BAYER AKTIENGESELLSCHAFT
Form 6-K
March 18, 2005

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SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549

Form 6-K

REPORT OF FOREIGN PRIVATE ISSUER
PURSUANT TO RULE 13a-16 OR 15d-16
OF THE SECURITIES EXCHANGE ACT OF 1934

For the month of March 2005

Bayer Aktiengesellschaft
Bayer Corporation*

(Translation of registrant s name into English)

Bayerwerk, Gebaeude W11
Kaiser-Wilhelm-Allee
51368 Leverkusen
Germany
(Address of principal executive offices)

Indicate by check mark whether the registrant files or will file annual reports under cover of Form 20-F or Form 40-F.

Form 20-F þ Form 40-F o

Indicate by check mark if the registrant is submitting the Form 6-K in paper as permitted by Regulation S-T Rule 101 (b)(1): N/A

Indicate by check mark if the registrant is submitting the Form 6-K in paper as permitted by Regulation S-T Rule 101 (b)(7): N/A

Indicate by check mark whether, by furnishing the information contained in this form, the registrant is also thereby furnishing the information to the Commission pursuant to Rule 12g3-2(b) under the Securities Exchange Act of 1934.

Yes o No þ

If Yes is marked, indicate below the file number assigned to the registrant in connection with Rule 12g3-2(b): N/A

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

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Science For A Better Life
Annual Report 2004

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Bayer Group Key Data **Bayer Annual Report 2004**

Bayer Group million	**2003**	**2004**	**Change** in%
Net sales	28,567	29,758	+ 4.2
EBITDA[1]	3,616	4,130	+ 14.2
Operating result [EBIT]	(1,119)	1,808	
Income (loss) before income taxes	(1,994)	985	
Net income (loss)	(1,361)	603	
Gross cash flow[2]	2,864	3,210	+ 12.1
Net cash flow[3]	3,293	2,450	25.6
Stockholders equity	12,213	12,268	+ 0.5
Total assets	37,445	37,804	+ 1.0
Capital expenditures	1,739	1,275	26.7
Employees at year end	115,400	113,000	2.1
Personnel expenses	7,906	7,306	7.6
Research and development expenses	2,404	2,107	12.4

Bayer AG	**2003**	**2004**	**Change** in %
Total dividend payment in million	365	402	+ 10.1
Dividend per share in	0.50	0.55	+ 10.0

1) EBITDA = operating result (EBIT) plus depreciation and amortization

2) Gross cash flow = operating result (EBIT) plus depreciation and amortization, minus income taxes, minus gains/plus losses on retirements of noncurrent assets, plus/minus changes in pension provisions

3) Net cash flow = cash flow from operating activities according to IAS 7

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Ten-Year Financial Summary **Bayer Annual Report 2004**

Bayer Group million	**1995**	**1996**	**1997**	**1998**	**1999**
Net sales	22,793	24,853	28,124	28,062	27,320
Sales outside Germany	80.5%	82.2%	83.9%	83.6%	84.3%
Sales of foreign consolidated companies	63.4%	65.4%	67.0%	67.5%	68.3%
Operating result [EBIT]	2,102	2,306	3,077	3,155	3,357
Income (loss) before income taxes	2,140	2,282	2,611	2,728	2,836
Income (loss) after taxes	1,238	1,405	1,509	1,615	2,018
Noncurrent assets	**9,437**	**10,689**	**12,230**	**13,981**	**15,614**
Intangible assets	488	729	1,051	1,909	2,213
Property, plant and equipment	7,966	8,974	10,307	10,970	11,986
Investments	983	986	872	1,102	1,415
Current assets	**13,211**	**14,593**	**15,467**	**15,396**	**15,665**
Inventories	4,762	5,144	5,424	5,781	4,992
Receivables	5,787	7,028	7,588	7,894	7,533
Liquid assets	2,662	2,421	2,455	1,721	3,140
Stockholders equity	**9,109**	**10,531**	**12,009**	**12,568**	**15,006**
Capital stock of Bayer AG	1,803	1,851	1,867	1,867	1,870
Capital reserves and retained earnings	6,082	7,287	8,638	9,087	11,134
Net income (loss)	1,224	1,393	1,504	1,614	2,002
Minority stockholders interest	**248**	**234**	**223**	**211**	**176**
Liabilities	**13,291**	**14,517**	**15,465**	**16,598**	**16,097**
Provisions	6,923	7,057	7,275	7,271	6,714
Other liabilities	6,368	7,460	8,190	9,327	9,383

Total assets	**22,648**	**25,282**	**27,697**	**29,377**	**31,279**
Proportion of total assets					
Noncurrent assets	41.7%	42.3%	44.2%	47.6%	49.9%
Current assets	58.3%	57.7%	55.8%	52.4%	50.1%
Stockholders equity	40.2%	41.7%	43.4%	42.8%	48.0%
Liabilities	58.7%	57.4%	55.8%	56.5%	51.5%
Financial liabilities	3,205	3,520	3,896	4,730	4,466
Long-term	1,436	1,615	2,150	2,404	2,359
Short-term	1,769	1,905	1,746	2,326	2,107
Interest income (expense) net	6	(44)	(157)	(179)	(196)
Noncurrent assets financed by stockholders equity	96.5%	98.5%	98.2%	89.9%	96.1%
Noncurrent assets and inventories financed by stockholders equity and long-term liabilities	110.7%	113.4%	114.2%	105.0%	111.5%
Return on sales	9.2%	9.3%	11.0%	12.6%	11.2%
Return on stockholders equity	13.7%	14.0%	13.1%	12.9%	14.4%
Gross cash flow[1)]	2,751	2,959	3,313	3,394	3,192
Capital expenditures for intangible assets, property, plant and equipment	1,620	1,931	2,331	2,703	2,632
Depreciation and amortization	1,184	1,326	1,479	1,521	1,744
Depreciation and amortization in percent of capital expenditures	73.1%	68.7%	63.4%	56.3%	66.3%
Personnel expenses (including pension expenses)	7,477	7,718	7,895	8,106	7,549
Number of employees (year end)	142,900	142,200	144,600	145,100	120,400
Research and development expenses	1,666	1,845	1,983	2,045	2,252

Bayer AG

Income (loss) after taxes/Net income (loss)	592	695	746	1,095	1,076
Allocation to (from) retained earnings	51	66	36	348	127
Total dividend payment	541	629	710	747	949
Dividend per share in	0.77	0.87	0.97	1.02	1.30

1) for definition see Bayer Group Key Data on front flap

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Ten-Year Financial Summary **Bayer Annual Report 2004**

2000	**2001**	**2002**	**2003**	**2004**	**Bayer Group** million
30,971	30,275	29,624	28,567	29,758	Net sales
85.6%	85.5%	86.4%	85.8%	86.3%	Sales outside Germany
69.0%	70.9%	72.2%	73.3%	72.7%	Sales of foreign consolidated companies
3,287	1,676	1,518	(1,119)	1,808	Operating result [EBIT]
2,990	1,115	956	(1,994)	985	Income (loss) before income taxes
1,842	961	1,063	(1,349)	600	Income (loss) after taxes
20,344	**21,702**	**23,513**	**18,232**	**16,855**	**Noncurrent assets**
4,843	5,014	8,879	6,514	6,017	Intangible assets
13,345	13,543	12,436	9,937	9,184	Property, plant and equipment
2,156	3,145	2,198	1,781	1,654	Investments
16,107	**15,337**	**16,890**	**17,673**	**19,547**	**Current assets**
6,095	5,818	6,342	5,885	6,215	Inventories
9,308	8,748	9,752	8,925	9,733	Receivables
704	771	796	2,863	3,599	Liquid assets
16,140	**16,922**	**15,335**	**12,213**	**12,268**	**Stockholders equity**
1,870	1,870	1,870	1,870	1,870	Capital stock of Bayer AG
12,454	14,087	12,405	11,704	9,795	Capital reserves and retained earnings
1,816	965	1,060	(1,361)	603	Net income (loss)
237	**98**	**120**	**123**	**111**	**Minority stockholders interest**
20,074	**20,019**	**23,320**	**23,013**	**23,534**	**Liabilities**
7,163	7,172	8,397	8,863	9,368	Provisions
12,911	12,847	14,923	14,150	14,166	Other liabilities

36,451	**37,039**	**41,692**	**37,445**	**37,804**	**Total assets**
					Proportion of total assets
55.8%	58.6%	56.4%	48.7%	44.6%	Noncurrent assets
44.2%	41.4%	40.5%	47.2%	51.7%	Current assets
44.3%	45.7%	36.8%	32.6%	32.5%	Stockholders equity
55.1%	54.0%	55.9%	61.5%	62.3%	Liabilities
6,665	7,380	10,159	9,426	9,722	Financial liabilities
2,803	3,071	7,318	7,378	7,117	Long-term
3,862	4,309	2,841	2,048	2,605	Short-term
(311)	(349)	(449)	(353)	(275)	Interest income (expense) net
79.3%	78.0%	65.2%	67.0%	72.8%	Noncurrent assets financed by stockholders equity
93.0%	93.9%	96.8%	107.1%	112.3%	Noncurrent assets and inventories financed by stockholders equity and long-term liabilities
11.2%	5.5%	5.1%	(3.9)%	6.1%	Return on sales
11.7%	5.8%	6.6%	(9.8)%	4.9%	Return on stockholders equity
4,164	3,009	2,782	2,864	3,210	Gross cash flow[1)]
2,647	2,617	2,383	1,739	1,275	Capital expenditures for intangible assets, property, plant and equipment
2,122	2,464	2,814	2,634	2,138	Depreciation and amortization
80.2%	94.2%	118.1%	151.5%	167.7%	Depreciation and amortization in percent of capital expenditures
7,735	7,849	8,176	7,906	7,306	Personnel expenses (including pension expenses)
122,100	116,900	122,600	115,400	113,000	Number of employees (year end)
2,393	2,559	2,588	2,404	2,107	Research and development expenses

Bayer AG

1,702	657	1,162	(185)	289	Income (loss) after taxes/Net income (loss)
680	0	505	(550)	(113)	Allocation to (from) retained earnings
1,022	657	657	365	402	Total dividend payment
1.40	0.90	0.90	0.50	0.55	Dividend per share in

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Corporate Structure **Bayer Annual Report 2004**

Bayer HealthCare

Bayer HealthCare plays a major role in improving the health of people and animals by researching, developing, manufacturing and marketing innovative products for disease prevention, diagnosis and treatment. Bayer HealthCare s activities are organized in six divisions: Animal Health, Biological Products, Consumer Care, Diabetes Care, Diagnostics and Pharmaceuticals.

Bayer HealthCare million	**2003**	**2004**	**Change** in %
Net external sales	8,871	8,485	4.4
Operating result [EBIT]	365	859	+ 135.3
Gross cash flow	815	962	+ 18.0
Net cash flow	782	1,007	+ 28.8
Capital expenditures	407	320	21.4

Operating Result [EBIT]
million

Bayer CropScience

Bayer CropScience is a global leader in crop protection and non-agricultural pest control. This company, with its highly effective products, pioneering innovations and keen customer focus, is aiming for further growth in the future. It is organized in three business groups Crop Protection, Environmental Science and BioScience. Bayer CropScience markets a balanced range of crop protection products and is among the leading suppliers of insecticides, fungicides, herbicides and seed treatments. It has a strong presence in all regions of the world.

Bayer CropScience million	**2003**	**2004**	**Change** in %
Net external sales	5,764	5,946	+ 3.2
Operating result [EBIT]	342	492	+ 43.9
Gross cash flow	860	893	+ 3.8
Net cash flow	1,165	778	33.2
Capital expenditures	413	209	49.4

Operating Result [EBIT]
million

Corporate Structure **Bayer Annual Report 2004**
Bayer MaterialScience

Bayer MaterialScience is a renowned supplier of high-performance materials and innovative system solutions used in a wide range of products for everyday life. Products with leading positions on the world market account for a major share of sales. Principal customers are the automotive and construction industries, the electrical/electronics sector and manufacturers of sports and leisure articles, packaging and medical equipment.

Bayer MaterialScience million	**2003**	**2004**	**Change** in %
Net external sales	7,453	8,597	+ 15.3
Operating result [EBIT]	(397)	641	
Gross cash flow	935	884	5.5
Net cash flow	1,113	498	55.3
Capital expenditures	464	332	28.4

Operating Result [EBIT]
million

Bayer

Strategic management in the Bayer Group is kept separate from everyday business operations. The subgroups and service companies operate independently under the guidance of the management holding company Bayer AG, which defines common values, goals and strategies for the whole enterprise and is headed by the four-member Group Management Board. The Corporate Center supports the Group Management Board in its tasks and also performs certain common functions for the subgroups.

Bayer Business Services

Bayer Business Services is the Bayer Group s competence center for IT-based business, administrative and scientific services. From consulting through the development of technical solutions and systems operation to the handling of entire corporate processes, Bayer Business Services offers integrated single-source services in the fields of finance, accounting, procurement, human resources, logistics, information technology, science, pensions and law. Subsidiaries also provide travel and media services.

Bayer Technology Services

Bayer Technology Services, the technological backbone of the Bayer Group, is engaged in process development and in process and plant engineering, construction and optimization. This company also develops innovative technology platforms that contribute substantially to the efficiency of Bayer s operating units. Bayer Technology Services offers integrated solutions along the life cycles of facilities, processes and products.

Bayer Industry Services

Bayer Industry Services is the operator of Germany s largest chemical park, with sites at Leverkusen, Dormagen, Krefeld-Uerdingen and Brunsbüttel covering a total area of 17 square kilometers. The company provides the foundation for the smooth operation of facilities at these sites, offering both internal and external clients a customized service portfolio ranging from technology through environmental protection, waste management, utility supply, infrastructure, safety and analytics to vocational training and continuing education courses. Bayer Industry Services also markets available land and buildings to companies interested in setting up operations within the chemical park.

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Working to Create Value through Innovation, Growth and Improved Earning Power

Bayer is a global enterprise with core competencies in the fields of health care, nutrition and high-tech materials. Our products and services are designed to benefit people and improve their quality of life. At the same time we want to create value through innovation, growth and improved earning power.

We already successfully reorganized the Bayer Group and further streamlined our portfolio to create a new Bayer that is focused on its corporate strengths, its customers and the markets of the future. To help us achieve this goal, we then carried out a strategic realignment in order to concentrate in future on three high-potential, agile sub-groups with largely independent operations: HealthCare, CropScience and MaterialScience, supported by three service companies. Our operating companies give us the access we need to the growth markets of the future.

As an inventor company, we plan to continue setting trends in research-intensive areas. Innovations are the foundation for our competitiveness and our corporate growth, and thus for our success in the future.

We believe our technical and commercial expertise entails a duty to contribute to sustainable development a principle we wholeheartedly endorse, mindful of its social, ethical and environmental elements. In awareness of our responsibilities as a corporate citizen, we define economy, ecology and social commitment as objectives of equal rank.

We seek to retain society s confidence through performance, flexibility and open communication as we work in pursuit of our overriding corporate goals: to steadily create corporate value and generate high value-added for the benefit of our stockholders, our employees and the community in every country in which we operate.

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4 Chairman s Letter

Our realignment is clearly successful

Dear Stockholders:

I am pleased to report that 2004 was a successful year in terms of both our business performance and the Group s strategic realignment.

Earnings moved ahead substantially. While the general economic backdrop was indeed favorable, this increase in profitability is still a remarkable achievement considering the challenges presented by the strength of the euro and the sharp rise in raw material costs.

The upward trend is reflected in our core business data for 2004:

- Sales up 4 percent to 29.8 billion
- Underlying EBIT up 53 percent to 2.24 billion
- Net income up to 603 million
- CFROI up 1.8 points to 9.9 percent

We thus exceeded our targets for sales and earnings.

I believe we can be satisfied with the advances made so far toward achieving the ambitious profitability goals we set ourselves for 2006.

We can also be satisfied with the major progress we made in 2004 with our strategic reorganization. We repositioned the Bayer Group, aligning it toward innovation and growth and thus laying the foundation for a sustained improvement in earning power.

Here, of course, I am thinking primarily of the spin-off of our chemicals activities and one third of our polymers business into LANXESS, which was accomplished in less than 15 months. With the successful stock-market listing of LANXESS, we have largely completed the comprehensive realignment of the Bayer Group, a process that took about three years in all.

Bayer now has a new face. We are heading into the future with our three subgroups Bayer HealthCare, Bayer CropScience and Bayer MaterialScience, supported by competent service companies. Our strategy is thus clearly defined.

We will now concentrate our financial resources and management expertise on the development and expansion of these businesses.

We have also made good progress with the refocus of Bayer HealthCare, aligning its Pharmaceuticals Division as a mid-sized European supplier without neglecting the important markets of North America, Asia and Latin America. Last year we formed a strategic alliance in the United States with Schering-Plough and thus strengthened the basis for our specialties business. Our pharmaceutical research activities will focus in the future on cardiovascular risk management including diabetes and cancer. With 2,200 highly skilled employees at two research centers and with excellent technology platforms, we have a wealth of expertise at our disposal. We are confident that concentrating on these areas will allow us to sustainably increase the productivity of our pharmaceutical R&D.

We have high hopes for two promising candidates in our research pipeline: one is a cancer drug that is currently undergoing phase III clinical testing and is expected to be launched next year. The other is our Factor Xa inhibitor for the prevention and therapy of thrombosis, which is currently in phase II clinical studies. We believe this substance could achieve annual sales of 1 billion if the trials continue to be successful. We also plan to strengthen our business through external growth options such as in-licensing.

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6 Chairman s Letter

I am convinced that this strategy is the right one to guide our pharmaceuticals business to success in the future.

Apart from Pharmaceuticals, we have also strengthened our other HealthCare divisions. Our acquisition of the Roche OTC business has made Consumer Care one of the world s top three suppliers of non-prescription medicines and brought us a step closer to our goal of attaining the number one position in this market.

We also hold strong to very strong positions worldwide in Diabetes Care, Diagnostics and Animal Health. The same applies to our Biological Products Division following the divestiture of the blood plasma business.

Our CropScience subgroup turned in a very pleasing performance in 2004, achieving its goal of becoming the world market leader in the crop protection sector. This underscores the excellent strategic positions we hold with our herbicides, insecticides, fungicides, seed treatments and Environmental Science products. In BioScience, both our conventional seed business and our genetically improved canola and cotton seed are on course for expansion. With an annual R&D budget of nearly 100 million, this area is a major focus of our investment. The innovative potential of Bayer CropScience is expressed by a well-stocked pipeline and a sales target of more than 1 billion a year from new products by 2006.

Our MaterialScience subgroup is among the global leaders in the fields of polyurethanes, polycarbonates and coating raw materials. We will continue to systematically expand in these promising areas, too, focusing primarily on the rapidly growing Chinese market. In the Shanghai region alone, we are currently building or planning several new production facilities for which we have scheduled capital expenditures totaling US$ 1.8 billion over the next five years. New areas of application, such as automotive glazing or self-healing automotive coatings, also offer exciting prospects. With new products currently accounting for some 20 percent of sales, we believe there is significant further potential here.

Following the extensive realignment of the Bayer Group, we clearly have a high-quality portfolio. Now our efforts are focused above all on reaching our goal of a benchmark performance in all areas. With savings in the region of 2.2 billion in the past three years 1 billion of which was achieved in 2004 alone the foundations for this have been laid.

Yet despite our emphasis on profitability, it is important to me personally that our business strategy embraces responsible corporate governance and thoroughly ethical conduct. We have therefore included a definition of our values as a key element in our new mission statement, which is reproduced in full in this Annual Report.

