Financial Report 2002

TABLE OF CONTENTS

BAYER

Key Data

→ Overall Contents
→ Quick Links

Bayer Group

€ million	2002	2001	Change in %
Sales	29,624	30,275	– 2.2
Operating result	1,574	1,611	– 2.3
Income before income taxes	956	1,115	– 14.3
Net income	1,060	965	+ 9.8
Gross cash flow	3,012	2,923	+ 3.0
Net cash flow	4,420	3,859	+ 14.5
Stockholders' equity	15,335	16,922	– 9.4
Total assets	41,692	37,039	+ 12.6
Capital expenditures	2,383	2,617	– 8.9
Employees *(at year end)*	122,600	116,900	+ 4.9
Personnel expenses	8,176	7,849	+ 4.2
Research and development expenses	2,577	2,559	+ 0.7

Bayer AG

		2002	2001	Change in %
Total dividend payment	*€ million*	657	657	0.0
Dividend per share	€	0.90	0.90	0.0

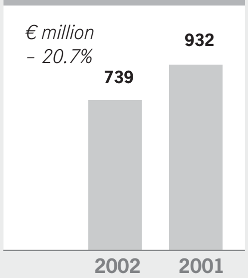
Key Data

→ Quick Links

Operating Result Before Exceptional Items

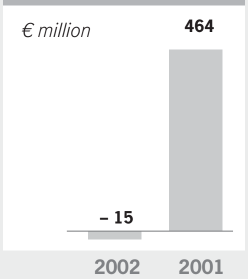
HealthCare

€ million	2002	2001	Change in %
External sales	9,372	10,691	– 12.3
Operating result before exceptionals	739	932	– 20.7
Operating result	582	553	+ 5.2
Capital expenditures	476	658	– 27.7



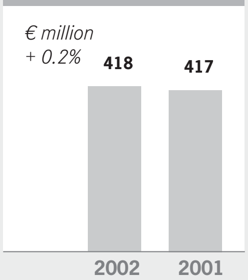
CropScience

€ million	2002	2001	Change in %
External sales	4,697	2,838	+ 65.5
Operating result before exceptionals	(15)	464	•
Operating result	(122)	464	•
Capital expenditures	297	199	+ 49.2



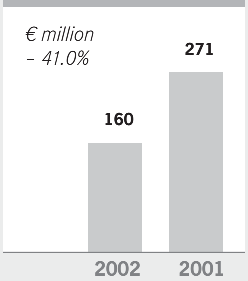
Polymers

€ million	2002	2001	Change in %
External sales	10,775	11,020	– 2.2
Operating result before exceptionals	418	417	+ 0.2
Operating result	(132)	247	•
Capital expenditures	1,010	1,004	+ 0.6



Chemicals

€ million	2002	2001	Change in %
External sales	3,304	3,749	– 11.9
Operating result before exceptionals	160	271	– 41.0
Operating result	134	203	– 34.0
Capital expenditures	285	444	– 35.8



→ Overall Contents
→ Quick Links

Dear Stockholders:

2002 was a year of change for Bayer. In the biggest reorganization project in our history, we realigned the Bayer Group with the aim of boosting our earning power and bringing the enterprise back onto a path of long-term growth. It was not without reason that we named this project "The New Bayer."

Our modern structure consists of a management holding company and four independent operating subgroups: Bayer HealthCare, Bayer CropScience, Bayer Polymers and Bayer Chemicals. These entities are supported by the service companies Bayer Business Services, Bayer Technology Services and Bayer Industry Services.

We are pleased to say that we were able to implement the basic structural changes within just one year. This was a major challenge, particularly in view of the difficult business environment.

While Bayer CropScience AG is already legally independent, the remaining companies are scheduled to take this step over the course of the year subject to the approval of the Annual Stockholders' Meeting.

The new corporate structure is an important basis for shaping our future and, in particular, for sustained growth in our company's value. It enhances the subgroups' responsibility for their own operations, promotes transparency and sharpens the focus on our customers. What's more, it gives us the maneuverability necessary to implement our portfolio management plans and our strategy.

The economic environment was difficult in 2002, and we were not satisfied with our performance.

Werner Wenning
Chairman of the Board of Management
of Bayer AG

Although we improved net income by 10 percent to €1.1 billion, chiefly through divestment proceeds, our operating result from continuing operations before exceptional items fell by 46 percent to €989 million.

As in the previous year, our HealthCare business area had to contend with the effects of the Lipobay®/Baycol® withdrawal. CropScience was burdened by the economic crisis in Latin America and by one-time charges related to the Aventis CropScience acquisition. In a weak economic environment, our industrial businesses – Polymers and Chemicals – continued to suffer from strong pressure on margins.

We achieved the capital-structure and cost-containment goals we set ourselves last year.

We initiated numerous efficiency-improvement programs designed to save €2.2 billion by 2005. With our cash-flow initiative, we have achieved impressive results. Since the program was launched, we have reduced working capital by more than €3 billion, boosting net cash flow by 15 percent to €4.4 billion. The gross operating cash flow rose by 3 percent to €3 billion. We also successfully implemented numerous divestitures to optimize our portfolio.

These measures allowed us to achieve our stated goal of considerably reducing debt. Since the acquisition of Aventis CropScience, we have slashed net debt by more than €6 billion to €8.9 billion.

We are doing everything to optimize value creation for our company and equip Bayer for the future. We are consistently pursuing our strategy of strengthening core businesses and concentrating investment on high-growth fields.

The optimization of our HealthCare portfolio has highest priority. The Consumer Care and Animal Health divisions are operationally healthy and generate high earnings. Our Diagnostics business is also performing well. Here we have achieved the turnaround, as in Biological Products. In all these businesses – that's to say in four of our five HealthCare divisions – we occupy excellent positions worldwide. In Pharmaceuticals, the biggest and most important value driver in our HealthCare business area, there is work still to be done. In light of the sales shortfall created by the withdrawal of our cholesterol-lowering drug Lipobay®/Baycol®, we are looking for a partner for this business.

Bayer CropScience is starting from an excellent position. The Aventis CropScience acquisition gives us the potential for global leadership in this area.

We already occupy leadership positions in Polymers. The task at hand is to improve the operating margin in line with our leading competitors.

In Chemicals we will press ahead with the restructuring process and focus strictly on our core competencies. We will act wherever we see opportunities to enter alliances that make strategic sense.

We have made good progress in optimizing our product base, having replaced half our portfolio over the past few years. We already hold leading positions in most of our businesses.

→ Quick Links

As you can see, we have terrific potential in our activities. In the coming months, we will concentrate on translating our leadership positions into top performance. Provided the current business climate does not worsen dramatically, we believe we can improve our operating result in 2003.

The economic environment remains difficult and the world political situation continues to restrain market growth. On top of this, the litigation connected with the voluntary withdrawal of our cholesterol-lowering drug Lipobay®/Baycol® is depressing the price of our stock.

We greatly regret that we – and thus our shareholders as well – have seen the value of Bayer stock decline significantly in recent weeks.

Attorneys for the plaintiffs have taken advantage of the media interest to publicly launch accusations against Bayer, a strategy that is certain to be continued in the coming weeks. Yet we are ready to defend ourselves against these allegations. I would like to reiterate that we remain firmly convinced we have acted responsibly, without undue delay and appropriately in the management of Lipobay®/Baycol®.

The drug was prescribed for over six million patients worldwide. The overwhelming majority of these individuals took it safely and effectively, with no serious side effects.

We are continuing our efforts to settle out of court on a case-by-case basis with individuals who may have experienced serious side effects. At the same time, we are defending ourselves vigorously in all cases in which there is no connection between Lipobay®/Baycol® and the health problems that are the subject of the claims.

On behalf of my colleagues on the Board of Management, I would like to thank you, our stockholders, for the trust you continue to place in our company during these difficult times.

Rest assured that we will do everything in our power to get Bayer back on the road to success.

I would also like to thank our employees, who have shown exemplary dedication to Bayer in the past year. I am certain that the path we have taken will soon lead to success.

Sincerely,

Dividend unchanged

In the weak environment of 2002, the price of Bayer stock moved more or less in line with the market, ending the year substantially lower. Despite a sharp drop in operating income and high restructuring charges, we are proposing to pay an unchanged dividend to allow our stockholders to benefit appropriately from the proceeds of last year's divestitures.

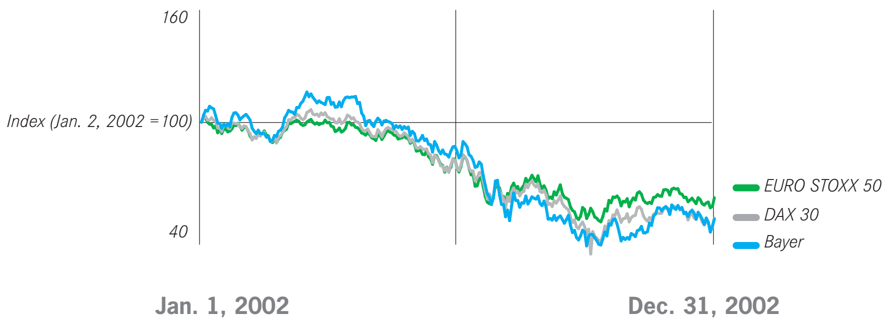
Markets in despondent mood

The global equity markets continued to lose ground in 2002. The German DAX 30 stock index declined for the third year in succession and was down 44 percent by year end – its worst performance in decades. The Dow Jones EURO STOXX 50 lost 36 percent over the year. Market sentiment was dominated by ongoing uncertainty about the geopolitical situation, especially in the Middle East, and a further deterioration in economic conditions during the year. Accounting scandals led to a massive loss of investor confidence, thereby adding to the downward pressure on financial markets.

These conditions affected the performance of Bayer stock in 2002. Having outperformed the market at the start of the year, it peaked at €40.80 on March 15, 2002. Thereafter it moved roughly in parallel with the weak market. The year-end price of €20.45 was 43 percent below that of December 30, 2001. This performance, which was very disappointing for the management and our stockholders, essentially mirrored the stock market trend in 2002.

Considerable uncertainty again dominated the markets in the first few weeks of 2003. Share prices remained depressed by continued doubt about political developments, high oil prices and the lack of a cyclical stimulus. Bayer stock moved with the market as before, losing a further 24 percent on the 2002 year-end price by February 20, 2003, when it traded at €15.47 per share.

Bayer Share Price 2002 (indexed)



Despite this continuing unsatisfactory trend, we will pursue the systematic restructuring we have embarked on, addressing the strategic issues facing us in order to improve our performance and thereby convince the capital markets that Bayer stock is a promising long-term investment.

Stockholders to benefit from divestment proceeds

The Bayer Group's financial performance in 2002 was marked by an unsatisfactory level of operating earnings, exceptional income from divestitures and high one-time expenses to restructure our business.

The operating result before exceptional items declined by 46 percent year-on-year. Divestments of business operations and affiliated companies led to exceptional income of €1.8 billion. These proceeds have been used mainly to strengthen the balance sheet by reducing net debt to €8.9 billion from the higher level that had resulted from the acquisition of Aventis CropScience.

To achieve a sustained improvement in the earning power of our businesses, we invested €427 million in restructuring programs. Further one-time expenses of €561 million comprised an impairment write-down in the polymers field and the cost of a settlement reached following an investigation into rebates for pharmaceutical products in the United States.

However, to ensure that our stockholders benefit appropriately from the proceeds of divestments made over the past year, the Board of Management and Supervisory Board are proposing that the dividend for 2002 remain unchanged at €0.90 per share. That would give a payout ratio of 62 percent and a dividend yield of 4.4 percent based on the stock price at the end of 2002.

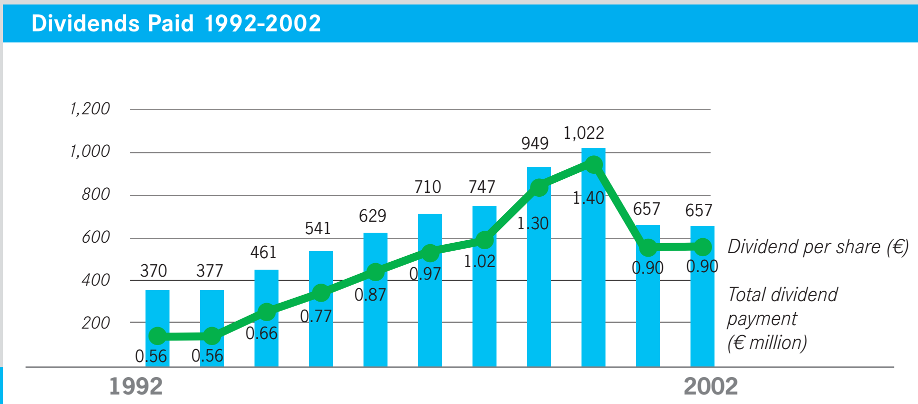
Bayer Stock Data		2002	2001
Dividend	€	**0.90**	0.90
Earnings per share	€	**1.45**	1.32
Cash flow per share	€	**4.12**	4.00
Equity per share	€	**21.00**	23.17
Year-end price*	€	**20.45**	35.80
High for the year*	€	**40.80**	57.80
Low for the year*	€	**17.45**	24.05
Shares issued as of year end	*million*	**730.34**	730.34
Shares to be issued upon the exercise of warrants	*million*	**0.0**	0.0
Share turnover on German stock exchanges	*million*	**969**	865
	€ billion	**27.4**	35.6
Market capitalization at year end	*€ billion*	**14.9**	26.1
Total dividend payment	*€ million*	**657**	657
Price/earnings ratio		**14.1**	27.1
Price/cash flow ratio		**5.0**	9.0
Dividend yield	%	**4.4**	2.5

* Xetra closing prices

Increasing the attractiveness of Bayer stock

The reorganization of the Bayer Group into a management holding structure is proceeding on schedule. The new corporate structure has been in place for practical purposes since July 1, 2002. Bayer CropScience is the first subgroup to have already gained legal independence. Bayer HealthCare, Bayer Polymers, Bayer Chemicals and the service companies Bayer Business Services, Bayer Industry Services and Bayer Technology Services are to become separate legal entities in the course of this year, subject to the approval of the 2003 Annual Stockholders' Meeting.

The new corporate structure is designed to sharpen Bayer's focus on our core competencies, enable us to respond more flexibly to changing market requirements, and make us even more performance-oriented. This structure forms the basis for solving the strategic challenges we face and improving our competitive stance for the long term. Through a convincing financial performance and value creation by the operations of our subgroups and service companies, we aim to give investors further proof of the attractiveness of Bayer stock.



Investor Relations activities further expanded

Last year was a year of transition for Bayer, so it was particularly important to maintain close contact with the financial markets. We therefore expanded our Investor Relations activities again in 2002, explaining and discussing Bayer's current situation and its strategic alignment in numerous one-on-one discussions, conference calls, road shows and investor conferences throughout the world.

The Internet has become an efficient and indeed indispensable communication tool for the financial community. To further improve our service to analysts as well as private and institutional investors, the Investor Relations website was completely relaunched last year, making it a comprehensive source of information on topics related to Bayer stock. The site is continually updated. Users have online access to facts and figures, current and historical share price data, investor news and financial reports. Investor conferences are broadcast live.

It is the goal of our Investor Relations team to continue communicating with the financial community in a consistent, timely, frank and open manner in 2003. In this way we aim to contribute to a fair valuation of Bayer stock.

Corporate Governance*

→ Overall Contents
→ Quick Links

A tradition of transparency

Corporate governance is about responsible management and oversight of a commercial enterprise. Bayer's commitment to these principles in the interest of value creation dates from long before the introduction of the German Corporate Governance Code.

Our corporate strategy has traditionally been geared to creating value. We therefore welcome the Corporate Governance Code since it should help to make the German system of corporate governance more transparent in the international arena.

Alongside statutory regulations, the Code incorporates nationally and internationally recognized standards for good management practice and responsible supervision of listed companies. It defines the rights of stockholders and the duties of the Board of Management and the Supervisory Board and sets standards for transparency, accounting and auditing. The Code is designed to boost the confidence of domestic and international investors, customers, employees and the general public in German corporate governance.

Bayer already complied with many of the Code's provisions well before it was adopted, so the Code has not necessitated major changes in our existing structures or procedures. The Board of Management and the Supervisory Board continue to work closely together for the good of the company.

Bayer AG – headquartered in Leverkusen, Germany – is subject to the German legislation on which the Corporate Governance Code is based. That includes the two-tier governance system, under which the Board of Management and Supervisory Board each have their own fields of responsibility. This contrasts with the Anglo-American system, where corporate management and oversight are the tasks of a single executive body, the board of directors.

Reflecting Bayer's international focus and operations, its shares are listed on stock exchanges in Germany and several other countries – including, since January 2002, the New York Stock Exchange. This means Bayer also has to comply with U.S. regulations.

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

Declaration by the Board of Management and the Supervisory Board

of Bayer AG concerning the German Corporate Governance Code pursuant to Article 161 of the German Stock Corporations Act

Under Section 161 of the German Stock Corporations Act, the Board of Management and the Supervisory Board of Bayer AG are required to issue an annual declaration that the company has conformed and is currently conforming with the recommendations of the "Government Commission on the German Corporate Governance Code" as published by the German Justice Ministry in the official section of the electronic Federal Gazette (Bundesanzeiger) and to give details of any recommendations that have not been or are not being applied. Under Article 15 of the Introductory Act of the Stock Corporations Act, this declaration is required for the first time in 2002. However, for this year it may be confined to a declaration that the company is currently conforming with the recommendations of the "Government Commission on the German Corporate Governance Code" or a statement of any recommendations that are not being applied. The declaration of conformity pursuant to Article 161 of the Stock Corporations Act shall be available to stockholders at all times.
The Management Board and 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 German Justice Ministry in the official section of the electronic Federal Gazette, except that the following recommendations currently are not being applied or are being applied in a modified form:

1. Section 2.3.3
The company shall facilitate the personal exercising of shareholders' voting rights. The company shall also assist the shareholders in the use of proxies. The Management Board shall arrange for the appointment of a representative to exercise shareholders' voting rights in accordance with instructions. As in the past, stockholders attending the Annual Stockholders' Meeting can exercise proxy voting rights and issue instructions via proxy voting cards. There are plans to facilitate the exercising of voting rights through the appointment of a representative starting at the Annual Stockholders' Meeting in 2004.
2. Section 3.8 Paragraph 2
If the company takes out a D&O (directors and officers' liability insurance) policy for the Management Board and Supervisory Board, a suitable deductible shall be agreed. The present D&O insurance policy at Bayer AG does not include cover for willful breach of duty. Where insurance cover is provided, there is no deductible for members of either the Management Board or the Supervisory Board. Bayer AG intends to obtain personal declarations from the members of its Management Board and Supervisory Board concerning the payment of a deductible, even if insurance cover otherwise continues to be provided under a D&O policy taken out by the company. Pursuant to these declarations, members of the Management Board who cause damage to the company or third parties through gross negligence in the performance of their duties are to pay for such damage up to an amount equivalent to half their total annual compensation for the year in which the damage occurs. Members of the Supervisory Board who cause damage to the company or third parties through gross negligence in the performance of their duties are to pay for such damage up to the equivalent of 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 5.4.5
Compensation of the Supervisory Board shall also take into account exercising of the Chair and membership in committees. This requires an amendment to the Articles of Incorporation. An amendment will be submitted to the Annual Stockholders' Meeting in April 2003 for approval.
4. Section 7.1.4
This recommends that the company publish a list of certain third-party companies and provide information about them, including their operating results for the last fiscal year. The operating results of third-party companies are only published if they are available when Bayer's financial statements are prepared.

