequate insurance coverage may not be available on the market or may not be available at reasonable conditions. Consequently, any harm resulting from the materialization of these risks could result in significant capital expenditures and expenses as well as liabilities, thereby harming our business and operating results.

Significant fluctuations in exchange rates affect our financial results

Bayer conducts a significant portion of its operations outside the euro zone. Fluctuations in currencies of countries outside the euro zone, especially the U.S. dollar and Japanese yen, can materially affect our revenue as well as our operating results. For example, changes in currency exchange rates may affect:

- the relative prices at which we and our competitors sell products in the same market;
- the cost of products and services we require for our operations; and
- the euro-denominated items in our financial statements.

Although these fluctuations can benefit us, they can also harm our results. From time to time, we may use financial instruments to hedge some of our exposure to foreign currency fluctuations. For further information on these products, see Item 11, *Quantitative and Qualitative Disclosures about Market Risk*.

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Negative developments affecting capital markets may make additional contributions to our pension funds necessary and changes in the yield assumptions could have an impact on the valuation of liabilities

Changes and movements in the equity, fixed income, real estate and other markets could significantly change the valuation of the assets of our plans. A change in yield assumptions could also have an impact on the discounted present value of our pension obligations. In addition, changes in pension and postretirement benefit plan assumptions, such as rates for compensation increase, retirement rates, mortality rates, health care cost trends and other factors can lead to significant increases or decreases in our pension or postretirement benefit obligations, which would affect the reported funded status of our plans and therefore could also negatively affect net periodic pension cost, future cash contributions and equity. For further details on underfunding of pensions and other post-retirement benefit obligations, refer to Note 28 to the consolidated financial statements appearing elsewhere in this annual report.

We cannot assure you that any future expenses or cash contributions that become necessary under our pension or postretirement benefit plans will not have a material adverse effect on our financial condition and results of operations.

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Item 4. ***Information on the Company***

HISTORY AND DEVELOPMENT OF THE COMPANY

Bayer Aktiengesellschaft, or Bayer AG, is a stock corporation (*Aktiengesellschaft*) organized under the laws of the Federal Republic of Germany.

Bayer AG was incorporated in 1951 under the name Farbenfabriken Bayer AG for an indefinite term and adopted its present name in 1972. Bayer AG s registered office (*Sitz*) and principal place of business are at the Bayerwerk, 51368 Leverkusen, Germany. Its telephone number is +49 (214) 30-1 and its home page on the World Wide Web is at www.bayer.com. Reference to our website does not incorporate the information contained on the website into this annual report on Form 20-F. The headquarters of Bayer AG s U.S. subsidiary, Bayer Corporation, are located at 100 Bayer Road, Pittsburgh, Pennsylvania 15205-9741.

The major acquisitions and divestitures of the Bayer Group during the last three years are listed below. For capital expenditures (excluding acquisitions) for these years, please refer to Item 5, *Operating and Financial Review and Prospects Liquidity and Capital Resources 2003, 2004 and 2005 Capital Expenditures*. For capital expenditures by individual business segment for the last three years, refer to the segment data in Note 1 to our consolidated financial statements appearing elsewhere in this annual report.

Our principal expenditures on acquisitions in the past three years were as follows:

In 2003, we spent a total of 68 million on acquisitions, mainly for increasing our interest in the Bayer Polymers Sheet Europe Group (formerly known as Makroform) to 100 percent.

In 2004, Bayer spent a total of 0.4 billion on acquisitions. Of this amount, approximately 0.1 billion was used for the purchase of Crompton Corporation s 50 percent stake in the Gustafson joint venture (seed treatment business) based in the United States, Canada and Mexico, in which Bayer already held a 50 percent share. In connection with the acquisition of Roche s Consumer Health business in 2005, Bayer acquired, by the end of 2004, Roche s 50 percent interest in the Bayer-Roche joint venture that had been established in the United States in 1996. The purchase price for the 50 percent equity interest was 0.2 billion. Not included in the 2004 total acquisition amount is a first payment of 0.2 billion we made for Roche s Consumer Health business in the rest of the world, because, as of December 31, 2004, this business had not yet been transferred to Bayer.

In 2005, we spent a total of 2.4 billion on acquisitions. Roche s Consumer Health business in the rest of the world (except in Japan) was acquired for approximately 2.1 billion. Both this amount and the 2005 total acquisition amount include the first payment of 0.2 billion we made for Roche s Consumer Health business in the rest of the world. Since January 2005, the business involving non-prescription drugs and vitamins has been part of Bayer HealthCare s Consumer Care Division and has already been integrated into the Bayer organization. Aside from the 50 percent stake in the Bayer-Roche joint venture, the acquired business includes five production sites, consumer brands such as *Aleve*®, *Bepanthen*®, *Redoxon*®, *Rennie*® and *Supradyn*®, vitamins and nutritional supplements. The acquisition has primarily been financed through the use of our own funds, although loans were taken out in several countries for legal and tax reasons.

The remaining 2005 acquisition amount of approximately 0.3 billion related primarily to expenses incurred in connection with a license agreement and a co-marketing and distribution agreement. After divesting its product rights concerning the active ingredient fipronil (see below), Bayer signed an agreement with BASF at the end of January 2005 to license back fipronil for agricultural uses in certain countries outside Europe, the United States and Brazil. The transaction has been approved by the relevant authorities. In July 2005, Bayer acquired marketing rights for the cardiovascular drug *Zetia*® under a co-marketing and distribution agreement with Schering-Plough.

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Our principal divestitures in the past three years were as follows:

In 2003, we sold the remaining parts of the household insecticides business (0.3 billion), our 50 percent interest in PolymerLatex (0.1 billion) and our stake in the biotechnology company Millennium Pharmaceuticals, Inc. (0.3 billion). As part of the conditions imposed by the European, U.S. and Canadian antitrust authorities in connection with the Aventis CropScience acquisition in 2002, a number of active ingredients, especially in the area of insecticides and fungicides, were divested (1.3 billion). In particular, Bayer divested the product rights concerning the active ingredient fipronil in the first quarter of 2003.

In July 2004, we sold, pursuant to contractual obligations, our 15 percent interest in the KWS Saat AG, a seed company acquired as part of Aventis CropScience in 2002.

In 2005, we divested our LANXESS subgroup, our plasma operations and several CropScience operations.

LANXESS: At the end of January 2005, the LANXESS subgroup was spun off and ceased to be part of the Bayer Group. As part of its portfolio realignment, Bayer had combined its former Bayer Chemicals segment (except for Wolff Walsrode and H.C. Starck) with parts of its former Bayer Polymers business to form the LANXESS subgroup with economic effect from July 1, 2004. Those portions of our business that were combined into our LANXESS subgroup and subsequently spun off are shown as discontinued operations in accordance with International Financial Reporting Standard (IFRS) 5. For further information on IFRS 5 and the treatment of LANXESS for reporting purposes, please refer to Item 5, *Operating and Financial Review and Prospects Operating Results 2003, 2004 and 2005 Discontinued Operations* and Note 7.2 to the consolidated financial statements contained elsewhere in this annual report.

Plasma: At the end of March 2005, Bayer divested the U.S. plasma operations of its former Biological Products division to two U.S. financial investors (approximately 0.2 billion). All plasma activities in the United States were transferred to Talecris BioTherapeutics, Inc. (Talecris), a corporation newly formed by the two investors. To account for the final agreements signed at the end of March 2005, we adjusted the previous year s presentation to show the continued non-U.S. marketing and distribution activities as part of the continuing operations. In our financial statements for 2005, only the U.S. plasma business is reflected in discontinued operations. Revenues from our marketing and distribution activities for plasma products outside the United States are reflected in sales from continuing operations of our Pharmaceuticals, Biological Products segment. The comparative periods 2004 and 2003 have been adjusted to reflect the inclusion of non-U.S. distribution in continuing operations. For further details on the treatment of our plasma operations for reporting purposes, please refer to *Bayer HealthCare Pharmaceuticals, Biological Products;* Item 5, *Operating and Financial Review and Prospects Operating Results 2003, 2004 and 2005 Discontinued Operations;* and Note 7.2 to the consolidated financial statements contained elsewhere in this annual report.

The Bayer CropScience subgroup divested a number of operations in 2005 for an aggregate selling price of approximately 80 million. These included the subsidiaries Philagro Holding S.A., France, and EqSeeds Comercia de Sementes Ltda., Brazil, as well as the location in Hauxton, UK. Bayer CropScience also divested the businesses relating to the manufacturing and marketing of certain active ingredients used by the Crop Protection business units and the Environmental Science business group, including the acaricide and insecticide amitraz (*Mitac*®).

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BUSINESS

We are a global company offering a wide range of products, including ethical pharmaceuticals, diagnostics and other health care products, agricultural products and polymers. Bayer AG is headquartered in Leverkusen, Germany and is the management holding company of the Bayer Group, which includes approximately 280 consolidated subsidiaries.

Following the spin-off of the LANXESS subgroup in January 2005, our business operations are organized in three subgroups:

Bayer HealthCare (consisting of four segments: Pharmaceuticals, Biological Products (renamed Pharmaceuticals as of January 1, 2006); Consumer Care; Diabetes Care, Diagnostics; and Animal Health) develops, produces and markets:

- prescription pharmaceuticals and biological products;
- over-the-counter medications and nutritional supplements;
- diagnostic products for laboratory testing, near-patient testing and self-testing applications; and
- veterinary medicines, nutritionals and grooming products for companion animals and livestock.

Bayer CropScience (consisting of the Crop Protection segment and the Environmental Science, BioScience segment):

- develops and markets a comprehensive portfolio of fungicides, herbicides, insecticides and seed treatment products to meet a wide range of regional requirements; and
- develops and markets a wide range of products for the green industry, garden care, non-agricultural pest and weed control and conventional seeds, and is active in plant biotechnology.

Bayer MaterialScience (comprising the Materials segment and the Systems segment) primarily develops, manufactures and markets:

- high-quality plastic granules, methylcellulose, metallic and ceramic powders and semi-finished products; and
- polyurethanes for a wide variety of applications as well as coating and adhesive raw materials and basic inorganic chemicals.

The following service organizations provide support functions to the three subgroups, Bayer AG and third parties:

Bayer Technology Services, which provides engineering functions such as process development, process and plant engineering, construction and optimization.

Bayer Business Services, which provides information management, accounting, consulting and administrative services.

Bayer Industry Services, which operates the Bayer Chemical Park network of industrial facilities in Germany and provides site-specific services in the areas of technology, environmental protection, waste management, utility supply, infrastructure, safety, chemical analysis and vocational training to Bayer and non-Bayer companies. Bayer Industry Services GmbH & Co. OHG is held by Bayer AG (60 percent) and by LANXESS (40 percent).

Our strategic alignment on core competencies should enable us to increase investment in growth businesses and innovative technologies. We expect that this will allow us to play a leading role in these markets and to expand our current strong positions. We intend to optimize the allocation of resources as well as continue with our cost-saving and efficiency-improvement programs in order to increase Bayer s corporate value over the long term.

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Bayer s long-term strategy and activities are guided by the role of a socially and ethically acting corporate citizen and the principles of sustainable development, whose objectives are to meet the economic, ecological and social needs of today s society without compromising the ability of future generations to meet their own needs. We contribute to sustainable development by participating in the worldwide *Responsible Care*® initiative developed by companies in the global chemical industry.

For the year ended December 31, 2005, Bayer reported total sales from continuing operations of 27,383 million, an operating result from continuing operations of 2,812 million and net income of 1,597 million. As of December 31, 2005, we employed 93,700 people worldwide. Based on customers location, Bayer s activities in Europe accounted for 43 percent of the Group s total sales in 2005; North America for 27 percent; the Asia/Pacific region amounted to 17 percent; and the Latin America/ Africa/Middle East region accounted for 13 percent of total sales.

The LANXESS spin-off in early 2005 and the acquisition of Roche s Consumer Health business led to a shift in the relative sizes of our businesses in terms of sales, operating result and assets. We therefore changed our segment structure and reporting with effect from January 1, 2005. We restated our segment reporting for 2003 and 2004 to correspond to the new structure in compliance with IAS 14 (Segment Reporting). The changes in our segments are as follows: The former Consumer Care, Diagnostics segment was divided into the Consumer Care segment (consisting of the historical Consumer Care business and the acquired Roche Consumer Health business) and the Diabetes Care, Diagnostics segment (consisting of our Diabetes Care and Diagnostics divisions). The former CropScience segment was divided into the Crop Protection segment (consisting of the strategic business units Insecticides, Fungicides, Herbicides and Seed Treatment) and the Environmental Science, BioScience segment (consisting of our business groups Environmental Science and BioScience).

The following table shows external sales from Bayer s continuing business activities by subgroup and reporting segment, with a reconciliation to the Bayer Group.

	2003	Percentage of total sales	2004	Percentage of total sales	2005	Percentage of total sales
			(Euros in millions)			
HealthCare	**8,497**	**37.9**	**8,058**	**34.6**	**9,429**	**34.4**
Pharmaceuticals, Biological Products[(a)]	4,371	19.5	3,961	17.0	4,067	14.9
Consumer Care	1,403	6.3	1,336	5.7	2,355	8.6
Diabetes Care, Diagnostics	1,933	8.6	1,975	8.5	2,151	7.9
Animal Health	790	3.5	786	3.4	856	3.0
CropScience	**5,764**	**25.7**	**5,946**	**25.5**	**5,896**	**21.5**
Crop Protection	4,801	21.4	4,957	21.3	4,874	17.8
Environmental Science, BioScience	963	4.3	989	4.2	1,022	3.7
MaterialScience	**7,453**	**33.2**	**8,597**	**36.9**	**10,695**	**39.1**
Materials	2,777	12.4	3,248	13.9	4,086	14.9
Systems	4,676	20.8	5,349	23.0	6,609	24.2
Reconciliation	703	3.2	677	3.0	1,363	5.0
Total Sales from Continuing Operations[(b)]	**22,417**	**100.0**	**23,278**	**100.0**	**27,383**	**100.0**

[(a)] With effect from January 1, 2006, the former Pharmaceuticals, Biological Products segment has been renamed the Pharmaceuticals segment.

(b) In accordance with new accounting standard IFRS 5 and other related standards, the financial information presented in this annual report only includes the continuing operations of the Bayer Group and its segments, except where specific reference is made to discontinued operations. Our revenues from discontinued operations were 627 million in 2005, 6,480 million in 2004 and 6,150 million in 2003.

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BAYER HEALTHCARE

PHARMACEUTICALS, BIOLOGICAL PRODUCTS

Overview

During the period to which this annual report relates, our Pharmaceuticals, Biological Products segment consisted of the Pharmaceuticals division and the Biological Products division. Effective January 1, 2006, the segment was renamed the Pharmaceuticals segment. It continues to contain all of the businesses that were formerly included in the Pharmaceuticals and Biological Products divisions (other than our U.S. plasma business, which has been divested as described below). The segment is now divided into the three business units Oncology, Primary Care and Hematology/ Cardiology, with all of the remaining activities from the former Biological Products division forming part of the Hematology/ Cardiology business unit. We continue to use the name Pharmaceuticals division when describing the current operations of the businesses that are part of our Pharmaceuticals segment for reporting purposes. Because the reorganization occurred after the end of the fiscal year to which this annual report relates, we refer to the segment and its divisions under their old names whenever we refer to past activities or financial performance.

The segment focuses on the development and marketing of ethical pharmaceuticals, *i.e.*, medications requiring a physician s prescription and sold under a specific brand name, and the development of recombinant protein therapies.

At the end of March 2005, Bayer divested the U.S. plasma operations of its Biological Products division to two U.S. financial investors, Cerberus Capital Management, L.P., New York, New York and Ampersand Ventures, Wellesley, Massachusetts. The newly-formed entity, named Talecris BioTherapeutics, Inc., began operations on April 1, 2005. The agreement covers the products, facilities and employees representing the plasma portion of the division. Key products include *Polyglobin*®, *Gamimune*® *N, Gamunex*® and *Prolastin*®. The remaining portion, consisting of our *Kogenate*® business, is not affected by this agreement and, effective January 1, 2006, forms part of our Pharmaceuticals division. To account for the final agreements signed at the end of March 2005, we adjusted the previous year s presentation to show the continued non-U.S. marketing and distribution activities as part of the continuing operations. In our financial statements for 2005 only the U.S. plasma business is reflected in discontinued operations. Revenues from our marketing and distribution activities for plasma products outside the United States are reflected in sales from continuing operations of our Pharmaceuticals, Biological Products segment. The comparative periods 2004 and 2003 have been adjusted to reflect the inclusion of non-U.S. distribution in continuing operations. For further information refer to Item 5, *Operating and Financial Review and Prospects Operating Results 2003, 2004 and 2005 Discontinued Operations.*

The following table shows the segment s performance for the last three years.

	2003	2004	2005
	(Euros in millions)		
External net sales	4,371	3,961	4,067
Percentage of total sales	19.5	17.0	14.9
Intersegment sales	42	38	58
Operating result	(16)	399	475
thereof special items[(a)]	(515)	(53)	(140)

[(a)] The significant special items are detailed in Item 5, *Operating and Financial Review and Prospects Operating Results 2003, 2004 and 2005 Segment Data.*

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The segment s sales by region for the past three years are as follows.

	2003	2004	2005
	(Euros in millions)		
Europe	1,412	1,577	1,600
North America	1,817	1,172	1,129
Asia/Pacific	804	851	900
Latin America/ Africa/Middle East	338	361	438
Total	4,371	3,961	4,067

Our Pharmaceuticals business unit generated 3,108 million in 2005, 3,166 million in 2004 and 3,635 million in sales in 2003, whereas our Biological Products business unit (not including our former U.S. plasma operations) generated 959 million 2005, 795 million in 2004 and 736 million in 2003. The following table shows our sales during the past three years from the products that account for the largest portion of segment sales.

	2003		2004		2005	
Product	**Sales**	**Percentage of Segment Sales**	**Sales**	**Percentage of Segment Sales**	**Sales**	**Percentage of Segment Sales**
	(Euros in millions)		**(Euros in millions)**		**(Euros in millions)**	
Kogenate®	497	11.4	563	14.2	663	16.3
Adalat®	676	15.5	670	16.9	659	16.2
Ciprobay®*/Cipro*®	1,411	32.3	837	21.2	525	12.9
Avalox®*/Avelox*®	299	6.8	318	8.0	364	9.0
Glucobay®	273	6.2	278	7.0	295	7.2
Levitra®	144	3.3	193	4.9	260	6.4
Trasylol®	157	3.6	171	4.3	230	5.7
Aspirin®[(a)]	111	2.5	147	3.7	177	4.3
Other	803	18.4	784	19.8	894	22.0
Total	4,371		3,961		4,067	

(a) *CardioAspirin* is also distributed by our Consumer Care division. These figures do not include sales by the Consumer Care division.

Segment Strategy

Our goal is to transform the segment into a specialty business, *i.e.*, a business that markets to specialists rather than general practitioners, with a focus on diseases that have a great need for improvement in diagnosis and treatment, especially in the fields of hematology, cardiology and oncology with our products *Kogenate*®, *Trasylol*® and

Nexavar®. These therapeutic areas are also the main focus of our research and development activities where we have several promising products in development, such as our Factor Xa inhibitor BAY 59-7939. See Item 5, *Operating and Financial Review and Prospects Research and Development.*

A major step in our transformation into a specialty business was the launch of *Nexavar*® for the treatment of advanced kidney cancer in the United States at the end of 2005. This treatment has also been submitted to regulatory authorities in Europe and other regions and is in late development phases for other cancers with unmet medical needs.

Another major step in our transformation into a specialty business, which illustrates the adaptation of our marketing strategy to fit our regional and product market strengths, is the marketing alliance with Schering-Plough in the U.S. primary care market. In this alliance formed in 2004, Schering-Plough markets and sells several of our primary care products in the United States, allowing our U.S. organization to focus on specialty

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products. Outside the United States, we intend to expand our specialty business to all major geographic regions, where we continue to have a strong presence in the primary care market with the growing products *Avelox*® and *Levitra*®, as well as with established products like *Adalat*®, *Glucobay*® and *Cipro*®.

Life cycle management, licensing activities and alliances continue to be major elements of our strategy. We use these business development activities in addition to R&D to strengthen our portfolio. *See* Item 5, *Operating and Financial Review and Prospects Research and Development*. Examples of licensing activities are the collaboration with Nuvelo on the development and commercialization of alfimeprase, a novel thrombolytic drug (blood clot dissolver) currently in Phase III development, and the acquisition of marketing rights from GlaxoSmithKline for the antihypertensive product *Pritor*® in certain European countries. These agreements are aimed at strengthening our cardiovascular specialty and primary care franchises, respectively.

Major Products

Adalat® is the brand name for nifedipine, a representative of the dihydropyridine class of calcium antagonists. Calcium plays an important role in the body s regulation of blood pressure and the supply of blood to the heart tissues. Calcium antagonists can reduce blood pressure and improve blood supply to heart tissue.

Ciprofloxacin, marketed under the trademark *Cipro*®, mainly in the United States, and *Ciproxin*®, *Ciproxine*®, *Ciprobay*®, *Ciproxina*®, *Baycip*®, *Ciflox*® and *Uniflox*® in other countries, is a broad-spectrum antimicrobial agent of the fluoroquinolone class. *Cipro*® s main uses are in the treatment of urinary tract infections and in severe hospital infections. It is also approved for the treatment of anthrax. In June 2004, market exclusivity for the active pharmaceutical ingredient in *Cipro*® expired in the United States.

Moxifloxacin, marketed under the trade name *Avelox*®, mainly in the United States, and *Avalox*®, *Izilox*®, *Actira*® and *Octegra*® in other countries, is an antibiotic used to treat common bacterial respiratory tract infections. It is indicated for the treatment of community-acquired pneumonia, acute exacerbations of chronic bronchitis, acute sinusitis and uncomplicated skin and skin structure infections.

Acarbose, marketed under the trademark *Glucobay*®, *Glucor*® in most countries, *Precose*® (in the United States) and *Prandase*® (mainly in Canada) is an oral antidiabetic product that delays carbohydrate digestion. *Glucobay*® improves metabolic control in diabetics alone or in combination with other antidiabetic drugs.

Vardenafil, our erectile dysfunction medication marketed under the trade name *Levitra*®, is marketed in the United States in co-operation with GlaxoSmithKline and Schering-Plough. We also jointly perform life cycle management with these companies.

CardioAspirin (*e.g.*, *Aspirin*® *Protect* in Germany and *Aspirin Regimen Bayer* in the United States) refers to Bayer s collective group of products (distributed by both our Consumer Care and Pharmaceuticals divisions depending on whether local regulations require a prescription for these products) that are professionally indicated for the prevention of an MI (myocardial infarction or heart attack) in either those individuals who have already had an initial MI (secondary prevention) or in individuals deemed at risk for a first MI by their physician (primary prevention).

Kogenate® *FS* (*Kogenate*® *Bayer* in the EU) is a genetically-engineered recombinant version of the protein FVIII. Patients with Hemophilia A cannot produce sufficient FVIII, and their blood therefore cannot clot properly. Physicians use both plasma-derived and recombinant FVIII to treat Hemophilia A. Because recombinant products like *Kogenate*® do not derive from human donors, the risk that their users will inadvertently contract infections, such as HIV, hepatitis or those caused by other viruses occasionally present in plasma-derived products, is greatly reduced.

We supply recombinant FVIII to ZLB Behring, which markets it under the brand name *Helixate*® *FS*.

For further information regarding the discontinued plasma business, please refer to the introduction to *Business*.

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Trasylol® Aprotinin, marketed under the trademark *Trasylol*®, is a natural proteinase inhibitor obtained from bovine lung tissue. Used prophylactically, it reduces blood loss during coronary bypass surgery, reducing the patient s need for blood transfusions.

In January 2006, two studies published in the medical literature reported an association of *Trasylol*® (aprotinin) with an increased risk of serious renal dysfunction and cardiovascular/ cerebrovascular events (heart failure and stroke) in patients undergoing open-heart surgery.

The first, a study by Mangano et al. (New England Journal of Medicine, January 2006), studied patients undergoing coronary artery bypass graft (CABG) surgery who received either aprotinin or one of two other drugs intended to decrease perioperative bleeding. The study reported an association of aprotinin with an increased risk of cardiovascular events (myocardial infarction or heart failure), cerebrovascular events such as stroke, encephalopathy or coma, and renal dysfunction or failure in these patients. The increases in renal failure, myocardial infarction, congestive heart failure and stroke or encephalopathy reported by the authors are not consistent with Bayer s data from randomized, placebo-controlled clinical trials of *Trasylol*®.

The second, a study by Karkouti et al. (Transfusion, On-Line Edition) reported an association of aprotinin with renal dysfunction and renal failure. Renal dysfunction and renal failure have previously been reported with *Trasylol*®. The data on renal function in patients receiving *Trasylol*® in Bayer s clinical trials are reflected in the approved labeling for *Trasylol*®. The findings by Karkouti et al., specifically that there was a statistically significant increased rate of serum creatinine elevations in the aprotinin group, is at variance with Bayer s own experience in randomized, placebo-controlled clinical trials of *Trasylol*®. Karkouti et al. did not find an increased rate of cardiovascular or cerebrovascular events in *Trasylol*®-treated patients and reported comparable mortality rates between the control treatment group and the *Trasylol*® group.

Relevant regulatory authorities are currently reviewing these reports. Based upon the results of these reviews, the authorities will determine what actions may be warranted. Negative findings or the negative publicity associated with the studies or the regulatory review could lead to a material reduction in the volume of *Trasylol*® sales, and this could have a material adverse affect on revenues or results of operations, at least at the segmental level. Bayer has been working and will continue to work closely with regulatory authorities worldwide to address questions of product safety.

Markets and Distribution

The Pharmaceuticals division s principal markets are North America, Western Europe and Asia (especially Japan).

We do not experience any significant seasonality in our markets for the division s products.

We generally distribute our products through wholesalers, pharmacies and hospitals as well as, to a certain extent, directly to patients. Where appropriate, we actively seek to supplement the efforts of our sales force through co-promotion and co-marketing arrangements. In November 2001, we entered into a co-promotion agreement with GlaxoSmithKline for *Levitra*® (Vardenafil), our erectile dysfunction medication. In January 2005, we terminated the *Levitra*® co-promotion agreement with GlaxoSmithKline in most of the world outside of the United States. This enables us to exercise the marketing rights ourselves. In September 2004, we entered into a strategic alliance with Schering-Plough. In this alliance, Schering-Plough markets and distributes selected primary care pharmaceutical products in the United States, including *Cipro*®, *Avelox*® and *Levitra*®. Furthermore, we are co-promoting selected Schering-Plough oncology products for a certain period of time in the United States and selected major European markets, *e.g.*, in Germany, France and Italy. Both parties intend to cooperate in marketing Schering-Plough s *Zetia*® in Japan after its approval by the Japanese regulatory authorities.

In October 2005, we entered into a strategic alliance with Ortho-McNeil Pharmaceutical Inc., a Johnson & Johnson subsidiary. In this alliance, Ortho-McNeil will contribute to the development of BAY 59-7939 and will later market and distribute BAY 59-7939 in the United States. BAY 59-7939 is an oral direct Factor Xa inhibitor, being developed to meet currently unmet clinical needs in the anticoagulation market for the prevention and treatment of thrombotic events. In addition, Bayer will co-promote Johnson & Johnson s *Elmiron*® in the United States.

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We produce the active ingredients for our ethical pharmaceutical products almost entirely in Wuppertal, Germany. Recombinant FVIII products are made at our facility in Berkeley, California, under an exclusive license from Genentech. Bayer facilities in countries around the world compound our raw materials and package the finished product for shipment. Our main pharmaceutical production facilities are in Leverkusen, Germany; Berkeley, California; Garbagnate, Italy; Rosia, Italy and Shiga, Japan.

We obtain raw materials for our active ingredients in ethical pharmaceuticals in part from our former LANXESS subgroup and the rest from third parties mainly in Europe and Asia. For our *Kogenate*® product, we obtain raw materials and packaging materials from diverse third-party suppliers in various countries around the world. As a rule, we approve our suppliers for each required material. For the production of *Kogenate*® we use human albumin sourced from Talecris for the nutrition of the cell lines.

We maintain strategic reserves of many of our key products to avoid shortages upon any breaks in the supply chain. Where a required material is available from only one supplier, our policy is to amass a strategic reserve, while mounting an intensive search for potential alternative suppliers. We obtain additional ingredients and packaging materials from diverse suppliers in various countries around the world. For building blocks and intermediates, used to manufacture active ingredients in ethical pharmaceuticals, we either approve several suppliers or enter into global contracts. This also helps us to reduce the effects of price volatility.

We encounter competition in all of our geographical markets from large national and international competitors, such as:

antibacterial products: Pfizer, GlaxoSmithKline and Abbott Laboratories;

hypertension and coronary heart disease therapy: Pfizer, Novartis, AstraZeneca and Merck & Co.;

oral antidiabetics: Takeda, GlaxoSmithKline, Aventis and Bristol-Myers Squibb;

blood coagulation: Baxter, Wyeth and ZLB Behring; and

erectile dysfunction: Pfizer and Eli Lilly.

Research and Development

Bayer HealthCare allocates the largest part of its research and development budget to the Pharmaceuticals division. Within this division, the Pharmaceuticals Research & Development department was divided into the Global Drug Discovery and the Global Development & Compliance units effective January 1, 2006. The restructuring measure is intended to direct research and development more intensively toward obtaining early evidence of efficacy in humans (also called proof of concept). The Research Center in West Haven, Connecticut focuses on oncology and activities in the Wuppertal Pharmaceuticals Center are concentrated on cardiovascular research. The division s main research and development facilities for *Kogenate*® are located in Berkeley, California.

Bayer HealthCare is carving out the anti-infectives research unit of its Pharmaceuticals division into a new company in which Santo Holding (Deutschland) AG of Stuttgart, Germany, will own a majority share. Bayer HealthCare will retain a minority share of 12 percent. The carve-out is expected to close in March 2006.

Life Cycle Management

We apply life cycle management measures to our marketed products to expand the scope of possible treatment opportunities by identifying new indications and improved formulations. *Adalat*® is a prime example of successful life cycle management: nineteen years after the patent protection for the active ingredient nifedipine, its key component, expired, the drug generated 659 million in sales in 2005. Similarly, we are implementing life cycle management measures, such as improved formulations and dosage forms or identifying new indications, for other major products.

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Phase II/III Trials

BAY 59-7939 is an oral direct Factor Xa inhibitor, being developed to meet currently unmet clinical needs in the anticoagulation market for prevention and treatment of thrombotic events. Phase III trials were initiated in December 2005 for the prevention of venous thromboembolism (VTE) after major orthopedic surgery. In chronic indications (VTE treatment, stroke prevention in patients with arterial fibrillation) Phase II trials are ongoing. In October 2005, Bayer HealthCare (BHC) and the Johnson & Johnson subsidiary Ortho-McNeil entered into an alliance under which Ortho-McNeil contributes to the development of BAY 59-7939.

At the end of 2005, the FDA granted U.S. approval for the anti-cancer drug *Nexavar*® (sorafenib), co-developed by Bayer HealthCare and Onyx Pharmaceuticals, Inc., for the treatment of patients with advanced renal cell carcinoma. *Nexavar*® is a novel multi-kinase inhibitor that targets serine/ threonine and receptor tyrosine kinases in both the tumor cell and the tumor vasculature. It has been shown to double progression free survival in patients with advanced renal cell carcinoma. BHC has also filed for regulatory approval with the European Medicines Evaluation Agency (EMEA) for the treatment of advanced renal cell carcinoma. In the first half of 2005, Phase III trials for the treatment of hepatocellular carcinoma and malignant melanoma were initiated. The launch of an additional Phase III program for the treatment of non-small cell lung cancer (NSCLC) was announced in December 2005. Other tumor types are under investigation in earlier stages of clinical development.

Drug candidates in Phase II/III of clinical development are listed in the following table with their respective indications:

Project	**Indication**	**Status**
Factor Xa inhibitor	VTE prevention,	In Phase III
	VTE treatment,	In Phase II
	Stroke prevention in patients with atrial fibrillation	
Nexavar®	Advanced renal cell carcinoma,	FDA approval
	Hepatocellular carcinoma,	In Phase III
	Malignant melanoma, NSCLC,	
	First line renal cell carcinoma	In Phase II
Trasylol® (aprotinin injection)	Hematology (Hip-surgery, Spinal-surgery)	In Phase III
Alfimeprase	Acute peripheral arterial occlusion (PAO)/catheter occlusion (CO)	In Phase III

The listed compounds represent a snapshot of the Bayer pipeline. The nature of drug discovery and development is such that not all compounds can be expected to meet the pre-defined project target profile, so it is possible that the above listed projects under clinical development may have to be discontinued due to scientific and/or commercial reasons and will not result in marketed products. It is also possible that the requisite FDA, EMEA or other regulatory approval will not be granted for our compounds described above.

Kogenate®

Key research and product development projects involving our *Kogenate*® product are *Kogenate*® *Next Generation* and *Kogenate*® *Bio-Set*®, as well as gene therapy for hemophilia B.

Kogenate® *Next Generation*

We have also identified five constructs for potential development of products under the umbrella *Kogenate*® *Next Generation.* Evaluation of proteins as well as technology is ongoing. Optimization of candidates is expected to be completed by the end of 2006.

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In June 2003, Bayer signed an exclusivity agreement with Opperbas Holding B.V. for use of their proprietary Liposome formulation for *Kogenate® FS*. Following signing of a license agreement with Zilip-Pharma, a subsidiary of Opperbas Holding B.V., in the fourth quarter of 2004, Bayer has begun Phase I clinical studies in the United States for BAY 79-4980 (*Kogenate®-FS* reconstituted with pegylated liposome diluent) under an Investigational New Drug application process (IND) filed by Bayer in April 2005 and accepted by the FDA.

Kogenate® FS Bio-Set® Delivery System

Kogenate® with *Bio-Set®* is a recombinant Factor VIII with a self-contained system that includes a needleless reconstitution device that avoids the risk of accidental needlestick injuries during reconstitution. In May 2005, a Phase I global trial was initiated in several European countries. Canada introduced *Bio-Set®* in September 2005 and trials in other European markets were launched in the fourth quarter of 2005. The United States launched *Bio-Set®* in January 2006. Japan is planning the introduction of *Bio-Set®* for the first quarter of 2006.

Gene Therapy

Finally, on May 18, 2005, Bayer entered into an early stage research and collaboration agreement to develop gene therapy for the treatment of Hemophilia with Askleplos Biopharmaceutical Inc.

Bayer HealthCare posts information on clinical trials on the internet

Bayer HealthCare posts information on the clinical trials being conducted by its Consumer Care and Pharmaceuticals divisions on the internet. The database is intended to increase the transparency of the clinical trials for physicians, scientists and other interested parties. This measure is consistent with the recommendations in the position paper issued by pharmaceutical associations in Europe, Japan and the United States, and the International Federation of Pharmaceutical Manufacturers and Associations.

Collaborations

Research Collaborations

To supplement our internal research and development efforts, we collaborate with several companies in different stages of the typical pharmaceutical research cycle. Our more significant collaborations are described in the table below.

Research Cycle	Discipline/ Technique	Research Company
Understanding the disease mechanism and identifying new targets	Functional genomics (*functional analysis of genetic data*)	Affymetrix, CuraGen
Screening the candidate substances	High-throughput screening (*rapid, automated testing of compounds for potential effectiveness against a given target*)	Axxam
Increasing the pool of potential drug candidates by small-chemical molecules and macromolecules (proteins, peptides)	Pharmacophore informatics Pool of Bayer biomolecules (*for example, monoclonal antibodies and conjugates*)	MetaKey Software Morphosys; Seattle Genetics

Our collaboration with LION Bioscience was terminated in 2004.

CuraGen

In 2001, CuraGen agreed to provide drug targets during an initial five-year period. The goal is to identify drug candidates for obesity and diabetes treatment for clinical development over a 15-year period. Our agreement

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provided that, during this period, we will share the expenses of pre-clinical and clinical development. Effective October 31, 2005, Bayer and CuraGen revised the agreement in that with respect to BAY 76-7171, CuraGen will no longer contribute to the ongoing development costs and revert to a tiered royalty structure on any BAY 76-7171 product sales.

Product Development Collaborations

The major collaborations in the area of product development are described below:

Onyx

Bayer and Onyx are co-developing *Nexavar*®, a novel Raf Kinase and VEGFR inhibitor that is intended to prevent tumor growth by combining two anti-cancer activities: inhibition of tumor cell proliferation and tumor angiogenesis. This collaboration results in Onyx funding 50 percent of the development costs for this compound except for Japan. In return, Onyx has a 50 percent profit share in the United States, where the companies may co-promote the product. In all markets outside Japan, Bayer has the right to market the product exclusively and will share profits equally with Onyx. In Japan, Bayer will develop and market the product exclusively and Onyx will receive a royalty.

Schering-Plough

In September 2004, Bayer entered into a strategic alliance with Schering-Plough. The alliance also includes cooperation in life cycle management mainly for *Avelox*® and *Levitra*®. See *Markets and Distribution.*

GlaxoSmithKline

Vardenafil, the active ingredient of *Levitra*®, researched by Bayer, is being marketed in cooperation with GlaxoSmithKline and Schering-Plough in the United States. The cooperation also includes life cycle management. In January 2005, we terminated our *Levitra*® co-promotion agreement with GlaxoSmithKline in most of the world outside of the United States in order to exercise the marketing rights ourselves.

Johnson & Johnson

Bayer HealthCare and Ortho-McNeil, a subsidiary of Johnson & Johnson, have concluded an agreement in October 2005 to develop and market BAY 59-7939 (Factor Xa inhibitor) for the prevention and treatment of thrombosis.

In-licensing activities

We supplement our portfolio of products emerging from our own research and development with in-licensed products, both on a global and a national level. Recent examples are the purchase of the European business for Boehringer Ingelheim s blood pressure treatment telmisartan (*Prito*® and *PritorPlus*®) from GlaxoSmithKline in January 2006. Also in January 2006, we entered into an agreement with Nuvelo, Inc. for the global development and commercialization of alfimeprase, a novel clot dissolver, which is currently in Phase III development and received Fast track status by the FDA in January 2006. Bayer will have the right to market the drug, once approved by the competent authorities, in all countries except the United States.

CONSUMER CARE

Overview

As further explained in the introduction to *Business,* we have changed our segment reporting with effect from January 1, 2005. The former Consumer Care, Diagnostics segment was divided into the Consumer Care segment (identical to the Consumer Care division, consisting of the hitherto existing Consumer Care business and the acquired Roche Consumer Health business) and the Diabetes Care, Diagnostics segment (consisting of our Diabetes Care and Diagnostics divisions). Our Consumer Care segment develops and markets over-the-counter

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(OTC) medications (analgesics, cough and cold, dermatological and gastrointestinal remedies), as well as vitamin and nutritional supplements.

The following table shows the segment s performance in the last three years. Segment data for 2003 and 2004 have been restated to reflect the presentation of Diagnostics and Diabetes Care as part of a new segment.

	2003	2004	2005
		(Euros in millions)	
External net sales	1,403	1,336	2,355
Percentage of total sales	6.3	5.7	8.6
Intersegment sales	7	16	14
Operating result	486	183	174
thereof special items[(a)]	288	(30)	(118)

(a) The significant special items are detailed in Item 5, *Operating and Financial Review and Prospects Operating Results 2003, 2004 and 2005 Segment Data.*

The segment s sales by region for the past three years are as follows. Segment data for 2003 and 2004 have been restated to reflect the presentation of Diagnostics and Diabetes Care as part of a new segment.

	2003	2004	2005
		(Euros in millions)	
Europe	387	401	1,019
North America	668	616	665
Asia/Pacific	56	40	132
Latin America/ Africa/Middle East	292	279	539
Total	1,403	1,336	2,355

The following table shows our sales during the past three years from the products that account for the largest portion of segment sales.

	2003		2004		2005	
Product	**Sales (Euros in millions)**	**Percentage of Segment Sales**	**Sales (Euros in millions)**	**Percentage of Segment Sales**	**Sales (Euros in millions)**	**Percentage of Segment Sales**
Aspirin®[(a)]	463	33.0	454	34.0	453	19.2
Aleve®*/Naproxen*[(b)]	88	6.3	90	6.7	178	7.6
Canesten®	135	9.6	140	10.5	145	6.2
Supradyn®[(c)]					125	5.3

One-A-Day®	130	9.3	127	9.5	118	5.0
Other	587	41.8	525	39.3	1,336	56.7
Total	1,403		1,336		2,355	

(a) *CardioAspirin* is also distributed by our Pharmaceuticals division. These figures do not include sales by the Pharmaceuticals division.

(b) As the product *Aleve*® was part of the former U.S. joint venture with Roche, sales figures for 2003 and 2004 only represent the Bayer portion of the joint venture s sales. 2005 sales figures represent total sales of the product after the acquisition of the remaining 50 percent of the U.S. joint venture. *Naproxen* is the active ingredient included in products marketed in the United States under the brand *Aleve*® and in other countries using different local brands, the latter having been acquired as part of Roche s Consumer Health business in 2005.

(c) Acquired as part of Roche s Consumer Health business in 2005.

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Segment Strategy

The objective of our Consumer Care division is to further consolidate our strong global position in the Consumer Health market.

Building on our successful acquisition and integration of the Roche Consumer Health business, the key element of our strategy is to exploit organic growth potential within our significant Consumer Health categories by leveraging the strength of our well-known brands (including *Aspirin*®, *Supradyn*®, *One-A-Day*®, *Canesten*® and *Bepanthen*®), as well as through cross-fertilization of the Bayer/ Roche portfolios, portfolio prioritization and a focus on marketing.

We also intend to drive growth in high growth regions of the world (such as Eastern Europe and Asia-Pacific) and develop business in new and emerging growth areas. We will also pursue external growth opportunities through acquisitions and licensing with appropriate strategic fit.

Major Products

Analgesics

The analgesics market comprises pain relief products both in oral form (for example, pills and tablets) and for topical use (for example, ointments and salves). We concentrate primarily on the oral products segment. Our Consumer Health products face competition from prescription drugs, for example cyclooxygenase (COX-II) inhibitor pain relievers and prescription non-steroidal anti-inflammatory drugs (NSAIDs).

Aspirin® (*Bayer*® brand aspirin in the United States) is a non-steroidal anti-inflammatory drug (NSAID). It is used for pain relief and, in countries where so indicated, for the prevention of heart attacks. *Aleve*® (also known as *Flanax*® and *Apronax*® in some Latin American countries) is a nonprescription strength version of the analgesic naproxen sodium. *Aleve*® is a long-lasting pain reliever and can be used for fever reduction. Our *Midol*® product family competes in the menstrual pain relief category.

CardioAspirin (see Pharmaceuticals, Biological Products Major Products)

CardioAspirin (*e.g.*, *Aspirin*® *Protect* in Germany and *Aspirin Regimen Bayer* in the United States) refers to Bayer s collective group of products (distributed by both our Consumer Care and Pharmaceuticals divisions depending on whether local regulations require a prescription for these products) that are professionally indicated for the prevention of an MI (myocardial infarction, or heart attack) in either those individuals who have already had an initial MI (secondary prevention) or in individuals deemed at risk for a first MI by their physician (primary prevention).

Cough/Cold

Within the total cough and cold market, we concentrate on the cold/flu remedy segment. This Consumer Health category faces competition from non-medicinal remedies (for example, nutritional or herbal products), as well as from preventive medicines available by prescription or under development.

Alka-Seltzer Plus®, marketed in the United States, is a product to relieve symptoms accompanying the common cold. *Tabcin*®, primarily marketed in Latin America, is a product line similar to *Alka-Seltzer Plus*®. *Aleve*® *Cold & Sinus* is a long-lasting combination of analgesic naproxen sodium and nasal decongestant.

Dermatologicals

The dermatological category includes a broad range of skin treatments. Within this market, we focus on the antifungal, wound healing and skin protection categories. Competition in topical dermatologicals ranges from prescription antifungal products to cosmetic emollients and locally marketed generic products and low priced brands.

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Canesten® is a treatment for vaginal yeast infections, athlete s foot and other dermatological fungal problems. *Rid*® is a topical head lice treatment marketed only in the United States. *Bepanthen*® is a topical wound healing brand with a sister brand *Bepanthol*® which is a skin protectant and emollient. These were both acquired in the Roche Consumer Health acquisition.

Gastrointestinals

The gastrointestinal (GI) category includes antacids, anti-gas products, digestives, laxatives and anti-diarrheals.

Alka-Seltzer® is used for speedy relief of acid indigestion, sour stomach or heartburn with headache, or body aches and pains. *Phillips Milk of Magnesia*® is a saline laxative used as an overnight remedy for constipation and acid indigestion, heartburn or sour stomach that may accompany it. *Rennie*® relieves symptoms of indigestion and is typically marketed directly to the consumer. *Talcid*® is used for the relief of symptoms from heartburn and acid indigestion.

Nutritionals

The nutritionals category is very broad, encompassing vitamins, minerals, multi-vitamins/ minerals, herbals, sports nutrition and specialty supplements in many different forms. Applicable regulations vary greatly, both from country to country and across nutritional segments (for example, herbals vs. vitamins). As a general rule, however, regulation of nutritionals tends to be less stringent than that of other Consumer Health products. Bayer s primary interests in the nutritionals field are in the vitamin and mineral (especially multi-vitamins/ minerals) areas.

One-A-Day® multivitamins offer a variety of special formulations, such as Men s, Women s, 50 Plus, Maximum, Essential and WeightSmart™ formulas. *Flintstones*® are multivitamin dietary supplements containing (depending on type) 10-19 essential nutrients for children ages 2-12.

Major vitamin/ mineral brands acquired in the Roche Consumer Health acquisition include *Supradyn*® (a multi vitamin/ mineral brand), *Redoxon*® (a vitamin C brand), and *Berocca*® (a higher potency supplement).

In 2005, we launched various line extensions to our existing brands.

Markets and Distribution

Our Consumer Care division focuses on the Consumer Health market for medicinal products that consumers may generally purchase without a prescription.

The division experiences moderate seasonality, primarily due to the cough/cold market.

The typical sales and marketing channels of the division outside Europe are supermarket chains, drugstores and other mass marketers. In Europe, however, pharmacies are the usual distribution channel.

Consumer Care procures some high-volume raw materials internally from within Bayer HealthCare. Our major externally procured high-volume raw materials are ascorbic acid, citric acid, paracetamol sodium citrate and tartaric acid. These are readily available and are usually not subject to significant price fluctuations. Changes in oil and energy prices can affect a few key items, such as phenol, a basic material for our major ingredient acetylsalicylic acid, and aluminum foil. We diversify our raw materials sources internationally to help balance business risk and generally seek long-term contracts with contract manufacturers. At the moment our major contract manufacturer is F. Hoffmann La Roche, Basle, with whom we have signed a global framework supply agreement as well as a global framework toll manufacturing agreement.

We regard the following companies as our main competitors:

analgesics: Johnson & Johnson, Bristol-Myers Squibb and Wyeth;

cough and cold products: Pfizer, Schering Plough and Novartis;

dermatological products: Johnson & Johnson, Pfizer and Novartis;

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gastrointestinal products: Procter & Gamble, Johnson & Johnson and GlaxoSmithKline; and

vitamins: Wyeth and Merck KGaA.

Research and Development

Consumer Care focuses its development activities on identifying, developing and launching products and initiatives that can contribute to achieving business growth through:

efficient development of new products and indications to support current brands; and

product development, clinical and regulatory strategies, which provide opportunity to capitalize on new technologies, expanded label indications and reclassifications of products from those for which a prescription is required to those dispensed over-the-counter.

The division s primary research and development facilities are located in Morristown, New Jersey and Gaillard, France.

DIAGNOSTICS, DIABETES CARE

Overview

As further explained in the introduction to *Business*, we have adjusted our segment reporting with effect from January 1, 2005. We have restated the segmented financial data for 2003 and 2004 to reflect the new structure. The former Consumer Care, Diagnostics segment was divided into the Consumer Care segment and the Diagnostics, Diabetes Care segment (the latter consisting of our Diagnostics and Diabetes Care divisions).

The following table shows the Diagnostics, Diabetes Care segment s performance in the last three years.

	2003	2004	2005
	(Euros in millions)		
External net sales	1,933	1,975	2,151
Percentage of total sales	8.6	8.5	7.9
Intersegment sales	0	1	1
Operating result	115	217	274
thereof special items[(a)]	(20)	0	34

[(a)] The significant special items are detailed in Item 5, *Operating and Financial Review and Prospects Operating Results 2003, 2004 and 2005 Segment Data*.

The segment s sales by region for the past three years are as follows:

	2003	2004	2005
	(Euros in millions)		
Europe	735	785	848
North America	836	824	893
Asia/Pacific	246	249	277
Latin America/ Africa/Middle East	116	117	133
Total	1,933	1,975	2,151

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The following table shows our sales during the past three years by division:

Division	2003	2004	2005
		(Euros in millions)	
Diagnostics	1,308	1,322	1,433
Diabetes Care	625	653	718
Total	1,933	1,975	2,151

The following table shows our sales during the past three years from the products that account for the largest portion of segment sales.

	2003		2004		2005	
Product	Sales (Euros in millions)	Percentage of Segment Sales	Sales (Euros in millions)	Percentage of Segment Sales	Sales (Euros in millions)	Percentage of Segment Sales
Ascensia®	578	29.9	627	31.7	701	32.6
Advia Centaur®	387	20.0	441	22.3	512	23.8
Rapidlab®/Rapidpoint®	154	8.0	153	7.7	163	7.6
Clinitek® Urinalysis	156	8.1	147	7.4	152	7.1
Advia Hematology®	117	6.0	130	6.6	141	6.6
Other	541	28.0	477	24.3	482	22.3
Total	1,933		1,975		2,151	

Segment Strategy

Diagnostics

The objective of the Diagnostics division is to be a global leader in the markets in which we compete and to pursue above-market profitability growth by being the preferred supplier for clinical laboratories.

Our strategy to achieve this objective is to focus our resources and investments in our high-growth business areas of Immunoassay, Clinical Chemistry, Molecular Testing as well as Lab Automation.

We aim at

focusing on growth in market segments that offer the greatest opportunity;

expanding to reach new groups of customers with our existing products while investing in fast growing markets such as Asia Pacific; and

building customer loyalty by delivering cost efficient systems solutions across all groups of customers we serve.

Diabetes Care

The Diabetes Care division s objective is to realign its core business of blood glucose monitoring (patient testing) to create a sustainable competitive advantage in the Diabetes Monitoring and Management market while allowing Diabetes Care to profitably grow market share.

To achieve our overall goal in the Diabetes Care division, we are expanding our product offering by developing second and third generations of meters and strips that are more intuitive and easier to use, resulting in glucose testing with minimal pain for diabetic patients. We intend to target our marketing efforts in order to direct customers to improved versions of our meters and to increase our competitiveness through continuous improvement of our products, reductions in our costs and operational efficiencies. We also plan to realign our research and development activities and investments. To support our objectives, we intend to continue to develop our strategic partnerships in desired areas of expertise to complement our in-house strengths.

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Diagnostics

Overview

The Diagnostics division is headquartered in Tarrytown, New York. We support customers with an extensive product portfolio of instruments and assays for the Central Clinical Laboratory, Near Patient Testing, Molecular Testing and Home Healthcare. All our products are used to serve patients in the health and the home health care sector.

Major Products

Central Laboratory Testing

The *Advia*® family of products is the centerpiece of our Central Laboratory Testing portfolio, which provides a wide range of solutions for the laboratory. *Advia*® products include medium- and high-throughput systems for immuno-diagnostics (the measurement of such substances as proteins, steroids, drugs and antibodies in patients blood), clinical chemistry, hematology and other diagnostic disciplines. The main analytical systems include *Advia Centaur*®*, Advia Centaur*® *CP* and *Advia*® *1650*. Through our *LabCell*®, *WorkCell*™ and *CentraLink*® products, we provide a broad range of automation and laboratory integration solutions. We are enhancing the attractiveness of our clinical laboratory testing portfolio by introducing new instrument systems and expanding the menu of assays available to the customer.

Near Patient Testing

We provide a variety of solutions for the Near Patient Testing environment, both in the hospital and in physicians office laboratories. For the critical care environment, we offer the *Rapid*™ family of instruments and reagents with its newest addition, the *Rapidlab*® *1200* analyzer, a high throughput, low-maintenance instrument for the measurement of blood gases and electrolytes. In the field of urinalysis, we offer the *Multistix*® family of urine reagent strips for visual reading of up to 10 parameters and the *Clinitek*® line of instruments. We also offer the *DCA 2000*®+ system that provides diagnostic tests for diabetes and kidney disease management.

Molecular Testing

Molecular testing offers a significant virology infectious disease portfolio including quantitative analysis, genotyping and resistance testing. For highly specific testing of infectious diseases, we offer a family of DNA probes under the *Versant*® brand for the testing of HIV, Hepatitis B and Hepatitis C. Molecular techniques detect nucleic acids such as DNA and RNA to allow for effective treatment of infectious and other diseases.

Home Healthcare

Together with Matsushita Electric Industrial Co. Ltd. we established the subsidiary Viterion TeleHealthcare LLC, which markets products and services for the telemedicine sector. Main products are the *Viterion*™ *100 TeleHealth Monitor*, a compact home health care monitor and the *Viterion*™ *500 TeleHealth Monitor*, a comprehensive home health care monitor.

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Products launched in 2005 include the following:

Product/ Brand Name	Principal application	Status[a]
Advia Centaur® menu expansion	Eight new infectious disease assays launched (HCV, HAV IgM & Total, HBc IgM, anti-HBs & HBc Total, HBsAg and HBsAg Confirmatory). Two additional claims for BNP.	Launched throughout 2005
Advia® *1650* and *Advia*® *2400* menu expansion	Nine new drugs-of-abuse assays (cannabinoid (thC), opiate (300 & 2000), benzodiazepine, methadone, phencyclidine, propoxyphene, cocaine, amphetamine and barbiturate).	Launched throughout 2005
Rapidlab® *1200*	High throughput, bench-top analyzer	Launched in July 2005
Advia Centaur® *CP*	Medium throughput, bench-top immunoassay analyzer	Launched in November 2005

[a] The term throughout refers to the fact that there are various versions of the products that were launched at different times throughout the year; launched in refers to a single product.

Markets and Distribution

Our Diagnostics division markets its products both directly and through a network of distributors. Our principal markets are North America, Western Europe and Japan.

Diagnostics division sales are typically lower in the first quarter, but show a slightly stronger performance in the fourth quarter.

We market our Central Laboratory and Molecular Testing products, as well as most of our Near Patient Testing products, directly to customers, who are primarily reference or private laboratories and hospitals. In the Near Patient Testing segment, we market urine chemistry primarily through distributors. We market our Home Healthcare products directly to home health care agencies, disease management companies and the various governmental agencies.

We manufacture or assemble a significant portion of our own products. In order to do so, we rely on a supplier management process to supply raw materials, sub-assemblies and finished goods on an OEM (original equipment manufacturer) basis. Most of our direct materials are readily available commodities. Typically, these materials are not subject to significant changes in price or availability. We do require some direct or OEM materials, for example antigens and blood chemistry systems, for the *Advia*® systems. If these were to become unavailable, the division s results of operations would be impacted. In these instances, we maintain strategic reserves of selected direct materials or finished products to avoid interruptions in our customers continuous and reliable supply.

Our primary competitors are:

Central Laboratory Testing: Roche, Abbott, Beckman Coulter, Dade Behring and Ortho Clinical Diagnostics;

Molecular Testing: Roche, Abbott and Gen-Probe;

Near Patient Testing: Roche, Radiometer, Abbott, Ortho Clinical Diagnostics and Biosite;

Home Healthcare: Alere Medical, AMD Telemedicine, American TeleCare, Cardiocom, Cybernet Medical, Health Hero Honeywell HomMed, iMetrikus, Philips Medical Systems.

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Research and Development

Our Diagnostics division focuses its research and development activities primarily on strengthening its core product lines and on developing products in the fast growing molecular markets:

in Central Laboratory Testing, through development of the *Advia*® family of systems and in the expansion of assays in growth areas;

in Molecular Testing, through menu expansion of assays for infectious disease and automation;

in Near Patient Testing, through enhancements of our *DCA 2000*®+ analyzer and through expansion of the immunoassay menu on the *Clinitek Status*® analyzer.

The division s primary research and development facilities are located in the United States: Tarrytown, New York; Edgewater, Cambridge and Walpole, Massachusetts and Berkeley, California.

We currently have a number of products in late stages of development. Depending on completion of clinical trials and subsequent grant of any necessary FDA approvals, the products we expect to launch during the periods indicated below include:

Product/ Brand Name	**Principal Application**	**Status**[(a)]
Advia Centaur® and *Advia Centaur*® *CP* menu expansion	Menu expansion for infectious disease, autoimmune, transplant drug monitoring, allergy and cardiovascular disease.	Launches planned throughout 2006
Advia® *1800*	Fully automated chemistry analyzer with 1800 test throughput per hour	Launch planned in 2006
Versant® *440*	Complete viral-load molecular system	Launch planned in 2006
Advia Centaur® *XP*	Next generation high throughput immunoassay system	Launch planned in 2006

(a) The term launch(es) planned throughout refers to the fact that there are multiple products that we expect to launch at different times throughout the year; launch planned in refers to a single product.

In September 2005, we signed a semi-exclusive license agreement with CIS Biotech, Inc., which will allow us to collaborate and commercialize automated serum assays for stroke testing.

In November 2005, we signed four agreements with Inverness Medical Innovations to broaden our assay menu offerings worldwide in the diagnostics arena. Two assays aid in improving early diagnosis of congestive heart failure, one assay assists in the early evaluation of acute coronary syndrome and the fourth agreement grants Bayer rights to hybridoma cell line capable of producing monoclonal antibodies against the envelope protein of the Hepatitis B virus.

Both the agreement with peS Gesellschaft fuer medizinische Diagnosesysteme mbH & Siemens Medical Solutions and the agreement with Amersham Biosciences Corp. were discontinued.

Diabetes Care

Overview

The Diabetes Care division is headquartered in Elkhart, Indiana and is a midsize Diabetes Care competitor. In November 2005, the division announced to move the headquarters to Tarrytown, New York during the year 2006. We support customers by delivering innovative products and services that empower people with diabetes to improve their quality of life.

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Major Products

In the Diabetes Care division, we continue to expand the *Ascensia*® brand by introducing several new blood glucose monitoring products. Our key products include two platforms, the multi test platform and the single test strip platform. Our family of multi test products include *Ascensia*® *Breeze*®, *Ascensia*® *Confirm, Ascensia*® *Dex*® and *Ascensia*® *Esprit*. These products incorporate a 10-test disc to provide greater convenience to patients who test their blood sugar levels several times per day. Our family of single strip products includes the *Ascensia Elite*®, *Ascensia Brio*®, *Ascensia*® *Entrust* and *Ascensia*® *Contour*® with its no coding feature for greater convenience and accuracy. This platform serves a wide spectrum of patient needs.

Markets and Distribution

We channel our Diabetes Care products to the consumer market through distributors and large pharmacy and retail chains. Our principal markets are North America, Western Europe and Japan.

Diabetes Care sales are typically lower in the first half of the year, but show a slightly stronger performance in the second half.

Our single manufacturing facility of Diabetes Care is located in Mishawaka, Indiana. We manufacture and/or assemble approximately one third (by units) of our own products with the balance coming from OEM suppliers. We rely on a supplier management process to supply raw materials, sub-assemblies and finished goods, of which most are contractually controlled and are not subject to significant changes in price or availability.

We do require some direct or Original Equipment Manufacturer (OEM) materials that would impact our results of operations if they were to become unavailable. These materials include, for in-house manufacturing, customized integrated circuits and sensors for the *Ascensia*® strips. In these instances, we maintain strategic reserves of selected direct materials or finished products to avoid interruptions in our customers continuous and reliable supply. We maintain a global supplier base with the majority of materials and products being sourced from South-East Asia.

Our primary competitors in the diabetes care market are: Roche Diagnostics, Lifescan (a Johnson & Johnson company) and Abbott Diagnostics.

Research and Development

Our Diabetes Care division focuses its research and development activities primarily on strengthening its core product lines and on expanding into high growth/high margin segments of the market. We achieve this through internal development and OEM of mass market, user-friendly whole blood glucose monitoring systems and by focusing research on a minimally invasive system, requiring only a small blood sample and having a short testing time, coupled with the convenience of no test strip handling. We are also investing in technologies that will allow glucose monitoring without painful invasive sampling of body fluids.

The division s research and development facility is located in the United States in Elkhart, Indiana. In November 2005, the division announced its intention to move the facility to Tarrytown, New York during the year 2006.

In 2004 and 2005, we continued to launch several new *Ascensia*® systems. During 2006, our research and development will continue the support of these newer systems and also will be developing next generation systems that we intend to introduce in 2007 and thereafter.

We continue to maintain a licensing agreement with Sontra Medical Corporation for their continuous non-invasive glucose monitoring technology, which includes worldwide rights to intellectual property relating to obtaining glucose readings using ultrasonic techniques.

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ANIMAL HEALTH

Overview

Our Animal Health segment researches, develops and markets new products for the health care of animals. These products are divided between the two business units Food Animal Products and Companion Animal Products. This range of products is supplemented by a line of farm hygiene products as well as cosmetic care products.

The following table shows the segment s performance for the last three years.

	2003	2004	2005
	(Euros in millions)		
External net sales	790	786	856
Percentage of total sales	3.5	3.4	3.0
Intersegment sales	6	4	8
Operating result	172	157	179
thereof special items[(a)]	22	0	7

(a) The significant special items are detailed in Item 5, *Operating and Financial Review and Prospects Operating Results 2003, 2004 and 2005 Segment Data*.

The Animal Health segment sales by region for the past three years are as follows:

	2003	2004	2005
	(Euros in millions)		
Europe	242	245	252
North America	305	295	314
Asia/Pacific	122	120	141
Latin America/ Africa/Middle East	121	126	149
Total	790	786	856

The following table shows our sales during the past three years for the two business units.

	2003	2004	2005
	(Euros in millions)		
Food Animal	383	375	394
Companion Animal	407	411	462
Total	790	786	856

2005 sales of the segments material products were 249 million for the *Advantage*®/(including Combi)/*K9 Advantix*® product family (representing 29.1 percent of total segment sales; compared to 206 million, or 26.2 percent, in 2004 and 196 million, or 24.8 percent, in 2003) and 163 million for *Baytril*® (representing 19.0 percent of total segment sales; compared to 160 million, or 20.4 percent, in 2004 and 170 million, or 21.5 percent, in 2003). Apart from these two products, no product of this segment accounted for more than 12 percent of total segment sales in

2005, 2004 or 2003.

Segment Strategy

Animal Health aims to be a worldwide leading competitor in the Food Animal and Companion market and strives to be the preferred partner for and provider of veterinary solutions.