In keeping with our principles, we responded quickly and informally to the tsunami disaster in South and Southeast Asia with donations of money and, above all, medicines worth a total of about 13 million. I would particularly like to thank our approximately 5,700 employees in the region, who fortunately came to no harm. These employees aided their fellow citizens by giving money and also assisting directly with relief work in the devastated areas. And I would also like to thank the many Bayer employees around the world who made donations to help ease the suffering of the flood victims.

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We have now set Bayer on a new course. I promised you that we would have tangible success to show for our reorganization process in 2004 and I am glad I could keep my promise.

I find it particularly encouraging that our efforts have been reflected in the price of Bayer stock. First, we did better than the DAX in 2004, with a performance of nearly 10 percent over the year. Then, in early 2005, Bayer and LANXESS stock together outperformed the DAX by more than seven percentage points in the first ten days of trading after the spin-off of LANXESS. Bayer stock has now reached its highest level since mid-2002.

Of course we want you, our stockholders, to benefit from our commercial success. We therefore propose to raise the dividend for 2004 by 10 percent to 0.55. This gives a payout of about two thirds of net income for the year, underlining our confidence in the future earnings capability of the realigned Bayer Group.

On behalf of the entire Board of Management, I would like to express my special thanks to our employees, who all pulled together during the realignment process and now have a tremendous achievement to their credit. Their skills, their experience and their hard work are instrumental to the future success of the enterprise. The spin-off paves the way for a bright future not just for Bayer, but also for LANXESS. We wish our former colleagues at LANXESS the best of success.

Following my review of 2004, let me now touch on our plans for the coming year.

We anticipate a further improvement in the Bayer Group s operating performance. Provided that current business conditions do not worsen, we expect the underlying operating result from continuing operations to grow by around 20 percent.

I and my colleagues on the Board of Management thank you for the trust you have placed in Bayer. We will remain dedicated to the successful course we have embarked upon. In line with our new mission statement and the slogan Bayer: Science For A Better Life , we are committed to sustainably improving people s quality of life through our products, now and in the future in the interests of the company and of society at large.

Sincerely,

/s/ Werner Wenning

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WERNER WENNING

Born in 1946, Werner Wenning joined Bayer AG in 1966 as a commercial trainee. He held a number of positions with Bayer in Germany and abroad, serving as Managing Director of Bayer subsidiaries in Peru and Spain and later as Head of the Corporate Planning and Controlling Division. Wenning was appointed to the Bayer AG Board of Management in 1997 and has been its Chairman since April 2002.

DR. RICHARD POTT

Born in 1953, Richard Pott studied physics at the University of Cologne, Germany, where he also obtained his doctorate. In 1984 he joined Bayer AG s Central Research Division. After holding various positions in the Corporate Staff Division he became Head of the former Specialty Products Business Group in 1999. Pott became a member of the Bayer AG Board of Management in May 2002. He is the company s Labor Director and is responsible for Strategy and Human Resources and the North, Central and South America regions.

KLAUS KÜHN

Born in 1952, Klaus Kühn studied mathematics and physics at the Technical University of Berlin, Germany, gaining a mathematics degree in 1978. He came to Bayer in 1998 as Head of the Finance Section. Shortly afterwards he was appointed Head of the Group Finance Division. Kühn joined the Bayer AG Board of Management in May 2002 as Chief Financial Officer. He is also responsible for the Europe, Africa and Middle East regions.

DR. UDO OELS

Born in 1944, Udo Oels studied chemistry at the Technical University of Hanover, Germany. He joined Bayer AG as a research chemist in 1976 and held a number of positions with Bayer in Germany and abroad. He was polycarbonate production manager in Baytown, Texas, and Head of Research and later General Manager of what was then the Organic Chemicals Business Group. Oels was appointed to the Bayer AG Board of Management in 1996. He is responsible for Innovation, Technology and Environment as well as the Asia region.

Management Report

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Bayer on the road to success: Encouraging growth in sales and earnings

Currency- and portfolio-adjusted sales rise by 9 percent

EBIT before special items up 53 percent to 2.2 billion

Bayer Group strategically realigned

Further substantial improvement in operating performance expected in 2005

Overview of Sales, Earnings and Financial Position

Bayer had a successful year in 2004. We exceeded our earnings and sales targets and at the same time realigned the Group for the future. The stock-market listing of LANXESS on January 31, 2005 was very well received by the capital market. Based on the average price of LANXESS shares in the first ten days of trading, the spin-off caused the value of Bayer stockholders investments to grow by a good 7 percentage points more than the German stock index DAX over the same period, adding 1.4 billion in combined market capitalization. We also made good progress with the restructuring of our HealthCare portfolio.

Change in Sales	**2003**	**2004**
Total	**-4%**	**+4%**
Volumes	+5%	+8%
Prices	0%	+1%
Exchange rates	-9%	-4%
Portfolio changes	0%	-1%

We greatly strengthened our consumer health activities through the acquisition of Roche s over-the-counter (OTC) business, which was largely completed in January 2005. In addition, we optimized our sales structures in the United States by forming a strategic alliance with U.S.-based Schering-Plough, at the same time strengthening the basis for our specialties business. In December 2004 as announced we reached an agreement to sell the blood plasma business to a group of U.S. investors.

Quarterly Sales by Subgroup in 2004

million

The economic background was favorable in 2004, and we saw a gratifying increase in demand for our products, particularly in the industrial businesses. Sales increased by 4.2 percent to 29,758 million (2003: 28,567 million). Adjusted for the effects of currency translations and portfolio changes, sales rose by 9.1 percent.

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The overall growth in business is even more gratifying in view of the decline in sales of our Cipro® anti-infective following the expiration of its U.S. patent and considerable adverse shifts in exchange rates. Sales expanded even faster in the fourth quarter, advancing by 8.8 percent to 7,748 million, with the currency- and portfolio-adjusted figure rising by 12.4 percent.

The upward trend in business was also reflected in earnings growth, to which all subgroups contributed significantly.

Before special items, EBIT increased by 53.1 percent to 2,244 million and EBITDA by 9.1 percent to 4,494 million. EBIT for the fourth quarter came in at 374 million also well ahead of the 42 million for the same period of the previous year.

The growth in underlying EBIT in 2004 was mainly the result of a marked recovery in business and our efforts to reduce costs and increase efficiency. These factors more than offset the sharp rise in raw material prices, negative currency effects and lower earnings from Cipro®. Lower depreciation and amortization also boosted income. Changes in obligations relating to the payment of employees post-retirement health care costs in the United States increased EBIT by 121 million.

There were, however, various special items in 2004 that had a net effect of minus 436 million (2003: minus 2,585 million). Chief among the special charges were litigation-related expenses (160 million), charges for the stock-market listing of LANXESS (77 million), losses on the sale of the plasma business (71 million), restructuring charges in Pharmaceuticals (24 million) and an allocation to environmental protection provisions for LANXESS (40 million). Positive special items comprised mainly a 39 million one-time gain from the sale of a license by Bayer HealthCare. Special items in the previous year consisted largely of 1,927 million in impairment losses and valuation adjustments related to the portfolio realignment and changes in economic conditions.

EBIT after special items in 2004 amounted to 1,808 million (2003: minus 1,119 million). EBITDA improved by 14.2 percent to 4,130 million. The non-operating result amounted to minus 823 million (2003: minus 875 million), yielding pre-tax income of 985 million (2003: minus 1,994 million). After taxes of 385 million and minority stockholders interest, the Bayer Group had net income of 603 million (2003: minus 1,361 million).

Business also developed well in the fourth quarter, with EBIT improving to 220 million (Q4 2003: minus 2,732 million). Fourth-quarter EBIT before special items rose to 374 million (Q4 2003: 42 million). Taking into account an improved non-operating result of minus 198 million, net income for the fourth quarter was 41 million (Q4 2003: minus 1,952 million).

The improvement in earnings in 2004 was also reflected in the gross cash flow, which climbed by 12.1 percent to 3,210 million (2003: 2,864 million). The considerably higher sales in the industrial businesses and Bayer CropScience, along with the sharp rise in raw material costs, led to an increase in working capital. Net cash flow thus fell by 25.6 percent to 2,450 million (2003: 3,293 million). Despite payments totaling 0.4 billion already made in 2004 in connection with the acquisition of the Roche OTC business, we achieved a further reduction in net debt, to 5.4 billion.

Operating Environment in 2004

The global economy showed a marked improvement in 2004, expanding by around 4 percent, the principal growth engines being the United States and China. Over the course of the year, the economy slowed due to the sharp rise in oil prices and weaker economic policy impulses. The economy nevertheless remained on an expansionary course, especially as the situation on the crude oil markets eased somewhat in the fall.

Economic development in the euro zone was comparatively restrained in 2004. The economy was buoyed primarily by foreign demand, while domestic demand picked up only slowly during the year. The recovery in Germany continued thanks to strong export demand, but began to run out of steam in the second half as the global economy slowed, there being little stimulus from private consumption.

The U.S. economy continued to expand in 2004. Growth decelerated as time went on, but picked up again slightly toward the end of the year. The positive trend was supported by a sustained high level of private consumption and corporate investment, while the firm recovery on the employment market boosted overall consumer confidence.

The rapid pace of growth in the Asia-Pacific region as a whole slowed somewhat during the year due to constrained foreign demand, with widely divergent trends especially in the important markets of China and Japan. In China, higher oil prices and policy measures aimed at cooling the economy have so far done little to slow the boom. By contrast, the upswing in Japan has leveled off since the summer. Both exports, which suffered from the appreciation of the yen, and domestic demand have weakened despite adherence to an expansionary monetary policy.

The economy in Latin America grew strongly in 2004, although the outlook became somewhat less bright toward the end of the year. The robust growth in this region due more than anything to high raw material prices was aided by industrial exports, which benefited from global economic expansion, and by historically low interest rates.

Performance by Subgroup

In 2004 our business activities were grouped together in the Bayer HealthCare, Bayer CropScience, Bayer MaterialScience and LANXESS subgroups, comprising the following reporting segments:

Subgroup	**Segments**
Bayer HealthCare	Pharmaceuticals, Biological Products; Consumer Care, Diagnostics; Animal Health
Bayer CropScience	CropScience
Bayer MaterialScience	Materials; Systems
LANXESS	LANXESS

Bayer HealthCare

Sales of the **Bayer HealthCare** subgroup declined by 4.4 percent to 8,485 million due to the genericization of Cipro® in the United States and to adverse currency effects. Currency- and portfolio-adjusted sales edged up by 0.8 percent year on year. **EBIT** more than doubled, to 859 million. However, the previous year s figure contained extensive special charges for Lipobay/Baycol and substantial asset write-downs in the plasma business. Before special items, EBIT improved by 14.3 percent to 1,037 million. **Gross cash flow** climbed by 18.0 percent to 962 million. A decrease in working capital boosted **net cash flow** by 28.8 percent to 1,007 million.

Bayer HealthCare million	**2003**	**2004**	**Change** in %
Sales	**8,871**	**8,485**	**- 4.4**
of which discontinuing operations	*613*	*660*	
EBITDA*	**1,252**	**1,341**	**+7.1**
of which discontinuing operations	*(122)*	*(10)*	
Operating result [EBIT]	**365**	**859**	**+135.3**
of which discontinuing operations	*(349)*	*(56)*	
of which special items	(542)	(178)	
Gross cash flow*	**815**	**962**	**+18.0**
of which discontinuing operations	*(122)*	*60*	
Net cash flow*	**782**	**1,007**	**+28.8**
of which discontinuing operations	*(98)*	*(16)*	

* for definition see Bayer Group Key Data on front flap

Best-Selling Bayer HealthCare Products million	**2004**	**Change** %	**Change** in local currencies %
Ciprobay®/Cipro® (Pharmaceuticals)	837	- 40.7	- 38.1
Adalat® (Pharmaceuticals)	670	- 0.9	+1.9
Ascensia® product line (Diabetes Care)	627	+8.5	+9.7
Aspirin® (Consumer Care/Pharmaceuticals)	615	+7.1	+11.7
Kogenate® (Biological Products)	563	+13.3	+15.9
ADVIA Centaur® system (Diagnostics)	441	+14.0	+19.1
Gamimune® N/Gamunex® (Biological Products)	343	+12.8	+21.1
Avalox®/Avelox® (Pharmaceuticals)	318	+6.4	+12.4

Glucobay® (Pharmaceuticals)	278	+1.8	+5.9
Advantage®/Advantix® (Animal Health)	206	+5.1	+12.2
Levitra® (Pharmaceuticals)	193	+34.0	+40.3
Trasylol® (Pharmaceuticals)	171	+8.9	+17.2
Prolastin® (Biological Products)	166	0.0	+7.2
Baytril® (Animal Health)	160	- 5.9	- 0.6
Canesten® (Consumer Care)	140	+3.7	+6.7
Total	**5,728**	**- 4.0**	**- 0.1**
Proportion of Bayer HealthCare sales	68%		

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Pharmaceuticals, Biological Products million	**2003**	**2004**	**Change** in %
Sales	**4,745**	**4,388**	**- 7.5**
of which discontinuing operations	*613*	*660*	
Pharmaceuticals	3,635	3,166	- 12.9
Biological Products	1,110	1,222	+10.1
EBITDA*	**147**	**522**	
of which discontinuing operations	*(122)*	*(10)*	
Operating result [EBIT]	**(408)**	**302**	
of which discontinuing operations	*(349)*	*(56)*	
of which special items	(832)	(148)	
Gross cash flow*	**23**	**405**	
of which discontinuing operations	*(122)*	*60*	
Net cash flow*	**(163)**	**215**	
of which discontinuing operations	*(98)*	*(16)*	

* for definition see Bayer Group Key Data on front flap

Pharmaceuticals, Biological Products

Sales of our **Pharmaceuticals, Biological Products** segment receded by 357 million, or 7.5 percent, to 4,388 million.

Sales of the **Pharmaceuticals** Division were down by 469 million, or 12.9 percent, to 3,166 million, and by 9.2 percent before currency translations. 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, year on year. Our once-daily formulation Cipro® XR had gained a 14 percent share of ciprofloxacin prescriptions in the United States by year end. As part of the realignment of our pharmaceuticals business, we signed an extensive cooperation agreement in September 2004 under which Schering-Plough now markets and distributes certain of our primary care products in return for sales-dependent license payments. As expected, our sales declined as a result.

Sales of our erectile dysfunction treatment Levitra® rose by 49 million, or 34.0 percent (currency-adjusted: 40.3 percent), to 193 million, though this was a smaller increase than we had anticipated. Levitra® has now been registered in all the major countries. By year end the product had gained a roughly 11 percent global market share and a 10 percent share in the United States, the most important market.

Sales of our respiratory antibiotic Avalox®/Avelox® continued to advance in a highly competitive environment, increasing by 6.4 percent (currency-adjusted: 12.4 percent) to 318 million. Despite keen generic competition, sales of our antihypertensive drug Adalat® remained steady year on year. Further growth was achieved by Aspirin® Cardio (heart attack and stroke prophylaxis), Trasylol® (used in open-heart surgery) and Glucobay® (diabetes).

We received positive clinical study results both for our developmental product Bay 43-9006 to treat advanced renal cell carcinoma and for our Factor Xa inhibitor for the prevention and treatment of thromboembolic disorders. We discontinued clinical trials for two phase II developmental products, taxane and repinotan, as the results did not meet our target profiles.

Sales of the **Biological Products** Division rose by 10.1 percent to 1,222 million (currency-adjusted: 15.5 percent). Both our hemophilia drug Kogenate® and the plasma products contributed to this positive performance. Kogenate® grew sales primarily in Europe, posting a considerable increase in volumes. The plasma business developed very well in North America due to new product launches (Gamunex®), but receded in Japan due to fierce competition and regulatory changes.

EBIT of the **Pharmaceuticals, Biological Products** segment improved from minus 408 million to 302 million. Before special items, EBIT rose by 6.1 percent to 450 million. The decline in EBIT of the Pharmaceuticals Division due to the expiration of our U.S. patent for Cipro® was more than offset by the higher sales of the Biological Products Division and further cost savings achieved. Special items in 2004 came to minus 148 million on aggregate, including a 71 million loss on the sale of the plasma business, further charges of 47 million for Lipobay/Baycol, total restructuring charges of 69 million in connection with the Schering-Plough alliance and the realignment of our pharmaceutical research, and 39 million in gains from the sale of a license to Alcon. In connection with the divestment of our plasma business and the related transfer of employees, we expect to book a gain of around 20 million in 2005 from the curtailment of pension plans. In addition, we will realize the operating result of the plasma business prior to closing of the transaction. Special items in the previous year mainly comprised expenses relating to the divestment of the plasma business and for accounting measures concerning Lipobay/Baycol.

Consumer Care, Diagnostics

Sales in the **Consumer Care, Diagnostics** segment dipped by 25 million, or 0.7 percent, to 3,311 million. Currency-adjusted sales grew by 4.6 percent.

Sales of the **Consumer Care** Division moved back by 4.8 percent to 1,336 million, but advanced by 3.2 percent when adjusted for portfolio effects related to the household insecticides divestiture and for shifts in currency parities. Business in Europe, particularly Italy, Germany and the United Kingdom, continued to expand thanks to the launch of new products such as Aspirin® Complex. In Latin America, Aspirin® sales were encouraging. By contrast, our OTC business in North America was level with the previous year.

Sales of blood glucose monitoring systems offered by our **Diabetes Care** Division grew by 4.5 percent to 653 million, and by 9.5 percent in local currencies. Particularly successful were the Ascensia® BREEZE and Ascensia® CONTOUR/MICROFILL test systems launched in 2003. Diabetes Care thus has the most extensive product range of any supplier worldwide. We achieved double-digit growth rates in important markets such as the United States, Germany, Spain and the United Kingdom.

The **Diagnostics** Division grew sales by 1.1 percent to 1,322 million, and by 5.7 percent before currency translation, 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.

EBIT of the **Consumer Care, Diagnostics** segment dropped by 201 million to 400 million. Before special items, however mainly litigation-related charges and expenses for the integration of the Roche OTC business EBIT for the segment increased considerably to 430 million (plus 29.1 percent). This earnings growth was due particularly to the sales increases in the Diabetes Care and Diagnostics divisions and to cost savings achieved. The principal special item in the previous year was the income from the sale of the household insecticides business.

Consumer Care, Diagnostics million	**2003**	**2004**	**Change** in %
Sales	**3,336**	**3,311**	**- 0.7**
Consumer Care	1,403	1,336	- 4.8
Diagnostics**	1,308	1,322	+ 1.1

Diabetes Care**	625	653	+ 4.5
EBITDA*	**901**	**639**	**- 29.1**
Operating result [EBIT]	**601**	**400**	**- 33.4**
of which special items	268	(30)	
Gross cash flow*	**648**	**448**	**- 30.9**
Net cash flow*	**719**	**667**	**- 7.2**

* for definition see Bayer Group Key Data on front flap
** Diagnostics (formerly Professional Testing Systems) / Diabetes Care (formerly Self Testing Systems)

Animal Health million	**2003**	**2004**	**Change** in %
Sales	**790**	**786**	**- 0.5**
EBITDA*	**204**	**180**	**- 11.8**
Operating result [EBIT]	**172**	**157**	**- 8.7**
of which special items	22	0	
Gross cash flow*	**144**	**109**	**- 24.3**
Net cash flow*	**226**	**125**	**- 44.7**

* for definition see Bayer Group Key Data on front flap

Animal Health

Sales of the **Animal Health** segment dipped by 4 million to 786 million, but advanced by 4.5 percent in local currencies. All regions contributed to this growth. Notable success was achieved with the launch of our antiparasitic Advantix® in Italy and with our Advantage® and Baytril® businesses in the United States.