Leverkusen, December 2002

Corporate governance is particularly impacted by the Sarbanes-Oxley Act passed in July 2002. Not all of the regulations contained in this Act have yet been fully integrated into the rules of the Securities and Exchange Commission (SEC). We will adapt our system of corporate governance as necessary to comply with any new rulings.

Stockholders' rights

The stockholders of Bayer AG exercise their rights at the Annual Stockholders' Meeting, where they can vote on the resolutions submitted. Voting rights are allocated on the principle of one vote per share. Bayer does not have shares with multiple or preferential voting rights, nor is there a limit on the number of votes that may be cast by individual stockholders. Every stockholder whose shares have been deposited as directed by the deadline announced prior to the meeting is entitled to attend, speak on the items on the agenda, ask pertinent questions and propose resolutions. The Annual Stockholders' Meeting is presided over by the Chairman of the Supervisory Board.

At the Annual Stockholders' Meeting, the Board of Management of Bayer AG presents the financial statements of Bayer AG and the Bayer Group for the previous fiscal year. As the body enacting the wishes of the stockholders, the Annual Stockholders' Meeting decides on the appropriation of the profit, ratifies the actions of the Board of Management and the Supervisory Board, elects the stockholders' representatives on the Supervisory Board and appoints the auditors. Amendments to the Articles of Incorporation and major corporate actions also have to be submitted to a Stockholders' Meeting for approval.

Cooperation between the Board of Management and the Supervisory Board

Bayer AG has a two-tier governance structure comprising a Board of Management with executive functions and a Supervisory Board with monitoring powers. A constant dialogue is maintained between the Board of Management and Supervisory Board in the interest of good governance. The Supervisory Board oversees the Management Board's conduct of the business and provides advice. The Board of Management consults the Supervisory Board regarding the strategic alignment of the company and submits regular progress reports on the implementation of corporate strategy. The Supervisory Board is directly involved in decisions on matters of fundamental importance to Bayer AG. These include decisions involving far-reaching changes to the company's net worth, financial position or earnings

Remuneration of the Members of the Board of Management*

	Period	Fixed salary €	Variable bonus €	Total €	Stock option rights (2002 tranche)
Klaus Kühn	May–Dec. 2002	271,550	320,332	**591,882**	119
Dr. Udo Oels	Jan.–Dec. 2002	414,079	480,498	**894,577**	119
Dr. Richard Pott	May–Dec. 2002	271,832	320,332	**592,164**	0
Werner Spinner	Jan.–Dec. 2002	408,513	480,498	**889,011**	119
Werner Wenning	Jan.–Dec. 2002	622,317	722,451	**1,344,768**	119

* The total remuneration of members who left the Board during the year, with respect to their periods of active membership, amounted to €1,273,980.

potential. The Board of Management and Supervisory Board are jointly responsible for ensuring that the Supervisory Board receives the information it needs to discharge its duties.

The Board of Management

As the executive organ of the Bayer Group, the Bayer AG Board of Management is committed to serving the interests of the entire enterprise and achieving a sustained increase in corporate value. The Chairman of the Board of Management coordinates the principles of corporate policy.

The most important tasks of the Board of Management are defining corporate strategy, setting the budget and allocating corporate resources. It publishes quarterly reports and annual financial statements for the Bayer Group and makes key staff appointments. The Board of Management also ensures that the Supervisory Board receives regular, timely and comprehensive information on all matters relating to Bayer AG's planning, business development, risk situation and risk management.

Remuneration of the Board of Management

The members of the Board of Management receive a fixed salary and a variable bonus. In addition, they may participate in a cash-settlement-based stock option program provided that they place shares of their own in a special deposit account. This long-term incentive system constitutes a further performance-related component of Board members' compensation.

The total remuneration for 2002 of those individuals who were active members of the Board of Management on the closing date for the financial statements amounted to €4,426,757, comprising €1,988,291 in fixed salaries and €2,324,111 in variable bonuses. These Board members also received remuneration in kind totaling €114,355 and consisting mainly of amounts such as the value assigned to the use of a company car for taxation purposes. The relevant taxes are payable by each Board member.

From the 2002 tranche of the stock option program, the members of the Board of Management received a total of 476 option rights on the basis of their own investments. These rights are initially blocked for three years. During the two-year exercise period thereafter, the option rights – entitling the participants to receive a maximum of 95,200 free shares in total – may be exercised if very demanding performance criteria are met. The options had no intrinsic value at the closing date.

€	Basic remuneration	Variable remuneration	Total
Dr. Paul Achleitner	3,389	35,583	**38,972**
Dr. Josef Ackermann	3,389	35,583	**38,972**
Karl-Josef Ellrich	5,000	52,500	**57,500**
Erhard Gipperich	7,500	78,750	**86,250**
Thomas Hellmuth	1,236	12,979	**14,215**
Prof. Dr.-Ing. e. h. Hans-Olaf Henkel	3,389	35,583	**38,972**
Dr. h. c. Martin Kohlhaussen	5,000	52,500	**57,500**
John Christian Kornblum	3,389	35,583	**38,972**
Petra Kronen	5,000	52,500	**57,500**
Dr. Heinrich von Pierer	5,000	52,500	**57,500**
Dr. Wolfgang Reitzle	3,389	35,583	**38,972**
Wolfgang Schenk	3,389	35,583	**38,972**
Hubertus Schmoldt	5,000	52,500	**57,500**
Dr. Manfred Schneider	10,167	106,750	**116,917**
Dieter Schulte	5,000	52,500	**57,500**
Siegfried Wendlandt	5,000	52,500	**57,500**
Reinhard Wendt	3,389	35,583	**38,972**
Thomas de Win	3,389	35,583	**38,972**
Prof. Dr. Ernst-Ludwig Winnacker	5,000	52,500	**57,500**
Dr. Hermann Wunderlich	5,000	52,500	**57,500**

Remuneration of the Members of the Supervisory Board

The Supervisory Board

The Supervisory Board of Bayer AG consists of 20 members. Under the German Codetermination Act, half of them are elected by the stockholders at Stockholders' Meetings, while the other half are elected representatives of the workforce. All members of the Supervisory Board are obligated to serve the interests of the company.

The Chairman coordinates the Supervisory Board's work and, of course, chairs its meetings. Through regular discussions with the Board of Management, the Supervisory Board is kept constantly informed of business policy, corporate planning and strategy. It has to approve the annual budget and the financial statements of Bayer AG and the Bayer Group, taking into account the auditors' report. Details are provided in the Report of the Supervisory Board.

Transparency

To maximize transparency, we regularly provide current information on the company's position and the main business trends to stockholders, financial analysts, stockholders' associations, the media and the general public. In line with the principle of fair disclosure, we provide the same information to all stockholders and key target groups. All significant new facts are disclosed immediately. Stockholders also have timely access to information that Bayer publishes in foreign countries in compliance with local stock market regulations.

Information is published in the annual report, quarterly reports, at semi-annual media conferences and analysts' meetings, and on Forms 20-F (annual report) and 6-K (quarterly report) required by the Securities and Exchange Commission (SEC). Bayer also uses the Internet as a platform for timely information disclosure. Key dates such as those of the Annual Stockholders' Meeting and the publication of annual and interim reports are posted on the website.

In addition to our regular reporting, we issue news releases and ad-hoc statements about developments that may affect our net worth, financial position or business trends in general and thus could materially impact on the price of Bayer stock. In addition, the Board of Management makes 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 gives notification without delay of any purchases or sales of Bayer AG or Group companies' shares, stock options or other share derivatives by members of the Board of Management or the Supervisory Board.

Accounting and auditing

The annual consolidated financial statements of the Bayer Group are a key source of information for stockholders and third parties. These statements are prepared in compliance with the International Accounting Standards (IAS), while the financial statements of Bayer AG are prepared according to the German Commercial Code. The financial statements of the Bayer Group are prepared by the Board of Management, approved by the Supervisory Board and audited by independent auditors.

Ethical guidelines

Bayer is committed to the ethical principles of Responsible Care. Our "Guidelines for Legal Compliance and Corporate Responsibility at Bayer" have been valid for all employees worldwide since they were introduced in July 1999. This code of conduct governs dealings with colleagues, customers, suppliers, other companies and authorities. For example, it contains a ban on anti-competitive practices, a commitment to the safe handling of hazardous materials and a pledge to respect ethical boundaries in the use of genetic engineering.

Further policy guidelines require all employees worldwide to observe the principles of sustainable development – including corporate social responsibility – and those of Responsible Care in the areas of environmental protection, health and safety.

Management Report 2002

→ Overall Contents
→ Quick Links

In the product development center of Bayer HealthCare's Consumer Care Division in Morristown, New Jersey, United States, researcher Ute Lex operates the high-pressure liquid chromatography system. This fully automated technology allows Bayer's researchers to verify the exact composition of, say, an Aspirin® tablet.

TABLE OF CONTENTS

FUTURE PERSPECTIVES

Higher net income – portfolio changes successfully implemented

Operating result impaired by one-time charges and difficult market conditions

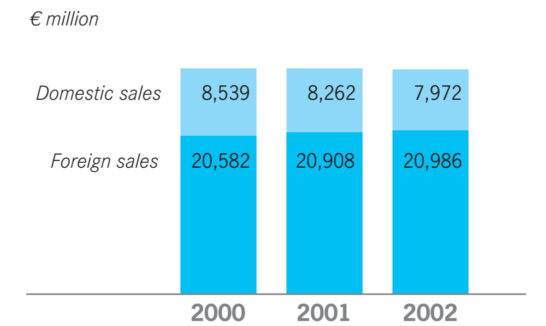
Capital-structure goals exceeded through strict asset management – operating cash flow improved

For Bayer, 2002 was characterized by portfolio changes, the realignment of our corporate structure and measures to improve efficiency. The continuing weak economy impaired performance, especially in the Polymers and Chemicals business areas. As in the previous year, HealthCare had to contend with the effects of the withdrawal of Lipobay®/Baycol®. The CropScience business was hampered by the economic crisis in Latin America and by one-time effects related to the Aventis CropScience (ACS) acquisition.

Change in Sales

Reported	– 2%
Continuing operations	**– 1%**
Volumes	0%
Prices	– 2%
Exchange rates	– 5%
Portfolio	+ 6%

Sales from Continuing Operations



Group sales declined by 2 percent, or €651 million, to €29,624 million. Sales from continuing operations dipped by 1 percent. Currency movements and price declines diminished sales by 5 and 2 percentage points, respectively, while portfolio changes – particularly the ACS acquisition – added 6 percentage points.

The operating result before exceptional items dropped by 46 percent to €989 million after €536 million in charges related to the first-time consolidation of ACS.

After exceptionals, the operating result amounted to €594 million. Exceptional charges of €1,212 million were incurred, relating mainly to asset write-downs, restructuring measures and site consolidations. Also included here are provisions established in connection with an agreement in principle reached with the U.S. federal authorities relating to an investigation into pharmaceutical product prices. These charges were partially offset by exceptional income of €817 million, generated mainly by the sale of Bayer Wohnungen GmbH and the household insecticides business.

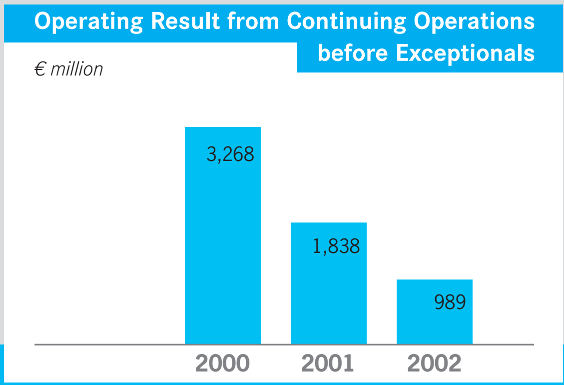
The operating result from discontinuing operations consists of €47 million in operating profit from the Haarmann & Reimer group and the €933 million gain from its divestiture on September 30, 2002. The previous year's figure contained €333 million pertaining to EC Erdölchemie.

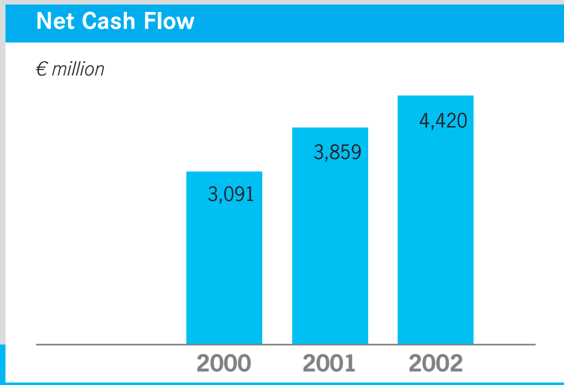
The total reported operating result was down by 2 percent year-on-year to €1,574 million.

Despite the decline in operating profit, our cash flow-based controlling parameters developed favorably. The gross operating cash flow rose by 3 percent to €3,012 million, and the net cash flow climbed by 15 percent to €4,420 million due to a €472 million cash inflow from changes in working capital.

Net income improved by 10 percent to €1,060 million.

For Bayer, 2002 was a year of change and transition – one in which we improved our cost structures with the aim of a sustained enhancement of performance.





BUSINESS ENVIRONMENT

General economic situation

In the spring of 2002 the world economy appeared to be recovering, buoyed by strong growth in the United States. Stimuli to growth were coming mainly from sharp cuts in interest rates, an expansionary U.S. fiscal policy and an economic upswing in the developing and industrializing countries of the Far East. By contrast, the euro zone economy grew more slowly than expected, due largely to a decline in private consumption.

In Japan, a modest recovery set in over the course of the year. The recovery continued in most of the East Asian industrializing countries.

The situation in Latin America was marked by currency devaluations, rising prices and higher interest rates in an unstable political environment.

In Germany, the Federal Statistics Office reported just 0.2 percent growth in the gross domestic product – the smallest increase since 1993.

In the end a sustained economic recovery in 2002 was prevented by weak stock markets, rising oil prices and continuing geopolitical uncertainty.

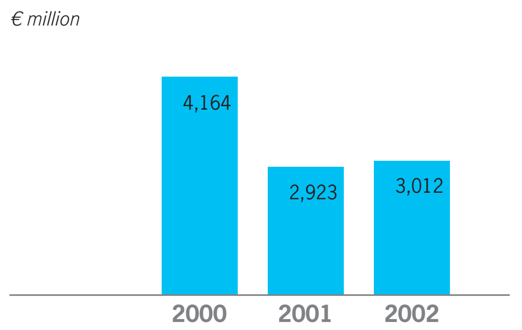
Economic situation by industry sector

In 2002, prices of health care products were squeezed by government and public pressure, particularly in Europe, North America and Japan. Competition also intensified among the major pharmaceutical companies and with ascendant generics manufacturers in Europe and North America. In the animal health market, both the livestock and, increasingly, the companion animals sectors registered growth, with heightened demand for parasiticides a major factor.

The market for crop protection products shrank in 2002, weighed down by the economic crises in Argentina and Brazil and adverse shifts in exchange rates. The European market, however, remained comparatively stable.

The polymers sector was subjected to higher raw material costs and continuing pressure on prices due to the weakness of the automotive, electronics and construction industries. Here, too, the economic downturn in western Europe and adverse currency

Gross Cash Flow



parities had a negative effect, as did slow growth in the construction and related industries.

The economy of the chemicals sector also slowed considerably compared with the previous year in all major foreign markets and downstream industries. The market is characterized by excess capacities and the increasing commoditization of many products. A weak semiconductor market, rising raw material prices and continuing high pressure on margins hampered growth.

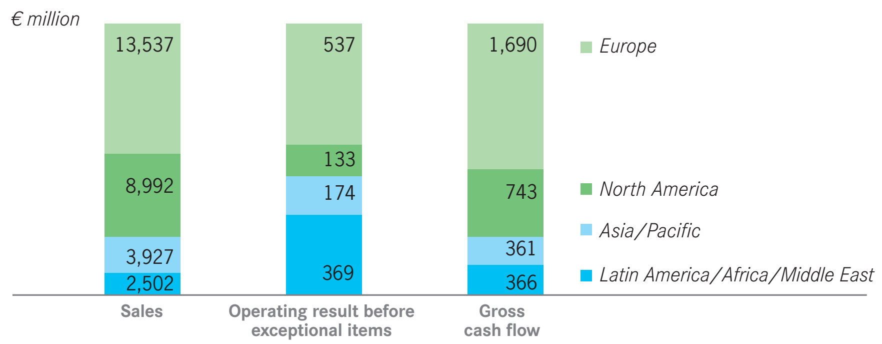
PERFORMANCE BY REGION

Europe

€ million	2002	2001	Change
Sales	13,537	13,151	+ 2.9%
Proportion of Group sales	46.7%	45.1%	
Operating result before exceptional items	537	1,709	– 68.6%
Return on sales before exceptional items	4.0%	13.0%	
Gross cash flow	1,690	1,865	– 9.4%
CFROI	8.6%	11.3%	

Sales of our European companies grew by 3 percent to €13,537 million, largely as a result of the ACS acquisition. By contrast, the operating result receded by 69 percent to €537 million, due in particular to acquisition-related charges. The gross cash flow fell to €1,690 million, while the return on sales and cash flow return on investment receded by 4 and 9 percent, respectively.

