Bayer

Segmentation Adjustments and Changes in Accounting Policies

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Ladies and Gentlemen,

Please find enclosed some information on Bayer´s new segment reporting and changes in accounting policies ahead of our Q1'05 release on May 10, 2005.

Segment reporting

The spin-off of LANXESS and the acquisition of the Roche consumer health activities have led to a shift in the relative sizes of our businesses in terms of sales, EBIT and assets. In compliance with IAS 14 (Segment Reporting), we have therefore adjusted our segmentation effective January 1, 2005 to reflect the new Group structure.

In line with the increased importance of our Consumer Care Division, the previous Consumer Care, Diagnostics segment has been split into two reporting segments. The new Consumer Care segment comprises both our existing Consumer Care business and the OTC business acquired from Roche. Our diagnostics activities, comprising the Diabetes Care and Diagnostics divisions, are now reported as a separate segment called Diabetes Care, Diagnostics.

Our Bayer CropScience subgroup was presented in the 2004 financial statements as a single segment. We are now reporting the largest business group, Crop Protection, as a separate segment, consisting of the strategic business units Insecticides, Fungicides, Herbicides and Seed Treatment. The new Environmental Science, BioScience segment comprises the Environmental Science und BioScience business groups.

Our Bayer MaterialScience subgroup is divided for reporting purposes into the Materials and Systems segments as before. Since the spin-off of LANXESS was entered in the Bayer AG commercial register on January 28, 2005, LANXESS is no longer a reporting segment of Bayer.

Changes in presentation in connection with the classification of assets and liabilities according to maturity as per IAS 1 (Presentation of Financial Statements) and of assets held for sale and discontinued operations as per IFRS 5 (Non-current Assets Held for Sale and Discontinued Operations)

The previous version of IAS 1 allowed the option of classifying assets and liabilities either according to maturity or in order of liquidity. The revised version of IAS 1, developed as part of the IASB's improvements project, prescribes classification according to maturity starting with the 2005 fiscal year.

LANXESS ceased to be part of the Bayer Group when it was spun off at the end of January 2005. The data of the LANXESS group are thus no longer included in the balance sheet as of March 31, 2005. In the income and cash flow statements for the first quarter of 2005 and the corresponding period of 2004, LANXESS is reported under discontinued operations according to IFRS 5. This new International Financial Reporting Standard requires reporting to be based primarily on continuing operations, while discontinued operations are to be stated separately in a single line item. Net earnings of the LANXESS group for the month of January are recognized in Bayer Group income for the current year. The individual items of the income statement such as sales, functional costs and the non-operating result reflect only continuing operations. The information in the Q1 report thus relates exclusively to continuing operations, except where specific reference is made to discontinued operations..

The plasma business of the Bayer HealthCare subgroup was divested effective March 31, 2005. Since Bayer is continuing to market plasma products outside the United States for a transitional period, only the U.S. plasma business is reflected in discontinued operations. The explanations in the above paragraph apply analogously. The revenues from our marketing activities outside the United States are reflected in the sales of our Pharmaceuticals, Biological Products segment from continuing operations.

Bayer largely completed the acquisition of the Roche consumer health business by January 1, 2005. The acquired business with non-prescription medicines and vitamins is now part of the Consumer Care Division of the Bayer HealthCare subgroup, and has already been integrated into the Bayer organization. The business acquired from Roche is thus reflected in the balance sheet, income statement and cash flow statement with effect from that date.

Change in pension accounting – application of the IAS 19 amendment

In December 2004 the IASB issued an amendment to IAS 19 (Employee Benefits). The amendment introduces an additional recognition option for actuarial gains and losses arising from defined benefit plans. This option is similar to the approach provided in the U.K. standard FRS 17 (Retirement Benefits), which requires recognition of all actuarial gains and losses in a “statement of total recognized gains and losses” that is separate from the income statement.

Previously, in the Bayer Group statements, the net cumulative amounts of actuarial gains and losses outside of the “corridor” that were reflected in the balance sheet at the end of the previous reporting period were recognized in the income statement as income or expense, respectively, over the expected average remaining working lives of existing employees. This “corridor” was 10 percent of the present value of the defined benefit obligation or 10 percent of the fair value of plan assets, whichever was greater at the end of the previous year. Under the new method of pension accounting, unrealized actuarial gains and losses, instead of being gradually amortized according to the corridor method and recognized in income, are offset in their entirety against stockholders’ equity. Thus no amortization of actuarial gains and losses is recognized in income.

Recognizing actuarial gains and losses in stockholders’ equity affects the amounts of receivables and of provisions for pensions and other post-employment benefits stated in the balance sheet and also requires the recognition of deferred taxes on the resulting differences. These taxes, too, are offset against the corresponding equity items.

The Group Management Board has decided to follow the recommendation of the IASB and implement the above change as of January 1, 2005 in order to enhance the transparency of our reporting. The previous year’s figures have been restated accordingly. The reporting change improves the 2004 operating result from continuing operations by €48 million and the non-operating result by €78 million. Application of IAS 19 (revised) leads to a deferred tax expense of €50 million. In view of its immateriality to 2004 EBIT of our segments, the €48 million gain has been reflected solely in the reconciliation column of the segment table. These non-cash reporting changes do not affect either gross or net cash flow.

Cessation of goodwill amortization

In March 2004, in connection with the issuance of IFRS 3, the IASB revised IAS 36 (Impairment of Assets) and IAS 38 (Intangible Assets). Among the major changes is that goodwill and other intangible assets with an indefinite useful life may no longer be amortized, but must be tested annually for possible impairment. If events or changes in circumstances indicate a possible decline in value, impairment testing must be performed more frequently. Reversals of impairment losses for goodwill are prohibited. An intangible asset must be treated as having an indefinite life if it is expected to generate cash flows for the enterprise for an indefinite period of time. The revised standards apply to goodwill and other intangible assets acquired in business combinations agreed upon on or after March 31, 2004 as well as to previously acquired goodwill and other intangible assets for annual periods beginning on or after March 31, 2004.

	Q1 / 2004 Continuing (partly restated)						
€ million	Sales	EBIT reported	Special Items	EBIT Clean	EBITDA reported	Gross Cash Flow	Net Cash Flow
HealthCare	**2,032**	**278**	**0**	**278**	**375**	**252**	**62**
PH/BP	1,084	165	0	165	200	117	(50)
CC	326	53	0	53	69	53	62
DC/DS	444	28	0	28	69	56	43
AH	178	32	0	32	37	26	7
CropScience	**1,732**	**379**	**0**	**379**	**556**	**347**	**(239)**
CP	1,416	283	0	283	428	273	(195)
ES/BS	316	96	0	96	128	74	(44)
MaterialScience	**1,877**	**135**	**0**	**135**	**281**	**231**	**52**
Materials	700	32	0	32	92	75	16
Systems	1,177	103	0	103	189	156	36
Reconciliation	**151**	**(38)**	**(7)**	**(31)**	**18**	**37**	**(80)**
Group	**5,792**	**754**	**(7)**	**761**	**1,230**	**867**	**(205)**

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