It is part of our business strategy for Animal Health to sustain its current profit position by focusing on attractive countries and markets. Furthermore, Animal Health pursues a policy of organic growth by exploiting existing core brands through life cycle management activities supported by new business development activities. To complete our existing product portfolio, Animal Health periodically evaluates the possibility of acquisitions or

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strategic alliances. The Animal Health segment collaborates closely with our Pharmaceuticals division and the Bayer CropScience subgroup as well as other life science companies in research and development in order to bring to the market new active ingredients and products that combat diseases in animals.

Major Products

Parasiticides

K9 Advantix® is a flea and tick control product in an easy-to-use spot-on application form with additional repelling effect against ticks and mosquitoes for dogs.

Advantage® is a flea control product in an easy-to-use, spot-on application form for dogs and cats.

The *Droncit*® and *Drontal*® product family offers solutions for the control of tapeworm and roundworm for dogs and cats.

Bayticol® is a topical product against major tick species that attack livestock animals.

Baycox® is a product for controlling coccidiosis in poultry and in piglets.

Antimicrobials

The *Baytril*® family is our line of fluoroquinolone antimicrobials for the treatment of severe bacterial infections in animals.

Biologicals

These products consist of vaccines covering Foot-and-Mouth Disease (FMD-vaccines) for livestock animals.

Nutritionals

These are premixes or feed additives, *e.g.*, vitamins, minerals and others, to support our business model with proprietary products like *Baytril*® and *Baycox*®.

Farm Hygiene

Integrated into our Food Animal Products business is our biosecurity management process that includes Farm Hygiene products. These products include insecticides for fly control, rodenticides against rats and mice (which now belong to the Bayer CropScience subgroup but are also marketed by Animal Health in some countries) and disinfectants against bacteria.

Markets and Distribution

The Animal Health business covers worldwide markets, including emerging markets such as China, Vietnam and others in South-East Asia. We divide our marketing activities into two main business areas: marketing for food-producing animals, and marketing for companion animals including horses.

On a worldwide basis, the activities of the Animal Health segment are not subject to any significant seasonal effects.

Depending on national legislation, Animal Health products may be available to end users on a prescription or non-prescription basis. End users may purchase prescription products directly from veterinarians or pharmacies with a written prescription issued from a licensed practicing veterinarian. Also, based on national legislation, non-prescription products may be available through over-the-counter retailers, cooperatives, pet shops, integrators in the livestock segment and other specialized channels in the companion animal market.

We currently obtain the active pharmaceutical ingredients for our veterinary pharmaceutical products either within the Bayer Group or from third parties worldwide. We obtain additional ingredients and packaging materials from diverse suppliers on a worldwide basis. As a rule, we approve our suppliers for each required material. We take measures in order to assure continuous product supply and to reduce the effects of price

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volatility. This includes entering into long-term contracts or building strategic reserves of the material in question.

Our main pharmaceutical production facilities devoted to formulation and packaging of our products for shipment are Kiel, Germany and Shawnee, Kansas.

Merial, Pfizer and Intervet are our main competitors, with Merial and Pfizer being active in both companion and livestock animal products and Intervet concentrating mainly on food animal products. The global animal health market is characterized by market consolidations and increasing competitive pressure from generic products.

Research and Development

The Animal Health segment focuses its research and development activities on antimicrobials, parasiticides and active ingredients useful for the treatment of non-infectious diseases such as renal failure, pain management, oncology and congestive heart failure. A particular goal of our research and development efforts is to provide the segment with innovative and patent-protected products (new active ingredients, formulations and application technologies).

The segment s primary research and development facilities are located in Monheim, Germany and Kansas City, Missouri.

We currently have several products or product families in late stages of development or they are subject to regulatory approval. We expect to launch these products between 2006 and 2010. Major products are:

Projects/ Products	Indication	Status
Endoparasiticide and ectoparasiticide combinations	Control of fleas, ticks, heartworm and gastrointestinal worms in cats and dogs	Launch/in registration/in clinical development
Red mite control remedy	Poultry	Submitted
Baycox® calves	Coccidiosis control in calves	In registration
Baytril® swine (North America)	Antimicrobial infections in pigs	In registration
Pradofloxacin	Antimicrobial for dogs and cats	In clinical development, two formulations in EU already submitted
Renal failure and congestive heart failure	Non-infectious diseases in dog and cats	Clinical development started

BAYER CROPSCIENCE

As described under the introduction to *Business,* we have changed our segment reporting with effect from January 1, 2005 in compliance with IAS 14 (Segment Reporting). The former CropScience segment is now split into the Crop Protection and the Environmental Science, BioScience segments. The segmented financial data for 2003 and 2004 have been restated to reflect the new structure.

CROP PROTECTION

Overview

Our Crop Protection segment markets chemical crop protection products for the control of insects, weeds and plant diseases and develops products for enhanced effectiveness against these target pests.

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The following table shows Crop Protection s performance for the last three years.

	2003	2004	2005
	(Euros in millions)		
External net sales	4,801	4,957	4,874
Percentage of total sales	21.4	21.3	17.8
Intersegment sales	62	71	70
Operating result	242	386	532
thereof special items[(a)]	(70)	(42)	7

(a) The significant special items are detailed in Item 5, *Operating and Financial Review and Prospects Operating Results 2003, 2004 and 2005 Segment Data.*

Crop Protection s sales by region and totals for the past three years are as follows.

	2003	2004	2005
	(Euros in millions)		
Europe	1,945	1,898	1,901
North America	919	979	1,076
Asia/Pacific	863	820	811
Latin America/ Africa/Middle East	1,074	1,260	1,086
Total	4,801	4,957	4,874

The following table sets forth Crop Protection s sales for the last three years, broken down by category of activity.

	2003	2004	2005
	(Euros in millions)		
Insecticides	1,376	1,378	1,311
Fungicides	1,168	1,277	1,248
Herbicides	1,848	1,855	1,840
Seed Treatment	409	447	475
Total	4,801	4,957	4,874

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The following table shows the segment s sales by major products[1] during the past three years.

	2003		2004		2005	
Product	**Sales**	**Percentage of Segment Sales**	**Sales**	**Percentage of Segment Sales**	**Sales**	**Percentage of Segment Sales**
	(Euros in millions)		**(Euros in millions)**		**(Euros in millions)**	
Confidor®/ Gaucho®/Admire®[a][b] (Insecticides/ Seed Treatment)	467	9.7	455	9.2	444	9.1
Folicur®/ Raxil®[a] (Fungicides/ Seed Treatment)	310	6.5	401	8.1	327	6.7
Basta®/ Liberty®[a] (Herbicides)	153	3.2	189	3.8	212	4.3
Puma®[a] (Herbicides)	226	4.7	226	4.6	202	4.1
Flint®/Stratego®/Sphere®[a] (Fungicides)	190	4.0	235	4.7	188	3.9
Atlantis®/Mesomaxx® (Herbicides)	58	1.2	97	2.0	142	2.9
Betanal®[a] (Herbicides)	142	3.0	143	2.9	127	2.6
Poncho® (Seed Treatment)	19	0.4	57	1.1	110	2.3
Temik® (Insecticides)	90	1.9	109	2.2	104	2.1
Fenikan®[a] (Herbicides)	105	2.2	104	2.1	101	2.1
Other	3,041	63.2	2,941	59.3	2,917	59.9
Total	4,801		4,957		4,874	

[a] The main active ingredients contained in these products are also used in products sold by the Environmental Science business group.

[b] The active ingredient imidacloprid contained in these products is also used in the Animal Health segment s *Advantage®* product. These figures do not include sales by the Animal Health segment.

Segment Strategy

Crop Protection aspires, together with Bayer CropScience s Environmental Science, BioScience segment, to be a leading partner for the production of quality food, feed and fiber. Our mission is to become the world s leading provider of products and combined solutions for agriculture. We strive to build long-term, consistent, predictable and mutually beneficial partnerships with our customers and stakeholders. We aim to fulfill our commitment to sustainable development and to achieve long-term profitable growth.

Key factors in achieving our profitability targets are new product launches, further portfolio streamlining and focus on cost management. Our Challenge 2007 cost savings and process improvement initiative should further enhance efficiency in all areas of Bayer CropScience by improving internal business processes.

With its Crop Protection business, Bayer CropScience strives to maintain its leading position in the crop protection industry (based on sales)[2] by utilizing its broad regional representation and a well-balanced portfolio comprising innovative, high-performance insecticides, fungicides, herbicides and seed treatment products.

We attempt to achieve these strategic objectives through the continuous introduction of new products from our research and development pipeline, our life cycle management and the complementary activities of our Environmental Science and BioScience businesses.

(1) The amounts shown represent sales by main active ingredient group; for the sake of clarity, however, only the principal brands are listed.

(2) This statement is based on 2004 and first half 2005 data published in *AgriFutura, The newsletter of Phillips McDougall-Agriservice, No. 65 (March 2005)* and *No. 70 (August 2005)*; data for the full year 2005 have not yet been published.

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Major Products

Insecticides

Imidacloprid (major brands: *Confidor*®, *Admire*®) is an active ingredient in the chemical class of neonicotinoids. It controls a broad range of pests, including aphids, thrips, whiteflies, leafhoppers, locusts, leafminers, wireworms and many species of beetles, and is suitable for a wide variety of application methods, including foliar spray, soil drench, seed treatment and drip irrigation. Imidacloprid is now marketed in more than 100 countries for use on numerous important crops.

Aldicarb (major brand: *Temik*®) is a broad-spectrum carbamate insecticide and nematicide in granular form. *Temik*® is applied to soil to protect crop roots from insects and nematodes and to protect against pests such as aphids or mites. *Temik*® is used on a large number of crops, such as cotton, citrus and potatoes.

Deltamethrin (major brand: *Decis*®) is a broad-spectrum pyrethroid insecticide. It is used primarily against chewing and biting insects, and is also effective against various sucking pests. *Decis*® is marketed in more than 100 countries for use on a wide range of crops (including cotton, soybeans, vegetables and cereals).

Fungicides

Tebuconazole (major brand: *Folicur*®) is a broad-spectrum fungicide sold in about 100 countries and effective in more than 90 crops. *Folicur*® is especially effective against Fusarium and rusts (in particular, soybean rust) as well as many other fungal diseases in cereals and is available in many liquid or solid formulations adapted to our customers needs.

Trifloxystrobin (major brand: *Flint*®), the active ingredient of the *Flint*® product family, is sold in more than 80 countries. The product range consists of solo products and several co-formulations (*e.g. Sphere*®, *Stratego*®, *Nativo*®), all tailor-made to meet the specific requirements of highly diverse crop production systems under various climatic conditions. These products feature crop safety, broad-spectrum disease control and beneficial physiological effects on yield, quality and shelf life of fruit and grain.

Prothioconazole (major brand: *Proline*®) is a broad-spectrum fungicide for use in cereals, canola (oilseed rape), peanuts, soybeans and field vegetables, which provides long-term protection by means of a uniform and stable distribution in the leaves. Products containing prothioconazole are effective against stem-based diseases, leaf diseases, especially *Septoria tritici,* as well as ear diseases (*Fusarium spp*) in cereals.

Herbicides

Glufosinate-Ammonium (major brand: *Basta*®), Bayer CropScience s best selling herbicide, is a post-emergence herbicide with a broad-spectrum of efficacy against annual and perennial weeds and grasses. It is primarily used on perennial tree crops, vegetables, non-crop areas and as a harvest aid. The product is also applied on herbicide-tolerant crops in Canada and the United States (*Liberty*®).

Fenoxaprop-P-ethyl (major brand: *Puma*®) is used in more than 75 countries and is one of the leading products used worldwide against grass weeds in cereals. It is also used in rice, soybeans and canola and controls grass weed problems under a wide range of conditions.

Mesosulfuron-methyl (major brands: *Mesomaxx*®, *Atlantis*®) belongs to the latest generation of safened cereal herbicide sulfonylureas. These products offer a broad and consistent grass control performance in global wheat production. Our ongoing development of new mesosulfuron-methyl combinations (major brands: *Alister*®*, Olympus*® *Flex*) is expected to continue to position Bayer CropScience as one of the leaders in cereal herbicides.

Seed Treatment

The insecticidal active ingredient imidacloprid (major brand: *Gaucho*®) is Bayer CropScience s best selling seed treatment product. It is marketed in over 70 countries for the treatment of early season pests and soil and leaf pests in key crops such as sugarbeet, corn, cereals and cotton.

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Clothianidin (major brand: *Poncho*®) is an active ingredient in the chemical class of neonicotinoids, jointly developed by Sumitomo Chemical Takeda Agro Co. Ltd. and Bayer CropScience AG. The active ingredient was developed primarily for the control of the major soil and early season pests in corn, sugarbeet, canola (oilseed rape), sunflower and cereals.

Tebuconazole (major brand: *Raxil*®) is registered in our most important markets worldwide as a seed treatment to control seed and soil-borne diseases in cereals.

Markets and Distribution

Europe has traditionally been our strongest market in Crop Protection, accounting for nearly 40 percent of our sales in this segment in 2005. Due to the fact that the major part of Bayer CropScience s Crop Protection business is realized in the northern hemisphere, the business is affected by the seasonality of the various crop and distribution cycles.

Crop Protection obtains a significant part of its raw materials from LANXESS, as well as from other non-Bayer companies, but also obtains part of its raw materials from within the Bayer Group. Some raw materials can be subject to price volatility caused by fluctuations in the price of oil or energy or transport costs.

Generally, we market our Crop Protection products through a two- or three-step distribution system, depending on local market conditions. Under this system, products are sold either to wholesalers or directly to retailers.

Our main competitors in the Crop Protection business are Syngenta, BASF, Dow AgroSciences, Monsanto and DuPont.

Research and Development

Crop Protection Research and Development operates major facilities on three continents: Monheim (headquarters) and Frankfurt, Germany; Lyon and Sophia Antipolis, France; Stilwell, Kansas and Raleigh, North Carolina; and Yuki City, Japan.

While research is concentrated in specialized sites, development activities range from central facilities to field testing stations across the globe, enabling product testing in the relevant geographical areas.

Crop Protection Research and Development is responsible for the identification and development of innovative, safe and economically sustainable solutions in crop protection. Research covers activities to identify new active ingredients that can be developed as insecticides, fungicides or herbicides. In addition to classical chemistry, biology and biochemistry, modern technologies such as combinatorial chemistry, ultra-high-throughput-screening, genomics and bioinformatics play an important role in the identification of new lead structures. Collaborations with third parties supplement our internal research activities.

Once a compound is identified for development, its biological, environmental and toxicological profile, as well as its economic potential, is assessed. Suitable candidates are launched in the market after having obtained the required regulatory approvals.

We actively support our products through continuous life cycle management. This includes the development of new formulations for existing active ingredients and products, *e.g.*, expanding their applicability to additional crops or improving handling and facilitating application of the product.

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The following new active ingredients were launched in 2004/2005 or are expected to be launched by Crop Protection in 2006, subject to regulatory approval.

New active ingredients	Product Family	Status
Fluoxastrobin	Fungicides	Launched in 2004/2005[a]
Spiromesifen	Insecticides	Launched in 2004/2005[a]
Ethiprole	Insecticides	Launched in 2005
Fluopicolide	Fungicides	Launch expected in 2006

[a] This active ingredient was first registered in a key market at the end of 2004, whereas its first significant sales were generated in 2005.

Fluoxastrobin is a leaf-systemic, broad-spectrum strobilurin with curative and protective properties. Products containing fluoxastrobin will be used for foliar (major brand: *Fandango*®) and seed treatment applications (*Bariton*®, *Scenic*®) in cereals, potatoes, vegetables, peanuts and other crops.

Spiromesifen (major brand: *Oberon*®) belongs to a new chemical class named tetronic acids. *Oberon*® is a new insecticide/ miticide for foliar application in annual crops, offering protection primarily against all important whitefly, mite and psyllid species. *Oberon*® has been developed for worldwide use on vegetables, fruits, cotton, corn, beans, tea and some ornamentals.

Ethiprole (major brands: *Curbix*® and *Kirappu*®) belongs to the family known as phenyl pyrazoles. It is effective against a wide range of biting-and-chewing and piercing-and-sucking insects, for example, thrips, stink bugs, plant hoppers and aphids. The main crops are rice, tea and fruits.

Fluopicolide (major brand: *Infinito*®) belongs to a new chemical class named acylpicolides. Products containing this novel chemical compound have been developed for use to control oomycete diseases in potatoes, vegetables and ornamentals. The new mode of action should enable farmers to control oomycete diseases that are resistant to standard fungicides.

ENVIRONMENTAL SCIENCE, BIOSCIENCE

Overview

The two business groups Environmental Science and BioScience together form the Environmental Science, BioScience segment.

The following table shows the segment s performance for the last three years.

	2003	2004	2005
	(Euros in millions)		
External net sales	963	989	1,022
Percentage of total sales	4.3	4.2	3.7
Intersegment sales	14	7	13
Operating result	100	106	158
thereof special items[a]	(11)	12	(2)

[a] The significant special items are detailed in Item 5, *Operating and Financial Review and Prospects Operating Results 2003, 2004 and 2005 Segment Data.*

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The segment s sales by region and totals for the past three years are as follows:

	2003	2004	2005
	(Euros in millions)		
Europe	351	340	340
North America	420	433	452
Asia/Pacific	100	107	122
Latin America/Africa/Middle East	92	109	108
Total	963	989	1,022

The following table sets forth the segment s sales for the last three years, broken down by category of activity.

	2003	2004	2005
	(Euros in millions)		
Environmental Science	692	678	694
BioScience	271	311	328
Total	963	989	1,022

2005 sales of the segments material products[3] were 143 million for *Merit®/Premise®* (representing 14.0 percent of total segment sales; compared to 148 million, or 15.0 percent, in 2004 and 123 million, or 12.8 percent, in 2003) and 68 million for *K-Othrine®* (representing 6.7 percent of total segment sales; compared to 66 million, or 6.7 percent, in 2004 and 56 million, or 5.8 percent, in 2003). Apart from these two products, no product of this segment accounted for more than 5 percent of total segment sales in 2005, 2004 or 2003.

Segment Strategy

The segment Environmental Science, BioScience complements Bayer CropScience s Crop Protection segment by addressing specific market needs. Environmental Science capitalizes on Crop Protection s development and production facilities and its pipeline of new active ingredients. BioScience leverages on the Crop Protection s customer base and biological competency in bringing seeds and plant biotechnology products to the market.

Environmental Science is among the leading suppliers for non-agricultural pest control solutions worldwide (in terms of sales)[4]. Our strategy is to strengthen our market position by developing and marketing quality products and providing solutions with health or hygiene benefits or that will allow growth of healthier plants and lawns. Our objective also includes the development of strong partnerships with our customers and the focus on proximity innovations, the ability to offer customized brand-connected solutions.

BioScience is internationally active in the research, development and marketing of seeds and solutions derived from plant biotechnology and breeding. We bring to the market seeds and agronomic traits in vegetables, canola, cotton and rice and plant-based solutions for agriculture and industrial use. Our strategic approach comprises three business fields: In Agricultural Crops, we focus on delivering seeds and crops with improved performance and productivity, particularly in respect of our three core crops. In New Business Ventures, we are developing plant-derived materials for applications in fields such as health, biomaterials and nutrition. In the Vegetables field, where we believe that the Nunhems unit of BioScience is among the leading developers and suppliers of high quality vegetable seed varieties, we intend to pursue growth opportunities.

(3) The amounts shown represent sales by main active ingredient group; for the sake of clarity, however, only the principal brands are listed.

(4) This statement is based on 2004 data published in the Cropnosis report *Industry performance Agchems&Agbiotech 2004-05 (September 2005)*.

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Environmental Science

Overview

Environmental Science serves non-agricultural professional and consumer markets worldwide, by developing and marketing products for professional pest control, the green industry (including the treatment of golf courses, lawn care and industrial vegetation management), lawn, garden and household care, termite and vector control, and rural hygiene.

Major Products

Imidacloprid-based *Premise*® is a termite control product launched in the United States in 1996. *Merit*®, another imidacloprid-based product, is used in the green industry segment, in particular in turf and ornamentals. It controls a large spectrum of insects such as grubs and cutworms.

Deltamethrin (major brands: *K-Othrine*®, *Deltagard*®), controls a large spectrum of flying and crawling insects. Deltamethrin is recommended by the World Health Organization and has been used for many years to control insect-borne diseases such as malaria.

Maxforce® is an insecticide used in passive treatment applications such as gels and baits. It contains hydramethylnone, fipronil or imidacloprid. *Maxforce*® s range of products includes a large number of insecticides controlling crawling insects.

Our consumer-branded products intended for sale to non-professional users and leisure gardeners are marketed under the umbrella brands *Bayer Advanced*® in the United States and *Bayer Garden*® in Europe.

Markets and Distribution

Environmental Science s business is subject to seasonality. This seasonality is particularly pronounced for the consumer branded lawn and garden business, which represents approximately 25 percent of segment sales, with its peak season usually running from January through May.

Environmental Science obtains a significant part of its raw materials from within the Bayer Group, but also enters into agreements with non-Bayer companies. Some raw materials may be subject to price volatility caused by fluctuations in the price of oil or energy or transport costs.

Our products are sold in the professional and consumer markets. For professional markets, products are sold to the pest control industry, the green industry and the public health and rural hygiene sectors. In the consumer business, lawn and garden products are sold to consumers through specialized distribution channels. Active ingredients are sold to marketers of household products.

Dow AgroSciences, Syngenta, BASF and Scotts are our main competitors in the overall Environmental Science business.

Research and Development

The molecules discovered by Crop Protection Research are also tested and evaluated in Environmental Science for potential development. Molecules from other companies may be tested and purchased if suitable. Development projects include passive treatments (gels, baits) and formulations to control insects, as well as new herbicide products and new mixtures of fungicides for the turf and ornamental market segments.

In 2005, we launched the insecticide *Allectus*® (imidacloprid-based) and the fungicide *Armada*® (trifloxystrobin+triadimefon-based) for the green industry and the insecticide tablet *K-O Tab*® 1-2-3 (deltamethrin-based) for impregnating mosquito bed nets. In 2006, we expect to launch the insecticide *Forbid*® (spiromesifen-based) in the green industry and the sprayable *Quickbayt*® (imidacloprid-based) for fly control in professional pest control applications.

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BioScience

Overview

BioScience focuses on the research, development and marketing of conventional and genetically enhanced seeds and other plant biotechnology products.

Major Products

With Nunhems (*Nunhems*®), Bayer CropScience is one of the leading developers and suppliers of high-quality vegetable seed varieties that are marketed to professional outdoor and greenhouse growers, plant raisers and the food processing and service industries. The main crop seeds are carrots, onions, melons, leeks and tomatoes.

FiberMax® cotton seed brand was launched in the U.S. market in 1998. It was also introduced in Greece, Spain, Turkey, Brazil and some other Latin American countries. *FiberMax*® varieties offer cotton growers high performance in lint yield and quality as well as advanced technologies for insect and herbicide control.

InVigor® hybrid canola (oilseed rape) varieties are available to farmers in Canada and the United States. *InVigor*® hybrid canola varieties provide high yield and require less cultivation. These hybrid varieties also have tolerance to glufosinate-ammonium.

Arize™ is the trademark for our hybrid rice seed offering a high-yield, high quality solution requiring less seeds per hectare than conventional rice. It has been introduced in India, the Philippines, Indonesia and Brazil.

Markets and Distribution

BioScience markets its seeds to end users, distributors and processing industries. We distribute plant biotechnology traits either through out-licensing to seed companies, to incorporate in their own commercial seeds, or through our own seed companies mainly under either the *InVigor*® or *FiberMax*® brands. In some cases, traits are provided to other companies that utilize the technology in their own research and products.

Due to the fact that the major part of our business is realized in the northern hemisphere, the business is affected by the seasonality of the crop and distribution cycles.

In the bio science business, DuPont, Monsanto and Syngenta are the market leaders.

Research and Development

The primary BioScience research and development facilities are located in Lyon, France; Haelen, The Netherlands; Gent, Belgium; and Potsdam, Germany.

Plant biotechnology research and development is predominantly directed towards agronomic and quality improvement. The technologies used include all relevant tools from identifying the gene of interest to developing it necessary to improve key crops (cotton, canola (oilseed rape), rice) for growers and industrial partners. Research activities range from the exploration of novel agronomic traits to the discovery of new plant-based specialty products for the Nutrition, Health and BioMaterials markets. This includes plants with improved stress tolerance (*e.g.*, drought resistance), health-promoting canola oils and the manufacture of materials based on renewable sources.

Our growth is supported by continuous new product introduction. We launched four new varieties of cotton and one new canola variety in 2005 and expect to launch several new varieties of cotton in 2006.

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BAYER MATERIALSCIENCE

As described under the introduction to *Business*, we have changed our segment reporting with effect from January 1, 2005. The financial data for our Materials and Systems segment have not been affected by this change.

MATERIALS

Overview

Our Materials segment comprises the business units Polycarbonates and Thermoplastic Polyurethanes, as well as our subsidiaries Wolff Walsrode and H.C. Starck. The following table shows the segment s performance for the last three years.

	2003	2004	2005
	(Euros in millions)		
External net sales	2,777	3,248	4,086
Percentage of total sales	12.4	13.9	14.9
Intersegment sales	10	13	14
Operating result	58	293	633
thereof special items[(a)]	(29)	0	27

(a) The significant special items are detailed in Item 5, *Operating and Financial Review and Prospects Operating Results 2003, 2004 and 2005 Segment Data*.

The segment s external sales, by region and in total, for the past three years are as follows:

	2003	2004	2005
	(Euros in millions)		
Europe	1,246	1,382	1,697
North America	608	703	901
Asia/Pacific	747	947	1,164
Latin America/ Africa/Middle East	176	216	324
Total	2,777	3,248	4,086

The following table sets forth the segment s external sales, broken down by category of activity, for the past three years:

	2003	2004	2005
	(Euros in millions)		
Polycarbonates	1,713	2,035	2,645
Thermoplastic Polyurethanes	177	182	192
Wolff Walsrode	323	328	329
H.C. Starck	564	703	920
Total	2,777	3,248	4,086

2005 sales of the segments material products were 1,513 million for the *Makrolon*® product family (representing 37.0 percent of total segment sales; compared to 1,088 million, or 33.5 percent, in 2004 and 903 million, or 32.5 percent, in 2003) and 485 million for *Bayblend*® (representing 11.9 percent of total segment sales; compared to 360 million, or 11.1 percent, in 2004 and 312 million, or 11.2 percent, in 2003). Apart from these two products, no product of this segment accounted for more than 5 percent of total segment sales in 2005, 2004 or 2003.

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Segment Strategy

Our goal is to continue expanding our global market positions by exploiting the growth potential of our optimized portfolio and focusing on our Asian investment projects. To achieve further performance improvements, we are continuing our cost and efficiency programs in the Materials segment. As announced in 2002, these programs include headcount reduction. From 2003 through 2005, total headcount reduction amounted to 410, which represents approximately 4.1 percent of the segment s headcount in January 2003.

For our Polycarbonates business, we strive to achieve cost-competitive world-scale facilities with new technology and to increase our capacities to fulfill the demand for polycarbonates. We intend to monitor product life cycles of current applications and allocate sufficient resources for product and application development. In addition to our growth market People s Republic of China we plan to evaluate potential business opportunities in other regions to continuously expand our market coverage. With respect to our semi-finished products Sheet and Films, we continue to improve profitability while focusing on market segments exhibiting higher growth rates.

Our Thermoplastic Polyurethanes (TPU) business unit plans to shift its focus towards high-margin growth segments with the goal of reaching and maintaining higher profitability levels. One strategic goal of TPU is to increase our Asian market share by means of entering into strategic partnerships or using own capacity to increase sales.

Wolff Walsrode, with its core business Wolff Cellulosics, continues to aim for above-market growth. We plan to achieve this by focusing on the building additives, food and pharmacy industries as well as on rapidly-growing markets.

H.C. Starck s portfolio consists of a combination of metal- and ceramics-related high performance materials and technologies. Our focus lies on rapidly-growing markets and we have designed our internal business processes to meet the requirements of our customers. The continuous development of our business is based on efficient R&D and is being supported by strategic partnerships as well as forward integration (further developing the product portfolio in order to fulfill more directly customers needs).

Polycarbonates

Overview

With its broad product portfolio, our business unit Polycarbonates (Polycarbonates, Polycarbonate Blends, Polycarbonate Films and Sheets) includes some of the leading global suppliers and manufacturers of engineering polycarbonates (based on capacity). Our Bayer Sheet Europe GmbH (formerly Makroform GmbH) has a strong position as a supplier of polycarbonate sheets. Our products have chemical and physical properties that enable them to resist low or high operating temperatures as well as corrosive chemicals and solvents.

Major Products

Polycarbonates (Makrolon®/APEC®)

Polycarbonates are plastics that are transparent and highly stable across a wide temperature range. Because of their light weight, impact stability and design flexibility, polycarbonates are used in the electrical/ electronic industry in general and in the field of optical data storage media (such as pre-recorded and recordable CDs and DVDs) in particular, for injection molding purposes, and as a carrier material for solar panels. The construction industry is also a major user of polycarbonates, for example, for polycarbonate sheet applications. *Makrolon®* is our leading polycarbonate product range. Its key characteristics include high transparency, heat resistance and toughness. It can be both sterilized important for the food and medical industries and recycled. Our other polycarbonates include the *APEC®* product range for high temperature uses, for example as components for automobile headlights.

Polycarbonate Blends (Bayblend®/Makroblend®)

Blend technology can transform a palette of a few basic polymers into a wide range of new, advanced polymers with tailored properties, creating user-specific solutions. Polycarbonate Blends are widely used in the

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automotive, electric/ electronic and business machine industries. *Makroblend*® is our brand name for engineering thermoplastics blends based on Polybutylene Terephthalate (PBT) or Polyethylene Terephthalate (PET). The *Bayblend*® product lines of amorphous, thermoplastic polymer blends based on polycarbonate and ABS (acrylonitrile/ butadiene/styrene) are our leading blends for applications in the health, automotive and IT area.

Polycarbonate Films

Polycarbonate films, *Makrofol*®, are made of our polycarbonate *Makrolon*® and are characterized by product attributes such as high heat resistance, good printability and graphic quality. The polycarbonate films of our *Makrofol*® range are used for applications such as instrument dials, automotive heater control panels, nameplates and a variety of film insert molding parts (a combination of a back printed and formed foil with *Makrolon*® and *Bayblend*®) as well as for security identification cards.

Bayfol® is the trade name of our films made of polycarbonate blends and other polymers. *Bayfol*® CR films are noted for their superior chemical resistance and enhanced flexibility compared with pure polycarbonate film. They are both thermo formable and cold formable, with good electrical insulating and dielectric properties, and are easily printable with standard inks. Their main application areas are keypads or housings in the IT industry. Further applications are in the area of IMD (In Mold Decoration) technology, automotive interior applications, electrical and electronic engineering, domestic appliances (decorative and functional panels), blister packaging and decorative top layers for athletic equipment.

Polycarbonate Sheets (Fabricated Products)

We also produce solid and multiwall sheets with a broad range of characteristics for a wide variety of applications. These materials consist of polycarbonates, polycarbonate blends or thermoplastic polyesters. We market our sheets as *Makrolon*®*, Bayloy*®*, Vivak*® and *Axpet*®. *Makrolon*® is a material with high impact resistance and can be exposed to a wide range of temperatures. *Vivak*® is a co-polyester sheet material which combines thermoforming and mechanical properties. *Axpet*® sheets are also thermoplastic polyester sheets, best suited in product and advertising presentations, particularly for folding displays, poster protection, price tags, cases and trays and for packaging food and pharmaceutical products. *Bayloy*® sheets are colored plastic sheets used when high shock-and break resistance is necessary.

Markets and Distribution

We sell the products of our Polycarbonates business entities to numerous customers worldwide. These customers include injection-molding operators and a large number of plastic-component manufacturers, whose products are overwhelmingly used in the automotive, electrical, electrical engineering, construction, data technology, medical and leisure industries.

Depending on the region and the general economic situation, sales of polycarbonates may show moderate seasonality. Generally, sales are lower in the first quarter in all regions.

Bayer does not produce basic petrochemicals. The principal petrochemical raw materials consumed by our Polycarbonates business unit are acetone and phenol, supplied exclusively by third parties. We do produce Bisphenol-A, which is a major precursor of polycarbonate based on phenol and acetone. Our costs are affected by fluctuations in raw material prices, mainly driven by the price volatility of crude oil and benzene. We typically procure third-party raw materials under long-term contracts that contain cost-based and market price formulas, which partially reduce raw material price fluctuation.

We market substantially all of our plastic products through regional distribution channels, supported by regional competence centers and by our head office. In addition, we also use trading houses and local distributors to work with small volume customers. We use e-commerce tools, such as our *BayerONE*® portal, to market our products.

Our most significant global competitor is GE Plastics. We also compete with several other companies, most notably Dow Chemical, and, particularly in the Far East, with local competitors such as Teijin, Chi Mei, Idemitsu, Mitsubishi Engineering Plastics and Formosa Plastics.

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Research and Development

Our Polycarbonates business unit allocates resources for research and development both to process and product development with the aim of constantly improving our manufacturing processes and of developing new formulations and applications of our products. The primary research and development facilities are located in Krefeld-Uerdingen, Leverkusen and Dormagen, Germany and Pittsburgh, Pennsylvania. The Polycarbonates business unit is also building a new polymers research and development center at Pudong, China (near Shanghai) together with the other Bayer MaterialScience (BMS) business units.

We are currently working on the optimization of our new polycarbonate melt manufacturing process for our investment in a new production facility in Caojing, China, part of the largest investment program Bayer has ever made outside Germany. Other current projects relate to the analysis of our existing manufacturing processes based on interfacial polycondensation to improve both product quality and cost performance.

In product development, we focus our activities on developing new blends, refining material for optical data storage, developing modified base materials for polycarbonate sheets and modifying the surface of polycarbonates using various coating technologies as summarized in the following table:

Product/ Brand Name	**Application**
Surface-modified *Makrolon*®	Automotive
Improved *Makrolon*® ODS grade	New ODS formats, such as Blue Laser based disks
Extension of *Bayblend*® FR series	Business machines/ information technology
Diffusor sheets for LCD Screens	Electric/ Electronic

In the area of polycarbonate glazing, Exatec, our joint venture with GE Plastics, is progressing with implementing the glazing technology, especially in the automotive industry. In March 2005, a first license agreement was signed between Exatec and a customer and we received regulatory approval for use of *Exatec® 900* for all non-windshield automotive glazing applications.

Thermoplastic Polyurethanes

Overview

Our Thermoplastic Polyurethanes business unit develops and markets a wide variety of granules that serve as raw materials for extrusion, blow molding, calandering, or injection molding processed products. Additionally, our subsidiaries Epurex Films (Germany) and Deerfield Urethane (Massachusetts) manufacture different grades of thermoplastic polyurethane films (TPU films).

Major Products

Thermoplastic polyurethanes, or TPUs (TPU resins and films), belong to the family of high-performance thermoplastic elastomers. A key property of TPUs is their high resistance to abrasion and wear. TPUs abrasion- and wear-resistant properties are substantially superior to those of abrasion-resistant rubber compounds. We market our thermoplastic polyurethanes granulates under the trademarks *Desmopan®, Texin® and Desmomelt®*. Since April 2005, our product range has also included the trademark *Desmoflex®*, a thermoplastic elastomer compound. BMS and PTS (Plastic Technologie Service Marketing & Vertriebs GmbH) have signed a cooperation agreement to develop and market *Desmoflex®*. Our TPU films are marketed under the trademarks *Walotex®*, *Walopur®*, and *Platilon®* (Epurex Films) and *Dureflex®* (Deerfield Urethane) and are used in a number of different applications, *e.g.*, as belts, hoses or automotive parts.

Markets and Distribution

Our Thermoplastic Polyurethanes business entities (TPU Resins and TPU Films) primarily serve customers of the sports and leisure, automotive and engineering industries. Other users include the textile, cable and agricultural industries.

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Our revenue is subject to moderate seasonality. All markets and regions taken as a whole, however, generate relatively constant revenue throughout the year.

Temporary fluctuations in price for raw materials and energy can have an impact on the cost of our products. We secure our most important chemical raw materials through long-term contracts.

Our head office in Leverkusen, Germany, has global responsibility for the business. We coordinate and carry out our sales and marketing from Leverkusen, Germany, for the regions Europe, Middle East, Africa and Latin America, from our regional hubs in North America (Pittsburgh) and the Asia/Pacific region (Hong Kong), and through our various national subsidiaries.

We regard the following companies as the main competitors of our TPU business entities:

TPU Resins: BASF/Elastogran, Lubrizol/ Noveon, Huntsman, Taiwan Uretec, Dow Chemical;

TPU Films: Stevens Urethane, Fait Plast, Ding Zing.

Research and Development

The bulk of research and development activities conducted by the Thermoplastic Polyurethanes business entities consists of developing products that we can formulate into high performance thermoplastic polyurethanes resins and films, such as transparent grades.

TPU Resins primary development facilities are located in Dormagen, Germany and Pittsburgh, Pennsylvania. The development facilities of TPU Films are located in Bomlitz, Germany (Epurex Films) and in Whately, Massachusetts (Deerfield Urethane).

Wolff Walsrode

Overview

We operate the Wolff Walsrode business group primarily through Wolff Walsrode AG, our wholly-owned subsidiary, assisted by other companies of the Bayer Group. The business group develops, produces and markets cellulose derivatives as well as various sausage casings.

Major Products

Cellulose Derivatives

Walocel® M is an additive that regulates water balance. It improves the workability and adhesion of building materials such as tile adhesives, plasters, mortars and dispersion paints.

Walsroder® NC serves in resin form in wood coatings and other industrial coatings as well as in printing inks for flexible packaging. It is also used as a component of nail polish and other specialty items.

Walocel® C is used primarily as a thickener and binder in water-based systems. It is used in pharmaceuticals, dairy products and toothpaste, as well as in ceramics compounding, textile and paper manufacture and oil drilling.

Other

Under the brand name *Walsroder®*, we offer a wide range of sausage skins for industrial or handcraft usage.

Markets and Distribution

Wolff Walsrode competes in the building materials, industrial coatings, flexible packaging ink and life sciences markets, as well as in specialized industrial fields.

Wolff Walsrode generally conducts direct sales operations in Germany and the United States for its cellulose products. Outside these geographic areas, we ordinarily sell through Bayer s worldwide sales organization.

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The main raw material for our cellulose derivatives is chemical-grade cellulose derived from wood pulp and cotton. Because we have developed technologies to use either wood pulp or pulp based on cotton linters and because we have qualified a number of suppliers for both types of pulp, we have not had any significant problems with availability. Prices for chemical-grade cellulose show only moderate fluctuations, as a result of our diversified supplier base (located in both the euro and dollar zones), the raw material mix and an increasing number of contracts with our suppliers having terms of one year.

Our main competitors in the cellulose derivatives business are Hercules (Aqualon), Dow, SE Tylose GmbH & Co.KG, Shin-Etsu Chemical Co., Bergerac NC/SNPE, Nobel Enterprises, Nitroquimica Brasileira, Noviant and Akzo Nobel.

Research and Development

Wolff Walsrode s research on cellulose and other polysaccharides takes advantage of the unique structural and chemical properties of these important renewable materials. The activities are focused on products such as additives for building materials, binders for printing inks and coatings, as well as formulation aids for food, cosmetics and pharmaceuticals.

Wolff Walsrode s primary research and development facilities, including a state-of-the-art pilot plant, are at industrial site Industriepark Walsrode in Bomlitz, near Walsrode, Germany.

H.C. Starck

Overview

Our subsidiary H.C. Starck develops, produces and markets metallic and ceramic powders and fabricated products for various markets and applications.

Major Products

H.C. Starck produces a broad portfolio of products ranging from ceramic materials to metals such as tungsten, molybdenum, tantalum and niobium and their alloys and compounds for industrial customers in the aircraft, medical, chemical, electronic, lighting, tooling and optical components industries. We manufacture these products both in the form of ceramic or metallic powders and as solid intermediates or finished parts. Products are marketed under brand names such as *Kulite*®, *Molyform*®, *Ampergy*®, *Amperkat*®, *Amperit*® and *Ampersint*®. Our conductive polymers for the electronic industry are marketed under the brand name *Baytron*® and our functional materials (such as colloidal silica) are named *Levasil*®.

Markets and Distribution

Some of our markets are affected by pressure on prices and fluctuations in demand. Sales are also influenced by currency exchange rates. China is the primary source of raw materials for tungsten products. In the past, China limited production, thus causing shortages. Since we have our own tungsten production and recycling facilities, we are only partially dependent on Chinese imports. The price for tungsten has increased significantly (+ 130 percent) during 2005 due to an increase in Chinese raw material prices. The price of molybdenum, historically less volatile, has increased substantially throughout the second half of 2004 and remained stable at the record high level throughout 2005. Tantalum raw material prices have remained relatively stable during the past three years. For this raw material, we secure our supply through long-term contracts generally lasting three to five years.

We maintain our own sales organizations and liaison offices in an number of countries. Additionally, we use Bayer or third-party sales organizations who maintain direct contact with our customers. *Amperit*® products are marketed jointly with Flame Spray Technologies B.V., Netherlands.

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We regard the following companies as our main competitors:

Metallic products and compounds (*Kulite*®, *Molyform*®, *Ampersint*® and other non-branded metallic and ceramic powders and part): Wolfram Bergbau- und Hütten GmbH, Cabot Group, Mitsui, MolymetOMG, Osram Sylvania, Japan New Metals, Plansee AG, Phelps Dodge;

Battery intermediates (*Ampergy*®): Tanaka Chemical, Kelong, Kansai Catalysts Co. Ltd, Jiangmen Chancsun Umicore Industry Co., Ltd.;

Chemical catalysts (*Amerkat*®): Johnson Matthey, Degussa, Grace-Davison, Engelhard;

Thermal spray powders (*Amperit*®): Praxair, Sulzer Metco, Fujimi;

Ceramic powders and parts: Denki Kagaku, SB Boron; GE Advanced Ceramics, Tokuyama.

Research and Development

H.C. Starck s research and development activities are directed at innovative products and system solutions. We are developing high-capacity tantalum and niobium powders as intermediates for capacitors and conducting polymers for polymer capacitors and antistatic applications. H.C. Starck is continuously developing new generations of improved sputtering targets for diffusion barrier coatings in microelectronic devices and flat panel displays. H.C. Starck is also committed to developing materials for fuel cells, hybrid vehicles and other energy storage and power generation applications. Additionally, we are working on high corrosive, high temperature resistant materials for powder metallurgy applications.

The primary research and development facilities of this subsidiary are located in Goslar, Laufenburg and Leverkusen, Germany; Newton, Massachusetts and Mito, Japan.

We currently have eleven product groups in late stages of development, and expect to start and continue their launch during 2006. The most important projects being:

Product/ Brand Name	**Application**
Powder and components for SOFC	SOFC (Solid Oxide Fuel Cells)
Tantalum 70/80, 100/120 and 150 K powder	Capacitors
Molybdenum plates for physical vapor disposition (PVD)	Flat panel displays
Tantalum plates for PVD	Microelectronic devices
HEM (High Energy Milled) and prealloyed binder powders	Powder metallurgy

SYSTEMS

Overview

Our segment Systems comprises the business units Polyurethanes; Coatings, Adhesives, Sealants; and Inorganic Basic Chemicals.

The following table shows the segment s performance for the last three years:

	2003	**2004**	**2005**
		(Euros in millions)	
External net sales	4,676	5,349	6,609
Percentage of total sales	20.8	23.0	24.2
Intersegment sales	103	116	142
Operating result	(455)	348	736
thereof special items[(a)]	(715)	(27)	(62)

(a) The significant special items are detailed in Item 5, *Operating and Financial Review and Prospects Operating Results 2003, 2004 and 2005 Segment Data*.

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The segment s external sales, by region and in total, for the past three years are as follows:

	2003	2004	2005
	(Euros in millions)		
Europe	2,107	2,494	3,035
North America	1,406	1,483	1,891
Asia/Pacific	678	822	979
Latin America/ Africa/Middle East	485	550	704
Total	4,676	5,349	6,609

The following table sets forth the business entities external sales for the last three years, broken down by category of activity:

	2003	2004	2005
	(Euros in millions)		
Polyurethanes	3,228	3,872	4,792
Coatings Adhesives Sealants	1,191	1,237	1,330
Inorganic Basic Chemicals	218	218	380
Others	39	22	107
Total	4,676	5,349	6,609

2005 sales of the segments material products were 1,983 million for *Desmodur*® products (representing 30.0 percent of total segment sales; compared to 1,708 million, or 31.9 percent, in 2004 and 1,567 million, or 33.5 percent, in 2003). Apart from *Desmodur*® and two other products, each of which accounted for less than 12 percent of segment sales in 2005, no other product of the segment accounted for more than 5 percent of segment sales in 2005, 2004 and 2003.

Segment Strategy

Our goal is to continue expanding our global market positions by exploiting the growth potential of the optimized portfolio and focusing on our Asian investment projects. To further achieve performance improvements, we will continue our cost and efficiency programs, which were announced in 2002, in all business units of the Systems segment. As part of these programs, we reduced headcount by a total of 1,127 from 2003 through 2005, which represents approximately 12.4 percent of the segment s headcount in January 2003.

For our Polyurethanes business we strive to achieve cost-competitive world-scale production facilities with new technology. We are pursuing an organic growth strategy supported by both product and process innovation. As part of our growth strategy, we are currently increasing our production capacity of diphenylmethane diisocyanates (MDI). In selected segments we strive to improve profitability by shifting our focus towards high value products. We believe that a well-balanced product portfolio combined with optimized R&D and cost structures will help keep the Polyurethanes business unit well positioned.

The Coatings, Adhesives and Sealants business unit will focus its activities on maintaining its current position in the field of Base Modified Isocyanates. Resins will increase its efforts to grow in profitable modern technologies and reduce the share of low margin products with limited value contribution. At the same time we intend to expand our portfolio with new products for new markets.

Using current technology, Inorganic Basic Chemicals provides basic raw materials such as chlorine and caustic soda to the Polyurethanes; Coatings, Adhesives, Sealants and Polycarbonates business units as well as to third parties. To ensure best possible cost position and uninterrupted supply, various strategic options related to making or buying raw materials are being pursued depending on the specific site set-up.

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Polyurethanes

Overview

Our Polyurethanes business entities (MDI, TDI, Polyether) focus on the development, production and marketing of isocyanates and polyol materials for polyurethane formulations and systems used in producing a wide variety of polyurethane polymers for a broad range of industrial and consumer applications.

Major Products

Polyurethanes are polymers formed through the reaction of two liquid chemicals: an isocyanate typically diphenylmethane diisocyanate (MDI) or toluene diisocyanate (TDI) and a polymeric alcohol such as polyether polyols. We produce a range of different isocyanates and polyether polyols under such brand names as *Desmodur*® and *Desmophen*®. The characteristics of a given polyurethane depend on both the material components used as well as the precise proportion of each in the mix.

Our customers use our isocyanates or polyether polyols, or both, to create their own specific polyurethane formulations. In addition, we design and evaluate custom blends to meet specific customer requirements. The customer receives a ready-to-use two-component system. The precise formulation of each custom blend is proprietary.

Typical applications for which our customers use our polyurethane materials include furniture, mattresses, shoes, automotive components, appliances, sport and leisure equipment and construction.

Markets and Distribution

Europe and the NAFTA nations remain the primary markets for our Polyurethanes business entities, with the Asian market showing the strongest growth.

The predominant cushioning material for upholstered furniture nowadays is flexible polyurethane foam. For our customers applications, there are no man-made or natural substitute materials that could replace significant amounts of flexible polyurethane foams in the future. Rigid polyurethane foam is used for thermal insulation purposes competing with other insulating materials such as mineral fibers or polystyrene foam. Conversely, polyurethane elastomers compete with other thermoplastic materials on cost, performance and fit with the production mix at the customer s site.

In the automotive area, there is constant competition between polyurethanes and other polymers in many applications due to required physical properties, costs, design or functional requirements.

On a worldwide level, the Polyurethanes business entities sales are not subject to significant seasonality. On the regional level, business can display seasonality where, for example, revenue depends on such seasonal industries as construction and other outdoor applications.

The basic raw materials for our isocyanates and polyols are petrochemical raw materials. We typically purchase these on the open market mostly under long-term contracts, as Bayer generally does not produce petrochemicals. However, through a global joint venture with Lyondell, we have acquired a source for propylene oxide, one of our key raw materials. These petrochemical raw materials are subject to price fluctuation driven by supply and demand factors and price volatility in the crude oil and derivates markets.

The Polyurethanes business entities sell their products directly to customers and, to a much smaller degree, through system houses and traders. System houses are focused regionally and typically serve smaller-volume customers.

To further increase efficiency along the supply chain, we have established regional service centers. They act as a central point of contact for customers on all issues concerning order processing, logistics and billing.

Our main competitors are BASF, Dow Chemical and Huntsman.

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Production facilities

Bayer s polyurethane raw material production facilities, which meet ISO 9001:2000 quality standards, are strategically located around the world to support its global product line. The business unit s main production sites are located in Antwerp, Belgium; Brunsbüttel, Dormagen and Krefeld-Uerdingen, Germany; Fos-sur-Mer, France; Tarragona, Spain; Baytown and Channelview, Texas, and South Charleston, West Virginia. Other production facilities are located in Brazil, Germany, Indonesia, Italy, Japan, Mexico, Taiwan and the United States. In addition, we have started building up capacities at our site in Caojing, China.

We have completed a consolidation phase regarding our production facilities by closing our TDI plants in Mexico, Germany, Belgium, Japan and, during 2005, in the United States. TDI production is now concentrated in three integrated plants in Baytown, Texas and Brunsbüttel and Dormagen, Germany.

Research and Development

The business entities primary research and technical development facilities are located in Dormagen and Leverkusen, Germany; Pittsburgh, Pennsylvania, South Charleston and New Martinsville, West Virginia; Amagasaki, Japan; and Shanghai, China.

The main areas of innovation in the polyurethane field are currently the development of new or improved polyether polyol types and blends as well as the improvement of manufacturing processes. The Polyurethanes business entities concentrate their research and development efforts with respect to aromatic isocyanates on improving existing products and technologies for their manufacture. Some research activities go into new structures for isocyanates. High-throughput experiments are used for the development of new formulations and will help to reduce time-to-market for new products.

Coatings, Adhesives, Sealants

Overview

Our Coatings, Adhesives, Sealants business entities (RES, BMI) develop and market a wide variety of products that serve as raw materials for lacquers, coatings, sealants and adhesives.

Major Products

Resins and Hardeners

Polyurethane lacquers are formed through the combination of an isocyanates component with a polyol-like polyester, polyacrylate-polyether- or polycarbonate-polyols. We offer a variety of polyol components branded as *Desmophen®, Rucote®* and *Bayhydrol®* (Resins; RES) and polyisocyanates such as *Desmodur®*, *Desmodur® BL, Crelan®* and *Bayhydur®* (Base- and modified isocyanates; BMI). This variety enables us to provide custom-tailored solutions for a number of different applications.

Special raw materials

Our special material unit produces such specialty products as *Pergut®* (Resins) for coatings and adhesives, *Impranil®*, our polyurethane coating systems for textiles, and *Baybond®* for glass fiber sizing.

Adhesive raw materials

Dispercoll®, Desmocoll® and *Baypren®* (Resins) are our raw materials for adhesives. Their primary users are shoe manufacturers, though we also have customers from the automotive, furniture and building industries.

Markets and Distribution

Our Coatings, Adhesives, Sealants business entities are a major producer of raw materials for coatings and adhesives. The primary ultimate end users of our products are the automotive, furniture, plastics, construction and adhesives industries; other users include the textile, shoe and building industries.

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Generally, our revenue is not subject to significant seasonality. Some of the individual markets and regions that we serve experience seasonal fluctuation, such as the building industry during the winter months or southern Europe during the summer.

Temporary fluctuations in prices, such as the price of crude oil or energy, can have a significant effect on the cost of our raw materials. We secure our most important chemical raw materials through long-term contracts.

We coordinate and carry out our sales and marketing from our head office in Leverkusen, Germany, as well as through our various national subsidiaries. Our key account managers serve our globally active major customers directly.

We regard the following companies as the chief competitors of our Coatings, Adhesives, Sealants business entities.

Resin components (RES): Cytec / UCB, Cray Valley, DIC (Dainippon Ink and Chemicals), DSM

Aliphatic isocyanates (BMI): Rhodia, Degussa, BASF, Asahi Kasei, NPU (Nippon Polyurethane Industry)

Aromatic isocyanates (BMI): Dow, Mitsui Takeda Chemicals, SAPICI

Research and Development

The Coatings, Adhesives, Sealants business entities focus their research and development activities on developing products that we can formulate into high performance coatings, such as aliphatic and aromatic polyisocyanates and resin components. We are also exploring ways of reducing the amount of solvent needed by technologies such as high solids and waterborne and powder coatings systems.

The business entities primary research and development facilities are located in Leverkusen, Germany and Pittsburgh, Pennsylvania.

Inorganic Basic Chemicals

Overview

The business unit Inorganic Basic Chemicals (IBC) produces inorganic basic chemicals such as chlorine, caustic soda, hydrogen and hydrochloric acid. The focus is on the safe and cost-efficient supply of chlorine to the customers. IBC has one of the largest production capacities of any chlorine manufacturer in Europe.

Major Products

Inorganic basic chemicals are of major importance for Bayer MaterialScience (BMS): about 70 percent of its sales are dependent on chlorine. Chlorine is used for the production of intermediates that are subsequently processed into a variety of products, such as polyurethanes (foams, insulating materials) and polycarbonates (CDs, glazing). The four IBC production sites in Leverkusen, Dormagen and Krefeld-Uerdingen, Germany, and Baytown, Texas, have a total chlorine capacity of around 1.4 million metric tons per year. At sites where Bayer does not produce any chlorine, IBC supports external chlorine procurement.

In addition to chlorine, sodium chloride electrolysis generates caustic soda and hydrogen. These by-products, as far as they are not used internally, are sold in external markets.

During the processing of chlorine into intermediate products, hydrochloric acid may be produced. IBC is responsible for managing the balance of hydrochloric acid: if it is not sold or used internally, it is recycled in the hydrochloric acid electrolysis units of IBC in Leverkusen and Dormagen, Germany and Baytown, Texas.

Markets and Distribution

In general, chlorine is supplied by pipeline to internal and external customers located at Bayer sites where chlorine is produced. IBC markets the caustic soda and hydrochloric acid that is not used internally to customers from various industries worldwide.

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The main raw materials for chlorine production are sodium chloride and power. Sodium chloride is purchased on the open market under long term contractual agreements and therefore generally not subject to price volatility. Power is purchased via Bayer Industry Services in Germany. Recently, costs of power have increased due to regulatory requirements of the European Union and Germany.

Our main competitors are Dow, Solvay, Akzo Nobel, BASF, Vestolit and Ineos.

Research and Development

Processes and plants are continuously enhanced and optimized within IBC while keeping in mind environmental compatibility. The main area of innovation in chlorine production is currently the development of the Oxygen Depolarized Cathode (ODC) in sodium chloride alkali (sodium chloride) and hydrochloric acid membrane electrolysis to save energy.

INTELLECTUAL PROPERTY PROTECTION

To succeed, Bayer must continually seek new products that provide our customers with better solutions for existing problems and new solutions for emerging problems. This requires us to expend significant effort on research, development, manufacturing and marketing. To preserve the value of our investment, we rely on the patent and trademark laws of the jurisdictions where we do business. In addition, our production technologies typically incorporate specialized proprietary know-how.

We have both developed intellectual property internally and acquired it as assignee through acquisitions. In addition, Bayer may from time to time grant licenses to third parties to use our patents and know-how, and may obtain licenses from others to manufacture and sell products using their technology and know-how.

Patents

We seek to protect our products with patents in major markets. Depending on the jurisdiction, patent protection may be available for:

- individual active ingredients;
- specific compounds, formulations and combinations containing active ingredients;
- manufacturing processes;
- intermediates useful in the manufacture of products;
- genomic research; and
- new uses for existing products.

The protection that a patent provides varies from country to country, depending on the type of claim granted, the scope of the claim s coverage and the legal remedies available for enforcement. For example, although patent protection in the United States is generally strong, under some circumstances, U.S. law permits generic pharmaceuticals manufacturers to seek regulatory approval of generic products before the patents expire. See Item 8, *Financial Information Legal Proceedings*. In addition, some developing countries have announced plans to reduce patent protection for some drugs.

The advance of genomic research has accelerated our patent filings for biological products. We typically seek protection upon determining a gene s function.

We currently hold thousands of patents, and have applications pending for a significant number of new patents. Although patents are important to our business, we believe that, with the exception of the patents covering *Adalat*®, *Avelox*®, *Cipro*®, *Levitra*® and imidacloprid, no single patent (or group of related patents) is material to our business as a whole.

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Term and Expiration of Patents

Patents are valid for varying periods, depending on the laws of the jurisdiction granting the patent. In some jurisdictions, patent protection begins from the date a patent application was filed; in others, it begins on the date the patent is granted.

The European Union, the United States, Japan and certain other countries extend or restore patent terms or provide supplementary protection to compensate for patent term loss due to regulatory review and substantial investments in product research and development and regulatory approval. Our policy is to obtain these extensions where possible.

Patent protection in our major markets for some of our key products is scheduled to expire in the near term. Although the expiration of a patent for an active ingredient normally results in the loss of market exclusivity, we may continue to derive commercial benefits from:

subsequently-granted patents on processes and intermediates used in manufacturing the active ingredient;

patents relating to specific uses for the active ingredient;

patents relating to novel compositions and formulations; and

in certain markets (including the United States), market exclusivity under laws other than patent laws.

The following table sets forth the expiration dates in our major markets of the patents covering *Adalat®*, *Avelox®*, ciprofloxacin, imidacloprid and vardenafil:

	Market							
Product	**Germany**	**France**	**U.K.**	**Italy**	**Spain**	**Japan**	**U.S.A.**	**Canada**
Adalat®								
Crystal patent (Retard)							2010	
Adalat® CC (Coat Core)	2008	2008	2008	2008	2008	2008	2008	2009
Avelox®								
Compound	2014	2014	2014	2014	2014	2009	2014	2015
Hydrochloride-Monohydrate	2016	2016	2016	2016	2016	2016	2016	2016
Tablet formulation	2019	2019	2019	2019	2019	2019	2019	2019
Ciprofloxacin								
Active ingredient				2009				
IV formulation	2006	2006	2006	2006	2006	2011	2007	2008
Tablet formulation	2007	2007	2007	2007	2007	2007	2011	2009
Imidacloprid	2006	2006	2006	2006	2007		2006	2007
Vardenafil compound	2018	2018	2018	2018	2018	2018	2018	2018

See Item 8, *Financial Information Legal Proceedings* for a description of patent-related litigation in which we are involved.

Trademarks

Our best-known trademarks include *Ascensia®, Kogenate®, Adalat®, Aspirin®, Ciprobay®/Cipro®, Avalox®/Avelox®, Levitra®, Aleve®, Confidor®/Gaucho®/Admire®/Merit®, Basta®/Liberty®, Flint®/ Stratego®/ Sphere® and Makrolon®*, as well as the Bayer name itself and our distinctive Bayer cross . Trademark protection varies widely throughout the world. In some countries, trademark protection continues as long as the mark is used. Other countries require registration of trademarks. Registrations are generally for fixed but renewable terms. Although our portfolio of trademarks is important to our business, we do not believe that any single trademark is material to Bayer s business as a whole.

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GOVERNMENTAL REGULATION

Our business is subject to significant governmental regulation. Many of our products must be examined and approved by regulatory agencies for safety, environmental impact and effectiveness before we may market them. In addition all our operations must comply with applicable environmental regulations. Relevant regulations are typically of a national scope, although within the European Union (EU), a considerable degree of harmonization exists. The EU institutions have created a common regulatory framework that applies in all of the EU Member States (and that sometimes allows EU Member States to adopt more detailed and more stringent regulations), and has indirect harmonizing effects in certain other European countries.

Product Regulation

The primary emphasis of product regulation is to assure the safety and effectiveness of our products. In the United States, the Food and Drug Administration (FDA) regulates many of our products, primarily in our HealthCare business. In addition, our pharmaceutical facilities typically require regulatory approval and are subject to periodic re-inspection. Comparable regulatory frameworks are in place in other regions as well, such as the EU, Japan, China and in most other industrialized countries.

The Toxic Substance Control Act (TSCA) administered under the U.S. Environmental Protection Agency (EPA) regulates product registrations, called premanufacture notices (PMNs), for new industrial chemicals and polymers and can also regulate existing chemicals under test rules. In addition, the FDA food-contact regulations permit use of many of our chemicals and materials in food-contact applications. Furthermore, the EPA registers biocidal products for use in antimicrobial applications in addition to those for agricultural uses. For industrial chemicals and polymers in the United States, in order to insure proper use and handling, product safety is regulated by the Occupational Safety and Health Administration (OSHA). The OSHA Hazard Communication Standard requires information concerning the hazards of chemicals to be transmitted to our workers and customers through material safety data sheets and precautionary product labels for potential hazards from exposure to chemicals.

Similarly, in the EU as well as in other regions, there are restrictive rules applying to areas including the production, marketing, processing, use and disposal of dangerous substances and preparations , food and feeding stuffs and the use of biocides.

Pharmaceutical Products

Pharmaceutical products must be examined and approved by regulatory agencies for safety and efficacy before we may market them. Our pharmaceutical facilities require regulatory approval and are subject to periodic re-inspection. All our operations must comply with applicable quality and environmental regulations. For more information on how regulatory requirements may impact our business, refer to Item 3, *Key Information Risk Factors Regulatory controls and changes in public policy may reduce the profitability of new or current products.*

The various regulatory authorities administer and execute requirements covering the testing, safety, efficacy, labeling, approval, manufacturing, marketing and post-marketing surveillance of prescription pharmaceuticals. Pharmaceutical products must receive regulatory approval before they can be marketed. The regulatory requirements follow stringent standards that vary by country. Before a drug can qualify for marketing approval, a registration dossier must be submitted to a regulatory authority for review and evaluation. The registration dossier principally contains detailed information about the safety, efficacy and quality of a new medication. It also provides details about the manufacturing process, the production facilities and information to be provided to patients. The registration process can last from a few months to a few years and depends on the nature of the medication under review, the quality of the submitted data and the efficiency of the relevant agency. If a drug meets the approval requirements, the regulatory authority will grant a product license for marketing. In some countries, negotiation on pricing and reimbursement follow the grant of the product license. The process of developing a pharmaceutical product from discovery through testing, registration and initial product launch could take approximately ten years but this period varies considerably for different products and countries. For

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marketed products, the pharmaceutical company is required to monitor adverse reactions and submit periodic reports on these reactions, if any, to the appropriate authorities.