Performance by Region



North America

€ million	2002	2001	Change
Sales	**8,992**	9,875	– 8.9%
Proportion of Group sales	**31.1%**	33.9%	
Operating result before exceptional items	**133**	3	•
Return on sales before exceptional items	**1.5%**	0.0%	
Gross cash flow	**743**	638	+ 16.5%
CFROI	**5.9%**	4.6%	

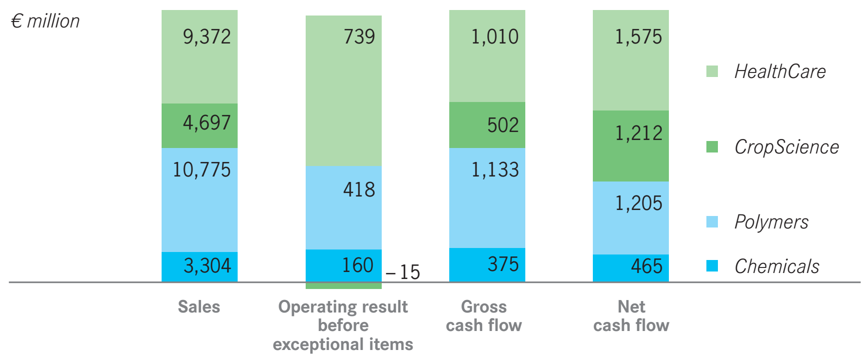
Sales in North America fell by 9 percent to €8,992 million. The operating result improved to €133 million. The previous year's figure contained charges resulting from the production problems for biological products and from the Lipobay®/Baycol® withdrawal. The gross cash flow grew in 2002 by 16 percent to €743 million.

Asia/Pacific

€ million	2002	2001	Change
Sales	**3,927**	3,819	+ 2.8%
Proportion of Group sales	**13.6%**	13.1%	
Operating result before exceptional items	**174**	242	– 28.1%
Return on sales before exceptional items	**4.4%**	6.3%	
Gross cash flow	**361**	311	+ 16.1%
CFROI	**12.6%**	11.2%	

Our companies in the Asia/Pacific region increased sales by 3 percent to €3,927 million. The operating result dropped by 28 percent to €174 million, mainly because of one-time charges, while the gross cash flow advanced by 16 percent to €361 million.

Performance by Business Area



Latin America/Africa/Middle East

€ million	**2002**	**2001**	**Change**
Sales	**2,502**	2,325	+ 7.6%
Proportion of Group sales	**8.6%**	8.0%	
Operating result before exceptional items	**369**	219	+ 68.5%
Return on sales before exceptional items	**14.7%**	9.4%	
Gross cash flow	**366**	226	+ 61.9%
CFROI	**25.4%**	14.5%	

Business in the Latin America/Africa/Middle East region expanded by 8 percent to €2,502 million, mainly as a result of the ACS acquisition. The operating result and the gross cash flow jumped to €369 million and €366 million, respectively.

PERFORMANCE BY BUSINESS AREA

Our business activities are grouped together in the HealthCare, CropScience, Polymers and Chemicals business areas, comprising the following reporting segments:

Business Area	**Segments**
HealthCare	Pharmaceuticals, Biological Products; Consumer Care, Diagnostics; Animal Health
CropScience	CropScience
Polymers	Plastics, Rubber; Polyurethanes, Coatings, Fibers
Chemicals	Chemicals

HealthCare			
€ million	**2002**	**2001**	**Change**
Sales	9,372	10,691	– 12.3%
Proportion of Group sales	32.4%	36.7%	
Operating result before exceptional items	739	932	– 20.7%
Return on sales before exceptional items	7.9%	8.7%	
Gross cash flow	1,010	916	+ 10.3%
CFROI	11.3%	9.3%	
Net cash flow	1,575	1,109	+ 42.0%

The Polymers business area once again includes the fibers operations, which in the previous year were reported as discontinuing.

The four business areas together generated an operating result of €1.3 billion before exceptional items and a gross cash flow of €3.0 billion on sales of €28.1 billion. HealthCare achieved the highest operating result in absolute terms, while Polymers accounted for the largest share of Group sales and gross cash flow.

HealthCare

Sales of the HealthCare business area decreased by 12 percent to €9,372 million. The operating result before exceptionals fell by 21 percent to €739 million. By contrast, the net cash flow increased by a gratifying 42 percent to €1,575 million.

Pharmaceuticals, Biological Products

€ million	2002	2001	Change
Sales	**4,767**	5,729	– 16.8%
Proportion of Group sales	**16.5%**	19.6%	
Pharmaceuticals	**3,688**	4,784	– 22.9%
Biological Products	**1,079**	945	+ 14.2%
Operating result before exceptional items	**151**	383	– 60.6%
Return on sales before exceptional items	**3.2%**	6.7%	
Gross cash flow	**1**	229	– 99.6%
CFROI	**0.0%**	4.2%	
Net cash flow	**484**	343	+ 41.1%

Business in **Pharmaceuticals** declined by €1,096 million, or 23 percent, to €3,688 million. The withdrawal of the cholesterol-lowering drug Lipobay®/Baycol® accounts for 8 percentage points of this decline, while a further 12 points are attributable to lower sales of the antibiotic Ciprobay®/Cipro®, for which demand had been particularly high in the previous year due to its indication for anthrax. Inventories were adjusted accordingly this year. Sales of the antihypertensive Adalat® were down by 18 percent to €800 million, due to increased

Best-Selling HealthCare Products

€ million	**2002**	**Change**
Ciprobay®/Cipro® (Pharmaceuticals)	1,411	– 28%
Adalat® (Pharmaceuticals)	800	– 18%
Aspirin® (Consumer Care/Pharmaceuticals)	589	– 14%
Ascensia® Elite (Diagnostics)	515	+ 5%
Kogenate® (Biological Products)	400	+ 60%
ADVIA® Centaur System (Diagnostics)	340	+ 31%
Gamimune® N (Biological Products)	333	– 3%
Glucobay® (Pharmaceuticals)	287	– 8%
Avalox®/Avelox® (Pharmaceuticals)	280	+ 55%
Advantage® (Animal Health)	189	– 10%
Total	5,144	– 9%
Proportion of business area sales	55%	+ 2

competition from generic products. Growth drivers for Pharmaceuticals were the respiratory antibiotic Avalox®/Avelox® and the cardiovascular drug Aspirin® Cardio.

Preparations for the launch of Levitra®, our new drug to treat erectile dysfunction, have now been largely completed. We expect to begin marketing the product in Europe during the first half of 2003 and in the United States during the second half of the year.

The U.S. Food and Drug Administration (FDA) has approved the new medicine Cipro® XR for the treatment of urinary tract infections. This regulatory clearance opens up further growth opportunities for anti-infectives.

Bayer signed an agreement with German company Boehringer Ingelheim to co-market the active ingredient telmisartan in Germany, Scandinavia and Switzerland under the tradename Kinzal®. This collaboration adds to our cardiovascular portfolio.

As a further move to streamline our portfolio, we divested our generics activities in France and Spain.

Sales of the **Biological Products** Division expanded by 14 percent, or €134 million, to €1,079 million. This was due primarily to significant growth in volumes for our Factor VIII drug Kogenate®. Now that the production problems have been rectified and the FDA has approved an increase in Kogenate® production, the foundation is laid for further growth.

Under long-term agreements signed with Canada's blood and blood product supply agencies, Bayer Biological Products has been selected to continue as the primary supplier to the blood system in Canada.

Plans for a biological products joint venture with Aventis Behring under Bayer's management control are no longer being pursued.

Consumer Care, Diagnostics

€ million	2002	2001	Change
Sales	3,755	4,104	– 8.5%
Proportion of Group sales	13.0%	14.1%	
Consumer Care	1,716	2,095	– 18.1%
Diagnostics	2,039	2,009	+ 1.5%
Operating result before exceptional items	408	388	+ 5.2%
Return on sales before exceptional items	10.9%	9.5%	
Gross cash flow	827	534	+ 54.9%
CFROI	23.9%	13.9%	
Net cash flow	951	576	+ 65.1%

Currency depreciation in Latin America and inventory reductions by North American drug suppliers caused sales of the **Consumer Care** Division to recede by 18 percent, or €379 million, to €1,716 million.

To further streamline our portfolio, we are divesting our household insecticides business to SC Johnson & Son of the United States. Of the €725 million total acquisition price, €386 million was realized in 2002 following regulatory approvals of the transaction in some countries. We expect transfer of the business in the remaining countries to take place in the first half of 2003.

Sales of the **Diagnostics** Division rose by 2 percent, or €30 million, to €2,039 million, driven mainly by growth in laboratory diagnostic systems and nucleic acid diagnostics.

The €62 million acquisition of Canadian company Visible Genetics on October 11, 2002, strengthens the infectious diseases business of our Diagnostics Division.

We signed a joint venture agreement with Matsushita Electric Industrial Co., Japan, to establish Viterion TeleHealthcare LLC, a company intended to market products and services for the fast-growing telemedicine sector.

Animal Health sales, at €850 million, matched the previous year. While business was hampered by lower demand for the antiparasitic treatment Advantage® and the economic crisis in Argentina, the North American market launch of the new antiparasitic treatment Advantix® in December 2002 was a resounding success.

CropScience € million	2002	2001	Change
Sales	4,697	2,838	+ 65.5%
Proportion of Group sales	16.2%	9.7%	
Operating result before exceptional items	(15)	464	•
Return on sales before exceptional items	(0.3)%	16.3%	
Gross cash flow	502	560	– 10.4%
CFROI	6.4%	13.9%	
Net cash flow	1,212	428	+ 183.2%

Animal Health

€ million	2002	2001	Change
Sales	**850**	858	– 0.9%
Proportion of Group sales	**2.9%**	2.9%	
Operating result before exceptional items	**180**	161	+ 11.8%
Return on sales before exceptional items	**21.2%**	18.8%	
Gross cash flow	**182**	153	+ 19.0%
CFROI	**30.4%**	24.3%	
Net cash flow	**140**	190	– 26.3%

CropScience

In the CropScience business area, 2002 was marked by the successful acquisition of Aventis CropScience. Taking into account the charges resulting from the remeasurement of assets upon first-time consolidation, the acquisition price came to €7.8 billion. Integration of the acquisition has so far proceeded smoothly, enabling the newly established Bayer CropScience subgroup to get off to a successful start.

This acquisition allowed CropScience to expand sales by 66 percent to €4,697 million. Disregarding the ACS business, sales dipped by 4 percent, mainly because of the weak economy in Latin America and a weather-related drop in demand in North America, Australia and Asia.

Additional depreciation and amortization of goodwill determined and assets remeasured in purchase accounting following the ACS acquisition led to €536 million in charges against the operating result. Earnings were also hampered by integration costs. On the other hand, the net cash flow increased to a gratifying €1,212 million through a reduction in working capital.

The divestitures mandated by the antitrust authorities in connection with the ACS acquisition are proceeding on schedule. At the end of 2002 the wheat herbicide Everest® was sold to U.S.-based Arvesta Corporation, while the herbicide Goltix® and certain distribution licenses for the herbicide Herold® were acquired by a Makhteshim group company. These divestitures contributed a total of €172 million to earnings. Agreements have already been concluded regarding all the other products that must be divested to meet the requirements of the regulatory authorities. They are expected to take effect in the first quarter of 2003.

Best-Selling CropScience Products

€ million	2002	Change
Confidor®/Gaucho®/Admire®/Provado®	561	– 8%
Folicur®/Raxil®	260	– 4%
FLINT®	159	+ 64%
Puma®/Accord®	92*	•
Decis®	87*	•
Sencor®	83	– 10%
Fenikan®/Javelin®	71*	•
Basta®/Liberty®	70*	•
Epic®/Axiom®/Terano®	65	– 7%
Antracol®	64	+ 3%
Total	1,512	+ 26%
Proportion of business area sales	32%	

* sales after ACS acquisition (June 2002)

Polymers

Our Polymers business area is undergoing a restructuring process, with consolidation of production sites intended to improve cost structures. Sales were restrained by the continuing low prices and negative currency effects. We posted an operating result of €418 million on sales of €10,775 million. Exceptional charges of €289 million resulted from impairment write-downs. The gross cash flow declined by 5 percent to €1,133 million and the net cash flow by 39 percent to €1,205 million.

Plastics, Rubber

€ million	2002	2001	Change
Sales	**5,378**	5,581	– 3.6%
Proportion of Group sales	**18.6%**	19.1%	
Plastics	**3,237**	3,374	– 4.1%
Rubber	**2,141**	2,207	– 3.0%
Operating result before exceptional items	**175**	288	– 39.2%
Return on sales before exceptional items	**3.3%**	5.2%	
Gross cash flow	**419**	587	– 28.6%
CFROI	**6.8%**	8.9%	
Net cash flow	**459**	954	– 51.9%

Sales of the **Plastics** Business Group fell by 4 percent, or €137 million, to €3,237 million, due mainly to a sharp decline in polycarbonate prices in Europe and Asia. Volumes were higher, especially in polycarbonates, styrenics and semicrystalline thermoplastics, with strong growth in Asia and Europe.

This business group has signed further cobranding agreements for better brand positioning of Makrolon® polycarbonate.

Sales in the **Rubber** Business Group declined by 3 percent, or €66 million, to €2,141 million. Pleasing increases in Asia failed to compensate for significantly lower demand in Europe and North America.

Polymers			
€ million	**2002**	**2001**	**Change**
Sales	10,775	11,020	– 2.2%
Proportion of Group sales	37.2%	37.8%	
Operating result before exceptional items	418	417	+ 0.2%
Return on sales before exceptional items	3.9%	3.8%	
Gross cash flow	1,133	1,193	– 5.0%
CFROI	8.0%	7.8%	
Net cash flow	1,205	1,970	– 38.8%

Polyurethanes, Coatings, Fibers

€ million	2002	2001	Change
Sales	**5,397**	5,439	– 0.8%
Proportion of Group sales	**18.6%**	18.6%	
Polyurethanes	**3,256**	3,193	+ 2.0%
Coatings and Colorants	**1,941**	2,014	– 3.6%
Fibers	**200**	232	– 13.8%
Operating result before exceptional items	**243**	129	+ 88.4%
Return on sales before exceptional items	**4.5%**	2.4%	
Gross cash flow	**714**	606	+ 17.8%
CFROI	**8.9%**	7.0%	
Net cash flow	**746**	1,016	– 26.6%

Polyurethanes sales grew by 2 percent, or €63 million, to €3,256 million. Volumes increased in all key markets despite an intensely competitive environment.

The €19 million acquisition of Tectrade A/S, Denmark, at the beginning of April 2002 strengthens this business group's market position in Scandinavia.

In **Coatings and Colorants** sales receded by 4 percent, or €73 million, to €1,941 million, due especially to a disappointing business trend in western Europe. However, gratifying sales growth was recorded in Asia with the exception of Japan.

A sharp decline in prices in western Europe caused sales of the **Fibers** Business Group to drop by 14 percent, or €32 million, to €200 million, despite an increase in volumes.

Chemicals			
€ million	**2002**	**2001**	**Change**
Sales	3,304	3,749	– 11.9%
Proportion of Group sales	11.4%	12.9%	
Basic and Fine Chemicals	931	1,025	– 9.2%
Specialty Products	1,403	1,469	– 4.5%
Wolff Walsrode	363	444	– 18.2%
H.C. Starck	607	811	– 25.2%
Operating result before exceptional items	160	271	– 41.0%
Return on sales before exceptional items	4.8%	7.2%	
Gross cash flow	375	379	– 1.1%
CFROI	8.6%	7.7%	
Net cash flow	465	399	+ 16.5%

Chemicals

Adverse exchange rates also impacted sales in the Chemicals business area, where a further negative factor was unsatisfactory demand from key downstream industries. Sales fell by 12 percent to €3,304 million, while the operating result fell by 41 percent to €160 million due to impaired profitability at H.C. Starck. The net cash flow improved by 17 percent to €465 million.

Sales of **Basic and Fine Chemicals** moved back by 9 percent, or €94 million, to €931 million, due primarily to the divestiture of ChemDesign Corporation, U.S.A., and to the transfer of certain activities to subsidiary H.C. Starck. The electrolysis business suffered from a drastic fall in the price of sodium hydroxide solution.

Specialty Products saw sales decline by 4 percent to €1,403 million.

Sales of **Wolff Walsrode** decreased by 18 percent to €363 million, mainly due to the transfer of certain activities to the Plastics Business Group and also because the previous year's figure included the sales of Covexx Films Walsrode, which has since been divested.

Continuing weak demand from the electronics industry and sharply reduced selling prices led to a 25 percent drop in sales of **H.C. Starck,** to €607 million.

Bayer Group Summary Cash Flow Statements

€ million	2002	2001
Gross operating cash flow	**3,012**	**2,923**
Changes in working capital	1,408	936
Net cash provided by operating activities	**4,420**	**3,859**
of which discontinuing operations	*87*	*131*
Net cash used in investing activities	**(6,570)**	**(2,132)**
of which discontinuing operations	*1,286*	*310*
Net cash provided by (used in) financing activities	**2,209**	**(1,549)**
of which discontinuing operations	*1*	*77*
Change in cash and cash equivalents	59	178
Cash and cash equivalents at beginning of year	719	491
Change due to exchange rate movements and to changes in scope of consolidation	(11)	50
Cash and cash equivalents at end of year	767	719
Marketable securities and other instruments	29	52
Liquid assets as per balance sheets	796	771

FINANCIAL CONDITION

Value-based controlling system

Our internal financing capability is measured by the gross cash flow (GCF). Our yardstick of performance is the cash value added (CVA). This is the difference between the GCF and the GCF hurdle which, in turn, is computed from the capital invested, the cost of capital and the strategic useful life of the assets. The capital invested is the gross carrying amount of the assets, less interest-free liabilities.

The €2.9 billion gross cash flow from continuing operations in 2002 amounted to 82 percent of the hurdle for the year, which was €3.6 billion.

€ million (continuing operations)	2002	2001
Gross cash flow	**2,935**	2,817
CVA	**(632)**	(358)
CFROI	**8.0%**	8.2%
Average capital invested	**36,520**	34,549

The profitability of the enterprise and of the individual business groups is measured by the cash flow return on investment (CFROI), which is the gross cash flow divided by the average capital invested. The 2002 fiscal year saw considerable growth in the capital invested, mainly because of acquisitions in the CropScience business area.

The CFROI was maintained at the previous year's level despite the increase in the capital invested.

Liquidity and capital resources

The **cash flow statement** shows the cash inflows and outflows from operating, investing and financing activities. The gross cash flow increased by 3 percent from the previous year, while the net cash flow rose by €0.6 billion, or 15 percent, to a record €4.4 billion thanks to our success in reducing working capital.