EBIT of the Animal Health segment fell by 15 million to 157 million. Adjusted for the previous year s one-time gains from the sale of product rights, EBIT grew by 4.6 percent in 2004.

Bayer CropScience

Our **Bayer CropScience** subgroup grew sales by 3.2 percent to 5,946 million in 2004. Currency- and portfolio-adjusted sales rose by 8.4 percent. Fourth-quarter sales rose by 2.6 percent year on year, to 1,448 million. This sales growth helped Bayer CropScience to improve its market position in 2004, and it is now the global number one in the industry.

Sales of the **Crop Protection** Business Group increased by 3.2 percent year on year to 4,957 million.

In the Insecticides business unit, sales remained steady at 1,378 million, advancing by 5.5 percent in local currencies. Our Confidor®/Gaucho®/Admire®/Merit® product group achieved sales of 603 million due mainly to increased use in cotton, vegetables and soy-beans in the United States and Brazil. Envidor®, which we introduced in 2003 for use in perennial crops, continued to perform very well in its second year on the market.

Sales of the Fungicides business unit increased by 109 million, or 9.3 percent, to 1,277 million, thanks largely to strong gains 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 against Asian rust in Brazil. Sales of our broad-spectrum fungicide Folicur® climbed again by 30.5 percent in 2004, to 411 million, mainly on account of its

Bayer CropScience million	**2003**	**2004**	**Change** in %

Sales	**5,764**	**5,946**	**+ 3.2**
Crop Protection	4,801	4,957	+ 3.2
Insecticides	1,376	1,378	+ 0.1
Fungicides	1,168	1,277	+ 9.3
Herbicides	1,848	1,855	+ 0.4
Seed Treatment	409	447	+ 9.3
Environmental Science	692	678	- 2.0
BioScience	271	311	+ 14.8
EBITDA*	**1,091**	**1,219**	**+ 11.7**
Operating result [EBIT]	**342**	**492**	**+ 43.9**
of which special items	(81)	(30)	
Gross cash flow*	**860**	**893**	**+ 3.8**
Net cash flow*	**1,165**	**778**	**- 33.2**

* for definition see Bayer Group Key Data on front flap

Best-Selling Bayer CropScience Products	2004	Change	Change in local currencies
million		in %	in %
Confidor®/Gaucho® /Admire®/Merit® (Ins./Seed T./ES)	603	+ 2.2	+ 6.6
Folicur®/Raxil® (Fungicides/Seed Treatment)	411	+ 30.5	+ 34.9
Flint®/Stratego® /Sphere® (Fungicides)	240	+ 20.0	+ 25.0
Puma® (Herbicides)	227	+ 0.4	+ 4.9
Basta®/Liberty® (Herbicides)	197	+ 23.9	+ 28.3
Decis®/K-Othrine® (Insecticides/Environmental Science)	172	+ 8.2	+ 12.6
Betanal® (Herbicides)	144	+ 0.7	+ 3.5
Fenikan® (Herbicides)	118	+ 2.6	+ 2.6
Temik® (Insecticides)	109	+ 21.1	+ 28.9
Aliette® (Fungicides)	99	- 7.5	- 4.7
Total	**2,320**	**+ 10.3**	**+ 14.4**
Proportion of Bayer CropScience sales	39%		

increasing use to control the cereal disease fusarium. Business with Flint® grew by 20.0 percent to 240 million, although market conditions in western Europe remained difficult. Sales of our Sphere® and Stratego® formulations for soybeans rose strongly in Brazil and Argentina. We also increased sales in many other countries and crops. In addition we had major success with the launch of our new Proline® range of cereal fungicides in Germany.

Business in the Herbicides unit edged up by 0.4 percent to 1,855 million despite a difficult market environment. A key factor in this growth was our successful portfolio of herbicides for the important cereal, sugar beet and rice markets, as well as for herbicide-tolerant crops such as canola. Sales of Basta®/Liberty® improved by 23.9 percent to 197 million. Our recently launched product Atlantis® had a very successful year thanks to its consistently high efficacy against grass weeds in cereal crops. Atlantis® is an important element of our strategy for rejuvenating our portfolio.

The 9.3 percent growth in sales of seed treatment products 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®.

Sales of the **Environmental Science** Business Group receded by 2.0 percent to 678 million, but grew by 3.2 percent before translation.

In the **BioScience** Business Group, sales climbed by 14.8 percent year on year to 311 million. The main contributors to this increase were InVigor® (canola seed) and FiberMax® (cotton seed), both with sales growth exceeding

50 percent. Business in vegetable seeds was also well above the previous year.

Despite negative currency effects, **EBIT** of Bayer CropScience showed a pleasing 43.9 percent improvement from 342 million to 492 million. This earnings performance was attributable both to business expansion and to strict cost management. Charges for restructuring were significantly lower than in the previous year. EBIT before special items improved by 99 million, or 23.4 percent, to 522 million. **Net cash flow** fell by 33.2 percent to 778 million because of an increase in working capital particularly inventories and trade accounts receivable related to the growth in business.

Bayer MaterialScience million	2003	2004	Change in %
Sales	**7,453**	**8,597**	**+ 15.3**
EBITDA*	**980**	**1,216**	**+ 24.1**
Operating result [EBIT]	**(397)**	**641**	
of which special items	(744)	(27)	
Gross cash flow*	**935**	**884**	**- 5.5**
Net cash flow*	**1,113**	**498**	**- 55.3**

* for definition see Bayer Group Key Data on front flap

Bayer MaterialScience

Sales of our **Bayer MaterialScience** subgroup moved ahead strongly in 2004, increasing by 1,144 million, or 15.3 percent, to 8,597 million; currency- and portfolio-adjusted sales climbed by 21.0 percent. This growth was rooted largely in the economic recovery in Asia-Pacific and Latin America and strong demand in North America. **EBIT** of the subgroup improved by more than 1 billion to 641 million, the previous year s figure having contained substantial asset impairment charges. Before special items, EBIT rose by 321 million, or 92.5 percent, to 668 million. This very gratifying performance stemmed mainly from improved profitability in the polycarbonates and polyurethanes businesses. As the year progressed, we were increasingly able to raise prices to offset the sharp rise in raw material costs. The strong uptrend in business led to an increase in inventories and trade accounts receivable, causing **net cash flow** to recede by 55.3 percent to 498 million.

Materials

Sales in the **Materials** segment were well ahead of the previous year, rising by 471 million, or 17.0 percent, to 3,248 million; currency-adjusted sales increased by 22.1 percent. The Polycarbonates business unit and H.C. Starck were instrumental in this favorable performance, with persistently high demand from the plastics and electronics industries allowing both units to achieve price and volume increases. Currency-adjusted sales of the Polycarbonates business unit grew by 42.0 percent in Asia-Pacific due to heavy demand, particularly in China. Sales of H.C. Starck rose significantly, especially in Europe.

EBIT of the Materials segment jumped from 58 million to 293 million in 2004. If the previous year s figure is adjusted for special items, the underlying increase comes to 206 million. This was chiefly due to growth in demand and the resulting improvements in capacity utilization. Moreover, we were able to pass on a large part of the substantially increased raw material costs from the third quarter onward.

Materials million	2003	2004	Change in %
Sales	**2,777**	**3,248**	**+ 17.0**

Polycarbonates	1,713	2,035	+ 18.8
Thermoplastic Polyurethanes	177	182	+ 2.8
Wolff Walsrode	323	328	+ 1.5
H.C. Starck	564	703	+ 24.6
EBITDA*	**327**	**542**	**+ 65.7**
Operating result [EBIT]	**58**	**293**	
of which special items	(29)	0	
Gross cash flow*	**312**	**400**	**+ 28.2**
Net cash flow*	**332**	**209**	**- 37.0**

* for definition see Bayer Group Key Data on front flap

Systems million	**2003**	**2004**	**Change** in %
Sales	**4,676**	**5,349**	**+ 14.4**
Polyurethanes	3,228	3,872	+ 20.0
Coatings, Adhesives, Sealants	1,191	1,237	+ 3.9
Inorganic Basic Chemicals	218	218	0.0
Other	39	22	- 43.6
EBITDA*	**653**	**674**	**+ 3.2**
Operating result [EBIT]	**(455)**	**348**	
of which special items	(715)	(27)	
Gross cash flow*	**623**	**484**	**- 22.3**
Net cash flow*	**781**	**289**	**- 63.0**

* for definition see Bayer Group Key Data on front flap

Systems

In the **Systems** segment, **sales** amounted to 5,349 million, up by 673 million or 14.4 percent from the previous year. On a currency-adjusted basis, business expanded by 18.8 percent. Continuing strong demand, particularly in Asia-Pacific, and price increases in the second half of the year helped sales of the Polyurethanes business unit to grow by 20.0 percent to 3,872 million. This included sales of raw materials, mainly styrene, manufactured in a new propylene oxide facility that was not in operation in the previous year. 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.

EBIT of the Systems segment climbed to 348 million in 2004. While the previous year s figure was depressed particularly by 622 million in impairments, the special items in 2004 consisted of a 27 million provision related to an agreement reached with the U.S. Justice Department in connection with an investigation into prices for polyester polyols. EBIT before special items advanced by 115 million, or 44.2 percent, to 375 million, helped by high utilization of capacities and successful cost-containment measures. In addition, the impairment losses 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.

LANXESS

Sales of the **LANXESS** subgroup grew in 2004 by 277 million, or 4.8 percent, from the previous year to 6,053 million. Currency-adjusted sales advanced by 7.8 percent.

The Chemical Intermediates unit reported sales up by 6.6 percent, to 1,132 million, or by 9.0 percent in local currencies. This improvement resulted from price increases made to offset higher raw material and energy costs, and from volume growth in the Basic Chemicals and Inorganic Pigments areas. Sales in Fine Chemicals declined year on year, largely as a result of continuing difficult market conditions for photographic chemicals, and despite an improvement in the agrochemicals market.

Sales of the Performance Chemicals unit dipped by 1.5 percent, to 1,856 million. Adjusted for the effects of foreign currency translation, however, sales rose by 1.6 percent. The expansion of business, particularly in Rhein Chemie, Ion Exchange Resins and Material Protection Products, was offset by lower sales in Functional Chemicals, Textile Processing Chemicals and other areas.

The Engineering Plastics unit posted a sharp improvement in sales, with business expanding by 18.4 percent to 1,586 million. Both the Styrenics and the Semi-

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LANXESS million	2003	2004	Change in %
Sales	**5,776**	**6,053**	**+ 4.8**
Chemical Intermediates	1,062	1,132	+ 6.6
Performance Chemicals	1,884	1,856	- 1.5
Engineering Plastics	1,339	1,586	+ 18.4
Performance Rubber	1,358	1,400	+ 3.1
Other	133	79	- 40.6
EBITDA*	**168**	**391**	**+ 132.7**
Operating result [EBIT]	**(1,290)**	**74**	
of which special items	(1,204)	(99)	
Gross cash flow*	**280**	**306**	**+ 9.3**
Net cash flow*	**131**	**234**	**+ 78.6**

* for definition see Bayer Group Key Data on front flap

Crystalline Products businesses contributed to this positive performance with price and volume increases. By contrast, sales of Fibers declined in a market characterized by global overcapacities and the resulting pressure on prices.

Performance Rubber sales moved ahead by 3.1 percent, to 1,400 million, with currency-adjusted sales up by 6.2 percent from the previous year. Growth resulted largely from an increase in selling prices occasioned by significant rises in raw material and energy costs. This unit also benefited from stronger demand for rubber products.

EBIT of the **LANXESS** subgroup improved in 2004 by a very substantial 1,364 million, to 74 million. Special items mainly comprised a 40 million provision for environmental protection measures and 21 million in litigation-related expenses. Earnings in the previous year were diminished in particular by impairment charges of 988 million. EBIT before special items thus climbed sharply from minus 86 million to 173 million, an improvement of 259 million, thanks mainly to higher gross profit and cost savings achieved through business process optimization, and to the lower depreciation and amortization resulting from the impairment losses recognized in 2003. On the other hand, margins came under pressure from further increases in raw material prices. Faced with higher raw material and energy costs, we succeeded in implementing only limited price increases. **Net cash flow** improved by 78.6 percent to 234 million.

Performance by Region

Sales of our European companies advanced by 6.2 percent. The Pharmaceuticals, Biological Products segment and MaterialScience achieved double-digit growth rates, while sales of CropScience were slightly down. Sales in

Germany grew much more slowly, posting a 0.7 percent increase to 4.1 billion.

In the North America region sales showed a small increase, measured in local currencies, on account of strong growth in our industrial businesses and CropScience. As expected, however, sales of the Pharmaceuticals, Biological Products segment fell sharply due to generic competition for Cipro®, with business shrinking by 21.4 percent in local currencies.

Sales in Asia-Pacific also grew by a double-digit percentage in local currencies. Our industrial businesses registered particularly large increases, thanks to rapid expansion in customer industries, especially plastics and electronics.

In the Latin America/Africa/Middle East region, we took advantage of the favorable market conditions especially in Latin America and grew sales considerably. The business environment in the agricultural industry improved overall, especially in Brazil. The appearance of Asian rust, a fungal disease, created an additional market for our fungicides. CropScience benefited from these favorable market conditions, increasing its sales in this region by 23.1 percent before currency translations.

Region and Segment in 2004

	Europe			North America			Asia/Pacific			Latin America/ Africa/Middle East				
		% yoy	adj. % yoy		% yoy	adj. % yoy		% yoy	adj. % yoy		% yoy	adj. % yoy		% yoy
uticals,	1,582	+ 11.5	+ 11.4	1,565	- 27.3	- 21.4	854	+ 5.5	+ 9.8	387	+ 6.6	+ 15.6	4,388	- 7.5
Care, cs	1,186	+ 5.7	+ 5.8	1,440	- 4.3	+ 4.6	289	- 4.0	- 0.3	396	- 3.1	+ 5.1	3,311	- 0.7
ealth	245	+ 0.9	+ 0.8	295	- 3.1	+ 6.2	120	- 1.4	+ 2.2	126	+ 4.4	+ 10.0	786	- 0.5
ce	2,238	- 2.5	- 2.4	1,412	+ 5.4	+ 14.3	927	- 3.6	+ 0.5	1,369	+ 17.4	+ 23.1	5,946	+ 3.2
	1,382	+ 10.9	+ 11.0	703	+ 15.8	+ 27.0	947	+ 26.7	+ 35.5	216	+ 23.2	+ 27.7	3,248	+ 17.0
	2,494	+ 18.3	+ 18.4	1,483	+ 5.5	+ 15.4	822	+ 21.2	+ 27.5	550	+ 13.4	+ 18.3	5,349	+ 14.4
S	3,134	+ 2.9	+ 2.9	1,372	+ 4.0	+ 13.0	981	+ 9.1	+ 12.9	566	+ 10.4	+ 14.3	6,053	+ 4.8
ons														
tion)	**12,915**	**+ 6.2**	**+ 6.2**	**8,277**	**- 4.2**	**+ 4.3**	**4,946**	**+ 9.2**	**+ 14.3**	**3,620**	**+ 11.7**	**+ 17.7**	**29,758**	**+ 4.2**

Value Management

We need to implement our strategic portfolio decisions on the one hand and further improve our performance on the other.

WERNER WENNING, CHAIRMAN OF THE BOARD OF MANAGEMENT OF BAYER AG

CVA-based system

One of the prime objectives of the Bayer Group is to sustainably increase enterprise value. In 1994 we became one of the first German companies to embark on the development of a value management system, which we introduced throughout the Group in 1997. The system is used for the planning, controlling and monitoring of our businesses. Our basic controlling parameter is the cash value added (CVA), which indicates the degree to which the cash flows needed to cover the costs of equity and debt and of reproducing depletable assets have been generated. If the CVA is positive, the company or business entity concerned has created value. If it is negative, the anticipated capital and asset reproduction costs have not been earned. Gross cash flow (GCF) and CVA are profitability indicators for a single reporting period. For a year-on-year comparison we therefore use the delta CVA, which is the difference between the CVAs of two consecutive periods. A positive delta CVA shows that value creation has increased from one period to the next.

Calculating the cost of capital

Bayer calculates the cost of capital by the weighted average cost of capital (WACC) formula. WACC is the average of the cost of the company s debt and equity financing, weighted according to their respective market values. The cost of equity corresponds to the return expected by our stockholders and is computed from capital market information. The cost of debt used in calculating WACC is based on the terms for our ten-year corporate bond issue.

To take into account the different risk and return profiles of our principal businesses, we calculate the cost of capital after taxes for each of our subgroups. This is 8.5 percent for HealthCare, 6.5 percent for CropScience and 6.0 percent for MaterialScience and LANXESS. The minimum return required for the Bayer Group as a whole comes out at 7.0 percent.

Gross cash flow, cash flow return on investment, and cash value added as performance yardsticks

The GCF, as published in our cash flow statement, is the measure of our internal financing capability. Bayer has chosen this parameter because it is relatively free of accounting influences and thus a more meaningful performance indicator.

The profitability of the Group and of its individual business entities is measured by the cash flow return on investment (CFROI). This is the ratio of the GCF to the capital invested (CI). The CI can be derived from the balance sheet and comprises the assets required for operations stated at cost of acquisition or construction plus working capital, less interest-free liabilities (such as short-term provisions). To allow for fluctuations during the year, the CFROI is computed on the basis of the average CI for the respective year.

Taking into account the costs of capital and of reproducing depletable assets, we determine the GCF hurdle. If the GCF hurdle is equaled or exceeded, the required return on equity and debt plus the cost of asset reproduction has been earned.

million	**2003**	**2004**
Gross cash flow	2,864	3,210
CVA	(809)	88
CFROI	8.1%	9.9%
Average capital invested	35,402	32,441

The GCF hurdle for 2004 was 3,122 million. The gross cash flow achieved was 3,210 million, or 103 percent of the hurdle. Thus in 2004 we earned our entire capital and asset reproduction costs, and the positive CVA of 88 million shows we created additional value. Given the previous year s CVA of minus 809 million, the Bayer Group therefore achieved a delta CVA of 897 million, which means we improved value creation by this amount in 2004 compared with the previous year.

The CFROI increased from 8.1 percent in 2003 to 9.9 percent in 2004, due both to the higher gross cash flow and to the lower capital invested.

The returns (CFROIs) of the subgroups also showed encouraging year-on-year gains in most cases. HealthCare posted a CFROI of 15.7 percent (2003: 10.9 percent), while the figure for CropScience was 10.6 percent (2003: 9.6 percent), for MaterialScience 9.9 percent (2003: 9.4 percent), and for LANXESS 6.7 percent (2003: 4.6 percent). The returns of our HealthCare and MaterialScience subgroups thus exceeded their hurdle rates (including asset reproduction costs), while CropScience approximately equaled the hurdle. The CFROI of LANXESS was below the hurdle.

Liquidity and Capital Resources

Gross cash flow increased by 12.1 percent from 2,864 million to 3,210 million, mainly due to the higher income from operations. The sales growth in CropScience and the industrial businesses, combined with significantly higher costs for petrochemical raw materials, led to an increase in inventories and trade accounts receivable. This in turn caused a 25.6 percent drop in net cash flow, to 2,450 million.

There was a net cash outflow of 814 million for investing activities, compared to a 460 million net inflow in the previous year. Disbursements 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 disbursements for acquisitions 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 in receipts 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 OTC business. The previous year s cash inflows of 258 million related to investments included, in particular, the proceeds from the divestment of our equity stake in Millennium Pharmaceuticals. The previous year s receipts from sales of property, plant and equipment contained mainly the 1,185 million in proceeds from the divestments of certain crop science businesses mandated by the antitrust authorities.

