

Schering acquisition crowns a strong year



Dear Stockholders:

We look back with satisfaction on an eventful and successful 2006 – a landmark year for Bayer, both strategically and operationally. Our employees around the world have good reason to be proud of last year's accomplishments:

- By acquiring Schering, Berlin, Germany, in what was the largest corporate transaction in Bayer's history, we further optimized our product portfolio and successfully continued the Group's realignment.
- We increased sales considerably, and operating performance (EBIT and EBITDA before special items) was at an all-time high.
- In China, we inaugurated production facilities representing Bayer's largest-ever capital expenditure project outside Germany.

The year's outstanding event was our acquisition of Schering AG for approximately €17 billion. The Schering business ideally complements our existing pharmaceutical activities, and the new Bayer Schering Pharma AG is among the world's leading suppliers of specialty pharmaceuticals. Our attractive product portfolio and well-stocked research and development pipeline offer excellent prospects for future success. We are convinced that Bayer Schering Pharma will strengthen our HealthCare business – and with it the entire Bayer Group – for the long term.

The integration process is proceeding as planned. We are well on track to achieve the communicated synergy goal of €700 million annually by 2009.

The Schering acquisition is founded on a balanced financing package of cash, borrowings and equity transactions. In addition to the mandatory convertible bond issued in March, we successfully placed 34 million new Bayer shares, worth €1.2 billion, in July.

We continued to focus our portfolio by divesting the diagnostics business and the subsidiaries H.C. Starck and Wolff Walsrode. The substantial proceeds of these transactions will help to reduce debt.

We also scored considerable success in our business operations:

- Sales rose 17 percent to €29 billion. Adjusted for currency fluctuations, the effect of the Schering acquisition and other portfolio changes, growth amounted to 5 percent.
- EBITDA before special items climbed by 21 percent from the prior year, to €5.6 billion. That gave us an underlying EBITDA margin of 19.3 percent, in line with our earnings guidance for 2006.
- EBIT before special items moved ahead 14 percent to a record high of €3.5 billion, while EBIT after special items advanced by 10 percent to €2.8 billion.

Of course we want you, our stockholders, to benefit from our economic success. We therefore propose to raise the dividend for 2006 by 5 percent to €1.00 per share.

Our good business performance is also reflected in the value of Bayer stock. The share price rose above €40 in 2006 for the first time in five years. Last year alone, our market capitalization grew by 20 percent to more than €31 billion. We will do all we can to ensure that this encouraging performance continues in the future.

Our success greatly depends on the skills and the dedication of more than 100,000 Bayer employees throughout the world, whom I would expressly like to thank on behalf of the entire Board of Management. Without their support, we could not have accomplished so much over the past year. We continue to rely on their high commitment and motivation.

Now let us look at the performance of the subgroups.

Sales of Bayer HealthCare rose considerably, thanks to the Schering acquisition and above-market growth in all divisions. We successfully introduced new products to the market and boosted the potential of existing products through expanded registrations.



Including Schering's sales prior to the acquisition date as well gave Bayer Schering Pharma total pro forma sales of more than €10 billion for 2006 – a very substantial revenue base.

Together with the Consumer Care, Diabetes Care and Animal Health divisions, which all hold leading international positions and also performed impressively last year, HealthCare will account for nearly 50 percent of Bayer Group sales in the future. As you can see, these activities are growing quickly and profitably.

Bayer CropScience stood up comparatively well to difficult market conditions in 2006. Our conventional crop protection business in particular had to contend with adverse weather conditions, heightening competition from generic products and the increasing cultivation of genetically modified crops. The company is implementing a new cost structure program to sustainably improve earnings. Innovation and growth prospects at Bayer CropScience are closely linked to the major opportunities presented by plant biotechnology. I for one believe that biotechnology is one of the most important technologies of the 21st century – and it will be of fundamental value to Bayer CropScience in mastering future challenges.

At Bayer MaterialScience, sales again developed well and earnings almost matched the high level of the previous year. Margins were squeezed primarily by the sharp rise in petrochemical feedstock and energy costs, along with unplanned production interruptions.

In polycarbonates we achieved a special milestone in 2006, becoming the world's number one supplier. This means Bayer is now the global leader in both polyurethanes and polycarbonates.

In China we are implementing our biggest capital expenditure project to date outside Germany, with a volume of approximately US\$ 1.8 billion through 2009. By building the facilities at the Bayer Integrated Site in Shanghai, Bayer MaterialScience has laid the foundation for further growth in the highly promising Asia-Pacific region, and China in particular.

We remain confident for 2007 and aim to boost Group sales by more than 10 percent. Adjusted for portfolio and currency effects, business should expand by about 5 percent. We plan to increase underlying EBITDA by more than 10 percent as well, and also slightly improve our underlying EBITDA margin.

Yet apart from the kind of corporate success that can be expressed in terms of sales and earnings, another aspect is very important to me. Our products are of great value to humankind and contribute substantially to improving the quality of life. They extend the health of people and animals, help ensure the quality and adequacy of food supplies, make cars safer, improve home living and contribute to climate protection. Thus the achievements of our employees are in evidence everywhere.

Our products save lives, improve conditions and are indispensable to many people. That is enormously motivating and a source of great satisfaction and pride.

In 2006 we also ran more than 300 activities that testify to our corporate social responsibility, ranging from training for young environmentalists around the world through programs for school students and talented scientists to the development of health care plans and projects to ease social hardship.

Bayer is mindful of its social responsibilities and is particularly committed to the principle of sustainability. We are a strong advocate of responsible corporate governance and business ethics, and we require strict observance of our corporate compliance program.

This year again, we want to live up to our mission statement "Bayer: Science For A Better Life." And I'm already sure we can succeed – not least because we can count on an exceptionally dedicated workforce. An example is the response to our new "Triple-i" initiative (inspiration, ideas, innovation), which is helping to strengthen the innovation culture throughout the Bayer Group. Employees around the world had already submitted more than 1,900 business ideas by the end of 2006. Many of these proposals show how Bayer could help to solve problems in the future by developing new lines of business that are in keeping with our mission statement.

We believe one of our most important tasks is not just to ensure a strong current performance, but at the same time to create the conditions for long-term success. Last year we took a major stride in that direction – in the interest of the company, our employees and, of course, our stockholders.

In closing, I would like to thank you on behalf of the Board of Management for your trust and your support. We will do everything in our power to live up to the expectations placed in us for 2007.

Sincerely,



Werner Wenning
Chairman of the Board of Management of Bayer AG