Bayer Group Summary Income Statement		
€ million	**2002**	**Change in %**
Net sales	29,624	– 2.2
Operating result	1,574	– 2.3
Non-operating result	(618)	– 24.6
Income before income taxes	956	– 14.3
Net income	1,060	+ 9.8

Net cash used in **investing activities** amounted to €6.6 billion. Total cash disbursements for the acquisition of Aventis CropScience amounted to €7.8 billion, while net cash receipts from interest, marketable securities, investments, property, plant and equipment were €1.2 billion. Of the cash inflows from investments, €0.7 billion relates to the sale of the remaining interest in Agfa-Gevaert N.V.

Net cash provided by **financing activities** came to €2.2 billion, with net borrowings amounting to €3.5 billion. Dividend and interest payments totaled €1.4 billion.

Cash and cash equivalents increased by €0.1 billion to €0.8 billion. The liquid assets stated in the balance sheet, which also include marketable securities and other instruments, remained at the previous year's level of €0.8 billion.

Earnings performance

The Group reported an **operating result** of €1.6 billion, the same as last year, on **sales** of €29.6 billion.

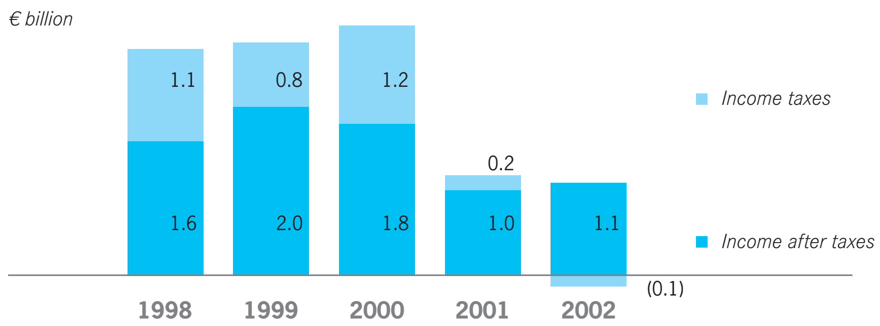
With sales from **continuing operations** down 1 percent to €29.0 billion, the operating result before exceptionals fell by 46 percent to €1.0 billion, giving a return on sales of 3 percent compared with 6 percent in 2001.

Exceptional charges totaled €1.2 billion, including €0.9 billion for restructuring and €0.3 billion for legal settlements. These charges were partially offset by €0.8 billion in exceptional income from the sale of housing units and trademark rights.

The operating result from **discontinuing operations** comprises the €47 million operating result of the Haarmann & Reimer group up to the date of divestiture and the €0.9 billion gain on the sale.

The **non-operating result** showed a €122 million decline to minus €618 million, mainly because of the additional interest expense associated with the financing of the Aventis CropScience acquisition and also as a consequence of securities write-downs. Income from investments in affiliated companies was sharply higher due to the sale of our interest in Agfa-Gevaert N.V.

Earnings



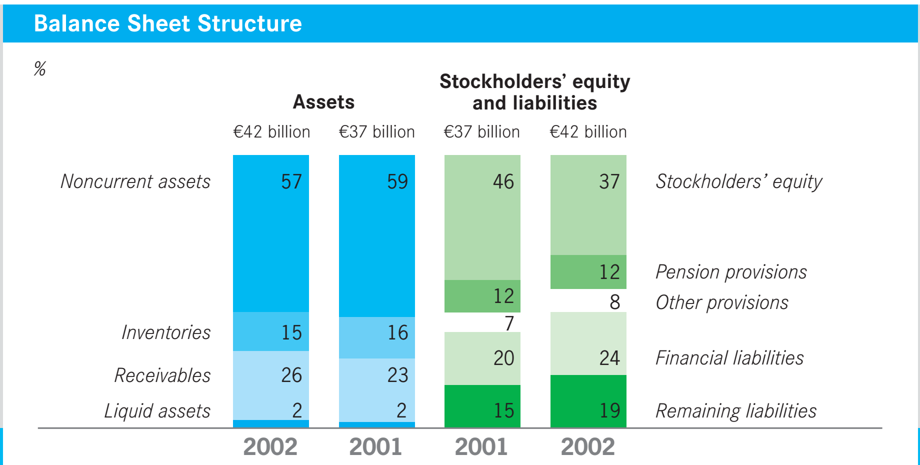
Income before income taxes shrank by 14 percent from 2001, to €1.0 billion. The lower operating result, tax-free income and deferred tax assets resulted in net tax income of €107 million. The effective tax rate calculated on taxable income was 37 percent.

Group net income rose by 10 percent to €1.1 billion.

The Group's profitability ratios were as follows:

		2002	2001
Cost of goods sold (%)*	Cost of goods sold / Net sales	**60.5**	57.4
R&D expenses (%)*	R&D expenses / Net sales	**8.7**	8.6
Return on sales before exceptional items (%)*	Operating result before exceptional items / Net sales	**3.4**	6.3
Return on stockholders' equity (%)	Income after taxes / Average stockholders' equity	**6.6**	5.8
Return on assets (%)	Income before income taxes and interest expense / Average total assets	**4.8**	4.3

* continuing operations



Asset and capital structure

Total assets increased compared with December 31, 2001 by €4.7 billion to €41.7 billion, mainly as a result of the first-time consolidation of Aventis CropScience.

Noncurrent assets grew by €1.8 billion on aggregate, with **intangibles** increasing by €3.9 billion to €8.9 billion as a result of the ACS acquisition.

Property, plant and equipment decreased by €1.1 billion, largely due to the divestment of Haarmann & Reimer. While capital expenditures amounted to €1.9 billion, depreciation came to €1.8 billion and retirements to €0.8 billion. The €0.9 billion decrease in **investments** arose primarily from the sale of the interest in Agfa-Gevaert N.V. and the fair-value remeasurement of financial instruments.

Current assets increased by €2.8 billion, or 19 percent, compared with the end of 2001. The **total of inventories and receivables** grew by €2.4 billion, or 18 percent, due to acquisitions. This was mainly the result of an increase in **other receivables and other assets**, which contained the fipronil business slated for divestment to meet antitrust conditions. **Inventories** expanded by 9 percent and **trade accounts receivable** by 2 percent. **Liquid assets** were virtually unchanged.

Stockholders' equity shrank by €1.6 billion to €15.3 billion. Here, the €1,060 million in Group net income for 2002 was offset by the €657 million dividend payment for 2001, €1,425 million in negative currency translation effects and a €565 million decrease arising from the fair-value remeasurement of financial instruments. Equity coverage of total assets was 37 percent.

Liabilities grew by €6.2 billion to €26.2 billion. This marked increase was primarily due to the launch of a €5 billion bond issue to finance the acquisition of Aventis CropScience.

Net debt rose by €2.3 billion year-on-year, to €8.9 billion.

Summary Balance Sheets

€ million	Dec. 31, 2002	Dec. 31, 2001
Noncurrent assets	23,513	21,702
Current assets	18,179	15,337
Stockholders' equity	15,335	16,922
Minority stockholders' interest	120	98
Liabilities	26,237	20,019
of which discontinuing operations	*0*	*233*
Balance sheet total	**41,692**	**37,039**
of which discontinuing operations	*0*	*820*

The balance sheet ratios are as follows:

		2002	2001
Noncurrent assets / Total assets	(%)	**56.4**	58.6
Depreciation / Capital expenditures	(%)	**118.1**	94.2
Net sales / Inventories		**4.7**	5.2
Net sales / Trade accounts receivable		**5.3**	5.6
Stockholders' equity / Total assets	(%)	**36.8**	45.7
Stockholders' equity / Noncurrent assets	(%)	**65.2**	78.0
Short-term liabilities / Total liabilities	(%)	**41.9**	51.9

Value Added by Continuing Operations

€ million	2002	Change in %
Source		
Net sales	28,958	– 0.7
Other income	2,468	•
Total operating performance	**31,426**	**+ 5.2**
Cost of materials	11,346	+ 2.3
Depreciation	3,266	+ 33.2
Other expenses	6,741	+ 3.4
Value added	**10,073**	**+ 7.1**

€ million	2002	Share in %
Distribution		
Stockholders	657	6.7
Employees	8,001	81.4
Governments	99	1.0
Lenders	913	9.3
Earnings retention	403	4.1
Value added	**10,073**	**100.0**

VALUE ADDED

The **total operating performance** of continuing operations rose by 5 percent to €31.4 billion. The **value added** was €10.1 billion, which was 7 percent above the previous year despite higher depreciation and other costs. Of the value added, €8.0 billion was distributed to employees, €0.1 billion to governments, €0.7 billion to stockholders and €0.9 billion to lenders; €0.4 billion will be retained by the company.

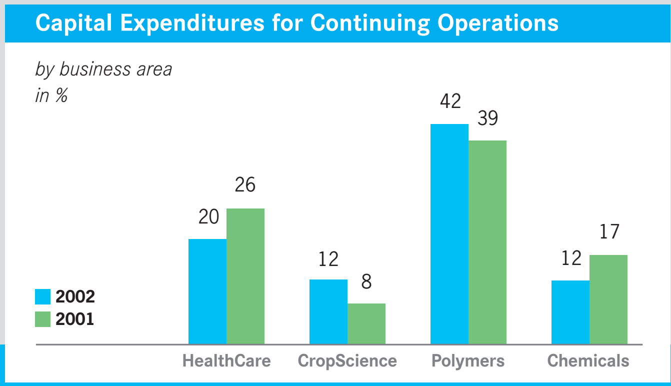
PROPOSAL FOR DISTRIBUTION OF THE PROFIT

Under German law the **dividend** is paid out of the balance sheet profit of the parent company Bayer AG. The balance sheet profit for 2002 amounted to €0.7 billion. A summary income statement for Bayer AG is given below.

Bayer AG Summary Income Statement*

€ million	2002	2001
Net sales	**9,513**	**10,824**
Cost of goods sold	6,771	6,963
Gross profit	2,742	3,861
Selling, R&D and administration expenses	2,997	3,848
Other operating income – net	167	9
Operating result	**(88)**	**22**
Non-operating result	**1,293**	**784**
Income before income taxes	**1,205**	**806**
Income taxes	43	149
Net income	**1,162**	**657**
Allocation from net income to retained earnings	505	0
Balance sheet profit	**657**	**657**

* The complete financial statements of Bayer AG with an unqualified opinion by the auditors are published in the "Bundesanzeiger" and have been included in the Commercial Register in Cologne. They are available from Bayer AG in English or German.



We will propose to the Annual Stockholders' Meeting on April 25, 2003 that the balance sheet profit be used to pay an unchanged dividend of €0.90 per share (730,341,920 shares) on the capital stock of €1,870 million entitled to the dividend for 2002.

EMPLOYEES

On December 31, 2002 there were 122,600 people employed in continuing operations of the Bayer Group. The increase of 9,600 over the end of 2001 was due to the inclusion for the first time of Aventis CropScience. A breakdown of employees according to business areas and regions can be found on page 72–73 of the notes to the financial statements. The average number of employees increased to 124,600.

Personnel expenses without discontinuing operations rose by 5 percent to €8.0 billion, and the ratio of personnel expenses to sales was 27 percent. The value added per employee dropped by €4,700 to €81,400.

CAPITAL EXPENDITURES

We spent a total of €2.4 billion for intangible assets, property, plant and equipment in 2002. Europe accounted for €1.4 billion, of which 78 percent was spent in Germany.

The breakdown of capital expenditures for property, plant and equipment is as follows:

€ million	**2002**	**Change in %**
Capacity expansions	861	– 28.0%
Replacement and modernization	880	+ 9.3%
Efficiency improvements	207	– 1.4%
Capital expenditures for property, plant and equipment	**1,948**	**– 11.9%**

Major projects included:

HealthCare

Investment volume: €0.5 billion

- Construction of a sterile filling facility for Factor VIII, Berkeley, California
- Construction of a small volume facility with pilot plant for Aspirin® production, Greppin, Germany

CropScience

Investment volume: €0.3 billion

- Completion of a multi-purpose facility for crop protection products, Dormagen, Germany

Polymers

Investment volume: €1.0 billion

- Modification of butyl rubber production, Zwijndrecht, Belgium and Sarnia, Canada
- Expansion of capacity for ABS plastics, Tarragona, Spain and Map Ta Phut, Thailand
- Expansion of polycarbonate capacity including precursors, Uerdingen, Germany
- Expansion of isocyanate capacity including precursors, Brunsbüttel, Dormagen and Uerdingen, Germany and Niihama, Japan
- Expansion/modification of electrolysis plants, Leverkusen, Germany

Chemicals

Investment volume: €0.3 billion

- Efficiency improvement in the integrated aromatics production network, Leverkusen, Germany
- Expansion of nitrocellulose production, Bomlitz, Germany

CAPITAL EXPENDITURE PROJECTS

Our planned investment volume for 2003 is €1.8 billion. The breakdown according to business area is as follows:

HealthCare
Investment volume: €0.5 billion

CropScience
Investment volume: €0.2 billion

Polymers
Investment volume: €0.6 billion

Chemicals
Investment volume: €0.2 billion

ACQUISITIONS/DIVESTITURES

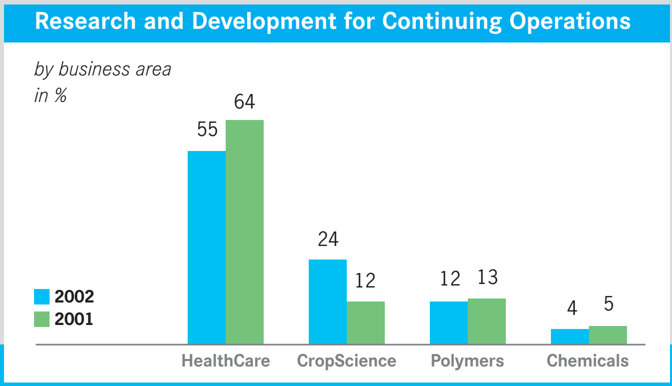
We spent €7.9 billion on acquisitions in 2002, of which €7.8 billion was expended to acquire Aventis CropScience – including the assumption of debt – effective June 1, 2002.
Major divestments in 2002 included:

- the sale of the Haarmann & Reimer group to financial investor EQT Northern Europe Private Equity Funds for €1.7 billion;
- the divestiture of Bayer's remaining 30 percent interest in Agfa-Gevaert N.V. to investment bank Goldman Sachs for €714 million;
- the sale of housing company Bayer Wohnungen GmbH to TreuHandStelle für Bergmannswohnstätten im rheinisch-westfälischen Steinkohlenbezirk GmbH for €528 million.

RESEARCH AND DEVELOPMENT

Innovation is the key factor for ensuring success in the global marketplace. In 2002 we invested a total of €2.5 billion in research and development. Bayer will remain a research-based company in its new organizational structure. We have dissolved our Central Research Division, as the responsibility for R&D in the future will rest with the HealthCare, CropScience, Polymers and Chemicals subgroups and – for engineering questions – with Bayer Technology Services.

Our research activities focus on the optimization of our product portfolio, the development of future-oriented products that strengthen our core businesses, and the improvement of our production processes. Our international R&D operations are supported by a number of collaborations with leading universities, public research institutes and partner companies, including start-up enterprises. The goal is to develop a broadly based network to open up new fields of innovation.



HealthCare

In 2002, €1,387 million, or 55 percent of the Bayer Group's research and development budget, was spent in the HealthCare business area. Grouping the Animal Health, Biological Products, Consumer Care, Diagnostics and Pharmaceuticals divisions together under the umbrella of Bayer HealthCare should help the company to better exploit synergy potentials in R&D in the future.

In **Pharmaceuticals**, we will conduct research in four core disciplines in the future with optimum use of resources. The best opportunities to successfully introduce new products to the market exist in the fields of cardiovascular disease, metabolic disorders, cancer and anti-infectives. In the cardiovascular, metabolism and anti-infective segments we have years of recognized experience all along the value chain from research to the market. Cancer is a core field of research in which we expect significant growth in the future based on an interesting pipeline and numerous innovative research approaches. Bayer's industry-leading research platform will also be a key factor for success. In cooperation with Curagen and Millennium, for example, Bayer has identified a series of novel targets that have been transferred to our U.S. research center in West Haven, Connecticut for further research.

Preparations for the launch of Levitra®, Bayer's product for the treatment of erectile dysfunction, are continuing apace. Marketing authorization and the sales start are expected for 2003. The market introduction of Cipro® XR for uncomplicated urinary tract infections was also intensively prepared. Thanks to an innovative formulation, patients need only take one tablet of Cipro® XR a day. The product was successfully launched onto the market at the beginning of 2003.

The **Biological Products** Division submitted a registration application for the improved immunoglobulin Gamunex® in the first quarter of 2002. Global launch of this product, which is manufactured utilizing a novel cleaning process, is expected before the end of the year. The production problems for Bayer's recombinant hemophilia treatment Kogenate® were rectified last year. Kogenate® enjoyed very good sales again in 2002, and even higher volumes are expected for the current year. We are convinced that our continuing research activities for the indication of hemophilia will allow us to offer further innovative medicines for the treatment of this disease in the future.

Diagnostics has introduced key innovations to the market in the past, such as the first blood glucose test and the first Glucometer®. Due to this ability to develop and successfully market new products, Diagnostics occupies excellent positions in all important segments. Investments in research will continue to focus on indications that promise high growth rates and profitability, particularly diabetes, nucleic acid tests, cancer and self-testing.

The grouping of our health care activities under the umbrella of Bayer HealthCare will allow us to tailor diagnosis, prevention and treatment to patients' individual needs in the future. We expect to transfer a series of products from our strong pipeline to the market in 2003.

With the registration of Advantix® in the United States in October 2002, the **Animal Health** Division has set a new standard in ectoparasite control for dogs. Advantix®, a product to combat ticks and fleas, is also effective in repelling mosquitoes and various species of flies – thus preventing the transmission of diseases by these parasites. The product is expected to be approved in Europe in 2003.

CropScience

By combining the Aventis CropScience acquisition with Bayer's former Crop Protection Business Group, we last year created the new subgroup Bayer CropScience, in which €598 million – or 24 percent – of the Bayer Group's R&D budget was spent in 2002.

Bayer CropScience thus occupies a leading role in crop protection research. The former competitors' respective platforms for the identification of new lead structures complement each other especially well, creating an excellent basis for future research breakthroughs. Aventis CropScience was particularly skilled in miniaturizing greenhouse tests to such an extent that a large number of chemical compounds could be tested in high-throughput screening procedures using extremely small substance volumes. In recent years, our former Crop Protection Business Group has assembled a technology platform that uses genome research to identify targets against which novel herbicides, fungicides or insecticides are effective. These two research approaches complement one another very well and form the basis for innovative products. Our goal is to introduce two to three new products to the market each year. Bayer CropScience occupies a leading position in safener technology. Safeners are additives that protect crops from the effects of herbicides. The identification of tailor-made safeners should expand the spectrum of use for highly effective novel herbicides.