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Bayer Group Summary Cash Flow Statements million	**2003**	**2004**
Gross cash flow*	**2,864**	**3,210**
Changes in working capital	429	(760)
Net cash provided by (used in) operating activities (net cash flow)	**3,293**	**2,450**
Net cash provided by (used in) investing activities	**460**	**(814)**
Net cash provided by (used in) financing activities	**(1,761)**	**(761)**
Change in cash and cash equivalents due to business activities	**1,992**	**875**
Cash and cash equivalents at beginning of year	**767**	**2,734**
Change due to exchange rate movements and to changes in scope of consolidation	(25)	(39)
Cash and cash equivalents at end of year	**2,734**	**3,570**
Marketable securities and other instruments	129	29
Liquid assets as per balance sheets	**2,863**	**3,599**

* for definition see Bayer Group Key Data on front flap

The net cash outflow of 761 million for financing activities in 2004 contained a total of 559 million for the dividend paid to our stockholders and advance capital gains tax payments on intragroup dividends, as well as 724 million in interest payments. These out-flows were partially offset by 512 million in net borrowings and 10 million in capital contributions to subsidiaries.

We reduced net debt by 530 million during 2004, to 5,422 million. On December 31, 2004, we had higher liquid assets of 3,599 million to enable us to pay the remaining portion approximately 2 billion of the purchase price for the Roche consumer health business at the beginning of 2005.

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. We are taking advantage of the currently favorable market conditions to improve the conditions of our syndicated credit line and safeguard them for the long term.

For 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, please refer to the section on financial strategy and note [38] (Financial instruments) to the financial statements.

Net Debt million	**Dec. 31, 2003**	**Dec. 31, 2004**
Long-term financial liabilities as per balance sheets (including derivatives)	7,378	7,117
Short-term financial liabilities as per balance sheets (including derivatives)	2,048	2,605
Derivative receivables as per balance sheets	(611)	(701)
Debt	**8,815**	**9,021**
Liquid assets as per balance sheets	(2,863)	(3,599)
Net debt	**5,952**	**5,422**

Capital Expenditures million	2003	2004	Change in %	2005 Budget
Bayer HealthCare	407	320	- 21.4	260
Bayer CropScience	413	209	- 49.4	206
Bayer MaterialScience	464	332	- 28.4	596
LANXESS	312	279	- 10.6	

Acquisitions and divestitures

In 2004 we spent a total of 358 million for acquisitions. Of this sum, the acquisition of Roche s 50 percent interest in the OTC joint venture we founded with that company in the United States in 1996 accounted for 208 million. This acquisition was made in connection with the purchase of Roche s global consumer health business (excluding Japan). We spent a further 100 million to acquire Crompton s 50 percent interest in the Gustafson seed treatment joint venture in the United States, Canada and Mexico, thus increasing our interest in Gustafson to 100 percent.

To satisfy the last remaining antitrust conditions relating to the purchase of Aventis CropScience, we sold the 15 percent interest in KWS Saat AG that we had acquired as part of that transaction.

Earnings Performance

Net sales of the Bayer Group increased by 4.2 percent, or 1,191 million, from the previous year to 29,758 million. In local currencies and adjusted for portfolio effects, sales rose by 9.1 percent.

The cost of goods sold increased by 3.5 percent to 17.4 billion, mainly as a result of higher volumes. The ratio of the cost of goods sold to total net sales was 58.4 percent, compared with 58.8 percent in the previous year. Despite initial charges related to the alliance with Schering-Plough, selling expenses declined by 4.7 percent to 6.2 billion, largely due to currency effects. Research and development expenses declined by 12.4 percent to 2.1 billion, mainly because of our concentration on our strategic core businesses and also for currency reasons. Administration expenses increased in 2004 by 2.5 percent to 1.7 billion, on account of charges related to the integration of the OTC business acquired from Roche, the LANXESS spin-off and an organization-related reclassification of certain expenses. The reduction in the negative balance of other operating income and expenses was mainly due to the fact that the previous year s amount contained impairment charges. Other operating expenses in 2004 included charges related to the divestiture of the plasma business and litigation-related expenses. Among the items of other operating income was a 121 million gain from changes in obligations relating to the payment of employees postretirement health care costs in the United States.

EBIT in 2004 amounted to 1,808 million. Before special items, EBIT climbed by 53.1 percent to 2,244 million.

The non-operating result improved by 52 million to minus 823 million, largely because of a decrease in net interest expense, lower write-downs of investments in subsidiaries and a drop in equity-method loss. This is a particularly pleasing development in view of the fact that the previous year s item contained the 190 million gain from the sale of our interest in Millennium Pharmaceuticals.

Income taxes in 2004 came to 385 million. In 2003, the global review of asset valuations led to substantial deferred taxes, resulting in net tax income of 645 million.

Group net income in 2004 thus improved by 1,964 million to 603 million.

Bayer Group Summary Income Statements million	2003	2004	Change in %
Net sales	**28,567**	**29,758**	**+4.2**
Cost of goods sold	(16,801)	(17,382)	+3.5
Selling expenses	(6,460)	(6,155)	4.7
Research and development expenses	(2,404)	(2,107)	12.4
General administration expenses	(1,673)	(1,714)	+2.5
Other operating income and expenses - net	(2,348)	(592)	74.8
Operating result [EBIT]	**(1,119)**	**1,808**	
Non-operating result	**(875)**	**(823)**	**+5.9**
Income (loss) before income taxes	**(1,994)**	**985**	
Income taxes	645	(385)	
Minority stockholders interest	(12)	3	
Net income (loss)	**(1,361)**	**603**	

Asset and Capital Structure

Total assets increased by 0.4 billion from the end of the previous year, to 37.8 billion.

Noncurrent assets shrank by 1.4 billion, or 7.6 percent. Intangibles decreased by 0.5 billion, with amortization of 0.8 billion and negative currency effects of 0.1 billion partially offset by additions of 0.5 billion from capital expenditures and acquisitions. Property, plant and equipment declined by 0.8 billion after 1.5 billion in depreciation and 1.2 billion in capital expenditures and acquisitions, with translation adjustments and asset retirements each accounting for a 0.2 billion reduction. The value of investments declined by 0.1 billion as a result of an equity-method loss and write-downs of investments in subsidiaries.

Current assets increased by 10.6 percent, to 19.5 billion. Inventories were up by 5.6 percent to 6.2 billion, while trade accounts receivable rose by 10.0 percent to 5.6 billion. These increases were due to the substantial growth in business, as well as to higher inventory valuation stemming from the rise in raw material prices. Other receivables increased by 7.8 percent to 4.2 billion, largely because of a 0.2 billion advance payment in connection with the Roche consumer health acquisition.

Despite the dividend payment for 2003 and negative currency effects, stockholders equity rose by 0.1 billion overall to 12.3 billion, thanks mainly to the Group net income of 0.6 billion. Equity coverage of total assets for 2004 thus totaled 32.5 percent on December 31, 2004 (2003: 32.6 percent).

Liabilities grew by   0.5 billion to   23.5 billion, chiefly because of the increase in other provisions. The total of other liabilities remained steady year on year.

Summary Balance Sheets	**Dec. 31, 2003**	**Dec. 31, 2004**
million		
Noncurrent assets	18,232	16,855
Current assets	17,673	19,547
Deferred taxes and deferred charges	1,540	1,402
Stockholders equity	12,213	12,268
Minority stockholders interest	123	111
Liabilities	23,013	23,534
Deferred taxes and deferred income	2,096	1,891
Balance sheet total	37,445	37,804

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Bayer Group Profitability Ratios

		2003	2004
Cost of goods sold (%)	Cost of goods sold / Net sales	58.8	58.4
R&D expenses (%)	R&D expenses / Net sales	8.4	7.1
Return on sales (%)	Operating result [EBIT] / Net sales	(3.9)	6.1
Return on stockholders equity (%)	Income (loss) after taxes / Average stockholders equity	(9.8)	4.9
Return on assets (%)	Income (loss) before income taxes and interest expense / Average total assets	(2.8)	4.5

The Bayer Group balance sheet ratios were as follows:

Bayer Group Balance Sheet Ratios

		2003	2004
Noncurrent assets / Total assets	(%)	48.7	44.6
Depreciation and amortization / Capital expenditures	(%)	151.5	167.7
Net sales / Inventories		4.9	4.8
Net sales / Trade accounts receivable		5.6	5.3
Stockholders equity / Total assets	(%)	32.6	32.5
Stockholders equity / Noncurrent assets	(%)	67.0	72.8
Short-term liabilities / Total liabilities	(%)	39.6	42.0

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Value-Added Source

million	2004	Change in %
Net sales	29,758	+ 4.2
Other income	1,121	- 18.4
Total operating performance	30,879	+ 3.1
Cost of materials	11,722	+ 0.9
Depreciation	2,322	- 51.0
Other expenses	7,567	+ 6.4
Value-added	**9,268**	**+ 43.1**

Value-Added

The Group s total operating performance increased by 3.1 percent to 30.9 billion as a result of the increase in sales. Value-added rose by 43.1 percent to 9.3 billion, primarily due to considerably lower depreciation and amortization charges. Stockholders received 0.4 billion, employees 7.3 billion, governments 0.6 billion and lenders 0.7 billion. The remaining portion of value-added was retained by the company.

Proposal for Distribution of the Profit

Under German law the dividend is paid out of the balance sheet profit of the parent company Bayer AG, which amounted to 0.4 billion in 2004.

Distribution million	**2004**	**Share** in %
Stockholders	402	4.3
Employees	7,306	78.8
Governments	617	6.7
Lenders	705	7.6
Earnings retention	238	2.6
Value-added	**9,268**	**100.0**

We will propose to the Annual Stockholders Meeting on April 29, 2005 that the balance sheet profit be used to pay a dividend of 0.55 per share (730,341,920 shares) on the capital stock of 1.9 billion entitled to the dividend for 2004.

Employees

On December 31, 2004 there were 113,000 employees in the Bayer Group, 2,400 fewer than at the beginning of the year. The average number of employees, at 113,825, was below the 2003 level. A breakdown of employees by reporting segment and region is provided in the notes to the financial statements on page 72 ff. Personnel expenses decreased by 7.6 percent in 2004 to 7.3 billion, equivalent to 24.6 percent of sales. The value added per employee increased to 82,000.

Bayer AG Summary Income Statements million	**2003**	**2004**
Net sales	**5,224**	**233**
Cost of goods sold	(4,204)	(184)
Gross profit	**1,020**	**49**
Selling, R&D and administration expenses	(1,081)	(189)
Other operating income and expenses net	(13)	(76)
Operating result [EBIT]	**(74)**	**(216)**
Non-operating result	**(50)**	**523**
Income (loss) before income taxes	**(124)**	**307**
Income taxes	(61)	(18)
Net income (loss)	**(185)**	**289**
Allocation from retained earnings	550	113
Balance sheet profit	**365**	**402**

In 2004 we had an extensive range of measures in place aimed at enhancing the performance potential of our employees and equipping them to deal with new tasks. Customized continuing education programs and international job rotation helped to develop and strengthen their skills and self-initiative. While the total number of employees declined, our personnel structure improved through new hirings. At our German sites alone, more than 150 university graduates were given jobs in 2004, while a further 875 young people entered company-sponsored vocational training programs.

Our employees shared in Bayer s success in 2004 by way of variable income components. A new long-term incentive system was evolved for the United States.

Social responsibility at Bayer continues to be expressed in our measures to help employees reconcile family and career demands, lead healthier lives and provide themselves with dependable retirement incomes through the corporate pension plan.

Constructive cooperation with employees representatives was instrumental in enabling us to master the additional challenges presented by the Group reorganization. We implemented the restructuring and carve-out activities related to the formation of LANXESS speedily and in a socially responsible manner. This included signing the third employment pact for Bayer s German sites which, among other things, basically rules out dismissals on economic grounds through 2007.

At the European level, the employees representatives met with Group management at the 13th Bayer European Forum to continue their cross-border information exchange and consultation process. Representatives from the countries that joined the E.U. during 2004 took part in the event for the first time.

In connection with its corporate realignment, Bayer published its new global mission statement in 2004 under the slogan Bayer: Science For A Better Life (see also page 142 ff). The values specified in the mission statement, together with the leadership principles derived from them, define a framework for running a business successfully while at the same time behaving fairly toward people and nature. Our corporate compliance program, reissued in January 2004, provides our employees with guidance on legal aspects of their daily work.

Procurement and Distribution

Bayer HealthCare

The Pharmaceuticals Division procures the raw materials for the active ingredients of its prescription medicines both from LANXESS and from other external European and Asian suppliers. We hold strategic reserves to prevent supply bottlenecks and possible dependence on a single supplier. We mitigate major price fluctuations by purchasing the intermediates required to manufacture our principal active ingredients from several suppliers on the basis of global contracts. The active ingredients of our prescription medicines are currently manufactured almost entirely in Wuppertal, Germany, for Bayer production facilities worldwide. Our most important pharmaceutical production plants are located in Leverkusen, Germany; Garbagnate, Italy; and Shiga, Japan. Our products are primarily distributed through wholesalers, pharmacies and hospitals, and sometimes directly to patients.

Since we actively compete with other drug suppliers worldwide, we seek to reinforce our external distribution network with co-promotion and co-marketing arrangements. In November 2001, for example, we signed a co-promotion agreement with GlaxoSmithKline for Levitra® (vardenafil). In January 2005 we regained from GlaxoSmithKline the

Levitra® marketing rights for certain countries other than the United States. In September 2004 we entered into a strategic alliance with Schering-Plough under which that company will distribute our primary care products in the United States. At the same time, we will co-market Schering-Plough s cancer drugs in selected countries. Bayer and Schering-Plough also plan to jointly market Schering-Plough s product Zetia® in Japan.

The Biological Products Division manufactures plasma-based products and the recombinant Factor VIII at its U.S. sites. We procure raw plasma and certain intermediates and auxiliary materials for plasma derivatives from external suppliers or other manufacturers. We also purchase raw materials and packaging for Kogenate® from external suppliers throughout the world. Our products are generally distributed through governmental agencies, wholesalers, pharmacies and hospitals, and in some cases directly to patients.

The activities of our Consumer Care Division are focused on over-the-counter medicines that patients can generally purchase without a prescription. Consumer Care procures extensive volumes of certain raw materials from within the Bayer Group. The most important raw materials that we buy in bulk from third parties are sodium citrate, sodium carbonate, citric acid and ascorbic acid. These are generally readily available. To minimize business risks, we diversify our raw material procurement sources worldwide. The division s sales and distribution channels outside Europe are typically supermarket chains, drugstores and other consumer outlets. In Europe, pharmacies are the primary distribution channel.

The Diagnostics Division manufactures or assembles most of its products itself. We operate a supplier management process and procure raw materials, components and finished products on an OEM (original equipment manufacturer) basis. The materials we purchase directly are generally not subject to significant fluctuations in price or availability. Our diagnostic systems are marketed directly to customers, who are primarily reference laboratories, private laboratories and hospitals, as well as through a network of distribution companies. Our diabetes care products are channeled to the consumer market through distributors, pharmacies and retail chains.

The Animal Health Division procures pharmaceutical ingredients for its veterinary medicines from within the Bayer Group and from external suppliers throughout the world. Supplementary ingredients and packaging materials are bought from various suppliers worldwide. Depending on local regulatory frameworks, animal health products may be available to end users over the counter or with a prescription issued by a veterinarian.

Bayer CropScience

CropScience procures most of its raw materials from LANXESS and other external companies, partly through supply agreements. The cost of some raw materials tends to depend on fluctuating oil and energy prices and freight charges.

As more than 80 percent of our sales are generated in the northern hemisphere, the business depends especially on the growing seasons for the relevant crops and the respective distribution cycles. The products of our Crop Protection Business Group are marketed either to wholesalers or directly to retailers through a two- or three-tier distribution system, according to local market conditions.

Our Environmental Science Business Group markets its products to both professional and private customers through various distribution channels. In the professional market, which comprises pest control and green-industry products, we market directly to companies. In the consumer market, we sell lawn and garden products through specialist dealers.

BioScience makes its seed products available to end users, distributors and processing industries. Traits developed using plant biotechnology are either marketed to other seed companies, which produce seed for the market on our behalf, outlicensed or sold through our own seed companies usually under the brand names InVigor® or FiberMax®. In some cases we provide plant traits to other companies for use in their own research and products.

Bayer MaterialScience

The Polycarbonates Business Unit of Bayer MaterialScience sells its products primarily to injection molding and extrusion processors and to manufacturers of plastics components used predominantly in the automotive, electronics, construction, data systems, medical equipment and leisure sectors. The key petrochemical raw materials used by our Polycarbonates business unit are acetone and phenol. With raw material costs affected mainly by the volatility of oil and benzene prices, we generally conclude long-term supply agreements containing cost-based and market-price-oriented adjustment formulas. Our products are marketed chiefly through regional distribution channels. We also use trading houses and sell to smaller customers through local distributors.

The activities of Wolff Walsrode focus on building materials, industrial coatings, printing inks for soft packaging, and the health care market. In Germany and the United States, Wolff Walsrode normally sells its cellulose products directly. Elsewhere, products are marketed through Bayer s global sales organization. The principal raw material for our cellulose derivatives is chemical-grade cellulose produced from raw cellulose and cotton. We regard our procurement risk for this material as low.

H.C. Starck supplies materials and components for the electronics, optics, aviation, aerospace and medical technology industries. China is the predominant source of tungsten. As we operate our own tungsten recycling facilities, however, we are only partially dependent on Chinese imports. The supply of raw materials is covered by long-term agreements which mostly run for three to five years. H.C. Starck maintains its own international sales organizations in Europe, the United States and Japan, its most important markets. In other countries, direct contact with customers is maintained through local liaison offices.

The polyurethane products of the Polyurethanes business unit, which are based on isocyanate-polyol systems, are used in the automotive, construction, electronics and furniture industries and in leisure articles. The primary raw materials are petrochemical feedstocks, which we mostly procure on the open market through long-term agreements. A global joint venture with Lyondell provides a supply source for propylene oxide, one of our most important raw materials. These petrochemical feedstocks are subject to price fluctuations on the crude oil and derivatives markets. We mostly sell our polyurethane products directly to customers. Europe and the NAFTA countries are the primary markets for our polyurethanes business, with the Asian market continuing to show the highest growth rates.

Our Coatings, Adhesives, Sealants business unit is a leading manufacturer of raw materials for coatings and adhesives used primarily in the automotive, furniture, plastics and construction industries. Temporary fluctuations in prices for oil or utilities, for example, can heavily impact the cost of our raw materials. For this reason, supplies of the principal chemical raw materials are secured through long-term agreements. Bulk customers with global operations are attended to directly by our key account managers.

Research and Development

Research and Development Expenses
by subgroup in %

In 2004 Bayer invested a total of 2,107 million in research and development. It is particularly important for us to continuously optimize our product portfolio and manufacturing processes, while at the same time developing new products aimed at strengthening our core businesses. All the subgroups work hand in hand with Bayer Technology

Services (BTS) regarding engineering issues, particularly in the area of process technology. BTS is also responsible for maintaining and expanding the Bayer Group s technology platforms, for example in the area of catalysis. Other research focuses are enabling technologies such as plant biotechnology and nanotechnology, which offer enormous potential for developing new products and businesses.

For innovation projects in particular, we depend on our network of collaborations with leading universities, public-sector research institutes and partner companies. These collaborations allow the pooling of expertise in order to rapidly translate new ideas into successful products.