In recent years, the European Medicines Evaluation Agency (EMEA) in the EU, the FDA in the United States and the Ministry of Health, Labor and Welfare (MHLW) in Japan have sought to shorten development and registration times for pharmaceutical products by harmonizing the individual requirements of the three regions. This process is called the International Conference on Harmonization. For the foreseeable future, however, we will need to obtain separate approval in each market.

Our Hematology/Cardiology business unit markets, among others, substances known as biologicals. Biologicals derive from biological sources (*e.g.*, from human plasma or from cell lines genetically engineered to produce a specific protein). In the United States and other markets, biologicals are regulated under specific sets of regulations that contain unique requirements specifically for biologicals. For example, in order to minimize the risk of infectious disease transmission, human plasma-derived products require donor screening and plasma testing, as well as multiple manufacturing steps designed to remove viruses and other infectious agents. Biological products are chemically complex, often depending on a precise structure (*e.g.*, the specific folding of a molecule) for their effectiveness. Regulations require us to subject these products to rigorous testing to ensure stability throughout their shelf life. Because biological products cannot withstand conventional sterilization techniques, we must use special processes to ensure sterility. Under applicable regulatory requirements, we must submit detailed documentation to demonstrate appropriate controls over our manufacturing facilities, including associated equipment and supporting utilities such as water supply and climate control.

Consumer Care Products

Most Consumer Care products are subject to regulations similar to those in the Pharmaceuticals segment. In the United States, for example, the FDA and, in part, the Federal Trade Commission, oversee the marketing, manufacturing and labeling of Consumer Care products.

Diagnostics Products

The products of the Diagnostics division are in vitro diagnostic (IVD) products, subject to regulatory controls similar to those governing the development and marketing of pharmaceutical products. In the United States, the FDA regulates IVD products as medical devices, through its Center for Devices and Radiological Health (CDRH), although the Center for Biologics Evaluation and Research (CBER) retains jurisdiction over medical devices intended for use in the diagnosis and monitoring of HIV infections. All manufacturers of medical devices must register their facilities with the FDA. Registered establishments are subject to periodic inspections by FDA investigators to ensure compliance with quality standards.

Most IVD products require FDA clearance or approval before they may be marketed. For devices requiring clearance, where possible we seek to obtain it on the grounds that the new product is substantially equivalent to a product the FDA has already cleared. FDA clearance usually takes between two and eighteen months, depending on the degree of novelty involved. For truly new IVD products, we must submit extensive data to the FDA based on actual clinical trials. FDA approval almost invariably involves an inspection of our facilities and a review of our design and manufacturing processes. After obtaining FDA approval, we must report all adverse incidents in which a product was allegedly involved.

In the EU, two Directives regulate these products. The Medical Device Directive governs diagnostic products that come in direct contact with the human body. The IVD Directive, as the name implies, applies to products used in vitro, that is those that do not come in direct contact with the human body. In Japan, a special section of the Pharmaceutical Affairs Law (PAL) regulates diagnostic products. The Japanese Ministry of Health is currently implementing significant PAL reforms with which all IVD manufacturers and their Japanese representatives must comply. In Australia and Canada, the applicable laws and regulations are similar to the European model. Many countries in South America and Asia have regulatory requirements similar to those promulgated either by the FDA or the European Commission. All of these requirements involve product registration and approval and the reporting of adverse incidents and corrective actions.

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Diabetes Care Products

Diabetes Care products are subject to regulations similar to those in the Diagnostics division. In the United States, for example, the FDA and, in part, the Federal Trade Commission, oversee the marketing, manufacturing and labeling of Diabetes Care products, while in the EU and in Japan, they are regulated by the Conformite Europeene (CE) and the MHLW, respectively.

Animal Health Products

Veterinary products must be examined and approved by regulatory agencies for quality, safety and efficacy before marketing in all countries. In the United States, the FDA s Center for Veterinary Medicine is responsible for ensuring that animal drugs are safe and effective for their intended uses and that food from treated animals is safe for human consumption. Animal health products are also regulated in the United States by the U.S. Department of Agriculture (USDA) and the EPA.

In the EU, animal health products are subject to regulations similar to those governing the Pharmaceutical sector. The centralized registration process is also governed by the European Agency for the Evaluation of Medicinal Products in London, but the committee responsible for animal health products is the Committee for Veterinary Medicinal Products (CVMP).

Three registration procedures with different regional coverage are available within the EU: In the centralized registration process (Centralized Procedure), after the dossier is submitted to the EMEA, the CVMP carries out a scientific evaluation. The CVMP opinion is then transmitted to the European Commission for its opinion, which, if also favorable, results in a binding decision for marketing authorization in all EU Member States. A company is obliged to use the Mutual Recognition Procedure if it intends to sell a medicinal product in more than one Member State, but not necessarily throughout the entire EU. A National Procedure can be used if a company wishes to license a product in just one Member State.

Crop Protection Products

In most countries, Crop Protection products must obtain government regulatory approval prior to marketing. This regulatory framework seeks to protect the consumer, the operator and the environment. Strict standards are applied in the United States, Japan and in the EU. Because humans may be exposed to these products (for example, through residues on food), the safety assessment considers human risk as well. If the product is used on a food crop, a legal limit for chemical residue is established.

It generally takes seven to nine years from discovery of a new crop protection product until the dossier is submitted to the appropriate regulatory authority for product approval. Afterwards, the authorities usually need another two to four years to evaluate the data submitted in order to decide whether a registration can be granted. The relatively long evaluation period, which may include new requirements imposed on a company after it has submitted a dossier for approval, shortens a company s utilizable patent protection time. In some jurisdictions, part of the patent period lost due to the long regulatory process can be regained through the granting of a supplemental protection certificate.

The introduction of new regulations, data requirements or test guidelines is a normal part of enhancing safety assessments for Crop Protection products. However, unpredictable new requirements and inappropriate deadlines have led to numerous delays of registrations of Crop Protection products in the past, especially in the authorization processes in the EU and in the NAFTA countries. Therefore, Bayer CropScience must anticipate new regulatory trends and must closely follow the process of developing and requiring new data. Bayer CropScience also actively participates in these processes by commenting on draft regulations proposed by the authorities.

Environmental Science Products

In both the professional and the consumer pest control business, as in crop protection, our products must obtain regulatory approval prior to marketing. In most countries, Environmental Science products are regulated by authorities other than those which regulate the Crop Protection products. The regulatory requirements are

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often different from Crop Protection products, due to different routes of exposure. Generally, there has been an increase of regulatory requirements, in particular in the United States, Europe and Japan. To some extent, the regulatory dossiers developed for Crop Protection products with the same active ingredients can also be used for the regulatory purposes in the Environmental Science area.

In the EU, certain products sold in the professional pest control area, as well as pest control products available to consumers, fall under the Biocidal Products Directive (BPD), which requires that complete regulatory dossiers be developed before placing these products or active substances for use in such products on the EU market. Certain green industry products and consumer lawn and garden products are governed by the Plant Protection Directive, which requires authorization before products can be placed on the market.

In the United States, registration of Environmental Science products is granted by the EPA. There has been an increase of registration requirements due to the implementation of the Food Quality Protection Act (FQPA), which considers both dietary and non-dietary exposure aspects. Certain food-related regulatory requirements exist in other areas, notably in the EU.

The review period for registration depends on the country and could vary from two to five years for a product containing a new active ingredient. These regulatory procedures may lead to an increase in the time period and costs involved with developing new Environmental Science products.

BioScience Products

Plant biotechnology products, marketed by our BioScience business group, in particular those based on genetic modification, are subject to specific regulatory oversight covering environmental impact as well as use and trade of products and derivatives in food and feed. The number of countries that have regulatory frameworks concerning plant technology is increasing each year and, in countries that already have such regulations, the requirements are also increasing or changing. The most important countries, based on their importance to us as an agricultural center and/or trading partner, include the United States, Canada, the EU, Japan, Brazil, Argentina, Australia and China. In the United States, the main regulatory authorities are the USDA, the FDA and the EPA. The EU has implemented a set of new regulations including the creation of a new EU Food Safety Authority. Similar regulations in Japan are under review and being updated. Many Asian countries have developed regulatory frameworks over the last few years, most recently China, Taiwan, Korea and the Philippines. With the Cartagena Protocol on BioSafety, which came into force in September 2003, it is expected that more countries will establish relevant regulatory frameworks over the next few years.

The timeframe for approvals varies substantially around the world. The development of the regulatory dossier generally takes two to three years. In the United States, Canada and Japan, the review of a regulatory dossier will typically take another one to two years. After over five years of moratoria and regulation changes, the EU is now operating under its new procedures with dossiers advancing slowly. To date the only significant progress has been on importation uses. Approvals of biotechnology-derived products for agricultural growing in the EU are not expected for some time yet.

Proposed new EU Regulations

We must comply with an increasing range of regulatory measures concerning testing, manufacturing and marketing of our products. In some countries, including the United States, regulatory controls have become increasingly demanding. We expect this trend to continue and expand to other countries.

Within the European Union a new chemicals policy has been proposed and may become effective in 2007/2008. It will, if adopted, mandate a significant increase in administration and in the testing and assessment of all chemicals used, leading to increased costs and reduced operating margins for these products.

In addition, the EU directive on emissions trading may affect Bayer s business opportunities, especially in Europe. The directive requires EU member states to meet the carbon dioxide emissions targets set for each member state under EU legislation and based on the Kyoto Protocol. Emissions levels have to be reduced by 21 percent in Germany and 7.5 percent in Belgium, in each case based on 1990 carbon dioxide emission levels.

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Compliance may require material capital expenditures in the future depending on developments in the market for emissions trading.

A communication entitled European Environment and Health Strategy was published by the Commission of the EU in June 2003 (SCALE). The strategy is intended to reduce the burden of disease caused by environmental factors in the EU by identifying and preventing new health threats caused by environmental factors. In furtherance of this strategy, the Commission adopted the European Environment and Health Action Plan for 2004-2010 on June 9, 2004. Currently, specific consequences of SCALE on our business cannot be estimated, but we are monitoring further developments and participate in relevant stakeholder processes.

Health, Safety and Environmental Regulations

The production and distribution of Bayer products involves the use, storage, transportation, handling and disposal of toxic and hazardous materials. We are subject to increasingly stringent environmental regulations, which address:

- emissions into the air;
- discharges of waste water;
- incidental and other releases into the environment;
- generation, handling, storage, transportation, treatment and disposal of hazardous and non-hazardous materials; and
- construction and operation of facilities.

It is our policy to comply with all health, safety and environmental requirements and to provide workplaces for employees that are safe. We track, check and evaluate all environmental legal initiatives and laws regarding their potential impact on our actual and past activities in order to develop appropriate measures in a timely and effective manner. When necessary, we incur capital expenditures to ensure this. We expect that Bayer will continue to be subject to stringent environmental regulation. Although we cannot predict future expenditures, we believe that current spending trends will continue.

We are subject to regulations that may require us to remove or mitigate the effects of the disposal or release of chemical substances into the environment. Under some of these regulations, a current or previous owner or operator of property may be held liable for the costs of remediation on, under, or in the property, without regard as to whether it knew of or caused the presence of the contaminants, and regardless of whether the practices that resulted in the contamination were legal at the time they occurred. As many of our industrial sites have long histories, we cannot predict the full impact of these regulations on us. We cannot assure that soil or groundwater contamination will not occur or be discovered.

In the United States, we are subject to potential liability under the U.S. Federal Comprehensive Environmental Response, Compensation, and Liability Act (CERCLA, commonly known as Superfund), the U.S. Resource Conservation and Recovery Act and related state laws for investigation and clean-up costs at a number of sites. At many of these sites, companies including Bayer have been notified that the EPA, the state governing body or private individuals consider such companies to be potentially responsible parties under Superfund or related laws. The proceedings relating to these sites are in various stages. The clean-up process at many sites is ongoing. We regularly review the liabilities for these sites and have accrued those currently quantifiable costs.

It is difficult to estimate the future costs of environmental protection and remediation because of uncertainties about the status of regulations and their future developments. Taking into consideration our experience and currently known facts, we believe that capital expenditures and remedial actions to comply with environmental regulations will not have a material adverse effect on our financial position, results of operations or cash flows. As of December 31, 2005, we had reserved 279 million for environmental matters.

We believe that we are in substantial compliance with applicable health, safety and environmental laws and regulations. We devote considerable attention to the health and safety of our employees and the protection of

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public health and the environment. As a member of the International Council of Chemical Associations (ICCA) and the American Chemistry Council, Bayer is committed to the principles of the *Responsible Care Global Charter,* the chemical industry s health, safety and environmental performance improvement initiative.

While our compliance has not adversely affected our competitive position or business, we cannot predict the impact of possible future regulations. Although we have adopted measures to address the stricter regulations, such as increasing the efficiency of our internal research and development process in order to reduce the impact of extended testing on time-to-market, stricter regulatory regimes could delay product development or restrict marketing and sales.

ORGANIZATIONAL STRUCTURE

As the management holding company of the Bayer Group, Bayer AG determines the long-term strategy for the Group and its subgroups and prescribes guidelines and principles for the corporate policy derived therefrom. Bayer AG holds equity interests in the subgroup management companies and the service companies (described below) and also in other domestic and foreign entities. The Bayer Group is managed by the four-member Board of Management of Bayer AG, which is supported by the Corporate Center. The Board of Management is responsible for the oversight of management and for the Group s financial management.

The Corporate Center, which provides services to the Board of Management and to the subgroup management companies, consists of the following corporate center functions: the Corporate Office; Communications; Investor Relations; Corporate Auditing; Corporate Human Resources & Organization; Corporate Development; Law & Patents, Insurance; Finance; Group Accounting and Controlling; Governmental & Product Affairs; and Regional Coordination.

After the spin-off of the LANXESS subgroup, effective January 28, 2005, the Bayer Group conducts its business operations in the three subgroups Bayer HealthCare, Bayer CropScience and Bayer MaterialScience. The management companies Bayer HealthCare AG, Bayer CropScience AG and Bayer MaterialScience AG, heading up the three subgroups, manage the business activities of the domestic and foreign affiliates assigned to them. Each subgroup is, within the framework of strategies, goals and guidelines determined by the Bayer AG Board of Management, an independent operating area with worldwide business accountability and its own management. Each of the subgroup management companies has entered into a control and profit and loss transfer agreement with Bayer AG.

Three service companies, Bayer Technology Services GmbH, Bayer Business Services GmbH and Bayer Industry Services GmbH & Co. OHG (in which Bayer AG owns a 60 percent stake and LANXESS a 40 percent stake), provide support functions to the three subgroups as well as to Bayer AG.

For more information on our current organizational structure, see the introduction to *Business.*

Subsidiaries

The financial statements of the Bayer Group as of December 31, 2005 included 283 consolidated companies, compared to 349 companies in 2004. With the deconsolidation of the LANXESS subgroup, 60 companies have left the Group in the first quarter of 2005.

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The following table lists Bayer AG s principal consolidated subsidiaries as of December 31, 2005 and its beneficial ownership interest in each.

Company Name and Place of Business	Bayer s Interest (%)
Germany	
Bayer Business Services GmbH, Leverkusen	100
Bayer CropScience AG, Monheim	100
Bayer CropScience Deutschland GmbH, Langenfeld	100
Bayer HealthCare AG, Leverkusen	100
Bayer Industry Services GmbH & Co. OHG, Leverkusen	60
Bayer MaterialScience AG, Leverkusen	100
Bayer Technology Services GmbH, Leverkusen	100
Bayer Vital GmbH, Leverkusen	100
H.C. Starck GmbH, Goslar	100
Wolff Cellulosics GmbH & Co. KG, Walsrode	100
Other European Countries	
Bayer Antwerpen Comm.V, Belgium	100
Bayer Consumer Care AG, Switzerland	100
Bayer CropScience France S.A.S., France	100
Bayer CropScience Limited, U.K	100
Bayer CropScience S.r.l., Italy	100
Bayer Diagnostics Europe Ltd., Ireland	100
Bayer International S.A., Switzerland	99.7
Bayer Pharma S.A.S., France	99.9
Bayer Polyols S.N.C., France	100
Bayer Public Limited Company, U.K	100
Bayer S.p.A., Italy	100
Bayer Santé Familiale S.A.S., France	100
Bayer SP.Z.O.O., Poland	100
Quimica Farmaceutica Bayer, S.A., Spain	100
North America	
Bayer CropScience Inc., Canada	100
Bayer CropScience LP, USA	100
Bayer HealthCare LLC, USA	100
Bayer Inc., Canada	100
Bayer MaterialScience LLC, USA	100
Bayer Pharmaceuticals Corporation, USA	100
H.C. Starck Inc., USA	100

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Company Name and Place of Business	Bayer s Interest (%)
Asia/Pacific	
Bayer Australia Limited, Australia	99.9
Bayer CropScience K.K., Japan	100
Bayer Korea Ltd., Republic of Korea	100
Bayer MaterialScience Limited, Hong Kong	100
Bayer Medical Ltd., Japan	100
Bayer South East Asia Pte Ltd., Singapore	100
Bayer Yakuhin, Ltd., Japan	100
H.C. Starck Ltd., Japan	100
Sumika Bayer Urethane Co., Ltd., Japan	60
Latin America/ Africa/Middle East	
Bayer (Proprietary) Limited, South Africa	100
Bayer CropScience Ltda., Brazil	100
Bayer de Mexico, S.A. de C.V., Mexico	100
Bayer S.A., Argentina	99.9
Bayer S.A., Brazil	99.9
Bayer Türk Kimya Sanayi Limited Sirketi, Turkey	100

Also included in the consolidated financial statements are the following material associated companies:

Company Name and Place of Business	Bayer s Interest (%)
GE Bayer Silicones GmbH & Co. KG, Germany	49.9
Lyondell Bayer Manufacturing Maasvlakte VOF, Netherlands	50.0
Palthough Industries (1998) Ltd., Israel	20.0
PO JV, LP, USA	42.7
Polygal Plastics Industries Ltd., Israel	25.8

PROPERTY, PLANTS AND EQUIPMENT

We operate through a large number of offices, research facilities and production sites throughout the world. The principal executive offices of Bayer AG are located in Leverkusen, Germany. Our key production facilities are located in Germany and the United States. We also have other properties, including office buildings, laboratory and research laboratories and distribution centers throughout the world. For the major production and R&D facilities by segment please refer to *Markets and Distribution* and *Research and Development* for each of the segments.

Our policy is to acquire full ownership rights in our manufacturing facilities whenever possible. We own most of our manufacturing facilities and other properties. Where locally applicable law does not permit this or acquisition of full property rights is otherwise unfeasible, we acquire possessory interests conferring substantially the same rights of use as ownership (for example, German-law hereditary building rights or *Erbbaurechte* and granted land-use rights in Asian countries).

We believe that our production plants and manufacturing facilities have capacities adequate for our current and projected needs. In 2005, no assets of the Bayer Group were pledged to secure financial liabilities.

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The acquisition of the Roche s global Consumer Health business except for Japan includes production sites in Germany, France, Morocco, Indonesia and Argentina. For further details on the acquisition refer to *History and Development of the Company*.

At the time of its spin-off, the LANXESS subgroup, which ceased to be part of the Bayer Group at the end of January 2005, operated production sites in about 18 countries. The sites were located on property owned or purchased by LANXESS, rented to LANXESS by Bayer or used by LANXESS based on hereditary building rights (*Erbbaurechte*). For further details on the spin-off, refer to *History and Development of the Company* or to Item 5, *Operating and Financial Review and Prospects Operating Results 2003, 2004 and 2005 Discontinued Operations LANXESS*.

The following table summarizes our major facilities by subgroup:

Location	Size of developed property in thousand square meters	Major use
Bayer HealthCare		
Leverkusen, Germany	125	Formulation and packaging of pharmaceutical products
Wuppertal, Germany	448	Production of active ingredients for ethical pharmaceutical products, research and development
Berkeley, California	112	Production of recombinant FVIII
Myerstown, Pennsylvania	44	Formulation and packaging of Consumer Care products
Mishawaka, Indiana	32	Production of instruments for Diabetes Care division
Bayer CropScience		
Monheim, Germany	651	Research and development for Crop Protection and Environmental Science, headquarters of Bayer CropScience
Frankfurt, Germany	261	Research and development as well as production and formulation for Crop Protection and Environmental Science
Dormagen, Germany	140	Production and formulation for Crop Protection and Environmental Science
Kansas City, Missouri	732	Production and formulation for Crop Protection and Environmental Science
Haelen, The Netherlands	500	Research and development as well as production for BioScience (Seeds)
Bayer MaterialScience		
Krefeld-Uerdingen, Germany	208	Production of polycarbonates, diphenylmethane diisocyanates, chlorine, caustic soda, hydrochloric acid and hydrogen
Baytown, Texas	1,628	Production of base- and modified isocyanates, polycarbonates, diphenylmethane diisocyanates, toluene diisocyanates, chlorine, caustic soda,

		hydrochloric acid and hydrogen
Dormagen, Germany	264	Production of modified isocyanates, resins, polycarbonate films, toluene diisocyanates, polyether, thermoplastic polyurethanes, chlorine, caustic soda, hydrochloric acid and hydrogen
Antwerp, Belgium	639	Production of polycarbonates, aniline, nitrobenzene and polyether
Brunsbüttel, Germany	137	Production of diphenylmethane diisocyanates, toluene diisocyanates, chlorine, hydrochloric acid and hydrogen

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Since the end of 2003, Bayer MaterialScience has been expanding capacities and establishing large-scale facilities at its integrated production site in Caojing, China (near Shanghai), as presented in the following table:

	Plant Capacity (in kt)	Start-Up	Status
Coatings, Adhesives, Sealants (*Desmodur® N*)	12	April 2003	In operation
Coatings, Adhesives, Sealants (*Desmodur® L*)	11	January 2005	In operation
Polycarbonates (Compounding)	40	July 2005	In operation
Polycarbonates (PCS Phase I)	100	expected: 2nd quarter 2006	Under construction
Polyurethanes (MDI Phase I, MMDI-Splitter)	80	expected: 3rd quarter 2006	Under construction
Coatings, Adhesives, Sealants (HDI-4)	30	expected: January 2007	Under construction
Polyurethanes (MDI Phase II)	350	2008	
Polycarbonates (PCS Phase II)	100	2008	
Polyurethanes (TDI)	160	2009	

For information on environmental issues relating to Bayer s properties see *Information on the Company Governmental Regulation Health, Safety and Environmental Regulations*. Additional information regarding Bayer s property, plant and equipment is contained in Item 5, *Operating and Financial Review and Prospects Liquidity and Capital Resources 2003, 2004 and 2005 Capital expenditures* and in Note 20 to the consolidated financial statements appearing elsewhere in this annual report.

Item 4A. ***Unresolved Staff Comments***

None.

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Item 5. ***Operating and Financial Review and Prospects***

Investors should read the following operating and financial review and prospects together with the consolidated financial statements and the notes to those financial statements included elsewhere in this annual report. We have prepared these financial statements in accordance with IFRS, which differs in some respects from U.S. GAAP. For a reconciliation of net income and stockholder s equity to U.S. GAAP, see Note 44 to our consolidated financial statements.

The forward-looking statements in this Item 5 are not guarantees of future performance. They involve both risk and uncertainty. Several important factors could cause our actual results to differ materially from those anticipated by these statements. Many of those factors are macroeconomic in nature and are, therefore, beyond the control of our management. See *Forward-Looking Information.*

We have based the presentation of our results in this section on certain significant accounting assumptions. For a more detailed description of these assumptions, see *Critical Accounting Policies,* below.

In connection with the adoption of IFRS 5, as well as the application of related IFRS standards, the financial information presented in this annual report for 2003, 2004 and 2005 only reflects continuing operations of the Bayer Group and its segments, except where specific reference is made to discontinued operations. The 2003 and 2004 figures for operating result, non-operating result, operating expenses and related key figures have been restated to give effect to this new form of presentation and to new IFRS accounting standards adopted in 2005 that require retrospective application. For more details, refer to *Basis of Presentation Effects of new accounting pronouncements* and Note 3 to the consolidated financial statements appearing elsewhere in this annual report.

OVERVIEW

We are a global company focusing on our strengths in the fields of health care, nutrition and innovative materials. Our goal is to strengthen the competitiveness of our businesses in the HealthCare, CropScience and MaterialScience subgroups by concentrating on the special needs of these businesses.

Bayer comprises the parent company, Bayer AG of Leverkusen, Germany, and approximately 280 consolidated subsidiaries. After the spin-off of the LANXESS subgroup, we are organized into eight business segments Pharmaceuticals, Biological Products (known as Pharmaceuticals effective January 1, 2006); Consumer Care; Diabetes Care, Diagnostics; Animal Health; Crop Protection; Environmental Science, BioScience; Materials and Systems. For further information on our organizational structure, see Item 4, *Information on the Company Business* and *Organizational Structure.*

To streamline our portfolio and to concentrate on our core businesses, we selectively divest businesses and assets that no longer fit our strategic plan. For our principal acquisitions and divestitures during the last three years, refer to Item 4, *Information on the Company History and Development of the Company* and Note 7.2 to the consolidated financial statements appearing elsewhere in this annual report.

At the end of January 2005, the LANXESS subgroup was spun off from, and ceased to be part of, the Bayer Group. LANXESS AG is now a legally independent company. The shares of LANXESS AG have been listed on the Frankfurt Stock Exchange since January 31, 2005. For more details on the spin-off, please refer to *Operating Results 2003, 2004 and 2005 Discontinued Operations.*

CRITICAL ACCOUNTING POLICIES

The preparation of the financial statements for the Bayer Group requires the use of estimates and assumptions. These affect the classification and valuation of assets, liabilities, income, expenses and contingent liabilities. Estimates and assumptions mainly relate to the useful life of noncurrent assets, the discounted cash flows used in impairment testing and the establishment of provisions for litigation, pensions and other benefits, taxes, environmental protection, inventory valuations, sales allowances, product liability and guarantees. Estimates are based on historical experience and other assumptions that are considered reasonable under the

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circumstances. Actual values may vary from the estimates. The estimates and the assumptions are continually reviewed.

To enhance the information content of the estimates, certain provisions that could have a material effect on the financial position, results of operations or cash flows of the Group are selected and tested for their sensitivity to changes in the underlying parameters. To reflect uncertainty about the likelihood of the assumed events actually occurring, the impact of a 5 percent change in the probability of occurrence is examined in each case. For long-term interest-bearing provisions, the impact of a 1 percent change in the interest rate used is analyzed. Analysis has not shown other provisions to be materially sensitive. The interest sensitivity of pension obligations is discussed in Note 28 to the consolidated financial statements appearing elsewhere in this annual report.

Critical accounting and valuation policies and methods are those that are both most important to the portrayal of the Bayer Group s financial position, results of operations and cash flows, and that require the application of difficult, subjective and complex judgments, often as a result of the need to make estimates about the effects of matters that are inherently uncertain and may change in subsequent periods. The main accounting and valuation policies used by the Bayer Group are outlined in Note 4.3 to the consolidated financial statements appearing elsewhere in this annual report. While not all of the significant accounting policies require difficult, subjective or complex judgments, the Company considers that the following accounting policies should be considered critical accounting policies.

Intangible assets and property, plant and equipment

At December 31, 2005 the Bayer Group had intangible assets with a net carrying amount of 7,688 million including goodwill of 2,623 million (Note 19), and property, plant and equipment with a net carrying amount of 8,321 million (Note 20). Intangible assets with finite useful lives and property, plant and equipment are amortized over their estimated useful lives. The estimated useful lives are based on estimates of the period during which the assets will generate revenue. Further, until the end of fiscal 2004, the Bayer Group amortized goodwill arising from business combinations with an agreement date prior to March 31, 2004 over its scheduled useful life. This practice was discontinued effective January 1, 2005 in compliance with IFRS 3 (Business Combinations) and the revised versions of IAS 36 (Impairment of Assets) and IAS 38 (Intangible Assets), which prohibit the amortization of goodwill and other intangible assets with indefinite useful lives.

Intangible assets with finite useful lives and property, plant and equipment are tested for impairment whenever events or changes in circumstances indicate that the carrying amount of the assets may no longer be recoverable. Goodwill and intangible assets with indefinite useful lives must be tested annually for impairment. In compliance with IAS 36 (Impairment of Assets), impairment losses are measured by comparing the carrying amounts to the discounted cash flows expected to be generated by the respective assets. Where it is not possible to estimate the impairment loss for an individual asset, the loss is assessed on the basis of the discounted cash flow for the cash-generating unit to which the asset belongs. Estimating the discounted future cash flows involves significant assumptions, especially regarding future sales prices, sales volumes and costs. The discounting process is also based on assumptions and estimations relating to business-specific costs of capital, which in turn are based on country risks, credit risks and additional risks resulting from the volatility of the respective line of business as well as the capital structure of the relevant subgroup. Further information on the procedure for impairment testing and the residual carrying amounts of goodwill at the balance sheet date is presented in Note 4.5 to the consolidated financial statements appearing elsewhere in this annual report.

To illustrate the Bayer Group s impairment loss measurement, if the actual present value of future cash flows were 10 percent lower than the anticipated present value, the net carrying amount of goodwill in the Crop Protection segment would have to be impaired by 48 million. The present value of future cash flows measures an asset s value in use , *i.e.*, its value based on our continuing use of the asset and its retirement at the end of its useful life. In the Systems segment, the net carrying amount of goodwill would have to be impaired by 5 million and that of other intangible assets by 19 million. If the weighted average cost of capital used for the impairment test were increased by 10 percent, it would not affect the net carrying amounts of the strategic business entities assets.

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Estimates are also used in the course of acquisitions to determine the fair value of the assets and liabilities acquired. Land, buildings and equipment are usually appraised independently, while marketable securities are valued at market price. If any intangible assets are identified, depending on the type of asset and the complexity of determining its fair value, Bayer either consults with an independent external valuation expert or develops the fair value internally, using an appropriate valuation technique which is generally derived from a forecast of the total expected future net cash flows. Assets may be valued using methods based on cost, market price or net present value, depending on the type of asset and the availability of information. The valuation method based on net present value (income approach) is particularly important with respect to intangible assets. Trademarks and licenses, for example, are valued by the relief-from-royalty method, which includes estimating the cost savings that result from the company s ownership of trademarks and licenses on which it does not have to pay royalties to a licensor. The intangible asset is then recognized at the present value of these savings.

Although the Board of Management of Bayer AG believes that its estimates of the relevant expected useful lives, its assumptions concerning the macroeconomic environment and developments in the industries in which the Bayer Group operates and its estimations of the discounted future cash flows are appropriate, changes in assumptions or circumstances could require changes in the analysis. This could lead to additional impairment charges in the future or to valuation write-backs should the trends expected by the Board of Management of Bayer AG reverse.

Research and development

In addition to the in-house research and development activities, various research and development collaborations and alliances are maintained with third parties; these collaborations and alliances involve the provision of funding and/or payments for the achievement of performance milestones. All research costs are expensed as incurred. Since development projects are subject to regulatory approval procedures and other uncertainties, the conditions for the capitalization of costs incurred before approvals are received are not satisfied, and these costs, too, are therefore expensed as incurred. With respect to costs incurred in collaborations and alliances with third parties, considerable judgment is involved in assessing whether milestone-based payments simply reflect the funding of research, in which case expensing is always required, or whether, by making a milestone payment, an asset is acquired. In the latter case, the relevant costs are capitalized.

Net sales

The nature of the Bayer Group s business activities means that the structure of many sales transactions is complex. Sales are recognized upon transfer of risk or rendering of services to third parties. Revenues from contracts that contain customer acceptance provisions are deferred until customer acceptance occurs. It is customary to grant price discounts in the normal course of business. Allocations to provisions for discounts and rebates to customers are recognized in the same period in which the related sales are recorded based on the contract terms, using a consistent method. The cost of such sales incentives is estimated on the basis of historical experience with similar incentive programs. For rebates, provisions are recorded based upon the experience ratio to the respective period s sales to determine the rebate accrual and related expense. Provisions related to the Group s trade accounts amounted to 648 million on December 31, 2005.

Some of the Bayer Group s revenues are generated from licensing agreements under which third parties are granted rights to certain of our products and technologies. Upfront payments and similar non-refundable payments received under these agreements are recorded as miscellaneous liabilities and recognized in income over the estimated performance period stipulated in the agreement. Non-refundable milestone payments linked to the achievement of a significant and substantive technical/ regulatory hurdle in the research and development process, pursuant to collaborative agreements, are recognized as revenue upon the achievement of the specified milestone. Revenues are also derived from research and development collaborations and co-promotion agreements. Such agreements may consist of multiple elements and provide for varying consideration terms, such as upfront, milestone and similar payments, which may be complex and require significant analysis by management in order to separate individual revenue components and recognize them on the most appropriate dates. This may have to be done partially on the basis of assumptions.

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Pensions and other post-employment benefits

Group companies provide retirement benefits for most of their employees, either directly or by contributing to independently-administered funds. The way these benefits are provided varies according to the legal, fiscal and economic conditions of each country, the benefits generally being based on the employees remuneration and years of service. The obligations relate both to existing retirees pensions and to pension entitlements of future retirees. Group companies provide retirement benefits under defined contribution and/or defined benefit plans. In the case of defined contribution plans, the company pays contributions to publicly or privately administered pension insurance plans on a mandatory, contractual or voluntary basis. Once the contributions have been paid, the company has no further payment obligations. All other retirement benefit systems are defined benefit plans, which may be either unfunded, *i.e.*, financed by provisions (accruals), or funded, *i.e.*, financed through pension funds. Statistical and actuarial methods are used to anticipate future events in calculating the expenses and liabilities related to the plans. These calculations include assumptions about the discount rate, expected return on plan assets and rate of future compensation increases.

The interest rate used to discount post-employment benefit obligations to present value is derived from the yields of senior, high-quality corporate bonds in the respective country at the balance sheet date. These generally include AA-rated securities. The discount rate is based on the yield of a portfolio of bonds whose weighted residual maturities approximately correspond to the duration necessary to cover the entire benefit obligation. If AA-rated corporate bonds of equal duration are not available, a discount rate equivalent to the effective interest rate for government bonds at the balance sheet date is used instead but increased by about 0.5 to 1.0 percentage point since corporate bonds generally provide higher yields by virtue of their risk structure.

Determination of the discount rate is also based on the average yield for a bond portfolio corresponding to the expected cash outflows from the pension plans.

The assumption for the expected return-on-assets reflects a long-term outlook for global capital market returns that corresponds to the duration of the pension obligation, and a diversified investment strategy. The investment policy of Bayer Pensionskasse is geared toward regulatory compliance and toward maintaining the risk structure corresponding to the benefit obligations. To this end, Bayer Pensionskasse has developed a strategic target portfolio commensurate with the risk profile. This investment strategy focuses principally on stringent management of downside risks rather than on maximizing absolute returns. In other countries, too, the key criteria for the funds investment strategies are the structure of the benefit obligations and the risk profile. Other determinants are risk diversification, portfolio efficiency and a country-specific and global risk/return profile capable of ensuring payment of all future benefits. The expected return is applied to the fair market value of plan assets at each year end.

Statistical information such as withdrawal and mortality rates is also used in estimating the expenses and liabilities under the plans. Because of changing market and economic conditions, the expenses and liabilities actually arising under the plans in the future may differ materially from the estimates made on the basis of these actuarial assumptions. The plan assets are partially comprised of equity and fixed-income instruments. Therefore, declining returns on equity markets and markets for fixed-income instruments could necessitate additional contributions to the plans in order to cover future pension obligations. Also, higher or lower withdrawal rates or longer or shorter life of participants may have an impact on the amount of pension income or expense recorded in the future. On December 31, 2005, the present value of provisions for pensions and other post-employment benefits payable under defined benefit plans was 15,561 million. Further details on pension provisions and their interest rate sensitivity are provided in Note 28 to the consolidated financial statements appearing elsewhere in this annual report.

Doubtful accounts

Doubtful accounts are reported at the amounts likely to be recoverable based on historical experience of customer default. As soon as it is learned that a particular account is subject to a risk over and above the normal credit risk (*e.g.*, low creditworthiness of customer, dispute as to the existence or the amount of the claim, non-enforceability of the claim for legal reasons etc.), the account is analyzed and written down if circumstances

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indicate the receivable is uncollectible. Accumulated write-downs of receivables amounted to 348 million as of December 31, 2005.

Environmental provisions

The business of the Bayer Group is subject to a variety of laws and regulations in the jurisdictions in which it operates or maintains properties. Provisions for expenses that may be incurred in complying with such laws and regulations are set aside if environmental inquiries or remediation measures are probable, the costs can be reliably estimated and no future benefits are expected from such measures.

It is difficult to estimate the future costs of environmental protection and remediation because of many uncertainties, particularly with regard to the status of laws, regulations and the information available about conditions in the various countries and at the individual sites. Significant factors in estimating the costs include previous experiences in similar cases, expert opinions regarding environmental programs, current costs and new developments affecting costs, management s interpretation of current environmental laws and regulations, the number and financial position of third parties that may become obligated to participate in any remediation costs on the basis of joint liability, and the remediation methods which are likely to be deployed. Changes in these assumptions could impact future reported results. Subject to these factors, but taking into consideration experience gained to date regarding environmental matters of a similar nature, Bayer believes the provisions to be adequate based upon currently available information. However, given the inherent difficulties in estimating liabilities in this area, it cannot be guaranteed that additional costs will not be incurred beyond the amounts accrued. It is possible that final resolution of these matters may require expenditures to be made in excess of established provisions, over an extended period of time and in a range of amounts that cannot be reasonably estimated. Management nevertheless believes that such additional amounts, if any, would not have a material adverse effect on the Group s financial position, results of operations or cash flows. Group provisions for environmental protection measures amounted to 279 million on December 31, 2005. Further information on environmental provisions can be found in Note 29.2 to the consolidated financial statements appearing elsewhere in this annual report.

Litigation provisions

As a global company with a diverse business portfolio, the Bayer Group is exposed to numerous legal risks, particularly in the areas of product liability, patent disputes, tax assessments, competition and antitrust law, and environmental matters. The outcome of the currently pending and future proceedings cannot be predicted with certainty. Thus, an adverse decision in a lawsuit could result in additional costs that are not covered, either wholly or partially, under insurance policies and that could significantly impact the business and results of operations of the Bayer Group. If the Bayer Group loses a case in which it seeks to enforce its patent rights, a decrease in future earnings could result as other manufacturers could be permitted to begin to market products that the Bayer Group or its predecessors had developed.

Litigation and other judicial proceedings as a rule raise difficult and complex legal issues and are subject to many uncertainties and complexities including, but not limited to, the facts and circumstances of each particular case, issues regarding the jurisdiction in which each suit is brought and differences in applicable law. Upon resolution of any pending legal matter, the Bayer Group may be forced to incur charges in excess of the presently established provisions and related insurance coverage. It is possible that the financial position, results of operations or cash flows of the Bayer Group could be materially affected by the unfavorable outcome of litigation. Litigation and administrative proceedings are evaluated on a case-by-case basis considering the available information, including that from legal counsel, to assess potential outcomes. Where it is considered probable that a future obligation will result in an outflow of resources, a provision is recorded in the amount of the present value of the expected cash outflows if these are deemed to be reliably measurable. These provisions cover the estimated payments to plaintiffs, court fees and the cost of potential settlements.

Provisions for litigation-related expenses totaled 663 million on December 31, 2005. Further details on legal risks are contained in Item 8, *Financial Information Legal Proceedings* and in Note 35 to the consolidated financial statements appearing elsewhere in this annual report.

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Income taxes

To compute provisions for taxes, estimates have to be made. Estimates are also necessary to determine whether valuation allowances are required against deferred tax assets. These involve assessing the probabilities that deferred tax assets resulting from deductible temporary differences and tax losses can be utilized to offset taxable income. Uncertainties exist with respect to the interpretation of complex tax regulations and the amount and timing of future taxable income. Given the wide range of international business relationships and the long-term nature and complexity of existing contractual agreements, differences arising between the actual results and the assumptions made, or future changes to such assumptions, could necessitate adjustments to tax income and expense in future periods. The Group establishes what it believes to be reasonable provisions for possible consequences of audits by the tax authorities of the respective countries. The amount of such provisions is based on various factors, such as experience with previous tax audits and differing interpretations of tax regulations by the taxable entity and the responsible tax authority. Such differences of interpretation may arise on a wide variety of issues depending on the conditions prevailing in the respective Group company s domicile. On December 31, 2005, net liabilities for current tax payments amounted to 381 million, and net deferred tax assets amounted to 1,418 million. Further information on income taxes is provided in Note 16 to the consolidated financial statements appearing elsewhere in this annual report.

OPERATING RESULTS 2003, 2004 AND 2005

Introduction

Most significant drivers of our sales, results of operations and cash flows in 2005

The most significant drivers of our sales, results of operations and cash flows in 2005 were:

- The general economic situation and improvements in the business climates in the industries of some of our customers in the course of 2005;
- Raw materials, pricing *i.e.*, the effects on our results of operations of the increased prices of petrochemical raw materials, other precursors and energy;
- Effects on net sales from acquisitions and divestitures particularly our acquisition of Roche s Consumer Health business and our spin-off of LANXESS;
- Our incurrence of other charges that we view as special, consisting primarily of provisions established and other expenses incurred in connection with legal matters (special charges did not affect our sales, results of operations and cash flows to the same extent as they did in 2003, when we incurred substantial impairment charges, unscheduled amortization expenses and other write-downs), which are discussed in *Reconciliation from operating result to operating result before special items.*

In addition, changes in exchange rates *i.e.*, the effects on our results of operations of the strengthening of the euro against other currencies have in recent years been a significant driver of our results of operations. In 2005, these changes were less significant.

General Economic Situation

The global economy continued to grow strongly in 2005. Following a slight downswing in the second quarter, rapid expansion continued for the remainder of the year. The uncertainty caused by several sharp rises in the price of oil, particularly in the first half of the year, did not completely negate the positive underlying trend. Two of the world s major growth engines, the United States and China, once again performed very well, stimulating other countries economies with their demand for imports. The overall business environment in the industrialized countries was further buoyed by favorable monetary conditions. Despite moderate increases in interest rates in the United States and Europe during the year, interest-rate policy as a whole, had a stimulating effect on the economy.

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Raw Materials, Pricing

The single most important factor that affects our costs is the price of raw materials for our products. Petrochemical feedstocks are important raw materials in many of our products, especially in our Materials and Systems segments. We do not produce petrochemical raw materials. For this reason and due to the volatility of oil and petroleum commodity and futures markets in recent years, our single greatest raw materials sensitivity is to fluctuations in the price of petrochemicals and related derivative products. In 2005, these prices were approximately 10 percent above the average prices in 2004. During the same period, the average annual crude oil price (IPE Brent) increased by approximately 30 percent.

Effects on net sales from acquisitions and divestitures

Acquisitions and divestitures during 2005 and 2004 had a positive effect on net sales in 2005 of 2,070 million, and acquisitions and divestitures during 2004 and 2003 had a negative effect on net sales in 2004 of 224 million. These portfolio changes affected the comparison between the three years sales figures as shown in the following two tables:

	Change in 2005 from 2004 (Euros in millions)
Acquisitions	
Roche	1,061
Gustafson (remaining 50 percent acquired in 2004)	25
BaySystems	7
	1,093
Divestitures	
Nutritions, Spain (divested in 2004)	(4)
Net sales to LANXESS after the spin-off on January 31, 2005 (in 2004, sales to LANXESS were classified as internal sales)	981
Net effects on sales	2,070

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	Change in 2004 from 2003 (Euros in millions)
Acquisitions	
Gustafson	34
Other	11
	45
Divestitures	
Dispositions in compliance with antitrust conditions in connection with purchase of Aventis CropScience	(100)
PolymerLatex group (divested in 2003)	(62)
Walothen GmbH (divested in 2003)	(47)
Household insecticides business (divested in 2003)	(25)
Animal Health vaccines (divested in 2003)	(16)
Bayer Shell (divested in 2003)	(15)
Other	(4)
	(269)
Net effects on sales	(224)

Reconciliation from operating result to operating result before special items

In the consolidated operating results information we present below, we report, in addition to our operating result, a measure of operating result that excludes impairment charges and write-downs, restructuring charges and unscheduled amortization, portfolio changes and other charges that we view as special (consisting primarily of provisions established and other expenses incurred in connection with legal matters), all of which we refer to as special items . Operating result before special items is defined neither under IFRS nor under U.S. GAAP and may not be comparable with measures of the same or similar title that are reported by other companies. Under the rules of the Securities and Exchange Commission (SEC) operating result before special items is considered a non-GAAP financial measure. It should not be considered as a substitute for, or confused with, any IFRS or U.S. GAAP financial measure. We believe the most comparable IFRS and U.S. GAAP measure is operating result. We present operating result before special items , both on a consolidated and on a segment basis, because we believe that doing so assists readers in understanding the performance of our business without the large impacts on the operating result figures resulting from our decisions to reorient our business and from certain expenses (such as some of our impairments and provisions and expenses in respect of legal matters). Readers should consider operating result before special items in conjunction with operating result recorded on our income statement. Due to the application of new International Financial Reporting Standard IFRS 5, all figures presented below are reported for our continuing business only. The special items described in this section therefore only relate to our continuing business operations. For information on the significant charges relating to our discontinued operations that were classified as special items in previous years, please refer to *Discontinued Operations*.

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The following table shows our operating result, the special items and our operating result before special items.

	2003	2004	2005
	(Euros in millions)		
Operating result	575	1,875	2,812
Impairment charges and write-downs	(622)	0	0
Restructuring charges and unscheduled amortization	(405)	(82)	(127)
Portfolio changes	458	(40)	(72)
Other charges	(495)	(120)	(289)
Total special items	(1,064)	(242)	(488)
Operating result before special items	1,639	2,117	3,300

Impairment charges and write-downs

In 2005, we did not incur any impairment charges or write-downs. All impairment charges and write-downs incurred by us in 2004 related to our discontinued businesses LANXESS and the U.S. activities of our former plasma business. They therefore do not appear in our operating result from continuing operations.

In 2003, we recognized charges related to impairments and other asset write-downs of 622 million relating to portions of our polymers activities that remained with the Bayer Group after the LANXESS spin-off and now form part of our Systems segment.

For details on those impairment charges and write downs in 2003 and 2004 that relate to LANXESS and the U.S. activities of our former plasma business, please refer to *Discontinued Operations*.

Restructuring charges and unscheduled amortization

In 2005, we incurred charges in connection with restructuring measures and unscheduled amortization totaling 127 million. The following table allocates the restructuring charges and unscheduled amortization of fixed assets and intangibles we recognized in 2005 according to the businesses and activities to which they relate:

Activity/ Business in 2005	Severance Payments	Unscheduled Amortization	Other Charges	Total
		(Euros in millions)		
Reorganization of the polyurethanes business	0	0	33	33
Restructuring measures relating to CropScience activities in France	23	0	0	23
Consolidation of smaller CropScience sites in the United States	7	2	3	12
Relocation of headquarters of the Diabetes Care division to Tarrytown, New York	7	12	0	19
Reduction in useful economic life of licenses and inventory write-down	0	15	3	18
Restructuring of pharmaceutical activities in West Haven, Connecticut and Wuppertal, Germany	0	17	5	22
Totals	37	46	44	127

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In 2004, we incurred charges in connection with restructuring measures and unscheduled amortization totaling 82 million. The following table allocates the restructuring charges and unscheduled amortization of fixed assets and intangibles we recognized in 2004 according to the businesses and activities to which they relate:

Activity/ Business in 2004	Severance Payments	Unscheduled Amortization	Other Charges	Total
		(Euros in millions)		
Restructuring of the pharmaceutical research and development activities	24	0	0	24
Closure of major parts of a production facility in Hauxton, U.K.	5	7	1	13
Personnel reductions in connection with the Schering-Plough alliance	32	0	13	45
Totals	61	7	14	82

In 2003, we incurred charges in connection with restructuring measures and unscheduled amortization totaling 405 million. The following table allocates the restructuring charges and unscheduled amortization of fixed assets and intangibles we recognized in 2003 according to the businesses and activities to which they relate:

Activity/ Business in 2003	Severance Payments	Unscheduled Amortization	Other Charges	Total
		(Euros in millions)		
Closure of research facilities in Kyoto, Japan and Berkeley, California	10	101	28	139
Continued integration of businesses acquired in 2002 from Aventis CropScience	100	2	0	102
Personnel adjustments in Polymers area	28	0	0	28
Plant closure in West Haven, Connecticut	8	21	3	32
Closure of the polyether production site at Institute, West Virginia	3	12	4	19
Further ongoing restructuring programs to improve profitability	0	5	36	41
Totals	149	141	71	361
Write-downs on enterprise management systems	0	44	0	44
Totals	149	185	71	405

Portfolio changes

Acquisition and disposition activities also affect our results of operations, and are responsible for substantial fluctuations in our results from year to year. In connection with our strategic reorientation and focus on our core businesses, we have been disposing of numerous businesses, investments and participations. Our most recent transactions are described in Item 4, *Information on the Company History and Development of the Company.* Our special items in connection with changes in our portfolio (other than those resulting from discontinued operations) had

a net negative effect of 72 million in 2005 and 40 million in 2004, and a positive effect of 458 million in 2003.

Our special items in connection with changes in our portfolio in 2005 were 71 million in costs for the integration of the consumer health business acquired from Roche, 13 million in charges relating to the LANXESS spin-off and a 12 million gain from the sale of business activities by Bayer Industry Services.

Our special items in connection with changes in our portfolio in 2004, with a net negative effect of 40 million, included 77 million in charges for the stock exchange listing of LANXESS and 51 million in gains from sales of licenses.

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Our special items in connection with changes in our portfolio in 2003, with a net positive effect of 458 million, comprised mainly the disposition of a large part of our global household insecticides business (256 million), the disposition of real estate in Germany, Belgium, Spain and the United States (109 million) and divestment of products in connection with the Aventis CropScience acquisition (46 million). The remaining 47 million primarily comprised the sale of our interest in the PolymerLatex Group and the sales of rights to brands.

Other charges

Other charges in 2005 that we view as special, had a net negative effect of 289 million and consisted primarily of provisions established and other expenses incurred totaling 451 million. These provisions and other expenses relate to several legal matters discussed in Item 8, *Financial Information Legal Proceedings*. The most significant charges related to the establishment of provisions in connection with antitrust proceedings for polymer products (336 million). In connection with HealthCare products we had litigation-related expenses totaling 105 million in 2005. Furthermore, we had one-time charges of 106 million arising from the termination of the co-promotion agreement with GlaxoSmithKline for *Levitra*® outside the United States. The charges were partially offset by a one-time non-cash gain of an aggregated 283 million due to changes to our pension plans in the United States and Germany.

In 2005, Bayer continued the reorganization of its corporate pension systems around the world, particularly in Germany and the United States. In the United States defined-benefit plans were replaced with a pure defined-contribution plan. The changes resulted in one-time pre-tax gain of 283 million, after offsetting minor effects of the adjustment of pension systems in Germany. The amount impacts all segments. For further details on the changes, please refer to Note 28 to the consolidated financial statements presented elsewhere in this annual report.

Our 2004 charges of 120 million primarily comprised provisions established and other expenses incurred totaling 139 million relating to a number of the legal matters discussed in Item 8, *Financial Information Legal Proceedings,* including 47 million in *Lipobay/ Baycol* charges. The charges were partially offset by gains from curtailment of pension plans amounting to 48 million.

The primary components of the other charges totaling 495 million in 2003 included a 300 million charge taken on the basis of the final agreement reached with the majority of insurers in connection with *Lipobay/ Baycol*. The remaining 195 million primarily comprised expenses incurred in relation with staff reductions through special early retirement and further *Lipobay/ Baycol* charges.

Changes in Exchange Rates

Our net sales and our operating result are generally affected by changes in exchange rates. Because a substantial portion of our assets, liabilities, sales and earnings are denominated in currencies other than the euro zone currencies, we have exposure to fluctuations in the values of these currencies relative to the euro. These currency fluctuations, especially the fluctuation of the value of the U.S. dollar relative to the euro, but also fluctuations in the currencies of the countries in which we have significant operations and/or sales, can have a material impact on our results of operations. We face both transaction risk, where our businesses generate sales in one currency but incur costs relating to that revenue in a different currency, and translation risk, which arises when we translate the income statements of our subsidiaries into euro for inclusion in our financial statements. We do not quantify the effects on our financial statements of transaction risks. Translation risks, which we do quantify and against which we do not hedge, do not affect our local currency cash flows or results of operations, but do affect our consolidated financial statements. For further information on transaction and translation risk, see Item 11, *Quantitative and Qualitative Disclosures about Market Risk Currency Risk.*

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The following table sets forth the exchange rates for the euro of currencies important for our results of operations during 2005:

	Units of Foreign Currency per Euro			
	At December 31,		Average For the Year Ended December 31,	
	2004	2005	2004	2005
Argentinean peso	4.05	3.57	3.66	3.64
Brazilian real	3.62	2.76	3.64	3.04
British pound	0.71	0.69	0.68	0.68
Canadian dollar	1.64	1.37	1.62	1.51
Japanese yen	139.65	138.90	134.40	136.86
Mexican peso	15.23	12.59	14.04	13.58
Swiss franc	1.54	1.56	1.54	1.55
U.S. dollar	1.36	1.18	1.24	1.24

The translation effects of these exchange rate changes had a positive impact on our sales in 2005, increasing them by 0.3 billion (compared to a decrease of 1.0 billion in 2004 and 1.8 billion in 2003). The discussion of our operating results below includes sales figures adjusted for these translation effects. These adjusted sales figures represent the sales that we would have generated had the average exchange rates we used to translate our non-euro denominated revenues into euros remained constant in the year under review as compared with the previous year. For further information concerning our exchange rate exposure, see Item 11, *Quantitative and Qualitative Disclosures about Market Risk.*

Discontinued Operations

Reporting of Discontinued Operations

In the financial statements and other financial information included in this annual report, LANXESS and our U.S. plasma activities are reported under discontinued operations in accordance with IFRS 5 and other applicable standards. IFRS 5 requires reporting to be based primarily on continuing operations, while disposal groups (groups of assets and liabilities, which we intend to dispose of in a single transaction) and discontinued operations are to be stated separately in a single line item on the balance sheet and income statement. The individual items of the income statement such as sales, functional costs and non-operating result therefore reflect only continuing operations of the Bayer Group.

For further explanation on IFRS 5, please refer to Note 3 to the consolidated financial statements included elsewhere in this annual report.

LANXESS

At the end of January 2005, we spun off the LANXESS subgroup to our stockholders, LANXESS thereupon ceased to be part of the Bayer Group. The shares of LANXESS AG have been listed on the Frankfurt Stock Exchange since January 31, 2005.

In November 2003, Bayer announced that it intended to maintain its focus on its core businesses and therefore combined the former Bayer Chemicals segment (except for Wolff Walsrode and H.C. Starck) with certain parts of the former Bayer Polymers business in a new company. LANXESS was created with economic effect from July 1, 2004. Wolff Walsrode and H.C. Starck were grouped together with the remaining parts of the Bayer Polymers business in a wholly-owned subsidiary of the Bayer Group called Bayer MaterialScience. Throughout 2004, LANXESS businesses were operated as the LANXESS segment of the Bayer Group. This segment had a comprehensive product portfolio in

polymers and basic, specialty and fine chemicals.

The LANXESS subgroup was deconsolidated from the Bayer Group effective January 31, 2005 and is no longer included in the balance sheet as of December 31, 2005. For the comparative periods of 2004 and 2003,

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LANXESS is reported separately in balance sheet line items titled Assets held for sale and discontinued operations and Liabilities directly related to assets held for sale and discontinued operations . Net earnings of the LANXESS group for the month of January 2005 are recognized in Bayer Group net income for 2005. In the income and cash flow statements for 2005, as well as for the comparative periods of 2004 and 2003, LANXESS is reported under discontinued operations. Since February 1, 2005, sales from Bayer companies to LANXESS are reported as external net sales.

LANXESS had net sales of 503 million in 2005 (for January only), 6,053 million in 2004 and 5,776 million in 2003. Operating results of LANXESS were 62 million in 2005 (for January only), 78 million in 2004 and minus 1,288 million in 2003. The 2003 result was diminished in particular by impairment charges of 988 million. The income from discontinued operations after taxes attributable to LANXESS was 38 million in 2005 (for January only), minus 4 million in 2004 and minus 973 million in 2003.

In both 2004 and 2003 we reported expenses and income for LANXESS that we considered to be special items. In 2004, these items had a net effect of minus 99 million on our income statement and primarily comprised a 40 million provision for environmental protection measures and a 20 million litigation-related expense in connection with an investigation into prices for rubber products. In addition, the total amount included 68 million in impairment charges, which were partly offset by adjustments of 29 million in connection with the 2003 impairments relating to our former polymers and chemicals activities. In 2003, special items had a net effect of minus 1,204 million and primarily consisted of impairment charges of 988 million and charges of 97 million for personnel-related measurement.

For a discussion of the risks and uncertainties that continue to face us in connection with the LANXESS spin-off, please see Item 3*, Key Information Risk Factors Our transactions relating to LANXESS expose us to continuing liability* and Item 10, *Additional Information Material Contracts.*

Plasma activities

At the end of March 2005, Bayer divested the U.S. plasma operations of its Biological Products division to two U.S. financial investors, Cerberus Capital Management, L.P., New York, New York and Ampersand Ventures, Wellesley, Massachusetts. The agreement covers the products, facilities and employees representing the plasma portion of the division. The remaining portion, consisting of our *Kogenate*® business, is not affected by this agreement and, effective January 1, 2006, forms part of our Pharmaceuticals division. All plasma activities in the United States were transferred to Talecris BioTherapeutics, Inc., a corporation newly formed by the two investors, that began operations on April 1, 2005. In most of the countries outside of the United States Bayer will continue to distribute plasma products.

2005 net earnings from the discontinued U.S. plasma operations are included in Bayer Group net income through March 31, 2005. These results include adjustments in connection with the purchase price. To account for the final agreement signed at the end of March 2005, we adjusted the previous year s presentation to show the continued non-U.S. distribution as part of our continuing operations. In our financial statements for 2005 only the U.S. plasma business is reflected in discontinued operations. Revenues from our marketing activities for plasma products outside the United States are reflected in sales from continuing operations of our Pharmaceuticals, Biological Products segment. The comparative periods 2004 and 2003 have been adjusted to reflect the inclusion of non-U.S. distribution in continuing operations.

The U.S. plasma operations had net sales of 124 million in 2005 (through March 31 only), 427 million in 2004 and 374 million in 2003. Operating result of the U.S. plasma activities was minus 2 million in 2005 (through March 31 only), minus 97 million in 2004 and minus 392 million in 2003. The loss from discontinued operations after taxes attributable to the U.S. plasma operations was 1 million in 2005 (through March 31 only), 63 million in 2004 and 269 million in 2003.

Expenses reported as special items in the previous annual report amounted to 71 million in losses and 24 million in write-downs in connection with the divestment of the plasma business in 2004 and an impairment charge of 317 million in 2003.

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The following table sets forth net sales, operating result and income (loss) from discontinued operations after tax attributable to LANXESS and the U.S. activities of our former plasma business for the three years under review. For further information, refer also to Note 7.2 to the consolidated financial statements appearing elsewhere in this annual report.

	LANXESS			Plasma			Total Discontinued Operations		
	2003	2004	2005	2003	2004	2005	2003	2004	2005
	(Euros in millions)			(Euros in millions)			(Euros in millions)		
Net sales	5,776	6,053	503	374	427	124	6,150	6,480	627
Operating result	(1,288)	78	62	(392)	(97)	(2)	(1,680)	(19)	60
Special items	(1,204)	(99)		(317)	(95)		(1,521)	(194)	
Net income (loss)	(973)	(4)	38	(269)	(63)	(1)	(1,242)	(67)	37
Affected segments	(LANXESS)			Pharmaceuticals, Biological Products					

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Bayer Group

In accordance with the new accounting standard IFRS 5 and other applicable IFRS standards, the financial information presented for 2003, 2004 and 2005 only reflects continuing operations of the Bayer Group and its segments, except where specific reference is made to discontinued operations. Furthermore, the figures for 2003 and 2004 have been restated to give effect to a change in the reporting of funded pension obligations in accordance with revised IAS 19 (Employee Benefits) and adjusted to reflect a change in presentation of our former plasma business. Our non-U.S. plasma operations, which had previously been classified as discontinuing operations , are now included in continuing operations (For details, please refer to Discontinued Operations). Moreover, the LANXESS spin-off in early 2005 and the acquisition of Roche s Consumer Health business led to a shift in the relative sizes of our business in terms of sales, operating result and assets. We therefore changed our segment structure and reporting with effect from January 1, 2005. We restated our segment reporting for 2003 and 2004 to correspond to the new structure in compliance with IAS 14 (Segment Reporting).

The following table shows sales and income for Bayer as a whole.

	2003[a]	Change from Previous Year (%)	2004[a]	Change from Previous Year (%)	2005[b]
	(Euros in millions)				
Net sales	22,417	3.8	23,278	17.6	27,383
Gross profit	10,638	2.1	10,857	13.8	12,356
as percentage of sales (%)	47.5		46.6		45.1
Selling expenses	(5,515)	5.0	(5,240)	(9.0)	(5,713)
Research and development expenses	(2,190)	12.0	(1,927)	2.1	(1,886)
General and administrative expenses	(1,410)	(0.8)	(1,421)	(1.6)	(1,444)
Other operating income	1,073	(31.0)	740	7.3	794
Other operating expenses	(2,021)	43.9	(1,134)	(14.2)	(1,295)
Operating result	575		1,875	50.0	2,812
as percentage of sales (%)	2.6		8.1		10.3
Non-operating result	(708)	7.8	(653)	6.1	(613)
Income before income taxes	(133)		1,222	80.0	2,199
Income from continuing operations after taxes	(49)		749	108.0	1,558
Income from discontinued operations after taxes	(1,242)	94.6	(67)		37
Group net income (total)	(1,303)		685	133.1	1,597

[a] 2003 and 2004 data have been restated to give effect to a change in the reporting of funded pension obligations in accordance with revised IAS 19 (Employee Benefits) and adjusted to reflect the LANXESS spin-off and the sale of the U.S. plasma operations in accordance with IFRS 5 and other applicable IFRS standards. For further information on these restatements, see *Discontinued Operations* and Note 7.2 to the consolidated financial statements appearing elsewhere in this annual report.

[b]

The Consumer Health business acquired from Roche is reflected in the income statement with effect from January 1, 2005.

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The following table shows a geographical breakdown of our sales from continuing operations based on where we sold our products.