R&D offers further opportunities for the future in the field of green biotechnology. BioScience researchers based in Potsdam, Germany; Ghent, Belgium; Lyon, France; and Haelen, Netherlands are working on promising projects involving five major crops: corn, soybeans, cotton, rice and oilseed rape.

Polymers

Bayer Polymers invested €298 million in research and development in 2002, thus supporting the steady expansion of its position as a technological leader and global supplier of material and system solutions.

Twenty years ago our Makrolon® polycarbonate paved the way for the incredible success of the compact disc (CD). The continuing optimization of Makrolon® eventually led to the development of the Digital Versatile Disc (DVD), and researchers are already focusing on the next generation: the "Blu-ray Disc," which will have five times the storage capacity of a DVD.

Another promising project in the plastics sector is the development of Triax® DP 3155, a product for car body parts that can be coated online. This means that metal and plastic components can be coated together in the same operation, which saves both time and money. This project is being pursued in close cooperation with Bayer's customers in the automotive industry.

In the field of environmentally friendly, water-reducible polyurethane coating systems, new crosslinking agents are currently being developed that should further expand the market potential of waterborne technology.

Bayer has expanded its range of Therban® XT, specialty rubber products. Our researchers have developed a product that can withstand extremely high temperatures and stresses. Following its successful market introduction, Therban® XT has found a number of applications in the automotive sector.

The research collaboration begun in 2001 with the renowned and tradition-rich Chinese Academy of Sciences was expanded last year to the field of polymer and materials research. The commitment of Bayer Polymers to the fast-growing Chinese market is thus being supported by the development of close links to the country's university system.

Chemicals

Bayer Chemicals invested €100 million in R&D in 2002 to further optimize production processes and expand its innovative product portfolio. The strength of this subgroup's research activities lies in the diversity of its product range and its broad spectrum of expertise in everything from basic and fine chemicals to specialty products such as ion exchange resins, preservatives, cellulose-based construction materials and high-grade metal and ceramic powders for electronic components.

Chemicals is pursuing the development of innovative dyes for the aforementioned Blu-ray Disc. Polycarbonate discs receive ultra-thin coatings of these new dyes, on which data is stored. In this project, synergies between Bayer Chemicals and Bayer Polymers are exploited through close cooperation between dye chemists and materials researchers. The ultimate aim is to accelerate product development.

Catalysts play a special role in the manufacture of fine chemicals as intermediates and active ingredients. To expand its technology platform in the field of homogeneous catalysis, Bayer Chemicals has entered into a research alliance with RhodiaChirex and has also signed a non-exclusive license agreement with the Massachusetts Institute of Technology (MIT) for the use of various patents and patent applications held by that university.

Novel BLANKOPHOR® fluorescent whiteners have been developed for use in paper manufacturing. These products ensure a very high degree of whiteness while increasing the productivity of the manufacturing process in the highly competitive paper market.

With the new product Bayoxide® E33, our researchers achieved a breakthrough in removing arsenic from drinking water. It is thus possible to reduce the level of arsenic in drinking water below the threshold laid down by the World Health Organization (WHO). The new Bayer product essentially consists of synthetic iron oxide hydroxide that reliably adsorbs arsenic and has great potential to eliminate other hazardous substances.

The H.C. Starck group manufactures advanced ceramic powders and offers expertise in production technology for sintered ceramic components. One future application of these is in the production of solid oxide fuel cells (SOFCs), which have considerable market potential in cogeneration facilities for decentralized energy supply.

RISK MANAGEMENT

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 and evaluate as early as possible the potential risks associated with our activities, assess the possible 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.

Risk management is an integral part of all decisions and business processes in the Bayer Group. We have begun to extend our risk management to the Aventis CropScience companies.

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.

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 Board of Management 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.

In addition, possible risks are identified and documented with respect to their quantitative and qualitative effects and the likelihood of their occurrence so that precautionary measures can be taken.

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 Board of Management and the Supervisory Board on the results of these evaluations.

Our business activities involve the following primary risks:

As a manufacturing company active in numerous areas of the health care and chemicals industry, we are subject to the **procurement market risk** that the raw materials and utilities needed to manufacture our products may not be available, or that their quality or quantity may be insufficient. During the reorganization process, therefore, the existing procurement structures were adapted to the new holding company structure with independent operating subgroups. The conversion of the previous, centrally organized 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 structure 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.

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.

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.

To counter risks that could arise from the numerous tax, competition, patent, antitrust 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 for risks resulting from new laws or legal judgments that apply retroactively.

Increased risks currently result from litigation in the United States following the voluntary withdrawals of Lipobay®/Baycol® and products containing PPA. In the event plaintiffs substantially prevail despite existing defense arguments, it is possible that Bayer could incur charges in excess of its insurance coverage that might materially affect the Group's business development, results of operations, cash flows and financial position. Due to the considerable uncertainty associated with these proceedings, it is currently not possible to more accurately estimate potential liability. For this reason, provisions for any amount for which liability might exceed insurance coverage have not presently been made. Depending on the progress of the litigation, we will continue to regularly reconsider the need to establish provisions which may have a negative effect on financial results.

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.

The future success of our business depends in no small part on the dedication, motivation and skills of our **employees.** We must be capable at all times of attracting suitably qualified technical and managerial personnel, successfully integrating them into our operations and ensuring that they stay with us over the long term.

With this goal in mind, we offer our employees internal education and training opportunities, as well as performance-oriented remuneration systems. To ensure that our employees act responsibly from both a professional and a legal point of view within their respective fields of work, we have promulgated a worldwide **legal compliance** program. Supported by thorough training, this behavioral code obligates employees to observe the relevant laws and regulations. Complying with the rules at all times and monitoring the way employees handle risks are among the basic duties of all managers and supervisors throughout the Group. Binding guidelines, instructions and manuals are distributed throughout the enterprise to help ensure that our employees act consistently and safely.

In addition to the risks described above, further risks could exist for our business that we currently are unaware of or regard as negligible.

SUBSEQUENT EVENTS

On January 31, 2003, the sale of the Organic Pigments Division of Bayer Corporation to Sun Chemical Group was completed.

In early 2003, we reached an agreement to divest our 50 percent interest in PolymerLatex GmbH & Co. KG, Marl, Germany, as part of our portfolio optimization program for the Polymers business area. This transaction is subject to the approval of the relevant antitrust authorities.

FUTURE PERSPECTIVES

ECONOMIC OUTLOOK

Due to the uncertainties surrounding the global economy and to a lack of clear signals, growth forecasts are currently difficult to make. However, investment and private consumption continue to be dampened by the significant downturn on the stock markets, political uncertainties and the resulting sharp rise in oil prices.

The positive impulses are expected to take effect only gradually over the course of the year as economic growth slowly gains momentum in the industrialized countries. However, the recovery is expected to be only modest, since consolidation pressures in the private and public sectors will remain strong. In the euro zone, slower growth is initially expected for the spring due partly to the appreciation of the euro.

The growth forecast for Germany has now fallen to below 1 percent, with consumption additionally burdened by tax hikes and increases in other levies. Overall, significant recovery of the economy is not expected until 2004.

Asia will most likely be the fastest-growing region again in 2003, with the boom in China expected to contribute particularly to above-average growth rates. Japan's outlook for 2003 remains gloomy, and lower growth rates are forecast for gross domestic product, private consumption and the manufacturing sector.

STRATEGY

"Our task is to create a new Bayer – a company with the potential to achieve or defend a leadership position in all its businesses. A company that convinces through performance, communicates fairly and openly with its stockholders and is committed to increasing its corporate value."

Consistent evolution into a strategic management holding structure

At the Annual Stockholders' Meeting in April 2002, the shareholders of Bayer AG approved the strategic evolution of the Bayer Group into a management holding structure. With the implementation of this decision, the crop protection business was transferred to Bayer CropScience AG retroactive to January 1, 2002. At the Annual Stockholders' Meeting in April 2003, the shareholders will be asked to approve the legal independence of the remaining three business areas and the service areas.

The Bayer Group's new holding structure is based on the four operating units HealthCare, CropScience, Polymers and Chemicals, and three service companies. This structure is primarily aimed at achieving a sharper focus on core competencies and strengthening entrepreneurial responsibility for operational management in the subgroups.

The operating companies should now benefit from even greater flexibility and market proximity in their sectors. They should be able to more rapidly exploit market opportunities and respond to customers' needs, thus helping to increase Bayer's corporate value and promote growth. At the same time, the legal independence of the operating units should facilitate the integration of acquisitions and create greater flexibility for partnerships and alliances.

Bayer AG as the holding company will drive the consistent evolution of the Group. Its functions primarily include the strategic management of the Bayer Group, as well as portfolio, financial and executive staff management and the allocation of resources.

The reorganization should help to reduce complexity within the Group and create well-defined and transparent structures and areas of responsibility that are recognizable both internally and externally. Although the Bayer Group has undergone a major reorganization process, the holding company aims to ensure that Bayer continues to act as one enterprise.

Value-based portfolio management

Strict and consistent value management is a core element of our corporate policy. Our performance-oriented remuneration systems are also focused toward the achievement of value-management goals. The new organization should considerably intensify portfolio management.

We aim to further improve our market positions through acquisitions and alliances. Only activities that earn a return exceeding the cost of capital over the long term can remain in the Group portfolio. That's why, in the future, we will continue to divest parts of the enterprise that no longer belong to our core business, or that do not promise sufficient value creation.

The Pharmaceuticals, Biological Products, Consumer Care, Diagnostics and Animal Health divisions are being brought together in a competitive health care entity. Our extensive network involving external partners and long-term alliances with biotech companies should continue to strengthen our research platform.

Thanks to the ACS acquisition, CropScience is very well positioned in the herbicides, insecticides, fungicides and seed treatment segments. Environmental Science is an industry leader in non-agricultural pest control. BioScience is active in the seed business and the fast-growing green biotechnology sector, for which experts are forecasting annual growth rates of more than 14 percent. This competitive portfolio, together with an outstanding product pipeline, should enable us to grow considerably faster than the market. To realize this goal, we need to optimally exploit the strengths of our broad-based product portfolio, successfully position upcoming product launches on the market and quickly achieve the planned synergies.

In Polymers, too, we are a market leader in many fields of business. Strategic acquisitions such as the purchase of Sybron or the Lyondell polyols business have allowed us to further consolidate our market positions. We intend to continue expanding our leadership position in the field of high-performance plastics in the future.

In the Chemicals business area, we continue to focus on specialty, fine and electronic chemicals. In view of the continuing consolidation in the industry, we are prepared to enter into partnerships in certain segments. In the medium term, we aim to improve our technological expertise, expand our marketing activities and enhance our presence in the world's key economic regions. Moreover, we must further optimize our cost structures and streamline our portfolio, particularly in basic chemicals.

Financial strategy

We generally pursue a conservative financial strategy aimed foremostly at avoiding liquidity risks, but also at optimizing financing costs. The latter objective requires that the Group's financing strategy be sufficiently flexible for us to quickly respond to emerging opportunities. We therefore aim to ensure a healthy balance between the different types and terms of the financial instruments in our financing portfolio. Another characteristic of our financial strategy is the centralization of capital procurement and risk management activities within Bayer AG, which ensures the efficient financial controlling of the Bayer Group and additionally helps us to achieve favorable prices. Of major importance in the short term is to consistently pursue the debt-reduction policy we so successfully implemented in 2002. To this end, we are applying strict capital discipline and using cash flows primarily to reduce debt.

OBJECTIVES FOR 2003

Our cost-containment and efficiency-improvement measures have already enabled us to achieve considerable savings. Current projects will be consistently pursued in 2003. Our systems for steering and monitoring working capital have proven very effective, allowing us to achieve gratifying improvements in the operating cash flow.

Our perspectives and goals for the individual business areas can be summarized as follows:

In **HealthCare,** Pharmaceuticals in particular should benefit from demographic developments over the medium and long term. In the United States, additional sales opportunities could result from an expansion of government-driven health care. However, rising research and development costs and considerably higher marketing costs will increase the pressure on margins. We are adjusting our structures in the wake of the Lipobay®/Baycol® withdrawal. In order to secure the business and gain market share over the long term, we are examining all options that could enhance our value. Yet we are also further expanding our business irrespective of these measures. An important milestone is the planned launch of Levitra®, our new treatment for erectile dysfunction, in the first half of 2003. A further focus of our activities is the market introduction of Cipro® XR. In addition, we are aiming to improve the margins and market share for Kogenate®.

In **CropScience**, we are steadily pressing ahead with the inter-company and international integration project started in 2002. The divestitures mandated in connection with the ACS acquisition are expected to be completed by the end of the first quarter of 2003. Further integration projects include the consolidation of our worldwide production sites, the concentration of our global research and development activities and the further consolidation and streamlining of all our organizational units with the goal of saving hundreds of millions of euros through synergies.

In **Polymers** we are focusing on improving our operating margin over the short and medium term. We are consolidating our production sites in an effort to increase our profitability. We are working to optimize our sales processes by creating regional service centers. In Polyurethanes we expect above-average growth, particularly through the expansion of our activities in Asia.

Our primary goal in **Chemicals** is to enhance our performance. We plan to achieve this by consistently implementing our restructuring programs and by steadily optimizing our existing product portfolio. We are also examining cooperation opportunities to improve our market position.

The currently uncertain economic situation prevents us from reliably forecasting earnings for the year. Thanks to the structural improvements undertaken in recent years, we believe we are equipped to deal with negative external developments. Provided the present situation does not radically deteriorate, we expect to increase our operating result over 2002.

Financial Statements 2002

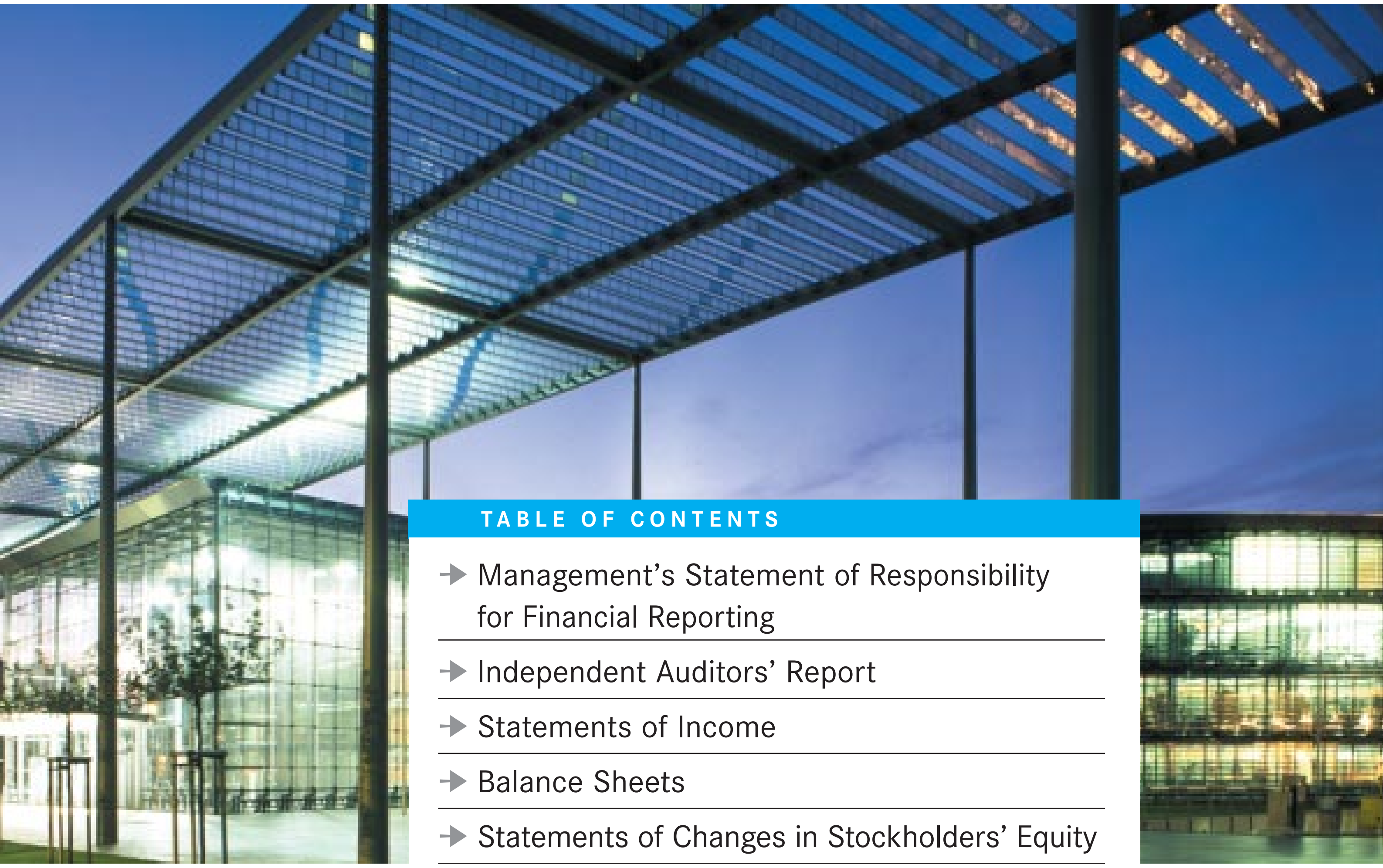


TABLE OF CONTENTS

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 Accounting 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 Presidial Committee of the Supervisory Board and at a plenary meeting of the Supervisory Board. The Report of the Supervisory Board (en_report_supervisory.pdf) appears separately in this Annual Report.

The Board of Management

Independent Auditors' Report

We have audited the consolidated financial statements of the Bayer Group, comprising 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, 2002. The preparation and the content of the financial statements according to the International Accounting Standards of the IASB (IAS) 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 IAS.

We conducted our audit of the consolidated financial statements in accordance with German auditing standards, the German principles for the auditing of financial statements promulgated by the Institut der Wirtschaftsprüfer (IDW) (German Institute of Certified Public Accountants), and 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. 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, based on our audit, the consolidated financial statements as of December 31, 2002 give a true and fair view of the net worth, financial position, results of operations and cash flows of the Bayer Group for the financial year in accordance with IAS.

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, 2002, has not led to any objections. In our opinion, the management report provides, on the whole, a fair 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, 2002 satisfy the conditions required for the company's exemption from its obligation to prepare the consolidated financial statements and the Group management report in accordance with the German Commercial Code.

Without qualifying our opinion we refer to the lawsuits associated with the withdrawal of the Lipobay/Baycol drug described in the Annual Report. Those lawsuits may result in material liability risks. Due to the unique trial situation in the United States of America it is currently not possible to quantify the liability risks and to assess whether these risks exceed the existing insurance coverage. Hence, a provision did not have to be set up.