Bayer HealthCare

In 2004, 1,044 million, or 50 percent of the Bayer Group s research and development budget, was spent by Bayer HealthCare. With this investment, the subgroup is laying the foundation in the Pharmaceuticals, Biological Products, Consumer Care, Diagnostics, Diabetes Care and Animal Health divisions for the introduction of further innovative products in expanding markets.

In connection with the realignment of the Pharmaceuticals Division, we have adjusted our global pharmaceutical research and development activities to reflect changing business conditions. Research operations in this division in the future will focus on the therapeutic areas cancer and cardiovascular risk management, including diabetes, at the sites in West Haven, Connecticut, United States, and Wuppertal, Germany.

Developmental projects in other therapeutic areas, such as anti-infectives and urology, will continue until the next development phase. Thereafter, various internal and external options will be investigated to achieve the best possible value-added from these projects. New active substance classes for the treatment of viral and bacterial infections or urological disorders will no longer be included in the research program. At the same time, Pharmaceuticals will intensify its product-related research, the purpose of which is to fully exhaust the potential of candidates at advanced development stages and products that are already on the market.

Biotechnology projects focusing on respiratory diseases have been placed into the new company Aerovance, based in Berkeley, California, for development and future marketing.

In 2004 positive clinical study results were achieved with the developmental product Bay 43-9006, including the results of a phase II study for monotherapy in patients with advanced metastatic kidney cancer. Twelve weeks after participants had been assigned to a treatment group, there was a statistically significantly higher percentage of participants whose disease had stopped progressing in the BAY 43-9006 group than in the placebo group. In 2004, the United States Food and Drug Administration granted fast-track (expedited registration process) and orphan drug status (market exclusivity for drug products to treat less common diseases) to this product for the treatment of metastatic renal cell carcinoma, an advanced form of kidney cancer. The product also received orphan drug status in the European Union from the Committee for Orphan Medicinal Products (COMP) of EMEA, the European regulatory body. Jointly developed by Bayer and Onyx, BAY 43-9006 is a novel compound designed to prevent tumor growth by combining two anticancer activities. The substance is currently in phase III trials for the treatment of advanced kidney cancer, and we are planning to launch the product for this indication in 2006. Phase I and II studies are currently being conducted for a number of other tumor types. Together with Onyx, we plan to begin phase III studies in patients with advanced liver cancer and skin cancer, as well as additional phase II testing for other tumor types.

Bay 59-7939 is an oral development product that directly inhibits Factor Xa. It is currently being investigated for the prevention and therapy of thromboembolic diseases, where there is a clear medical need for improved treatment options. As an oral medicine, BAY 59-7939 could be of particular use to patients requiring anticoagulation therapy to inhibit blood clotting, including long-term prophylaxis, both in the hospital setting and at home. The phase I and II clinical studies conducted to date have shown the substance to be safe and well tolerated across a broad dose spectrum. Based on promising clinical results, we plan to begin phase III clinical testing in 2005.

The development program for repinotan, a substance to treat patients with acute ischemic stroke, was discontinued in December 2004, as phase IIb studies failed to demonstrate the expected clinical benefit. Other indications are currently being examined for this substance. We also discontinued the development of a novel active substance from the taxanes group, as the results of recently completed phase II studies did not correspond to the clinical target profile.

In the Biological Products Division we have identified five new protein variants for potential development of the next Kogenate® generation. We are currently evaluating the proteins and technology; a decision concerning the selection of product candidates for inclusion in clinical studies is expected to be made in 2005. We have signed an exclusive, worldwide license agreement with Dutch-based Zilip-Pharma concerning the development and marketing of a new, longer-acting Kogenate® formulation. The agreement involves the application of patented liposome technology developed over several years by Zilip-Pharma and its affiliated companies. Clinical results obtained by Zilip-Pharma suggest that the interval between bleeding episodes is prolonged when Factor VIII attached to liposomes is administered to individuals with hemophilia A. Kogenate® with BIO-SET® is a recombinant Factor VIII medicine administered with a unique needle-free system that eliminates the risk of needle-stick injuries. An application for registration of the product was submitted to the FDA in 2003. The BIO-SET® was approved by Health Canada in June 2004 and by the E.U. Commission in September 2004. Successive global launch of the product is scheduled to begin in 2005.

Research and development activities of the Consumer Care Division focus on the identification, development and market introduction of non-prescription products. Further initiatives focus on the expansion of indications to support existing brands and on the reclassification of current prescription medicines as over-the-counter products.

R&D activities in the Diagnostics Division concentrate on strengthening core product lines and expanding genome-based tests. Areas of focus include the further development of the ADVIA® system family in Central Laboratory Testing, the expansion of tests for infectious diseases and oncology in Molecular Testing, and the improvement of our rapid tests and Clinitek products in Near Patient Testing.

Researchers in our Diabetes Care Division are working to strengthen core product lines and expand into market segments characterized by strong growth and margins. We achieve this through user-friendly blood glucose measurement devices that meet the individual needs of diabetic patients. We are also investing in technologies that enable continuous monitoring of blood glucose levels and, in the longer term, blood-free glucose monitoring.

In the Animal Health Division, our research efforts focus on antibiotics, parasiticides and active ingredients to treat non-infectious diseases such as liver failure, cancer and congestive heart failure.

Bayer CropScience

In 2004, 679 million or 32 percent of the Bayer Group s R&D budget was spent at Bayer CropScience. Bayer CropScience has at its disposal an extensive network of global research and development facilities. Numerous field testing stations in various countries support the activities of the R&D facilities and enable future products to be tested under regional climate conditions. Research activities encompass all measures aimed at identifying new active ingredients which could be developed into insecticides, fungicides or herbicides. The technology platform for identifying new lead structures includes genomics, high-throughput screening and combinatorial chemistry. Cooperation agreements with external research companies supplement our own activities.

Bayer CropScience actively expands the use of its products through continuous life-cycle management. This includes the development of new formulations for existing active substances and products so that they can be used for other crops and in other countries, or to improve handling or processing of the product for users.

Substances discovered by our crop protection researchers are also tested and evaluated by Environmental Science to determine whether they have potential for further development. Development projects include passive treatments (gels, bait) and innovative pest control formulations, as well as new herbicide products and fungicidal combinations for the lawn care and ornamental plants sectors.

R&D in the field of plant biotechnology is mainly geared toward improving the agronomic and qualitative properties of crops. From the identification of a target gene to the development of a plant, the technologies comprise all relevant tools required to improve important crops such as cotton, canola and rice for producers and industry partners. Activities range from research into novel agronomic traits to the discovery of new plant-based specialty products for the areas of nutrition, health care and biomaterials.

The following three active substances were introduced to the market in 2004 or will be launched in 2005 once they have received regulatory approval:

Prothioconazole (Proline®) is the most recent development in the field of triazole chemistry for a broad-spectrum fungicide. In the context of plant resistance management, products containing prothioconazole are used for leaf spraying (Proline®, Prosaro®, Input®) and seed treatment (Redigo®) in cereals, canola, peanuts, dry beans and other crops.

Spiromesifen (Oberon®) belongs to a new chemical class called tetronic acids. Oberon® is a new insecticide/mite control product for spray application to control all types of white flies, mites and jumping plant lice that affect annual crops. Oberon® was developed for global use in vegetables, fruit, cotton, corn, beans, tea and certain ornamentals.

Our fungicide fluoxastrobin is a systemic broad-spectrum strobilurin for leaf application with curative and protective properties. Products containing fluoxastrobin are designed for spray application (Fandango®) and seed treatment (Bariton®, Scenic®) in cereals, potatoes, vegetables, peanuts and other crops.

Bayer MaterialScience

In 2004 Bayer MaterialScience spent 236 million on research and development, not including joint development activities with customers, to further expand its position as a technology leader and global supplier of customized, high-quality materials and systems solutions.

In the five Bayer MaterialScience business units Polyurethanes; Polycarbonates; Coatings, Adhesives, Sealants; Thermoplastic Polyurethanes; and Inorganic Basic Chemicals ultra-modern technologies and production processes are used to implement new products and applications in close cooperation with our external partners and customers.

The Polycarbonates Business Unit, for example, is constructing a new polycarbonate facility equipped with ultra-modern production technologies in Caojing, China. An outstanding example of a new product application is Smart Surface Technology, which for the first time enables the manufacture of three-dimensionally formable, illuminated plastic components. Developed in cooperation with Lumitec AG, the new technology has already been used by BREE to produce a women s handbag with interior illumination. The technology will serve as the basis for a number of other illumination concepts.

In our Polyurethanes Business Unit, the Multitec® sprayable glass fiber-reinforced polyurethane system for producing large molded parts is a highly innovative technology. It is not only more cost-effective than conventional manufacturing methods, but also makes an important contribution to reducing solvent emissions.

The Coatings, Adhesives, Sealants Business Unit is another showcase for our innovative capability. It is concentrating on the development of polyurethane raw materials for the formulation of high-grade products. Raw materials for more environmentally friendly low-solvent systems are an important focus and include starting products for self-healing automotive coatings which can repair tiny scratches.

Innovation also plays an important role at our subsidiaries Wolff Walsrode and H.C. Starck. Research activities at Wolff Walsrode aim at exploiting the unique structural and chemical properties of cellulose and other polysaccharides, which are important renewable raw materials. New developments at H.C. Starck include precursors and components for high-temperature fuel cells to be used in stationary and automotive applications.

To exploit profitable fields of activity for the future, the New Business section of Bayer MaterialScience constantly tracks and evaluates new technological and market trends. The most promising ideas are channeled into research and development projects. Here too, we place great emphasis on global cooperation with universities and other institutes.

Bayer Innovation

Responsibility for the development of innovative products and completely new fields of business outside of the subgroups core activities lies with Bayer Innovation GmbH (BIG), a subsidiary headquartered in Düsseldorf, Germany. The goal of this company is to add to Bayer s business portfolio and facilitate access to new growth markets. The focus is on medical and security technology. In the field of medical technology, the mastery of new materials combined with knowledge of human physiology and diseases is crucial in creating the novel and promising products termed drug-embedded devices . These include catheters, blood vessel prostheses, stents and adhesive plasters in which pharmaceutical active ingredients are embedded to help prevent infections, stop undesirable cell growth and accelerate the healing process. Security technology is regarded as a major growth field in a world characterized by increasing threats. One key to secure access control is a high-capacity, copy-proof, incorruptible memory that can store biometric identifiers such as fingerprints, iris scans or facial characteristics in an easy-to-read form on an area the size of a postage stamp.

Risk Management

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

As a global company, Bayer is exposed to a wide variety of risks in the course of its worldwide activities. Even before Germany s Law on Corporate Supervision and Transparency came into force on May 1, 1998, Bayer AG operated an effective system for identifying, communicating and dealing with risks at an early stage. The principles behind that system are spelled out in the Risk Management Guidelines valid throughout the Bayer Group. The goal is to identify the potential risks associated with our activities as early as possible by recording them in a central database, evaluate them according to set criteria, assess the possible quantitative and qualitative consequences of their occurrence, and take suitable measures to mitigate them. The various processes and instruments used depending on the respective risk profile are constantly being improved, supplemented and optimized in line with statutory requirements.

Reporting plays a key role in monitoring the economic risks of our everyday business. It must ensure that the business performance of individual Group companies is described and explained according to uniform guidelines. In addition to the data on which external reports are based, internal reports are produced each month to ensure that the Group Management Board and the various management levels are fully alerted to possible risks in a timely fashion. Group accounting and controlling functions support these activities and work to increase the responsiveness and efficiency of the reporting system. Our risk management system is supported by monitoring and control mechanisms based on established standard software. These mechanisms are the subject of continuous improvement and are adjusted to changes in circumstances.

The internal audit department examines at regular intervals the risk management system s efficiency and functionality. Additionally, our external auditors regularly evaluate the system s functionality and brief the Group Management Board and the Supervisory Board on the results of these evaluations. The Audit Committee of the Supervisory Board consults regularly on risk management.

To counter risks that could arise from the numerous tax, competition, patent, antitrust, capital market and environmental regulations and laws, we make our decisions and engineer our business processes on the basis of comprehensive legal advice provided both by our own experts and by acknowledged external specialists. We establish provisions in the balance sheet, and regularly evaluate the adequacy thereof, for legal risks relating to past events.

Overall business risk

The development of our business and the related fiscal objectives depends in part on the performance of the economy in those countries and regions which are relevant to our operations. The early identification of economic trends is a particularly important element in the management of our business. Continuous observation of the economic situation in the most important countries and regions is essential in this context. Our analyses of the global economy and forecasts of medium-term economic development are documented in detail on a quarterly basis and used to support operative business planning. For a summary forecast of economic development, see Future Perspectives Economic Outlook on page 42.

Industry risk

The sales and earnings of the Bayer Group s industrial businesses are impacted by the volatility and business cycles of their customer industries. These include in particular the plastics processing, automotive supply, construction, electronics and electrical industries. In times of rapid economic growth in the respective downstream industries, chemical companies generally expand capacities in order to maximize revenues. In the past, capacity expansions in some areas have exceeded market growth, which has resulted in surplus capacities worldwide.

During an extended phase of economic weakness, excess capacities can lead to a decline in prices, and thus to reduced margins and perhaps also operating losses for the Bayer Group.

In the agrochemicals business, Bayer Group sales are subject mainly to seasonal and weather-related effects as well as to fluctuations in selling prices for agricultural products. New agrochemical substances can increase competitive pressure and reduce sales of our products. In addition, the increasing importance of biotechnology in the crop science industry could lead to lower demand for some of our agrochemical products and, if there are other suppliers in the market, to declining sales.

In the agrochemical and pharmaceutical industries, patent-protected products compete only with alternative products or applications. Following the expiration of patent protection, a previously protected product is generally subjected to intensified competition due to the market entrance of generic suppliers. This can cause a loss of market share and declining sales for the Bayer Group.

Procurement market risk

As a manufacturing company active in numerous areas of the health care and chemicals industry, we procure significant quantities of aromatics (benzene, toluene), propylene, gas, coal, electrical energy and oil for the manufacture of our products. In this context, we are subject to the risk that the raw materials and utilities we need may not be available, or that the quality or quantity may not satisfy our requirements. Moreover, market prices may fluctuate considerably depending on the supply of and demand for these raw materials.

The ongoing development of the procurement system into a flexible network structure allows Bayer to more easily identify risks on the procurement markets at an early stage, respond to changes and ensure a constant supply of raw materials. The holding company also ensures that Bayer can leverage its position as a single enterprise to achieve more favorable prices and supply terms for the Group as a whole.

Exchange and interest rate risks

We guard against exchange and interest rate risks by financing our business in local currencies or by hedging currency and interest positions using derivative financial instruments that serve no other purpose. Such instruments are employed according to the respective risk assessments and on the basis of detailed guidelines. See page 132 for a detailed explanation of the use of derivative financial instruments.

Product and environmental risks

We address product and environmental risks by way of suitable quality assurance measures. These include certifying our operations to international standards, continuously upgrading our plants and processes, and developing new and improved products. Strict quality requirements are met by applying uniform standards throughout the world. We place great importance on the safety of our products and their proper usage by customers. We are committed to the international Responsible Care initiative of the chemical industry and to our own safety and environmental management system, which we report on at regular intervals. Specially developed guidelines on product stewardship, occupational safety and environmental protection are designed to ensure that all of our employees act competently and responsibly.

To guard against possible liability risks and compensation claims, we have concluded insurance agreements to keep the potential consequences within reasonable limits or exclude them completely. The level of insurance coverage is continuously reexamined.

Legal risks

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 any current or future proceedings cannot be predicted with certainty. It is therefore possible that legal judgments could give rise to expenses that are not covered, or not fully covered, by insurers compensation payments and could significantly affect our revenues and earnings.

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

Lipobay/Baycol: Over the course of the Lipobay/Baycol litigation, Bayer has been named as a defendant in approximately 14,660 cases worldwide (more than 14,550 of them in the United States). As of February 18, 2005, the number of Lipobay/Baycol cases pending against Bayer worldwide was 6,191 (6,111 of them in the United States, including several class actions). The decrease in the number of U.S. cases is attributable to various reasons, including voluntary dismissals by plaintiffs, dismissals based on settlements and court-ordered dismissals, such as for failure to satisfy procedural requirements. Several courts had entered orders requiring plaintiffs alleging injury from Baycol to furnish medical evidence of such injury according to a court-imposed schedule, and numerous cases have been dismissed for failure to provide such evidence.

As of February 18, 2005, Bayer had settled 2,938 Lipobay/Baycol cases worldwide without acknowledging any liability and resulting in settlement payments of approximately US$ 1.114 billion. Bayer will continue to offer fair compensation to people who experienced serious side effects while taking Lipobay/Baycol on a voluntary basis and without concession of liability.

After more than three years of litigation we are currently aware of fewer than 100 pending cases in the United States that in our opinion hold a potential for settlement, although we cannot rule out the possibility that additional cases involving serious side effects from Lipobay/Baycol may come to our attention. In addition, there could be further settlements of cases outside of the United States.

In the 2003 fiscal year, Bayer recorded a 300 million charge to the operating result exceeding the expected insurance coverage of approximately US$ 1.2 billion taking into consideration expenses already incurred and quantifiable expenses expected in the future to be incurred in connection with the Lipobay/Baycol litigation risk. Further insurers have since acceded to the agreement concluded in the spring of 2004 under which the insurers have withdrawn the reservation of rights customary in these cases. Negotiations with one remaining insurer are ongoing. A 47 million charge to the operating result was recorded in 2004 in light of settlements already concluded or expected to be concluded and anticipated defense costs.

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

PPA: Bayer is a defendant in numerous product liability lawsuits relating to phenylpropanolamine (PPA), which was previously contained in a cough/cold product of the company supplied in effervescent-tablet form. The first PPA lawsuits were filed after the U.S. Food and Drug Administration recommended in the fall of 2000 that manufacturers voluntarily cease marketing products containing this active ingredient. Since that time, Bayer and other manufacturers of PPA-containing products, along with several retailers and distributors, have been named in numerous lawsuits in the United States brought by plaintiffs alleging injuries related to the claimed ingestion of PPA. Following the dismissal or withdrawal of many of these lawsuits, fewer than 850 cases remain pending against Bayer. Bayer is the sole defendant in approximately 550 cases and co-defendant together with other former manufacturers of PPA-containing products in approximately 300 cases. The majority of these cases are still at an early stage. Further dismissals are therefore possible, particularly should plaintiffs fail to comply with court orders requiring the submission of causative evidence. Currently, approximately 290 appeals have been filed by some of the plaintiffs whose suits were dismissed in the first instance on the grounds of procedural deficiency.

Two PPA cases against Bayer have gone to trial so far. In the first case, in October 2004, a Texas jury awarded a plaintiff damages amounting to US$ 400,000. Bayer will appeal this decision. In the second case, in February 2005 in Utah, the jury returned a verdict in Bayer s favor.

Although Bayer plans to vigorously defend the majority of its PPA cases, there are cases where Bayer may consider settlement to be appropriate. To date, the company has settled several cases without acknowledging liability.

Based on the relatively small number of pending cases in which adequate factual records have been developed to permit a meaningful assessment, a provision taking into account existing insurance coverage was established in 2004 for those cases where Bayer is considering settlement. This provision, in the amount of 16 million, is for possible settlements and further defense costs. It remains impossible, however, to reasonably estimate potential liability with respect to the balance of the pending PPA cases, so no provision has been recorded for them.