	2003	Change from Previous Year (%)	2004	Change from Previous Year (%)	2005
			(Euros in millions)		
Europe	9,110	7.3	9,775	22.0	11,930
North America	6,981	(6.7)	6,512	12.7	7,340
Asia/Pacific	3,625	9.3	3,962	15.5	4,578
Latin America/ Africa/Middle East	2,701	12.1	3,029	16.7	3,535

2005 compared with 2004

Net Sales

Net sales represent the gross inflow of economic benefits that are recognized upon the transfer of risk or rendering of services to third parties. Net sales excludes rebates and discounts that we give our customers, as well as the amounts that we collect on behalf of third parties, such as sales taxes, goods and services taxes and value added taxes. Net sales of the Bayer Group rose by 17.6 percent, or 4,105 million, to 27,383 million in 2005, compared with 23,278 million in 2004. Had the average exchange rates we used to translate our non-euro denominated revenues into euros stayed constant in 2005 as compared with 2004, our net sales would have increased by 16.4 percent. In comparison with 2004, price increases of 7.0 percent that were primarily attributable to MaterialScience led to an increase of 1,647 million in net sales. Changes in our portfolio of businesses, primarily relating to the Consumer Health business acquired from Roche and our spin-off of LANXESS (leading to a reclassification of sales to LANXESS from inter-segment sales to external sales), accounted for an increase of 2,070 million (8.9 percent) in our net sales.

Gross Profit

Gross profit represents net sales after deducting cost of goods sold. Cost of goods sold include the production costs of goods sold and the cost of goods purchased for resale. The cost of goods sold and services provided increased by 21.0 percent in 2005 to 15,027 million, due mainly to the overall growth in our business, in particular in our MaterialScience business, and due to the changes in our portfolio, primarily relating to the acquisition of Roche s Consumer Health business and the LANXESS spin-off (analogous to presenting sales to LANXESS as external sales, costs of goods sold increased because of related costs). The ratio of the cost of goods sold to total net sales was 54.9 percent, compared with 53.4 percent in the previous year. The single largest driver of this increase was higher raw material prices.

Operating Result

Operating result represents gross profit after deducting selling expenses, research and development expenses, general administration expenses and other operating income and expenses.

Selling expenses increased by 473 million, or 9.0 percent, to 5,713 million, primarily due to higher marketing and distribution costs in our HealthCare and MaterialScience businesses.

Research and development expenses declined by 41 million, or 2.1 percent to 1,886 million, mainly because of our concentration on our strategic core businesses within Bayer HealthCare and Bayer CropScience.

General administration expenses increased by 23 million, or 1.6 percent, to 1,444 million, due primarily to the acquisition of Roche s Consumer Health business. The resulting increase in cost could only partly be offset by cost reduction measures.

Other operating income increased by 54 million, or 7.3 percent, to 794 million, mainly due to gains from changes to our pension systems in the United States and Germany (283 million). In 2004, other operating income included

169 million gains relating to pension and 51 million in gains from sales of licenses.

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Other operating expenses increased by 161 million, or 14.2 percent, to 1,295 million. The expenses included the establishment of provisions in connection with antitrust proceedings involving products in the polymers area (336 million) and litigation-related expenses in connection with HealthCare products (105 million). Other operating expenses in 2004 included provisions established and other expenses incurred totaling 139 million in connection with a number of legal matters. Moreover, in 2004 amortization of goodwill and intangible assets with indefinite useful lives under former IFRS regulations accounted for 185 million.

Operating result improved by 50.0 percent, or 937 million, to 2,812 million in 2005, compared with 1,875 million in 2004. The largest contributions to the growth in operating result were made by the Materials (340 million) and Systems segments (388 million) and resulted largely from price increases. Special items had a net negative effect of 488 million on our operating result, compared with 242 million in 2004. For a breakdown of these special items, see *Introduction Reconciliation from operating result to operating result before special items*. Operating result before special items climbed by 55.9 percent to 3,300 million (2004: 2,117 million).

Non-Operating Result

Non-operating result represents income and expenses from investments in affiliated companies, interest income and expenses, and other non-operating income and expenses. Non-operating result improved by 40 million, or 6.1 percent, to an expense of 613 million. Net loss from investments in affiliated companies declined significantly, while net interest expense rose due to the acquisition-related increase in net debt at the beginning of the year. The loss from affiliated companies mainly comprises an equity-method loss of 47 million (2004: 131 million) from two production joint ventures with Lyondell.

Income Before Income Taxes

Income before income taxes represents operating result plus non-operating result. In 2005 we had positive income before income taxes of 2,199 million, as compared with 1,222 million in 2004.

Income Taxes

Income taxes represent the income taxes paid or accrued in the individual countries, plus deferred taxes. We recognized an income tax charge of 641 million in 2005, as compared with 473 million in 2004. The tax rate for our Group was 29.1 percent in 2005. The tax result was composed of income taxes paid or payable of 541 million as well as deferred taxes that led to a net charge of 100 million.

Income from Discontinued Operations After Taxes

According to IFRS 5 (Non-current Assets Held for Sale and Discontinued Operations) the post-tax profit or loss of discontinued operations and the post-tax gain or loss recognized on the measurement to fair value less costs to sell or on the disposal of the disposal group are reported separately in a single line item on the income statement.

Income from discontinued operations after taxes amounted to income of 37 million in 2005, compared to a loss of 67 million in 2004. The 2005 figure includes the income from our former LANXESS segment for January 2005 as well as the income from the U.S. activities of our former plasma business for the first quarter 2005, including adjustments made in connection with the purchase price.

For details refer to *Discontinued Operations* or to Note 7.2 to the consolidated financial statement included elsewhere in this annual report.

Net Income

Net income represents income from continuing operations after taxes plus income from discontinued operations after taxes minus minority stockholders interest. Group income rose by 912 million to 1,597 million from an net income of 685 million in 2004. Income from continuing operations after taxes amounted to

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1,558 million in 2005 and 749 million in 2004. Income from discontinued operations after taxes was 37 million in 2005 and minus 67 million in 2004.

2004 compared with 2003

Net Sales

Net sales increased by 861 million, or 3.8 percent, to 23,278 million in 2004, compared with 22,417 million in 2003. Had the average exchange rates we used to translate our non-euro denominated revenues into euros stayed constant in 2004 as compared with 2003 rather than declining as they in fact did, our net sales would have increased by 1,807 million, or 8.0 percent. This increase was primarily due to volume growth. In comparison with 2003, price increases of an average of 0.8 percent led to 174 million of increased net sales. Changes in our portfolio of businesses (other than those resulting from discontinued operations) accounted for a 224 million reduction in our net sales. For details refer to *Introduction Effects on net sales from acquisitions and divestitures*.

Gross Profit

The cost of goods sold and services provided increased by 5.5 percent in 2004 to 12,421 million, due mainly to the overall growth in our business, in particular in our MaterialScience business. Had the average exchange rates we used to translate our non-euro denominated costs into euros stayed constant in 2004, the increase would have been 9.9 percent.

Operating Result

Selling expenses declined by 275 million, or 5.0 percent, to 5,240 million, primarily due to currency effects.

Research and development expenses declined by 263 million, or 12.0 percent to 1,927 million, mainly because of our concentration on our strategic core businesses within Bayer HealthCare and Bayer CropScience and also due to currency effects.

General administration expenses remained relatively constant with an increase of 11 million, or 0.8 percent, to 1,421 million.

Other operating income decreased by 333 million, or 31.0 percent, to 740 million. The figure for 2004 included a 121 million net gain from a reduction in obligations to pay supplementary medical expenses for retirees in the United States, as well as 51 million in gains from sales of licenses and 48 million in gains resulting from pension curtailments, both of which we consider special items. Other operating income for 2003 included gains from the sale of the remaining part of the household insecticides business (256 million), the PolymerLatex group (28 million), the divestment of products in connection with the Aventis CropScience acquisition (46 million) and the disposition of real estate in Germany, Belgium, Spain and the United States (109 million).

Other operating expenses decreased by 887 million, or 43.9 percent, to 1,134 million, primarily because the 2003 amount contained impairment charges and other write-downs of 622 million as well as 300 million charges taken on the basis of the final agreement reached with the majority of insurers in connection with *Lipobay/ Baycol*. Other operating expenses in 2004 included provisions established and other expenses incurred totaling 139 million in connection with a number of legal matters, including 47 million in *Lipobay/ Baycol* charges.

Operating result improved by 1,300 million to 1,875 million, with special items having a 242 million net negative effect. For a breakdown of these special items, see *Introduction Reconciliation from operating result to operating result before special items.* Operating result before special items increased by 29.2 percent to 2,117 million.

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Non-Operating Result

The non-operating result improved by 55 million, or 7.8 percent, to an expense of 653 million, largely because of a decrease in net interest expense mainly due to reduced net debt and lower interest rates, as well as lower write-downs of investments in subsidiaries. For a definition of our net debt measure, see *Liquidity and Capital Resources 2003, 2004 and 2005 Cash Flows Financing Activities*.

Income Before Income Taxes

In 2004 we had a positive income before income taxes of 1,222 million, as compared with a loss before income taxes of 133 million in 2003.

Income Taxes

We recognized an income tax charge of 473 million in 2004, as compared with a benefit of 84 million in 2003. The tax rate for our Group was 39 percent in 2004. The tax result was composed of income taxes paid or payable of 490 million, partly offset by deferred taxes that led to a net credit of 17 million.

Income from Discontinued Operations After Taxes

Income from discontinued operations after taxes amounted to a loss of 67 million in 2004 compared with a loss of 1,242 million in 2003. The 2003 result was primarily influenced by impairments and asset write-downs totaling 1,305 million.

For details refer to *Discontinued Operations* and to Note 7.2 to the consolidated financial statement appearing elsewhere in this annual report.

Net Income

Group income rose by 1,988 million to 685 million from a net loss of 1,303 million in 2003. Income from continuing operations after tax increased from a loss of 49 million in 2003 to a positive income of 749 million. Income from discontinued operations after tax was at minus 67 million in 2004 compared to a loss of 1,242 million in 2003.

Segment Data

The LANXESS spin-off in early 2005 and the acquisition of Roche s Consumer Health business led to a shift in the relative sizes of our business in terms of sales, operating result and assets. We therefore changed our segment structure and reporting with effect from January 1, 2005. We restated our segment reporting for 2003 and 2004 to correspond to the new structure in compliance with IAS 14 (Segment Reporting).

We use operating result before special items as an internal reporting measure for our segments in order to promote comparability from period to period. The special items we report include primarily expenses relating to impairment charges, accelerated depreciation, restructuring measures charged to operating result, costs of facilities shutdowns and income from divestments. On a consolidated basis, operating result before special items is considered a non-GAAP financial measure under applicable rules of the Securities and Exchange Commission. See *Introduction Reconciliation from operating result to operating result before special items*.

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Pharmaceuticals, Biological Products

Effective January 1, 2006 the former Pharmaceuticals, Biological Products segment has been renamed the Pharmaceuticals segment.

	2003[1]	Change from Previous Year (%)	2004[1]	Change from Previous Year (%)	2005
	(Euros in millions)				
Net sales (external)	4,371	(9.4)	3,961	2.7	4,067
Intersegment sales	42	(9.5)	38	52.6	58
Operating result	(16)		399	19.0	475
Special items	(515)		(53)		(140)
Operating result before special items	499	(9.4)	452	36.1	615

[1] 2003 and 2004 data have been restated to reflect the sale of the U.S. plasma operations in accordance with IFRS 5. As explained above under *Discontinued Operations,* only our U.S. plasma operations are classified as discontinued operations . Our non-U.S. plasma operations, which had previously been classified as discontinuing operations , are now included in continuing operations . For further information on these restatements, see *Discontinued Operations* and Note 7.2 to the consolidated financial statements appearing elsewhere in this annual report.

The primary special items were as follows:

Year	Nature of special item	Income/ charge (Euros in millions)
2003	Charges taken on the basis of the final agreement reached with the majority of insurers in connection with *Lipobay/ Baycol*	(300)
	Closure of research and production facilities	(171)
2004	Charges in connection with restructuring pharmaceuticals research and development	(24)
	Gain on a sale of a license	39
	Charges in connection with *Lipobay/ Baycol*	(47)
	Restructuring charges in connection with the Schering-Plough alliance	(45)
	Pension curtailment in connection with the Schering-Plough alliance	24
2005	Charges in connection with the termination of the co-promotion agreement with GlaxoSmithKline for *Levitra®*	(106)
	Litigation-related expenses in connection with *Lipobay/ Baycol*	(43)
	One-time non-cash gain due to changes to our pension plans in the United States and Germany	49
		(22)

Restructuring of pharmaceutical activities in West Haven, Connecticut
and
Wuppertal, Germany

2005 compared with 2004

Sales of the Pharmaceuticals, Biological Products segment rose by 106 million, or 2.7 percent, to 4,067 million in 2005. Had the average exchange rates we used to translate our non-euro denominated revenues into euros stayed constant in 2005 as compared with 2004, our net sales in this segment would have increased by 67 million or 1.7 percent.

Sales of the Pharmaceuticals division receded by 58 million, or 1.8 percent, to 3,108 million. We achieved growth in our sales of specialty products, particularly *Trasylol*®, in the United States, and of *Avelox*® and *Levitra*® outside the United States. This enabled us partially to offset a 312 million decline in sales due to the expiration of the U.S. patent on our anti-infective *Cipro*® and the marketing of our primary care products in the United

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States by Schering-Plough. For further information on changes in sales of our major products, please refer to the relevant segment discussion in Item 4 *Business.*

In the Biological Products division, sales rose by 164 million, or 20.6 percent, to 959 million. Our sales of *Kogenate*® expanded, mostly in Europe and the United States, by 100 million, or 17.8 percent, to 663 million. In Europe and Canada, we benefited from the market introduction of our *Bio-Set*® delivery device for more convenient infusion.

Operating result of the Pharmaceuticals, Biological Products segment improved by 76 million, or 19.0 percent, to 475 million. Operating result before special items rose by 163 million, or 36.1 percent, to 615 million, due mainly to improved cost structures and increases in sales discussed above.

Special items in 2005 had a net negative effect of 140 million, primarily comprising charges in connection with the termination of our co-promotion agreement with GlaxoSmithKline for *Levitra*® outside the United States (106 million), further charges for *Lipobay/ Baycol* (43 million) and measures relating to restructuring projects and unscheduled amortization in the United States and Germany (40 million). Charges were partially offset by a one-time non-cash gain of 49 million due to changes to our pension plans in the United States and Germany. Special items in 2004 comprised mainly restructuring charges, *Lipobay/ Baycol* charges, gains from a license sale and curtailment of pension plans.

2004 compared with 2003

Sales of our Pharmaceuticals, Biological Products segment declined by 410 million, or 9.4 percent, to 3,961 million. Had the average exchange rates we used to translate our non-euro denominated revenues into euros stayed constant in 2004 as compared with 2003, our net sales in this segment would have decreased by 259 million, or 5.9 percent, in 2004.

Sales of the Pharmaceuticals division declined by 469 million, or 12.9 percent, to 3,166 million. This was mostly due to the expiration of our U.S. patent for the anti-infective *Cipro*®. Total sales of *Ciprobay*®/*Cipro*® (active ingredient: ciprofloxacin) fell by 574 million, or 40.7 percent. As part of the realignment of our pharmaceuticals business, we signed an extensive cooperation agreement in September 2004 under which Schering-Plough now markets selected primary care products in the United States in return for sales-dependent license payments or, in the case of *Levitra*®, in return for a share of the earnings realized. Those license payments together with our share of the earnings now represent the bulk of our sales in the United States. As license payments are only a share of sales to market, our sales declined compared to 2003. Sales of our erectile dysfunction treatment *Levitra*® rose by 49 million, or 34.0 percent, to 193 million; a smaller increase than we had anticipated. Sales of our respiratory antibiotic *Avalox*®/*Avelox*® continued to advance in a highly competitive environment, increasing by 6.4 percent to 318 million. Despite keen competition from generics, sales of our antihypertensive drug *Adalat*® remained steady. Further growth was achieved by *Aspirin*® *Cardio* (heart attack and stroke prophylaxis), *Trasylol*® (used in open-heart surgery) and *Glucobay*® (diabetes).

Sales of the Biological Products division rose by 8.0 percent to 795 million, with sales growing by 10.4 percent when using 2003 exchange rates. Sales of our hemophilia drug *Kogenate*® grew primarily in Europe, with a considerable increase in volumes. Revenues from our marketing activities for plasma products outside the United States declined by 3.2 percent to 232 million. Especially in Japan the plasma business receded due to fierce competition and regulatory changes.

Operating result of the Pharmaceuticals, Biological Products segment improved from minus 16 million to 399 million. Operating result before special items decreased by 9.4 percent to 452 million. The decline was in particular due to the expiration of our U.S. patent for *Cipro*®, and was only partially offset by the higher sales of the Biological Products division and further cost savings.

Special items in 2004 amounted to minus 53 million in aggregate, and are primarily comprised of charges of 47 million for *Lipobay/ Baycol,* 21 million in restructuring charges partially offset by a gain from curtailment of pension plans in connection with the Schering-Plough alliance, 24 million related to restructuring charges in connection with the realignment of our pharmaceuticals research and development and a 39 million gain from

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the sale of a license. Special items in the previous year mainly comprised expenses relating to accounting measures concerning *Lipobay/ Baycol*.

Consumer Care

	2003	Change from Previous Year (%)	2004	Change from Previous Year (%)	2005[a]
			(Euros in millions)		
Net sales (external)	1,403	(4.8)	1,336	76.3	2,355
Intersegment sales	7	128.6	16	(12.5)	14
Operating result	486	(62.3)	183	(4.9)	174
Special items	288		(30)		(118)
Operating result before special items	198	7.6	213	37.1	292

[a] The consumer health business acquired from Roche is reflected in the income statement with effect from January 1, 2005.

The primary special items were as follows:

Year	Nature of special item	Income/ charge (Euros in millions)
2003	Divestment of household insecticides business	256
2004	Provision for litigation	(16)
	Expenses relating to the integration of the Roche Consumer Health business	(14)
2005	Expenses relating to the integration of the Roche Consumer Health business	(71)
	Provision for litigation	(62)

2005 compared with 2004

Sales of the Consumer Care segment rose by 1,019 million, or 76.3 percent, to 2,355 million in 2005. Had the average exchange rates we used to translate our non-euro denominated revenues into euros stayed constant in 2005 as compared with 2004, our net sales in this segment would have increased by 75.2 percent. Without taking into account the sales attributable to the acquired Consumer Health business from Roche, our segment sales declined by 3.1 percent.

The integration of the acquired Consumer Health business proceeded more favorably than expected. High sales increases were recorded by products integrated into our portfolio resulting from the Roche acquisition, especially *Bepanthen®/Bepanthol®*, *Rennie®* and *Supradyn®*, with the new activities accounting for sales of 1,061 million in 2005. For further information on changes in sales of our major products, please refer to the segment discussion in Item 4 *Business.*

Operating result of the Consumer Care segment fell by 9 million, or 4.9 percent, to 174 million. This was after the effect of acquiring inventories from Roche at selling prices, which diminished margins by 57 million. Operating result

before special items climbed by 37.1 percent, or 79 million, to 292 million, with a major earnings contribution from the newly-acquired Consumer Health business. Special items amounted to charges of 118 million in 2005 and 30 million in 2004. In both years, special items related to the integration of the business acquired from Roche and to litigation-related expenses.

2004 compared with 2003

Sales in the Consumer Care segment fell by 4.8 percent to 1,336 million. Had the average exchange rates we used to translate our non-euro denominated revenues into euros stayed constant in 2004 as compared with 2003 rather than declining as they in fact did, our net sales would have increased by 1.4 percent. Business in

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Europe, particularly Italy, Germany and the United Kingdom, continued to expand because of the launch of new products such as *Aspirin® Complex*. In Latin America, *Aspirin®* sales increased. By contrast, our Consumer Health business in North America was level with the previous year.

Operating result of the Consumer Care segment dropped by 303 million to 183 million. However, before special items consisting of litigation-related charges of 16 million and expenses for the integration of the Roche Consumer Health business of 14 million in 2004 operating result for the segment increased to 213 million (plus 7.6 percent) mainly due to cost savings initiatives. The principal special item in 2003 was a gain of 256 million from the sale of the household insecticides business.

Diabetes Care, Diagnostics

	2003	Change from Previous Year (%)	2004	Change from Previous Year (%)	2005
			(Euros in millions)		
Net sales (external)	1,933	2.2	1,975	8.9	2,151
Intersegment sales	0		1	0.0	1
Operating result	115	88.7	217	26.3	274
Special items[(a)]	(20)		0		34
Operating result before special items	135	60.7	217	10.6	240

(a) The primary special items in 2003 were write-downs on enterprise management systems (minus 43 million) and a litigation settlement (22 million). Special items in 2005 were charges of 19 million in connection with the reorganization of headquarters in the United States and a one-time non-cash gain of 53 million due to changes to our pension plans in the United States and Germany.

2005 compared with 2004

Sales of the Diabetes Care, Diagnostics segment grew by 176 million, or 8.9 percent, to 2,151 million. Had the average exchange rates we used to translate our non-euro denominated revenues into euros stayed constant in 2005 as compared with 2004, our net sales in this segment would have increased by 8.1 percent.

In the Diabetes Care division, sales increased by 10.0 percent to 718 million, mainly due to strong growth in Europe. Sales of the Diagnostics division rose by 8.4 percent to 1,433 million, primarily because of high sales levels of our *Advia Centaur®* laboratory testing systems. For further information on changes in sales of our major products, please refer to the segment discussion in Item 4 *Business.*

Operating result of the segment increased by 57 million, or 26.3 percent, to 274 million. Special items in 2005 related to charges of 19 million in connection with the relocation of the headquarters from Elkhart, Indiana to Tarrytown, New York and to an one-time non-cash gain of 53 million due to changes to our pension plans in the United States and Germany. Operating result before special items rose by 23 million, or 10.6 percent, to 240 million.

2004 compared with 2003

Sales in the Diabetes Care, Diagnostics segment increased by 42 million, or 2.2 percent, to 1,975 million. Had we translated our non-euro denominated revenues in 2004 at 2003 s average exchange rates, net sales would have increased by 133 million or 6.9 percent in 2004.

Sales of blood glucose monitoring systems offered by our Diabetes Care division grew by 4.5 percent to 653 million, with sales rising by 9.5 percent when using 2003 exchange rates. Particularly successful were the *Ascensia® Breeze* and *Ascensia® Contour/ Microfill* test systems launched in 2003. We achieved double-digit growth

rates in important markets such as the United States, Germany, Spain and the United Kingdom.

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The Diagnostics division grew sales by 1.1 percent to 1,322 million, and by 5.7 percent when applying 2003 exchange rates, with all business units and all regions contributing to the increase. We posted double-digit growth rates in some countries, particularly in Latin America and Asia-Pacific. Complementing the existing product line was the new *Advia® 1200* system.

Operating result of the Diabetes Care, Diagnostics segment grew by 88.7 percent or 102 million to 217 million. This earnings growth was due particularly to cost efficiency programs in both divisions. Operating result before special items increased by 60.7 percent to 217 million. Special items in 2003 amounted to a charge of 20 million and primarily comprised write-downs on enterprise management systems (minus 43 million) and a litigation settlement (22 million).

Animal Health

	2003	Change from Previous Year (%)	2004	Change from Previous Year (%)	2005
			(Euros in millions)		
Net sales (external)	790	(0.5)	786	8.9	856
Intersegment sales	6	(33.3)	4	100.0	8
Operating result	172	(8.7)	157	14.0	179
Special items[(a)]	22		0		7
Operating result before special items	150	4.7	157	9.6	172

[(a)] Special items in 2003 primarily included gains from the disposal of the rights to the *Bayovac®/Baypamun®* products. Special items in 2005 related to a one-time non-cash gain of 7 million due to changes to our pension plans in the United States and Germany.

2005 compared with 2004

Sales of the Animal Health segment rose by 70 million, or 8.9 percent, to 856 million in 2005. Had the average exchange rates we used to translate our non-euro denominated revenues into euros stayed constant in 2005 as compared with 2004, our net sales in this segment would have increased by 7.1 percent. The increase was mainly the result of a strong performance by our *Advantage®* product line in the United States. Also contributing to growth were the market introductions of our parasiticides *Advocate®* in Europe and Canada and *Profender®* in Europe. For further information on changes in sales of our major products, please refer to the segment discussion in Item 4 *Business.*

Operating result of the Animal Health segment advanced by 22 million, or 14.0 percent, to 179 million. Operating result before special items improved by 9.6 percent to 172 million. The special items amounted to a one-time non-cash gain of 7 million due to changes to our pension plans in the United States and Germany.

2004 compared with 2003

Sales of the Animal Health segment declined by 4 million, or 0.5 percent, to 786 million. Had we translated our non-euro denominated revenues in 2004 at 2003 s average exchange rates, we would have had 36 million more net sales in 2004 than reported. All regions contributed to this growth. Notable success was achieved with the launch of our antiparasitic *Advantix®* in Italy and with the development of our *Advantage®* and *Baytril®* businesses in the United States.

Operating result of the Animal Health segment fell by 15 million, or 8.7 percent, to 157 million. Adjusted for the previous year s one-time gain from the sale of product rights, operating result before special items grew by 4.7 percent in 2004.

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Crop Protection

	2003	Change from Previous Year (%)	2004	Change from Previous Year (%)	2005
	(Euros in millions)				
Net sales (external)	4,801	3.2	4,957	(1.7)	4,874
Intersegment sales	62	14.5	71	(1.4)	70
Operating result	242	59.5	386	37.8	532
Special items	(70)		(42)		7
Operating result before special items	312	37.2	428	22.7	525

The primary special items were as follows:

Year	Nature of special item	Income/ charge (Euros in millions)
2003	Restructuring related to the Aventis CropScience acquisition	(91)
	Gains from the divestment of former Bayer CropScience products in connection with the Aventis CropScience acquisition	46
2004	Closure of major parts of a production facility in Hauxton, U.K.	(13)
	Pension accruals in connection with divestiture to BASF	(14)
2005	Restructuring measures relating to CropScience activities in France	(20)
	Termination of a research and development cooperation	(15)
	One-time non-cash gain due to changes to our pension plans in the United States and Germany	46

2005 compared with 2004

Sales in the Crop Protection segment decreased by 83 million, or 1.7 percent, to 4,874 million in 2005. Had the average exchange rates we used to translate our non-euro denominated revenues into euros stayed constant in 2005 as compared with 2004, our net sales in this segment would have decreased by 4.3 percent in 2005.

In the Insecticides business unit, sales decreased by 4.9 percent to 1,311 million. The continuing drought in southern Europe, Brazil and Australia led to lower sales of some products. Furthermore, much lower pest infestation diminished sales of our products, particularly in the Asian-Pacific region. Sales in the Fungicides business unit declined by 2.3 percent to 1,248 million. Although Asian rust, a disease affecting soybean crop, persisted in large areas of Brazil, business with our *Flint*® and *Folicur*® fungicides declined considerably due to the extreme prolonged drought in the south of the country and farmers economic predicament. Sales in the Herbicides business unit decreased by 0.8 percent to 1,840 million. Although unfavorable weather conditions impacted our sales in southern Europe, aggregate sales of our new products *Atlantis*®, *Hussar*®, *MaisTer*® and *Olympus*® increased 16 percent. Sales of the Seed Treatment business unit rose by 6.3 percent to 475 million, largely due to the 2004 acquisition of the remaining 50-percent interest in Gustafson. For further information on changes in sales of our major products, please refer to the segment discussion in Item 4 *Business.*

Operating result of the Crop Protection segment grew by 146 million, or 37.8 percent, to 532 million. Special items of 7 million in gains primarily comprised charges relating to restructuring measures in France (20 million) and

the termination of research and development activities (15 million), which were offset by a one-time non-cash gain due to changes to our pension plans in the United States and Germany (46 million). Operating result before special items increased by 97 million, or 22.7 percent, to 525 million, which was primarily attributable to the absence of scheduled goodwill amortization of 98 million. In the previous year special items primarily consisted of restructuring charges and pension accruals.

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2004 compared with 2003

Sales of the Crop Protection segment increased by 3.2 percent to 4,957 million. Had we translated our non-euro denominated revenues in 2004 at 2003 s average exchange rates, sales would have increased by 7.0 percent.

In the Insecticides business unit, sales remained steady at 1,378 million, advancing by 5.5 percent when using 2003 exchange rates. Our *Confidor*®/*Gaucho*®/*Admire*® product group achieved sales of 455 million (-2.6 percent) due mainly to increased use in cotton, vegetables and soybeans in the United States and Brazil. Sales of the Fungicides business unit increased by 109 million, or 9.3 percent, to 1,277 million, largely due to strong volume increases for our top fungicides *Folicur*® and *Flint*®. The growth in sales, particularly in the first and fourth quarters, resulted mainly from the efforts to combat Asian rust in Brazil. Business with *Flint*® grew by 23.7 percent to 235 million, although market conditions in Western Europe remained difficult. Sales in the Herbicides unit edged up by 0.4 percent to 1,855 million despite a difficult market environment. Sales of *Basta*®/*Liberty*® improved by 23.5 percent to 189 million. Our recently launched product *Atlantis*® had a successful year due to its high efficacy against grass weeds in cereal crops. The 9.3 percent growth in sales of seed treatment products to 447 million was attributable not only to the acquisition of Crompton Corporation s 50 percent interest in Gustafson, but also to a substantial increase in sales of our successful new seed treatment *Poncho*®.

Operating result of the Crop Protection segment increased by 144 million to 386 million. Before special items of minus 42 million primarily restructuring charges and pension accruals , operating result grew by 116 million; an increase that was mainly driven by an increase in sales and favorable foreign exchange effects. Special items in 2003 mainly related to restructuring charges in connection with the integration of the Aventis CropScience business.

Environmental Science, BioScience

	2003	Change from Previous Year (%)	2004	Change from Previous Year (%)	2005
			(Euros in millions)		
Net sales (external)	963	2.7	989	3.3	1,022
Intersegment sales	14	(50.0)	7	85.7	13
Operating result	100	6.0	106	49.1	158
Special items[a]	(11)		12		(2)
Operating result before special items	111	(15.3)	94	70.2	160

[a] Special items in 2003 comprise restructuring expenses related to the Aventis CropScience acquisition (11 million) and in 2004 gains from the sale of biotechnology assets. Special items in 2005 primarily relate to the consolidation of smaller sites in the United States (charge of 8 million) and to an one-time non-cash gain due to changes to our pension plans in the United States and Germany (9 million).

2005 compared with 2004

Sales of the Environmental Science, BioScience segment rose by 33 million, or 3.3 percent, to 1,022 million in 2005. Had the average exchange rates we used to translate our non-euro denominated revenues into euros stayed constant in 2005 as compared with 2004, our net sales in this segment would have increased by 2.1 percent in 2005.

The Environmental Science business group saw business expand by 2.4 percent to 694 million, due in part to higher sales of *Premise*®, *Revolver*® and *K-O Tab*®. Sales of Consumer Products remained constant. In the BioScience business group, sales advanced by 5.5 percent to 328 million, the main contributions to growth coming from *InVigor*® (canola seed) in North America, *FiberMax*® (cotton seed) in the United States and Europe, and the vegetable seeds business. For further information on changes in sales of our major products, please refer to the segment discussion in

Item 4 *Business*.

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Operating result of the Environmental Science, BioScience segment improved by 52 million, or 49.1 percent to 158 million. Special items amounting to a 2 million charge primarily relate to the consolidation of smaller sites in the United States (charge of 8 million) and an one-time non-cash gain due to changes to our pension plans in the United States and Germany (9 million). Operating result before special items rose by 66 million, or 70.2 percent, to 160 million, due primarily to the expansion of the Professional Products business and the absence of scheduled goodwill amortization of 36 million. In the previous year, special items primarily included gains from a sale of biotechnology assets.

2004 compared with 2003

Sales of the Environmental Science, BioScience segment rose by 2.7 percent to 989 million; however, when applying 2003 exchange rates, sales increased by 7.5 percent, due mainly to the favorable development of our BioScience business. Sales of the Environmental Science business group receded by 2.0 percent to 678 million; however, when applying 2003 exchange rates, sales increased by 3.2 percent. In the BioScience business group, sales climbed by 14.8 percent to 311 million. The main contributors to this increase were *InVigor*® (canola seed) and *FiberMax*® (cotton seed), both with sales growth exceeding 50 percent. Sales in vegetable seeds were also well above levels of the previous year.

Operating result of the Environmental Science, BioScience segment increased by 6.0 percent to 106 million. However, before special items, operating result decreased by 15.3 percent to 94 million.

Materials

	2003	Change from Previous Year (%)	2004	Change from Previous Year (%)	2005
			(Euros in millions)		
Net sales (external)	2,777	17.0	3,248	25.8	4,086
Intersegment sales	10	30.0	13	7.7	14
Operating result	58		293	116.0	633
Special items	(29)		0		27
Operating result before special items	87		293	106.8	606

The primary special items were as follows:

Year	Nature of special item	Income/charge (Euros in millions)
2003	Restructuring charges in connection with headcount reductions	(16)
	Expenses for achieving staff reductions through special early retirement	(9)
2005	One-time non-cash gain due to changes to our pension plans in the United States and Germany	27

2005 compared with 2004

Sales in the Materials segment grew by 838 million, or 25.8 percent, to 4,086 million in 2005. Had the average exchange rates we used to translate our non-euro denominated revenues into euros stayed constant in 2005 as compared with 2004, our net sales in this segment would have increased by 25.5 percent. Sales of our Polycarbonates

and H.C. Starck businesses increased by approximately 30 percent each. Both of these business units registered slight volume growth and considerably higher selling prices for some products. For further information on changes in sales of our major products, please refer to the segment discussion in Item 4 *Business*.

Operating result of the Materials segment more than doubled, climbing 340 million to 633 million. Before special items of 27 million comprising a gain due to changes to our pension plans operating result rose by 313 million to 606 million, mainly due to selling price increases that compensated not only for higher raw material costs but also improved our margins.

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2004 compared with 2003

Sales in the Materials segment increased over the previous year by 471 million, or 17.0 percent, to 3,248 million in 2004. Had we translated our non-euro denominated revenues in 2004 at 2003 s average exchange rates, we would have had 143 million more net sales in 2004 than reported. The business unit Polycarbonates and H.C. Starck contributed most significantly to the increase, with high demand from the plastics and electronics industries allowing both units to achieve price and volume increases. Sales of the Polycarbonates business unit grew by 31.7 percent in Asia-Pacific due to heavy demand, particularly in China. Sales of H.C. Starck rose significantly; especially Europe contributed to this favorable development with an increase in sales by 24.2 percent.

Operating result of the Materials segment increased from 58 million to 293 million in 2004. If special items totaling 29 million were eliminated from the previous year s figure, operating result would have increased by 206 million due to growth in demand, the resulting improvements in capacity utilization, and price increases related to our increased raw material costs.

Systems

	2003	Change from Previous Year (%)	2004	Change from Previous Year (%)	2005
			(Euros in millions)		
Net sales (external)	4,676	14.4	5,349	23.6	6,609
Intersegment sales	103	12.6	116	22.4	142
Operating result	(455)		348	111.5	736
Special items	(715)		(27)		(62)
Operating result before special items	260	44.2	375	112.8	798

The primary special items were as follows:

Year	Nature of special item	Income/ charge (Euros in millions)
2003	Impairment charges	(622)
	Shutdown and restructuring charges	(60)
2004	Legal provisions for agreement with U.S. authorities in the context of an investigation into prices for polymer products	(27)
2005	One-time non-cash gain due to changes to our pension plans in the United States and Germany	47
	Legal provisions in connection with antitrust litigation related to polymer products	(66)
	Charges relating to the reorganization of the polyurethanes business	(33)

2005 compared with 2004

Sales of the Systems segment increased by 1,260 million, or 23.6 percent, to 6,609 million in 2005. Had the average exchange rates we used to translate our non-euro denominated revenues into euros stayed constant in 2005 as compared with 2004, our net sales in this segment would have increased by 22.8 percent. Growth in net sales was primarily attributable to our Polyurethanes business unit that benefited from considerably higher selling prices. Sales

growth in the Inorganic Basic Chemicals business unit resulted from higher market prices for sodium hydroxide solution and in particular from product sales to LANXESS. Prior to the spin-off of LANXESS, such sales were recorded as inter-segment sales. Excluding the additional sales due to the reclassification of sales to LANXESS, this segment s sales would have increased by 17.5 percent. For further information on changes in sales of our major products, please refer to the segment discussion in Item 4 *Business*.

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Operating result of the Systems segment also showed a major improvement, increasing by 388 million to 736 million. Operating result before special items rose by 423 million to 798 million. The growth was mainly attributable to higher selling prices, which offset the rise in raw material costs. In 2005, special items with a net negative effect of 62 million primarily comprised charges relating to the reorganization of the polyurethanes business (33 million) and to legal provisions in connection with antitrust litigation related to polymer products (66 million). The charges were partially offset by a one-time non-cash gain due to changes to our pension plans in the United States and Germany (47 million). In the previous year, special items were legal provisions of 27 million.

2004 compared with 2003

In the Systems segment, sales amounted to 5,349 million in 2004, up by 673 million or 14.4 percent from the previous year. Had we translated our non-euro denominated revenues in 2004 at 2003 s average exchange rates, we would have had 206 million more net sales in 2004 than reported. Continuing strong demand, particularly in Asia-Pacific, and price increases in the second half of the year helped sales of the Polyurethanes business unit grow by 20.0 percent to 3,872 million. This includes sales of raw materials, mainly styrene manufactured in a new facility that did not come on stream in 2003. These sales were not contained in the previous year s figure. Sales of the Coatings, Adhesives, Sealants business unit improved by 3.9 percent to 1,237 million. While sales rose significantly in Asia-Pacific and Latin America, the picture in Europe was mixed, particularly due to the weakness of the automotive and construction sectors.

Operating result of the Systems segment climbed to 348 million in 2004 from a loss of 455 million in 2003. Special items in 2004 comprised the establishment of a 27 million provision arising from an agreement reached with the U.S. Justice Department in connection with an investigation into prices for polyester polyols. The previous year s operating result figure was impacted by 622 million in impairments and 60 million in restructuring measures for shutdowns. Operating result before special items advanced by 115 million, or 44.2 percent, to 375 million. The improvement of the operating result was based on high utilization of capacities and successful cost-containment measures. In addition, the impairments recognized in the previous year led to lower depreciation and amortization. The sharp rise in raw material costs, particularly for aromatic raw materials, was offset in many cases by price increases.

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LIQUIDITY AND CAPITAL RESOURCES 2003, 2004 AND 2005

Cash Flows

In recent years, our primary source of liquidity has been cash from operations. We use cash in investing activities primarily for acquisitions as well as for additions to property, plant, equipment and investments; these activities represented our primary liquidity requirements. We use cash in financing activities primarily to retire debt and pay dividends. We believe that our working capital levels are sufficient to fund our present requirements. There are no material legal or economic restrictions on the ability of member companies of the Bayer Group to transfer funds to Bayer AG.

The following table summarizes our cash flows in each of the last three years:

	2003[a]	Change from Previous Year (%)	2004[a]	Change from Previous Year (%)	2005
	(Euros in millions)				
Gross operating cash flow	2,741	5.3	2,885	20.5	3,477
Changes in working capital	517		(623)		65
Net cash provided by (used in) operating activities *(net cash flow, continuing operations)*	3,258	(30.6)	2,262	56.6	3,542
Net cash provided by (used in) operating activities *(net cash flow, discontinued operations)*	35		188		(40)
Net cash provided by (used in) operating activities (net cash flow, total)	3,293	(25.6)	2,450	42.9	3,502
Net cash provided by (used in) investing activities (total)	460		(814)	(113.9)	(1,741)
Net cash provided by (used in) financing activities (total)	(1,761)	56.8	(761)	(147.2)	(1,881)
Change in cash and cash equivalents	1,992	(56.1)	875		(120)
Cash and cash equivalents at beginning of period	767		2,734	30.6	3,570
Change in scope of consolidation	1		6		(196)
Exchange rate movements	(26)	(73.1)	(45)		36
Cash and cash equivalents at end of year	2,734	30.6	3,570	(7.8)	3,290
Marketable securities and other instruments	129	(77.5)	29		233
Liquid assets as per balance sheet	2,863	25.7	3,599	(2.1)	3,523

[a] 2003 and 2004 data have been restated to account for a change in the reporting of funded pension obligations in accordance with revised IAS 19 (Employee Benefits) and to reflect the LANXESS spin-off and the sale of the U.S. plasma operations in accordance with IFRS 5. As explained above under *Operating Results 2003, 2004 and*

2005 Discontinued Operations, only our U.S. plasma operations are classified as discontinued operations . Our non-U.S. plasma operations, which had previously been classified as discontinuing operations , are now included in continuing operations . For further information on these restatements, see *Operating Results 2003, 2004 and 2005 Discontinued Operations* and Note 7.2 to the consolidated financial statements appearing elsewhere in this annual report.

Cash from Operating Activities

Gross operating cash flow from continuing operations was 3.5 billion in 2005, 2.9 billion in 2004 and 2.7 billion in 2003. 2005 gross operating cash flow increased by 20.5 percent compared to 2004, due to a

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stronger business performance. Despite substantially higher pre-tax earnings, income tax payments were only slightly above the previous year, partly due to utilization of loss carryforwards. The gains from the changes in our company pension plans in the United States and Germany were non-cash items and thus did not affect gross or net cash flow. 2004 gross operating cash flow increased by 5.3 percent compared to 2003, mainly due to the higher income from operations.

Net cash flow from continuing operations rose by 56.6 percent in 2005 to 3,542 million. All of the subgroups posted significant year-on-year growth in cash flow. The overall increase resulted from both a better business performance and a positive change in working capital. Cash outflow for inventories was much lower than in 2004, especially in MaterialScience. In addition, the Group s cash contribution from changes in accounts receivables improved significantly from minus 404 million in 2004 to 156 million in 2005. Net cash provided by operating activities from our continuing operations in 2004 amounted to 2,262 million, a 30.6 percent decline from the 3,258 million in 2003. The sales growth in CropScience and MaterialScience, combined with significantly higher costs for petrochemical raw materials, led to an increase in inventories and trade accounts and consequently to the decline in net cash provided by operating activities. The 2003 figure reflects a disbursement of 231 million made following a settlement reached with U.S. authorities in the context of an investigation into pharmaceutical product prices. Provisions for these payments were recorded in 2002.

Net cash provided by operating activities from discontinued operations relating to the divested U.S. plasma operations and LANXESS represented an outflow of 40 million in 2005, and inflows of 188 million in 2004 and 35 million in 2003. The total net cash flow from operating activities amounted to 3,502 million in 2005, 2,450 million in 2004 and 3,293 in 2003, respectively.

Investing Activities

Net cash used in investing activities totaled 1,741 million in 2005, as compared to a net cash outflow of 814 million in 2004. The cash outflow for acquisitions amounted to 2,188 million, including approximately 1.9 billion for the Consumer Health business of Roche. Further cash outflows related mainly to the purchase of marketing rights in connection with a license agreement and a co-marketing and distribution agreement in the Bayer CropScience and Bayer HealthCare subgroups, respectively. Cash outflow for additions to property, plant, equipment and intangible assets amounted to 1,389 million in 2005.

Cash inflows related to investments amounted to 1,189 million. This figure primarily included the scheduled repayment of loans from LANXESS, the expiration of currency-hedging derivatives and the sale of the LANXESS mandatory convertible bond with a nominal volume of 200 million. Cash receipts from sales of property, plant and equipment totaled 398 million, including approximately 230 million from the divestment of the plasma business in the first quarter of 2005.

In 2004, the cash outflow of 1,251 million for additions to property, plant and equipment and 358 million for acquisitions were partially offset by 200 million in cash receipts from sales of property, plant and equipment, 90 million in inflows related to investments, 400 million in interest and dividend receipts and 105 million in inflows from marketable securities. The 358 million in cash outflow for acquisitions in 2004 comprised mainly the 100 million purchase price for the remaining 50 percent of the shares of Gustafson and 208 million for the remaining 50 percent interest in the U.S. joint venture with Roche, both of which we now wholly own. The 90 million cash inflow in 2004 related to investments comprised mainly a 327 million payment from Aventis in connection with the 2002 acquisition of Aventis CropScience, as well as outflows of around 200 million for advance payments related to the acquisition of the Roche Consumer Health business.

The net cash inflow from investing activities amounted to 460 million in 2003. Capital expenditures of 1,653 million were more than offset by cash receipts from sales of property, plant and equipment. We received cash totaling 1,644 million mainly from the divestments of crop science businesses mandated by the antitrust authorities in connection with the Aventis CropScience acquisition (1,185 million) and the sale of our interest in PolymerLatex (118 million). Further cash from investments of 258 million was provided by the divestment of our equity stakes in Millennium Pharmaceuticals and others. Cash was consumed, however, by the purchase of the remaining 45.5 percent of the shares of the Bayer Polymers Sheet Europe group (formerly Makroform GmbH).

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Financing Activities

Net cash used in financing activities was 1,881 million in 2005, compared with net cash used in financing activities of 761 million in 2004. The 2005 outflow included 440 million in dividend payments, 654 million in net repayments of borrowings and 787 million in interest payments. Taking advantage of favorable market conditions, a subordinated hybrid bond with a maturity of 100 years was issued in the third quarter of 2005 in the nominal amount of 1.3 billion with a 5 percent coupon. At the same time, part of the 5.375 percent Bayer bond due on April 10, 2007 was repurchased early. The repurchased volume had a face value of approximately 860 million. The higher interest payments were primarily attributable to 56 million resulting from a one-time charge in connection with this transaction.

Including marketable securities and other instruments, the Group had liquid assets of 3,523 million on December 31, 2005. Cash of 253 million was deposited in escrow accounts to be used solely for payments in connection with civil litigation settlements (See also Item 8, *Financial Information Legal Proceedings*). In view of the restriction on its use, the cash in these escrow accounts was not deducted when calculating net debt. On December 31, 2005, including the 253 million deposited in an escrow account, net debt (see below for a reconciliation) stood at 5,494 million, which was only 603 million above the level on December 31, 2004.

In 2004, the cash used in financing activities amounted to 761 million. The outflow contained a total of 559 million in dividends paid to our stockholders and advance capital gains tax payments on intra-Group dividends as well as 724 million in interest payments. These outflows were partially offset by 512 million in net borrowing and 10 million in capital contributions to subsidiaries. Net debt (continuing operations) amounted to 4,891 million. On December 31, 2004, we had liquid assets of 3,599 million.

In 2003, the cash used in financing activities totaling 1,761 million comprised dividend payments of 664 million, interest payments of 782 million and 315 million in net borrowing retirements. Net debt (continuing operations) amounted to 5,346 million.

The following table sets forth the calculation of the net debt figure.

	Dec. 31, 2003	**Dec. 31, 2004**	**Dec. 31, 2005**
		(Euros in million)	
Noncurrent financial liabilities as per balance sheet (including derivatives)	6,772	7,025	7,185
Current financial liabilities as per balance sheet (including derivatives)	2,046	2,166	1,767
Derivative receivables	(609)	(701)	(188)
Cash and cash equivalents as per balance sheet less cash earmarked for civil litigation settlements	(2,863)	(3,599)	(3,270)[(a)]
Net debt* (continuing operations)	5,346	4,891	5,494
Net debt* (discontinued operations)	606	531	0
Net debt* (total)	5,952	5,422	5,494

[(a)] Liquid assets as per balance sheet (3,523 million) minus cash deposited in escrow accounts (253 million) equals 3,270 million.

(*) Net Debt is defined neither under IFRS nor under U.S. GAAP and may not be comparable with measures of the same or similar title that are reported by other companies. Under SEC rules Net Debt is considered a non-GAAP financial measure. It should not be considered as a substitute for, or confused with, any IFRS or U.S. GAAP financial measure. We believe the most comparable IFRS and U.S. GAAP measures are noncurrent and current financial obligations. Bayer defines Net Debt as described above and believes that this measure provides investors, analysts and credit rating agencies with useful information disclosing and summarizing the

status of the net financial borrowings due to third parties. We believe that subtracting liquid assets from our noncurrent and current financial obligations (that includes liabilities from derivative financial instruments) and netting this with the receivables resulting from derivative financial instruments is appropriate in providing a useful measure of the obligations associated with our outstanding debt. We thus

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believe that Net Debt is an indicator of the Bayer Group s creditworthiness. However, the subtraction of liquid assets should not cause the reader to believe that we have less debt than actually appears on our balance sheet. For this reason, you should consider our net debt measure in conjunction with the noncurrent and current financial obligations recorded on our balance sheet.

Financing Strategy

The financial management of the Bayer Group is conducted by the management holding company Bayer AG. Finance is a global resource, generally procured centrally and distributed within the Group. The prime objectives of our financial management are to ensure sufficient liquidity and help bring about a sustained increase in corporate value. With these goals in mind we aim to optimize our capital structure, manage risks effectively and reduce financing costs.

Standard & Poor s currently gives Bayer a long-term A rating, while Moody s rates us at A3. The short-term ratings are A-1 (Standard & Poor s) and P-2 (Moody s). Our financial strategy is geared toward maintaining a credit rating that reflects high solvency.

We generally pursue a prudent debt management strategy aimed at ensuring flexibility. We consider it important to draw on a balanced mix of capital resources to finance our activities. Chief among these resources in keeping with our requirements are a syndicated credit facility, a multi-currency commercial paper program and a multi-currency Euro Medium Term Note program. We also supplement our financing with various structured products, such as an asset-backed securities program.

The situation on the international financial markets of relevance to the Bayer Group was again positive in 2005. We took advantage of this favorable market environment to considerably improve the conditions of our syndicated credit line. We do not expect this positive market environment to change significantly in the short term.

Further details of our risk management objectives and the ways in which we hedge all the major types of transaction to which hedge accounting is applied, along with procurement market, credit, liquidity and cash flow risks, as they relate to our use of financial instruments, are given in Note 33 to the consolidated financial statements appearing elsewhere in this annual report.

We have ample borrowing capacity available. To provide flexible short- to medium-term funding, we established a U.S. $8 billion global commercial paper program and a 8 billion European Medium-Term Note program.

At December 31, 2005, we had approximately 5.4 billion of total lines of credit, of which 0.7 billion was used and 4.7 billion was unused and available for borrowing on an unsecured basis. The majority of these lines of credit are represented by a multicurrency syndicated credit facility, which we established in 2003. When drawing under this facility, we are required to prove that there has been no material adverse change in our financial position. The facility can be terminated by the lenders if a change of control of Bayer AG occurs and the majority of the lenders opt to terminate the facility.

Capital Expenditures

We generally fund our capital expenditures with cash flow from operations and, if such funds are not sufficient, through other cash on hand and from the sale of liquid investments, including cash equivalents and marketable securities. We fund any further capital expenditures with borrowings.

Capital expenditures amounted to 1.4 billion in 2005, compared to 1.0 billion in 2004 and 1.4 billion in 2003.

We spent a total of 1.4 billion for intangible assets and property, plant and equipment in 2005. As in recent years, the focus of our capital expenditures were our Material and Systems segments.

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Our major capital expenditures since 2003 included:

Year	Segment	Description
2003	Pharmaceuticals, Biological Products	Addition to capacity solid dosage plant, Leverkusen, Germany Construction of a sterile filling facility, Berkeley, California
	Consumer Care	Construction of a lacquering (small-scale production), Greppin, Germany
	Diabetes Care, Diagnostics	Elkhart site consolidation, Elkhart, Indiana
	Animal Health	Good manufacturing practice upgrade, Panwol, South Korea
	Crop Protection	Multi-purpose plant, Dormagen, Germany Fungicide plant extension, Muttenz, Switzerland
	Environmental Science, BioScience	New research & development building, Gent, Belgium
	Materials	Expansion of methylcellulose production, Bitterfeld, Germany
	Systems	Expansion of isocyanate capacity including precursors, Brunsbüttel and Dormagen, Germany Expansion/ modification of electrolysis plant, Leverkusen, Germany
2004	Pharmaceuticals, Biological Products	Construction of process development facility (Kogenate) in Berkeley, California
	Crop Protection	Installation of a production line for the new fungicide Fandango, Kansas City, Kansas
	Materials	Construction of production facility for polycarbonate in Caojing, PRC Expansion of capacities for tantalum powder in Goslar, Germany
	Systems	Expansion of isocyanate capacities in Tarragona, Spain; Baytown, Texas, and Brunsbüttel, Germany Construction of production facility for methylene-diphenyl-diisocyanate in Caojing, PRC Expansion of polyisocyanate capacity in Caojing, PRC Construction of production facility for hexamethylene-diiisocyanate in Caojing, PRC
2005	Pharmaceuticals, Biological Products	Construction of a clinical manufacturing facility for Kogenate in Berkeley, California
	Consumer Care	Expansion of production facility in Jakarta, Indonesia
	Crop Protection	Insourcing and relocation of products/ intermediates in Dormagen, Knapsack and Frankfurt, Germany Product insourcing projects in Vapi and Ankleshwar, India
	Environmental Science, BioScience	Expansion of greenhouse facilities in Haelen, The Netherlands
	Materials	Construction of a polycarbonate compounding facility in Caojing, PRC Expansion of the polycarbonate facility in Map Ta Phut, Thailand Start of capacity expansion projects for polycarbonate in Caojing, PRC
	Systems	Construction of a *Desmodur®-L* production facility in Caojing, PRC Start of construction of a world-scale MDI production facility in Caojing, PRC Installation of a new plant for MDI specialty products in Baytown,

Texas
Capacity increase of the chlorine production facility in Baytown, Texas

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Commitments

Off-Balance Sheet Arrangements

Our unconsolidated entities are not considered special-purpose entities and do not constitute other off-balance sheet arrangements.

Contractual Obligations and Commercial Commitments

The table below summarizes all of the Group s contractual and commercial obligations as of December 31, 2005. The timing of payments for collaborative agreements assumes that milestones or other conditions are met. We do not foresee any material payment triggers or milestone payments in our current collaborative arrangements.

Contractual Obligations	Total	Under One Year	One Year to Less than Three Years	Three Years to Less than Five Years	After 5 Years
			(Euros in millions)		
Long-term debt, excluding capital leases	8,484	1,706	2,346	471	3,961
Capital leases without interest portion	468	61	68	51	288
Operating leases	452	106	161	111	74
Purchase obligations	294	292	2	0	0
Other long-term liabilities (collaboration agreements)	562	109	193	178	82
Other liabilities[(a)]	2,532	2,016	304	89	123
Total contractual obligations	12,792	4,290	3,074	900	4,528

[(a)] Other liabilities comprise primarily guarantees of bills and checks, payment guarantees and indirect financial guarantees; commissions to customers and expense reimbursements; as well as social security and payroll liabilities and other liabilities as set forth in Note 32 to the consolidated financial statements included elsewhere in this annual report.

Payments for guarantees and endorsements of bills and of warranties of 177 million have been excluded from the other commercial commitments table above, as we do not expect to make any payments under these commercial commitments.

Other Commitments

In 2005, our minimum non-discounted future lease payments relating to long-term lease and rental arrangements totaled 1.0 billion, compared with 1.0 billion in the previous year. Of this amount, 596 million represented future payments under financial leases (548 million in 2004).

Our financial commitment for orders placed under purchase agreements relating to planned or ongoing capital expenditure projects totaled 294 million in 2005. We expect to pay the majority of this amount in 2006. In 2004, this figure was 142 million, and in 2003, 144 million.

Under collective agreements on part-time work arrangements for certain older employees, we have to accept applications for such arrangements from a certain quotum of the work force. Other financial obligations that may arise from such work arrangements in the future cannot be quantified, since the quotum has already been exceeded.

In addition, we have entered into research agreements with a number of third parties. Under these agreements, we have agreed to fund various research projects or to assume other commitments. Our payments under these agreements

are typically based on the achievement of certain milestones or the fulfillment of other specific conditions by our research partners. In 2005, the total amount of these commitments was 562 million. For 2004, the figure was 847 million. For details on lines of credit see *Financing Strategy.*

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Borrowings

Our consolidated financial statements reflect borrowings as financial obligations , which include debentures, liabilities to banks, liabilities under lease agreements, liabilities from the issuance of promissory notes, commercial paper and other financial obligations. We have no restrictions in the use of our borrowing. See the tables under *Commitments Contractual Obligations and Commercial Commitments* above for a summary of our current financial obligations. See also Note 30 to our consolidated financial statements appearing elsewhere in this annual report.

Funding and Treasury Policies

We are exposed to interest rate risk. We are also exposed to currency-related risks such as transaction exchange rate and translation risk. To hedge our risks, we primarily use over-the-counter derivative instruments, particularly forward foreign exchange contracts, foreign exchange option contracts, interest rate swaps, interest and principal currency swaps and interest rate option contracts.

Interest rate risk applies mainly to receivables and payables with maturities of over one year. We primarily use interest rate swaps to convert a portion of our fixed rate borrowings into, in effect, floating rate borrowings. The bonds issued under our EMTN program make up the largest portion of our fixed rate borrowings. See also Note 30 to our consolidated financial statements. In a normal interest rate environment, short-term interest rates are lower than long-term interest rates. Thus, floating rate debt generally leads to lower interest costs in the long run. Short-term interest rate hedging contracts (excluding principal currency swaps) totaled a nominal amount of 0.4 billion in 2005, 0.1 billion in 2004 and 0.3 billion in 2003. In 2004, hedges maturing in more than one year represented a nominal amount of 10.9 billion, in 2004, 5.7 billion and in 2003, 6.0 billion. The cash and cash equivalents that we held on December 31, 2005 were mainly denominated in euro.

Because a substantial portion of Bayer s assets, liabilities, sales and earnings are denominated in currencies other than euro zone currencies, we have translation exposure to fluctuations in the values of these currencies relative to the euro. Since these effects do not have an impact on our cash flows, we do not hedge these risks resulting from currency fluctuations.

We also face transaction risk when our businesses generate revenue in one currency but incur costs relating to that revenue in a different currency. We hedge a portion of our transaction currency risk through the use of derivative financial instruments, particularly forward foreign exchange contracts, currency swaps, currency options and interest and principal currency swaps. Our Corporate Treasury department has the central responsibility for managing our currency exposures and using currency derivatives. We establish the maturity dates of hedging contracts according to the anticipated cash flows of the Bayer Group. Our policy is to use a mixture of instruments depending upon our view of market conditions based on fundamental and technical analysis. Our Board of Management has provided clear guidance on how to limit and monitor cash flow risks that result from this approach. As of December 31, 2005, we had entered into forward foreign exchange contracts, currency swaps, currency swaps and interest and principal currency swaps with a total notional value of 5.7 billion.

For more information on, including quantification of, these risks, and our policies in managing them, see Item 11, *Quantitative and Qualitative Disclosures about Market Risk.*

Inflation, Seasonality and Cyclicality

Inflation has not had a material effect on our operating results in recent years. Seasonality does not materially affect our business as a whole. However, several of our individual business lines are subject to seasonal effects. In addition, a number of our business groups are subject to cyclicality, either directly or because of the effect of cyclicality on their customers businesses. See the descriptions of our various business segments in Item 4, *Information on the Company* for a discussion of those businesses subject to seasonal or cyclical effects.

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RESEARCH AND DEVELOPMENT

The following table sets forth our total research and development expenditures for our continuing businesses during the last three full years.

	2003	Change from Previous Year (%)	2004	Change from Previous Year (%)	2005
			(Euros in million)		
Research and development expenditures:					
Bayer HealthCare	1,201	(17.1)	996	(4.2)	954
Bayer CropScience	725	(6.3)	679	(2.2)	664
Bayer MaterialScience	249	(5.2)	236	6.4	251
Reconciliation	15	6.7	16	6.3	17
Total from Continuing Operations	2,190	(12.0)	1,927	(2.1)	1,886
As a percentage of sales	9.8		8.3		6.9

We typically allocate the largest portion of our research and development expenses to our HealthCare businesses, primarily in the Pharmaceuticals, Biological Products segment. In 2005, Pharmaceuticals, Biological Products accounted for 36.0 percent of our total research and development spending (2004: 38.4 percent; 2003: 42.0 percent).

For a more detailed discussion of our research and development activities and policies, see the descriptions of each business group s research and development activities in Item 4, *Information on the Company Business.* We discuss our patents and other intellectual property protection in Item 4, *Information on the Company Intellectual Property Protection.*

BASIS OF PRESENTATION

We prepared the consolidated financial statements that appear elsewhere in this annual report on Form 20-F in accordance with IFRS. See Note 44 to our consolidated financial statements for a reconciliation of the significant differences between IFRS and U.S. GAAP.

Effects of new accounting pronouncements

Accounting standards applied for the first time in 2005

Material effects of reporting changes on earnings per share are explained in Note 18 to the consolidated financial statements appearing elsewhere in the annual report.

The consolidated financial statements for 2005 comply with the following new or revised International Financial Reporting Standards: IAS 1 (Presentation of Financial Statements), IAS 2 (Inventories), IAS 8 (Accounting Policies, Changes in Accounting Estimates and Errors), IAS 10 (Events After the Balance Sheet Date), IAS 16 (Property, Plant and Equipment), IAS 17 (Leases), IAS 21 (The Effects of Changes in Foreign Exchange Rates), IAS 24 (Related Party Disclosures), IAS 27 (Consolidated and Separate Financial Statements), IAS 28 (Investments in Associates), IAS 31 (Interests in Joint Ventures), IAS 32 (Financial Instruments: Disclosure and Presentation), IAS 33 (Earnings per Share), IAS 39 (Financial Instruments: Recognition and Measurement) and IAS 40 (Investment Property). The revised standards supersede the previous versions and apply for annual periods beginning on or after January 1, 2005.

In February 2004, the IASB issued International Financial Reporting Standard (IFRS) 2 (Share-based Payment), which deals with accounting for share-based payment transactions, including grants of share options to employees. IFRS 2 specifies the financial reporting by an entity when it undertakes a share-based payment transaction and

requires an entity to reflect in its profit or loss and financial position the effects of share-based payment transactions, including expenses associated with transactions in which share options are granted to

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employees. The first-time application of IFRS 2 led to a 7 million pre-tax adjustment to the value of existing obligations under stock-based compensation programs as of January 1, 2005. The adjustment resulting from measuring these obligations retrospectively at fair value instead of intrinsic value includes a pre-tax amount of 3 million pertaining to the 2004 fiscal year.

In March 2004, the IASB issued IFRS 3 (Business Combinations) to replace IAS 22 (Business Combinations). IFRS 3 requires all business combinations within its scope to be accounted for by applying the purchase method of accounting. The pooling of interests method is prohibited. At the acquisition date, the acquiree s identifiable assets, liabilities and contingent liabilities are to be recognized at fair value. It requires that goodwill no longer be amortized but tested annually for impairment. IFRS 3 is applied to business combinations for which the agreement date is on or after March 31, 2004. For goodwill and other intangible assets acquired in a business combination for which the agreement date was prior to March 31, 2004, the standard must be applied prospectively from the beginning of the first annual period beginning on or after March 31, 2004.