Essen, February 26, 2003

PwC Deutsche Revision
Aktiengesellschaft
Wirtschaftsprüfungsgesellschaft

P. Albrecht	V. Linke
(Certified Public Accountant)	(Certified Public Accountant)

Bayer Group Consolidated Statements of Income

€ million	Note	2002	2001 1)
Net sales	[1]	**29,624**	**30,275**
Net sales from discontinuing operations	[6]	*(666)*	*(1,105)*
Net sales from continuing operations		28,958	29,170
Cost of goods sold		(17,509)	(16,747)
Gross profit		**11,449**	**12,423**
Selling expenses	[2]	(6,786)	(7,006)
Research and development expenses	[3]	(2,532)	(2,496)
General administration expenses		(1,228)	(999)
Other operating income	[4]	1,732	481
Other operating expenses	[5]	(2,041)	(1,198)
Operating result from continuing operations		**594**	**1,205**
Operating result from discontinuing operations	[6]	*980*	*406*
Operating result	[7]	**1,574**	**1,611**
Income from investments in affiliated companies – net	[8]	223	54
Interest expense – net	[9]	(449)	(349)
Other non-operating expenses – net	[10]	(392)	(201)
Non-operating result		**(618)**	**(496)**
Income before income taxes		**956**	**1,115**
Income taxes	[11]	107	(154)
Income after taxes		**1,063**	**961**
Minority stockholders' interest	[13]	(3)	4
Net income		**1,060**	**965**
Earnings per share (€)	[14]	**1.45**	**1.32**
Diluted earnings per share (€)	[14]	**1.45**	**1.32**

1) 2001 figures restated

Bayer Group Consolidated Balance Sheets

€ million	Note	Dec. 31, 2002	Dec. 31, 2001 [1]
Assets			
Noncurrent assets			
Intangible assets	[18]	8,879	5,014
Property, plant and equipment	[19]	12,436	13,543
Investments	[20]	2,198	3,145
		23,513	**21,702**
Current assets			
Inventories	[21]	6,342	5,818
Receivables and other assets			
Trade accounts receivable	[22]	5,542	5,415
Other receivables and other assets	[23]	4,210	2,447
		9,752	**7,862**
Liquid assets	[24]		
Marketable securities and other instruments		29	52
Cash and cash equivalents		767	719
		796	**771**
		16,890	**14,451**
Deferred taxes	[11]	**967**	**608**
Deferred charges	[25]	**322**	**278**
		41,692	**37,039**
of which discontinuing operations	[35]	*0*	*820*
Stockholders' Equity and Liabilities			
Stockholders' equity			
Capital stock of Bayer AG		1,870	1,870
Capital reserves of Bayer AG		2,942	2,942
Retained earnings		10,076	9,841
Net income		1,060	965
Other comprehensive income			
Currency translation adjustment		(593)	759
Miscellaneous items		(20)	545
	[26]	**15,335**	**16,922**
Minority stockholders' interest	[27]	**120**	**98**
Liabilities			
Long-term liabilities			
Long-term financial liabilities	[30]	7,318	3,071
Miscellaneous long-term liabilities	[32]	92	140
Provisions for pensions and other post-employment benefits	[28]	4,925	4,407
Other long-term provisions	[29]	1,215	1,288
		13,550	**8,906**
Short-term liabilities			
Short-term financial liabilities	[30]	2,841	4,309
Trade accounts payable	[31]	2,534	1,993
Miscellaneous short-term liabilities	[32]	2,138	1,832
Short-term provisions	[29]	2,257	1,477
		9,770	**9,611**
		23,320	**18,517**
of which discontinuing operations	[35]	*0*	*233*
Deferred taxes	[11]	**2,453**	**1,238**
Deferred income	[34]	**464**	**264**
		41,692	**37,039**

1) 2001 figures restated

Bayer Group Consolidated Statements of Changes in Stockholders' Equity

€ million	Capital stock of Bayer AG	Capital reserves of Bayer AG	Retained earnings	Net income	Miscellaneous items: Currency translation adjustment	Miscellaneous items: Fair-value remeasurement of securities	Miscellaneous items: Cash flow hedges	Total
Dec. 31, 2000	1,870	2,942	9,047	1,816	465	0	0	16,140
Jan. 1, 2001	1,870	2,942	9,047	1,816	465	1,339	95	17,574
Changes in stockholders' equity resulting from capital contributions and dividend payments								
Capital contributions								0
Dividend payments				(1,022)				(1,022)
				(1,022)				**(1,022)**
Other changes in stockholders' equity not recognized in net income								
Exchange differences					294			294
Other differences						(785)	(104)	(889)
of which realized gains (losses)						*(25)*	*(68)*	*(93)*
					294	**(785)**	**(104)**	**(595)**
Changes in stockholders' equity recognized in net income								
Allocation to retained earnings			794	(794)				0
Net income for 2001				965				965
			794	**171**				**965**
Dec. 31, 2001	1,870	2,942	9,841	965	759	554	(9)	16,922
Changes in stockholders' equity resulting from capital contributions and dividend payments								
Capital contributions								0
Dividend payments				(657)				(657)
				(657)				**(657)**
Other changes in stockholders' equity not recognized in net income								
Exchange differences					(1,352)			(1,352)
Other differences						(561)	(4)	(565)
of which realized gains (losses)						*(154)*	*9*	*(145)*
					(1,352)	**(561)**	**(4)**	**(1,917)**
Changes in stockholders' equity recognized in net income								
Allocation to retained earnings			235	(308)				(73)
Net income for 2002				1,060				1,060
			235	**752**				**987**
Dec. 31, 2002	**1,870**	**2,942**	**10,076**	**1,060**	**(593)**	**(7)**	**(13)**	**15,335**

Bayer Group Consolidated Statements of Cash Flows

€ million	Note	2002	2001 [1)]
Operating result		1,574	1,611
Income taxes		(339)	(637)
Depreciation and amortization		3,313	2,516
Change in long-term provisions		(135)	(193)
Gains on retirements of noncurrent assets		(1,401)	(374)
Gross cash provided by operating activities		**3,012**	**2,923**
(Increase) Decrease in inventories		(55)	146
Decrease in trade accounts receivable		546	638
Increase in trade accounts payable		419	73
Changes in other working capital		498	79
Net cash provided by operating activities	[39]	**4,420**	**3,859**
of which discontinuing operations	[42]	*87*	*131*
Cash outflows for additions to property, plant and equipment		(2,239)	(2,617)
Cash inflows from sales of property, plant and equipment		2,114	521
Cash inflows from sales of investments		903	109
Cash outflows for acquisitions less acquired cash		(7,776)	(502)
Interest and dividends received		402	138
Net cash inflow from marketable securities		26	219
Net cash used in investing activities	[40]	**(6,570)**	**(2,132)**
of which discontinuing operations	[42]	*1,286*	*310*
Bayer AG dividend and dividend payments to minority stockholders		(662)	(1,028)
Issuances of debt		7,427	2,514
Retirements of debt		(3,890)	(2,551)
Interest paid		(704)	(505)
Taxes on the non-operating result		38	21
Net cash provided by (used in) financing activities	[41]	**2,209**	**(1,549)**
of which discontinuing operations	[42]	*1*	*77*
Change in cash and cash equivalents due to business activities		**59**	**178**
Cash and cash equivalents at beginning of year		**719**	**491**
Change in cash and cash equivalents due to changes in scope of consolidation		4	42
Change in cash and cash equivalents due to exchange rate movements		(15)	8
Cash and cash equivalents at end of year	[43]	**767**	**719**
Marketable securities and other instruments		29	52
Liquid assets as per balance sheets		**796**	**771**

1) 2001 figures restated

Notes to the Consolidated Financial Statements of the Bayer Group

Accounting policies

The consolidated financial statements of the Bayer Group are prepared – pursuant to Article 292a of the German Commercial Code – in accordance with the rules of the International Accounting Standards Board (IASB), London, in effect at the closing date. They comply with the European Union's guidelines on consolidation of financial statements (Directive 83/349/EEC).

A Declaration of Conformity with the German Corporate Governance Code has been issued in compliance with §161 of the German Stock Corporation Act and made available to stockholders.

The financial statements of the consolidated companies are prepared according to uniform recognition and valuation principles. Valuation adjustments made for tax reasons are not reflected in the Group statements. The individual companies' statements are prepared as of the closing date for the Group statements.

In compliance with IAS 37 (Provisions, Contingent Liabilities and Contingent Assets), provisions are established for contingent liabilities if available information indicates that an asset has been impaired or a liability has been incurred, and the amount of the impairment loss can be estimated with sufficient reliability.

Certain income statement and balance sheet items are combined for the sake of clarity, as explained in the Notes. A distinction is made in the balance sheet between long-term and short-term liabilities in accordance with IAS 1 (Presentation of Financial Statements). Liabilities are stated as short-term if they mature within one year. Income received such as royalties, rental income, interest income or dividend income is recognized on an accrual basis.

Changes in recognition and valuation principles are explained in the Notes. The previous year's figures are restated accordingly. Accounting policies for individual categories of items in the income statement and balance sheet are included in the relevant notes.

In a few instances, estimates and assumptions have to be made. These affect the classification and valuation of assets, liabilities, income, expenses and contingent liabilities. The actual values may vary from the estimates.

Explanation of significant deviations from German accounting rules pursuant to Article 292a of the German Commercial Code

Financial statements prepared in compliance with the International Accounting Standards (IAS) aim to provide information on which investors can base their decisions. Accordingly, IAS prescribes strict separation of commercial and tax accounting, provisions for expenses are not permitted, a different definition of realized gains is used in certain cases, recognition and valuation options are more narrowly defined, and more extensive notes and explanations are required.

Material differences relate primarily to the accounting treatment of securities, foreign currency receivables and payables, and derivative financial instruments, which under IAS are stated at closing values whereas German accounting regulations apply the imparity principle.

IAS stipulates that minority stockholders' interest in income be recognized separately in the income statement and shown as a separate item on the balance sheet below equity.

Under IAS, provisions may only be set up for liabilities to third parties. Pension provisions are calculated using the projected unit credit method, taking into account future increases in remuneration and pensions. The German tax-based method is not permitted.

IAS requires deferred taxes to be recognized for all temporary differences between the tax and accounting balance sheets. Deferred taxes must also be recognized for loss carryforwards if it is sufficiently probable that these loss carryforwards can be utilized.

Effect of new accounting pronouncements

The consolidated financial statements of the Bayer Group for the 2002 fiscal year comply with the following new or revised interpretations of the Standing Interpretations Committee (SIC), which the Group implemented for the first time in 2002:

SIC-27 Evaluating the Substance of Transactions Involving the Legal Form of a Lease
SIC-28 Business Combinations – "Date of Exchange" and Fair Value of Equity Instruments
SIC-29 Disclosure – Service Concession Agreements
SIC-30 Reporting Currency – Translation from Measurement Currency to Presentation Currency
SIC-31 Revenue – Barter Transactions Involving Advertising Services
SIC-32 Intangible Assets - Web Site Costs
SIC-33 Consolidation and Equity Method - Potential Voting Rights and Allocation of Ownership Interests

The adoption of these new interpretations did not have any significant impact on Bayer's financial position or its results of operations during 2002 or on the comparability of its 2002 and 2001 consolidated financial statements.

The following new International Accounting Standard (IAS) will be implemented in 2003:

IAS 41 Agriculture

IAS 41 Agriculture prescribes the accounting treatment, financial statement presentation and disclosures related to agricultural activity. This standard stipulates, among other things, the accounting treatment for biological assets during the period of growth, degeneration, production and procreation, and for the initial measurement of agricultural produce at the point of harvest. It prescribes that biological assets be included at fair value less estimated point-of-sale costs, provided that fair value can be measured reliably. Agricultural produce harvested from such biological assets is also recognized at fair value at the point of harvest less estimated point-of-sale costs.

Scope of consolidation

The financial statements of the Bayer Group as of December 31, 2002 include Bayer AG and 59 German and 268 foreign consolidated subsidiaries in which Bayer AG, directly or indirectly, has a majority of the voting rights, over which it exercises uniform control, or from which it is able to derive benefit by virtue of its power to govern corporate financial and operating policies. The total number of consolidated companies has risen by 89 from the previous year. Excluded from consolidation are 154 subsidiaries that in aggregate are immaterial to the net worth, financial position and earnings of the Bayer Group; they account for less than 1 percent of Group sales. The rise in the number of subsidiaries is principally due to the acquisition of Aventis CropScience Holding S.A., France, effective June 1, 2002.

We have included 11 joint ventures – one fewer than in the previous year – by proportionate consolidation in compliance with IAS 31 (Financial Reporting of Interests in Joint Ventures). The effect of joint ventures on the Group balance sheet and income statement is as follows:

€ million	2002
Noncurrent assets	217
Current assets	151
Pension provisions	(7)
Other provisions	(11)
Financial liabilities	(61)
Remaining liabilities	(53)
Net assets	**236**

€ million	2002
Income	428
Expenses	383
Income after taxes	**45**

While 11 companies are stated at equity, 61 companies that in aggregate are of minor importance are stated at their carrying amounts.

Consolidated for the first time are 145 companies, while 56 companies have been deconsolidated. The increase is largely due to the acquisition of Aventis CropScience (108 companies) and the Visible Genetics group (10 companies). The companies no longer consolidated are those of the divested Haarmann & Reimer group (22 companies), those merged with former Aventis CropScience companies, and 12 other companies.

Acquisitions are accounted for by the purchase method. Accordingly, the results of operations of the acquired businesses are included in the consolidated financial statements as from the respective dates of acquisition. The purchase prices of acquisitions outside the euro zone are translated at the exchange rates in effect at the respective dates of acquisition.

In 2002 a total of €7.9 billion was spent on acquisitions, calculated at exchange rates at the time of acquisition. They were paid for in cash, not with shares in Bayer AG. These acquisitions led to goodwill of €2.3 billion. The goodwill amounts are being amortized by the straight-line method over periods not exceeding 15 years.

Bayer CropScience AG, Monheim, acquired Aventis CropScience Holding S.A., France, effective June 1, 2002 from its previous owners Aventis S.A., France, and Schering AG, Berlin, Germany, for €7.8 billion, including the assumption of debt. Aventis CropScience is one of the leading companies in the areas of crop protection, biotechnology and agrochemical specialties. The €2.2 billion in acquired goodwill is being amortized over a useful life of 15 years.

Approval of this acquisition by the relevant antitrust authorities, particularly in Europe and the United States, was conditional upon Bayer's divesting or outlicensing a number of products with total sales of €650-700 million.

On October 11, 2002 Bayer Corporation, United States, acquired Visible Genetics Inc., Canada. The purchase price was €62 million. This acquisition gives the Diagnostics Business Group two automated DNA sequencing systems marketed under the tradename OpenGene™ and the TRUGENE™ HIV genotyping kits, which permit testing for resistance to HIV drugs. The acquired goodwill of €12 million is being amortized over an estimated useful life of 15 years.

Bayer acquired Tectrade A/S, Denmark, at the start of April 2002 for €19 million. Tectrade develops customized polyurethane formulations. The acquisition comprises further subsidiaries, a technical service center and a formulating plant. The acquired goodwill of €16 million is being amortized over 10 years.

Effective December 6, 2002 our U.S. subsidiary Bayer Corporation acquired two biocides – thiabendazole and dibromodicyanobutane – and certain patented formulations of these biocides from Ondeo Nalco Inc., United States for €14 million. The acquisition also includes the Tektamer®, Biochek® and Metasol® tradenames. The active substances acquired provide protection against microorganisms such as yeasts, fungi, bacteria and algae, which can impair the quality of products and functional fluids. The rights are being amortized over an estimated useful life of 10 years.

The following significant **divestitures** were made in 2002:

As part of the streamlining of the Bayer Group's portfolio, Bayer AG sold its wholly owned subsidiary Haarmann & Reimer GmbH, a manufacturer of flavors and fragrances based in Holzminden, Germany, including its subsidiaries, to the financial investor EQT Northern Europe Private Equity Funds, for €1.7 billion effective September 30, 2002. The divestiture of this business group, which is reflected in discontinuing operations, included not only the Haarmann & Reimer companies but also the Haarmann & Reimer business operations of several of Bayer's foreign subsidiaries.

The 30 percent interest in the Belgian imaging company Agfa-Gevaert N.V., which Bayer continued to hold after the stock market placement of the other 70 percent of the shares in 1999, was sold to the investment bank Goldman Sachs for €714 million at the start of June 2002.

Effective March 1, 2002 Bayer AG sold its 94.9 percent interest in Bayer Wohnungen GmbH to TreuHandStelle für Bergmannswohnstätten im rheinisch-westfälischen Steinkohlenbezirk GmbH for €528 million. In addition to this interest, the transaction included further land and buildings owned by Bayer Wohnungen GmbH.

As part of the continued streamlining of its portfolio, Bayer sold to SC Johnson & Son Inc., United States, a large part of the global household insecticides business of its Consumer Care Business Group for €386 million effective December 31, 2002. The operations sold at year end were those for which regulatory approval of the transactions had already been given. In addition to the affiliates in Indonesia and Barbados and the inventories, SC Johnson has acquired the marketing rights to products such as Baygon®, Autan®, Bayclin® and Bayfresh®. Bayer will continue to manufacture the active ingredients for these products, which it will supply to SC Johnson and other customers. The divestment of the household insecticides in fiscal 2002 relates to Australia, Belgium, Brazil, Costa Rica, El Salvador, Guatemala, Hong Kong, Indonesia, Italy, the Philippines, South Africa and Spain. Closing of the transaction for the remaining countries is expected in the first quarter of 2003, pending the necessary approval by the relevant antitrust authorities.

In fiscal 2002, conditions set by the European antitrust authorities, the Federal Trade Commission (FTC) in the United States and the Canadian Competition Bureau for the acquisition of Aventis CropScience Holding S.A., France, were met. At the end of December 2002 the cereal herbicide Everest® was sold to Arvesta Corporation, which is headquartered in the United States, for €123 million, while the crop protection agent Goltix® and the exclusive marketing licenses for Herold® in Germany and Belgium were sold to Makhteshim-Agan Industries Ltd., Israel, for €138 million.

In fiscal 2002 the Bayer Group divested its French and Spanish generic pharmaceuticals operations as part of its drive to streamline the portfolio. Effective June 28, 2002 Bayer sold its stake in Bayer Classics S.A., France and the production site in Sens, via its French subsidiary Bayer Pharma France S.A., to the Israeli company Teva Pharmaceutical Industries Ltd. for €97 million. On April 17, 2002 Bayer sold its 50 percent interest in the Spanish generics company Bayvit S.A., Barcelona, which specializes in marketing and distribution, for €33 million. Bayer's stake and the remaining 50 percent, which was held by the privately owned company Vita Invest S.A., Spain, were acquired by STADA Arzneimittel AG, Bad Vilbel, Germany.