Bayer intends to vigorously defend the Lipobay/Baycol and PPA litigation. Since the existing insurance coverage is exhausted, it is possible depending on the future progress of the litigation that Bayer could face further payments that are not covered by the accounting measures already taken. We will regularly review the possibility of further accounting measures depending on the progress of the litigation.

Cipro®: 39 putative class action lawsuits, one individual lawsuit and one consumer protection group lawsuit against Bayer involving the medication Cipro® have been filed since July 2000 in the United States. The plaintiffs are suing Bayer and other companies also named as defendants, alleging that a settlement to end patent litigation reached in 1997 between Bayer and Barr Laboratories, Inc. violated antitrust regulations. The plaintiffs claim the alleged violation prevented the marketing of generic ciprofloxacin as of 1997. In particular, they are seeking triple damages under U.S. law. Bayer believes that it has meritorious defenses and will vigorously defend the litigation. Bayer believes the plaintiffs will not be able to establish that the settlement with Barr was outside of the scope of Bayer s valid Cipro® patent, which patent has been the subject of a successful re-examination by the U.S. Patent and Trademark Office and of successful defenses in U.S. Federal Courts.

Rubber, polyester polyols, urethane: Risks also exist in connection with investigations by the E.U. Commission and the U.S. and Canadian antitrust authorities for alleged anticompetitive conduct involving certain products in the rubber field. In two cases Bayer AG has already reached agreements with the U.S. Department of Justice to pay fines, amounting to US$ 66 million for antitrust violations relating to rubber chemicals and approximately US$ 5 million for those relating to acrylonitrile-butadiene rubber. Both these agreements have received court approval and the respective amounts have since been paid. Provisions of 50 million were established in 2003 for risks arising out of the E.U. Commission s investigation, although a reliable estimate cannot yet be made as to the actual amount of any fines.

Bayer Corporation has reached agreement with the U.S. Department of Justice to pay a fine of US$ 33 million for antitrust violations in the United States relating to adipic-based polyester polyols. This fine, for which a provision has been established, requires court approval. A similar investigation is pending in Canada, but it is not currently possible to estimate the amount of any fine that may result.

A number of civil claims for damages have been filed in the United States, and a few in Canada, against Bayer AG and some of its subsidiaries. These lawsuits, involving allegations of unlawful collusion on prices for certain rubber and polyester polyol product lines, are still at a very early stage.

The financial risk associated with all of the above litigation (with the exception of those criminal proceedings in which fines have already been imposed), including the financial risk of private claims for damages, is currently not quantifiable, so no accounting measures have been taken in this regard. The company expects that, in the course of the above-mentioned regulatory proceedings and civil damages suits, significant expenses will become necessary that may be of material importance to the company.

In the United States, civil actions are also pending involving allegations of unlawful collusion on prices for polyether polyols and other raw materials for urethane products. These lawsuits are also at a very early stage.

Patent and contractual disputes: Further risks arise from patent disputes in the United States. Bayer is alleged to have infringed third-party patents relating to the blood coagulation factor Kogenate® and the ADVIA Centaur® immunoassay system. In another dispute, Bayer has filed suit against several companies alleging patent infringement in connection with moxifloxacin. These companies are defending the action, claiming, among other things, that the patents are invalid and not enforceable.

Risks also exist in connection with court or out-of-court proceedings in which Bayer is alleged to have violated contractual or pre-contractual obligations. For example, Aventis Behring LLC alleges that Bayer violated contractual obligations relating to the supply of Helixate® and is seeking damages. The purchaser of the global Everest® herbicide business alleges that, during the negotiations for the sale of the business, information was withheld or misrepresented and has filed suit for rescission of the transaction or damages. Limagrain Genetics Corporation has filed suit against Bayer as legal successor to Rhône-Poulenc for indemnity against liabilities to third parties arising from breach of contract.

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

Product liability and other litigation: Legal risks also arise from product liability lawsuits other than those concerning Lipobay/Baycol and PPA. A class action is pending in the United States against Bayer Corporation, seeking damages for plaintiffs resident outside of the United States who claim to have been become infected with HIV through blood plasma products. This class action has been widened to include U.S. residents who claim to have become infected with HCV (hepatitis C virus) through such products. Bayer Corporation is also a defendant in cases in which plaintiffs are asserting claims alleging damage to health from the substance thimoseral, which was used in immunoglobulin and nasal sprays. Claims are also being asserted against Bayer in the United States for damage to bees, honey and wax allegedly caused by imidacloprid.

Also in the United States, a case is pending against Bayer CropScience LP for compensation for loss of earnings and damage allegedly caused by effects of fipronil in crawfish farms.

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

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

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

Acquisition and capital expenditure risks

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

Liability considerations following the LANXESS spin-off

The liability situation following the spin-off of the LANXESS subgroup is governed by both statutory and contractual provisions.

Under the German Transformation Act, all entities that are parties to a spin-off are jointly and severally liable for obligations of the transferor entity that are established prior to the spin-off date. Bayer AG and LANXESS AG are thus jointly and severally liable for 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 ceases to be liable for such obligations after a five-year period.

Under the Master Agreement, Bayer AG and LANXESS AG shall release the other party from those liabilities each has assumed as principal debtor according to the Spin-Off Agreement 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.

Subsequent Events

At the beginning of 2005, Bayer regained the co-promotion rights for Levitra® in the most important markets outside the United States. The existing co-promotion agreement with GlaxoSmithKline was terminated for these markets, giving Bayer exclusive distribution rights. The transaction will have a one-time negative effect of about 100 million on first-quarter earnings in 2005.

Effective January 1, 2005, we largely completed the purchase of Roche Consumer Health. Since January, this business with non-prescription drugs and vitamins has been part of the Consumer Care Division of Bayer HealthCare. The transaction includes the global activities of Roche Consumer Health, 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 three largest global suppliers of prescription-free medicines. The provisional acquisition price for the worldwide consumer health business of Roche, before the assumption of debt, is approximately 2,373 million, including about 208 million for the purchase completed in 2004 of the remaining 50 percent interest in our U.S. joint venture with Roche. The acquisition of the remaining global business was accomplished in 2005 by way of a 2,082 million cash transfer, of which 200 was paid in advance at the end of 2004, and the assumption of some 64 million in financial liabilities. The ancillary costs of the acquisition so far amount to about 18 million. Since the acquisition closed only recently, it has not yet been possible to allocate the acquisition price among the acquired assets.

On January 28, 2005, the spin-off of LANXESS was entered into the commercial register for Bayer AG. Since January 31, 2005, LANXESS shares have been listed in the Prime Standard sub-segment of the official market segment (Amtlicher Markt) of the Frankfurt Stock Exchange.

Future Perspectives

Economic Outlook

We expect the global economy to remain on an expansionary course and maintain its robust growth in 2005, albeit at a slower pace for the time being due to the continuing high price of oil and the upward trend in interest rates. However, we do not expect these factors to lead to a major downturn.

In the euro zone, although the positive global business environment and advantageous financing conditions favor further expansion, we do not expect the pace of growth to pick up significantly in an economy that is largely driven by exports. By contrast, domestic demand could gradually gain momentum over the course of the year. In Germany we expect the moderate recovery to continue, with domestic demand increasing slightly and growth in exports slowing. On the other hand, the dynamic growth trend in the countries of eastern Europe will continue as in 2004, with investment and exports providing the main stimulus.

We expect the U.S. economy to slow down in the coming months but remain robust overall, based on increasing private-sector investment and continuing strong private consumption driven by an improvement on the employment market.

Due to the ongoing positive economic situation in Asia, we expect further stable growth in that region. However, there are indications that export growth will slow due to the weakening global economy. Overall economic expansion in China will most likely slow somewhat due to government measures to control the economy and to declining export growth. Nevertheless, we expect growth rates to remain high overall. In Japan we anticipate that the slowdown will continue, with only moderate growth in 2005.

The outlook for most Latin American economies has dimmed somewhat. Economic growth is expected to slow, particularly as a result of the more restrained development in the United States and a decline in raw material prices from what in some cases are very high levels. We also see risks for exports should South American currencies gain significant long-term value against the U.S. dollar.

Business Strategy

Following the successful stock-market listing of LANXESS, the Bayer Group is concentrating on the fast-growing, innovation-driven health care, nutrition and high-tech materials businesses in line with its mission statement: Bayer: Science For A Better Life . By strategically aligning ourselves to these attractive markets and concentrating on our core competencies, we will invest more intensively in growth areas and innovative technologies in order to achieve a leadership role or expand our already strong market positions. We will optimize our allocation of resources and press ahead with cost-containment and efficiency-improvement programs in order to make Bayer more successful, and thus increase the company s value, over the long term.

Bayer HealthCare

As part of its realignment, the Bayer HealthCare subgroup is positioning its Pharmaceuticals Division as a medium-sized supplier with appropriate structures. On the basis of the existing portfolio, the priorities in Pharmaceuticals are currently infectious diseases, cardiovascular risk management (including diabetes), urology and oncology. Oncology and cardiovascular risk management, including diabetes, will be the main areas of strategic focus in the future. Accordingly, Bayer s global pharmaceutical research and development activities are being adapted to the division s new business framework. This adjustment entails a reduction in R&D staff.

Our pharmaceutical strategy also includes the regular evaluation of opportunities to enter into regional collaborations, alliances and license agreements, as well as continuous life-cycle management to further enhance the success of products that are already on the market.

In this context, we have formed an extensive regional pharmaceutical alliance with Schering-Plough Corporation, under which this U.S.-based company will market and distribute some of our primary care products in that country. A co-marketing agreement concerning the future promotion of Schering-Plough s cardiovascular drug Zetia® in Japan has also been signed. At the same time, we are establishing a global Specialty Care business unit in the United States that will focus on oncology. In that country, Bayer will concentrate on highly profitable medicines and biotech products for medical specialists.

Following the divestiture of the plasma business of the Biological Products Division, we aim to expand our Kogenate® brand while maintaining profitability. To achieve this, we plan to increasingly set Kogenate® apart from competing products and gain market share by focusing on patient needs particularly an improved quality of life for people with hemophilia.

Our Consumer Care Division aims to outperform the OTC market and thus strengthen its global position. One focus is the analgesics business, and the Aspirin® brand in particular. In July 2004 Bayer announced its acquisition of Roche s consumer health business and the integration of these activities into the Consumer Care Division. We also acquired Roche s 50-percent interest in the joint venture we established with that company in 1996 in the United States, as well as five other production sites. The global headquarters of the company created by this merger will be in Morristown, New Jersey, United States. We continue to regularly examine external growth opportunities designed to strengthen both our portfolio and our regional presence.

In the area of diagnostics, we have divided our professional testing and self-testing activities into the Diagnostics and Diabetes Care divisions. The Diagnostics Division comprises the strategic business entities of Central Laboratory Testing, Near Patient Testing and Molecular Testing (formerly Nucleic Acid Diagnostics). Diagnostics aims to outperform the market and attain a strong position for the long term, with profitability above the market average. The division plans to achieve this by introducing innovative solutions for its customers and concentrating on a comprehensive and highly diversified product portfolio.

The objectives of the Diabetes Care Division are to grow faster than the market and to improve profitability. To this end, we are expanding our product range by developing new measurement systems and test strips with more intuitive and user-friendly application to enable diabetes patients to monitor their blood sugar levels with minimal inconvenience. In order to achieve our goals, we will continue to strengthen our expertise through strategic partnerships.

We aim to continue developing the profitable business of the Animal Health Division. In addition to enhancing existing core products, Animal Health regularly evaluates opportunities to round out its product portfolio.

Bayer CropScience

The Bayer CropScience subgroup aims to be a preferred partner in the production of high-quality food and animal feeds, renewable raw materials and fibers. We strive to become the world s leading supplier of innovative products and solutions for both agricultural and non-agricultural (Environmental Science) applications. Bayer CropScience intends to achieve its earnings targets primarily by introducing new products, realizing synergies, keeping tight control on costs and consolidating its product range. In 2004 we launched an initiative to further enhance efficiency in all areas of the company by improving internal business processes and adapting research and development activities.

The Crop Protection Business Group is committed to defending its leading market position. Here we are relying in particular on our strong presence in all parts of the world and on our balanced range of innovative, high-performance insecticides, fungicides, herbicides and seed treatment products. An important growth factor is the continuous introduction of new products from our research and development pipeline.

Environmental Science is one of the world s leading suppliers of non-agricultural pest control products. Our goal is to further expand this market position by steadily improving our product range, building strong partnerships with our customers and offering customer-oriented innovations.

BioScience is globally active in seed research, development and marketing and in solutions derived from plant biotechnology and breeding. Our strategic focus lies on the following areas:

Agricultural crops, focused on seed and plants with improved performance and productivity, especially for the core crops of cotton, canola and rice.

New business ventures, where we develop innovative, plant-based materials for applications in health care, biomaterials and nutrition.

Vegetables, where we are among the leading developers and suppliers of high-quality vegetable seed varieties. Here we intend to exploit further growth opportunities.

Bayer MaterialScience

The Bayer MaterialScience subgroup aims to further expand its global market positions by exploiting the growth potential of its new and optimized portfolio and by concentrating on capital expenditure projects in Asia. We are pursuing an organic growth strategy supported by both product and process innovations and active portfolio management in order to maintain a balanced mix of commodities and specialty products. We aim to steadily expand the contribution of specialties by pursuing activities in future growth fields. Examples here include developing functional surfaces and smart materials such as photoaddressable polymers for holographic data storage and evaluating how nanotechnology could contribute to the Bayer MaterialScience product range.

We plan to improve our margins by continuously streamlining our existing product portfolio, introducing efficient cost structures, eliminating capacity bottlenecks and continuing to exploit our regional growth potential, particularly in Asia and with a focus on China. For both our polycarbonates and our polyurethanes businesses, we strive to achieve the most cost-effective production possible by establishing world-scale facilities. Through optimized procurement strategies for petrochemicals, we hope to limit the otherwise substantial raw material price risk and thus improve the earnings situation in all business units. We also constantly investigate options for external growth through collaborations and joint ventures.

Financial strategy

The financial management of the Bayer Group is conducted centrally within the management holding company Bayer AG. The prime objectives of our financial management are the provision of sufficient short- and medium-term liquidity, a generally conservative debt policy and effective risk management. In pursuing these objectives, we endeavor at the same time to optimize our financing costs.

The situation on the international financial markets of relevance to the Bayer Group was stable last year. We do not expect this situation to change in the short term.

Against this background, our financial strategy remains geared toward maintaining a favorable credit rating. 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 by Standard & Poor s and P-2 by Moody s.

The Roche OTC acquisition was paid for at the end of 2004 and the beginning of 2005 out of liquid assets without additional borrowings. While this reduction in liquidity results in a short-term increase in net debt, the increase will be offset by a positive operating cash flow, cash receipts from loan repayments, and the assumption of 1.1 billion in debt by the LANXESS group. As planned, LANXESS financed the latter transaction externally on the credit and capital market.

Our medium term financial strategy remains directed toward further reducing net debt, which we have done consistently in the two years since the Aventis CropScience acquisition. Bayer plans to divest the shares it receives upon conversion of the mandatory convertible bonds of LANXESS AG so as to impact the market price as little as possible. We do not intend to hold a long-term interest in LANXESS, but plan to use the proceeds from the sale of the shares along with cash flows from our business operations to reduce debt.

We use financial derivatives to hedge against risks arising from business operations or related financial transactions. We do not enter into speculative transactions. It is our policy to diminish the default risk by selecting trading partners with a high credit standing. We closely monitor the execution of all transactions, which are conducted according to detailed Group-wide guidelines laid down by the Board of Management.

Planning assumptions

Our operating budget is based on an exchange rate of US$ 1.35 to the euro, petrochemical raw material prices roughly in line with the high level of the fourth quarter 2004, and a positive overall business environment, with growth rates down slightly compared to the previous year.

For fiscal 2005 we anticipate depreciation and amortization of about 1.7 billion and capital expenditures of approximately 1.4 billion.

Group sales and earnings performance

We expect to further improve the Bayer Group s operating performance in 2005, targeting an increase of more than 5 percent growth in currency- and portfolio-adjusted sales from continuing operations, to over 25 billion.

As far as earnings are concerned, we aim to improve EBIT from continuing operations before special items by roughly 20 percent year on year, which would be another major step toward achieving our medium-term profitability target.

We are budgeting for special charges of approximately 300 million in 2005, mainly from the integration of the Roche OTC business, the termination of the co-promotion agreement with GlaxoSmithKline for Levitra®, and restructuring measures. This amount does not include litigation-related expenses.

Subgroups sales and earnings performance

For the health care sector and thus for our **HealthCare** subgroup, we expect a favorable business environment again in 2005. Against this background, we aim to grow faster than the market in local currencies in the Consumer Care, Diabetes Care and Animal Health divisions, and with Kogenate®. We expect sales of the Pharmaceuticals Division to decline, as additional business with new products will not completely offset the decline in business with Ciprobay®/Cipro®. The underlying earnings performance of HealthCare this year will be impaired by lower sales of Cipro® and lower margins resulting from the fair-value recognition of the inventories received with the Roche consumer health acquisition. Without this one-time effect, we expect EBIT of our HealthCare business before special items to remain more or less steady year on year. For the Pharmaceuticals, Biological Products segment we are aiming for an underlying EBIT margin of about 10 percent.

We expect a considerable improvement in the earnings of our **CropScience** subgroup. We believe that the business environment will remain positive, and our goal is to outperform the market in local currencies. We anticipate that sales will decline slightly because of currency effects.

MaterialScience expects a significant expansion in business, and thus also a considerable improvement in EBIT before special items. We anticipate that selling prices will improve, while raw material costs will remain high, and that our cost-containment measures will help to boost earnings.

Bayer stock gains momentum in the second half of 2004

Despite rising raw material prices and the strength of the euro, Bayer stock did well over the year as a whole, posting a performance of almost 10 percent (including the dividend). Our financial market communications centered on the progress of the Bayer Group s realignment. The spin-off of LANXESS succeeded in creating additional value for stockholders.

Equity market rallied in second half

Following double-digit gains in the previous year, 2004 was essentially a year of consolidation on the German equity market with, on average, smaller rises in share prices. The German stock index DAX closed the year up 7.3 percent at 4,256 points, mainly on account of a rally in the second half that was driven by a drop in the oil price, encouraging economic data in the United States and predominantly positive reports from the corporate sector. The European blue-chip index EURO STOXX 50, which includes Bayer, was up 9.8 percent on the year.

Bayer stock also developed well, closing the year at 24.94 (+ 7.4 percent). Including the 2003 dividend of 0.50 per share, paid in 2004, our stock achieved a performance of 9.6 percent.

Bayer stock, like the DAX, moved mainly sideways in the first half, reaching a year low of 19.49 (closing price on March 22, 2004) and then regaining ground up to mid-year, due partly to strong quarterly results and encouraging data for our cancer drug currently in clinical development. Between mid-August and year end, Bayer stock rose more than 25 percent, mirroring the general improvement in market sentiment. This upward trend was aided by the improved outlook for our industrial business, the pharmaceuticals alliance with Schering-Plough, and the divestment of the plasma activities to a group of U.S. investors.

LANXESS spin-off creates value for stockholders

The spin-off of most of the chemicals business and about one third of the polymers activities to LANXESS AG was successfully accomplished, generating additional value for Bayer stockholders. After the first ten days trading, LANXESS stock was quoted at 16.64 (February 11, 2005).

Compared with the last price of 24.94* quoted for Bayer stock before the spin-off (January 28, 2005), the value created amounted to 12.3 percent. The DAX rose by 4.4 percent over the same period.

Financial analysts were positive about the effects of the spin-off, and some reduced the conglomerate discount. Bayer was considered to have sharpened its focus on its core competencies.