In March 2004, in connection with the issuance of IFRS 3, the IASB revised IAS 36 (Impairment of Assets) and IAS 38 (Intangible Assets). The main revisions require goodwill and intangible assets with indefinite useful lives to be tested for impairment annually, or more frequently if events or changes in circumstances indicate a possible impairment, prohibit reversal of impairment losses for goodwill, require an intangible asset to be treated as having an indefinite useful life when there is no foreseeable limit on the period over which the asset is expected to generate net cash inflows for the entity, and prohibit the amortization of such intangible assets. The revised standards are effective for goodwill and other intangible assets acquired in business combinations for which the agreement date is on or after March 31, 2004 and for all other such assets for annual periods beginning on or after March 31, 2004. The new standard has been applied prospectively, *i.e.* the new recognition and valuation principles are applied only in the current statements and not for the preceding period. Had the new standard been applicable for the 2004 fiscal year, the absence of amortization of goodwill and other intangible assets with indefinite useful lives would have reduced operating expense by 185 million.

In March 2004, the IASB issued IFRS 5 (Non-current Assets Held for Sale and Discontinued Operations), which contains specific recognition principles for assets and liabilities held for sale and for discontinued operations. To improve transparency and comparability, the Group s financial reporting is based primarily on continuing operations, while assets held for sale and discontinued operations are stated separately in a single line item in the balance sheet, income statement and cash flow statement. The distinction between continuing operations and discontinued operations or assets held for sale is thus drawn differently starting on January 1, 2005 than in the financial statements as of December 31, 2004.

In March 2004, the IASB issued an amendment to IAS 39 (Financial Instruments: Recognition and Measurement). The amendment simplifies the implementation of IAS 39 by enabling fair value hedge accounting to be used more readily for portfolio hedging of interest rate risk than under previous versions of IAS 39.

In May 2004, the International Financial Reporting Interpretations Committee (IFRIC) issued IFRIC Interpretation 1 (Changes in Existing Decommissioning, Restoration and Similar Liabilities). The interpretation addresses the accounting for changes in cash outflows and discount rates, and increases resulting from the passage of time in existing decommissioning, restoration, and similar liabilities that are recognized both as part of the capitalized cost of an item of property plant and equipment and as a provision.

In November 2004, the IFRIC released an amendment to SIC-12 (Consolidation Special Purpose Entities). The amendment removes SIC-12 s scope exception for equity compensation plans, thereby requiring an entity that controls an employee benefit trust (or similar entity) set up for the purpose of a share-based payment arrangement to consolidate that trust upon adopting IFRS 2 (Share-based Payment). Further, it amends the scope exclusion in SIC-12 for post-employment benefit plans to include other long-term employee benefit plans in order to ensure consistency with the requirements of IAS 19 (Employee Benefits).

In December 2004, the IASB published an amendment to IAS 19 (Employee Benefits). The amendment introduces an additional recognition option that permits immediate recognition of actuarial gains and losses arising in defined benefit plans. The option is similar to the approach provided in U.K. standard FRS 17 (Retirement Benefits), which requires recognition of all actuarial gains and losses in a statement of total

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recognized gains and losses that is separate from the income statement. Other features of the amendment include (1) a clarification that a contractual agreement between a multi-employer plan and participating employers that determines how a surplus is to be distributed or a deficit funded will give rise to an asset or liability, (2) accounting requirements for group defined benefit plans in the separate or individual financial statements of entities within a group, and (3) additional disclosure requirements.

Previously, in the Bayer Group statements, net cumulative amounts of actuarial gains and losses outside of the corridor that were reflected in the balance sheet at the end of the previous reporting period were recognized in the income statement as income or expense, respectively, over the average remaining working lives of existing employees. This corridor was 10 percent of the present value of the defined benefit obligation or 10 percent of the fair value of plan assets, whichever was greater at the end of the previous year. Under the new method of post-employment benefit accounting, unrealized actuarial gains and losses, instead of being gradually amortized according to the corridor method and recognized in income, are offset in their entirety against stockholders equity. Thus, no amortization of actuarial gains and losses is recognized in income.

Recognizing actuarial gains and losses in stockholders equity affects the amounts of receivables and of provisions for pensions and other post-employment benefits stated in the balance sheet and also requires the recognition of deferred taxes on the resulting differences. These taxes, too, are offset against the corresponding equity items. The Group Management Board has decided to follow the recommendation of the IASB and implement the above change as of January 1, 2005 in order to enhance the transparency of the reporting. The previous year s figures have been restated accordingly. This reporting change improves the 2004 operating result from continuing operations by 48 million and the non-operating result by 78 million, but also gives rise to a deferred tax expense of 50 million. In view of its immateriality to 2004 operating result of the segments, the 48 million gain has been reflected solely in the reconciliation column of the segment table. These reporting changes do not affect either gross or net cash flows.

The impact of the change on the relevant balance sheet items as of December 31, 2004 was as follows:

	Carrying amount before the change	Impact of the change	Carrying amount after the change
		(Euros in million)	
Assets			
Benefit plan assets in excess of obligations	540	(468)	72
Deferred tax assets	936	283	1,219
Assets held for sale and discontinued operations	4,788	(31)	4,757
Stockholders Equity and Liabilities			
Other reserves	7,452	(1,432)	6,020
Provisions for pensions and other post-employment benefits	4,581	1,638	6,219
Deferred tax liabilities	1,171	(527)	644
Liabilities directly related to assets held for sale and discontinued operations	2,282	105	2,387

In April 2005, the International Accounting Standards Board (IASB) issued an amendment to IAS 39 (Financial Instruments: Recognition and Measurement) to permit the foreign currency risk of a highly probable forecast intragroup transaction to qualify as the hedged item in consolidated financial statements provided that the transaction is denominated in a currency other than the functional currency of the entity entering into that transaction and the foreign currency risk will affect consolidated profit or loss. The amendment also specifies that if the hedge of a forecast intragroup transaction qualifies for hedge accounting, any gain or loss that is recognized directly in equity in accordance with the hedge accounting rules in IAS 39 must be reclassified into profit or loss in the same period or

periods during which the foreign currency risk of the hedged transaction affects consolidated profit or loss. The amendments shall be applied for annual periods beginning on or after January 1, 2006. The Bayer Group has early adopted this standard and is applying the interpretation in its current

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financial statements. The adoption has not had a material impact on the Group s shareholders equity, financial position or results of operations.

In June 2005, the IASB issued a further amendment to IAS 39 (Financial Instruments: Recognition and Measurement). This amendment introduces a restriction to the use of the option of designating any financial asset or any financial liability to be measured at fair value through profit or loss (the fair value option). The amendment limits the use of this option to financial instruments that meet certain conditions. Those conditions are that: (1) the fair value option designation eliminates or significantly reduces a measurement or recognition inconsistency, (2) a group of financial assets, financial liabilities, or both are managed and their performance is evaluated on a fair value basis in accordance with a documented risk management or investment strategy, and (3) an instrument contains an embedded derivative that meets particular conditions. The amendment shall be applied for annual periods beginning on or after January 1, 2006. The Bayer Group has early adopted this amendment and applied it in its 2005 financial statements. The adoption has not had a material impact on the Group s shareholders equity, financial position or results of operations.

Newly issued accounting standards

In December 2004, the International Financial Reporting Interpretations Committee (IFRIC) issued IFRIC Interpretation 5, Rights to Interests Arising From Decommissioning, Restoration and Environmental Rehabilitation Funds (IFRIC 5). The interpretation addresses how to account for obligations to decommission assets for which a company contributes to a fund established to meet the costs of the decommissioning or environmental rehabilitation. IFRIC 5 is to be applied for annual periods beginning on or after January 1, 2006. The Bayer Group does not believe that the application of this standard will have a material impact on the Group s financial position, results of operations or cash flows.

In August 2005, the IASB amended requirements for financial guarantee contracts through limited amendments to IAS 39 (Financial Instruments: Recognition and Measurement) and IFRS 4 (Insurance Contracts). The amendments require the issuer of a financial guarantee contract to measure the contract initially at fair value, and subsequently at the higher of (1) the amount determined in accordance with IAS 37 (Provisions, Contingent Liabilities and Contingent Assets), and (2) the amount initially recognized less, when appropriate, cumulative amortization recognized in accordance with IAS 18 (Revenue). If an issuer has previously asserted explicitly that it regards such contracts as insurance contracts and has used accounting applicable to insurance contracts, the issuer may elect to apply to such contracts the accounting model described above or elect to account for such contracts under IFRS 4. The amendments shall be applied for annual periods beginning on or after January 1, 2006. The Bayer Group does not believe that the application of this standard will have a material impact on the Group s financial position, results of operations or cash flows.

In September 2005, the IFRIC issued IFRIC Interpretation 6, Liabilities Arising from Participating in a Specific Market Waste Electrical and Electronic Equipment (IFRIC 6). The interpretation addresses when certain producers of electrical goods are required to recognize a liability for the cost of waste management relating to the decommissioning of waste electrical and electronic equipment (historical waste) supplied to private households. The IFRIC concluded that the event giving rise to the liability for cost of such historical waste, and thus its recognition, is participating in the market during a measurement period. IFRIC 6 is to be applied for annual periods beginning on or after December 1, 2005. The Bayer Group is currently evaluating the impact the standard will have on the Group s financial position, results of operations or cash flows.

In November 2005, the IFRIC issued IFRIC Interpretation 7, Applying the Restatement Approach under IAS 29 (Financial Reporting in Hyperinflationary Economies) . IFRIC 7 clarifies how comparative amounts in financial statements should be restated when an entity s functional currency becomes hyperinflationary. IFRIC agreed that when hyperinflationary status is reached, an entity must restate its financial statements as though the economy had always been hyperinflationary. In addition, IFRIC 7 also provides guidance on how deferred tax items in the opening balance sheet should be restated. The Bayer Group is currently evaluating the impact the standard will have on the Group s financial position, results of operations or cash flows.

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U.S. GAAP

In July 2005, the FASB issued FSP No. APB 18-1, Accounting by an Investor for Its Proportionate Share of Other Comprehensive Income of an Investee Accounted for under the Equity Method in Accordance with APB Opinion No. 18 upon a Loss of Significant Influence . The FSP states that an investor s proportionate share of an investee s equity adjustments for other comprehensive income should be offset against the carrying value of the investment at the time significant influence is lost. The guidance in this FSP is effective as of the first reporting period beginning after July 12, 2005. The Bayer Group is currently evaluating the impact the standard will have on the Group s financial position, results of operations and cash flows.

Item 6. ***Directors, Senior Management and Employees***

Directors and Senior Management

In accordance with the German Stock Corporation Act (*Aktiengesetz*), Bayer AG has both a Board of Management (*Vorstand*) and a Supervisory Board (*Aufsichtsrat*). The Board of Management is responsible for the management of our business; the Supervisory Board supervises the Board of Management and appoints its members. The two boards are separate, and no individual may simultaneously be a member of both boards.

Members of both the Board of Management and the Supervisory Board owe a duty of loyalty and care to Bayer AG. In exercising their duties, the applicable standard of care is that of a diligent and prudent businessperson. Members of both boards must take into account a broad range of considerations when making decisions, including the interests of Bayer AG and its stockholders as well as of employees and creditors.

The members of the Board of Management and the Supervisory Board may be held personally liable to Bayer AG for breaches of their duties of loyalty and care. Bayer AG must bring an action for breach of duty against the Board of Management or Supervisory Board upon a resolution of the Stockholders Meeting passed by a simple majority of votes cast, or upon the request of stockholders holding, as a group, at least 10 percent of the outstanding share capital. With the exception of stockholders of companies that (unlike Bayer AG) are under the control of another company, individual stockholders of German companies cannot sue directors on behalf of the company in a manner analogous to a stockholder s derivative action under U.S. law. Under German law, directors may be liable for breach of duty to stockholders (as opposed to a duty to the company itself) only where a breach of duty to the company also constitutes a breach of a statutory provision enacted specifically for the protection of stockholders. As a practical matter, stockholders are able to assert liability against directors for breaches of this sort only in unusual circumstances.

Board of Management

The Board of Management is responsible for managing the business of Bayer AG in accordance with the German Stock Corporation Act and Bayer AG s Articles of Association. It also represents Bayer AG in its dealings with third parties and in court. According to the Articles of Association, the Board of Management consists of a minimum of two members. The Supervisory Board determines the number of and appoints the members of the Board of Management. Members of the Board of Management are appointed for a maximum term of five years and are eligible for reappointment after the completion of their term in office.

Bayer AG is legally represented by two members of the Board of Management acting together, or by one member of the Board of Management together with a person possessing a special power of attorney (*Prokura*).

The Board of Management must report regularly to the Supervisory Board, particularly on proposed business policy and strategy, on profitability and on the current business of Bayer AG, as well as on any exceptional matters that may arise from time to time. If not otherwise required by law, the Board of Management decides with a simple majority of the votes cast. In case of deadlock, the vote of the chairperson is the relevant vote.

Under certain circumstances, such as a serious breach of duty or a vote of no confidence by the stockholders in an annual meeting, a member of the Board of Management may be removed by the Supervisory Board prior to

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the expiration of his/her term. A member of the Board of Management may not deal with, or vote on, matters relating to proposals, arrangements or contracts between him/herself and Bayer AG.

Individual Board members serve as representatives with primary responsibility for our various corporate functions and as representatives for the various geographic regions in which we operate.

The following table shows the members of our current Board of Management, their ages, positions and the years in which their current terms expire.

	Name and Age	Position	Current Term Expires
	Werner Wenning (59)	Chairman	2007
*	Dr. Udo Oels (62)	Member	2006
	Klaus Kühn (54)	Member	2007
	Dr. Richard Pott (52)	Member	2007
**	Dr. Wolfgang Plischke (54)	Member	2009

* Until April 28, 2006

** As of March 1, 2006

Werner Wenning became chairman of our Board of Management in April 2002. He has served on the Board since 1997. Prior to becoming chairman, he served as chief financial officer and was a member of the Corporate Coordination and Human Resources Committees. From 1996 until he joined the Board in 1997, Mr. Wenning was head of Corporate Planning and Controlling. In addition to his responsibilities on the Board, he is a member of the supervisory boards of Gerling-Konzern Versicherungs-Beteiligungs AG and Henkel KGaA.

Dr. Udo Oels joined the Board of Management in 1996 and currently is responsible on a Group level for innovation, technology and environment. In addition to his responsibilities on the Board, he is chairman of the supervisory board of Bayer Technology Services and of Bayer Industry Services as well as a member of the supervisory boards of Bayer Chemicals AG and ThyssenKrupp Services AG.

Klaus Kühn is Bayer s chief financial officer. Prior to joining the Board in May 2002, Mr. Kühn was head of Bayer s Finance function. Prior to that appointment, he oversaw the spin-off of Bayer s former Agfa division. Before joining Bayer in 1998, Mr. Kühn worked with Schering AG, most recently as head of finance. In addition to his responsibilities on the Board, he is chairman of the supervisory board of Bayer CropScience AG.

Dr. Richard Pott joined the Board in May 2002. He had previously served as General Manager of our Specialty Products business group. Before assuming responsibility for Specialty Products, he served Bayer in a number of positions, most recently as head of the Strategic Planning Department and then as head of Corporate Planning and Controlling. Dr. Pott oversees strategy and human resources and serves as *Arbeitsdirektor* (that member of the Board of Management responsible for personnel and social issues within the corporation). In addition to his responsibilities on the Board, he is a chairman of the supervisory board of Bayer HealthCare AG and Bayer MaterialScience AG.

Dr. Wolfgang Plischke joined the Board in March 2006. He started his career in 1980 with Bayer s subsidiary Miles Diagnostics. Starting in 2000, Dr. Plischke headed the Pharmaceuticals division in North America and was a member of the Executive Committee of Bayer Corporation. In January 2002, he was appointed General Manager of the Pharmaceuticals division at Bayer AG. He has been a member of the Bayer HealthCare Executive Committee and responsible for the Pharmaceuticals division since July 1, 2002.

Supervisory Board

Under the German Stock Corporation Act, the German Co-Determination Act (*Mitbestimmungsgesetz*) of 1976 and our Articles of Association, the Supervisory Board consists of 20 members. The principal function of the Supervisory Board is to supervise the Board of Management and to appoint its members. The Supervisory Board oversees our business policy, corporate planning and strategy. It also approves the annual budget and the financial

statements of Bayer AG and of the Bayer Group. The Supervisory Board may not make management

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decisions, but the Board of Management s Standard Operating Procedures (*Geschäftsordnung*) may require the prior consent of the Supervisory Board for specified transactions above a specified threshold, including:

- the acquisition or disposition of assets;
- the acquisition, disposition or encumbrance of real property;
- the creation of new business units or the disposition of existing units; and
- the issuance of bonds, entering into of credit agreements, or grant of guaranties, sureties (*Bürgschaften*) and loans, except to subsidiaries.

Our stockholders elect ten members of the Supervisory Board at the Annual Stockholders Meeting. Pursuant to the Co-Determination Act of 1976, our employees elect the remaining ten members. The term of a Supervisory Board member expires at the end of the Annual Stockholders Meeting in which the stockholders discharge Supervisory Board members for the fourth fiscal year following the year in which the member was elected. There is no compulsory retirement age for members of the Supervisory Board. However, in accordance with the German Corporate Governance Code, Supervisory Board members are encouraged to retire at the Annual Stockholders Meeting following the member s 72nd birthday.

Any member elected by the stockholders at the Annual Stockholders Meeting may be removed by a majority of three quarters of the votes cast by the stockholders in such meeting. Any member elected by the employees may be removed by a majority of three quarters of the votes cast by the employees. Unless otherwise required by law or by the Articles of Association of Bayer AG, resolutions of the Supervisory Board are passed by simple majority of the votes cast. According to the Articles of Association, in the case of a deadlock, a second vote is held in which the chairman of the Supervisory Board is entitled to one additional vote. In order to constitute a quorum, at least half of the total members of the Supervisory Board must participate in the voting.

The following table shows the current members of our Supervisory Board, their principal occupations, the year in which they were first elected or appointed and memberships they hold on the supervisory boards of other companies. Employee representatives are identified by an asterisk.

Name	Position	Principal Occupation	First Elected	Membership on other Supervisory Boards
Dr. Manfred Schneider	Chairman	Former chairman of the Management Board	2002	Allianz AG, DaimlerChrysler AG, Linde AG, Metro AG, RWE AG, TUI AG
*Erhard Gipperich[1]	Vice Chairman	Chairman of the Group and Central Works Councils of Bayer AG, Leverkusen	1998	Baywoge GmbH
Dr. Paul Achleitner	Member	Member of the management board, Allianz AG	2002	Allianz Global Investors AG, Allianz Immobilien GmbH, MAN AG, RWE AG
Dr. Josef Ackermann	Member	Chairman of the management board, Deutsche Bank AG	2002	Deutsche Lufthansa AG, Linde AG, Siemens AG
*Andreas Becker[2]	Member	Chairman of the Works Council of H.C. Starck	2005	H.C. Starck GmbH

*Karl-Josef Ellrich	Member	Chairman of the Works Council, Dormagen Site	2000	Bayer CropScience AG
*Dr. Thomas Fischer[3]	Member	Head of Process and Plant Safety, Bayer MaterialScience	2005	Bayer MaterialScience AG
*Thomas Hellmuth	Member	Agricultural Engineer	2002	

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Name	Position	Principal Occupation	First Elected	Membership on other Supervisory Boards
Prof. Dr.-Ing. E.h. Hans-Olaf Henkel	Member	Honorary professor of the University of Mannheim	2002	Continental AG, DaimlerChrysler Aerospace AG, SMS GmbH, Brambles Industries, Orange SA, Ringier AG
Gregor Jüsten[4]	Member	Member of the Works Councils, Leverkusen Site	2006	
Dr. rer. pol. Klaus Kleinfeld[5]	Member	Chairman of the management board, Siemens AG	2005	Alcoa Inc., Citigroup Inc.
Dr. h.c. Martin Kohlhaussen	Member	Chairman of the supervisory board, Commerzbank AG	1992	Heraeus Holding GmbH, Hochtief AG, Intermediate Capital Group, National Pensions Reserve Fund, Schering AG, ThyssenKrupp AG, Verlagsgruppe Georg von Holtzbrinck GmbH
John Christian Kornblum	Member	Chairman of Lazard & Co.	2002	ThyssenKrupp Technologies AG, Motorola Inc.
*Petra Kronen	Member	Chairwoman of the Works Council, Uerdingen Site	2000	Bayer MaterialScience AG
Dr. Heinrich von Pierer[6]	Member	Chairman of the supervisory board, Siemens AG	1993	Deutsche Bank AG, Hochtief AG, Münchener Rückversicherungs-Gesellschaft AG, ThyssenKrupp AG, Volkswagen AG
*Wolfgang Schenk[7]	Member	Engineer	2002	
*Hubertus Schmoldt	Member	Chairman of German Mine, Chemical and Power Workers Union	1995	BHW AG, Deutsche BP AG, DOW Olefinverbund GmbH, E.ON AG, RAG AG, RAG Coal International
*Dieter Schulte	Member	Former Chairman of German Unions Federation	1997	
Dr.-Ing. Ekkehard D. Schulz [5]	Member	Chairman of the management board, ThyssenKrupp AG	2005	AXA Konzern AG, Commerzbank AG, Deutsche Bahn AG, MAN AG, RAG AG, TUI AG,

ThyssenKrupp Automotive AG, ThyssenKrupp Elevator AG, ThyssenKrupp Services AG, ThyssenKrupp Steel Beteiligungen AG

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Name	Position	Principal Occupation	First Elected	Membership on other Supervisory Boards
Dr.-Ing. E.h. Jürgen Weber	Member	Chairman of the supervisory board, Deutsche Lufthansa AG	2003	Allianz Lebensversicherungs- AG, Deutsche Bank AG, Deutsche Post AG, Thomas Cook AG, Voith AG, Loyalty Partner GmbH, Tetra Laval Group
*Siegfried Wendlandt	Member	North Rhine District Secretary of German Mine, Chemical and Power Workers Union	2001	Baywoge GmbH, HT Troplast AG, Rütgers AG
*Reinhard Wendt[6]	Member	Chairman of the works council of Wolff Walsrode AG	2002	Wolff Walsrode AG
*Thomas de Win	Member	Commercial Clerk[8]	2002	Bayer Material Science AG
Prof. Dr. Dr. h.c Ernst- Ludwig Winnacker	Member	University Professor, Bonn; President of the German Research Association, Bonn	1997	MEDIGENE AG, KWS Saat AG, Wacker Chemie AG
Dr. Hermann Wunderlich[6]	Member	Former Vice Chairman of the Management Board	1996	

(1) Resigned January 31, 2006

(2) First elected April 29, 2005

(3) First elected September 30, 2005

(4) Elected February 1, 2006.

(5) Elected April 29, 2005 to serve until the 2007 Annual Stockholders Meeting

(6) Resigned April 29, 2005

(7) Resigned September 30, 2005

(8) Chairman of the Group and Central Works Council of Bayer AG since February 1, 2006; Vice Chairman of the Supervisory Board since March 2, 2006

Supervisory Board Committees

Currently, the Supervisory Board has the following committees:

The Presidium was established pursuant to § 27 (3) of the Co-Determination Act and consists of the chairman and vice chairman of the Supervisory Board, as well as of one stockholder representative and one employee

representative. It serves as our nomination committee (*Vermittlungsausschuss*). The purpose of this committee is to nominate members of the Board of Management for election by a simple majority of the votes of the Supervisory Board in the event that the Supervisory Board is unable to appoint members of the Board of Management with the votes of at least a two thirds majority of the Supervisory Board. Pursuant to § 9 (2) of the Standard Operating Procedures (*Geschäftsordnung*) of the Supervisory Board, the Presidium also prepares the general meetings of the full Supervisory Board. The current members of the Presidium are Mr. Schneider (chairman), Mr. Achleitner, Mr. Gipperich (until January 31, 2006) and Mr. Schmoldt.

The personnel committee (*Personalausschuss*) was established pursuant to § 10 of the Standard Operating Procedures of the Supervisory Board. The personnel committee consists of four members of the Supervisory Board. The chairman of the Supervisory Board acts as chairman of the personnel committee. The main responsibility of the personnel committee is the determination of the salary and further conditions of the employment of Board of Management members, the legal representation of the

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Company in affairs with Board of Management members pursuant to § 112 of the German Stock Corporation Act, the approval of agreements with Supervisory Board members pursuant to § 114 of the German Stock Corporation Act and the approval of loans granted to Supervisory Board and Board of Management members and other persons pursuant to § 89 and § 115 of the German Stock Corporation Act. The current members of the personnel committee are Mr. Schneider (chairman), Mr. Kohlhaussen, Mr. Ellrich and Ms. Kronen.

The audit committee (*Prüfungsausschuss*) was established pursuant to § 11 of the Standard Operating Procedures of the Supervisory Board. The audit committee consists of six members of the Supervisory Board. The main responsibilities of the audit committee are oversight of financial accounting, risk management, the preparation of the resolutions of the Supervisory Board with respect to the annual financial statements, the review of all non-audit services to be performed by the independent auditor, oversight over the independent auditors including scope of services, fees and schedules, the direct receipt of the audit reports, and the direct receipt of reports of accounting irregularities. The current members of the audit committee are Mr. Kohlhaussen (chairman), Mr. Schneider, Mr. Fischer, Mr. Henkel, Mr. Wendlandt and Mr. de Win.

Share Ownership

Because the shares of Bayer AG are in bearer form, we cannot obtain precise information as to their holders. To the best of our knowledge, however, no member of the Supervisory Board or the Board of Management beneficially owns shares of Bayer AG totaling one percent or more of all outstanding shares.

Compensation

The members of the Board of Management receive a base salary, a fixed supplement and a variable bonus. The variable bonus for a given year is tied to the attainment of the Group target based on EBITDA[5]. The total remuneration of members of the Board of Management in 2005 amounted to 7,064,828 (2004: 6,518,626), comprising 1,985,580 (2004: 1,884,929) in base salaries and 837,073 (2004: 810,573) in fixed supplements (both aggregated under the term fixed salary) and 4,085,754 (2004: 3,665,880) in variable bonuses. Also included in the total is an aggregate 156,421 (2004: 157,244) of remuneration in kind consisting mainly of amounts such as the value assigned for taxation purposes to the use of a company car, and other payments. Other payments of 55,086 included in base salaries in the previous year have been reclassified.

In addition, members of the Board of Management can participate in a cash-settlement-based stock option program provided that they place their own shares in a special deposit account. In relation to this program a total of 32,025 instruments with a fair value of 1,009,750 were granted as of December 31, 2004.

Since 2005, the members of the Board of Management have participated in the long-term stock-based compensation program *Aspire I* (2005 tranche). Further details of this program are presented in *Employee Stock-Based Compensation Programs Long-term incentive program for members of the Board of Management and other senior executives* (*Aspire I*). The table below shows the remuneration components of those individual members of our Board of Management who were active on the Board as of December 31, 2005.

The current entitlement for 2005 along with compensation arising from previous years programs, parts of which have not yet been earned is stated as a separate compensation component.

The changes in the value of previously existing entitlements under long-term stock-based compensation programs that were acquired prior to 2005 are shown separately. They result from the upward trend in the price of Bayer stock in 2005.

(5) EBITDA is defined as operating result plus depreciation and amortization.

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Remuneration of the Members of the Board of Management

	Base salary	Fixed supplement	Variable bonus	Remuneration in kind and other payments	Total	Stock-based compensation: Entitlements acquired in 2005	Stock-based compensation: Change in value of entitlements acquired prior to 2005
				(In Euros)			
Klaus Kühn	412,236	170,647	843,713	35,266	1,461,862	285,748	99,693
Dr. Udo Oels	412,236	170,647	843,713	41,942	1,468,538	285,748	99,693
Dr. Richard Pott	412,236	170,647	843,713	39,044	1,465,640	284,248	98,055
Werner Wenning	748,872	325,132	1,554,615	40,169	2,668,788	495,504	169,289
	1,985,580	837,073	4,085,754	156,421	7,064,828	1,351,248	466,730

Pension provisions for the current members of the Board of Management amounted to 32,218,996 (2004: 26,098,637).

Beginning in 2001, we established a severance plan for the members of our Board of Management. This plan provides for payments to Board members if their relationship with Bayer AG ends or is terminated in certain circumstances. In 2004, we replaced the previous change in control provision with a general severance indemnity clause, which main elements are as follows:

If a member of the Group Management Board is not offered a new service contract upon expiration of his existing service contract because he is not reappointed to the Board, or if the member is removed from the Board 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 maximum period of 60 months less the period for which the Board member was released from his duties on full pay.

If, in the event of a change in control, the service contract is terminated within 12 months thereafter by mutual consent, due to its expiration, or voluntarily by the Board member in certain circumstances such as a change of strategy the Board member will receive a monthly bridging allowance amounting to 80 percent of his last monthly fixed salary for a period of 60 months, not counting the period for which he was released from his duties on full pay.

His pension entitlement is based on the final target pension level. If this has not already been reached, his pension entitlement will be supplemented up to this level.

Active members of the Board of Management are entitled to receive pension up from the age of 60. The yearly pension entitlement is based on at least 30 percent of the sum of the last yearly base salary and fixed supplement. This percentage increases over time depending on years of service as a Board member and determines the final target pension level, which is capped at 80 percent.

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, a percentage that is adjusted every three years taking into account the official German consumer price index (*Verbraucherpreisindex).* These amounts are in addition to any

amounts they receive as a result of their participation in the Bayer pension plan described below. See *Employee Pension Plan.*

Emoluments to retired members of the Board of Management and their surviving dependents amounted to 10,323,009 (2004: 9,917,575). Pension provisions for former members of the Board of Management and their surviving dependents amounted to 115,972,457 (2004: 109,174,509).

The following table shows the remuneration paid to individual members of the Supervisory Board who were active on the Board as of December 31, 2005. Employee representatives, who receive salaries from us unrelated

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to their work on the Supervisory Board, are identified by an asterisk. The aggregate amount of the salaries they received in 2005 in their capacities other than as members of the Supervisory Board is 683,665.

Remuneration of the Members of the Supervisory Board

	Basic Remuneration	Variable Remuneration	Totals
		(In Euros)	
Dr. Paul Achleitner	70,041.67	21,012.50	91,054.17
Dr. Josef Ackermann	60,000.00	18,000.00	78,000.00
*Andreas Becker[1]	40,167.00	12,050.00	52,217.00
*Karl-Josef Ellrich	75,000.00	22,500.00	97,500.00
*Dr. Thomas Fischer[3]	18,750.00	5,625.00	24,375.00
*Erhard Gipperich[5]	105,000.00	31,500.00	136,500.00
*Thomas Hellmuth	60,000.00	18,000.00	78,000.00
Prof. Dr.-Ing. e.h. Hans-Olaf Henkel	75,000.00	22,500.00	97,500.00
Dr. rer. pol. Klaus Kleinfeld[1]	40,167.00	12,050.00	52,217.00
Dr. h.c. Martin Kohlhaussen	105,000.00	31,500.00	136,500.00
John Christian Kornblum	60,000.00	18,000.00	78,000.00
*Petra Kronen	75,000.00	22,500.00	97,500.00
Dr. Heinrich von Pierer[2]	24,791.33	7,437.50	32,228.83
*Wolfgang Schenk[4]	56,250.00	16,875.00	73,125.00
*Hubertus Schmoldt	75,000.00	22,500.00	97,500.00
Dr. Manfred Schneider	180,000.00	54,000.00	234,000.00
*Dieter Schulte	60,000.00	18,000.00	78,000.00
Dr.-Ing. Ekkehard D. Schulz[1]	40,167.00	12,050.00	52,217.00
Dr.-Ing. e.h. Jürgen Weber	60,000.00	18,000.00	78,000.00
*Siegfried Wendlandt	75,000.00	22,500.00	97,500.00
*Reinhard Wendt[2]	19,833.00	5,950.00	25,783.00
*Thomas de Win	75,000.00	22,500.00	97,500.00
Prof. Dr. Dr. h.c. Ernst-Ludwig Winnacker	60,000.00	18,000.00	78,000.00
Dr. Hermann Wunderlich[2]	19,833.00	5,950.00	25,783.00

(1) First elected April 29, 2005.

(2) Resigned April 29, 2005.

(3) First elected September 30, 2005.

(4) Resigned September 30, 2005.

(5) Resigned January 31, 2006.

Employee Stock-Based Compensation Programs

Stock-based compensation in the Bayer Group is granted primarily under standard programs and also on an individual agreement basis.

Individual agreements enable the company to link remuneration components to stock price or future stock price trends. Awards under such agreements may be contingent upon the attainment of agreed targets, or they may be based

solely on length of service.

Standard programs exist for 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

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variable stock-based awards. This program provides for cash payments. Middle managers were offered a stock incentive program, while other groups of employees were offered a stock participation program.

A new stock-based compensation program for top and middle management, known as Aspire , was introduced in 2005. It comprises two variants, which are described below. For other managers and non-managerial employees, a different type of stock participation program was offered in 2005, under which Bayer subsidizes employee purchases of shares in the company.

As with other remuneration systems involving cash settlement, awards to be made under the stock-based programs are covered by provisions in the amount of the fair value of the obligations existing as of the date of the financial statements vis-à-vis the respective employee group. Adjustments to provisions relating to all existing stock-based compensation programs are recognized in the income statement.

In the past, these programs were measured on the basis of intrinsic value. Starting in 2005, measurement is based on fair value, and prior periods have therefore been restated accordingly. This change affected provisions as follows:

	Stock option program	Stock incentive program	Stock participation program
		(Euros in million)	
Intrinsic value as of December 31, 2004	2	1	1
One-time remeasurement effect	1	1	5
Fair value as of January 1, 2005	3	2	6

The table below shows the change in provisions for the various programs:

	Stock option program	Stock incentive program	Stock participation program	Aspire I	Aspire II
			(Euros in million)		
January 1, 2005	3	2	6	0	0
Allocations	10	1	6	11	23
Utilization		0	0	0	0
Reversal	0	0	(1)	0	0
December 31, 2005	13	3	11	11	23

Total expenses for stock-based compensation programs in 2005 were 57 million (2004: 8 million), including 34 million for the new Aspire programs introduced in 2005 and 2 million in subsidies for the 2005 short-term stock participation program (2004: 4 million).

In 2005 provisions of 4 million were recorded in the financial statements at the fair value of obligations entered into under individual stock-based compensation agreements. The obligations were measured in the same way as those incurred under the standard programs.

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

Dividend yield	2.27 percent
Risk-free interest rate	2.92 percent
Volatility of Bayer stock	38.00 percent
Volatility of the EURO STOXX 50sm	19.55 percent
Correlation between Bayer stock price and the EURO STOXX 50sm	0.56

The expected exercise period is three to five years.

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Long-term incentive program for members of the Board of Management and other senior executives (Aspire I)

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 determined on the basis of specific guidelines and to retain them for the full term of the program.

A percentage of their annual base salary is defined as a target for variable payments (Aspire target opportunity). Depending on the performance of Bayer stock, both in absolute terms and relative to the EURO STOXX 50sm benchmark index, participants are granted an award of between 0 percent and 200 percent of their individual target opportunity.

Participants may ask for their Aspire award to be paid out in cash immediately at the end of the three-year performance period, or they may convert it into performance units . These can then be redeemed within a two-year exercise period for a cash payment that depends on the Bayer stock price on the exercise date.

Long-term incentive program for middle management (Aspire II)

A variant of the Aspire program with the following modifications is offered to middle management:

No personal investment in Bayer shares is required.

The amount of the award in relation to the employee s personal Aspire target opportunity is based entirely on the absolute performance of Bayer stock during the performance period.

The award varies between 0 percent and 150 percent of the Aspire target opportunity.

This variant of the Aspire program is not linked to the EURO STOXX 50sm index.

Stock Participation Program (2005) for other managers and non-managerial employees

Under this program, Bayer offered employees the opportunity to purchase shares at a discount as follows:

up to 30 Bayer shares at a discount of 6.75 per share and

additional Bayer shares at a 15 percent discount up to a maximum total value of 2,500.

Managers not eligible to participate in the Aspire program could purchase discounted shares up to a maximum value of 4,000.

The shares purchased under the 2005 Stock Participation Program must be held in a special deposit account and may not be sold prior to December 31, 2006. Employees acquired a total of 523,072 Bayer shares under the 2005 Stock Participation Program.

Stock-based compensation programs 2000-2004

The stock-based compensation programs offered to the different employee groups in 2000 through 2004 were all similar in their respective structures. Provisions for the obligations under these programs are recorded in the balance sheet and recognized in the income statement at fair value. Entitlement to awards under these programs is conditioned on retention of the Bayer stock designated under the program for a certain time period.

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The following table shows the programs applicable through December 31, 2004:

	Stock option program	Stock incentive program	Stock participation program
Year of issue	2000-2004	2000-2004	2000-2004
Original term in years	5	10	10
Retention period/distribution date in years from issue date	3	2/6/10	2/6/10
Reference price	0	0	0
Performance criteria	Yes	Yes	No

Stock Option Program (2000-2004)

A maximum personal investment in Bayer stock was defined for each Board of Management member or other senior executive who wished to participate in the Stock Option Program.

The Stock Option Program also contains a three-year retention condition. The retention period is followed by a two-year exercise period, after which any option rights not exercised expire. Eligibility to exercise option rights and the award to which the holder is entitled depend on the absolute and relative performance of Bayer AG stock.

For the tranches issued in 2000-2002, every participant received one option for every 20 shares placed in a special account (personal investment). Each option originally could reach a maximum value of 200 shares during the term of the tranche, depending on the performance of Bayer stock, both in absolute terms and relative to the EURO STOXX 50[sm] index.

For the tranches issued in 2003 and 2004, participants received up to three options per share of their personal investments placed in the special account. 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, respectively.

The stock options issued under the 2001 and 2002 tranches can currently be exercised. However, as of the date of the financial statements their intrinsic value was nil.

Stock Incentive Program (2000-2004)

To participate in this program, each participant was required to deposit shares with a maximum aggregate value of 50 percent of his or her performance-related bonus for the preceding fiscal year. The incentive award depends on the number of Bayer shares deposited at the launch of each tranche and the overall performance of Bayer stock. The Stock Incentive Program differs from the Stock Option Program in that participants may sell their shares during the term of the program, although any shares sold do not count for purposes of calculating the incentive awards on subsequent distribution dates. The Stock Incentive Program runs for a ten-year period, during which there are three incentive payment dates.

Incentive payments under the program are only made if Bayer stock has outperformed the EURO STOXX 50[sm] index on the respective distribution dates. For every ten Bayer shares originally placed in their special account and retained until the distribution date, participants receive payments equal to the value of two shares after two years, four shares after six years and an additional four shares after ten years.

Stock Participation Program (2000-2004)

Under the Stock Participation Program, only half as many shares as under the Stock Incentive Program are awarded per ten shares deposited, but the award is not conditioned on any performance criteria.

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Employee Pension Plan

Employees who enter into employment with Bayer AG or its group management companies on or after January 1, 2005, become members of the new BayerPLUS pension plan and must join Bayer AG s new pension fund Rheinische Pensionskasse (*RPK*), a mutual insurance company. As a member of the *RPK,* an employee makes a mandatory monthly contribution of 2 percent of his or her monthly contribution-eligible income (up to the threshold (*Beitragsbemessungsgrenze*) for the statutory pension insurance (*gesetzliche Rentenversicherung*), which for 2005 was a salary of 5,200 per month or 62,400 per year) to the pension fund. These contributions are withheld from the member s salary. Bayer AG and its group management companies match the employee s contribution. Upon retirement, the employee is entitled to receive a monthly basic pension payment (*Grundrente*) from the *RPK* calculated on the basis of contributions made multiplied by an age factor based on actuarial principles and including a guaranteed interest rate of 2.75 percent. Entitlements under the basic pension plan vest immediately. If the *RPK* generates a surplus, the pension benefits paid will rise accordingly.

Employees who entered into employment with Bayer AG or its group management companies on or after January 1, 2005 and whose annual contribution-eligible income exceeds the statutory pension insurance threshold are entitled to receive an additional monthly pension payment (*Zusatzrente*) from a supplementary pension plan, for which book reserves are included in the balance sheet. Under this plan, entitlements are calculated in the same manner as under the *RPK*. Bayer AG and its group management companies make a mandatory notional contribution of 6 percent of that portion of the employee s salary exceeding the statutory pension insurance threshold into the supplementary pension plan. In addition, Bayer matches any contributions made by the employee up to 9 percent of that employee s income eligible for contributions (contribution-eligible income). Entitlements based on employer contributions vest after a period of five years. Entitlements based on an employee s own contributions vest immediately.

Employees who entered into employment with Bayer AG or its group management companies before January 1, 2005 became members of the old pension plan (which is no longer open to new members) and joined the *Bayer-Pensionskasse*. As a member of the *Bayer-Pensionskasse,* an employee also makes a mandatory monthly contribution of 2 percent of his or her monthly contribution-eligible income (up to the statutory pension insurance threshold). Employees whose annual contribution-eligible income exceeds the annual statutory pension insurance threshold by up to 46,800 are entitled to receive an additional monthly pension payment (*Zusatzrente*) from a supplementary pension plan, for which book reserves are included in the balance sheet. Employees whose annual contribution-eligible income exceed the total of 62,400 plus 46,800 (*i.e.*, 109,200), received an individual pension promise in 2005. Bayer AG and its group management companies also include this individual pension entitlement as book reserves in the balance sheet. Starting on January 1, 2006, the portion of these employees contribution-eligible income in excess of 111,000 (the sum of the 2006 statutory pension insurance threshold and the 2006 *Zusatzrente*) is treated in the same manner as is contribution-eligible income of new employees that exceeds the statutory pension insurance threshold.

Key senior managers in leadership positions essential for the Group (*i.e.*, who shape the future of the Group as a whole) are assigned to so-called Group Leadership Circles (GLC). A manager s assignment to a GLC depends on his/her position and his/her reporting relationship at Group level. Members of the Board of Management are assigned to GLC I. (Their pension entitlements are discussed in *Compensation.*) For GLC II and GLC III members (*i.e.*, members of our senior management), who are appointed after March 18, 2005, a new pension contract applies in addition to their entitlements under the pension plans described above: Bayer AG matches the employee s contributions (up to 9 percent of the respective contribution-eligible income) at a 200 percent (GLC III) or 300 percent (GLC II) level. These benefits are also financed by book reserves. The pension contracts of GLC members appointed prior to that date remain unchanged on a defined benefit basis.

The changes for the German employees reflect the process of moving from Defined Benefit to Defined Contribution plans. The Bayer Group started this process in the 1990s and today Bayer has introduced Defined Contribution plans for new employees in all major countries. In the United States several of Bayer s current Defined Benefit plans were replaced with a pure Defined Contribution plan effective January 1, 2006. Pension entitlements under the modified Defined Benefit plans will be determined as of December 31, 2005 and frozen.

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For further information, please refer to Note 28 to the consolidated financial statements appearing elsewhere in this annual report.

Employees

The following tables set forth the average number of employees in continuing operations during 2003, 2004 and 2005 by area of primary activity and an approximate breakdown of employees as of December 31, 2003, 2004 and 2005 by geographical region:

	Employees by Activity Average for				
	2003	Change from Previous Year (%)	2004	Change from Previous Year (%)	2005
Technology/ Manufacturing	46,441	(5.19)	44,033	(0.05)	44,011
Marketing	30,254	(2.24)	29,576	3.32	30,558
Administration	9,073	(0.61)	9,018	4.33	9,409
Research	10,544	(9.33)	9,560	(3.92)	9,185
Total	96,312	(4.28)	92,187	1.06	93,163

	Breakdown by Region As of December 31,				
	2003	Change from Previous Year (%)	2004	Change from Previous Year (%)	2005
Europe	51,900	(1.93)	50,900	1.96	51,900
North America	18,700	(4.81)	17,800	(8.99)	16,200
Asia/Pacific	12,200	0.0	12,200	13.93	13,900
Latin America/ Africa/Middle East	10,000	3.00	10,300	8.74	11,200
Corporate	500	0.0	500	0.0	500

Labor Relations

The union-organized employees at our German sites belong to several unions, the most important of which is IG BCE, the German Mining, Chemical and Energy Industrial Union. We do not negotiate collective bargaining agreements directly with these unions to cover our employees. Instead, in accordance with German practice, unions negotiate agreements with industry-wide employers associations, in our case, the German Chemical Industry Association.

In Germany, employers associations and unions typically negotiate collective bargaining agreements annually. However, collective bargaining agreements may be entered into for longer terms. A German collective bargaining agreement governs the employment of all employees up to a certain level of responsibility organized in the relevant union. At Bayer, even the employees in those employee groups governed by collective bargaining agreements who are not union members are granted rights under the collective bargaining agreements by means of reference in the

individual agreements.

The current agreement covering our employees has a term of 19 months and began in June 2005. It grants employees a salary increase of 2.7 percent over the previous collectively-agreed monthly salary (*monatliches Tarifentgelt*) for the term of the agreement. In addition, it grants employees a lump-sum payment amounting to a certain percentage of the previous monthly collectively-agreed salary. The percentage varies between 24 and 32 percent, depending on work schedules and shift. For Bayer AG, its group management companies (except for Bayer Industry Services) and the majority of Bayer AG s German affiliates, the lump-sum payment under the current agreement was made in 2005. For Bayer Industry Services the lump-sum payment was made in February 2006.

There are 13 pay grades, based on job description, for our employees in positions governed by collective bargaining agreements. Our management employees, who have individual employment or service contracts, are

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organized in six contract levels. The Chemical Industry has a union for academics (*Verband der Angestellten Akademiker* (VAA)). Apart from a specific collective bargaining agreement for young entry level academics, management contracts at Bayer are not subject to collective bargaining agreements.

Each Bayer site in Germany has a works council (*Betriebsrat*), elected by all non-management employees. Members serve a four-year term; the last elections took place in March 2002. Accordingly the next elections are scheduled to take place at the respective Bayer sites between April 2 and April 6, 2006. The works councils facilitate communications between management and staff at the site level. A joint works council (*Gesamtbetriebsrat*) serves a similar purpose at the company-wide level and the same applies to the Group works council (*Konzernbetriebsrat*) at Group level, Germany-wide. The rights and responsibilities of works councils are set forth in the German Works Council Constitution Act (*Betriebsverfassungsgesetz*). Within the given framework of laws and collective bargaining agreements, works councils have participatory rights on site and company level with respect to managing staff-related issues as well as working conditions such as:

working hours (namely, beginning and end of daily working hours);

vacation guidelines;

social services (*e.g.*, subsidized cafeterias); and

distribution guidelines for performance-related bonuses.

A works council has generally no authority, however, to negotiate with an employer on wage and salary compensation or other issues included or typically included in collective bargaining agreements between employers associations and labor unions, unless the relevant collective bargaining agreement provides otherwise. Under German labor law, employees may not legitimately strike during the term of the collective bargaining agreements. The provisions of the applicable collective bargaining agreements determine whether the right to strike in request of issues not covered by the applicable collective bargaining agreements is also excluded during such term. Works councils generally have no legal authority to call a work stoppage. On the European level, we put in practice a customized procedure for information and consultation of employee representatives based on a voluntary agreement between Bayer AG and the Group works council (*Europaforum*).

Associated with restructuring measures within the Bayer Group, on November 7, 2003, the Board of Management and the employee representatives of the Supervisory Board agreed on principles for the extension of the existing agreement with the joint works council dated December 12, 2000 for safeguarding employment at several of our major German sites, taking effect January 1, 2004. Collective agreements with the competent representative bodies were signed June 30, 2004 and July 1, 2004 respectively. Under these principles, an act of solidarity by all employees at German Bayer locations allows us to maintain 1,000 full time equivalent (FTE) positions more than previously planned. By reducing performance-related variable income of all employees of German sites covered by the agreement by up to 10 percent, personnel costs for temporarily-unassigned employees are covered. On the basis of these options for cost cuts, we agreed that we would not, except in exceptional circumstances, lay off employees at our Leverkusen, Dormagen, Krefeld-Uerdingen, Elberfeld and Brunsbüttel sites for operational reasons before December 31, 2007. If exceptional circumstances arise that are beyond our control and lead to an overcapacity of employees, we have agreed to negotiate with the joint works council in order to find a solution that will serve the interests of the company and the employees to the greatest possible extent. In accordance with the agreements, performance-related variable income for 2005 was reduced by 2.3 percent.

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Item 7. *Major Shareholders and Related Party Transactions*

Major Shareholders

Under our Articles of Association, each of our ordinary shares represents one vote. Major shareholders do not have different voting rights.

Under the German Securities Trading Act (*Wertpapierhandelsgesetz*), holders of voting securities of a listed German company must notify that company of the level of their holding whenever it reaches, exceeds or falls below specified thresholds. These thresholds are 5, 10, 25, 50 and 75 percent of the company s outstanding voting securities. One shareholder, The Capital Group Companies, Inc., has notified us on February 8, 2006 pursuant to section 21(1) of the German Securities Trading Act (WpHG) that the proportion of voting rights it held in our company fell below five percent on February 1, 2006, and has since been at 4.94 percent. Allianz AG informed us on January 12, 2005 pursuant to section 21(1) of the WpHG that the proportion of voting rights it held in our company fell below five percent on January 6, 2005.

Based on the notifications we have received pursuant to section 21(1) of the WpHG through February 28, 2006, as of that date we are not aware of any single shareholder holding five percent or more of our outstanding shares.

U.S. shareholders can hold Bayer shares either directly or indirectly through our sponsored American Depositary Receipt (ADR) program with The Bank of New York as depositary. Because the shares of Bayer AG are in bearer form, we cannot obtain precise information as to the identity of shareholders or the distribution of the shares among them. From time to time, however, we conduct surveys, using the assistance of banks, to form estimates as to Bayer AG s shareholder base. Our last such survey measured our shareholder structure as of June 1, 2001. The survey recorded responses with respect to 95.6 percent of our approximately 500,000 shareholders. Of this number, 94 percent were individuals, who together owned 24 percent of the shares. Approximately 55,000, or 12 percent, of the individual shareholders were Bayer employees, who together held approximately 2 percent of Bayer AG s outstanding shares. Institutional investors (*e.g.*, banks, insurance companies and investment funds) held another 67 percent of the shares. Shareholders in Germany numbered approximately 437,000 and owned 61 percent of the shares. Approximately 59,000 shareholders in 135 other countries held 39 percent of the shares. Of this group, British shareholders held approximately 10 percent, and U.S. shareholders approximately 8 percent, of the shares.

Furthermore, while Bayer cannot obtain precise information as to the identity (and location) of its shareholders, the records of the depositary under its ADR program show that as of January 31, 2006 there were 1,599 registered holders of Bayer American Depositary Shares (ADSs). Bayer assumes that these ADSs are owned by persons resident in the United States. The ADSs are listed on the New York Stock Exchange and each ADS represents one ordinary share. As of February 28, 2006 the ADS holders collectively held 38,098,820 ADSs, or approximately 5.2 percent of the total outstanding share capital of Bayer. Since U.S. residents can also hold Bayer ordinary shares directly, however, Bayer assumes that the percentage of its total shares outstanding currently held by U.S. residents in both ordinary share and ADS form is greater.

To our knowledge, we are not directly or indirectly owned or controlled by another corporation, by any government, or by any other natural or legal person severally or jointly, and there are no arrangements which may result in a change of control.

See also in Item 6, *Directors, Senior Management and Employees Share Ownership.*

Related Party Transactions

In the ordinary course of business, we purchase materials, supplies and services from numerous companies throughout the world. Members of Bayer AG s Supervisory Board are affiliated with some of these companies. We conduct our transactions with such companies on an arm s length basis. We do not consider the amounts involved in such transactions to be material to our business and believe that these amounts are not material to the business of the companies involved.

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During our most recent full fiscal year and through the date of this annual report on Form 20-F, we have not been involved in, and we do not currently anticipate becoming involved in, any transactions that are material to us or any of our related parties and that are unusual in their nature or conditions. We have not made any outstanding loans to or for the benefit of:

- enterprises that, directly or indirectly, control or are controlled by, or are under common control with, us (except at arm s length conditions in the ordinary course of business);
- enterprises in which we have significant influence or which have significant influence over us (except at arm s length conditions in the ordinary course of business);
- shareholders beneficially owning a 10 percent or greater interest in our voting power;
- key management personnel; or
- enterprises in which persons described above own, directly or indirectly, a substantial interest in the voting power.

Interests of Experts and Counsel

Not applicable.

Item 8. *Financial Information*

Consolidated Financial Statements and Other Financial Information

See Item 18, *Financial Statements*.

Legal Proceedings

Bayer is involved in a number of legal proceedings. As a global company active in a wide range of life sciences and chemical activities, we may in the ordinary course of business become involved in proceedings relating to such matters as:

- product liability;
- competition and antitrust;
- patent validity and infringement;
- tax assessments; and
- past waste disposal practices and release of chemicals into the environment.

The following discussion, although not an exhaustive list of claims or proceedings in which Bayer AG or its subsidiaries are involved, nevertheless describes what we believe to be the most significant of those claims and proceedings. Subsequent developments in any pending matter, as well as additional claims that may arise from time to time, including additional claims similar to those described below, could become significant to Bayer. References to Bayer include claims or proceedings to which Bayer AG and/or one or more of its subsidiaries is a party.

We cannot predict with certainty the outcome of any proceedings in which we are or may become involved. An adverse decision in a lawsuit seeking damages from us, or our decision to settle certain cases, could result in monetary payments to the plaintiff and other costs and expenses. If we lose a case in which we seek to enforce our patent rights or in which we have been accused of infringing another company s patent rights, we will sustain a loss of future revenue if we no longer can sell the product covered by the patent or command prices for the affected products that reflect the exclusivity conferred by the patent. While payments and other costs and expenses we might have to bear as a result of these actions are covered by insurance in some circumstances, the coverage under some of these insurance policies has (as indicated below) been exhausted, and other payments may not be covered by our insurance policies in full or at all. Accordingly, each of the legal proceedings

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described in the following discussion could be significant to Bayer, and the payments, costs and expenses above those already incurred or accrued could have a material adverse effect on our results of operations, financial position or cash flows.

Product liability proceedings

Cerivastatin litigation

In August 2001 Bayer voluntarily ceased marketing the anticholesterol product cerivastatin (marketed in the United States and Canada under the trade name Baycol) in response to reports of serious side effects in some patients. Claims for compensation have been made against us in several countries. Many lawsuits were filed, primarily in the United States and Canada. It is possible that additional lawsuits may be filed in the United States and elsewhere.

U.S. litigation. As of January 13, 2006, approximately 5,900 lawsuits were pending in the United States in both federal and state courts against Bayer, including putative class actions. The actions in the United States have been based primarily on theories of product liability, consumer fraud, predatory pricing and unjust enrichment. These lawsuits seek remedies including compensatory and punitive damages, disgorgement of funds received from the marketing and sale of Baycol and the establishment of a trust fund to finance the medical monitoring of former Baycol users. The federal cases were transferred to federal district court in Minnesota for coordinated discovery and other pre-trial proceedings. This court denied a motion for certification of nationwide personal injury, medical monitoring and economic refund classes on September 17, 2003. A motion to certify a class of persons claiming personal injuries was also denied by an Illinois state court. A Pennsylvania state court, which had certified a class of Pennsylvania residents who took Baycol and sought medical monitoring, granted judgment in favor of Bayer and denied all claims of the class. That same court certified a class of third party payors who allegedly suffered economic loss because the withdrawal of Baycol caused them to incur costs for unused medicine and expenses related to their patients changing to another medicine. Bayer has reached agreement to settle this matter. A state court in Oklahoma certified a class of Oklahoma residents who took Baycol and sustained muscular/ skeletal injuries as a result, and its decision has been upheld by the appellate courts. A state court in Illinois has certified a class of Illinois residents who purchased Baycol and who do not claim any personal injury. This class seeks monetary damages under the Illinois consumer protection law. The certification of a class is unrelated to a determination of our liability.

Five U.S. cases have been tried to date to final judgment, all of which resulted in verdicts in our favor.

In January 2004, Bayer Corporation received a subpoena for documents principally relating to Baycol from the Defense Criminal Investigative Service of the U.S. Department of Defense Inspector General followed by a related subpoena issued by the U.S. Attorney for New Jersey in February 2006. Prior to the withdrawal of Baycol, Bayer had a contract with the Department to provide it with a supply of Baycol. The investigation is a joint Department of Defense/Food and Drug Administration inquiry relating to Baycol. Bayer is not aware of any charges or complaints filed in connection with this inquiry. Bayer believes it acted responsibly and fulfilled its responsibilities to the U.S. government, and has cooperated in the investigation, including by providing the information requested. Since April 2004, Bayer also has received civil investigative demands from 26 states seeking documents regarding the marketing of Baycol. These state investigations are being conducted pursuant to consumer protection laws. Bayer is not aware of any complaints filed in connection with these state investigations. In some countries, criminal proceedings have been initiated by the relevant authorities. Bayer believes that it acted responsibly in the marketing of Baycol and will cooperate in providing the information requested.

Litigation in other countries. As of January 13, 2006, 70 actions were pending against Bayer companies in other countries, including class actions in Canada. Settlement agreements were entered into in January and March 2004 with lawyers representing plaintiffs in Ontario, Quebec and British Columbia who ingested Baycol. These agreements together establish a procedure to resolve claims of all Canadian residents arising from the alleged contraction of rhabdomyolysis from Baycol. However, in 2004 and 2005, provincial courts in Newfoundland and Manitoba granted motions to certify classes for residents of all Canadian provinces except for Québec and

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Saskatchewan, who claim personal injury from Baycol other than rhabdomyolysis. Bayer s requests for leave to appeal these class certifications have been denied and these cases will proceed as class actions.

Impact of cerivastatin litigation on Bayer. Without acknowledging any liability, we have settled 3,082 cases worldwide as of January 13, 2006, resulting in settlement payments of approximately U.S. $1.147 billion. Bayer will continue, on a voluntary basis and without concession of liability, to offer fair compensation to people who experienced serious side effects while taking cerivastatin. After more than four years of litigation we are currently aware of fewer than 50 cases in the United States that in our opinion hold a potential for settlement, although we cannot rule out the possibility that additional cases involving serious side effects from cerivastatin may come to our attention. In cases where an examination of the facts indicates that cerivastatin played no part in the patient s medical situation, or where a settlement is not achieved, Bayer will continue to defend itself vigorously. Bayer believes it has meritorious defenses in these actions.

Following an agreement reached with the majority of the insurers in the cerivastatin litigation, Bayer established provisions in 2003 that resulted in a charge to the operating result of 300 million, reflecting an excess of the expected payments including defense costs over the expected insurance coverage. All insurers have since acceded to this agreement and have withdrawn their reservations of rights. As a result of updated facts in ongoing cases, further charges of 47 million and 43 million to the operating result were recorded in 2004 and 2005, respectively, each in respect of settlements already concluded or expected to be concluded and anticipated defense costs.

Due to the considerable uncertainty associated with the cerivastatin litigation, it is currently not possible to estimate the potential liability. Since the existing insurance coverage is exhausted, Bayer could incur further costs that are not covered by the provisions already established. We will regularly review the necessity of further provisions and related charges to the operating result as the cerivastatin litigation proceeds.

In the United States, Bayer co-promoted Baycol with SmithKline Beecham Corporation. SmithKline Beecham Corporation and Bayer have signed an allocation agreement under which SmithKline Beecham has agreed to pay five percent of all settlements and compensatory damage judgments arising out of actions based on the sale or distribution of Baycol in the United States, with each party responsible for paying its own attorneys fees.

Blood plasma products litigation

HIV-related actions. Since the 1980 s, Bayer, as well as other fractionators of plasma products, have been involved in lawsuits alleging that hemophiliacs became infected with the human immunodeficiency virus (HIV), or ultimately developed AIDS, by using allegedly infected clotting factor concentrates derived from human plasma. Plaintiffs brought actions on these grounds in the United States, Ireland, Italy, Taiwan, Argentina, Canada, Japan and Germany. All of the actions brought on these grounds by residents of the United States have been resolved. Actions brought on these grounds outside the United States are still pending. Bayer has established provisions in respect of this litigation in the amount of U.S. $12 million.

HIV/HCV-related actions. In 2003, a putative class action against Bayer and other manufacturers was filed in the United States on behalf of U.S. residents claiming compensation for HCV (hepatitis C virus) infections and non-U.S. residents claiming compensation for HIV and/or HCV infections allegedly acquired through blood plasma products manufactured in the United States. The court denied the plaintiffs motion to certify a class. Prior to and since the denial of class certification, U.S. and non-U.S. residents filed additional cases involving multiple plaintiffs against Bayer and other manufacturers, claiming compensation for HIV and/or HCV infections allegedly acquired through blood plasma products manufactured in the United States. All of these matters have been filed in or transferred to federal district court in Illinois for coordinated proceedings. On January 5, 2006, the court granted defendants motion, on the basis of forum non conveniens, to dismiss the claims of the eight residents of the United Kingdom who are plaintiffs in one of the cases. Plaintiffs counsel have announced their intention to appeal the ruling to the United States Court of Appeals for the Seventh Circuit.

We believe that we have meritorious defenses in the blood plasma products litigation and intend to defend it vigorously. Due to the considerable uncertainty associated with these proceedings, it is currently not possible to

estimate potential liability and we will continue to consider the need to establish provisions as the proceedings continue.

Phenylpropanolamine (PPA) litigation

In late 2000, Bayer voluntarily discontinued marketing over-the-counter cough and cold remedies containing the decongestant phenylpropanolamine (PPA) in the United States in response to a recommendation from the FDA that manufacturers voluntarily discontinue marketing products containing PPA. The FDA issued this recommendation after one epidemiological study suggested a possible association between PPA and hemorrhagic stroke.

As of January 13, 2006, 286 lawsuits were pending in U.S. federal and state courts against Bayer, of which 136 name Bayer as the only manufacturing defendant. An additional 295 cases are on appeal in federal court after the plaintiffs claims had been dismissed for failure to comply with procedural requirements. No lawsuits have been filed outside the United States.

The PPA claims primarily relate to compensation for alleged damage to health and personal injury, breach of warranty, negligent and reckless misrepresentation, entitlement to subsequent monitoring, reimbursement of the purchase price, and conspiracy to defraud and fraudulently conceal. Claims for punitive damages have also been filed.

Three state cases have proceeded to trial. Two have resulted in defense verdicts for Bayer. In one case, the plaintiff was awarded damages of U.S. $400,000. This case was settled in July 2005 while on appeal.

Bayer believes it has meritorious defenses in these actions and intends to defend them vigorously. As of January 13, 2006, Bayer had settled 247 cases resulting in payments of approximately U.S. $42 million, without acknowledging any liability. Bayer will continue, on a voluntary basis and without concession of liability, to offer fair compensation to people who suffered hemorrhagic stroke while taking a Bayer product containing PPA. Through December 31, 2005, Bayer had recorded a charge to the operating result in the amount of 78 million, of which 62 million were recorded in 2005 and 16 million in 2004. Such charges were for settlements already concluded or expected to be concluded, and defense costs which exceed the amount of existing insurance coverage.