Acquisitions and divestitures of businesses affected the Group's assets and liabilities as of the dates of acquisition or divestiture as follows:

2002	Acquisitions	Divestitures
€ million		
Noncurrent assets	6,449	537
Current assets (excluding liquid assets)	5,101	481
Liquid assets	353	29
Assets	**11,903**	**1,047**
Pension provisions	578	74
Other provisions	133	47
Financial liabilities	2,545	170
Remaining liabilities	2,725	124
Liabilities	**5,981**	**415**

Lists of Bayer AG's direct and indirect holdings have been included in the Cologne commercial register. They also are available directly from Bayer AG on request.

The principal companies included in the consolidated financial statements are listed in the following table:

Company Name and Place of Business	Bayer's interest (%)
Germany	
Bayer Buna GmbH, Marl	100
Bayer CropScience Aktiengesellschaft, Monheim	100
Bayer Distribution Service GmbH, Leverkusen	100
Bayer Industrieprodukte GmbH & Co. KG, Leverkusen	100
Bayer Vital GmbH, Leverkusen	100
H. C. Starck GmbH, Goslar	100
Wolff Walsrode AG, Walsrode	100
Other European Countries	
Bayer A/S, Denmark	100
Bayer Antwerpen N.V., Belgium	100
Bayer B.V., Netherlands	100
Bayer CropScience France S.A., France	100
Bayer CropScience Holding S.A., France	100
Bayer CropScience S.A., France	100
Bayer Hispania, S.A., Spain	100
Bayer International S.A., Switzerland	99.7
Bayer Pharma S.A., France	99.9
Bayer plc, United Kingdom	100
Bayer Rubber N.V., Belgium	100
Bayer S.A.S, France	99.9
Bayer S.p.A., Italy	100
Química Farmacéutica Bayer, S.A., Spain	100
North America	
Bayer Corporation, United States	100
Bayer CropScience LP, United States	100
Bayer CropScience Inc., Canada	100
Bayer Inc., Canada	100
Asia/Pacific	
Bayer (India) Ltd., India	55.3
Bayer (South East Asia) Pte Ltd., Singapore	100
Bayer Australia Ltd., Australia	99.9
Bayer China Co. Ltd., Hong Kong	99.3
Bayer CropScience K.K., Japan	100
Bayer Ltd., Japan	100
Bayer Polymers Co. Ltd., Hong Kong	100
Bayer Yakuhin Ltd., Japan	100
Sumika Bayer Urethane Co. Ltd., Japan	60
Latin America/Africa/Middle East	
Bayer (Proprietary) Ltd., South Africa	100
Bayer CropScience Brasil S.A., Brazil	100
Bayer de México, S.A. de C.V., Mexico	100
Bayer S.A., Argentina	99.9
Bayer S.A., Brazil	99.9

The following domestic subsidiaries availed themselves in 2002 of certain exemptions granted under Articles 264, paragraph 3 and 264 b, No. 4 of the German Commercial Code regarding the preparation, auditing and publication of financial statements: Bayer Distribution Service GmbH, Leverkusen; Bayer-Kaufhaus GmbH, Leverkusen; Bayer Polymers Customer Services GmbH & Co. KG, Leverkusen; Generics Holding GmbH, Leverkusen; Bayer Innovation GmbH, Leverkusen; Bayer Kautschuk GmbH, Dormagen; Bayer Handelsges. mbH, Leverkusen; Bayer Buna GmbH, Marl; KVP Pharma + Veterinär Produkte GmbH, Kiel; Euroservices Bayer GmbH, Leverkusen; Travelboard GmbH, Leverkusen; Chemion Logistik GmbH, Leverkusen; Bayer Restaurant + Service GmbH, Leverkusen; Bayer Industrieprodukte GmbH & Co. KG, Leverkusen; Bayer Bitterfeld GmbH, Greppin; IAB Ionenaustauscher GmbH, Greppin; Wolff Walsrode AG, Walsrode; Probis GmbH, Bomlitz; Walothen GmbH, Bomlitz; Wolff Cellulosics KG, Bomlitz; Epurex Films KG, Bomlitz, and CaseTech KG, Bomlitz.

Foreign currency translation

The financial statements for 2002 are drawn up in euros (€).

In the financial statements of the individual consolidated companies, foreign currency receivables and payables are translated at closing rates, irrespective of whether they are exchange-hedged. Forward contracts that, from an economic point of view, serve as a hedge against fluctuations in exchange rates are stated at fair value.

The majority of consolidated companies outside the euro zone are to be regarded as foreign entities since they are financially, economically and organizationally autonomous. Their functional currencies according to IAS 21 (The Effects of Changes in Foreign Exchange Rates) are thus the respective local currencies. The assets and liabilities of these companies are therefore translated at closing rates, income and expense items at average rates for the year.

Where the operations of a company outside the euro zone are integral to those of Bayer AG, the functional currency is the euro.

Property, plant and equipment, intangible assets, investments in affiliated companies and other securities included in investments are translated at the historical exchange rate on the date of addition, along with any relevant amortization, depreciation and write-downs. All other balance sheet items are translated at closing rates. Income and expense items (except amortization, depreciation and write-downs) are translated at average rates for the year.

Companies operating in hyperinflationary economies prepare their statements in hard currency and thus, in effect, by the temporal method described above.

Exchange differences arising from the translation of foreign companies' balance sheets are shown in a separate stockholders' equity item.

In case of divestiture, the respective exchange differences are reversed and recognized in income.

The exchange rates for major currencies against the euro varied as follows:

€1		Closing rate 2002	Closing rate 2001	Average rate 2002	Average rate 2001
U.S.A.	USD	1.05	0.88	0.95	0.90
U.K.	GBP	0.65	0.61	0.63	0.62
Japan	JPY	124.39	115.33	118.06	108.74
Canada	CAD	1.66	1.41	1.48	1.39
Switzerland	CHF	1.45	1.48	1.47	1.51

Consolidation methods

Capital consolidation is performed according to IAS 22 (Business Combinations) by offsetting investments in subsidiaries against the underlying equities at the dates of acquisition. The identifiable assets and liabilities of subsidiaries and joint ventures are included at their fair values in proportion to Bayer's interest. Remaining differences are recognized as goodwill.

Where the statements of individual consolidated companies reflect write-downs or write-backs of investments in other consolidated companies, these are reversed for the Group statements.

Intragroup sales, profits, losses, income, expenses, receivables and payables are eliminated.

Deferred taxes are recognized for temporary differences related to consolidation entries.

Joint ventures are included by proportionate consolidation according to the same principles.

The consolidated financial statements include the accounts of those material subsidiaries in which Bayer AG is able to exercise operational control, generally through an ownership interest greater than 50 percent.

The equity method is used to account for investments in material entities in which Bayer AG exerts significant influence, generally through an ownership interest between 20 and 50 percent.

Intercompany profits and losses on transactions with companies included at equity were immaterial in 2002 and 2001.

Cash flow statement

The cash flow statement shows how the liquidity of the Bayer group was affected by the inflow and outflow of cash and cash equivalents during the year. The effects of acquisitions, divestitures and other changes in the scope of consolidation are eliminated. Cash flows are classified by operating, investing and financing activities in accordance with IAS 7 (Cash Flow Statements). Cash and cash equivalents shown in the balance sheet comprise cash, checks, balances with banks and securities with original maturities of up to three months. An adjustment is shown to reconcile cash and cash equivalents at the end of the year to the liquid assets reflected in the balance sheet.

The amounts reported by consolidated companies outside the euro zone are translated at average exchange rates for the year, with the exception of cash and cash equivalents, which are translated at closing rates as in the balance sheet. The effect of changes in exchange rates on cash and cash equivalents is shown separately.

NOTES TO THE STATEMENTS OF INCOME

[1] Net sales

Sales are recognized upon delivery of goods or rendering of services to third parties and are reported net of sales taxes and rebates. Revenues from contracts that contain customer acceptance provisions are deferred until customer acceptance occurs or the contractual acceptance period has lapsed. Allocations to provisions for rebates to customers are recognized in the period in which the related sales are recorded based on the contract terms. Payments relating to the sale or outlicensing of technologies or technological expertise – once the respective agreements have become effective – are immediately recognized in income if all rights to the technologies and all obligations resulting from them have been relinquished under the contract terms. However, if rights to the technologies continue to exist or obligations resulting from them have yet to be fulfilled, the payments received are recorded in line with the actual circumstances.

Total reported sales declined by €651 million compared with 2001, to €29,624 million. Sales from **continuing operations** were €212 million lower than in 2001. A €54 million increase in volumes was offset by negative contributions of €715 million from lower selling prices and €1,421 million from adverse shifts in exchange rates. The net effect of acquisitions and divestitures raised sales by €1,870 million. Acquisitions and divestitures during 2002 and 2001 affected the comparison between the two years' sales figures by the following amounts:

2002	
€ million	
Acquisitions	
Aventis CropScience Holding S.A., Lyon, France	1,977
Tectrade A/S, Copenhagen, Denmark	12
Other	3
	1,992
Divestitures	
ChemDesign Corporation (divested in 2001)	(56)
Covexx Films (divested in 2001)	(42)
Sale of the generics business	(16)
Other	(8)
	(122)
Net effect on sales from continuing operations	**1,870**

Breakdowns of net sales by segment and by region are given in the table on pages 20-21.

[2] Selling expenses

Selling expenses include €797 million (2001: €789 million) in shipping and handling costs. They also include advertising and promotion costs, expensed in the period in which they are incurred. These costs amount to €1,051 million (2001: €1,392 million).

[3] Research and development expenses

According to IAS 38 (Intangible Assets), research costs cannot be capitalized; development costs can only be capitalized if specific conditions are fulfilled. Development costs must be capitalized if it is sufficiently certain that the future economic benefits to the company will cover not only the usual production, selling and administrative costs but also the development costs themselves. There are also several other criteria relating to the development project and the product or process being developed, all of which have to be met to justify asset recognition. As in previous years, these conditions are not satisfied.

[4] Other operating income

Other operating income from continuing operations in 2002 arose mainly from portfolio adjustments and the fulfillment of conditions imposed by the antitrust authorities in connection with the acquisition of Aventis CropScience Holding S.A., France. The divestitures of Bayer Wohnungen GmbH, the household insecticides business of the Consumer Care Division, certain CropScience trademarks, the generics operations of the Pharmaceuticals Division and the sale of other noncurrent assets generated a total gain of €1,106 million (2001: €74 million). A further €154 million (2001: €68 million) came from reversals of unutilized provisions and €56 million (2001: €24 million) from sideline operations. The cost of goods sold incurred for sideline operations has been offset against the corresponding revenues to more clearly reflect the earnings position.

[5] Other operating expenses

Included in other operating expenses for continuing operations in 2002 are €101 million (2001: €91 million) in write-downs of receivables, €189 million (2001: €94 million) in amortization of acquired goodwill and €42 million (2001: €15 million) in losses from the sale of property, plant and equipment. In particular, impairment write-downs of intangible assets, property, plant and equipment of the polyols and fibers operations in the Polymers business area together accounted for expenses of €289 million. In addition, €427 million (2001: €214 million) was spent on restructuring. Further details of restructuring expenses are given on page 48-49.

[6] Discontinuing operations

As part of its reorganization Bayer divested the Haarmann & Reimer Business Group effective September 30, 2002 as it defined these activities as non-core. Thus it sold the wholly owned subsidiary Haarmann & Reimer GmbH, a manufacturer of fragrances and flavors based in Holzminden, Germany, to EQT Northern Europe Private Equity Funds. The operating result of this business for the period of 2002 up to the date of divestiture is therefore reflected in the operating result from discontinuing operations. This item also contains the gain from the divestiture recognized in 2002 income.

The remaining operations of the Fibers business group, including the production facilities for Dorlastan® spandex fibers and Perlon® monofil at three sites – Dormagen and Goch, Germany, and Bushy Park, South Carolina, U.S.A. – are continuing as part of the Bayer Group and accordingly are reflected in continuing operations. The previous year's figures have been restated accordingly.

Effective May 1, 2001 Bayer sold its 50 percent interest in EC Erdölchemie GmbH, Cologne, Germany, to its former partner Deutsche BP AG, Hamburg, Germany. The operating result of this business for the period of 2001 up to the date of divestiture was therefore reflected in the operating result from discontinuing operations. This item also contained the gain from the sale of the 50 percent interest recognized in 2001 income.

The non-operating results and the income taxes attributable to Haarmann & Reimer and Erdölchemie are reflected in the corresponding items of the income statement.

A breakdown of the results of discontinuing operations is given below.

	Haarmann & Reimer		Erdölchemie	Total	
	2002	2001	2001	2002	2001
€ million					
Net sales	**666**	**872**	**233**	**666**	**1,105**
Cost of goods sold	(376)	(481)	(196)	(376)	(677)
Selling expenses	(147)	(199)	(16)	(147)	(215)
Research and development expenses	(45)	(63)	(–)	(45)	(63)
General administration expenses	(27)	(38)	(3)	(27)	(41)
Other operating income	938	23	316	938	339
Other operating expenses	(29)	(41)	(1)	(29)	(42)
Operating result from discontinuing operations	**980**	**73**	**333**	**980**	**406**
Non-operating result	(11)	(4)	(1)	(11)	(5)
Income (Loss) before income taxes	**969**	**69**	**332**	**969**	**401**
Income taxes	(15)	(35)	(6)	(15)	(41)
Income (Loss) after taxes	**954**	**34**	**326**	**954**	**360**

[7] Operating result

Breakdowns of the operating result by segment and by region are given in the table on pages 20–21.

Key Data by Segment

€ million	HealthCare: Pharmaceuticals, Biological Products		HealthCare: Consumer Care, Diagnostics		HealthCare: Animal Health		CropScience: CropScience		Polymers: Plastics, Rubber		Polymers: Polyurethanes, Coatings, Fibers	
	2002	**2001**	**2002**	**2001**	**2002**	**2001**	**2002**	**2001**	**2002**	**2001**	**2002**	**2001**
Net sales (external)	4,767	5,729	3,755	4,104	850	858	4,697	2,838	5,378	5,581	5,397	5,439
• Change in €	–16.8%	– 6.7%	– 8.5%	+ 5.6%	– 0.9%	– 1.7%	+65.5%	+ 9.9%	– 3.6%	– 4.0%	– 0.8%	– 2.6%
• Change in local currencies	–11.7%	– 6.7%	– 1.4%	+ 5.0%	+ 5.4%	– 1.7%	+74.9%	+10.2%	– 0.7%	– 5.0%	+ 3.4%	– 3.1%
Intersegment sales	33	38	2	2	1	4	90	102	115	116	78	138
Other operating income	124	62	329	49	10	13	339	102	84	87	64	52
Operating result before exceptionals	151	383	408	388	180	161	(15)	464	175	288	243	129
Return on sales before exceptionals	3.2%	6.7%	10.9%	9.5%	21.2%	18.8%	(0.3)%	16.3%	3.3%	5.2%	4.5%	2.4%
Exceptional items	(339)	(332)	193	(47)	(11)	0	(107)	0	(102)	(50)	(448)*	(120)
Operating result	(188)	51	601	341	169	161	(122)	464	73	238	(205)	9
Return on sales	(3.9)%	0.9%	16.0%	8.3%	19.9%	18.8%	(2.6)%	16.3%	1.4%	4.3%	(3.8)%	0.2%
Gross cash flow	1	229	827	534	182	153	502	560	419	587	714	606
Capital invested	4,095	5,352	3,152	3,799	592	579	10,085	3,950	5,771	6,405	7,750	8,496
CFROI	0.0%	4.2%	23.9%	13.9%	30.4%	24.3%	6.4%	13.9%	6.8%	8.9%	8.9%	7.0%
Net cash flow	484	343	951	576	140	190	1,212	428	459	954	746	1,016
Equity-method income	0	0	0	0	0	0	0	0	0	0	(3)	0
Equity-method investments	16	16	0	0	0	0	0	0	10	27	728	773
Total assets	4,221	5,303	3,352	3,956	637	734	13,462	3,488	5,165	5,867	5,912	7,722
Capital expenditures	178	375	272	238	26	45	297	199	504	536	506	468
Amortization and depreciation	349	364	340	291	50	40	628	247	436	482	1,001	639
Liabilities	2,130	1,869	1,236	1,271	304	379	2,944	1,130	1,377	1,339	1,615	2,385
Research and development expenses	1,072	1,242	235	252	80	91	598	299	125	134	173	194
Number of employees (as of Dec. 31)	25,900	26,800	14,700	14,900	3,400	3,900	23,000	10,900	17,100	17,900	15,500	16,100

€ million	Chemicals: Chemicals		Reconciliation		Continuing operations		Discontinuing operations		Bayer Group	
	2002	**2001**	**2002**	**2001**	**2002**	**2001**	**2002**	**2001**	**2002**	**2001**
Net sales (external)	3,304	3,749	810	872	28,958	29,170	666	1,105	29,624	30,275
• Change in €	–11.9%	+ 9.9%			– 0.7%	+ 0.2%			– 2.2%	– 2.2%
• Change in local currencies	– 5.7%	+10.0%			+ 4.2%	– 0.1%			+ 2.6%	– 2.5%
Intersegment sales	409	456	(728)	(856)						
Other operating income	49	53	733	63	1,732	481	5	339	1,737	820
Operating result before exceptionals	160	271	(313)	(246)	989	1,838	47	93	1,036	1,931
Return on sales before exceptionals	4.8%	7.2%			3.4%	6.3%			3.5%	6.4%
Exceptional items	(26)	(68)	445	(16)	(395)	(633)	933	313	538	(320)
Operating result	134	203	132	(262)	594	1,205	980	406	1,574	1,611
Return on sales	4.1%	5.4%			2.1%	4.1%			5.3%	5.3%
Gross cash flow	375	379	(85)	(230)	2,935	2,818	77	105	3,012	2,923
Capital invested	3,987	4,774	1,280	556	36,712	33,911	0	947	36,712	34,858
CFROI	8.6%	7.7%			8.0%	8.2%			8.1%	8.2%
Net cash flow	465	399	(124)	(177)	4,333	3,729	87	130	4,420	3,859
Equity-method income	1	0	4	12	2	12	3	14	5	26
Equity-method investments	14	13	157	158	925	987	170	179	1,095	1,166
Total assets	3,500	4,216	5,443	4,933	41,692	36,219	0	820	41,692	37,039
Capital expenditures	285	444	315	255	2,383	2,560	0	57	2,383	2,617
Amortization and depreciation	298	334	163	41	3,265	2,438	48	78	3,313	2,516
Liabilities	1,315	1,797	15,316	9,616	26,237	19,786	0	233	26,237	20,019
Research and development expenses	100	114	149	170	2,532	2,496	45	63	2,577	2,559
Number of employees (as of Dec. 31)	17,800	19,500	5,200	3,000	122,600	113,000	0	3,900	122,600	116,900