Increased dividend of 0.55 per share proposed

The Board of Management and Supervisory Board will propose to the Annual Stockholders Meeting that a dividend of 0.55 per share be declared for 2004. This is 10 percent more than last year and gives a payout ratio of approximately 67 percent of Group net income. The dividend yield calculated on the year-end share price comes to 2.2 percent.

Bayer Stock Data		**2003**	**2004**
Dividend		0.50	0.55
Earnings per share		(1.86)	0.83
Cash flow per share		3.92**	4.40
Equity per share		16.72	16.80
Year-end price***		23.22	24.94
High for the year***		23.85	25.44
Low for the year***		10.28	19.49
Shares issued as of year end	million	730.34	730.34
Average daily share turnover on German stock exchanges	million	5.4	3.9
Market capitalization at year end	billion	17.0	18.2
Total dividend payment	million	365	402

Price/earnings ratio			30.0
Price/cash flow ratio		5.9	5.7
Dividend yield	%	2.2	2.2

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* historical price. Pre-spin-off prices have since been adjusted by Deutsche Börse and the information services.

** 2003 figure restated

*** XETRA closing prices

This dividend proposal underlines the confidence of the Board of Management and Supervisory Board in the future earning power of the new Bayer Group.

Group realignment dominated investor relations activities

In 2004 our financial market communications were dominated by the realignment of the Bayer Group. The LANXESS spin-off featured prominently at our investors and analysts meetings, with CEO Werner Wenning and CFO Klaus Kühn providing detailed information on the LANXESS stock market listing, the new company s capital resources and Bayer s future direction.

Bayer gave a total of more than 30 presentations to investors in Germany and international financial centers during 2004.

Major discussion topics concerning Bayer HealthCare were the announcement of the Roche OTC acquisition in July and the creation of a pharmaceuticals alliance with Schering-Plough in September. Arthur Higgins, Chairman of the Executive Committee of Bayer HealthCare since July 2004, outlined the subgroup s new strategy at numerous meetings.

Bayer CropScience is also under new management. Professor Friedrich Berschauer, its CEO since April 2004, spoke with members of the financial community in Frankfurt and London about the prospects for the agrochemicals market, the subgroup s strategic alignment and the steps being taken to achieve its performance targets.

In 2004 investors also showed growing interest in our industrial business. Bayer MaterialScience CEO Dr. Hagen Noerenberg answered questions on topics such as the effects of increases in raw material prices, our presence in fast-growing markets and our views on the sustainability of their expansion.

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Management also provided information to private investors at equity forums organized by various banks. In October we set up a hotline that private investors and employees could call for technical information on the spin-off of LANXESS.

Investor relations website in great demand

Last year the Internet continued to be among the most popular sources of information. To supplement services such as downloads of financial reports and presentations and webcasts of analysts   conferences,we have now added information on our corporate bonds, including details of our financing strategy, debt programs and current credit ratings.

Further awards for IR website

For the second year in a row, MZ Consult of the United States awarded our website 8 [1] first place in its IR Global Rankings, which covered 400 companies in 40 countries.

The online communications agency NetFederation Interactive Media also gave Bayer the top score in its IR Benchmark Study 2004, putting Bayer in first place among 110 companies in both the overall and the DAX 30 rankings.

8[1] **WWW.INVESTOR.BAYER.COM**

Management and oversight in accordance with German law and Corporate Governance Code

Bayer respects the German Corporate Governance Code,8 [1] **which is integrated into paragraph 161 of the German Stock Corporation Act. In the past year the company has taken further action to comply with the Code s recommendations, as amended on May 21, 2003. For example, the company now applies the recommendation that the Board of Management appoint a representative to exercise stockholders voting rights in accordance with their instructions (Section 2.3.3).**

This applies primarily to our Annual Stockholders Meeting, which is presided over by the Chairman of the Supervisory Board. Stockholders who have deposited their shares with authorized agents by a given date are entitled to attend these meetings.

Resolutions adopted at stockholders meetings are binding on all stockholders and the company. They include resolutions on profit distribution, ratification of the actions of the Board of Management and Supervisory Board, and the appointment of auditors. Decisions to amend the company s Articles of Incorporation or allow changes to the capital stock may only be made at a stockholders meeting and subsequently implemented by the Board of Management. The stockholders can submit countermotions to the resolutions proposed by the Board of Management and Supervisory Board. They can also contest a resolution adopted by the Stockholders Meeting and demand that it be submitted for judicial review.

Since last year,Bayer has also complied with Section 4.2.3, paragraph 2, sentence 4 of the Code, under which the Supervisory Board should agree a cap on payments to Board of Management members under stock option or similar programs in the event of extraordinary, unforeseen developments. Agreements to this effect have been made with the members of the Board of Management for the current stock option program.

Board of Management: three components of annual remuneration

The Board of Management,8 [2] as the executive body of Bayer AG, is obligated to act in the best interests of the company. The Chairman of the Board of Management coordinates the principles of corporate policy. The most important tasks of the Board of Management include defining the company s strategy, setting budgets and allocating corporate resources. It publishes the consolidated quarterly and annual financial statements of Bayer AG and the Bayer Group and makes key executive appointments. The Board of Management also ensures that the Supervisory Board receives regular, timely and comprehensive information on all relevant aspects of the company s planning, business development, risk situation and risk management.

The remuneration of the Board of Management comprises an annual base salary, a fixed supplement, and a variable bonus that is oriented to the achievement of defined gross cash flow targets for the Bayer Group. In addition, members of the Board of Management may participate in a cash-settlement-based stock option program provided that they place shares of their own in a special deposit account. The stock option program constitutes a further performance-related component of their compensation.

The total remuneration of the Board of Management in 2004 amounted to 6,518,626, comprising 1,940,016 in base salaries, 810,573 in fixed supplements and 3,665,880 in variable bonuses. Also included in the total is an aggregate 102,157 of remuneration in kind, consisting mainly of amounts such as the value assigned for taxation purposes to the use of a company car.

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* report pursuant to Section 3.10 of the German Corporate Governance Code

8[1] **WWW.BAYER.COM** > ABOUT BAYER > CORPORATE GOVERNANCE
8[2] **WWW.BAYER.COM** > ABOUT BAYER > BOARD OF MANAGEMENT

Remuneration of the Members of the Board of Management

	Period	**Base salary**	**Fixed supple-ment**	**Variable bonus**	**Total**	**Stock options** 2004 tranche	**Stock options** 2004 tranche Fair value in
Klaus Kühn	Jan.-Dec.2004	408,417	170,647	771,120	1,350,184	6,735	212,355
Dr. Udo Oels	Jan.-Dec.2004	411,613	170,647	771,120	1,353,380	6,735	212,355
Dr. Richard Pott	Jan.-Dec.2004	408,627	170,647	771,120	1,350,394	6,735	212,355
Werner Wenning	Jan.-Dec.2004	711,359	298,632	1,352,520	2,362,511	11,820	372,685

From the 2004 tranche of the stock option program, the members of the Board of Management received a total of 32,025 stock options by virtue of their own investments. These options are blocked for the first three years. During the two-year exercise period thereafter, the holders will receive a cash payment not exceeding ten times their own investment, provided demanding performance criteria are met. The stock options from the 2004 tranche had a fair value of 31.53 each at the balance sheet date.

Supervisory Board: oversight and control functions

Under Bayer AG s Articles of Incorporation,[3] the remuneration of the Supervisory Board also takes the membership or chairmanship of Supervisory Board committees into account, in line with Section 5.4.5 of the German Corporate Governance Code.

The role of the 20-member Supervisory Board is to oversee the work of the Board of Management and provide advice. Under the German Codetermination Act, half the members of the Supervisory Board are elected by the stockholders, and half by the employees. The Supervisory Board is directly involved in decisions on matters of fundamental importance to the company and confers with the Board of Management on the company s strategic alignment. It also holds regular discussions with the Board of Management on the company s business strategy and the status of its implementation.

The Chairman of the Supervisory Board coordinates its work and presides over the meetings. Through regular discussions with the Board of Management, the Supervisory Board is kept constantly informed of business policy, corporate planning and strategy. The annual budget and the consolidated financial statements of Bayer AG and the Bayer Group are submitted to the Supervisory Board to obtain its approval, which must also take the auditors report into account. Details are provided in the Report of the Supervisory Board on page 138 ff of this Annual Report.

The committees set up by the Bayer AG Supervisory Board operate in compliance with the German Stock Corporation Act, the German Corporate Governance Code, the U.S. Sarbanes-Oxley Act and the rules of the New York Stock

Exchange. The committees of the Supervisory Board are as follows:

Presidial Committee: This comprises two representatives of the stockholders and two representatives of the employees. Its main task is to serve as the mediation committee required by the German Codetermination Act. It submits proposals to the Supervisory Board on the appointment of members of the Board of Management if the necessary two-thirds majority is not achieved in the first vote by the full Supervisory Board.

Audit Committee: The Audit Committee comprises three stockholder representatives and three employee representatives. This committee meets regularly, three or four times a year. Its tasks include examining the company s internal and external accounting and the quarterly and annual financial statements prepared by

8[3] **WWW.BAYER.COM** > ABOUT BAYER > SUPERVISORY BOARD

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Declaration by the Board of Management and the Supervisory Board of Bayer AG

concerning the German Corporate Governance Code (May 21, 2003 version) pursuant to Article 161 of the German Stock Corporation Act

Under article 161 of the German Stock Corporation Act, the Board of Management and the Supervisory Board of Bayer AG are required to issue an annual declaration that the company has been, and is, in compliance with the recommendations of the Government Commission on the German Corporate Governance Code as published by the Federal Ministry of Justice in the official section of the electronic Federal Gazette (Bundesanzeiger), or to advise of any recommendations that have not been, or are not being, applied. The declaration pursuant to article 161 of the Stock Corporation Act shall be available to shareholders at all times.

The Board of Management and the Supervisory Board of Bayer AG hereby declare that the company is in compliance with the recommendations of the Government Commission on the German Corporate Governance Code as published by the Federal Ministry of Justice in the official section of the electronic Federal Gazette and has been in compliance since issuance of the last declaration of conformity in December 2003/January 2004. Only the following recommendations were not, or are not being, applied or were, or are being, applied in a modified form:

1. Section 2.3.3: The Company shall facilitate the personal exercising of shareholders rights. The company shall also assist the shareholders in the use of proxies. The Board of Management shall arrange for the appointment of a representative to exercise shareholders voting rights in accordance with instructions. *The recommendation that a representative should be appointed to exercise stockholders voting rights in accordance with instructions was applied for the first time at the Annual Stockholders Meeting on April 30, 2004. Since then, all the above-mentioned recommendations have been fulfilled.*

2. Section 3.8, Paragraph 2: If the company obtains D&O (Directors and Officers Liability) insurance for the Board of Management and the Supervisory Board, a suitable deductible should be agreed. *The present D&O insurance for Bayer AG does not cover an intentional breach of duty. To the extent insurance coverage is provided, there is no deductible for members of the Board of Management or the Supervisory Board. Bayer AG has obtained personal declarations of obligation from the members of its Board of Management and Supervisory Board concerning the payment of a deductible, even if insurance coverage otherwise exists under D&O insurance obtained by the company. Pursuant to these declarations, members of the Board of Management who cause damage to the company or third parties through gross negligence under German standards in their Board of Management activity are to pay for such damage up to an amount equivalent to half of their annual income in the year in which the damage occurs. Members of the Supervisory Board who cause damage to the company or third parties through gross negligence under German standards in their Supervisory Board activity are to pay for such damage up to an amount equivalent to the variable portion of their respective annual compensation as members of the Supervisory Board for the year in which the damage occurs. This does not limit their liability toward the company or third parties.*

3. Section 4.2.3, Paragraph 2, Sentence 4: For exceptional, unforeseen developments, the Supervisory Board (in connection with stock option programs or similar arrangements for boards of management) should agree on a possible limit (cap). *The stock option program introduced in 2004 complies with this recommendation. The Supervisory Board also intends to reach corresponding agreements with the members of the Board of Management with regard to future stock option programs and similar arrangements.*

4. Section 7.1.2. Sentence 2: The Consolidated Financial Statements shall be publicly accessible within 90 days following the end of the fiscal year; interim reports shall be publicly accessible within 45 days following the end

of the reporting period. *The interim reports for the first half and third quarter of 2004 were not published within 45 days following the respective closing dates because of the preparations to carve out certain chemicals and polymers activities. This recommendation will be applied again in the future.*

Leverkusen, December 2004

For the Board of Management:		**For the Supervisory Board:**
/s/ Werner Wenning	**/s/ Klaus Kühn**	**/s/ Manfred Schneider**
Wenning	**Kühn**	**Schneider**

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Remuneration of the Members of the Supervisory Board

	Basic remuneration	Variable remuneration	Total
Dr. Paul Achleitner	40,000	6,000	46,000
Dr. Josef Ackermann	40,000	6,000	46,000
Karl-Josef Ellrich	50,000	7,500	57,500
Erhard Gipperich	70,000	10,500	80,500
Thomas Hellmuth	40,000	6,000	46,000
Prof. Dr.-Ing.e.h. Hans-Olaf Henkel	50,000	7,500	57,500
Dr. h. c. Martin Kohlhaussen	70,000	10,500	80,500
John Christian Kornblum	40,000	6,000	46,000
Petra Kronen	50,000	7,500	57,500
Dr. Heinrich von Pierer	50,000	7,500	57,500
Wolfgang Schenk	50,000	7,500	57,500
Hubertus Schmoldt	50,000	7,500	57,500
Dr. Manfred Schneider	120,000	18,000	138,000
Dieter Schulte	40,000	6,000	46,000
Dipl.-Ing. Dr.-Ing. e.h. Jürgen Weber	40,000	6,000	46,000
Siegfried Wendlandt	50,000	7,500	57,500
Reinhard Wendt	40,000	6,000	46,000
Thomas de Win	50,000	7,500	57,500
Prof. Dr. Dr. h. c. Ernst-Ludwig Winnacker	40,000	6,000	46,000
Dr.Hermann Wunderlich	40,000	6,000	46,000

the Board of Management. On the basis of the auditors report on the annual financial statements, the Audit Committee submits proposals concerning their approval by the full Supervisory Board.

The Audit Committee also oversees the company s internal control system and the procedures used to identify, track and manage risks. Other responsibilities include monitoring compliance with statutory and regulatory requirements.

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

The Supervisory Board of Bayer AG has designated Dr. Manfred Schneider as an Audit Committee Financial Expert pursuant to the Sarbanes-Oxley Act.

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

Personal liability in place of a deductible

With regard to the recommendation made by the German Corporate Governance Code that a deductible be agreed for any D&O (directors and officers liability) insurance, Bayer hereby reiterates that its D&O insurance does not cover an intentional breach of duty and that no deductible applies.

Instead, personal declarations have been given by the members of the Board of Management and Supervisory Board that, should they cause damage to the company or third parties through gross negligence (by German standards) in the performance of their duties, they undertake to pay for such damage up to the equivalent of half their total annual compensation for the year in which such damage occurs. The members of the Supervisory Board undertake to pay for such damage, if caused by them, up to the equivalent of the variable portion of their respective annual compensation as Supervisory Board members for the relevant year.

Systematic monitoring of all business activities

Bayer has an internal control system in place to ensure early identification of business or financial risks and enable it to manage such risks so as to minimize any impact on the achievement of its commercial objectives. The control system is designed to ensure timely and accurate accounting for all business processes and the constant availability of reliable data on the company s financial position.

Where acquisitions are made during a fiscal year, every effort is made to align their internal control procedures to Bayer standards as quickly as possible.

Nevertheless, the control and risk management system cannot protect the company from all business risks. In particular, it cannot provide absolute protection against losses or fraudulent actions.

Corporate Compliance Program

Our corporate activity is governed by national and local laws and statutes that place a range of obligations on the Bayer Group and its employees throughout the world. Bayer manages its business responsibly in compliance with the statutory and regulatory requirements of the countries in which it operates.

The Board of Management has also issued directives to help it do so. These are summarized in the Program for Legal Compliance and Corporate Responsibility at Bayer (Corporate Compliance Program),[4] which contains binding rules on complying with international trade law, adhering to the principle of fair competition, and concluding contracts with business partners on fair terms.

To avoid conflicts of interest, every employee is required to separate corporate and private interests. The program also lays down clear rules for employee integrity toward the company and the responsible handling of insider information.

Compliance Committees have been set up at Bayer AG and its subgroups and service companies: Bayer Health-Care, Bayer CropScience, Bayer MaterialScience, Bayer Business Services, Bayer Technology Services and Bayer Industry Services. Each of these committees is chaired by a Compliance Officer who is a member, or reports directly to a member, of the respective company s management or executive board. Each Compliance Committee includes at least one legal counsel.

The role of these committees is to initiate and monitor systematic, business-specific training and other measures necessary to ensure implementation of the Corporate Compliance Program. They are also responsible for investigating any suspected violations of the Corporate Compliance Program and, if necessary, taking steps to rectify them. All Compliance Committees report at least once a year to a coordination committee chaired by the Chief Financial Officer on any violations notified to them, the investigations carried out and their outcomes, and any corrective or disciplinary action taken. They also report on the systematic training and implementation measures they have initiated to foster compliance.

All Bayer employees are required to immediately report any violations of the Compliance Program. In Germany a telephone hotline to a law firm has been set up to allow this to be done anonymously.

Detailed reporting

To maximize transparency, we provide regular and timely information on the company s position and significant changes in business activities to stockholders, financial analysts, stockholders associations, the media and the general public. Our reporting therefore complies with the recommendations of the Corporate Governance Code: Bayer publishes reports on business trends, earnings and the Group s financial position four times a year. The annual consolidated financial state-

8 [4] **WWW.BAYER.COM** > ABOUT BAYER > LEGAL COMPLIANCE

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ments of the Bayer Group are published within 90 days following the end of the fiscal year. In addition to the annual report, quarterly reports, news conferences and analysts meetings, Bayer publishes the reports on Form 20-F (annual report) and 6-K (quarterly report) required by the U.S. Securities and Exchange Commission (SEC). Bayer also uses the Internet as a platform for timely disclosure of information. This includes details of the dates of major publications and events such as the annual report, quarterly reports and the Annual Stockholders Meeting.

In line with the principle of fair disclosure, we provide the same information to all stockholders and all main target groups. All significant new facts are disclosed immediately. Stockholders also have timely access to the information that Bayer publishes in foreign countries in compliance with local stock market regulations.

In addition to our regular reporting, we issue ad-hoc statements on developments that might not otherwise become publicly known but have the potential to materially affect the price of Bayer stock. In addition, the Board of Management issues an announcement as soon as it becomes aware that the voting rights held by a single stockholder have reached, exceeded or dropped below 5, 10, 25, 50 or 75 percent as a result of the purchase or sale of stock or any other circumstance. Similarly, Bayer provides information without delay on purchases or sales of Bayer AG or Group companies shares, stock options or other stock derivatives by members of the Board of Management or the Supervisory Board pursuant to Article 15a of the German Securities Trading Act.

Investor protection in compliance with the Sarbanes-Oxley Act

As an international company with subsidiaries in many countries, Bayer AG is listed on a number of stock exchanges around the world, including since January 2002 the New York Stock Exchange. Alongside the rules of the U.S. stock exchange regulator, the Securities and Exchange Commission (SEC), it therefore has to comply with specific U.S. laws such as the Sarbanes-Oxley Act adopted by the U.S. Congress in July 2002. This law is designed to provide greater protection for investors and has also resulted in a range of new corporate governance requirements in addition to the rules of the SEC.