Due to the considerable uncertainty associated with these proceedings, it is currently not possible to further estimate potential payments with respect to the remaining pending PPA cases and thus additional provisions for such potential payments have not yet been made. Future insurance coverage for expenses incurred and damages suffered as a result of the PPA litigation is limited to 0.05 for each 1.00 incurred. Accordingly, Bayer could incur further costs that are not covered by the provisions already established. We will regularly review the necessity of further provisions and related charges to the operating result as the proceedings continue.

Thimerosal litigation

Bayer Corporation is a defendant in 7 lawsuits filed in various state and U.S. federal courts by or on behalf of persons alleging injuries from the use of Bayer products containing thimerosal, specifically immunoglobulin therapies. Other cases involving thimerosal in over-the-counter nasal spray products have been dismissed. Numerous manufacturers used thimerosal as preservative agents in vaccines and other medical products. Plaintiffs allege that use of products containing these compounds has caused autism, neurodevelopmental disorders and other injuries. They are requesting various remedies for the allegedly resulting injuries including compensatory, punitive and statutory damages and funding for medical monitoring and research. Additional cases may be filed. Bayer believes it has meritorious defenses in these actions and intends to defend them vigorously. Due to the considerable uncertainty associated with these proceedings, it is currently not possible to estimate potential liability.

Isocyanate litigation

Bayer is a defendant in three Alabama state court isocyanate cases. Collectively the cases involve the claims of more than 1,600 plaintiffs who allege personal injuries (primarily respiratory) caused by exposure to

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diphenylmethane diisocyanate (MDI) from products supplied by Bayer and other co-defendants. The products were used in underground coal mines in Alabama where the plaintiffs worked. Bayer s co-defendants include two other MDI manufacturers, several distributors and contracting companies that used MDI-containing products in those mines. Plaintiffs assert claims of negligence, wantonness, outrage, failure to warn, misrepresentation, concealment, breach of warranties and conspiracy. Punitive damages are sought. A jury trial to decide common issues relating to defendants liability as to all of the more than 1,600 plaintiffs is scheduled to begin on April 13, 2006. A trial relating to the alleged injury and damages claims of an initial group of approximately 25 plaintiffs is scheduled to begin upon conclusion of the common issues trial.

Bayer is a defendant in a purported class action filed in federal district court in Alabama. Bayer s co-defendants include isocyanate trade associations, MDI manufacturers, several distributors and contracting companies that used MDI-containing products in the underground coal mines where plaintiffs worked. The case was filed by fifteen (15) individual plaintiffs on behalf of themselves and a class of all similarly situated coal miners in the United States seeking redress for alleged personal injuries, declaratory and injunctive relief as a result of their alleged exposure. Plaintiffs likewise allege that they are entitled to medical monitoring for injuries that may manifest themselves in the future as a result of past MDI exposure.

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

Proceedings involving Imidacloprid

In the United States, keepers of honeybees and honeybee hives have filed a putative class action lawsuit against Bayer in the U.S. District Court for the Middle District of Pennsylvania alleging that imidacloprid caused damage to their honeybees, to the honey, the wax and the beekeeping equipment. In June 2005, the court denied plaintiffs motion to certify this matter as a class action. With the court s action, nine individual plaintiff lawsuits remain. Bayer believes that it has meritorious defenses in these actions and intends to defend them vigorously. The Company believes, however, the aggregate amount of damages alleged in these individual lawsuits is not material.

Antitrust proceedings

Proceedings involving former rubber-related lines of business

Government investigations. Bayer is the subject of criminal and civil investigations conducted by the Antitrust Division of the U.S. Department of Justice (DOJ), the Directorate General for Competition of the European Commission (EC), and the Canadian Competition Bureau (CCB) (collectively, the Competition Authorities). The Competition Authorities are investigating potential violations of their respective antitrust or competition laws involving certain of Bayer s former rubber-related lines of business.

Since September 2002, the DOJ has undertaken criminal grand jury investigations of potential antitrust violations involving Bayer s former rubber chemicals, ethylene propylene diene monomer (EPDM) synthetic rubber, and acrylonitrile butadiene rubber (NBR) synthetic rubber lines of business. To settle charges related to allegations that its former rubber chemicals business unit engaged in anti-competitive activities between 1995 and 2001, Bayer pleaded guilty and paid a fine of U.S. $66 million. To settle charges related to allegations that its former NBR business unit engaged in anti-competitive activities between May and December 2002, Bayer pleaded guilty and paid a fine of U.S. $4.7 million. The two agreements resolve all criminal charges against Bayer in the United States for activities related to its former rubber chemicals and NBR business. The DOJ investigation into potential antitrust violations involving EPDM remains ongoing.

The CCB is conducting criminal investigations of potential violations of Canadian competition laws involving Bayer s former rubber chemicals, EPDM and NBR lines of business. Bayer is in the process of negotiating settlement agreements with the CCB that would resolve all charges in Canada related to allegations that its former rubber chemicals and NBR business units engaged in anti-competitive activities between 1995 and

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2001 and between May and December 2002, respectively. The CCB s investigation into potential antitrust violations involving EPDM remains ongoing.

The DOJ and the CCB have also launched criminal investigations of possible anti-competitive behavior involving a further product attributable to the former rubber-related lines of business. The DOJ and the CCB have granted conditional amnesty from the imposition of criminal liability in connection with these investigations. Conditional amnesty requires continued cooperation by Bayer.

The EC has been conducting investigations of and initiated respective proceedings regarding potential violations of European competition laws involving Bayer s former rubber chemicals, EPDM and NBR lines of business. In December 2005, the EC imposed a fine of 58.9 million on Bayer in concluding the rubber chemicals proceeding. The EC investigations into potential antitrust violations involving EPDM and NBR remain ongoing. Bayer is cooperating with the EC and the antitrust authorities of certain member states of the EU with respect to their investigations of possible anti-competitive behavior involving several additional products attributable to Bayer s former rubber-related lines of business. The EC and certain member state authorities have granted conditional amnesty from the imposition of fines in connection with the investigations involving these additional products. Conditional amnesty requires continued cooperation by Bayer.

Civil litigation. Bayer has been named, among others, as a defendant in multiple putative class action lawsuits in various state courts in the United States and as defendants in lawsuits including multiple putative class actions pending before various federal courts in the United States. The actions involve rubber chemicals, EPDM, NBR and polychloroprene rubber (CR). In the state court actions, the plaintiffs have alleged violations based on the defendants purported participation in a conspiracy to fix prices and seek damages as indirect purchasers of the allegedly affected products. In the federal court actions, the plaintiffs have alleged the defendants participation in a conspiracy to fix the prices and/or to allocate markets and customers for the sale of the allegedly affected products and seek damages as direct purchasers of those products. Bayer has reached agreements or agreements in principle to settle a number of these court actions. Certain of these agreements, once finalized, remain subject to court approval. The foregoing settlements do not resolve all of the pending civil litigation with respect to the aforementioned products, nor do they preclude the bringing of additional claims.

Bayer also has been named, among others, as a defendant in multiple putative class action lawsuits in three Canadian courts. The actions involve rubber chemicals, EPDM, NBR and CR. In the Canadian actions, the plaintiffs have alleged violations based on the defendants alleged participation in a conspiracy to fix prices, and the Canadian plaintiffs seek damages as direct and indirect purchasers of the allegedly affected products. These proceedings are at various preliminary stages.

Proceedings involving polyester polyols, urethanes and urethane chemicals

Government investigation. Bayer Corporation was the subject of a criminal antitrust investigation by the DOJ involving allegations that it had engaged in anti-competitive activities from February 1998 through December 2002 with respect to adipic-based polyester polyols. Under the terms of a September 2004 settlement agreement with the DOJ, Bayer Corporation pleaded guilty and paid a fine of U.S. $33 million. The agreement resolves all criminal charges against Bayer Corporation in the United States for activities related to its adipic-based polyester polyols business. The CCB in Canada is conducting a similar investigation.

Civil litigation. Bayer has been named, among others, as a defendant in multiple putative class action lawsuits in various state courts in the United States and as defendants in lawsuits including multiple putative class action lawsuits which have been consolidated in federal district court in Kansas, involving allegations of price fixing with respect to polyester polyols and/or urethanes and urethane chemicals. Plaintiffs in the federal court actions seek damages on behalf of direct purchasers of polyester polyols and related polyurethane systems, while plaintiffs in the state court actions seek damages on behalf of indirect purchasers of products that contain urethanes and urethane chemicals. These cases are at various preliminary stages.

Bayer also has been named, among others, as a defendant in putative class action lawsuits involving polyester polyols in two Canadian courts, involving allegations of a price fixing conspiracy. The Canadian

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plaintiffs seek damages on behalf of a class of direct and indirect purchasers of the allegedly affected products. These cases are at various preliminary stages.

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

Government investigation. On February 16, 2006, Bayer Corporation was served with a subpoena by the DOJ seeking information relating to the manufacture and sale of methylene diphenyl diisocyanate (MDI), toluene diisocyanate (TDI) and polyether polyols and related systems. Bayer Corporation will cooperate with the DOJ in connection with the subpoena.

Civil litigation. Bayer has also been named, among others, as a defendant in multiple putative class action lawsuits which have been consolidated in federal district court in Kansas, involving allegations of price fixing of, inter alia, polyether polyols and certain other precursors for urethane end-use products. These matters are at an early stage, and a motion to dismiss the consolidated action is currently pending. Bayer has reached an agreement to settle all of the class action cases, subject to court approval, relating to polyether polyols, MDI and TDI (and related systems) direct purchaser claims. The foregoing settlement does not resolve all of the pending civil litigation with respect to the aforementioned products, nor does it preclude the bringing of additional claims.

Impact of rubber-related and urethane-related antitrust proceedings on Bayer

In consideration of the portion allocated to LANXESS, expenses in the amount of 336 million were accrued in the course of 2005 which led to the establishment of a provision for the previously described civil proceedings in the amount of 285 million as of December 31, 2005. Bayer created a provision of 80 million as of December 31, 2005 in respect of the rubber-related EU proceedings noted above, although a reliable estimate cannot be made as to the actual amount of any additional fines.

These provisions taken may not be sufficient to cover the ultimate outcome of the above-described matters. The amount of provisions established in 2005 for civil claims was based on the expected payments under the settlement agreements or agreements in principle described above. In the case of proposed settlements in civil matters which have been asserted as class actions, members of the putative classes have the right to opt out of the class, meaning that they elect not to participate in the settlement. Plaintiffs that opt out are not bound by the terms of the settlement and have the right to independently bring individual actions in their own names to recover damages they allegedly suffered. We cannot predict the size or impact of the opt-out groups, if any, on the settlement agreements recently approved or awaiting court approval.

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

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

Additionally, Bayer and its former affiliate LANXESS AG entered into a master agreement, dated September 22, 2004, pursuant to which the parties, among other things, apportion liability for certain of the antitrust proceedings described above. For a general description of this apportionment mechanism, please refer to Item 10. *Additional Information Material Contracts*.

Proceedings involving Ciprofloxacin

In January 1997, Bayer settled a patent infringement suit it brought in the United States against Barr Laboratories, Inc. This suit had arisen when Barr filed an Abbreviated New Drug Application (ANDA) (IV) seeking regulatory approval of a generic form of Bayer s ciprofloxacin anti-infective product, which we sell in the United States under the trademark *Cipro*®. Shortly after settling this suit, Bayer applied to the U.S. Patent and Trademark Office for re-examination of its patent. The Patent and Trademark Office reissued the patent in

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February 1999. In addition, Bayer s *Cipro*® patent was the subject of additional patent invalidity challenges litigated in the U.S. federal district courts and in each instance, the validity of Bayer s patent was upheld. The patent expired in December 2003.

Since July 2000, Bayer has been named as one of several defendants in 39 putative class action lawsuits, one individual lawsuit and one consumer protection group lawsuit (which has since been dismissed) filed in a number of state and federal courts in the United States. The plaintiffs in these suits allege that they are direct or indirect purchasers of *Cipro*® who were damaged because Bayer s settlement of the Barr ANDA (IV) litigation prevented generic manufacturers from selling a generic version of *Cipro*®. The plaintiffs allege that the settlement violated various federal antitrust and state business, antitrust, unfair trade practices, and consumer protection statutes, and seek treble damages and injunctive relief. The Barr settlement is also the subject of an ongoing antitrust investigation by the U.S. Federal Trade Commission and a number of state attorneys general.

All the actions pending in federal court were consolidated in federal district court in New York in a multidistrict litigation (MDL) proceeding. In May 2004, Bayer moved for summary judgment on all of plaintiffs antitrust claims in the consolidated cases brought by direct purchaser and indirect purchaser plaintiffs pending in that court, including certain plaintiffs claims related to Bayer s actions during the prosecution of the *Cipro*® patent in the U.S. Patent and Trademark Office and its enforcement against third party infringers. Bayer also moved to dismiss those plaintiffs patent-related claims on grounds that these claims do not state a claim for relief under the antitrust laws. The direct purchaser plaintiffs filed a cross-motion seeking summary judgment on certain liability issues. On March 31, 2005, the court granted Bayer s motion for summary judgment and dismissed all of plaintiffs claims in the MDL proceeding. The plaintiffs are appealing this decision.

The remaining lawsuits consist of a class action lawsuit brought on behalf of indirect purchasers in California state court, as well as putative class action lawsuits in Florida, New York, Kansas, Tennessee and Wisconsin. The New York and Wisconsin cases have been dismissed by the trial courts and plaintiffs have appealed the dismissals. On December 13, 2005, the New York intermediate appellate court affirmed dismissal of the New York class action suit. The California and Kansas cases have been stayed. Bayer Corporation filed an answer in the Florida state court action, and there has been no subsequent activity in that case. A motion to dismiss is pending in the Tennessee state court proceeding.

These cases may involve joint and several liability among the defendants, in the aggregate allege substantial unquantified damages and also seek treble and punitive damages and penalties. Due to the considerable uncertainty associated with these proceedings, it is currently not possible to estimate potential liability. However, we believe that we have meritorious defenses to the above-described litigation and intend to defend them vigorously. We will regularly consider the need to establish provisions as the proceedings continue.

Proceedings involving Premise®

Bayer and BASF Corporation, are named as defendants in a putative nationwide class action pending in federal court in North Carolina. Plaintiff alleges that Bayer conspired with intermediaries to fix the price at which those intermediaries resold the Bayer product *Premise*® to pest control operators and that Bayer conspired with BASF Corporation to utilize an agency system for distributing *Premise*® (and BASF s termiticide), permitting them to maintain prices at a high levels in violation of the Sherman Act. The plaintiff asserts that it is entitled to recover on behalf of the proposed class a total amount in excess of U.S. $200 million (subject to trebling and the addition of plaintiff s antitrust fees, under the antitrust laws). Formal discovery has commenced, but plaintiff has not yet moved for certification of the putative class.

We believe that we have meritorious defenses in the proceedings involving *Premise*® and intend to defend them vigorously. Due to the considerable uncertainty associated with these proceedings, it is currently not possible to estimate potential liability.

Average wholesale price manipulation proceedings

Sixty-one pending lawsuits allege that a number of pharmaceutical companies, including Bayer, manipulated the average wholesale price (AWP) and/or Medicaid best price of their products resulting in overcharges to

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Medicare beneficiaries, Medicaid recipients, state governmental health programs, private health plans and privately insured patients. These suits generally seek damages, treble damages, disgorgement of profits, restitution and attorney s fees. Some of these purported class actions allege injury to patients or payors. However, no class has yet been certified against Bayer. In addition, suits have been filed by the attorneys general of eight states as well as the City of New York and numerous New York counties. These suits generally seek to recover for excess costs incurred by the governmental entities and their constituents as a result of the alleged overcharges. Discovery is proceeding.

The claims of four states have been dismissed based on our settlement of earlier AWP litigation. We believe that we have meritorious defenses in the remaining actions and intend to defend them vigorously. Due to the considerable uncertainty associated with these proceedings, it is currently not possible to estimate potential liability. We will regularly consider the need to establish provisions as the proceedings continue.

Patent validity challenges and infringement proceedings

Proceedings involving Moxifloxacin

In February 2004, Bayer received a notice letter pursuant to the Hatch-Waxman Act from the generic manufacturers Dr. Reddy s Laboratories, Ltd. and Dr. Reddy s Laboratories, Inc. stating that they had filed ANDAs with the U.S. FDA seeking regulatory marketing approval for allegedly bioequivalent versions of *Avelox*®, our respiratory tract anti-infective, prior to the expiration of one or more patents covering *Avelox*® and/or its use. Dr. Reddy s sought the approval for its generic product prior to the expiration of three Bayer patents protecting the active ingredient of *Avelox*®, moxifloxacin, which expire on December 11, 2011, March 14, 2014, and December 5, 2016, respectively. Bayer filed a patent infringement suit against Dr. Reddy s Laboratories, Ltd. and Dr. Reddy s Laboratories Inc. in the United States District Court for the District of Delaware alleging infringement of the first two U.S. patents listed above. Dr. Reddy s alleged that the patents are invalid, not infringed and unenforceable.

A trial has been scheduled for Spring 2006. If the court rules that the applicant s product will not infringe the patent or that the patent is invalid or unenforceable, the FDA may grant approval immediately. If, on the other hand, the court rules that the product will infringe the patent, the FDA may not grant final approval until the original patent has expired. We believe that we have meritorious claims and defenses in this action and intend to defend Bayer s patents vigorously.

Bayer received separate notice letters from two other generic manufacturers, each stating that it had filed an ANDA seeking regulatory marketing approval for a generic version of *Avelox*®. Each sought approval of its generic product to be effective after the first two Bayer patents listed above had expired but prior to the expiration of the third patent listed above. Bayer has not filed actions against either manufacturer.

On February 24, 2006, Bayer received a notice letter pursuant to the Hatch-Waxman Act from generic manufacturer Teva Pharmaceuticals, stating that it had filed an Abbreviated New Drug Application (ANDA) with the FDA seeking regulatory marketing approval for allegedly bioequivalent versions of *Vigamox*®, an ophthalmic preparation of our anti-infective compound moxifloxacin sold by Alcon Laboratories Inc. under license from Bayer, prior to the expiration of one or more patents covering moxifloxacin, and/or its use. The relevant patents expire on December 8, 2011 and March 4, 2014. Bayer is evaluating the ANDA IV certification letter on its merits to decide what further action to take.

Proceedings involving Kogenate

Patent-related. In April 2003, two affiliates of Aventis, A. Nattermann & Cie GmbH and Aventis Behring LLC, filed a lawsuit against Bayer in federal district court in Pennsylvania alleging that Bayer s manufacture and distribution of *Kogenate*® constitutes an infringement of U.S. Patent No. 5,565,427, expiring in 2013. Bayer denied that allegation and averred that the patent is invalid or that Bayer s contract with Aventis Behring for the supply to them of a recombinant factor VIII product known as *Helixate*® includes any necessary license. After re-examination of the patent, the U.S. Patent and Trademark Office has indicated its intent to issue a re-examination certificate. Discovery in this matter is proceeding. Bayer believes it has meritorious defenses in

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this action and intends to defend it vigorously. Due to the considerable uncertainty associated with these proceedings, it is currently not possible to estimate potential liability.

Contract-related. In December 2003, Aventis Behring filed suit against Bayer in state court in Pennsylvania, alleging that Aventis Behring has been damaged as a result of Bayer s breach of a contract to supply Aventis Behring with agreed-upon quantities of *Helixate*®. Discovery in this matter is ongoing. Bayer believes it has meritorious defenses in this action and intends to defend it vigorously. Due to the considerable uncertainty associated with these proceedings, it is currently not possible to estimate potential liability.

Proceeding involving blood glucose monitors

In August 2005, Abbott commenced a lawsuit in a federal district court in California against Bayer and Roche Diagnostics alleging infringement of two of Abbott s U.S. patents relating to blood glucose monitoring devices. The Bayer product accused of infringing the Abbott patents is the *Ascensia*® *Contour*® system, which is supplied to Bayer by Matsushita. Bayer believes that it has meritorious defenses in this action and intends to defend it vigorously. Due to the considerable uncertainty associated with this proceeding, it is currently not possible to estimate potential liability. Matsushita is contractually obligated to indemnify Bayer against the potential liability with respect to this claim, as well as defense costs, and management expects Bayer to be reimbursed by Matsushita for a substantial portion of all such costs and liability, if any.

Advia Centaur®*-related actions*

Patent-related action. In February 2003, Bayer HealthCare LLC sued Abbott Laboratories in the U.S. District Court for the District of Delaware alleging that Abbott s Architect® immunoassay analyzer infringes four Bayer U.S. patents protecting Bayer s *ACS:180*® SE Automated Chemiluminescence System. A jury trial in this case was scheduled for late 2005. In September 2004, Abbott filed suit in the U.S. District Court for the District of Delaware against Bayer HealthCare LLC and Bayer Corporation alleging that Bayer is infringing three U.S. patents by the operation of Bayer s *Advia Centaur*® Immunoassay System. In mid-2005, Abbott voluntarily withdrew its countersuit against Bayer. In November 2005, the parties settled Bayer s case against Abbott.

Securities litigation

Bayer AG and Bayer Corporation, along with two of their current or former officers, have been named as defendants in a purported class action lawsuit pending in the U.S. District Court for the Southern District of New York. The lawsuit alleges violations of the U.S. securities laws and asserts that the defendants made false and misleading statements and omissions with respect to the commercial prospects, safety and efficacy of our cerivastatin anticholesterol products and with respect to the extent of the potential product liability exposure following our voluntary decision to cease marketing and to withdraw these products in August 2001. Plaintiffs seek unspecified damages on behalf of a class of all persons who purchased Bayer AG stock (including Bayer AG American Depository Receipts) between August 4, 2000 and February 21, 2003 at allegedly inflated prices. On September 14, 2005, the court dismissed with prejudice the claims of non-U.S. purchasers of Bayer AG stock on non-U.S. exchanges. Bayer believes that it has meritorious defenses in this action and intends to defend it vigorously. Due to the considerable uncertainty associated with this proceeding, it is currently not possible to estimate potential liability.

Asbestos litigation

Bayer is a defendant in asbestos cases in the United States which allege that Bayer, along with other premises defendants, employed contractors at industrial sites where they were exposed to asbestos and were injured. Plaintiffs contend that Bayer failed to warn or protect them from the known hazards of asbestos during the 1960s, 1970s and 1980s. The majority of cases are pending in West Virginia and Texas.

A Bayer subsidiary in the United States also is the legal successor to entities that sold asbestos-containing products from the 1940 s until 1976 and is named as a defendant in asbestos-related litigation. Bayer is and has been fully indemnified for its costs with respect to this litigation by Union Carbide. Union Carbide continues to

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accept Bayer s tender of these cases, and it defends and settles them in Bayer s name, in its own name and in the name of the several predecessor companies to Bayer.

We believe that we have meritorious defenses in these actions and intend to defend them vigorously. Without acknowledging any liability, we have settled a number of these cases in the past. We may, on a case-by-case basis, settle additional cases for reasonable amounts when, in our judgment, settlement is economically feasible given the risks and costs inherent in the litigation. We have made what we believe to be appropriate provisions in light of our experience in handling these cases.

Other commercial proceedings

Proceedings involving Everest

In January 2004, the purchaser of Bayer s Everest herbicide business, Arvesta, filed a lawsuit demanding rescission of the asset purchase agreement and return of the purchase price or, alternatively, monetary damages. Arvesta alleged that Bayer withheld material information concerning Everest use in the United States and Canada. This case was settled in April 2005 for an immaterial amount and the lawsuit dismissed with prejudice.

Lyondell Arbitration

Bayer asserted claims against Lyondell Chemical Company and/or certain of its subsidiaries (Lyondell) in a binding arbitration proceeding for breach of contract, declaratory judgment and related causes of action. Bayer seeks to recover alleged overcharges in connection with the parties joint venture in the manufacture of propylene oxide, and to recover damages for alleged violation of the parties non-compete agreement. Damages sought total approximately U.S. $274 million through December 31, 2004. Lyondell counterclaimed against Bayer for more than U.S. $121 million in damages through June 2005. The hearing in this matter was held in November 2005. Closing arguments were held in February 2006. The parties also seek pre-judgment interest and attorneys fees and costs.

Bayer also has notified Lyondell of its potential claim for approximately U.S. $94 million in connection with Lyondell s failure to compensate Bayer for taking approximately 351 million pounds of propylene oxide from Bayer s share of capacity under the joint venture. The parties are in the process of exchanging dispute resolution communications concerning this potential claim.

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

Proceedings involving Limagrain Genetics Corporation

In July 2004, Bayer, as successor in interest to Rhone Poulenc Inc., was served with a Notice of Arbitration by Limagrain Genetics Corporation, Inc. Limagrain is seeking indemnification from Bayer for liability Limagrain has incurred to a third party, Midwest Oilseeds. This liability arises from a judgment entered against Limagrain, and upheld on appeal, for an alleged breach of a 1986 contract to which Midwest Oilseeds and a former business unit of Rhone Poulenc Inc. were parties. Limagrain seeks indemnification for more than U.S. $60 million. An arbitration proceeding between Limagrain and Bayer was held in October 2005, and Bayer is awaiting the decision of the arbitration panel. In a parallel proceeding in France, Limagrain has sued Bayer, as successor in interest to Rhone Poulenc Agrochimie SA, to recover the judgment amount Limagrain is obligated to pay Midwest Oilseeds. Bayer believes that it has meritorious defenses in these actions and intends to defend them vigorously.

Dividend Policy and Liquidation Proceeds

Our stockholders may declare dividends at an ordinary Annual Stockholders Meeting, which must be held within the first eight months of each fiscal year.

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Under German law, Bayer AG may pay dividends only from balance sheet profits reflected in its unconsolidated financial statements (as opposed to the consolidated financial statements of the Bayer Group), as adopted and approved by the Board of Management and the Supervisory Board. In determining the balance sheet profits that may be distributed as dividends, the Board of Management may under German law and the provisions of our Articles of Association allocate to other retained earnings (*andere Gewinnrücklagen*) the net income of Bayer AG for the fiscal year that remains after deducting amounts to be allocated to legal and statutory reserves (*gesetzliche Rücklagen*) and losses carried forward. More than 50 percent of the net income may be allocated to other retained earnings only if such retained earnings would then not exceed 50 percent of our capital stock. The Board of Management may also increase balance sheet profits when preparing the financial statements with funds withdrawn from retained earnings.

Our stockholders, in their resolution on the appropriation of balance sheet profits, may carry forward balance sheet profits in part or in full and may allocate additional amounts to retained earnings. Profits carried forward will be automatically incorporated in the balance sheet profits of the next fiscal year and may be used in their entirety to pay dividends in the next fiscal year. Amounts allocated to the retained earnings are available for dividends only if and to the extent the retained earnings have been dissolved by the Board of Management when preparing the financial statements, thereby increasing the balance sheet profits.

Dividends approved at an ordinary Annual Stockholders Meeting are payable promptly after the meeting, unless otherwise decided at the meeting. Because all of Bayer AG s shares are in book-entry form represented by a global certificate deposited with Clearstream Banking AG in Frankfurt am Main, Germany, stockholders receive dividends through Clearstream for credit to their deposit accounts. Additionally, the ordinary Annual Stockholders Meeting may decide to distribute the balance sheet profit partly or in total to the stockholders by way of distribution in kind.

We expect to continue to pay dividends, although we can give no assurance as to the payment of a dividend for any particular year or as to the particular amounts that we may pay from year to year.

Apart from liquidation as a result of insolvency proceedings, Bayer AG may be liquidated only with a combined majority of the votes cast and three-quarters of the share capital present or represented at a stockholders meeting at which the vote is taken. In accordance with the German Stock Corporation Act, upon a liquidation of Bayer AG, any liquidation proceeds remaining after paying off all of Bayer AG s liabilities would be distributed among the stockholders in proportion to the total number of shares held by each stockholders.

See also Item 3, *Key Information Dividends.*

Significant Changes

Except as discussed elsewhere in this annual report on Form 20-F, no significant change has occurred since the date of the annual financial statements included in this annual report on Form 20-F.

Item 9. *The Listing*

Listing Details and Markets

American Depository Shares (ADSs), each representing one of our ordinary shares, are listed on the New York Stock Exchange and trade under the symbol BAY. The depositary for the ADSs is The Bank of New York.

The principal trading market for our ordinary shares is the Frankfurt Stock Exchange. Our shares are traded on Xetra, a computerized trading system operated by Deutsche Börse AG, in addition to being traded on the auction market (floor). Our shares are also listed on the other German stock exchanges, including Berlin-Bremen, Dusseldorf, Hamburg, Hannover, Stuttgart and Munich. In addition, our shares are listed on the Barcelona, Madrid, London, Zurich and Tokyo Stock Exchanges.

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The table below sets forth, for the periods indicated, the reported high and low closing prices for our shares on the Frankfurt Stock Exchange (Xetra, Source: Bloomberg) and our ADSs on the New York Stock Exchange.

	Frankfurt Stock Exchange[2]		New York Stock Exchange[2]	
	High	Low	High	Low
	(In Euros)		(In U.S. dollars)	
2001	53.51	24.57		
2002[1]	38.37	16.41	36.00	17.30
2003	22.17	9.67	29.41	11.24
2004:				
First quarter	23.88	18.33	32.15	23.52
Second quarter	22.33	18.88	29.09	24.52
Third quarter	22.27	18.68	29.17	24.33
Fourth quarter	23.92	20.44	34.12	27.00
Full year 2004	23.92	18.33	34.12	23.52
2005:				
First quarter	26.82	22.11	35.61	30.84
Second quarter	28.62	24.79	34.94	31.16
Third quarter	30.84	26.78	38.50	31.85
Fourth quarter	35.92	27.86	42.87	33.70
Full year 2005	35.92	22.11	42.87	30.84
Previous six months				
September 2005	30.84	28.70	38.50	35.23
October 2005	31.23	27.86	37.35	33.70
November 2005	33.95	28.86	40.32	34.34
December 2005	35.92	33.73	42.87	39.83
January 2006	36.37	33.61	44.31	40.80
February 2006	35.07	33.50	41.95	40.07

(1) From January 24, 2002 for New York Stock Exchange.

(2) The spin-off of LANXESS from Bayer became legally effective on January 28, 2005 and trading in the shares of LANXESS on the Frankfurt Stock Exchange commenced on January 31, 2005. Since January 31, 2005, Bayer shares have been traded ex LANXESS on the Frankfurt Stock Exchange and since February 8, 2005, Bayer ADSs have been traded ex LANXESS on the New York Stock Exchange. The share prices presented here for the New York Stock Exchange have not been retroactively adjusted for the spin-off.

On February 28, 2006 the closing sales price per Bayer AG ordinary share on Xetra was 33.79 and per Bayer AG ADS on the New York Stock Exchange was U.S. $40.24.

The average daily volume of Bayer shares traded on the German Stock Exchanges (Xetra and floors) for the years 2005, 2004 and 2003 was 4,138,431, 3,931,299 and 5,405,362 respectively. The average daily trading volume on the New York Stock Exchange in 2005, 2004 and 2003 was 110,548, 134,025 and 213,972.

Item 10. ***Additional Information***

Memorandum and Articles of Association

In the following section we describe the material provisions of our Articles of Association and German law to the extent that they affect the rights of our stockholders. This description is only a summary and does not

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provide a complete description of all relevant provisions. An English translation of our Articles of Association is filed as Exhibit 1.1 to this annual report on Form 20-F.

Registration

We are registered in the Commercial Register (*Handelsregister*) maintained by the local court (*Amtsgericht*) in Cologne, Germany, under the registration number HRB 48248. Copies of our Articles of Association may be obtained from the Commercial Register.

Object and Purposes

According to Section 2 of our Articles of Association, our object and purpose is the manufacturing, marketing and other industrial activities or provision of services in the fields of health care, agriculture, polymers and chemicals.

Members of the Board of Management and the Supervisory Board

Members of the Board of Management or the Supervisory Board typically may not vote on matters in which they have a material interest. Particularly, it is not permissible for the members of either of our boards to vote on compensation to themselves or any members of their body. Pursuant to the German Stock Corporation Act, the compensation of Management Board members is determined by the Supervisory Board. Our stockholders have resolved to specify the amount of compensation of Supervisory Board members in our Articles of Association. Any increase or decrease of the Supervisory Board members compensation requires an additional stockholders resolution.

Pursuant to the German Stock Corporation Act, a Supervisory Board member may not receive a loan from Bayer AG unless approved by the Supervisory Board. A member of the Board of Management may only receive a loan from us upon prior approval by the Supervisory Board.

There is no compulsory retirement age for members of the Supervisory Board. However, in accordance with the German Corporate Governance Code, Supervisory Board members are encouraged to retire at the Annual Stockholders Meeting following the member s 72nd birthday.

There is no share ownership requirement for the members of either our Board of Management or Supervisory Board.

Like most German companies, Bayer does not stagger the terms of office of the members of its Supervisory Board.

Rights, Preferences and Restrictions Attaching to our Shares

Information Rights

The principal means by which our stockholders may obtain information on our company is through our audited annual financial statements (*Jahresabschluss*), a report prepared by our Board of Management discussing these financial statements, certain risk factors and business trends (*Lagebericht*), a report by our supervisory board and a recommendation by our Board of Management regarding the distribution of our earnings. We are required to make these materials available for inspection at our principal offices starting on the date when the annual stockholders meeting is convened. In addition, each shareholder is entitled to receive a copy of these materials upon request.

Furthermore, each stockholder attending a stockholders meeting is entitled to ask certain types of questions, which members of our Board of Management, who are required to attend the meeting, are obliged to answer. By contrast, our stockholders have no right to inspect the books and records of our company.

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Dividend Rights and Other Distributions

In accordance with the Stock Corporation Act, the record date for determining which holders of our shares are entitled to the payment of dividends, if any, or other distributions, whether in cash, stock or property, is the date of the Annual Stockholders Meeting at which such dividends or other distributions are declared. For a summary of our stockholders dividend rights, please see Item 8, *Dividend Policy and Liquidation Proceeds.*

Voting Rights

Our stockholders vote at stockholders meetings. By contrast, German corporate law does not allow stockholders to approve matters by written consent in lieu of a meeting.

Each share entitles its holder to cast one vote at stockholders meetings. In certain cases, a stockholders right to cast a vote is excluded. Stockholders may pass resolutions at a general meeting by a simple majority of the votes cast, unless a greater majority is required by law or by our Articles of Association. Neither the Stock Corporation Act nor our Articles of Association provide for minimum quorum requirements for passing resolutions at stockholders meetings. The Stock Corporation Act requires that significant resolutions (*i.e.*, those relating to amendments to our Articles of Association, capital increases and decreases, exclusion of stockholder pre-emptive rights, the dissolution of our company, mergers or consolidations, the transfer of substantially all of our assets, and certain other significant matters) be passed by a majority of the votes cast and at least 75 percent of the share capital present at the meeting.

Neither German law nor our Articles of Association restrict the rights of our domestic, non-resident or foreign stockholders to hold or vote their shares.

Liquidation Rights

In case we are liquidated, any liquidation proceeds remaining after our liabilities have been paid off are distributed among our stockholders in proportion to the number of shares held by them.

Pre-emptive Rights

Under the German Stock Corporation Act, each stockholder of a corporation generally has a pre-emptive right (*Bezugsrecht*). Pre-emptive rights are preferential rights to subscribe for issues by the corporation of new shares, securities convertible into shares, securities with warrants to purchase shares, or instruments granting a profit participation right. The proportional share of the issue to which the shareholder may subscribe is equal to the proportional share of existing capital of the corporation that the shareholder holds. Subscription rights are freely transferable and may be traded on the German stock exchanges during the exercise period for these rights. When authorizing a capital increase and a new issue of shares, our stockholders may exclude pre-emptive rights, in whole or in part. In addition, when creating authorized capital, stockholders may authorize the Board of Management to exclude the pre-emptive rights attaching to any shares issued pursuant to the authorized capital. In addition to being approved by the stockholders meeting, any exclusion or restriction of pre-emptive rights requires a justification, which our Board of Management has to set forth in a written report to our stockholders. If our Board of Management increases our share capital, it may exclude pre-emptive rights in accordance with Section 4 of our Articles of Association.

Derivative suits

Under the German Stock Corporation Act, individual stockholders are generally not entitled to bring derivative actions on behalf of or in the interest of our company in case a member of our Board of Management or Supervisory Board violates his or her fiduciary duties. A majority of the votes represented at a stockholders meeting, however, may demand that an action be brought by the Board of Management or the Supervisory Board against a member who has allegedly violated his or her duties. In addition, the stockholders meeting or stockholders representing at least 10 percent of the company s share capital or shares with a nominal value of 1,000,000, may appoint special representatives to bring such action.

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On November 1, 2005, the German Stock Corporation Act was amended to facilitate derivative suits by individual stockholders. Under the new law, minority stockholders representing at least one percent of the company s share capital or shares with a nominal value of 100,000 may now file an application in court requesting that an action be admitted against a member of either of the company s boards on behalf of the company in their own name. The court must admit such stockholders derivative suit if, among other things, the minority stockholders can show a reasonable suspicion that the board members harmed the company through actions conducted in bad faith or a fundamental violation of the law or the Articles of Association, and that an enforcement of the claims would not be against the prevailing interests of the company. Furthermore, the minority must show that they have first demanded from the company that action be brought and that such demand has been futile.

Stockholders Meetings Convocation and Participation

A stockholders meeting may be called by the Board of Management or by stockholders who, in the aggregate, hold at least 5 percent of our share capital. In addition, if required in our interest, the Supervisory Board must call a stockholders meeting. Stockholders holding in the aggregate at least 500,000, or at least 5 percent of our issued share capital, may require that particular items be placed on the agenda. The Annual Stockholders Meeting must be held within the first eight months of each fiscal year and is called by the Board of Management, upon receipt of the Supervisory Board s report on our annual financial statements.

Under our Articles of Association, to be eligible to attend and vote at an Annual Stockholders Meeting, a stockholder must register with us to participate at the stockholders meeting by the end of the seventh day before the day of the stockholders meeting and provide proof of ownership of stock.

We are required to publish a notice of each ordinary or extraordinary stockholders meeting in the electronic Federal Gazette (*elektronischer Bundesanzeiger*) at least thirty days prior to the deadline for registration for the stockholders meeting. In addition, we are required to publish a notice in one national, authorized stock exchange journal.

Repurchase of Shares

We may not repurchase our own shares unless so authorized by a resolution duly adopted by our stockholders at a general meeting or in other very limited circumstances set forth in the German Stock Corporation Act, including for example in order to satisfy obligations under employee stock participation plans. Any repurchase is subject to various restrictions and conditions relating to, among other things, the manner and timing of such purchase. Any stockholders resolution that authorizes us to repurchase shares may not be in effect for a period longer than 18 months. The German Stock Corporation Act limits share repurchases to 10 percent of our share capital. Any resale of repurchased shares must be effected on a stock exchange or in a manner that treats all stockholders equally, unless otherwise approved by the stockholders at the stockholders meeting that authorized the repurchase of the shares.

On April 29, 2005, our stockholders authorized our Board of Management to repurchase our own shares representing up to 10 percent of our outstanding share capital in one or more steps on or before October 28, 2006. The repurchase may be effected for various purposes, including to fulfill option rights held by our executives or employees, or executives or employees of our subsidiaries, on the basis of our stock option programs.

Anti-takeover Defenses

The German Takeover Act provides that, while a tender offer for the shares of a company is underway, the company s management board may not take any action that may have the effect of thwarting the success of the tender offer. Certain defenses, however, are permitted. In particular, the company s management board may: (i) search for a white knight (*i.e.*, a third party that is willing to make a tender offer for the shares); (ii) perform any acts that a diligent and conscientious manager would perform in the absence of a tender offer; and (iii) perform any acts that have been approved by the company s supervisory board. In addition, the Act permits the stockholders meeting of the company, provided no tender offer is currently underway, to authorize the company s management board to take any actions that may have the effect of frustrating the success of a future

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tender offer, so long as the authorization is sufficiently specific and falls within the competence of the stockholders meeting. Any such authorization may remain in effect for a maximum of 18 months.

Disclosure Requirements

For a description of disclosure requirements pursuant to Section 21 of the German Securities Trading Act (*Wertpapierhandelsgesetz*), please refer to Item 7, *Major Shareholders and Related Party Transactions Major Shareholders.*

The German Securities Trading Act further requires the reporting of dealings by certain persons carrying managerial responsibilities and other persons close to them. Members of our Board of Management and Supervisory Boards must notify both us and the German Federal Financial Supervisory Authority of any acquisitions and sales of our shares or financial instruments linked to our shares in writing within five business days. Transactions are exempt from the notification obligations if the value of the shares or related financial instruments acquired or sold does not exceed in the aggregate 5,000 per calendar year. This obligation also applies to certain relatives of our board members, particularly, spouses, dependent children and other relatives who have been living in the same household for at least one year. In addition, we must publish on our website all notifications we have thus received, keep them posted for at least a period of one month and send proof of such publication to the German Federal Financial Supervisory Authority.

In addition, the German Takeover Act (*Wertpapiererwerbs- und Übernahmegesetz*), which came into effect on January 1, 2002, provides that a person who has acquired 30 percent or more of the voting rights of an issuer whose securities are admitted for trading on a German stock exchange is deemed to have gained control of the issuer and is required to publish this fact and to launch a public tender offer for the outstanding shares.

Material contracts

Relating to LANXESS

Bayer AG (Bayer) and LANXESS AG (LANXESS) are party to a spin-off and acquisition agreement dated September 22, 2004, which sets forth the assets and liabilities, including in particular the entire equity interest in LANXESS GmbH, transferred by Bayer to LANXESS by way of a spin-off pursuant to section 123 (2) No. 1 of the German Transformation Act (*Umwandlungsgesetz*). The spin-off, which took retroactive economic effect as of July 1, 2004, became legally effective upon its registration in the Commercial Register (*Handelsregister*) for Bayer at the Local Court of Cologne (*Amtsgericht Köln*) on January 28, 2005. Pursuant to the spin-off and acquisition agreement, all of LANXESS no par value ordinary bearer shares were granted to the stockholders of Bayer in the ratio of one LANXESS share for every ten Bayer shares. On September 10, 2004, Bayer Chemicals AG and Bayer MaterialScience AG had already transferred Bayer s chemicals activities and portions of its polymers activities to LANXESS GmbH under two separate spin-off and acquisition agreements.

Bayer and LANXESS also entered into a master agreement, dated September 22, 2004, pursuant to which Bayer and LANXESS agreed on measures to ensure the formation of the LANXESS subgroup as well as on provisions for the general apportionment of liability as between the parties and special provisions relating to the apportionment of product liability, liability for environmental contamination and liability for antitrust proceedings, in each case arising under administrative, civil and criminal proceedings and settlements thereof. The rules on general apportionment of liability provide that Bayer is to indemnify LANXESS and its affiliates with respect to liabilities of Bayer or its affiliates arising by statute or by application of common law and which were not allocated to LANXESS. In the area of environmental contamination, liability is essentially established based on the contamination of the properties used by the relevant party or its affiliates on July 1, 2004, subject to a ceiling on the liability of LANXESS and its affiliates of 350 million. Bayer is responsible for any claims asserted against LANXESS and its affiliates to the extent to which such claims in total exceed the ceiling. With respect to antitrust proceedings, each party has agreed generally to bear all liability that relates to those antitrust violations committed by it. With respect to products sold by the former Rubber business group, Bayer generally assumed 70 percent of liabilities arising from antitrust proceedings and LANXESS assumed 30 percent. LANXESS total liability arising from antitrust proceedings with respect to products sold by the former Rubber business group is generally limited to 100 million. Bayer is responsible for any expenses in excess of this limit incurred by

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LANXESS and its affiliates arising out of or in connection with these proceedings. Finally, Bayer and LANXESS will generally be liable for any claims arising out of or in connection with defective products that the respective party or its affiliates introduced to the market prior to January 28, 2005.

Relating to Roche

Pursuant to a share and asset purchase agreement among Roche Holding AG, certain of its affiliates and Bayer HealthCare AG, dated as of July 16, 2004, Bayer agreed to acquire the global activities (except in Japan) of Roche Consumer Health (over-the-counter drugs and vitamins), the Swiss healthcare group s 50 percent share of the 1996 Bayer/ Roche joint venture in the United States and five Roche production sites in Germany, France, Argentina, Morocco and Indonesia. The acquisition price, after the assumption of debt, was approximately 2,338 million, including about 208 million for the purchase, completed in 2004, of Roche s 50 percent share of the Bayer/ Roche joint venture in the United States.

The transaction was approved by the European Commission in November 2004. This approval was the key condition precedent to the closings. The first of several closings, resulting in Bayer HealthCare AG s attaining control over the majority of the Roche activities that are the subject of the agreement, occurred on January 1, 2005. The parties have a right to terminate the agreement in case certain conditions precedent have not been satisfied or waived by June 30, 2005, chief among them the non-occurrence of a material adverse effect. The sellers overall liability under the agreement is generally limited to 30 percent of the purchase price and is generally only triggered if aggregate claims for damages under the agreement exceed CHF 15,000,000.

Exchange controls

There are currently no German foreign exchange control restrictions on the payment of dividends on the shares or the conduct of our operations.

Taxation

The following is a discussion of the material U.S. federal income and German tax consequences to you as a Qualified Holder of Bayer AG shares. This discussion is based upon existing U.S. federal income and German tax law, including legislation, regulations, administrative rulings and court decisions, as in effect on the date of this annual report on Form 20-F, all of which are subject to change, possibly with retroactive effect.

For the purposes of this discussion, you are a Qualified Holder if you are the beneficial owner of ordinary Bayer AG shares and (1) are a resident of the United States for purposes of the Convention Between the United States of America and the Federal Republic of Germany for the Avoidance of Double Taxation and the Prevention of Fiscal Evasion with Respect to Taxes on Income and Capital, as amended (the Income Tax Treaty), which generally includes an individual U.S. resident, a corporation created or organized under the laws of the United States, any state thereof or the District of Columbia and a partnership, estate or trust, to the extent its income is subject to taxation in the United States as the income of a U.S. resident, either in its hands or in the hands of its partners or beneficiaries, (2) do not hold Bayer AG shares as part of the business property of a permanent establishment located in Germany or as part of a fixed base located in Germany and used for the performance of independent personal services and (3) if you are not an individual, are not subject to the limitation on benefits restrictions in the Income Tax Treaty. This discussion assumes that you hold Bayer AG shares as capital assets. This discussion does not address all aspects of U.S. federal income and German taxation that may be relevant to you in light of your particular circumstances. For example, this discussion does not apply to Qualified Holders whose shares were acquired pursuant to the exercise of an employee share option or otherwise as compensation or who are subject to special treatment under U.S. federal income tax laws such as financial institutions, insurance companies, tax-exempt organizations, holders of 10 percent or more of Bayer AG shares, broker-dealers in securities or currencies, persons that hold Bayer AG shares as part of a hedging or a conversion transaction or as a position in a straddle , and persons whose functional currency is other than the U.S. dollar. This discussion also does not address any aspects of state, local or non-U.S. (other than certain German) tax law. If a partnership holds Bayer AG shares, the tax treatment of a partner generally will depend upon the status of the partner and the activities of the partnership. If a Qualified Holder is a partner in a partnership that holds Bayer

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AG shares, the Holder is urged to consult its own tax advisor regarding the specific tax consequences of the purchase, ownership and disposition of the Bayer AG shares.

In general, for U.S. federal income tax purposes, if you are a Qualified Holder of ADRs evidencing ADSs, you will be treated as the owner of the Bayer AG shares represented by such ADSs. Unless the context requires otherwise, all references in this section to Bayer shares are deemed to refer likewise to ADSs evidencing an ownership interest in Bayer AG shares.

We urge you to consult your tax advisor as to the U.S. federal income and German tax consequences of holding Bayer AG shares, including the particular facts and circumstances that may be unique to you, and as to any other tax consequences of holding Bayer AG shares.

Taxation of Dividends

We were required under German law to withhold tax on dividends in respect of the 2005 fiscal year in an amount equal to 20 percent of the gross amount paid to German resident and non-resident stockholders, and we will be required to so withhold on dividends in respect of the 2006 fiscal year.

A surtax on the German withholding tax is currently levied on dividend distributions paid by a German resident company. The rate of this surtax is 5.5 percent on the withholding tax due. The surtax will equal 1.1 percent (5.5 percent x 20 percent) of the gross dividend.

As a Qualified Holder, you are eligible to receive a partial refund of the withholding tax (including surtax) under the Income Tax Treaty (subject to certain limitations), effectively reducing the withholding tax (including surtax) to 15 percent of the gross amount of the dividend. Thus, for each U.S. $100 of gross dividend paid by Bayer AG to you, the dividend will be subject to net German withholding tax (including surtax) of U.S. $15 under the Income Tax Treaty. The net cash received per U.S. $100 of gross dividend thus will be U.S. $85.

For U.S. federal income tax purposes, the gross amount of dividends paid on your Bayer AG shares, without reduction for German withholding tax, will be included in your gross income on the date the dividends are received or treated as received by you, translating dividends paid in euro into U.S. dollars using the exchange rate in effect on that date. Subject to certain exceptions for short-term and hedged positions, the U.S. dollar amount of dividends paid on your Bayer AG shares generally will be subject to U.S. taxation at a maximum rate of 15 percent in respect of dividends received before 2009 if you are an individual and the dividends are qualified dividends . Dividends that we pay generally will be treated as qualified dividends if we were not, in the year prior to the year in which the dividend was paid, and are not, in the year in which the dividend is paid, a passive foreign investment company (PFIC). Based on our audited financial statements and relevant market and shareholder data, we believe that we were not treated as a PFIC for U.S. federal income tax purposes with respect to our 2005 taxable year. In addition, based on our audited financial statements and current expectations regarding the value and nature of our assets, the sources and nature of our income, and relevant market data, we do not anticipate becoming a PFIC for our 2006 taxable year. However, whether we in fact are classified as a PFIC is a factual matter that must be determined annually at the close of each taxable year. Therefore, there can be no certainty as to our actual PFIC status in any particular year until the close of the taxable year in question.

If dividends paid in euros are converted into U.S. dollars on the date you receive or are treated as receiving them, you generally should not be required to recognize foreign currency gain or loss in respect of such dividend. You will not be entitled to the dividends received deduction with respect to any dividends we pay.

German tax withheld from dividends will be treated, up to the 15 percent rate provided under the Income Tax Treaty, as a foreign income tax that, subject to generally applicable limitations under U.S. tax law, is eligible for credit against your U.S. federal income tax liability, or, if you have elected to deduct such taxes, generally may be deducted in computing your taxable income for U.S. federal income tax purposes.

Refund Procedures

To claim the refund reflecting the reduction of the German withholding tax from 20 percent to 15 percent and the refund of the 5.5 percent German surtax, when applicable, you must submit (either directly, or, as

described below, through our U.S. transfer agent or the Depository Trust Company) a claim for refund to the German tax authorities, with the original bank voucher (or a certified copy thereof) issued by the paying entity documenting the tax withheld within four years from the end of the calendar year in which the dividend is received. Claims for refunds are made on a special form, which must be filed with the German tax authorities at the following address: Bundeszentralamt für Steuern, 53225 Bonn-Beuel, Germany. A refund claim form may be obtained from the German tax authorities at the same address as where applications are filed, from the Embassy of the Federal Republic of Germany, 4645 Reservoir Road, N.W., Washington, D.C. 20007-1998 or from the Office of International Operations, Internal Revenue Service, 1325 K Street, N.W., Washington, D.C. 20225, Attention: Taxpayer Service Division, Room 900.

You also must submit to the German tax authorities certification of your last filed U.S. federal income tax return (IRS Form 6166). You generally can obtain this certification from the office of the Director of the Internal Revenue Service Center by filing a request for certification (generally an IRS Form 8802) with the Internal Revenue Service Center in Philadelphia, Pennsylvania, U.S. Residency Certification Request, P.O. Box 16347, Philadelphia, PA 19114-0447. You should consult your tax advisor and the instructions to IRS Form 8802 for further details regarding how to obtain this certification.

Our U.S. transfer agent will perform administrative functions necessary to claim the refund reflecting the reduction in German withholding tax from 20 percent to 15 percent and the refund of the 5.5 percent German surtax, when applicable, for you. However, these arrangements may be amended or revoked at any time in the future. Under the current procedure, the U.S. transfer agent will prepare the German claim for refund forms on your behalf and file them with the German tax authorities. In order for the U.S. transfer agent to file the claim for refund forms, the U.S. transfer agent will prepare and mail to you, and will ask that you sign and return to the U.S. transfer agent, (1) a statement authorizing the U.S. transfer agent to perform these procedures and agreeing that the German tax authorities may inform the Internal Revenue Service of any refunds of German taxes and (2) a written authorization to remit the refund of withholding to an account other than yours. The U.S. transfer agent will also require certification of your last filed United States federal income tax return (IRS Form 6166). The U.S. transfer agent will attach the signed statement, the IRS Form 6166 and the documentation issued by the paying agency documenting the dividend paid and the tax withheld to the claim for refund form and file them with the German tax authorities.

A simplified refund procedure will be available to you if your Bayer AG shares are registered with brokers participating in the Depository Trust Company. Under this simplified refund procedure, the Depository Trust Company will provide the German tax authorities with electronic certification of your U.S. taxpayer status based on information it receives from its broker participants, and will claim a refund on your behalf. If approved by the German tax authorities, a similar simplified refund procedure may also be implemented by the U.S. transfer agent in the future. Under such a simplified refund procedure, following each dividend payment, the U.S. transfer agent would file a claim for refund automatically on your behalf if you have instructed the U.S. transfer agent in writing to file on your behalf.

The German tax authorities will issue refunds denominated in euro. The refunds will be issued in the name of the U.S. transfer agent or the Depository Trust Company, as the case may be, which will then convert the refunds to dollars and make corresponding refund payments to you or your broker. This broker, in turn, will remit corresponding refund amounts to you.

If you receive a refund attributable to reduced withholding taxes under the Income Tax Treaty, you may be required to recognize foreign currency gain or loss for U.S. federal income tax purposes, which will be treated as ordinary income or loss for such purposes to the extent that the U.S. dollar value of the refund received or treated as received by you differs from the U.S. dollar equivalent of the refund on the date the dividend on which such withholding taxes were imposed was received or treated as received by you.

Taxation of Capital Gains

Under the Income Tax Treaty, you will not be liable for German tax on capital gains realized or accrued on the sale or other disposition of Bayer AG shares.

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Upon a sale or other disposition of Bayer AG shares, you will recognize capital gain or loss for U.S. federal income tax purposes equal to the difference between the U.S. dollar value of the amount realized and your U.S. dollar adjusted tax basis in the Bayer AG shares. This gain or loss generally will be U.S. source gain or loss, and will be treated as long-term capital gain or loss if your holding period in the Bayer AG shares exceeds one year. The net amount of long-term capital gain recognized by an individual U.S. holder before January 1, 2009 is generally subject to a taxation at a maximum rate of 15 percent. The deductibility of capital losses is subject to significant limitations.

German Gift and Inheritance Taxes

The Convention between the United States of America and the Federal Republic of Germany for the Avoidance of Double Taxation with Respect to Taxes on Estates, Inheritances and Gifts, as amended (the Estate Tax Treaty), provides that an individual whose domicile is determined to be in the United States for purposes of such treaty will not be subject to German inheritance and gift tax (the equivalent of the U.S. federal estate and gift tax) on the individual s death or making of a gift unless the Bayer AG shares (1) are part of the business property of a permanent establishment located in Germany or (2) are part of the assets of a fixed base of an individual located in Germany and used for the performance of independent personal services. An individual s domicile in the United States, however, does not prevent imposition of German inheritance and gift tax with respect to an heir, donee or other beneficiary who is domiciled in Germany at the time the individual died or the gift was made.

The Estate Tax Treaty also provides a credit against U.S. federal estate and gift tax liability for the amount of inheritance and gift tax paid in Germany, subject to certain limitations, in a case where the shares are subject both to German inheritance or gift tax and U.S. federal estate or gift tax.

German Capital Tax (Vermögensteuer)

The Income Tax Treaty provides that you will not be subject to German capital tax (*Vermögensteuer*) with respect to the Bayer AG shares. As a result of a judicial decision, the German capital tax (*Vermögensteuer*) presently is not imposed.

Other German Taxes

There are no German transfer, stamp or other similar taxes that would apply to you upon receipt, purchase, holding or sale of Bayer AG shares.

U.S. Information Reporting and Backup Withholding

Dividends on Bayer AG shares and payments of the proceeds of a sale of Bayer AG shares paid within the United States or through certain U.S.-related financial intermediaries are subject to information reporting and may be subject to backup withholding unless you (1) are a corporation or other exempt recipient or (2) provide a taxpayer identification number and certify that no loss of exemption from backup withholding has occurred. U.S. persons who are required to establish their exempt status generally must file IRS Form W-9 (Request for Taxpayer Identification Number and Certification). Non-U.S. holders generally will not be subject to U.S. information reporting or backup withholding. However, these holders may be required to provide certification of non-U.S. status (generally on IRS Form W-8BEN) in connection with payments received in the United States or through certain U.S.-related financial intermediaries.

Backup withholding is not an additional tax. Amounts withheld as backup withholding may be credited against your U.S. federal income tax liability. You may obtain a refund of any excess amounts withheld under the backup withholding rules by filing the appropriate claim for refund with the Internal Revenue Service and furnishing any required information.

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Documents on display

You can inspect the documents concerning Bayer AG mentioned in this annual report during normal business hours at Bayer AG s headquarters at the Bayerwerk, 51368 Leverkusen, Germany, as well as at the headquarters of Bayer AG s U.S. subsidiary, Bayer Corporation, 100 Bayer Road, Pittsburgh, PA 15205-9741.

Significant Differences in Corporate Governance Practices

For a description of the significant ways in which our corporate governance practices differ from those followed by U.S. companies under the listing standards of the New York Stock Exchange, please refer to our website at http://www.bayer.com/about_bayer/ corporate_governance/german_corporate_governance_practices/ page2255.htm. (Reference to this uniform resource locator or URL is made as an inactive textual reference for informational purposes only. The information found at this website is not incorporated by reference into this document.)

Item 11. ***Quantitative and Qualitative Disclosures about Market Risk***

Market Risk

The global nature of our business exposes our operations, financial results and cash flows to a number of risks, including those listed below.

Currency exchange rate fluctuations. We are exposed to fluctuations between the euro and other major world currencies. The majority of our currency fluctuation risks are between the euro and the U.S. dollar, between the euro and the Japanese yen, between the euro and the Canadian dollar and between the U.S. dollar and the Brazilian real.

Interest rate fluctuations. We are exposed to changes in interest rates. Our primary interest rate exposure is to fluctuations in short-and long-term European and U.S. interest rates.

Credit risk. We are exposed to credit risk with respect to the counterparties in our transactions.

Raw material, commodity and energy price fluctuations. We are exposed to possible increases in raw material, commodity and energy prices. We may not be able to pass any such increases on to our customers.

Any of these risks could harm our operating results and financial condition.

From time to time, we enter into hedging arrangements to mitigate our exposure to currency, interest and commodity price risks. Our primary tools for hedging financial risks are over-the-counter derivative instruments, particularly forward foreign exchange contracts, foreign exchange option contracts, interest rate swaps and interest and principal currency swaps, interest rate options, commodity price swaps and commodity price options. As a matter of policy, we enter into these transactions only with counterparties of high credit standing. We have established uniform guidelines and internal controls for the use of these derivatives. We use these instruments only to economically hedge risks arising from our business operations and from related investments and financing transactions. We do not use derivatives for speculative purposes. A portion of our transactions hedge anticipated risks from currency exchange and raw material price fluctuations but do not qualify for hedge accounting under IAS and U.S. GAAP. Such transactions are monitored closely and require authorization by our head of finance, our risk committee (consisting of the head of Finance and the heads of the major divisions within Finance) or the Board of Management. Our Board of Management has provided us with loss limits for all derivative transactions that do not qualify for hedge accounting under IAS and U.S. GAAP and do not hedge other balance sheet items. All other derivative transactions are either limited by volume or by hedging degree. For example, we have a loss limit for the commodity hedges we use to reduce volatility in future cash flows from anticipated raw material purchases but which do not qualify for hedge accounting.

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Sensitivity Analysis

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). The risk estimates we provide below assume:

a simultaneous, parallel foreign exchange rates shift in which the euro depreciates against all currencies by 10 percent,

a simultaneous, parallel commodity price increase of 20 percent in all relevant commodities with respect to which we hold derivatives; and

a parallel shift of 100 basis points of the interest rate yield curves in all currencies.

We use our business experience, 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 our managers, stockholders, employees, suppliers and customers to appreciate an approximation of the effect changing market conditions could have on our business. Additionally, it allows our management after becoming aware of the impact of immediate and substantial changes to take the necessary steps to address such risks.

Sensitivity analysis is subject to material limitations, consisting of the following:

The risk-mitigating effects caused by correlation and diversification among different currencies, commodity prices and interest rate areas or between these different risk exposures are not taken into account. This may lead to an overestimation of risk, since a simultaneous adverse shift in all currencies, commodity prices and yield curves is highly unlikely.

Unlike other more complex risk modeling concepts, it applies only two shifts (up or down) in each risk category with the direction causing the adverse outcome chosen. While it is possible to apply more sophisticated risk measurement techniques, it is our view that sensitivity analysis gives decision makers in our non-financial businesses a sufficient warning of potential losses. We may apply further detailed analyses using the specific facts of a given situation to determine if appropriate corrective actions are needed.

Sensitivity analyses offer a snapshot of exposures at and between specific dates in time. However, there is continuous change in the Other Than Trading Portfolio. For example, positions are continually being opened and closed, assets and liabilities mature and new interest rates take effect. We accept this limitation and whenever we believe that more current information is required, produce either updated sensitivity analyses or utilize other management reporting options to understand in detail the effects of changing market conditions.

Sensitivity analyses do not provide an answer to the question of how long a sharp rise or fall of market rates will continue. Accordingly, we develop our own market direction projections and obtain other professional predictions that we then use in our financial planning and in modeling earnings impacts.

We continually refine our risk measurement and reporting procedures, including a periodic re-examination of the underlying assumptions and parameters utilized. Compared to last fiscal year, there have not been any changes that have resulted in material quantitative changes in market risk exposure. The differences between periods principally reflect changes in our exposures and the market rates and prices only.

The sensitivity analyses included in the risk sections below present the hypothetical loss in cash flows of financial instruments and derivative financial instruments that we held as of December 31, 2005 and 2004. These instruments were subject to changes in foreign exchange rates, commodity prices and interest rates. The range of

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sensitivities that we chose for these analyses reflects our view of changes reasonably possible over a one-year period.

Interest Rate Risk

Interest rate risk is the possibility that the total return (all changes in fair value and interest rate performance) of a financial instrument will change due to movements in market rates of interest. This risk primarily affects debt with maturities of more than one year. Items with these long maturities are not of material significance to our operations, but are relevant to our financial obligations.

We sometimes make loans to employees. Although a small proportion of these loans are interest-free, they generally bear interest at market-oriented, fixed rates. More than three quarters of our loans to employees have terms of over five years. All of these loans are real estate related, many of them secured by real estate. None of these loans were provided to any of the members of our Board of Management.

Derivative financial instruments

Derivative financial instruments are our main method of interest rate hedging. We use interest rate swaps to convert a portion of our fixed rate borrowings into, in effect, floating rate debt. We do this because, in a normal interest rate environment, short-term interest rates are lower than long-term interest rates. Thus, floating debt leads to lower interest costs in the long-run. The derivatives we use to hedge interest rate risk are primarily over-the-counter instruments, particularly interest rate swaps and, in rare cases, options. Our Corporate Treasury department has central responsibility for managing our interest rate exposures and using interest rate derivatives. Our Board of Management has provided clear guidance on how to limit and monitor cash flow risks that result from this approach.

The notional amount of these derivatives is the total nominal value of the underlying transactions. The fair value of these derivatives is their repurchase value, based on quoted prices or, in the case of contracts not publicly traded, their values as determined by standard methods, as of a given closing date. The table below shows the notional amount and fair value of the interest rate derivatives we held as of December 31, 2005 and 2004; the fair values quoted disregard any compensating movements in the values of the underlying transactions.

	Notional Amount As of December 31,		**Fair value As of December 31,**	
	2004	**2005**	**2004**	**2005**
		(Euros in millions)		
Interest rate hedging contracts	5,791	11,327	149	109

At December 31, 2005, the notional amount of our short-term interest rate hedging contracts (including interest rate swaps and options) totaled 0.4 billion (2004: 0.1 billion); those maturing after more than one year totaled 10.9 billion (2004: 5.7 billion). We do not anticipate a significant change in the level of interest rate risk with respect to our current business operations during 2006.

Sensitivity Analysis

Based on our floating interest rate debt position at year-end 2005, a hypothetical increase of 100 basis points, or one percent per year, of the interest rates applicable to our debt denominated in all currencies (holding currency rates constant), effective beginning January 1, 2006, would have resulted in an increase in our interest expense for the year ended December 31, 2005 of 39.7 million (2005 (based on year-end 2004 debt levels): 32.5 million).

Currency Risk

Because we conduct our operations in many currencies, we face a variety of risks associated with fluctuations in the relative values of these currencies. The primary currencies with respect to which we have material exchange rate risk are the U.S. dollar, Japanese yen, Canadian dollar and Brazilian real. In general, appreciation of the euro in relation to another currency has an adverse effect on our reported revenues and results,

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and depreciation of the euro has a positive effect. Since we are not including anticipated cash flows in our sensitivity analysis, the main impact of an adverse change results from derivatives used to hedge our anticipated exposure in foreign currencies. We therefore apply an adverse change in currencies where the euro depreciates against all other currencies by 10 percent.

Transaction Risk

We face transaction risk when our businesses generate revenue in one currency but incur costs relating to that revenue in a different currency. For example, an increase in the value of the U.S. dollar relative to the euro will increase the euro value of Bayer s sales and earnings made in the dollar zone and increase the competitiveness of its products produced in Europe against products exported from the United States. Because we enter into foreign exchange transactions for a significant portion of our contracted and forecasted operational foreign exchange exposures, we believe that a significant increase or decrease in the exchange rate of the euro relative to other major world currencies would not, in the short term, materially affect our future cash flows. Over time, however, to the extent that we cannot reflect these exchange rate movements in the pricing of our products in local currency, they could harm our cash flows.

Translation Risk

Many of the companies of the Bayer Group are located outside the euro zone. Because the euro is our financial reporting currency, we translate the financial statements of these subsidiaries into euro for inclusion in our consolidated financial statements. Period-to-period changes in the average exchange rate for a particular country s currency can significantly affect the translation into euro of both revenues and operating income denominated in that currency. Unlike the effect of exchange rate fluctuations on transaction exposure, the effect of exchange rate translation exposure does not affect our local currency cash flows. See Note 33 to the consolidated financial statements appearing elsewhere in this annual report.

Outside the euro zone, we hold significant assets, liabilities and operations denominated in local currencies, most importantly the U.S. dollar, the Japanese yen and the Brazilian real. Although we regularly assess and evaluate the long-term currency risk inherent in these investments, we generally undertake foreign exchange hedge transactions addressing this type of risk only when we are considering withdrawal from a specific venture and repatriating the funds that our withdrawal generates. However, we reflect effects from currency fluctuations on the translation of net asset amounts into euro in our equity position.

The translation effects of currency fluctuations were positive in 2005, increasing our sales by 0.3 billion compared to a decrease of 1.0 billion in 2004 and 1.8 billion in 2003. This effect was mainly due to an increase of the value of the Brazilian real compared to the euro (the average relative value of one euro in 2005 was R3.04, compared with average values of R3.64 in 2004 and R3.47 in 2003).

Derivative financial instruments

To mitigate the impact of currency exchange fluctuations, we regularly assess our transaction exposure to currency risks and hedge a portion of those risks with derivative financial instruments. Our Corporate Treasury department has central responsibility for managing our currency exposures and using currency derivatives. Our Board of Management has provided clear guidance on how to limit and monitor cash flow risks that result from this approach.

We relate the maturity dates of hedging contracts to the anticipated cash flows of the Bayer Group. Our policy is generally to use forward hedges and in some cases options depending upon our view of market conditions based on fundamental and technical analysis.

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The table below shows the notional amounts and fair values of the currency derivatives we held as of December 31, 2005 and 2004. We have included interest and principal currency swaps in this presentation since they are primarily used to hedge currency risks.

	Notional Amount As of December 31,		Fair Value As of December 31,	
	2004	2005	2004	2005
	(Euros in millions)			
Forward exchange contracts, currency swaps and interest and principal currency swaps	6,210	5,533	480	(116)
Currency options	123	169	10	(2)

At December 31, 2005, we estimated that our aggregate annual direct net transaction risk from sales and purchases in foreign currencies was approximately 2.5 billion, which consisted primarily of U.S. dollars (U.S. $1.8 billion), Japanese yen (¥58 billion), Canadian dollars (CAN $400 million) and Brazilian reals (R1.1 billion). We do not anticipate a significant change in these levels of risk with respect to our current business operations during 2006. The increase in risk compared to December 31, 2004 (1.3 billion) is mainly related to the U.S. dollar resulting from changes in our operational business (in particular, divestments in the United States and expansions in China, combined with a positive development in our U.S dollar-denominated sales).

Sensitivity Analysis

We applied a hypothetical adverse change of 10 percent in foreign currency exchange rates, where the U.S. dollar, Japanese yen, Canadian dollar and Brazilian real simultaneously strengthened against the euro using the year-end exchange rates of these currencies as a basis. The estimated hypothetical loss in cash flows of derivative and non-derivative financial instruments as of December 31, 2005 would be 85 million (2004: 38 million). Of these 85 million, 53 million are related to the U.S. dollar, 16 million to the Japanese yen and 16 million to other currencies. 84 million of the estimated hypothetical loss in cash flow of 85 million resulted from derivatives used to hedge our anticipated exposure in foreign currencies. These transactions typically qualify for hedge accounting. The impact of foreign currency exchange rate fluctuations on our anticipated sales in foreign currencies is not included in this calculation.

Credit Risk

Credit risk is the possibility that the value of our assets may become impaired if counterparties cannot meet their obligations in transactions involving financial instruments. Since we do not conclude master netting arrangements with our customers, the total of the amounts recognized in assets represents our maximum exposure to credit risk.

Raw Materials, Commodity and Energy Price Risks

We operate in markets in which economic cyclicality often affects raw material and product prices. Fluctuations in prices and availability of raw materials, commodities and energies affect major parts of our business. In order to secure our supply of raw materials, we are party to long-term supply contracts, buy additional quantities on the spot markets, and enter into swap agreements to manage our supply/ demand as needed. The most important of our raw materials and energies affected by price fluctuations are:

Benzene;

Phenol;

Acetone;

Propylene oxide;

Ethylene;

Toluene;

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Electric power; and

Steam.

As these products are derived from crude oil, naphtha and natural gas, their prices are affected by the volatility in the markets for these underlying basic feedstocks. Sometimes, however, their prices are decoupled from those for the underlying basic feedstocks and instead driven by the global supply and demand in the markets for these derivative products.

We typically use the following measures to avoid and manage pricing risk in purchasing raw materials and energies:

coverage of recurrent requirements with long-term contracts to reduce the price volatility of purchases on the spot markets;

incorporating pricing formulas linked to economic indices and pre-products into our contracts, rather than using published prices;

stock-keeping, flexibility in supply sources and, wherever possible, other alternative production plants to limit risks from raw material availability (only applicable to raw materials); and

hedging.

Derivative financial instruments

Facing increasing volatility in commodity and energy markets, we started a price risk management program in 2003 designed to reduce the variability of our expenditures for energy and commodity purchases by entering into financial swaps, collars and options on the over-the-counter markets. The gas and steam contracts for our major European sites are linked to liquidly traded fuel oil and gas oil indices; the U.S. contracts are based on different U.S. natural gas indices. The majority of the hedges for these contracts qualify for hedge accounting under IAS and U.S. GAAP. Our commodity hedges for petrochemical purchases are typically linked to crude oil and Naphtha, which are all feedstock to the production process of the raw materials our production depends on. These contracts are treated as trading instruments for accounting purposes.

The strategy for economically hedging energy and commodity price risks is based on contracts with a maturity of up to three years. Our procurement departments have central responsibility for managing our raw material, commodity and energy price risks. All financial derivatives which are not directly executed with suppliers in conjunction with purchasing agreements are executed and managed by our Corporate Treasury department. Our Board of Management has provided clear guidance on how to limit and monitor cash flow risks that result from this approach.

The notional amount of these derivatives is the nominal value of the underlying transactions. The fair value of these derivatives is their repurchase value, based on quoted prices or, in the case of contracts not publicly traded, their values as determined by standard methods, as of a given closing date. The table below shows the notional amount and fair value of the financial derivatives we held as of December 31, 2005 and 2004; the fair values quoted disregard any compensating movements in the values of the underlying transactions.

	Notional Amount As of December 31,		Fair Value As of December 31,	
	2004	2005	2004	2005
	(Euros in millions)			
Commodity hedging contracts	802	416	28	85
Commodity option hedging contracts		49		(13)

At December 31, 2005, the notional amount of our commodity and energy hedging contracts totaled 465 million (2004: 802 million). We do not anticipate a significant change in the level of commodity and energy price risk with respect to our current business operations during 2006.

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Sensitivity Analysis

We applied a hypothetical adverse change of 20 percent in commodity and energy prices, where all prices simultaneously decrease. The estimated hypothetical loss in cash flows of derivative financial instruments as of December 31, 2005 would be 66 million (2004: 67 million).

Item 12. ***Description of Securities Other Than Equity Securities***

Not applicable.

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PART II

Item 13. ***Defaults, Dividend Arrearages and Delinquencies***

None.

Item 14. ***Material Modifications to the Rights of Security Holders and Use of Proceeds***

None.

Item 15. ***Controls and Procedures***

We carried out an evaluation under the supervision and with the participation of our management, including our chief executive officer and chief financial officer, of the effectiveness of our disclosure controls and procedures as of December 31, 2005. There are inherent limitations to the effectiveness of any system of disclosure controls and procedures, including the possibility of human error and the circumvention or overriding of the controls and procedures. Accordingly, even effective disclosure controls and procedures can only provide reasonable assurance of achieving their control objectives. Based upon our evaluation, our chief executive officer and chief financial officer concluded that the disclosure controls and procedures were effective to provide reasonable assurance that information required to be disclosed by us in the reports we file or submit under the Securities Exchange Act of 1934, as amended, is recorded, processed, summarized and reported, within the time periods specified in the applicable rules and forms, and that it is accumulated and communicated to our management, including our chief executive officer and chief financial officer, as appropriate to allow timely decisions regarding required disclosure.

There has been no change in our internal control over financial reporting during 2005 that has materially affected, or is reasonably likely to materially affect, our internal control over financial reporting.

Item 16. ***[Reserved]***

Item 16A. ***Audit Committee Financial Expert***

Our Supervisory Board has determined that Dr. Schneider is an audit committee financial expert, as that term is defined in Item 16A(b) of Form 20-F.

Item 16B. ***Code of Ethics***

We have adopted a code of ethics, as that term is defined by Item 16B(b) of Form 20-F, that is applicable to all of our employees, including our principal executive officer, principal financial officer and principal accounting officer. Our code of ethics is available on our website at http://www.bayer.com/about-bayer/corporate-compliance/page1134.htm. (Reference to this uniform resource locator or URL is made as an inactive textual reference for informational purposes only. The information found at this website is not incorporated by reference into this document.)

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Item 16C. ***Principal Accountant Fees and Services***

Independent Auditor Fees

Fees billed to the Company for professional services by its principal accountant, PricewaterhouseCoopers, during the fiscal years 2003, 2004 and 2005 were as follows:

Type of fees	2003	2004	2005
	(Euros in millions)		
Audit fees	23	18	16
Audit-related fees	3	8	5
Tax fees	1	1	1
Fees for other services	*	*	1
Total	27	27	23

* All other fees amounted to less than 500,000 in 2003 and 2004

The audit-related services PricewaterhouseCoopers provided related to acquisition/ disposition due diligence, an audit of a carve-out statement, reviews of Bayer s information system unrelated to audit and audits of employee benefit plans. No services falling under the de minimis exception of paragraph (c)(7)(i)(c) of Rule 2-01 of Regulation S-X were provided to the Company by PricewaterhouseCoopers in 2003, 2004 and 2005.

Audit Committee Pre-Approval Policies

All services provided by our auditor and companies affiliated with our auditor must be pre-approved by the audit committee of our Supervisory Board (*Aufsichtsrat*). The annual contract conditions and fees relating to the audit of the financial statements of the Bayer Group and Bayer AG must be approved by the audit committee on a case-by-case basis. Other services may be pre-approved by the audit committee within the authorities the audit committee has adopted; if they fall outside these authorities, they require case-by-case approval. Our policies for these pre-approvals grant authority to management to engage our auditor and companies affiliated with our auditor for:

Audit services up to an annual aggregate, which was 23 million in 2003, 18 million in 2004 and 16 million in 2005 for Bayer Group and Bayer AG and which include the audit of the consolidated financial statements of Bayer and its affiliates; services necessary to provide audit opinions; services in connection with the submission of reports to the SEC; attest services for reports prepared on Bayer s internal control system and review of Bayer s information systems; accounting and disclosure advice in connection with the annual audit; and audit services relating to the audit of restated prior-year figures, if any.

Audit-related services, which include acquisition/ disposition due diligence; audits of material companies acquired or to be acquired, of carve-out statements relating to acquisitions or dispositions, of closing balances for dispositions and of employee benefit plans; procedures necessary to meet finance, accounting or other regulatory reporting requirements; advice on internal control systems; reviews of Bayer s information systems unrelated to audit; assistance in interpreting SEC requirements; and evaluation of risk management.

Tax advisory services, provided that the auditor or affiliate does not act as a representative of Bayer and did not recommend the transaction to which the tax advisory services relate; these include tax planning and advice; assistance with tax compliance; reviewing tax declarations; assistance in tax audits and appeals; and tax appraisals.

Other services, which include other risk management advice; audits of valuations performed by other advisors; analysis or review of business plans or planning processes (but not design or implementation thereof); and other financial related advice.

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Pre-approval for the audit-related services, tax advisory services and other services categories is only valid if these services together aggregate below 66 percent of the annual budget set for audit services. Any requests for services to be provided by the auditor or an affiliate must be made through Bayer s accounting department, which will, if necessary, prepare the individual approval applications. The accounting department also notifies the audit committee of services provided pursuant to the pre-approval policies, monitors the pre-approval budget, notifies the chairman of the audit committee once the 66 percent pre-approval threshold has been reached and maintains records of all services provided by the auditor and its affiliates.

Item 16D. ***Exemptions from the Listing Standards for Audit Committees***

We rely on the exemption afforded by Rule 10A-3(b)(1)(iv)(C) under the Securities Exchange Act of 1934, as amended. We believe that such reliance does not materially adversely affect the ability of our audit committee to act independently or to satisfy the other requirements of Rule 10A-3.

Item 16E. ***Purchases of Equity Securities by the Issuer and Affiliated Purchasers***

The following table sets forth certain information concerning purchases by us of Bayer AG ordinary shares of no par value during 2005:

Period (2005)	Total Number of Shares Purchased[(a)]	Average Price Paid per Share in Euro[(b)]	Total Number of Shares Purchased as Part of Publicly Announced Plans or Programs	Maximum Number (or Approximate Dollar Value) of Shares (or Units) that May Yet Be Purchased Under the Plans or Programs
January	29,671	26.67	[N/A]	[N/A]
February	33,916	26.42	[N/A]	[N/A]
March	36,633	29.32	[N/A]	[N/A]
April	52,284	25.61	[N/A]	[N/A]
May	69,290	25.51	[N/A]	[N/A]
June	30,521	28.64	[N/A]	[N/A]
July	31,236	27.60	[N/A]	[N/A]
August	30,933	29.74	[N/A]	[N/A]
September	150,338	29.84	[N/A]	[N/A]
October	371,323	28.88	[N/A]	[N/A]
November	95,250	28.59	[N/A]	[N/A]
December	33,482	34.17	[N/A]	[N/A]

[(a)] Relates to purchases of Bayer AG ordinary shares of no par value made by Bayer to accommodate its employee stock participation programs in Germany, the United States and Canada. Purchases made by Bayer under the remaining employee stock participation programs represent an amount that is immaterial in the aggregate. Our Board of Management is authorized until October 28, 2006 to purchase Bayer AG ordinary shares representing up to 10 percent of Bayer s capital stock, including for the purpose of accommodating Bayer s Stock Participation

Program. For further information on our Stock Participation Program, see Item 6, *Directors, Senior Management and Employees Employee Stock-Based Compensation Program*.

(b) Average price paid per share includes commissions.

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PART III

Item 17. ***Financial Statements***

We have responded to Item 18 in lieu of responding to this item.

Item 18. ***Financial Statements***

See pages F-1 through F-134, incorporated herein by reference.

Item 19. ***Exhibits***

Documents filed as exhibits to this annual report on Form 20-F:

Exhibit 1.1	Articles of Association (*Satzung*) of Bayer AG, as amended to date, in English translation.
Exhibit 2.1	The total amount of long-term debt securities Bayer AG authorized under any instrument does not exceed 10 percent of the total assets of the Company. Bayer AG agrees to furnish to the Securities and Exchange Commission, upon its request, a copy of any instrument defining the rights of holders of long-term debt of Bayer AG or its subsidiaries for which consolidated or unconsolidated financial statements are required to be filed.
Exhibit 4.1	Spin-Off and Acquisition Agreement, dated September 22, 2004, between Bayer AG and Lanxess AG, in English translation, is incorporated by reference to Exhibit 4.1 to Bayer AG s Annual Report on Form 20-F for the Year Ended December 31, 2004.
Exhibit 4.2	Master Agreement, dated September 22, 2004, between Bayer AG and LANXESS AG, in English translation, is incorporated by reference to Exhibit 4.2 to Bayer AG s Annual Report on Form 20-F for the Year Ended December 31, 2004.
Exhibit 4.3	Share and Asset Purchase Agreement, dated as of July 16, 2004, by and among Roche Holding AG, Roche Finanz AG, Roche Pharmholding B.V., Roche Deutschland Holding GmbH, Hoffmann-La Roche France SAS and Bayer HealthCare AG, and the amendment thereto dated as of December 28, 2004, in English translation, is incorporated by reference to Exhibit 4.3 to Bayer AG s Annual Report on Form 20-F for the Year Ended December 31, 2004.
Exhibit 4.4	Summary of Employment Arrangements between Bayer AG and Werner Wenning.
Exhibit 4.5	Summary of Employment Arrangements between Bayer AG and Dr. Udo Oels.
Exhibit 4.6	Summary of Employment Arrangements between Bayer AG and Klaus Kühn.
Exhibit 4.7	Summary of Employment Arrangements between Bayer AG and Dr. Richard Pott.
Exhibit 8.1	Significant subsidiaries as of the end of the year covered by this report as defined in rule 1-02(w) of Regulation S-X: See Item 4, *Information on the Company Organizational Structure*.
Exhibit 12.1	Certification of the Principal Executive Officer pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.
Exhibit 12.2	Certification of the Principal Financial Officer pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.
Exhibit 13.1	Certification in accordance with 18 U.S.C. § 1350 as adopted by § 906 of the Sarbanes-Oxley Act of 2002.

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SIGNATURES

The registrant hereby certifies that it meets all of the requirements for filing on Form 20-F and that it has duly caused and authorized the undersigned to sign this annual report on its behalf.

BAYER AG

/s/ Werner Wenning

Name: Werner Wenning
Title: Chairman of the Board of Management

/s/ Dr. Roland Hartwig

Name: Dr. Roland Hartwig
Title: General Counsel

Date: March 6, 2006

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BAYER GROUP
Index to Consolidated Financial Statements

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Report of Independent Registered Public Accounting Firm

To the Board of Directors
and Stockholders of Bayer AG

We have audited the accompanying consolidated balance sheets of Bayer AG and its subsidiaries as of December 31, 2005 and 2004, and the related consolidated statements of income, recognized income and expense and cash flows for each of the three years in the period ended December 31, 2005. These financial statements are the responsibility of the Company s management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with International Standards on Auditing and the standards of the Public Company Accounting Oversight Board of the United States of America. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the financial position of Bayer AG and its subsidiaries at December 31, 2005 and 2004, and the results of its operations and its cash flows for each of the three years in the period ended December 31, 2005 in accordance with International Financial Reporting Standards (IFRS).

IFRS vary in certain significant respects from accounting principles generally accepted in the United States of America and as allowed by Item 18 to Form 20-F. Information relating to the nature and effect of such differences is presented in Note [44] to the consolidated financial statements.

As discussed in Note [3] to the consolidated financial statements, Bayer AG adopted various accounting standards effective January 1, 2005 and, as required for certain of the accounting changes, has restated prior periods for comparison purposes.

Essen, Germany
March 1, 2006, except for Note [44],
as to which the date is March 6, 2006
PricewaterhouseCoopers
Aktiengesellschaft
Wirtschaftsprüfungsgesellschaft

/s/ ALBRECHT	/s/ LINKE
P. Albrecht Wirtschaftsprüfer (German Public Accountant)	V. Linke Wirtschaftsprüfer (German Public Accountant)

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Bayer Group
Consolidated Statements of Income

	Note	2003	2004	2005
			(million)	
Net sales	[8]	22,417	23,278	27,383
Cost of goods sold		(11,779)	(12,421)	(15,027)
Gross profit		10,638	10,857	12,356
Selling expenses	[9]	(5,515)	(5,240)	(5,713)
Research and development expenses	[10]	(2,190)	(1,927)	(1,886)
General administration expenses		(1,410)	(1,421)	(1,444)
Other operating income	[11]	1,073	740	794
Other operating expenses	[12]	(2,021)	(1,134)	(1,295)
Operating result	[14]	575	1,875	2,812
Equity-method loss	[15.1]	(165)	(139)	(10)
Non-operating income		750	483	634
Non-operating expenses		(1,293)	(997)	(1,237)
Non-operating result	[15]	(708)	(653)	(613)
Income (loss) before income taxes		(133)	1,222	2,199
Income taxes	[16]	84	(473)	(641)
Income (loss) from continuing operations after taxes		(49)	749	1,558
Income (loss) from discontinued operations after taxes	[7.2]	(1,242)	(67)	37
Income (loss) after taxes		(1,291)	682	1,595
of which				
attributable to minority interest	[17]	12	(3)	(2)
attributable to Bayer AG stockholders (net income (loss))		(1,303)	685	1,597
Earnings (loss) per share ( )				
From continuing operations	[18]	(0.08)	1.03	2.14
Basic		(0.08)	1.03	2.14
Diluted		(0.08)	1.03	2.14

From continuing and discontinued operations	[18]	(1.78)	0.94	2.19
Basic		(1.78)	0.94	2.19
Diluted		(1.78)	0.94	2.19

The accompanying notes are an integral part of the financial statements

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Bayer Group
Consolidated Balance Sheets

	Note	Dec. 31, 2004	Dec. 31, 2005
		(million)	
Noncurrent assets			
Goodwill and other intangible assets	[19]	5,952	7,688
Property, plant and equipment	[20]	7,662	8,321
Investments in associates	[21]	744	795
Other financial assets	[22]	1,169	1,429
Other receivables	[23]	113	199
Deferred taxes	[16]	1,219	1,698
		16,859	20,130
Current assets			
Inventories	[24]	4,738	5,504
Trade accounts receivable	[25]	4,475	5,204
Other financial assets	[22]	794	214
Other receivables	[23]	1,543	1,421
Claims for tax refunds	[16]	823	726
Liquid assets	[26]		
Marketable securities and other instruments		29	233
Cash and cash equivalents		3,570	3,290
		15,972	16,592
Assets held for sale and discontinued operations	[7.2]	4,757	
Total current assets		20,729	16,592
Assets		37,588	36,722
Equity attributable to Bayer AG stockholders			
Capital stock of Bayer AG		1,870	1,870
Capital reserves of Bayer AG		2,942	2,942
Other reserves		6,399	6,265
Accumulated other comprehensive income (loss) from discontinued operations		(379)	
		10,832	11,077
Equity attributable to minority interest		111	80
Stockholders equity	[27]	10,943	11,157
Noncurrent liabilities			
Provisions for pensions and other post-employment benefits	[28]	6,219	7,174

Other provisions	[29]	1,204	1,340
Financial liabilities	[30]	7,025	7,185
Miscellaneous liabilities	[32]	203	516
Deferred taxes	[16]	644	280
		15,295	16,495
Current liabilities			
Other provisions	[29]	2,707	3,009
Financial liabilities	[30]	2,166	1,767
Trade accounts payable	[31]	1,759	1,974
Tax liabilities	[16]	413	304
Miscellaneous liabilities	[32]	1,918	2,016
		8,963	9,070
Liabilities directly related to assets held for sale and discontinued operations	[7.2]	2,387	
Total current liabilities		11,350	9,070
Liabilities		26,645	25,565
Stockholders equity and liabilities		37,588	36,722

The accompanying notes are an integral part of the financial statements

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Bayer Group
Consolidated Statements of Cash Flows

	Note	2003	2004	2005
			(million)	
Operating result		575	1,875	2,812
Income taxes		(728)	(490)	(541)
Depreciation and amortization		3,050	1,959	1,835
Change in pension provisions		(51)	(424)	(586)
(Gains) Losses on retirements of noncurrent assets		(105)	(35)	(43)
Gross cash flow		2,741	2,885	3,477
Decrease (Increase) in inventories		(127)	(425)	(181)
Decrease (Increase) in trade accounts receivable		116	(404)	156
(Decrease) Increase in trade accounts payable		(90)	(5)	(115)
Changes in other working capital, other non-cash items		618	211	205
Net cash provided by (used in) operating activities (net cash flow, continuing operations)	[36]	3,258	2,262	3,542
Net cash provided by (used in) operating activities (net cash flow, discontinued operations)	[7.2]	35	188	(40)
Net cash provided by (used in) operating activities (net cash flow, total)		3,293	2,450	3,502
Cash outflows for additions to property, plant, equipment and intangible assets		(1,653)	(1,251)	(1,389)
Cash inflows from sales of property, plant, equipment and other assets		1,644	200	398
Cash inflows from sales of investments		258	90	1,189
Cash outflows for acquisitions less acquired cash		(72)	(358)	(2,188)
Interest and dividends received		366	400	451
Cash inflows from (outflows for) marketable securities		(83)	105	(202)
Net cash provided by (used in) investing activities (total)	[37]	460	(814)	(1,741)
Capital contributions			10	
Bayer AG dividend and dividend payments to minority stockholders		(664)	(559)	(440)
Issuances of debt		1,621	1,393	2,005
Retirements of debt		(1,936)	(881)	(2,659)
Interest paid		(782)	(724)	(787)
Net cash provided by (used in) financing activities (total)	[38]	(1,761)	(761)	(1,881)
Change in cash and cash equivalents due to business activities (total)		1,992	875	(120)

Cash and cash equivalents at beginning of year		767	2,734	3,570
Change in cash and cash equivalents due to changes in scope of consolidation		1	6	(196)
Change in cash and cash equivalents due to exchange rate movements		(26)	(45)	36
Cash and cash equivalents at end of year	[39]	2,734	3,570	3,290
Marketable securities and other instruments		129	29	233
Liquid assets as per balance sheets		2,863	3,599	3,523

The accompanying notes are an integral part of the financial statements

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Bayer Group
Consolidated Statements of Recognized Income and Expense

	Dec. 31, 2003	Dec. 31, 2004	Dec. 31, 2005
		(million)	
Changes in fair values of hedging instruments, recognized in stockholders equity	(15)	64	(15)
Gains (losses) on hedging instruments, recognized in the income statement	*3*	*4*	*3*
Changes in fair values of available-for-sale securities, recognized in stockholders equity	19	12	9
Gains (losses) on available-for-sale securities, recognized in the income statement	*1*	*(6)*	
Revaluation surplus (IFRS 3)		66	
Actuarial gains (losses) relating to pensions and other post-employment benefits	(519)	(740)	(1,207)
Exchange differences on translation of operations outside the euro zone	(1,106)	(304)	857
Deferred taxes on valuation adjustments, recognized directly in stockholders equity	229	251	470
Deferred taxes on valuation adjustments, removed from stockholders equity and recognized in the income statement	(1)	(2)	
Valuation adjustments recognized directly in stockholders equity	(1,389)	(655)	117
Income (loss) after taxes	(1,291)	682	1,595
Total income and expense recognized in the financial statements	(2,680)	27	1,712
of which attributable to minority interest	12	(3)	6
of which attributable to Bayer AG stockholders	(2,692)	30	1,706

The accompanying notes are an integral part of the financial statements

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Notes to the Consolidated Financial Statements of the Bayer Group

[1] Key Data by Business Segment and Region

Key Data by Business Segment

	HealthCare								CropScience			
	Pharmaceuticals, Biological Products		Consumer Care		Diabetes Care, Diagnostics		Animal Health		Crop Protection		Environmen Science, BioScienc	
ess Segments	2004	2005	2004	2005	2004	2005	2004	2005	2004	2005	2004	20
						(million)						
ales (external)	3,961	4,067	1,336	2,355	1,975	2,151	786	856	4,957	4,874	989	1,
nge	(9.4)%	2.7%	(4.8)%	76.3%	2.2%	8.9%	(0.5)%	8.9%	3.2%	(1.7)%	2.7%	
nge currency ed	(5.9)%	1.7%	1.4%	75.2%	6.9%	8.1%	4.5%	7.1%	7.0%	(4.3)%	7.5%	
egment sales	38	58	16	14	1	1	4	8	71	70	7	
operating e	128	49	20	38	6	67	12	5	134	217	37	
ting result	399	475	183	174	217	274	157	179	386	532	106	
n on sales	10.1%	11.7%	13.7%	7.4%	11.0%	12.7%	20.0%	20.9%	7.8%	10.9%	10.7%	1
cash flow	386	449	161	223	287	320	109	146	739	762	154	
al invested	2,305	2,501	792	2,860	1,817	1,978	392	408	6,932	7,372	1,454	1,
I	16.8%	18.7%	20.1%	7.6%	14.7%	16.9%	27.2%	36.5%	10.9%	10.7%	10.6%	1
ash flow	261	481	279	323	388	373	125	174	637	699	141	
y-method e (loss)												
y-method ments	4	4										
assets	4,052	3,489	1,287	3,621	1,809	1,955	554	642	9,117	8,836	1,703	1,
al ditures	115	142	40	59	121	108	25	21	181	175	28	
tization and ciation	174	188	69	120	170	178	23	24	592	494	135	
ities	2,138	2,086	505	816	687	748	202	341	2,450	2,668	360	
rch and opment ses	740	680	45	57	144	148	67	69	571	548	108	
er of yees (as of 31)	18,400	16,900	3,800	6,800	7,000	7,100	2,900	3,000	16,500	16,000	2,900	2,

	MaterialScience			
	Materials	Systems	Reconciliation	Continuing Operations

Business Segments	2004	2005	2004	2005	2004	2005	2004	2005
				(million)				
Net sales (external)	3,248	4,086	5,349	6,609	677	1,363	23,278	27,383
Change	17.0%	25.8%	14.4%	23.6%			3.8%	17.6%
Change currency adjusted	22.1%	25.5%	18.8%	22.8%			8.0%	16.4%
Intersegment sales	13	14	116	142	(266)	(320)		
Other operating income	32	19	96	26	275	340	740	794
Operating result	293	633	348	736	(214)	(349)	1,875	2,812
Return on sales	9.0%	15.5%	6.5%	11.1%			8.1%	10.3%
Gross cash flow	400	621	484	781	165	(27)	2,885	3,477
Capital invested	3,645	4,325	4,344	4,791	3,684	2,848	25,365	28,560
CFRoI	11.1%	15.6%	9.8%	17.1%			10.8%	12.4%
Net cash flow	209	517	289	871	(67)	(101)	2,262	3,542
Equity-method income (loss)	4	37	(131)	(47)	(12)		(139)	(10)
Equity-method investments	178	211	562	580			744	795
Total assets	3,789	4,314	4,724	5,125	5,796	7,149	32,831	36,722
Capital expenditures	147	377	185	338	135	142	977	1,388
Amortization and depreciation	249	225	326	320	221	186	1,959	1,835
Liabilities	964	1,090	1,475	1,632	15,477	15,815	24,258	25,565
Research and development expenses	97	107	139	144	16	17	1,927	1,886
Number of employees (as of Dec. 31)	9,100	9,300	8,800	9,500	22,300	22,300	91,700	93,700

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Notes to the Consolidated Financial Statements of the Bayer Group (Continued)

Key Data by Business Segment

	HealthCare						CropScience					
	Pharmaceuticals, Biological Products		Consumer Care		Diabetes Care, Diagnostics		Animal Health		Crop Protection		Environme Science BioScien	
ss Segments	**2003**	**2004**	**2003**	**2004**	**2003**	**2004**	**2003**	**2004**	**2003**	**2004**	**2003**	**2**
						(million)						
es (external)	4,371	3,961	1,403	1,336	1,933	1,975	790	786	4,801	4,957	963	
ge	0.9%	(9.4)%	(18.2)%	(4.8)%	(5.2)%	2.2%	(7.1)%	(0.5)%	20.0%	3.2%	38.6%	
ge currency d	12.2%	(5.9)%	(5.8)%	1.4%	5.1%	6.9%	4.7%	4.5%	32.1%	7.0%	56.1%	
gment sales	42	38	7	16		1	6	4	62	71	14	
perating	100	128	347	20	36	6	25	12	278	134	51	
ing result	(16)	399	486	183	115	217	172	157	242	386	100	
on sales	(0.4)%	10.1%	34.6%	13.7%	5.9%	11.0%	21.8%	20.0%	5.0%	7.8%	10.4%	
cash flow	180	386	371	161	277	287	144	109	692	739	168	
invested	2,287	2,305	808	792	2,083	1,817	409	392	6,575	6,932	1,458	1
	5.8%	16.8%	39.7%	20.1%	12.8%	14.7%	27.1%	27.2%	9.3%	10.9%	11.0%	
sh flow	(67)	261	444	279	275	388	226	125	847	637	318	
-method (loss)												
-method ents	4	4										
ssets	4,089	4,052	1,078	1,287	2,129	1,809	575	554	8,921	9,117	1,824	1
itures	158	115	46	40	155	121	21	25	236	181	177	
zation and ation	328	174	69	69	231	170	32	23	600	592	149	
ies	2,418	2,138	512	505	614	687	229	202	2,556	2,450	412	
ch and pment es	920	740	46	45	163	144	72	67	630	571	95	
r of ees (as of 1)	19,100	18,400	3,800	3,800	7,200	7,000	2,900	2,900	16,300	16,500	3,100	2

	MaterialScience							
	Materials		Systems		Reconciliation		Continuing Operations	
Business Segments	**2003**	**2004**	**2003**	**2004**	**2003**	**2004**	**2003**	**2004**

				(million)				
Net sales (external)	2,777	3,248	4,676	5,349	703	677	22,417	23,278
Change	(3.4)%	17.0%	(2.3)%	14.4%			0.6%	3.8%
Change currency adjusted	5.1%	22.1%	6.5%	18.8%			10.9%	8.0%
Intersegment sales	10	13	103	116	(244)	(266)		
Other operating income	21	32	44	96	171	275	1,073	740
Operating result	58	293	(455)	348	(127)	(214)	575	1,875
Return on sales	2.1%	9.0%	(9.7)%	6.5%			2.6%	8.1%
Gross cash flow	312	400	623	484	(26)	165	2,741	2,885
Capital invested	3,557	3,645	5,551	4,344	5,297	3,684	28,025	25,365
CFRoI	8.0%	11.1%	10.3%	9.8%			9.6%	10.8%
Net cash flow	332	209	781	289	102	(67)	3,258	2,262
Equity-method income (loss)	(11)	4	(23)	(131)	(131)	(12)	(165)	(139)
Equity-method investments	163	178	703	562			870	744
Total assets	3,861	3,789	3,957	4,724	6,589	5,796	33,023	32,831
Capital expenditures	169	147	295	185	143	135	1,400	977
Amortization and depreciation	269	249	1,108	326	264	221	3,050	1,959
Liabilities	829	964	1,494	1,475	14,969	15,477	24,033	24,258
Research and development expenses	116	97	133	139	15	16	2,190	1,927
Number of employees (as of Dec. 31)	9,100	9,100	9,200	8,800	22,600	22,300	93,300	91,700

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Notes to the Consolidated Financial Statements of the Bayer Group (Continued)

Key Data by Business Region

	Europe			North America			Asia/Pacific			Latin America/ Africa/Middle Eas	
	2003	2004	2005	2003	2004	2005	2003	2004	2005	2003	2004
						(million)					
s) by	9,110	9,775	11,930	6,981	6,512	7,340	3,625	3,962	4,578	2,701	3,029
e	2.6%	7.3%	22.0%	0.8%	(6.7)%	12.7%	(3.5)%	9.3%	15.5%	(1.0)%	12.1%
e	3.6%	7.4%	21.9%	19.0%	1.6%	11.9%	8.5%	14.7%	14.8%	17.2%	18.4%
s) by origin	9,873	10,646	12,912	7,027	6,570	7,386	3,398	3,708	4,383	2,119	2,354
e	6.3%	7.8%	21.3%	(2.8)%	(6.5)%	12.4%	(1.6)%	9.1%	18.2%	(8.3)%	11.1%
e	7.1%	7.8%	21.1%	15.0%	1.9%	11.6%	11.3%	14.9%	17.4%	12.3%	18.6%
onal	3,333	3,512	3,933	1,705	1,690	1,913	233	193	198	113	119
erating	748	492	348	53	130	295	79	57	49	193	61
g	602	953	1,285	(400)	396	924	119	362	455	421	395
n sales	6.1%	9.0%	10.0%	(5.7)%	6.0%	12.5%	3.5%	9.8%	10.4%	19.9%	16.8%
sh	1,388	1,503	1,733	803	770	1,126	268	376	459	368	346
nethod loss)	(166)	(39)	6		(100)	(17)	1		1		
nethod ents	452	431	443	412	307	345	2	2	3	4	4
sets	19,659	19,118	20,294	7,770	7,684	8,199	2,521	2,754	3,904	1,466	1,885
ures	805	550	606	422	231	284	119	140	400	54	56
ation tion	1,376	1,173	1,077	1,360	542	526	239	132	113	56	50
es	15,097	16,058	17,638	5,543	5,328	5,040	1,122	987	1,088	634	742
n and ment s	1,521	1,322	1,228	580	515	565	74	70	68	15	20
of es (as 31)	52,400	51,400	52,400	18,700	17,800	16,200	12,200	12,200	13,900	10,000	10,300

	Reconciliation			Continuing Operations		
Regions	**2003**	**2004**	**2005**	**2003**	**2004**	**2005**
				(million)		
Net sales (external) by market				22,417	23,278	27,383
Change				0.6%	3.8%	17.6%
Change currency adjusted				10.9%	8.0%	16.4%
Net sales (external) by point of origin				22,417	23,278	27,383
Change				0.6%	3.8%	17.6%
Change currency adjusted				10.9%	8.0%	16.4%
Interregional sales	(5,384)	(5,514)	(6,220)			
Other operating income				1,073	740	794
Operating result	(167)	(231)	(166)	575	1,875	2,812
Return on sales				2.6%	8.1%	10.3%
Gross cash flow	(86)	(110)	(117)	2,741	2,885	3,477
Equity-method income (loss)				(165)	(139)	(10)
Equity-method investments				870	744	795
Total assets	1,607	1,390	1,902	33,023	32,831	36,722
Capital expenditures				1,400	977	1,388
Amortization and depreciation	19	62	54	3,050	1,959	1,835
Liabilities	1,637	1,143	792	24,033	24,258	25,565
Research and development expenses				2,190	1,927	1,886
Number of employees (as of Dec. 31)				93,300	91,700	93,700

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Notes to the Consolidated Financial Statements of the Bayer Group (Continued)

[2] General information

The consolidated financial statements of the Bayer Group are prepared pursuant to Article 315a of the German Commercial Code according to the International Financial Reporting Standards (IFRS) of the International Accounting Standards Board (IASB), London, and the Interpretations of the International Financial Reporting Interpretations Committee (IFRIC), effective at closing date. Publication approval by the Supervisory Board takes place on March 2, 2006. Since 2002 the term International Financial Reporting Standards (IFRS) has been used to refer to the body of accounting and reporting standards compiled by the International Accounting Standards Board (IASB), London. It thus replaces the term International Accounting Standards (IAS). However, standards issued prior to the name change continue to be referred to as IAS.

Bayer is a global enterprise based in Germany. Its business activities in the fields of health care, nutrition and high-tech materials are divided among the Bayer HealthCare, Bayer CropScience and Bayer MaterialScience subgroups, respectively (see Note [6]: Segment Reporting).

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.

The Group financial statements are based on the principle of the historical cost of acquisition, construction or production, with the exception of certain items such as available-for-sale financial assets and derivative financial instruments, which are reflected at fair value. The financial statements of the consolidated companies are prepared according to uniform recognition and valuation principles. Valuation adjustments made for tax reasons are not reflected in the Group statements. The individual companies statements are prepared as of the closing date for the Group statements.

The consolidated financial statements of the Bayer Group are drawn up in euros ( ). Amounts are stated in millions of euros (million) except where otherwise indicated.

The income statement is prepared using the cost-of-sales method.

In the income statement and balance sheet, certain items are combined for the sake of clarity, as explained in the Notes. The previous version of IAS 1 allowed the option of classifying assets and liabilities either according to maturity or in order of liquidity. The revised version of IAS 1, developed as part of the IASB improvements project, prescribes classification according to maturity starting with the 2005 fiscal year. Assets and liabilities are classified as current if they mature within one year.

Accordingly, assets and liabilities are classified as noncurrent if they remain in the Bayer Group for more than one year. Trade accounts receivable and payable and inventories are always presented as current items, deferred tax assets and liabilities as noncurrent items.

Third parties minority interests in consolidated subsidiaries are no longer shown as a separate item between equity and liabilities, but recognized as part of stockholders equity.

In compliance with IFRS 5, which was approved by the IASB on March 31, 2004, the distinction between continuing operations and discontinued operations or assets held for sale is drawn differently starting on January 1, 2005 than in the financial statements as of December 31, 2004. Assets, liabilities, income and expense relating to discontinued operations are disclosed separately in the balance sheet and income statement. All data in these Notes refer to continuing operations, except where otherwise indicated. Discontinued operations are described in Note [7.2].

Changes in recognition and valuation principles are explained in the Notes. The retrospective application of new or revised standards requires except as otherwise provided in the respective standard that the amounts recognized in the financial statements for the preceding annual period and the opening balance sheet for the reporting period be restated as if the new recognition and valuation principles had been applied in the past. The financial statements as of December 31, 2003 and 2004 have therefore been restated in line with the new and revised standards applied by the Bayer Group as of January 1, 2005.

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Notes to the Consolidated Financial Statements of the Bayer Group (Continued)

[3] Effects of new accounting pronouncements

Accounting standards applied for the first time in 2005

Material effects of reporting changes on earnings per share are explained in Note [18].

The consolidated financial statements for 2005 comply with the following new or revised International Financial Reporting Standards: IAS 1 (Presentation of Financial Statements), IAS 2 (Inventories), IAS 8 (Accounting Policies, Changes in Accounting Estimates and Errors), IAS 10 (Events After the Balance Sheet Date), IAS 16 (Property, Plant and Equipment), IAS 17 (Leases), IAS 21 (The Effects of Changes in Foreign Exchange Rates), IAS 24 (Related Party Disclosures), IAS 27 (Consolidated and Separate Financial Statements), IAS 28 (Investments in Associates), IAS 31 (Interests in Joint Ventures), IAS 32 (Financial Instruments: Disclosure and Presentation), IAS 33 (Earnings per Share), IAS 39 (Financial Instruments: Recognition and Measurement) and IAS 40 (Investment Property). The revised standards supersede the previous versions and apply for annual periods beginning on or after January 1, 2005.

In February 2004, the IASB issued International Financial Reporting Standard (IFRS) 2 (Share-based Payment), which deals with accounting for share-based payment transactions, including grants of share options to employees. IFRS 2 specifies the financial reporting by an entity when it undertakes a share-based payment transaction and requires an entity to reflect in its profit or loss and financial position the effects of share-based payment transactions, including expenses associated with transactions in which share options are granted to employees. The first-time application of IFRS 2 led to a 7 million pre-tax adjustment to the value of existing obligations under stock-based compensation programs as of January 1, 2005. The adjustment resulting from measuring these obligations retrospectively at fair value instead of intrinsic value includes a pre-tax amount of 3 million pertaining to the 2004 fiscal year.

In March 2004, the IASB issued IFRS 3 (Business Combinations) to replace IAS 22 (Business Combinations). IFRS 3 requires all business combinations within its scope to be accounted for by applying the purchase method of accounting. The pooling of interests method is prohibited. At the acquisition date, the acquiree s identifiable assets, liabilities and contingent liabilities are to be recognized at fair value. It requires that goodwill no longer be amortized but tested annually for impairment. IFRS 3 is applied to business combinations for which the agreement date is on or after March 31, 2004. For goodwill and other intangible assets acquired in a business combination for which the agreement date was prior to March 31, 2004, the standard must be applied prospectively from the beginning of the first annual period beginning on or after March 31, 2004.

In March 2004, in connection with the issuance of IFRS 3, the IASB revised IAS 36 (Impairment of Assets) and IAS 38 (Intangible Assets). The main revisions require goodwill and intangible assets with indefinite useful lives to be tested for impairment annually, or more frequently if events or changes in circumstances indicate a possible impairment, prohibit reversal of impairment losses for goodwill, require an intangible asset to be treated as having an indefinite useful life when there is no foreseeable limit on the period over which the asset is expected to generate net cash inflows for the entity, and prohibit the amortization of such intangible assets. The revised standards are effective for goodwill and other intangible assets acquired in business combinations for which the agreement date is on or after March 31, 2004 and for all other such assets for annual periods beginning on or after March 31, 2004. The new standard has been applied prospectively, *i.e.* the new recognition and valuation principles are applied only in the current statements and not for the preceding period. Had the new standard been applicable for the 2004 fiscal year, the absence of amortization of goodwill and other intangible assets with indefinite useful lives would have reduced operating expense by 185 million.

In March 2004, the IASB issued IFRS 5 (Non-current Assets Held for Sale and Discontinued Operations), which contains specific recognition principles for assets and liabilities held for sale and for discontinued operations. To improve transparency and comparability, the Group s financial reporting is based primarily on continuing operations, while assets held for sale and discontinued operations are stated separately in a single line item in the balance sheet, income statement and cash flow statement. The distinction between continuing

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Notes to the Consolidated Financial Statements of the Bayer Group (Continued)

operations and discontinued operations or assets held for sale is thus drawn differently starting on January 1, 2005 than in the financial statements as of December 31, 2004.

In March 2004, the IASB issued an amendment to IAS 39 (Financial Instruments: Recognition and Measurement). The amendment simplifies the implementation of IAS 39 by enabling fair value hedge accounting to be used more readily for portfolio hedging of interest rate risk than under previous versions of IAS 39.

In May 2004, the International Financial Reporting Interpretations Committee (IFRIC) issued IFRIC Interpretation 1 (Changes in Existing Decommissioning, Restoration and Similar Liabilities). The interpretation addresses the accounting for changes in cash outflows and discount rates, and increases resulting from the passage of time in existing decommissioning, restoration, and similar liabilities that are recognized both as part of the capitalized cost of an item of property plant and equipment and as a provision.

In November 2004, the IFRIC released an amendment to SIC-12 (Consolidation Special Purpose Entities). The amendment removes SIC-12 s scope exception for equity compensation plans, thereby requiring an entity that controls an employee benefit trust (or similar entity) set up for the purpose of a share-based payment arrangement to consolidate that trust upon adopting IFRS 2 (Share-based Payment). Further, it amends the scope exclusion in SIC-12 for post-employment benefit plans to include other long-term employee benefit plans in order to ensure consistency with the requirements of IAS 19 (Employee Benefits).

In December 2004, the IASB published an amendment to IAS 19 (Employee Benefits). The amendment introduces an additional recognition option that permits immediate recognition of actuarial gains and losses arising in defined benefit plans. The option is similar to the approach provided in U.K. standard FRS 17 (Retirement Benefits), which requires recognition of all actuarial gains and losses in a statement of total recognized gains and losses that is separate from the income statement. Other features of the amendment include (1) a clarification that a contractual agreement between a multi-employer plan and participating employers that determines how a surplus is to be distributed or a deficit funded will give rise to an asset or liability, (2) accounting requirements for group defined benefit plans in the separate or individual financial statements of entities within a group, and (3) additional disclosure requirements.

Previously, in the Bayer Group statements, net cumulative amounts of actuarial gains and losses outside of the corridor that were reflected in the balance sheet at the end of the previous reporting period were recognized in the income statement as income or expense, respectively, over the average remaining working lives of existing employees. This corridor was 10 percent of the present value of the defined benefit obligation or 10 percent of the fair value of plan assets, whichever was greater at the end of the previous year. Under the new method of post-employment benefit accounting, unrealized actuarial gains and losses, instead of being gradually amortized according to the corridor method and recognized in income, are offset in their entirety against stockholders equity. Thus, no amortization of actuarial gains and losses is recognized in income.

Recognizing actuarial gains and losses in stockholders equity affects the amounts of receivables and of provisions for pensions and other post-employment benefits stated in the balance sheet and also requires the recognition of deferred taxes on the resulting differences. These taxes, too, are offset against the corresponding equity items. The Group Management Board has decided to follow the recommendation of the IASB and implement the above change as of January 1, 2005 in order to enhance the transparency of the reporting. The previous year s figures have been restated accordingly. This reporting change improves the 2004 operating result from continuing operations by 48 million and the non-operating result by 78 million, but also gives rise to a deferred tax expense of 50 million. In view of its immateriality to 2004 operating result of the segments, the 48 million gain has been reflected solely in the reconciliation column of the segment table. These reporting changes do not affect either gross or net cash flows.

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Notes to the Consolidated Financial Statements of the Bayer Group (Continued)

The impact of the change on the relevant balance sheet items as of December 31, 2004 was as follows:

	Carrying amount before the change	Impact of the change	Carrying amount after the change
		(million)	
Assets			
Benefit plan assets in excess of obligations	540	(468)	72
Deferred tax assets	936	283	1,219
Assets held for sale and discontinued operations	4,788	(31)	4,757
Stockholders equity and liabilities			
Other reserves	7,452	(1,432)	6,020
Provisions for pensions and other post-employment benefits	4,581	1,638	6,219
Deferred tax liabilities	1,171	(527)	644
Liabilities directly related to assets held for sale and discontinued operations	2,282	105	2,387

In April 2005, the International Accounting Standards Board (IASB) issued an amendment to IAS 39 (Financial Instruments: Recognition and Measurement) to permit the foreign currency risk of a highly probable forecast intragroup transaction to qualify as the hedged item in consolidated financial statements provided that the transaction is denominated in a currency other than the functional currency of the entity entering into that transaction and the foreign currency risk will affect consolidated profit or loss. The amendment also specifies that if the hedge of a forecast intragroup transaction qualifies for hedge accounting, any gain or loss that is recognized directly in equity in accordance with the hedge accounting rules in IAS 39 must be reclassified into profit or loss in the same period or periods during which the foreign currency risk of the hedged transaction affects consolidated profit or loss. The amendments shall be applied for annual periods beginning on or after January 1, 2006. The Bayer Group has early adopted this standard and is applying the interpretation in its current financial statements. The adoption has not had a material impact on the Group s shareholders equity, financial position or results of operations.

In June 2005, the IASB issued a further amendment to IAS 39 (Financial Instruments: Recognition and Measurement). This amendment introduces a restriction to the use of the option of designating any financial asset or any financial liability to be measured at fair value through profit or loss (the fair value option). The amendment limits the use of this option to financial instruments that meet certain conditions. Those conditions are that: (1) the fair value option designation eliminates or significantly reduces a measurement or recognition inconsistency, (2) a group of financial assets, financial liabilities, or both are managed and their performance is evaluated on a fair value basis in accordance with a documented risk management or investment strategy, and (3) an instrument contains an embedded derivative that meets particular conditions. The amendment shall be applied for annual periods beginning on or after January 1, 2006. The Bayer Group has early adopted this amendment and applied it in its 2005 financial statements. The adoption has not had a material impact on the Group s shareholders equity, financial position or results of operations.

Newly issued accounting standards

In December 2004, the International Financial Reporting Interpretations Committee (IFRIC) issued IFRIC Interpretation 5 (Rights to Interests Arising From Decommissioning, Restoration and Environmental Rehabilitation Funds). The interpretation addresses how to account for obligations to decommission assets for which a company

contributes to a fund established to meet the costs of the decommissioning or environmental rehabilitation. IFRIC 5 is to be applied for annual periods beginning on or after January 1, 2006. The Bayer Group does not believe that the application of this standard will have a material impact on the Group s financial position, results of operations or cash flows.

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Notes to the Consolidated Financial Statements of the Bayer Group (Continued)

In August 2005, the IASB amended requirements for financial guarantee contracts through limited amendments to IAS 39 (Financial Instruments: Recognition and Measurement) and IFRS 4 (Insurance Contracts). The amendments require the issuer of a financial guarantee contract to measure the contract initially at fair value, and subsequently at the higher of (1) the amount determined in accordance with IAS 37 (Provisions, Contingent Liabilities and Contingent Assets) and (2) the amount initially recognized less, when appropriate, cumulative amortization recognized in accordance with IAS 18 (Revenue). If an issuer has previously asserted explicitly that it regards such contracts as insurance contracts and has used accounting applicable to insurance contracts, the issuer may elect to apply to such contracts the accounting model described above or elect to account for such contracts under IFRS 4. The amendments shall be applied for annual periods beginning on or after January 1, 2006. The Bayer Group does not believe that the application of this standard will have a material impact on the Group s financial position, results of operations or cash flows.

In September 2005, the IFRIC issued IFRIC Interpretation 6 (Liabilities Arising from Participating in a Specific Market Waste Electrical and Electronic Equipment). The interpretation addresses when certain producers of electrical goods are required to recognize a liability for the cost of waste management relating to the decommissioning of waste electrical and electronic equipment (historical waste) supplied to private households. The IFRIC concluded that the event giving rise to the liability for cost of such historical waste, and thus its recognition, is participating in the market during a measurement period. IFRIC 6 is to be applied for annual periods beginning on or after December 1, 2005. The Bayer Group is currently evaluating the impact the standard will have on the Group s financial position, results of operations or cash flows.

In November 2005, the IFRIC issued IFRIC 7 (Applying the Restatement Approach under IAS 29 (Financial Reporting in Hyperinflationary Economies)). IFRIC 7 clarifies how comparative amounts in financial statements should be restated when an entity s functional currency becomes hyperinflationary. IFRIC agreed that when hyperinflationary status is reached, an entity must restate its financial statements as though the economy had always been hyperinflationary. In addition, IFRIC 7 also provides guidance on how deferred tax items in the opening balance sheet should be restated. The Bayer Group is currently evaluating the impact the standard will have on the Group s financial position, results of operations or cash flows.

[4] Basic principles of the consolidated financial statements

[4.1] Consolidation methods

Capital consolidation is performed according to IAS 27 (Consolidated and Separate Financial Statements) by offsetting investments in subsidiaries against the underlying equity at the dates of acquisition. The identifiable assets and liabilities (including contingent liabilities) of subsidiaries and joint ventures are included at their fair values in proportion to Bayer s interest. Remaining differences are recognized as goodwill. Fair value adjustments of the assets and liabilities concerned are amortized together with the corresponding assets and liabilities in subsequent periods.

Where financial statements of consolidated companies recorded write-downs or write-backs of investments in other consolidated companies, these are eliminated for the Group statements.

Intragroup sales, profits, losses, income, expenses, receivables and payables are eliminated.

Deferred taxes are recognized for temporary differences related to consolidation entries.

Joint ventures are included by proportionate consolidation according to the same principles.

The consolidated financial statements include the accounts of those companies in which Bayer AG directly or indirectly has a majority of the voting rights (subsidiaries) or from which it is able to derive the greater part of the economic benefit and bears the greater part of the risk by virtue of its power to govern corporate financial and operating policies, generally through an ownership interest greater than 50 percent. Inclusion of such companies accounts in the consolidated financial statements begins when Bayer AG starts to exercise control over the company and ceases when it is no longer able to do so. Subsidiaries and joint ventures that do not have a material

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impact on the Group s net worth or financial position, either individually or on aggregate, are not consolidated but recognized at fair value, which generally corresponds to amortized cost.

However, investments in material entities in which Bayer AG exerts significant influence, generally through an ownership interest between 20 and 50 percent (associates), are accounted for by the equity method. The cost of acquisition of an associate is adjusted annually by the percentage of any change in its stockholders equity corresponding to Bayer s percentage interest in the company. Any goodwill arising from the first-time inclusion of companies at equity is accounted for in the same way as goodwill relating to fully consolidated companies. The financial statements of associates are prepared according to uniform recognition and valuation principles. Bayer s share of the changes in these companies stockholders equities that are recognized in their income statements including write-downs of goodwill are recognized in the Bayer Group consolidated income statement in the operating result. Intercompany profits and losses on transactions with associates were immaterial in 2005 and 2004. Participations of between 20 and 50 percent that do not have a material impact on the Group s financial position, results of operations or cash flows, either individually or on aggregate, are not included at equity but at the lower of amortized cost or fair value. Further information on associates can be found in Note [21].

[4.2] Foreign currency translation

In the financial statements of the individual consolidated companies, foreign currency receivables and payables are translated at closing rates, irrespective of whether they are exchange-hedged. Forward contracts that, from an economic point of view, serve as a hedge against fluctuations in exchange rates are stated at fair value.

The majority of consolidated companies outside the euro zone are to be regarded as foreign entities since they are financially, economically and organizationally autonomous. Their functional currencies according to IAS 21 (The Effects of Changes in Foreign Exchange Rates) are thus the respective local currencies. The assets and liabilities of these companies are therefore translated at closing rates, while income and expense items are translated at average rates for the year.

Where the operations of a company outside the euro zone are integral to those of Bayer AG, the functional currency is the euro. Property, plant and equipment, intangible assets, investments in affiliated companies and other securities included in investments are translated at the historical exchange rates on the dates of addition, along with any relevant amortization, depreciation and write-downs. All other balance sheet items are translated at closing rates. Income and expense items (except amortization, depreciation and write-downs) are translated at average rates for the year.

Exchange differences arising from the translation of foreign companies balance sheets are shown in a separate stockholders equity item.

In case of divestiture, the respective exchange differences are reversed and recognized in income.

The exchange rates for major currencies against the euro varied as follows:

		Closing rate			Average rate		
		2003	2004	2005	2003	2004	2005
			(1)			(1)	
Argentina	ARS	3.70	4.05	3.57	3.33	3.66	3.64
Brazil	BRL	3.66	3.62	2.76	3.47	3.64	3.04
U.K.	GBP	0.70	0.71	0.69	0.69	0.68	0.68
Japan	JPY	135.05	139.65	138.90	130.96	134.40	136.86
Canada	CAD	1.62	1.64	1.37	1.58	1.62	1.51
Mexico	MXN	14.18	15.23	12.59	12.22	14.04	13.58
Switzerland	CHF	1.56	1.54	1.56	1.52	1.54	1.55
U.S.A.	USD	1.26	1.36	1.18	1.13	1.24	1.24

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[4.3] Recognition and valuation principles

Net sales and other operating income

Sales are recognized upon transfer of risk or rendering of services to third parties and are reported net of sales taxes and rebates. Revenues from contracts that contain customer acceptance provisions are deferred until customer acceptance occurs.

Where sales of products or services involve the provision of multiple elements which may contain different remuneration arrangements such as prepayments, milestone payments etc. for example research and development alliances and co-promotion agreements they are assessed to determine whether separate delivery of the individual elements of such arrangements comprises more than one unit of accounting. The delivered elements are separated if (1) they have value to the customer on a stand-alone basis, (2) there is objective and reliable evidence of the fair value of the undelivered element(s) and (3) if the arrangement includes a general right of return relative to the delivered element(s), delivery or performance of the undelivered element(s) is considered probable and substantially in the control of the company. If all three criteria are fulfilled, the appropriate revenue recognition convention is then applied to each separate accounting unit.

Allocations to provisions for rebates to customers are recognized in the period in which the related sales are recorded. These amounts are deducted from sales. Payments relating to the sale or outlicensing of technologies or technological expertise once the respective agreements have become effective are immediately recognized in income if all rights to the technologies and all obligations resulting from them have been relinquished under the contract terms and Bayer has no continuing obligation to perform under the agreement. However, if rights to the technologies continue to exist or obligations resulting from them have yet to be fulfilled, the payments received are recorded in line with the actual circumstances.

Contractually agreed upfront payments and similar non-refundable payments are recorded as deferred revenue and recognized in income over the estimated performance period stipulated in the agreement. Non-refundable milestone payments linked to the achievement of a significant and substantive technical/ regulatory hurdle in the research and development process, pursuant to collaborative agreements, are recognized as revenue upon the achievement of the specified milestone. Revenues such as license fees, rentals, interest income or dividends are recognized according to the same principles.

Research and development expenses

A substantial proportion of the Bayer Group s financial resources is invested in research and development. This is necessary to maintain continued success in the research- and technology-intensive markets in which it operates. In addition to in-house research and development activities, especially in the health care business, various research and development collaborations and alliances are maintained with third parties involving the provision of funding and/or payments for the achievement of performance milestones.