The Bayer Group has brought its corporate governance into line with U.S. regulations. For example, it has set up a Disclosure Committee to review and approve all work-flows, especially those that generate material financial information about the company, before such information is published. A certification procedure has also been implemented to enable the management teams of the subgroups and subsidiaries to verify the accuracy of the financial data they provide for Group reporting purposes. This enables the Chief Executive Officer (the Chairman of the Board of Management) and the Chief Financial Officer to certify the Group financial statements as required by the Sarbanes-Oxley Act and duly submit them to the SEC.

Bayer has also redefined the tasks of the Audit Committee to comply with U.S. regulations and issued new rules on relations with the independent auditors.

Auditing in line with international standards

The financial statements for the Bayer Group are prepared in accordance with the principles set out in the International Financial Reporting Standards (IFRS). The financial statements of Bayer AG meet the requirements of the German Commercial Code. The financial statements of Bayer AG and the Bayer Group are prepared by the Board of Management, approved by the Supervisory Board and audited by independent auditors.

Since fiscal 2004 Bayer has also complied with the recommendation of the German Corporate Governance Code concerning the publication of a list of legal entities in which it has a shareholding that is not of minor importance

(Section 7.1.4).

Sustainability requires change

Aligning our corporate actions to sustainable-development principles means assuming economic, ecological and social responsibilities. It also means regularly reviewing our own structures and adapting them to equip our company and its employees for the future. In today s rapidly changing world, no solutions are permanent.

We have largely completed the realignment of the Bayer Group and positioned ourselves for the future. A new Bayer mission statement describes the goals, strategy and values of our company. Listed here among the basic values to which we are committed are respect for people and nature and sustainability of our actions. Since living these values also requires formal structures, we have set up a Corporate Sustainability Board, which began its work in 2004. The subgroups and the holding company have worked closely together to define a Bayer Group Sustainable Development Policy on the basis of the recently issued Values and Leadership Principles.

As well as publishing our key safety and environmental performance indicators, we plan in future to provide further data to more specifically describe our social commitment. The considerable reductions in the figures for 2004 compared with 2003 (see table on next page), while also reflecting substantial improvements in our sustainability performance in all key areas due to steady technological advances, are predominantly related to the separation of LANXESS.

In 2004 Bayer became a registered Organizational Stakeholder of the Global Reporting Initiative (GRI). We support the mission of the GRI to develop globally accepted sustainability reporting guidelines through a worldwide multi-stakeholder process. Accordingly, we will continue to enhance our own reporting and publish regular Sustainable Development Reports 8[1].

Bayer is keenly involved in the discussion of environmental and consumer protection regulations and strategies at both the local and international levels. We are committed to the goals of a modern chemicals policy for the European Union and are willing to contribute to constructive solutions. However, the competitiveness of the European industry must not be jeopardized by over-regulation. We welcome the E.U. Commission s environment and health strategy (SCALE), which is aimed particularly at improving the health of children and young people, and favor an approach to this issue that takes all health-relevant factors into account.

Working for climate and environmental protection

We also support the European climate policy, advocate an emissions trading system that does justice both to the interests of industry and to the need to protect the Earth s climate. Our own contribution to climate protection is exemplary: since 1990 Bayer has reduced direct greenhouse gas emissions from its facilities by more than 60 percent. We have achieved this by modifying processes, employing the latest technologies, closing down older facilities and using new power plants that burn gas instead of coal and are therefore more efficient and emit smaller amounts of pollutants. By cutting back greenhouse gas emissions by almost two thirds over the past fifteen years, we have complied with the Kyoto Protocol and have already exceeded the 50 percent reduction that the Enquête Commission of the German parliament set as the target for 2020.

Our products and innovative manufacturing processes also help to reduce emissions in other ways. Here are two examples:

Together with partners, Bayer has developed a new hydrochloric acid electrolysis process for chlorine production. Based on oxygen depolarized cathode technology, it uses 30 percent less electrical energy than the process it replaces and thus also reduces carbon dioxide emissions. The first such facility has come on stream at our site in Brunsbüttel, Germany.

A novel polyurethane composite heat insulation system based on Bayer raw materials was approved for use in buildings in Germany in 2004. Such systems also have great potential in China, as they allow energy savings of up to 75 percent compared with the current Chinese standard.

Our environmental protection experts have also been particularly creative in the area of wastewater treatment.

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8 [1] **WWW.SD.BAYER.COM**

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Key Safety and Environmental Performance Indicators

Category	Indicator	2003	2004**
Safety	Industrial injuries to Bayer employees resulting in at least one day s absence (MAQ* value)	3.4	2.7
	Reportable industrial injuries to Bayer employees (MAQ* value)	7.2	4.7
	Environmental or damage-causing incidents	21	6
	Number of transportation incidents according to CEFIC guidelines	28	11
Emissions and solid waste	**Emissions to the atmosphere**		
	Climate-relevant gases (million metric tons CO_2 equivalent per year)	5.4	4.2
	Volatile organic compounds (thousand metric tons per year)	10.7	4.6
	Emissions into water		
	Total phosphorus (thousand metric tons per year)	0.6	0.8
	Total nitrogen (thousand metric tons per year)	3.4	0.7
	Hazardous waste		
	Generated (million metric tons per year)	0.5	0.3
	Landfilled (million metric tons per year)	0.2	0.1
Resource consumption	Water consumption (million cubic meters per day)	2.1	1.4
	Energy consumption (petajoules [= 10^{15} joules] per year)	141	91

* MAQ = million-working-hour quota = number of injuries per million hours worked that resulted in at least one day s absence

** data excluding LANXESS

Ozonolysis is the name given to a new, patented use for a process that reduces the volume of wastewater sludge at Bayer s Wuppertal site by up to 90 percent and at the same time treats the wastewater more efficiently. The invention not only benefits the environment, but also considerably reduces waste disposal costs a prime example of constructive interplay between ecology and economy.

Bayer is also pursuing an innovative approach with its strategy for sustainable agriculture. Development of the strategy began in 2003 with a broadly based internal and external stakeholder process. This was followed in 2004 by the internal implementation phase, which included regional working groups, a case study series on the Internet and the development of targets, measures and performance parameters. The strategy defines three principal ways in which we can contribute to the spread of sustainable agriculture: by developing innovative agricultural technologies and solutions, by encouraging a life-cycle approach to product stewardship, and by promoting good agricultural practices and services.

Putting products to the test

For Bayer, the goal of sustainable, environmentally and socially responsible development applies not only to new processes and products, but also to existing ones. Systematic product analysis provides the basis for strategic decision-making, guides product development and thus enables state-of-the-art product management. It also identifies potential starting-points for new, worthwhile processes and technologies that may contribute to Bayer s success in the future.

Recognition by the financial markets

Sustainability is an increasingly important criterion for investment decisions by financial services providers: in 2004 Bayer stock was again listed in the Dow Jones Sustainability World Index (DJSI World) and the European Dow Jones STOXX Sustainability Index (DJSI STOXX). These indices contain the shares of companies that are among the leaders in their respective industries with respect to economic, ecological and social performance. Bayer was rated very highly in categories such as Strategic Planning and Environmental Reporting , and was judged the best chemical company with regard to talent recruitment, employee retention and working conditions. More than 50 financial services providers in 14 countries now base their investment decisions on the Dow Jones Sustainability Indices. In 2004 these companies managed a total investment volume of nearly 3 billion. Bayer has been continuously included in the two most important sustainability indices since they were established in 1999 (DJSI World) and 2001 (DJSI STOXX), respectively.

Commitment to the environment, education, sports and health

As part of its commitment to corporate citizenship, Bayer supports some 300 projects worldwide in the fields of education and research, environment and nature, basic social needs, sports and the arts. The company provides economic and technical expertise and donates money and materials, with many employees making active personal contributions to society and environmental protection in the context of these corporate efforts. Like sustainable development, corporate social responsibility is an integral part of Bayer s new mission statement and corporate policy.

A major focus of our social commitment 8[1] in the fields of education and the environment is the partnership with UNEP, the United Nations Environment Programme. Building on many years experience with joint projects in Southeast Asia, we have globally expanded this collaboration through a cooperation agreement that makes Bayer the first private-sector partner to UNEP in the area of youth and the environment. To support the projects, Bayer will provide 1 million annually and further contributions in kind for an initial period of three years.

The partnership is aimed at increasing environmental awareness among young people throughout the world. The educational activities supported by Bayer range from youth environmental conferences through the international magazine Tunza to children s art contests and prizes for young photographers. At the heart of the partnership is the Young Environmental Envoy program. At the end of 2004, another 50 young people from Asia, eastern Europe and Latin America went on a week-long study trip to Germany at the invitation of Bayer AG. Already active in environmental initiatives in their own countries, the youngsters received first-hand information on the latest environmental protection technologies at Bayer s facilities. They also had the opportunity to talk about important aspects of sustainable development, both with Bayer experts and during visits to environmental institutions. Upon returning home, the young environmental envoys pass on their experience and expanded knowledge through their diverse networks. Since 1998 a total of 150 environmental envoys have visited Bayer under this program. Some of them now hold positions in which they have responsibility for environmental issues and can thus contribute significantly to sustainable development in their own countries.

Vocational training opportunities for disadvantaged youths

Young people are also at the focus of vocational training projects initiated by Bayer in Germany. For example, the company runs a career preparation program to help applicants who did not qualify for a vocational training placement on their first attempt. At the beginning of 2004 we considerably increased the number of places in this successful program to 175, and it now operates at the Wuppertal and Brunsbüttel sites as well as in Leverkusen, Dormagen and Uerdingen. Since 1988, 597 young people who successfully completed the one-year qualification phase have been accepted into vocational training programs. The children s charity Deutsches Kinderhilfswerk honored Bayer s commitment to socially disadvantaged young people with an award for corporate social responsibility presented under the patronage of Wolfgang Thierse, President of the German Bundestag.

Fair treatment of employees

A company s social responsibilities include showing a commitment to its employees and offering them good occupational and development opportunities. Bayer takes these responsibilities seriously and addresses them in exemplary fashion, as evidenced by the Fair Company prize presented to Bayer by German magazine *Junge Karriere.* This award was made in recognition of Bayer s responsible deployment of interns, trainees and entrance-level workers who do not hold full-time positions. Each year the company offers about 700 students

8[1] **WWW.BAYER.COM** > ABOUT BAYER > SOCIAL RESPONSIBILITY

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the opportunity to gain employment experience through qualified internships and thus improve their job prospects. Bayer regards the recruitment of highly educated young people as an important investment in the company s future. Bayer s German companies plan to hire about another 400 university graduates by 2007.

Disease control

Bayer s worldwide social commitment is helping to achieve the aims of the United Nations Global Compact initiative. In the summer of 2000, Bayer was among the first industrial companies to join this worldwide initiative aimed at protecting human rights, caring for the environment, fighting corruption and ensuring certain minimum social standards. In 2004 Bayer again supported developing countries in their efforts to provide effective health care. For example, Bayer HealthCare is now donating supplies of the blood coagulation factor Kogenate® worth approximately US$ 10 million to the World Federation of Hemophilia. Providing this medicine free of charge will enable urgently needed treatment for hemophilia patients in 27 countries in Latin America, Africa, Asia and eastern Europe. In Central and South America, Bayer is assisting the World Health Organization in the fight against Chagas disease, an infection spread by blood-sucking parasites. Between 16 and 18 million people are currently infected, and a further 120 million are acutely at risk. Bayer is donating 250,000 Lampit® tablets to combat the disease, enough to cover the estimated demand for the drug for one year.

The fight against acquired immune deficiency syndrome (AIDS) is one of the biggest challenges facing the African continent. In Mozambique, Bayer is cooperating with the Community of Sant Egidio, an international charity, on its DREAM project (Drug Enhancement Resource Against AIDS and Malnutrition). We are providing Sant Egidio with test kits for monitoring the progression of HIV so that it can be more effectively treated. Some 60,000 people stand to benefit from these tests by 2006. We are also giving scientific and technical training to the medical workers concerned. Following the project s successful launch in Mozambique, it is to be extended to other African countries in the coming years.

The Chinese government has placed the fight against AIDS on its political agenda and invited corporate involvement. Bayer has willingly taken up this cause in the world s most populous country and has initiated diverse support projects, ranging from radio information campaigns to employee health programs and treatment projects in the communities near its sites. Mindful of the need for professional media communications to promote lasting awareness of the HIV/AIDS risk, Bayer has joined with Tsinghua University in Beijing in launching the Tsinghua Bayer Public Health and HIV/AIDS Media Studies Program, an innovative course of study on health reporting. For years, Bayer has been a member of the Global Business Coalition on HIV/AIDS (GBC), an alliance of over 180 international companies dedicated to combating the AIDS epidemic. In the spring of 2004, a first meeting took place in Beijing between high-ranking Chinese politicians and GBC corporate representatives to explore the prospects for joint action. Bayer played a major role in convening the meeting.

100 years of Bayer sports

The promotion of leisure pursuits, cultural activities and sports 8[2] is another aspect of Bayer s social commitment. In Germany alone, the company supports 67 sports clubs and cultural societies with a total of over 61,000 members. This wide range of company-sponsored clubs and societies is unique in Europe and has a long tradition. The training department and the orchestral society of what was then called Farbenfabriken Bayer were established in 1901. TSV Bayer 04 Leverkusen, Germany s first company sports club, celebrated its centennial in 2004. Bayer athletes to date have won a total of 60 Olympic medals and more than 150 world or European championships. Through its support for 29 sports clubs, Bayer contributes significantly to the promotion of youth, recreational, professional and disabled sports in Germany.

Our many years of steady commitment to corporate social responsibility were acknowledged in a Europe-wide study conducted by the German publication *manager-magazin* that rates Bayer among the leading companies in this respect.

8[2] **WWW.SPORT.BAYER.COM**

Consolidated Financial Statements of the Bayer Group

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Notes to the Consolidated Financial Statements of the Bayer Group

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Management s Statement of Responsibility for Financial Reporting

The consolidated financial statements of the Bayer Group have been prepared by the management, which is responsible for the substance and objectivity of the information contained therein. The same applies to the management report, which is consistent with the financial statements.

Our financial reporting takes place according to the rules issued by the International Accounting Standards Board, London.

Effective internal monitoring procedures instituted by Group management at the consolidated companies along with appropriate staff training ensure the propriety of our reporting and its compliance with legal provisions. Integrity and social responsibility form the basis of our corporate principles and of their application in areas such as environmental protection, quality, product safety, plant safety and adherence to local laws and regulations. The worldwide implementation of these principles and the reliability and effectiveness of the monitoring procedures are continuously verified by our Corporate Auditing Department.

These measures in conjunction with a uniform reporting system throughout the Group ensure that Group companies present the management with an accurate view of their business operations, enabling us to discern risks to our assets or fluctuations in the economic performances of Group companies at an early stage and at the same time providing a reliable basis for the consolidated financial statements and management report.

The Board of Management conducts the business of the Group in the interests of the stockholders and in awareness of its responsibilities toward employees, communities and the environment in all the countries in which we operate. Our declared aim is to deploy the resources entrusted to us in order to increase the value of the Bayer Group as a whole.

In accordance with the resolution of the Annual Stockholders Meeting, the Supervisory Board appointed PwC Deutsche Revision Aktiengesellschaft Wirtschaftsprüfungsgesellschaft as independent auditors of the consolidated financial statements and of the statements compliance with the International Financial Reporting Standards. The scope of the auditors report, which appears on the following page, also includes Bayer s risk management system, which they have audited in light of the German Law on Corporate Supervision and Transparency. The consolidated financial statements, the management report and the auditors report were discussed in detail, in the presence of the auditors, by the Audit Committee of the Supervisory Board and at a plenary meeting of the Supervisory Board. The Report of the Supervisory Board appears on page 138 ff of this Annual Report.

The Board of Management

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Independent Auditors Report

We have audited the consolidated financial statements of the Bayer Group, established by Bayer Aktiengesellschaft, Leverkusen, Germany and consisting of the income statement, the balance sheet, the statement of changes in stockholders equity and the statement of cash flows as well as the notes to the financial statements for the financial year from January 1 through December 31, 2004. The preparation and the content of the financial statements according to the International Financial Reporting Standards (IFRS) of the IASB are the responsibility of the Board of Management of Bayer AG. Our responsibility is to express an opinion, based on our audit, about whether the consolidated financial statements are in accordance with IFRS.

We conducted our audit of the consolidated financial statements in accordance with German auditing regulations and generally accepted standards for the audit of financial statements promulgated by the Institut der Wirtschaftsprüfer in Deutschland (IDW) (German Institute of Certified Public Accountants), and additionally observed the International Standards on Auditing (ISA). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the consolidated financial statements are free of material misstatements. Knowledge of the business activities and the economic and legal environment of the Group and evaluations of possible misstatements are taken into account in the determination of audit procedures. The evidence supporting the amounts and disclosures in the consolidated financial statements is examined on a test basis within the framework of the audit. The audit includes assessing the accounting principles used and significant estimates made by the Board of Management, as well as evaluating the overall presentation of the consolidated financial statements. We believe that our audit provides a reasonable basis for our opinion.

In our opinion, the consolidated financial statements as of December 31, 2004 give a true and fair view of the net assets, financial position, results of operations and cash flows of the Bayer Group for the financial year in accordance with IFRS.

Our audit, which - according to German auditing regulations - also extends to the Group management report prepared by the Board of Management for the financial year from January 1 through December 31, 2004, has not led to any reservations. In our opinion, on the whole the Group management report, together with the other information in the consolidated financial statements, provides a suitable understanding of the Group s position and adequately presents the risks related to its future development. In addition, we confirm that the consolidated financial statements of the Bayer Group and the Group management report for the financial year from January 1 through December 31, 2004 satisfy the conditions required for the Company s exemption from its duty to prepare the consolidated financial statements and the Group management report in accordance with German accounting law.

Essen, March 3, 2005

PwC Deutsche Revision
Aktiengesellschaft
Wirtschaftsprüfungsgesellschaft

P. Albrecht	V. Linke
(Wirtschaftsprüfer)	(Wirtschaftsprüfer)

Bayer Group Consolidated Statements of Income

million	Note	2003[1)]	2004
Net sales	[1]	**28,567**	**29,758**
of which discontinuing operations	[6]	*6,389*	*6,713*
Cost of goods sold		(16,801)	(17,382)
Gross profit		**11,766**	**12,376**
Selling expenses	[2]	(6,460)	(6,155)
Research and development expenses	[3]	(2,404)	(2,107)
General administration expenses		(1,673)	(1,714)
Other operating income	[4]	1,158	804
Other operating expenses	[5]	(3,506)	(1,396)
Operating result [EBIT]	[7]	**(1,119)**	**1,808**
of which discontinuing operations	[6]	*(1,639)*	*18*
Expense from investments in affiliated companies - net	[8]	(93)	(158)
Interest expense - net	[9]	(353)	(275)
Other non-operating expenses - net	[10]	(429)	(390)
Non-operating result		**(875)**	**(823)**
Income (loss) before income taxes		**(1,994)**	**985**
Income taxes	[11]	645	(385)

Income (loss) after taxes		**(1,349)**	**600**
Minority stockholders interest	[13]	(12)	3
Net income (loss)		**(1,361)**	**603**
Earnings per share ( )	[14]	**(1.86)**	**0.83**
Diluted earnings per share ( )	[14]	**(1.86)**	**0.83**

1) 2003 figures restated

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Consolidated Financial Statements of the Bayer Group

Bayer Group Consolidated Balance Sheets

million	Note	Dec. 31, 2003(1)	Dec. 31, 2004
Assets			