For accounting purposes, research expenses are defined as costs incurred for current or planned investigations undertaken with the prospect of gaining new scientific or technical knowledge and understanding. Development expenses are defined as costs incurred for the application of research findings or specialist knowledge to production, production methods, services or goods prior to the commencement of commercial production or use. All research costs are expensed as incurred. According to IAS 38 (Intangible Assets), research costs cannot be capitalized; development costs must be capitalized if, and only if, specific, narrowly defined conditions are fulfilled. Development costs must be capitalized if it is sufficiently certain that the future economic benefits to the company will cover not only the usual production, selling and administrative costs but also the development costs themselves.

Since development projects are subject to regulatory approvals and other imponderables, the conditions for the capitalization of costs incurred prior to the approval are not satisfied and the respective costs are therefore expensed as incurred. With respect to costs incurred in collaborations and alliances with third parties, considerable judgment is involved in assessing whether milestone-based payments simply reflect the funding of

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research, in which case expensing is always required, or whether, by making a milestone payment, an asset is acquired. In the latter case, the relevant costs are to be capitalized.

The following costs in particular, by their very nature, constitute research and development expenses: the appropriate allocations of direct personnel and material costs and related overheads for internal or external application technology, engineering and other departments that provide the respective services; costs for experimental and pilot facilities (including depreciation of buildings or parts of buildings used for research or development purposes); costs for clinical research; regular costs for the utilization of third parties patents for research and development purposes; other taxes related to research facilities; and fees for the filing and registration of self-generated patents that are not capitalized.

Goodwill and other intangible assets

Acquired intangible assets with the exception of goodwill and other intangibles assets with indefinite useful lives are recognized at cost and amortized by the straight-line method over a period of 3 to 30 years, depending on their estimated useful lives. Write-downs are made for impairment losses. Investments are written back if the reasons for previous years write-downs no longer apply. Such write-backs, however, must not cause the net carrying amounts of the assets to exceed the amortized cost at which they would have been recognized if the write-downs had not been made. Amortization for 2005 has been allocated to the cost of goods sold, selling expenses, research and development expenses or general administration expenses. Amortization of other intangible assets in 2005 totaled 622 million (2004: 577 million).

The Bayer Cross trademark, which Bayer had been unable to use in the United States and Canada since its confiscation at the end of the First World War but which was reacquired in 1994 and thus can now be used worldwide, was recognized in fiscal 2005 as an intangible asset with an indefinite useful life. Bayer is of the opinion that the use of the Bayer Cross by its operating units serves to set Bayer products apart from others, particularly in the U.S. market. There are no regulatory or statutory restrictions on its use. Bayer protects the value of this trademark through a policy of not granting utilization rights to any party outside the Bayer Group. Thus the intrinsic value of the Bayer Cross can be utilized indefinitely. The residual carrying amount of the intangible asset associated with the Bayer Cross at December 31, 2005 was 107 million. The 11 million annual amortization was no longer recognized in 2005.

While self-created intangible assets generally are not capitalized, certain development costs such as those relating to the application development stage of internally developed software are capitalized in the Group balance sheet. These costs are amortized over the useful life of the software from the date it is placed in service.

Goodwill, including that arising on acquisitions, is no longer amortized. In accordance with IFRS 3 (Business Combinations) and the related revised versions of IAS 36 (Impairment of Assets) and IAS 38 (Intangible Assets), goodwill, including that arising on acquisitions, is no longer amortized, but in common with other intangible assets with indefinite useful lives tested annually for possible impairment. This is done more frequently if events or changes in circumstances indicate a possible impairment. Further details of the annual impairment test for goodwill are given in Note [4.5]. Amortization of goodwill in 2004 amounted to 174 million.

Property, plant and equipment

Property, plant and equipment is carried at the cost of acquisition or construction and where subject to depletion depreciated over its estimated useful life or written down if its value falls below its net carrying amount (impairment loss).

The cost of acquisition comprises the acquisition price, ancillary costs and subsequent acquisition costs less any reduction received on the acquisition price. Where an obligation exists to dismantle or remove the asset or restore a site to its former condition at the end of the asset s useful life, the estimated cost of such dismantlement, removal or restoration is added to the asset s cost of acquisition.

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The cost 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 and write-downs of assets used in construction. It includes the shares of expenses for company pension plans and discretionary employee benefits that are attributable to construction.

If the construction phase of property, plant or equipment extends over a long period, the interest incurred on borrowed capital up to the date of completion is capitalized as part of the cost of acquisition or construction.

Expenses for the repair of property, plant and equipment, such as ongoing maintenance costs, are normally charged to income. The cost of acquisition or construction is capitalized retroactively if the expenses related to the asset will result in future economic benefits.

Property, plant and equipment is depreciated by the straight-line method, except where depreciation based on the actual utilization pattern is more appropriate. Depreciation for 2005 has been allocated to the cost of goods sold, selling expenses, research and development expenses or general administration expenses. Depreciation of property, plant and equipment in 2005 totaled 1,213 million (2004: 1,208 million).

If an asset s value falls below its net carrying amount, the latter is reduced accordingly. In compliance with IAS 36 (Impairment of Assets), such impairment losses are measured by comparing the carrying amounts to the discounted cash flows expected to be generated by the respective assets. These asset write-downs are reversed if the reasons for them no longer apply. Further details of the impairment test are given in Note [4.5].

When assets are sold, closed down, or scrapped, the difference between the net proceeds and the net carrying amount of the assets is recognized as a gain or loss in other operating income or expenses, respectively.

The following depreciation periods, based on the estimated useful lives of the respective assets, are applied throughout the Group:

Buildings	20 to 50 years
Outdoor infrastructure	10 to 20 years
Plant installations	6 to 20 years
Machinery and equipment	6 to 12 years
Laboratory and research facilities	3 to 5 years
Storage tanks and pipelines	10 to 20 years
Vehicles	5 to 8 years
Computer equipment	3 to 5 years
Furniture and fixtures	4 to 10 years

In accordance with IAS 17 (Leases), assets leased on terms equivalent to financing a purchase by a long-term loan (finance leases) are capitalized at the lower of their fair value or the present value of the minimum lease payments at the date of addition. The leased assets are depreciated over their estimated useful lives except where subsequent transfer of title is uncertain, in which case they are depreciated over their estimated useful lives or the respective lease terms, whichever are shorter.

Investments in associates

Investments in material entities in which Bayer AG exerts significant influence, generally through an ownership interest between 20 and 50 percent (associates), are accounted for by the equity method. Further information on associates can be found in Note [21].

Financial assets

Financial assets comprise receivables, securities, equity instruments, derivative financial instruments with positive fair values, and liquid assets. They are classified as financial assets held for trading , held-to-maturity

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investments , loans and receivables or available-for-sale financial assets and accounted for in accordance with IAS 39 (Financial Instruments: Recognition and Measurement).

Receivables are classified under loans and receivables and recognized at amortized cost. Interest-free and low-interest receivables are stated at the present value of expected future cash flows. Securities and equity instruments are classified as available for sale and recognized at fair value without affecting the income statement. All purchases and sales are posted on the date of performance, *i.e.* the date on which the asset actually changes hands. Embedded derivatives are accounted for separately provided that (1) their economic characteristics and risks are not closely related to those of the host contract, (2) they are not, or are not intended to be, transferred independently of the underlying contract, and (3) the host contract is recognized at fair value. The accounting for changes in the fair value of a derivative instrument depends on whether it has been designated and qualifies as part of a hedging relationship and, if so, the reason for holding it. In most cases, derivative financial instruments are recognized at fair value through profit or loss. In certain cases, however, a derivative that is part of a hedge accounting relationship may be recognized at fair value in equity as a cash flow hedge. The management of financial and commodity price risks, the accounting treatment of primary and derivative financial instruments, and the use of derivatives for hedging purposes are outlined in more detail in Note [33]. Liquid assets are stated at nominal value.

If receivables are impaired, they are written down to the present value of expected future cash flows. Available-for-sale securities and equity instruments are recorded at fair value. If the fair value is expected to remain below the (amortized) cost of acquisition, the difference is removed from stockholders equity (other comprehensive income) and recognized in the income statement.

Where it is possible to determine a market price for an equity instrument or security, this is regarded as its fair value. If no quoted market price exists, however, the instrument is recognized at amortized cost. If there are objective and substantial indications of impairment, an assessment is made of whether the carrying amount exceeds the present value of the expected future cash flows. If this is the case, the asset is written down by the amount of the difference. Impairment indicators include a reduction in market value, a substantial decline in credit standing, a specific breach of contract, a high probability of insolvency or other form of financial reorganization of the debtor, or the disappearance of an active market.

Available-for-sale debt instruments and loans and receivables are written back if the reasons for previous years write-downs no longer apply. However, such write-backs must not cause the carrying amount to exceed the cost of acquisition. No write-backs are made for available-for-sale equity instruments .

Inventories

In accordance with IAS 2 (Inventories), inventories encompass assets (finished goods and trading goods) held for sale in the ordinary course of business, in the process of production for such sale (work in process) or in the form of materials or supplies to be consumed in the production process or in the rendering of services (raw materials and supplies). Inventories are usually valued by the weighted-average method and recognized at the lower of cost or fair value less costs to sell, which is the estimated normal selling price less the estimated production costs and selling expenses.

The cost of acquisition comprises all costs incurred to bring inventories to their present location in their present condition. The cost of production comprises the direct cost of materials, direct manufacturing expenses and appropriate allocations of fixed and variable material and manufacturing overheads, where these are attributable to production.

It also includes the shares of expenses for company pension plans and discretionary employee benefits that are attributable to production. Administrative costs are included where they are attributable to production. Financing costs are not included in the cost of production.

In view of the production sequences characteristic of the Bayer Group, work in process and finished goods are grouped together.

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Taxes

Income taxes comprise all taxes levied on the Group s taxable income. The remaining taxes, such as property, electricity and other energy taxes, are included in the cost of goods sold or in selling, research and development or general administration expenses.

Deferred taxes are calculated in accordance with IAS 12 (Income Taxes). Deferred taxes arise from temporary differences between the carrying amounts of assets or liabilities in the IFRS and tax balance sheets, from consolidation measures and likely to be realizable tax loss carryforwards.

Deferred tax assets relating to deductible temporary differences and tax loss carryforwards are carried at the amount considered sufficiently likely to be recoverable in the future by offsetting against actual taxable income.

Deferred taxes are calculated at the rates which on the basis of the statutory regulations in force, or already enacted in relation to future periods, as of the closing date are expected to apply in the individual countries at the time of realization. Deferred tax assets and deferred tax liabilities are offset if they relate to income taxes levied by the same taxation authority.

Provisions

Provisions are recognized for obligations arising from past events that will probably give rise to a future outflow of resources, provided that a reliable estimate can be made of the the amount of the obligation.

The accounting and valuation principles for pension and other post-employment benefit obligations are outlined in Note [28].

Other provisions are measured in accordance with IAS 37 (Provisions, Contingent Liabilities and Contingent Assets) and, where appropriate, IAS 19 (Employee Benefits), using the best estimate of the extent of the expenditure that would be required to meet the present obligation as of the reporting date. Where the cash outflow to settle an obligation is not expected to occur until after one year, the provision is recognized at the present value of the expected cash outflow. Compensation entitlements from third parties are capitalized as receivables separately if their realization is probable.

If the projected obligation declines as a result of a change in the estimate, the provision is reversed by the corresponding amount and the resulting income recognized in the cost of goods sold or operating expense item(s) in which the original charge was recognized.

Personnel commitments mainly include annual bonus payments, vacation entitlements, service awards and other personnel costs. Reimbursements to be received from the German authorities under the senior part-time work program are recorded as receivables and recognized in income as soon as the criteria for such reimbursements are fulfilled. Trade-related commitments mainly include rebates, as well as obligations relating to services already received but not yet invoiced.

Litigation and administrative proceedings are evaluated on a case-by-case basis and the available information, including that from Bayer s legal counsel, is considered to assess potential outcomes. Where estimates show that a future obligation will probably result in an outflow of resources, a provision is recorded in the amount of the present value of the expected cash outflows if these are deemed to be reasonably estimable. These provisions cover the estimated payments to plaintiffs, court fees, attorney costs and the cost of potential settlements. Further details of legal risks are given in Note [35].

Financial liabilities

Financial liabilities, including derivative financial instruments with negative fair values, are recognized at amortized cost. Accordingly, current liabilities are carried at payment or redemption amounts. Noncurrent liabilities and financial liabilities that are not the hedged item in a permissible hedge accounting relationship are

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carried at amortized cost using the effective interest rate method. Liabilities relating to finance leases are carried at the present value of the future minimum lease payments.

Under IAS 32, financial instruments are only classified as equity if no contractual obligation exists to repay the capital or deliver other financial assets to the issuer. Where a third party holding a (minority) interest in a consolidated subsidiary is contractually entitled to terminate its participation and at the same time claim repayment of its capital contribution, such capital is recognized as a liability in the Group statements even if it is classified as equity in the respective jurisdiction. The redeemable capital of a minority stockholder is recognized at the amount of such stockholder s pro-rata share of the subsidiary s net assets.

The management of financial and commodity price risks, the accounting treatment of primary and derivative financial instruments, and the use of derivatives for hedging purposes are outlined in more detail in Note [33].

Miscellaneous receivables and liabilities

Accrued items, advance payments and non-financial assets and liabilities are carried at amortized cost. They are amortized to income by the straight-line method or according to performance of the underlying transaction.

In accordance with IAS 20 (Accounting for Government Grants and Disclosure of Government Assistance), grants and subsidies that serve to promote investment are reflected in the balance sheet under miscellaneous liabilities and amortized to income over the useful lives of the respective assets.

[4.4] Cash flow statement

The cash flow statement shows how the liquidity of the Bayer Group was affected by the inflow and outflow of cash and cash equivalents during the year. The effects of acquisitions, divestitures and other changes in the scope of consolidation are eliminated. Cash flows are classified by operating, investing and financing activities in accordance with IAS 7 (Cash Flow Statements). Cash and cash equivalents shown in the balance sheet comprise cash, checks, balances with banks and securities with original maturities of up to three months. A reconciliation of cash and cash equivalents at the end of the year to liquid assets as reflected in the balance sheet supplements the cash flow statement.

The amounts reported by consolidated companies outside the euro zone are translated at average exchange rates for the year, with the exception of cash and cash equivalents, which are translated at closing rates as in the balance sheet. The effect of changes in exchange rates on cash and cash equivalents is shown separately.

IFRS 5, approved by the IASB on March 31, 2004, contains the requirement that cash flows from operating, investing and financing activities be classified by continuing and discontinued operations. The discontinued operations shares of the cash flows from operating, investing and financing activities are stated separately in Note [7.2].

The statement of cash flows shows the change in cash and cash equivalents from one balance sheet date to the next. Cash and cash equivalents contain both the proceeds from the divestiture of discontinued operations and cash inflows from these operations prior to their disposal. Consequently, the statement of cash flows must contain all cash inflows and outflows for both continuing and discontinued operations.

In both the balance sheet and the income statement, however, the amounts corresponding to the components of the net operating cash flow are shown for continuing operations only. This is the case, for example, with the amounts of inventories, receivables and payables recognized in the balance sheet that determine the changes in working capital shown in the cash flow statement. Similarly, the operating result that is recognized in the income statement and forms the starting-point for the cash flow statement includes continuing operations only. To ensure that the presentation of operating activities in the cash flow statement is consistent with the income statement and balance sheet, the net operating cash flow from continuing operations is therefore stated first on the face of the cash flow statement. The total net operating cash flow from discontinued operations is shown in the next line, by

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analogy with the presentation of income after taxes in the income statement. The cash flows from continuing and discontinued operations are added together to give the net operating cash flow for the entire business.

Since the distinction between continuing operations and discontinued operations is drawn differently starting on January 1, 2005 than in the financial statements as of December 31, 2004, the previous year s amounts which were classified as discontinued have been reclassified to ensure comparability.

[4.5] Procedure and impact of global impairment testing

According to IAS 36 (Impairment of Assets) and IAS 38 (Intangible Assets), goodwill and other intangible assets with indefinite useful lives must be tested for impairment annually, or more frequently if events or changes in circumstances indicate a possible impairment. Amortization of such assets is prohibited.

For the consolidated financial statements, assets are tested for impairment by comparing the residual carrying amount of each cash-generating unit to the recoverable amount, which is the higher of the cash-generating unit s fair value less costs to sell and its value in use.

In line with the definition of cash-generating units, those of the Bayer Group are identified as the strategic business entities, which are the next financial reporting levels below the segments.

Where the carrying amount of a cash-generating unit exceeds the recoverable amount, an impairment loss is recognized for the difference. First, the goodwill of the relevant strategic business entity is written down accordingly. Any remaining impairment loss is allocated among the other assets of the strategic business entity in proportion to their net carrying amounts. This value adjustment is recognized in the income statement under other operating expenses.

The recoverable amount is determined from the present value of future cash flows, based on continuing use of the asset by the strategic business entity and its retirement at the end of its useful life. The cash flow forecasts are derived from the current long-term planning for the Bayer Group.

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

To take into account the different risk and return profiles of the principal businesses, the cost of capital after taxes is calculated for each of the subgroups. This is 7.4 percent for HealthCare, 8.0 percent for CropScience and 7.0 percent for MaterialScience. The respective interest rates are used to discount the estimated cash flows.

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The residual carrying amounts of acquired goodwill for the operating subgroups and reporting segments are shown in the table:

	Pharmaceuticals, Biological Products	Consumer Care	Diabetes Care, Diagnostics	Animal Health	Health Care	Crop Protection	Environmental Science, BioScience
					(million)		
Net carrying amounts, Jan. 1, 2004	2	99	13		**114**	1,168	459
Amortization in 2004		(13)	(2)		**(15)**	(98)	(36)
Acquisitions		113			**113**	101	
Retirements		(22)			**(22)**	(1)	
Exchange differences		(14)			**(14)**	(27)	(8)
Changes in scope of consolidation						2	
Net carrying amounts, Dec. 31, 2004	**2**	**163**	**11**		**176**	**1,145**	**415**
Amortization in 2005							
Acquisitions		644			**644**	5	3
Retirements	—	(1)			**(1)**	(30)	(13)
Exchange differences		77	1		**78**	45	10
Net carrying amounts, Dec. 31, 2005	**2**	**883**	**12**		**897**	**1,165**	**415**

	CropScience	Materials	Systems	Material Science	Reconciliation	Bayer Group
				(million)		
Net carrying amounts, Jan. 1, 2004	**1,627**	144	13	**157**		**1,898**
Amortization in 2004	**(134)**	(24)	(1)	**(25)**		**(174)**
Acquisitions	**101**					**214**
Retirements	**(1)**					**(23)**
Exchange differences	**(35)**	(2)		**(2)**		**(51)**
Changes in scope of consolidation	**2**					**2**
Net carrying amounts, Dec. 31, 2004	**1,560**	**118**	**12**	**130**		**1,866**

Amortization in 2005					
Acquisitions	**8**		9	**9**	**661**
Retirements	**(43)**				**(44)**
Exchange differences	**55**	6	1	**7**	**140**
Net carrying amounts, Dec. 31, 2005	**1,580**	**124**	**22**	**146**	**2,623**

For further information on acquisitions and divestitures see Note [7.2].

[5] Critical accounting policies

The preparation of the financial statements for the Bayer Group requires the use of estimates and assumptions. These affect the classification and valuation of assets, liabilities, income, expenses and contingent liabilities. Estimates and assumptions mainly relate to the useful life of noncurrent assets, the discounted cash flows used in impairment testing and the establishment of provisions for litigation, pensions and other benefits, taxes, environmental protection, inventory valuations, sales allowances, product liability and guarantees. Estimates are based on historical experience and other assumptions that are considered reasonable under the circumstances. Actual values may vary from the estimates. The estimates and the assumptions are continually reviewed.

To enhance the information content of the estimates, certain provisions that could have a material effect on the financial position, results of operations or cash flows of the Group are selected and tested for their sensitivity to changes in the underlying parameters. To reflect uncertainty about the likelihood of the assumed events

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actually occurring, the impact of a 5 percent change in the probability of occurrence is examined in each case. For long-term interest-bearing provisions, the impact of a 1 percent change in the interest rate used is analyzed. Analysis has not shown other provisions to be materially sensitive. The interest sensitivity of pension obligations is discussed in Note [28].

Critical accounting and valuation policies and methods are those that are both most important to the portrayal of the Bayer Group s financial position, results of operations and cash flows, and that require the application of difficult, subjective and complex judgments, often as a result of the need to make estimates about the effects of matters that are inherently uncertain and may change in subsequent periods. The main accounting and valuation policies used by the Bayer Group are outlined in Note [4.3]. While not all of the significant accounting policies require difficult, subjective or complex judgments, the Company considers that the following accounting policies should be considered critical accounting policies.

Intangible assets and property, plant and equipment

At December 31, 2005 the Bayer Group had intangible assets with a net carrying amount of 7,688 million (Note [19]) including goodwill of 2,623 million (Note [4.5]), and property, plant and equipment with a net carrying amount of 8,321 million (Note [20]). Intangible assets with finite useful lives and property, plant and equipment are amortized over their estimated useful lives. The estimated useful lives are based on estimates of the period during which the assets will generate revenue. Further, until the end of fiscal 2004, the Bayer Group amortized goodwill arising from business combinations with an agreement date prior to March 31, 2004 over its scheduled useful life. This practice was discontinued effective January 1, 2005 in compliance with IFRS 3 (Business Combinations) and the revised versions of IAS 36 (Impairment of Assets) and IAS 38 (Intangible Assets), which prohibit the amortization of goodwill and other intangible assets with indefinite useful lives.

Intangible assets with finite useful lives and property, plant and equipment are tested for impairment whenever events or changes in circumstances indicate that the carrying amount of the assets may no longer be recoverable. Goodwill and intangible assets with indefinite useful lives must be tested annually for impairment. In compliance with IAS 36 (Impairment of Assets), such impairment losses are measured by comparing the carrying amounts to the discounted cash flows expected to be generated by the respective assets. Where it is not possible to estimate the impairment loss for an individual asset, the loss is assessed on the basis of the discounted cash flow for the cash-generating unit to which the asset belongs. Estimating the discounted future cash flows involves significant assumptions, especially regarding future sales prices, sales volumes and costs. The discounting process is also based on assumptions and estimations relating to business-specific costs of capital, which in turn are based on country risks, credit risks and additional risks resulting from the volatility of the respective line of business as well as the capital structure of the relevant subgroup. Further information on the procedure for impairment testing and the residual carrying amounts of goodwill at the balance sheet date is given in Note [4.5].

To illustrate the Bayer Group s impairment loss measurement, if the actual present value of future cash flows were 10 percent lower than the anticipated present value, the net carrying amount of goodwill in the Crop Protection segment would have to be impaired by 48 million. The present value of future cash flows measures an asset s value in use , *i.e.*, its value based on our continuing use of the asset and its retirement at the end of its useful life. In the Systems segment, the net carrying amount of goodwill would have to be impaired by 5 million and that of other intangible assets by 19 million. If the weighted average cost of capital used for the impairment test were increased by 10 percent, it would not affect the net carrying amounts of the strategic business entities assets.

Estimates are also used in the course of acquisitions to determine the fair value of the assets and liabilities acquired. Land, buildings and equipment are usually appraised independently, while marketable securities are valued at market price. If any intangible assets are identified, depending on the type of asset and the complexity of determining its fair value, Bayer either consults with an independent external valuation expert or develops the fair value internally, using an appropriate valuation technique which is generally derived from a forecast of the total expected future net cash flows. Assets may be valued using methods based on cost, market price or net

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present value, depending on the type of asset and the availability of information. The valuation method based on net present value (income approach) is particularly important with respect to intangible assets. Trademarks and licenses, for example, are valued by the relief-from-royalty method, which includes estimating the cost savings that result from the company s ownership of trademarks and licenses on which it does not have to pay royalties to a licensor. The intangible asset is then recognized at the present value of these savings.

Although the Board of Management of Bayer AG believes that its estimates of the relevant expected useful lives, its assumptions concerning the macroeconomic environment and developments in the industries in which the Bayer Group operates and its estimations of the discounted future cash flows are appropriate, changes in assumptions or circumstances could require changes in the analysis. This could lead to additional impairment charges in the future or to valuation write-backs should the trends expected by the Board of Management of Bayer AG reverse.

Research and development

In addition to the in-house research and development activities, various research and development collaborations and alliances are maintained with third parties; these collaborations and alliances involve the provision of funding and/or payments for the achievement of performance milestones. All research costs are expensed as incurred. Since development projects are subject to regulatory approval procedures and other uncertainties, the conditions for the capitalization of costs incurred before approvals are received are not satisfied, and these costs, too, are therefore expensed as incurred. With respect to costs incurred in collaborations and alliances with third parties, considerable judgment is involved in assessing whether milestone-based payments simply reflect the funding of research, in which case expensing is always required, or whether, by making a milestone payment, an asset is acquired. In the latter case, the relevant costs are capitalized.

Net sales

The nature of the Bayer Group s business activities means that the structure of many sales transactions is complex. Sales are recognized upon transfer of risk or rendering of services to third parties. Revenues from contracts that contain customer acceptance provisions are deferred until customer acceptance occurs. It is customary to grant price discounts in the normal course of business. Allocations to provisions for discounts and rebates to customers are recognized in the same period in which the related sales are recorded based on the contract terms, using a consistent method. The cost of such sales incentives is estimated on the basis of historical experience with similar incentive programs. For rebates, provisions are recorded based upon the experience ratio to the respective period s sales to determine the rebate accrual and related expense. Provisions related to the Group s trade accounts amounted to 648 million on December 31, 2005.

Some of the Bayer Group s revenues are generated from licensing agreements under which third parties are granted rights to certain of our products and technologies. Upfront payments and similar non-refundable payments received under these agreements are recorded as miscellaneous liabilities and recognized in income over the estimated performance period stipulated in the agreement. Non-refundable milestone payments linked to the achievement of a significant and substantive technical/ regulatory hurdle in the research and development process, pursuant to collaborative agreements, are recognized as revenue upon the achievement of the specified milestone. Revenues are also derived from research and development collaborations and co-promotion agreements. Such agreements may consist of multiple elements and provide for varying consideration terms, such as upfront, milestone and similar payments, which may be complex and require significant analysis by management in order to separate individual revenue components and recognize them on the most appropriate dates. This may have to be done partially on the basis of assumptions.

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Pensions and other post-employment benefits

Group companies provide retirement benefits for most of their employees, either directly or by contributing to independently-administered funds. The way these benefits are provided varies according to the legal, fiscal and economic conditions of each country, the benefits generally being based on the employees remuneration and years of service. The obligations relate both to existing retirees pensions and to pension entitlements of future retirees. Group companies provide retirement benefits under defined contribution and/or defined benefit plans. In the case of defined contribution plans, the company pays contributions to publicly or privately administered pension insurance plans on a mandatory, contractual or voluntary basis. Once the contributions have been paid, the company has no further payment obligations. All other retirement benefit systems are defined benefit plans, which may be either unfunded, *i.e.*, financed by provisions (accruals), or funded, *i.e.*, financed through pension funds.

Statistical and actuarial methods are used to anticipate future events in calculating the expenses and liabilities related to the plans. These calculations include assumptions about the discount rate, expected return on plan assets and rate of future compensation increases. The interest rate used to discount post-employment benefit obligations to present value is derived from the yields of senior, high-quality corporate bonds in the respective country at the balance sheet date. These generally include AA-rated securities. The discount rate is based on the yield of a portfolio of bonds whose weighted residual maturities approximately correspond to the duration necessary to cover the entire benefit obligation. If AA-rated corporate bonds of equal duration are not available, a discount rate equivalent to the effective interest rate for government bonds at the balance sheet date is used instead but increased by about 0.5 to 1.0 percentage point since corporate bonds generally provide higher yields by virtue of their risk structure. Determination of the discount rate is also based on the average yield for a bond portfolio corresponding to the expected cash outflows from the pension plans.

The assumption for the expected return-on-assets reflects a long-term outlook for global capital market returns that corresponds to the duration of the pension obligation, and a diversified investment strategy. The investment policy of Bayer Pensionskasse is geared toward regulatory compliance and toward maintaining the risk structure corresponding to the benefit obligations. To this end, Bayer Pensionskasse has developed a strategic target portfolio commensurate with the risk profile. This investment strategy focuses principally on stringent management of downside risks rather than on maximizing absolute returns. In other countries, too, the key criteria for the funds investment strategies are the structure of the benefit obligations and the risk profile. Other determinants are risk diversification, portfolio efficiency and a country-specific and global risk/return profile capable of ensuring payment of all future benefits. The expected return is applied to the fair market value of plan assets at each year end.

Statistical information such as withdrawal and mortality rates is also used in estimating the expenses and liabilities under the plans. Because of changing market and economic conditions, the expenses and liabilities actually arising under the plans in the future may differ materially from the estimates made on the basis of these actuarial assumptions. The plan assets are partially comprised of equity and fixed-income instruments. Therefore, declining returns on equity markets and markets for fixed-income instruments could necessitate additional contributions to the plans in order to cover future pension obligations. Also, higher or lower withdrawal rates or longer or shorter life of participants may have an impact on the amount of pension income or expense recorded in the future. On December 31, 2005, the present value of provisions for pensions and other post-employment benefits payable under defined benefit plans was 15,561 million. Further details on pension provisions and their interest rate sensitivity are given in Note [28].

Doubtful accounts

Doubtful accounts are reported at the amounts likely to be recoverable based on historical experience of customer default. As soon as it is learned that a particular account is subject to a risk over and above the normal credit risk (*e.g.*, low creditworthiness of customer, dispute as to the existence or the amount of the claim, non-enforceability of the claim for legal reasons etc.), the account is analyzed and written down if circumstances

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indicate the receivable is uncollectible. Accumulated write-downs of receivables amounted to 348 million as of December 31, 2005.

Environmental provisions

The business of the Bayer Group is subject to a variety of laws and regulations in the jurisdictions in which it operates or maintains properties. Provisions for expenses that may be incurred in complying with such laws and regulations are set aside if environmental inquiries or remediation measures are probable, the costs can be reliably estimated and no future benefits are expected from such measures.

It is difficult to estimate the future costs of environmental protection and remediation because of many uncertainties, particularly with regard to the status of laws, regulations and the information available about conditions in the various countries and at the individual sites. Significant factors in estimating the costs include previous experiences in similar cases, expert opinions regarding environmental programs, current costs and new developments affecting costs, management s interpretation of current environmental laws and regulations, the number and financial position of third parties that may become obligated to participate in any remediation costs on the basis of joint liability, and the remediation methods which are likely to be deployed. Changes in these assumptions could impact future reported results. Subject to these factors, but taking into consideration experience gained to date regarding environmental matters of a similar nature, Bayer believes the provisions to be adequate based upon currently available information. However, given the inherent difficulties in estimating liabilities in this area, it cannot be guaranteed that additional costs will not be incurred beyond the amounts accrued. It is possible that final resolution of these matters may require expenditures to be made in excess of established provisions, over an extended period of time and in a range of amounts that cannot be reasonably estimated. Management nevertheless believes that such additional amounts, if any, would not have a material adverse effect on the Group s financial position, results of operations or cash flows. Group provisions for environmental protection measures amounted to 279 million on December 31, 2005. Further information on environmental provisions can be found in Note [29.2].

Litigation provisions

As a global company with a diverse business portfolio, the Bayer Group is exposed to numerous legal risks, particularly in the areas of product liability, patent disputes, tax assessments, competition and antitrust law, and environmental matters. The outcome of the currently pending and future proceedings cannot be predicted with certainty. Thus, an adverse decision in a lawsuit could result in additional costs that are not covered, either wholly or partially, under insurance policies and that could significantly impact the business and results of operations of the Bayer Group. If the Bayer Group loses a case in which it seeks to enforce its patent rights, a decrease in future earnings could result as other manufacturers could be permitted to begin to market products that the Bayer Group or its predecessors had developed.

Litigation and other judicial proceedings as a rule raise difficult and complex legal issues and are subject to many uncertainties and complexities including, but not limited to, the facts and circumstances of each particular case, issues regarding the jurisdiction in which each suit is brought and differences in applicable law. Upon resolution of any pending legal matter, the Bayer Group may be forced to incur charges in excess of the presently established provisions and related insurance coverage. It is possible that the financial position, results of operations or cash flows of the Bayer Group could be materially affected by the unfavorable outcome of litigation. Litigation and administrative proceedings are evaluated on a case-by-case basis considering the available information, including that from legal counsel, to assess potential outcomes. Where it is considered probable that a future obligation will result in an outflow of resources, a provision is recorded in the amount of the present value of the expected cash outflows if these are deemed to be reliably measurable. These provisions cover the estimated payments to plaintiffs, court fees and the cost of potential settlements.

Provisions for litigation-related expenses totaled 663 million on December 31, 2005. Further details on legal risks are given in Note [35].

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Income taxes

To compute provisions for taxes, estimates have to be made. Estimates are also necessary to determine whether valuation allowances are required against deferred tax assets. These involve assessing the probabilities that deferred tax assets resulting from deductible temporary differences and tax losses can be utilized to offset taxable income. Uncertainties exist with respect to the interpretation of complex tax regulations and the amount and timing of future taxable income. Given the wide range of international business relationships and the long-term nature and complexity of existing contractual agreements, differences arising between the actual results and the assumptions made, or future changes to such assumptions, could necessitate adjustments to tax income and expense in future periods. The Group establishes what it believes to be reasonable provisions for possible consequences of audits by the tax authorities of the respective countries. The amount of such provisions is based on various factors, such as experience with previous tax audits and differing interpretations of tax regulations by the taxable entity and the responsible tax authority. Such differences of interpretation may arise on a wide variety of issues depending on the conditions prevailing in the respective Group company s domicile. On December 31, 2005, net liabilities for current tax payments amounted to 381 million, and net deferred tax assets amounted to 1,418 million. Further information on income taxes is given in Note [16].

[6] Segment reporting

In accordance with IAS 14 (Segment Reporting), a breakdown of certain data in the financial statements is given by segments and geographical region. The segments and regions are the same as those used for internal reporting, allowing a reliable assessment of risks and returns. The aim is to provide users of the financial statements with information regarding the profitability and future prospects of the Group s various activities.

As of December 31, 2005 the Bayer Group comprised three subgroups with operations subdivided into divisions (HealthCare), business groups or strategic business entities (CropScience and MaterialScience). Their activities are aggregated into the eight reporting segments listed below according to economic characteristics, products, production processes, customer relationships and methods of distribution.

The subgroups activities are as follows:

Subgroup / Segment	Activities
HealthCare	
Pharmaceuticals, Biological Products	Development and marketing of prescription pharmaceuticals
Consumer Care	Development and marketing of over-the-counter medications and nutritional supplements
Diabetes Care, Diagnostics	Development and marketing of diagnostic products for laboratory testing, near-patient testing and self-testing applications
Animal Health	Development and marketing of veterinary medicines, nutritionals and grooming products for companion animals and livestock
CropScience	
Crop Protection	Development and marketing of a comprehensive portfolio of fungicides, herbicides, insecticides and seed treatment products to meet a wide range of regional requirements
Environmental Science, BioScience	Development and marketing of a wide range of products for the green industry, garden care, non-agricultural pest and weed control and conventional seeds, and plant biotechnology

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Subgroup / Segment	Activities
MaterialScience	
Materials	Production and marketing of high-quality plastics granules, methylcellulose, metallic and ceramic powders and semi-finished products
Systems	Development, manufacturing and marketing of polyurethanes for a wide variety of applications as well as coating and adhesive raw materials; production and marketing of basic inorganic chemicals

The spin-off of LANXESS and the acquisition of the Roche OTC business have led to a shift in the relative sizes of the Group s businesses in terms of sales, operating result and assets. In compliance with IAS 14 (Segment Reporting), the segmentation has therefore been adjusted effective January 1, 2005 to reflect the new Group structure.

Moreover, IFRS 5, which was approved by the IASB on March 31, 2004, introduces specific recognition principles for assets and liabilities held for sale and for discontinued operations and requires that reporting now be based primarily on continuing operations. In contrast to the table in the financial statements as of December 31, 2004, the segment table for 2005 therefore reflects continuing operations only. The prior-year figures have been reclassified to ensure comparability.

Effective January 1, 2006 the Pharmaceuticals, Biological Products segment was renamed the Pharmaceuticals segment. The former Biological Products and Pharmaceuticals divisions were combined to form a new Pharmaceuticals Division.

The **reconciliation** eliminates intersegment items and reflects income and expenses not allocable to segments. These include in particular the Corporate Center, the service companies and sideline operations.

The segment data are calculated as follows:

The intersegment sales reflect intragroup transactions effected at transfer prices fixed on an arm s-length basis.

The return on sales is the ratio of the operating result to external net sales.

The gross cash flow comprises the operating result plus depreciation, amortization and write-downs, minus income taxes, minus gains/plus losses on retirements of noncurrent assets, plus/minus changes in pension provisions. The latter item includes the elimination of non-cash components of the operating result. It also contains benefit payments during the year.

The net cash flow is the cash flow from operating activities as defined in IAS 7.

The capital invested comprises all assets serving the respective segment that are required to yield a return on their cost of acquisition. Noncurrent assets are included at cost of acquisition or construction throughout their useful lives because the calculation of cash flow return on investment (CFRoI) requires that depreciation and amortization be excluded. Interest-free liabilities are deducted. The capital invested is stated as of December 31.

The CFRoI is the ratio of the gross cash flow to the average capital invested for the year and is thus a measure of the return on capital employed.

The equity items are those reflected in the balance sheet and income statement. They are allocated to the segments where possible.

Capital expenditures, amortization and depreciation relate to intangible assets, property, plant and equipment.

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Since financial management of Group companies is carried out centrally by Bayer AG, financial liabilities are not allocated directly to the respective segments. Consequently, the liabilities shown for the individual segments do not include financial liabilities.

[7] Changes in the Bayer Group

[7.1] Scope of consolidation

	Germany	Other Countries	Total
Bayer AG and consolidated companies			
January 1, 2005	69	280	349
Additions		7	7
Retirements	(17)	(59)	(76)
Reclassifications	2	1	3
December 31, 2005	**54**	**229**	**283**
Companies included at equity (associates)			
January 1, 2005	3	8	11
Additions			
Retirements			
Reclassifications			
December 31, 2005	**3**	**8**	**11**
Non-consolidated subsidiaries			
January 1, 2005	37	90	127
Additions	5	6	11
Retirements	(8)	(22)	(30)
Reclassifications			
December 31, 2005	**34**	**74**	**108**
Other affiliated companies (Bayer s interest >5%)	**31**	**35**	**66**
Additions	6	3	9
Retirements	(4)	(12)	(16)

The financial statements of the Bayer Group as of December 31, 2005 include Bayer AG and 52 German and 225 foreign consolidated subsidiaries in which Bayer AG, directly or indirectly, has a majority of the voting rights or from which it is able to derive benefit by virtue of its power to govern corporate financial and operating policies. The total number of consolidated subsidiaries decreased by 66 compared with the previous year. Ten companies are consolidated for the first time, while 76 companies included in the previous year have been deconsolidated. The latter number is accounted for mainly by the spin-off of the LANXESS subgroup (60 companies) and mergers between Bayer companies. Five joint ventures the same number as in the previous year are included by proportionate consolidation in compliance with IAS 31 (Financial Reporting of Interests in Joint Ventures). Excluded from consolidation are 108 subsidiaries that in aggregate are immaterial to the net worth, financial position and earnings of

the Bayer Group; they account for less than 0.2 percent of Group sales, less than 0.7 percent of stockholders equity and less than 0.4 percent of total assets.

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The effect of joint ventures on the Group balance sheet and income statement is as follows:

	2005 (million)
Current assets	15
Noncurrent assets	62
Current liabilities	(23)
Noncurrent liabilities	(10)
Net assets	44
Income	50
Expenses	(47)
Income after taxes	3

While 11 companies are accounted for by the equity method, 39 companies that in aggregate are of minor importance are stated at amortized cost.

Lists of Bayer AG s direct and indirect holdings have been included in the Cologne commercial register. They also are available directly from Bayer AG on request.

The principal companies consolidated in the financial statements are listed in the following table:

Company Name and Place of Business	Bayer s Interest (%)
Germany	
Bayer Business Services GmbH, Leverkusen	100
Bayer CropScience AG, Monheim	100
Bayer CropScience Deutschland GmbH, Langenfeld	100
Bayer HealthCare AG, Leverkusen	100
Bayer Industry Services GmbH & Co. OHG, Leverkusen	60
Bayer MaterialScience AG, Leverkusen	100
Bayer Technology Services GmbH, Leverkusen	100
Bayer Vital GmbH, Leverkusen	100
H. C. Starck GmbH, Goslar	100
Wolff Cellulosics GmbH & Co. KG, Walsrode	100

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Company Name and Place of Business	Bayer s Interest (%)
Other European Countries	
Bayer Antwerpen Comm.V, Belgium	100
Bayer Consumer Care AG, Switzerland	100
Bayer CropScience France S.A.S., France	100
Bayer CropScience Limited, U.K.	100
Bayer CropScience S.r.l., Italy	100
Bayer Diagnostics Europe Ltd., Ireland	100
Bayer International S.A., Switzerland	99.7
Bayer Pharma S.A.S., France	99.9
Bayer Polyols S.N.C., France	100
Bayer Public Limited Company, U.K.	100
Bayer S.p.A., Italy	100
Bayer Santé Familiale S.A.S., France	100
Bayer SP.Z.O.O., Poland	100
Quimica Farmaceutica Bayer, S.A., Spain	100
North America	
Bayer CropScience Inc., Canada	100
Bayer CropScience LP, U.S.A.	100
Bayer HealthCare LLC, U.S.A.	100
Bayer Inc., Canada	100
Bayer MaterialScience LLC, U.S.A.	100
Bayer Pharmaceuticals Corporation, U.S.A.	100
H.C. Starck Inc., U.S.A.	100
Asia/Pacific	
Bayer Australia Limited, Australia	99.9
Bayer CropScience K.K., Japan	100
Bayer Korea Ltd., Republic of Korea	100
Bayer MaterialScience Limited, Hong Kong	100
Bayer Medical Ltd., Japan	100
Bayer South East Asia Pte Ltd., Singapore	100
Bayer Yakuhin, Ltd., Japan	100
H.C. Starck Ltd., Japan	100
Sumika Bayer Urethane Co., Ltd., Japan	60
Latin America/ Africa/Middle East	
Bayer (Proprietary) Limited, South Africa	100
Bayer CropScience Ltda., Brazil	100
Bayer de Mexico, S.A. de C.V., Mexico	100
Bayer S.A., Argentina	99.9
Bayer S.A., Brazil	99.9
Bayer Türk Kimya Sanayi Limited Sirketi, Turkey	100

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Also included in the consolidated financial statements are the following material associates, which are accounted for by the equity method:

Company Name and Place of Business	Bayer s Interest (%)
GE Bayer Silicones GmbH & Co. KG, Germany	49.9
Lyondell Bayer Manufacturing Maasvlakte VOF, Netherlands	50
Palthough Industries (1998) Ltd., Israel	20
PO JV, LP, U.S.A.	42.7
Polygal Plastics Industries Ltd., Israel	25.8

The following domestic subsidiaries availed themselves in 2005 of certain exemptions granted under Articles 264, paragraph 3 and 264 b, No. 4 of the German Commercial Code regarding the preparation, auditing and publication of financial statements:

Company Name	Place of Business
Bayer 04 Immobilien GmbH	Leverkusen
Bayer 04 Leverkusen Fußball GmbH	Leverkusen
Bayer 04 Mobilien GmbH	Leverkusen
Bayer Beteiligungsverwaltungsgesellschaft mbH	Leverkusen
Bayer Bitterfeld GmbH	Greppin
Bayer Business Services GmbH	Leverkusen
Bayer Chemicals AG	Leverkusen
Bayer CropScience AG	Monheim
Bayer Gastronomie GmbH	Leverkusen
Bayer Gesellschaft für Beteiligungen mbH	Greppin
Bayer HealthCare AG	Leverkusen
Bayer Industry Services GmbH & Co. OHG	Leverkusen
Bayer Innovation GmbH	Leverkusen
Bayer MaterialScience AG	Leverkusen
Bayer MaterialScience Customer Services GmbH	Leverkusen
Bayer Technology Services GmbH	Leverkusen
Bayer Vital GmbH	Leverkusen
Bayer-Handelsgesellschaft mbH	Leverkusen
Bayer-Kaufhaus GmbH	Leverkusen
Case Tech GmbH & Co. KG	Bomlitz
Chemion Logistik GmbH	Leverkusen
Drugofa GmbH	Köln
DYNEVO GmbH	Leverkusen
EPUREX Films GmbH & Co. KG	Bomlitz
Erste K-W-A Beteiligungsgesellschaft mbH	Leverkusen
Euroservices Bayer GmbH	Leverkusen
Generics Holding GmbH	Leverkusen
Gesellschaft für Wohnen und Gebäudemanagement mbH	Leverkusen
GP Grenzach Produktions GmbH	Grenzach
KVP Pharma+Veterinär-Produkte GmbH	Kiel

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Company Name	Place of Business
Probis GmbH	Bomlitz
Sportrechte Vermarktungs- und Verwertungs-GmbH & Co. oHG	Leverkusen
Travel Board GmbH	Leverkusen
Wolff Cellulosics GmbH & Co. KG	Bomlitz
Wolff Walsrode AG	Walsrode
Zweite K-W-A Beteiligungsgesellschaft mbH	Leverkusen

[7.2] Business combinations and other acquisitions; divestments; discontinued operations

Business combinations are accounted for by the purchase method. Accordingly, the results of operations of the acquired businesses are included in the consolidated financial statements as from the respective dates of acquisition. The purchase prices of acquisitions of companies domiciled outside the euro zone are translated at the exchange rates in effect at the respective dates of acquisition.

In 2005 a total of 2,406 million was spent for acquisitions constituting business combinations within the scope of IFRS 3 and for other acquisitions. The respective amounts are translated at the exchange rates in effect on the respective acquisition dates. The purchase prices of these acquisitions were settled by cash payments and by the assumption of 46 million in liabilities. Goodwill arising on these acquisitions totaled 661 million and is subject to an annual impairment test.

Since January 2005, the worldwide Roche Consumer Health business with non-prescription drugs and vitamins has been part of the Consumer Care Division of Bayer HealthCare. The transaction includes the global Consumer Health activities of Roche, with the exception of Japan, including the five production sites in Grenzach, Germany; Gaillard, France; Pilar, Argentina; Casablanca, Morocco and Jakarta, Indonesia. Among the brands acquired are Aleve®, Bepanthen®, Redoxon®, Rennie® and Supradyn®. The merger puts Bayer among the largest global suppliers of prescription-free medicines.

The acquired business contributed 1,061 million to Group sales. Since the sales forces, distribution function and support functions such as controlling have been combined in the Group s legal entities, it is not practicable to separately identify an operating result of the former Roche business.

The acquisition price for the worldwide Consumer Health business of Roche, including the assumption of net financial liabilities, was approximately 2,338 million, including about 208 million for the purchase of the remaining 50 percent interest in the U.S. joint venture with Roche. This purchase was completed in 2004 in an economically and legally separate transaction. The acquisition of the remaining global business was accomplished in 2005 by way of a 2,130 million cash transfer, of which 200 was paid in advance at the end of 2004, and the assumption of some 46 million in net financial liabilities. The ancillary costs of the acquisition amounted to about 28 million.

The assets and goodwill acquired were as follows:

	(million)
Acquisition costs excluding assumption of debt	2,056
Ancillary acquisition costs	28
Purchase price	2,084
Fair value of acquired net assets	1,440
Goodwill	644

Goodwill is attributable to a number of factors, including significant synergies that the Bayer Group expects to achieve by acquiring the Roche OTC business. Apart from general administrative processes and infrastructure synergies, these comprise significant savings in sales and marketing costs, for example. The acquisition also

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strengthens the Bayer Group s global market position in the OTC sector. Of the 644 million in recognized goodwill, 183 million is tax-deductible.

The purchase price can be allocated among the acquired assets and assumed liabilities at the date of acquisition as follows:

	Net Carrying Amount Prior to the Acquisition	Fair Value Adjustments	Net Carrying Amount After the Acquisition
		(million)	
Acquired assets and assumed liabilities			
Other intangible assets		1,142	1,142
Goodwill		644	644
Property, plant and equipment	142	9	151
Inventories	97	57	154
Other current assets (excluding liquid assets)	255	9	264
Liquid assets	28		28
Financial liabilities	(74)		(74)
Miscellaneous liabilities	(129)		(129)
Pensions and other post-employment benefits	(25)		(25)
Other provisions	(9)		(9)
Deferred taxes	6	(68)	(62)
Purchase price			2,084
of which are ancillary acquisition costs			*28*
Assumed net financial liabilities			(46)
Net cash outflow for the acquisition			2,130

The expected useful lives of the acquired intangible assets are as follows:

	Fair Value	Useful Life
	(million)	(Years)
Trademarks	1,055	20-30
Marketing and customer-related rights	41	20-30
Software and technologies	46	5-8

In addition to the acquisition of the Roche Consumer Health business, the following significant acquisitions or other transactions were made in 2005:

In connection with the acquisition of Aventis CropScience Holding, S.A., France, in 2002, the antitrust authorities required Bayer to divest some of the operations acquired from Aventis. In this connection, the business with the active ingredient Fipronil was sold to BASF AG, Ludwigshafen, Germany, in 2003. On January 31, 2005, Bayer CropScience AG, Monheim, Germany, signed an agreement with BASF to license back the rights to this product for agricultural applications in certain countries outside of Europe and the United States, for 125 million.

On February 10, 2005, Bayer CropScience GmbH, Frankfurt am Main, Germany, and Bayer CropScience LP, Research Triangle Park, North Carolina, United States, acquired various intangible assets and the property, plant and equipment required for the production of cotton seeds from Associated Farmers Delinting, Inc., a regional cotton seed producer based in Littlefield, Texas, for 9 million.

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On July 8, 2005, Bayer South East Asia Pte Ltd., Singapore, received marketing rights for the cardiovascular drug Zetia® to the value of 100 million under a co-marketing and distribution agreement with Schering-Plough.

Bayer MaterialScience LLC, Pittsburgh, Pennsylvania, acquired Polythane Systems, Inc. (PSI), Spring, Texas, on August 31, 2005, for 20 million. PSI is a leading American supplier of polyurethane spray foam systems for roof insulation.

The total net assets and goodwill acquired in the above acquisitions and transactions and a number of smaller ones is comprised as follows:

	(million)
Acquisition costs	276
Ancillary acquisition costs	
Purchase price	276
Fair value of acquired net assets	259
Goodwill	17

The acquisitions and other transactions affected the Group s assets and liabilities as of the dates of acquisition as follows:

	2005
	(million)
Acquired assets and assumed liabilities	
Other intangible assets	242
Goodwill	17
Property, plant and equipment	4
Other financial assets	3
Other current assets	10
Purchase price	276
of which are ancillary acquisition costs	
Assumed net financial liabilities	
Net cash outflow for the business combinations and other acquisitions	276

IFRS 3 requires that information is provided not only on business combinations in the year under report but also on those taking place between the closing date and the date of approval of the financial statements for publication. It is therefore reported here that on January 9, 2006, Bayer Innovation GmbH acquired the biotech company Icon Genetics AG, Munich, Germany. Icon Genetics discovers innovative methods for the development and use of engineered plants to produce therapeutically active substances. The purchase price upon conclusion of the sale-and-purchase agreement was 18 million. Since this acquisition was made only recently, allocation of the purchase price among the acquired assets and liabilities has not yet been completed. It is expected to be allocated primarily to research and development work in process.

The Bayer Group made the following significant **divestitures**, the proceeds of which totaled 87 million, in 2005:

The Bayer CropScience subgroup divested a number of activities in 2005 to strengthen the focus on its core business. These included Philagro Holding S.A., France, and EqSeeds Comercia de Sementes Ltda., Brazil. Bayer CropScience also divested the businesses with various active ingredients together with the related rights, including the acaricide and insecticide Amitraz, which it marketed as Mitac®. CropScience also sold its site in

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Hauxton, United Kingdom, in December 2005, and BCS S.A., France, divested its interest in Holdisa S.r.l., Italy. The selling prices of the operations divested by Bayer CropScience in fiscal 2005 totaled 80 million.

The remaining 7 million relates to several minor divestitures in the Bayer Group.

The divestitures affected the Group s assets and liabilities as of the respective dates of divestiture as follows:

	2005 (million)
Divested assets and liabilities	
Other intangible assets	5
Property, plant and equipment	13
Other financial assets	7
Other current assets	3
Pensions and other post-employment benefits	(7)
Other provisions	(1)
Net gain on divestitures	67
Total selling price	87
Net divested financial liabilities	
Net cash inflow from the divestitures	87

The following significant acquisitions and divestitures were made in 2004:

In 2004 a total of 358 million was spent on acquisitions, translated at the exchange rates in effect on the respective acquisition dates. In all cases, the purchase prices of these acquisitions were settled by cash payments. Goodwill arising on these acquisitions totaled 214 million. Under IFRS 3 (Business Combinations) which came into effect on March 31, 2004, acquired goodwill may no longer be amortized; instead it must be tested annually for impairment. This standard applies immediately to business combinations for which the agreement date is on or after March 31, 2004. Amortization of goodwill arising on transactions effected prior to March 31, 2004 is prohibited beginning January 1, 2005. Thus from January 1, 2005, Bayer has ceased amortizing all acquired goodwill and tests it annually for impairment.

Bilag Industries Private Ltd., India, a joint venture with the Indian company Bilakhias, acquired 6 percent of its own shares on February 17, 2004, and a further 10 percent on April 8, 2004, from Bilakhias as part of its buy-back plan. The total purchase price was 29 million. The resulting goodwill totaled 24 million. The goodwill of 9 million arising on the first part of this transaction had to be amortized until year-end 2004. By contrast, under IFRS 3, the goodwill of 15 million relating to the second part of the transaction immediately became subject to annual impairment testing. Following closing of both transactions, Bayer CropScience S.A., France, now holds 91 percent of the shares of Bilag Industries Private Ltd.

Effective March 22, 2004 we acquired the remaining interest in the seed treatment business of Gustafson in the United States, Canada and Mexico from Crompton Corporation for 100 million. Bayer CropScience already held a 50 percent interest in the U.S. and Canadian Gustafson joint ventures headquartered in Plano, Texas, and Calgary, Alberta. The acquired goodwill of 71 million was amortized until year-end 2004 because the purchase agreement was concluded on March 22, 2004 and the non-amortization provisions of IFRS 3 therefore do not yet have to be applied. Gustafson manufactures and markets seed treatment products and related technical equipment.

In connection with the acquisition of the Roche Consumer Health business, Bayer HealthCare LLC, Pittsburgh,

Pennsylvania, acquired on December 29, 2004 Roche s 50 percent interest in the Bayer-Roche OTC joint venture in the United States that was established in 1996. The purchase price for the 50 percent equity interest plus additional plant and inventories was 208 million. The noncurrent assets thus acquired chiefly comprise the Aleve®, Midol® and Vanquish® brands, valued as intangible assets at 66 million, along with

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Notes to the Consolidated Financial Statements of the Bayer Group (Continued)

goodwill of 113 million. The brands will be amortized over their useful life of 20 years. Under IFRS 3 the acquired goodwill is not amortized but tested annually for impairment.

The following significant **divestitures,** the proceeds of which totaled 76 million, were made in 2004:

On January 30, 2004 Bayer CropScience sold the rights to GA 21, a technology for herbicide tolerance in corn, to Syngenta International AG, Basel, Switzerland.

On July 14, 2004 Bayer divested its 15 percent equity interest in KWS Saat AG, acquired through the purchase of Aventis CropScience in 2002, to private investors Tessner Beteiligungs GmbH and Dr. Arend Oetker to fulfil a contractual commitment made by the Bayer Group in connection with the acquisition of the Aventis CropScience group.

The acquisition of the Frankfurt-based textile dyes business DyStar by the global financial investor Platinum Equity, Los Angeles, California, was completed on August 5, 2004. All the shares held by the previous owners Bayer (35 percent), Hoechst (35 percent) and BASF (30 percent) were transferred to Platinum Equity. DyStar, the world s premier supplier of dyes and services for the textile industry, was established in 1995 by Bayer and Hoechst and expanded in 2000 to include the textile dyes operations of BASF.

Acquisitions and divestitures of businesses affected the Group s assets and liabilities as of the dates of acquisition or divesture as follows:

2004	Acquisitions	Divestitures
	(million)	
Noncurrent assets	358	79
Current assets (excluding liquid assets)	98	
Liquid assets		2
Assets	456	81
Pension provisions	(1)	
Other provisions	(2)	
Financial obligations		
Remaining liabilities	(41)	(2)
Liabilities	(44)	(2)

Discontinued operations

IFRS 5, which was approved by the IASB on March 31, 2004, introduces specific recognition principles for assets and liabilities held for sale and for discontinued operations and requires that financial reporting be based primarily on continuing operations. To improve transparency and comparability, the Group s financial reporting is based primarily on continuing operations, while assets held for sale and discontinued operations are stated separately in a single line item in the balance sheet, income statement and cash flow statement. Both the LANXESS business and the divested plasma business in the United States are reported as discontinued operations.

In November 2003 the Board of Management and Supervisory Board of Bayer AG decided to separate from the Bayer Group major parts of the chemicals activities and about one third of the polymers activities. These activities were subsequently placed in the LANXESS subgroup. The separation took place by way of a spin-off pursuant to the German Transformation Act (Umwandlungsgesetz). For this purpose, a Spin-Off and Acquisition Agreement was concluded between Bayer AG and LANXESS AG in September 2004. This was approved at an Extraordinary Stockholders Meeting of Bayer AG held in Essen, Germany, on November 17, 2004.

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The Joint Spin-Off Report of the boards of management of Bayer AG and LANXESS AG contains a detailed description of the spin-off, together with an explanation of the background.

On January 28, 2005 the spin-off of LANXESS was entered in the commercial register for Bayer AG. The shares of LANXESS AG were legally assigned upon their issuance on that date to Bayer AG stockholders. Since January 31, 2005 shares in LANXESS have been listed in the Prime Standard subsegment of the official market segment (Amtlicher Markt) of the Frankfurt Stock Exchange. The LANXESS subgroup was therefore deconsolidated from the Bayer Group effective January 31, 2005.

In addition, plans were announced in October 2003 to divest the plasma activities of the Biological Products Division of the HealthCare subgroup. These activities, too, are reported as discontinued operations. This decision does not affect the Kogenate® operations. In December 2004 a contract was signed to sell the plasma business in the United States to Talecris BioTherapeutics, Inc., a new company controlled by the U.S. equity investors Cerberus Capital Management L.P., New York, and Ampersand Ventures, Wellesley, Massachusetts. This transaction was closed on March 31, 2005.

The amounts shown in the consolidated financial statements of the Bayer Group under discontinued operations relate, respectively, to the plasma operations in the United States and to all assets, liabilities, income and expenses pertaining to the activities transferred to LANXESS. The LANXESS data are presented from the standpoint of the Bayer Group and are not intended to portray either the LANXESS activities or the remaining activities of Bayer as those of stand-alone entities. The presentation thus follows the principles set out in IFRS 5 for reporting discontinued operations.

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Notes to the Consolidated Financial Statements of the Bayer Group (Continued)

A breakdown of the results of discontinued operations is given below:

	LANXESS			Plasma Business			Total		
	2003	2004	2005	2003	2004	2005	2003	2004	2005
		(million)			(million)			(million)	
Net sales	5,776	6,053	503	374	427	124	6,150	6,480	627
Cost of goods sold	(4,701)	(4,635)	(345)	(314)	(309)	(91)	(5,015)	(4,944)	(436)
Selling expenses	(881)	(846)	(62)	(62)	(56)	(14)	(943)	(902)	(76)
Research and development expenses	(168)	(126)	(8)	(44)	(48)	(11)	(212)	(174)	(19)
General administration expenses	(242)	(263)	(20)	(18)	(18)	(11)	(260)	(281)	(31)
Other operating income (expenses) net	(1,072)	(105)	(6)	(328)	(93)	1	(1,400)	(198)	(5)
Operating result from discontinued operations	(1,288)	78	62	(392)	(97)	(2)	(1,680)	(19)	60
Non-operating result	(87)	(84)	(4)				(87)	(84)	(4)
Net income (loss) before income taxes	(1,375)	(6)	58	(392)	(97)	(2)	(1,767)	(103)	56
Income taxes	402	2	(20)	123	34	1	525	36	(19)
Income (loss) after taxes	(973)	(4)	38	(269)	(63)	(1)	(1,242)	(67)	37
Of which:									
Current income (loss) from discontinued operations (before taxes)	(1,375)	(6)	58	(72)	(7)	22	(1,447)	(13)	80
Income taxes	402	2	(20)		3	(7)	402	5	(27)
Current income (loss) from discontinued operations (after taxes)	(973)	(4)	38	(72)	(4)	15	(1,045)	(8)	53
Income (loss) from the sale of discontinued operations (before taxes)				(320)	(90)	(24)	(320)	(90)	(24)
Income taxes				123	31	8	123	31	8
Income (loss) from the sale of discontinued operations (after taxes)				(197)	(59)	(16)	(197)	(59)	(16)
Total income (loss) from discontinued operations	(973)	(4)	38	(269)	(63)	(1)	(1,242)	(67)	37

after taxes

For fiscal 2005, the results of the LANXESS activities that were spun off relate solely to the month of January because LANXESS was deconsolidated as of January 31, 2005.

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Notes to the Consolidated Financial Statements of the Bayer Group (Continued)

The separate asset and liability line items in the balance sheet reflect the following amounts pertaining to the discontinued LANXESS and plasma operations:

	LANXESS		Plasma Business		Total	
	2004	2005	2004	2005	2004	2005
			(million)			
Noncurrent assets	1,900		124		2,024	
Goodwill and other intangible assets	65				65	
Property, plant and equipment	1,521		1		1,522	
Other noncurrent assets	106				106	
Deferred taxes	208		123		331	
Current assets	2,328		405		2,733	
Inventories	1,151		326		1,477	
Trade accounts receivable	1,029		76		1,105	
Other current assets	148		3		151	
Assets held for sale and discontinued operations	4,228		529		4,757	
Noncurrent liabilities	968				968	
Provisions for pensions and other post-employment benefits	573				573	
Other provisions	238				238	
Financial liabilities	92				92	
Miscellaneous noncurrent liabilities	42				42	
Deferred taxes	23				23	
Current liabilities	1,299		120		1,419	
Other provisions	207		20		227	
Financial liabilities	439				439	
Trade accounts payable	494		23		517	
Miscellaneous current liabilities	159		77		236	
Liabilities directly related to assets held for sale and discontinued operations	2,267		120		2,387	

Discontinued operations affected the Group cash flow statements as follows:

	LANXESS	Plasma Business	Total

	2003	2004	2005	2003	2004	2005	2003	2004	2005
					(million)				
Net cash provided by (used in) operating activities									