* includes €289 million in impairment write-downs (cf. Note 5)

Key Data by Region

€ million	Europe		North America		Asia/Pacific		Latin America/ Africa/Middle East	
	2002	**2001**	**2002**	**2001**	**2002**	**2001**	**2002**	**2001**
Net sales (external) – by market	11,970	11,794	8,863	9,527	4,794	4,675	3,331	3,174
Net sales (external) – by point of origin	13,537	13,151	8,992	9,875	3,927	3,819	2,502	2,325
• Change in €	+ 2.9%	– 1.3%	– 8.9%	+ 0.9%	+ 2.8%	+ 1.5%	+ 7.6%	+ 3.5%
• Change in local currencies	+ 3.0%	– 1.4%	– 3.5%	– 2.1%	+ 8.4%	+ 7.3%	+ 35.1%	+ 2.6%
Interregional sales	3,181	3,157	1,961	1,946	227	227	139	116
Other operating income	1,464	313	91	70	88	48	89	50
Operating result before exceptionals	537	1,709	133	3	174	242	369	219
Return on sales before exceptionals	4.0%	13.0%	1.5%	0.0%	4.4%	6.3%	14.7%	9.4%
Exceptional items	404	(289)	(832)	(281)	12	(14)	21	(30)
Operating result	941	1,420	(699)	(278)	186	228	390	189
Return on sales	7.0%	10.8%	(7.8)%	(2.8)%	4.7%	6.0%	15.6%	8.1%
Gross cash flow	1,690	1,865	743	638	361	311	366	226
Capital invested	21,346	16,506	11,593	13,099	2,458	2,712	1,323	1,609
CFROI	8.6%	11.3%	5.9%	4.6%	12.6%	11.2%	25.4%	14.5%
Equity-method income	2	12	0	0	0	0	0	0
Equity-method investments	401	351	506	618	2	2	16	16
Total assets	23,694	17,424	11,565	12,749	3,225	3,138	1,734	1,834
Capital expenditures	1,422	1,627	676	560	188	255	97	118
Amortization and depreciation	1,698	1,237	1,344	943	158	150	64	104
Liabilities	14,370	9,820	6,390	6,433	1,613	1,379	945	672
Research and development expenses	1,776	1,723	694	696	48	68	14	9
Number of employees (as of Dec. 31)	70,600	66,000	24,600	23,400	15,400	12,600	12,000	11,000

€ million	Reconciliation		Continuing operations		Discontinuing operations		Bayer Group	
	2002	**2001**	**2002**	**2001**	**2002**	**2001**	**2002**	**2001**
Net sales (external) – by market			28,958	29,170	666	1,105	29,624	30,275
Net sales (external) – by point of origin			28,958	29,170	666	1,105	29,624	30,275
• Change in €			– 0.7%	+ 0.2%			– 2.2%	– 2.2%
• Change in local currencies			+ 4.2%	– 0.1%			+ 2.6%	– 2.5%
Interregional sales	(5,508)	(5,446)						
Other operating income			1,732	481	5	339	1,737	820
Operating result before exceptionals	(224)	(335)	989	1,838	47	93	1,036	1,931
Return on sales before exceptionals			3.4%	6.3%			3.5%	6.4%
Exceptional items	0	(19)	(395)	(633)	933	313	538	(320)
Operating result	(224)	(354)	594	1,205	980	406	1,574	1,611
Return on sales			2.1%	4.1%			5.3%	5.3%
Gross cash flow	(225)	(222)	2,935	2,818	77	105	3,012	2,923
Capital invested	(8)	(15)	36,712	33,911	0	947	36,712	34,858
CFROI			8.0%	8.2%			8.1%	8.2%
Equity-method income			2	12	3	14	5	26
Equity-method investments			925	987	170	179	1,095	1,166
Total assets	1,474	1,074	41,692	36,219	0	820	41,692	37,039
Capital expenditures	0	0	2,383	2,560	0	57	2,383	2,617
Amortization and depreciation	1	4	3,265	2,438	48	78	3,313	2,516
Liabilities	2,919	1,482	26,237	19,786	0	233	26,237	20,019
Research and development expenses	0	0	2,532	2,496	45	63	2,577	2,559
Number of employees (as of Dec. 31)	0	0	122,600	113,000	0	3,900	122,600	116,900

Notes on segment reporting

In accordance with IAS 14 (Segment Reporting), a breakdown of certain data in the financial statements is given by segment and geographical region. The segments and regions are the same as those used for internal reporting, allowing a reliable assessment of risks and returns. The aim is to provide users of the financial statements with information regarding the profitability and future prospects of the Group's various activities. To allow a more accurate appraisal of continuing operations, the discontinuing operations are shown separately.

The Bayer Group is managed on the basis of business groups, currently aggregated into the seven reportable segments listed below according to economic characteristics, products, production processes, customer relationships and methods of distribution. These segments, in turn, are grouped together into the four business areas shown.

The segments reported as **continuing operations** embrace the following activities:

Business area	*Activity*
HealthCare	
Pharmaceuticals, Biological Products	Development and marketing of prescription pharmaceuticals
Consumer Care, Diagnostics	Development and marketing of over-the-counter medications, nutritional supplements, insecticides and insect repellents, and diagnostic products for central laboratory, near patient testing, and self-testing applications
Animal Health	Development and marketing of veterinary medicines, nutritionals and grooming products for companion animals and livestock
CropScience	
CropScience	Development and marketing of insecticides, fungicides and herbicides for all climate zones; biotechnology and agrochemical specialties
Polymers	
Plastics, Rubber	Manufacturing and marketing of engineering plastics and a variety of raw materials for the rubber and tire industries
Polyurethanes, Coatings, Fibers	Development, manufacturing and marketing of a range of polyurethane raw materials for a wide variety of applications, as well as coating and adhesive raw materials and colorants
Chemicals	
Chemicals	Manufacture and marketing of bulk and specialty chemicals, metal and ceramic powders and cellulosics

The **reconciliation** eliminates intersegment items and reflects income and expenses not allocable to segments, such as corporate costs, and revenues and expenses from sideline operations. It also reflects non-allocable assets and liabilities.

Business activities that Bayer has already divested or intends to divest are shown as **discontinuing operations**. These are Haarmann & Reimer and, in 2001, Erdölchemie.

The segment data are calculated as follows:

- The intersegment and interregional sales reflect intragroup transactions effected at transfer prices fixed on an arm's-length basis.
- Comparability of the operating results of different years may be restricted by exceptional items relating particularly to restructuring measures and acquisitions or divestitures of companies or businesses. The operating result before exceptional items is therefore shown in addition.
- The return on sales before exceptional items is the ratio of the operating result before exceptional items to external sales.
- Expenses included in exceptional items mainly relate to restructuring measures charged to the operating result; the income reflected in exceptional items was realized mainly from divestments.
- The return on sales is the ratio of the operating result after exceptional items to external sales.
- Gross cash flow is the excess of cash receipts over cash disbursements before application of funds.
- The capital invested comprises all the assets that serve a segment and are required to yield a return, less interest-free liabilities. It is stated as of December 31.
- The CFROI is the ratio of the gross cash flow to the average capital invested for the year.
- The equity items are those reflected in the balance sheet and income statement. They are allocated to the segments where possible. The reconciliation of equity-method income to the income statement line "Income from investments in affiliated companies – net" is apparent from Note 8.
- Capital expenditures, amortization and depreciation relate to intangible assets, property, plant and equipment.

[8] Income from investments in affiliated companies - net

This comprises the following items:

	2002	2001
€ million		
Dividends and similar income *of which €23 million (2001: €12 million) from subsidiaries*	25	15
Income from profit and loss transfer agreements *of which €1 million (2001: € • million) from subsidiaries*	1	•
Equity-method income	5	26
Gains from the sale of investments in affiliated companies	274	16
Losses from the sale of investments in affiliated companies	0	(3)
Write-downs of investments in affiliated companies	(82)	0
	223	**54**

The increase in income from investments in affiliated companies is mainly attributable to the €259 million gain from the sale of the remaining 30 percent interest in Agfa-Gevaert N.V., Belgium, to investment bank Goldman Sachs.

[9] Interest expense - net

Interest income and expense comprises:

	2002	2001
€ million		
Income from other securities and loans included in investments	8	9
Other interest and similar income *of which €2 million (2001: €1 million) from subsidiaries*	459	108
Interest and similar expenses *of which €13 million (2001: €5 million) to subsidiaries*	(916)	(466)
	(449)	**(349)**

Finance leases are capitalized under property, plant and equipment in compliance with IAS 17 (Leases). The interest portion of the lease payments, amounting to €34 million (2001: €9 million), is reflected in interest expense.

Interest expense incurred to finance the construction phase of major investment projects is not included here. Such interest expense, amounting in 2002 to €22 million (2001: €30 million), is capitalized as part of the cost of acquisition or construction of the property, plant or equipment concerned, based on an unchanged average capitalization rate of 5 percent.

[10] Other non-operating expense - net

This item comprises:

	2002	2001
€ million		
Interest portion of interest-bearing provisions	(296)	(274)
Net exchange gain	31	49
Miscellaneous non-operating expenses	(174)	(28)
Miscellaneous non-operating income	47	52
	(392)	**(201)**

Miscellaneous non-operating expenses contain €81 million in write-downs of other securities included in investments, and €16 million in write-downs of marketable securities (2001: €0 million).

[11] Income taxes

This item comprises the income taxes paid or accrued in the individual countries, plus deferred taxes. Deferred taxes arise from temporary differences between the carrying amounts of assets or liabilities in the accounting and tax balance sheets, from consolidation measures and from realizable loss carryforwards. Deferred taxes are calculated at the rates which – on the basis of the statutory regulations in force, or already enacted in relation to future periods, as of the closing date – are expected to apply in the individual countries at the time of realization.

The breakdown of pre-tax income and income tax expense by origin is as follows:

	2002	2001
€ million		
Income before income taxes		
- Germany	1,392	971
- Other countries	(436)	144
	956	**1,115**
Income taxes paid or accrued		
- Germany	129	122
- Other countries	169	502
	298	**624**
Deferred taxes		
- from temporary differences	(185)	(272)
- from loss carryforwards	(220)	(198)
	(405)	**(470)**
	(107)	**154**

A valuation allowance is recognized against tax loss carryforwards when it is not sufficiently certain that this income will be realized.

In September 2002 the German government adopted legislation to provide assistance to people affected by severe flooding in summer 2002. This provides for an increase in the corporate income tax rate from 25 percent to 26.5 percent for 2003 only. Since the higher rate of tax had no material impact on the Group statements for 2002, deferred tax expense did not change as a result of changes in tax rates. In 2001, changes in tax rates diminished deferred tax expense by €8 million.

Deferred taxes – computed according to IAS 12 (Income Taxes) – result primarily from temporary differences between the accounting and tax balance sheets of the individual consolidated companies with regard to the recognition and/or valuation of certain items.

The deferred tax assets and liabilities are allocable to the various balance sheet items as follows:

€ million	Dec. 31, 2002 Deferred tax assets	Dec. 31, 2002 Deferred tax liabilities	Dec. 31, 2001 Deferred tax assets	Dec. 31, 2001 Deferred tax liabilities
Intangible assets	416	1,589	438	177
Property, plant and equipment	419	1,558	243	1,672
Investments	52	106	20	88
Inventories	308	75	267	86
Receivables	113	70	122	53
Other current assets	52	242	11	189
Pension provisions	328	225	357	247
Other provisions	254	66	166	74
Other liabilities	55	172	158	30
Loss carryforwards	743	–	282	–
Valuation allowance for loss carryforwards	(123)	–	(78)	–
	2,617	**4,103**	**1,986**	**2,616**
Set-off *	(1,650)	(1,650)	(1,378)	(1,378)
	967	**2,453**	**608**	**1,238**

* According to IAS 12 (Income Taxes), deferred tax assets and deferred tax liabilities should, under certain conditions, be offset if they relate to income taxes levied by the same taxation authority.

In 2002, deferred tax assets of €331 million and deferred tax liabilities of €1,340 million relate to changes in the scope of consolidation. Utilization of tax loss carryforwards from previous years diminished the amount of income taxes paid or accrued in 2002 by €11 million (2001: €88 million).

The value of existing loss carryforwards by expiration date is as follows:

€ million	Dec. 31, 2002	Dec. 31, 2001
Within one year	17	6
Within two years	4	11
Within three years	17	16
Within four years	17	50
Within five years or more	1,936	653
	1,991	**736**

Deferred tax assets of €620 million (2001: €204 million) are recognized on the €1,731 million (2001: €540 million) in loss carryforwards that represent income likely to be realized in the future. Recognition of these deferred tax assets results in deferred tax income of €220 million (2001: €198 million).

Deferred tax liabilities have not been recognized for temporary differences associated with investments in foreign subsidiaries of €3,327 (2001: €3,030 million) as Bayer has determined that the profits concerned will not be distributed in the foreseeable future. If deferred taxes were recognized for these temporary differences, the liability would be based on the respective withholding tax rates only. For most countries, double taxation agreements ensure that any withholding taxes paid can be deducted from the tax base or the tax to be paid in Germany.

The actual tax income for 2002 is €107 million (2001: €154 million expense). This figure differs by €465 million (2001: €259 million) from the €358 million expense (2001: €413 million expense) that would result from applying to the pre-tax income of the Group a tax rate of 37.5 percent (2001: 37.1 percent), which is the weighted average of the theoretical tax rates for the individual Group companies.

The reconciliation of theoretical to actual income tax expense for the Group is as follows:

	2002		2001	
	€ million	**%**	**€ million**	**%**
Theoretical income tax expense	358	100	413	100
Lower taxes due to tax-free income	(677)	(189)	(283)	(68)
Higher taxes due to non-tax-deductible expenses	168	47	47	11
Other tax effects	44	12	(23)	(5)
Actual income tax expense	**(107)**	**(30)**	**154**	**38**
Effective tax rate in %	(11.2)		13.8	

[12] Other taxes

Other taxes amounting to €221 million (2001: €247 million) are included in the cost of production, selling expenses, research and development expenses or general administration expenses. These are mainly property-related taxes.

[13] Minority stockholders' interest

Minority interest in income amounts to €12 million (2001: €6 million), and minority interest in losses to €9 million (2001: €10 million).

[14] Earnings per share

Earnings per share are determined according to IAS 33 (Earnings Per Share) by dividing the net income by the average number of shares.

In 2002, as in 2001, the number of shares remained constant at 730,341,920. Earnings per share were €1.45 (2001: €1.32).

There were no subscription rights outstanding in 2002 or 2001, and therefore no dilutive potential shares.

[15] Cost of materials

The total cost of materials for continuing operations amounted to €11,346 million (2001: €11,093 million), comprising €10,760 million (2001: €10,387 million) in expenses for raw materials, supplies and goods purchased for resale, and €586 million (2001: €706 million) in expenses for purchased services.

The cost of materials for discontinuing operations was €268 million (2001: €497 million). The figure for 2002 was attributable in its entirety to the inclusion of the Haarmann & Reimer group for the first nine months until the date of divestiture. The cost of materials for Haarmann & Reimer was €268 million (2001: €344 million), including €4 million (2001: €10 million) for purchased services. The €153 million cost of materials pertaining to Erdölchemie in 2001 related solely to raw materials and supplies.

[16] Personnel expenses

Personnel expenses for continuing operations rose in 2002 on aggregate by €387 million to €8,001 million, despite a €214 million reduction due to currency translations.

The breakdown of personnel expenses is as follows:

	Continuing operations		Discontinuing operations		
			Haarmann & Reimer		Erdöl-chemie
	2002	2001	2002	2001	2001
€ million					
Wages and salaries	6,317	6,037	138	188	18
Social expenses	1,684	1,577	37	47	5
of which pension expenses	*[519]*	*[430]*	*[25]*	*[14]*	*[2]*
	8,001	**7,614**	**175**	**235**	**23**

[17] Number of employees

The average number of employees in continuing operations, classified by corporate functions, was as follows:

	2002	2001
Marketing	35,985	33,875
Technology	66,051	61,055
Research	12,521	11,206
Administration	10,035	9,091
	124,592	**115,227**
of which trainees	*2,564*	*2,646*

The employees of joint ventures are included in the above figures in proportion to Bayer's interests in the respective companies. The total number of people employed by our joint ventures in 2002 was 1,102 (2001: 1,075).

NOTES TO THE BALANCE SHEETS

[18] Intangible assets

Acquired intangible assets other than goodwill are recognized at cost and amortized by the straight-line method over a period of 4 to 15 years, depending on their estimated useful lives. Write-downs are made for impairment losses. Assets are written back if the reasons for previous years' write-downs no longer apply.

Goodwill, including that resulting from capital consolidation, is capitalized in accordance with IAS 22 (Business Combinations) and amortized on a straight-line basis over a maximum estimated useful life of 20 years. The value of goodwill is reassessed regularly based on impairment indicators and written down if necessary. In compliance with IAS 36 (Impairment of Assets), such write-downs of goodwill are measured by comparison to the discounted cash flows expected to be generated by the assets to which the goodwill can be ascribed.

Self-created intangible assets generally are not capitalized.

Certain development costs relating to the application development stage of internally developed software are, however, capitalized in the Group balance sheet. These costs are amortized over their useful life from the date they are placed in service.

Changes in intangible assets in 2002 were as follows:

€ million	Acquired concessions, industrial property rights, similar rights and assets, and licenses thereunder	Acquired goodwill	Advance payments	Total
Gross carrying amounts, Dec. 31, 2001	**5,240**	**1,399**	**42**	**6,681**
Exchange differences	(529)	(163)	(4)	(696)
Changes in scope of consolidation	2	7	–	9
Acquisitions	3,057	2,267	–	5,324
Capital expenditures	363	–	72	435
Retirements	(249)	(204)	(13)	(466)
Transfers	39	–	(39)	–
Gross carrying amounts, Dec. 31, 2002	**7,923**	**3,306**	**58**	**11,287**
Accumulated amortization and write-downs, Dec. 31, 2001	1,243	424	–	1,667
Exchange differences	(149)	(43)	–	(192)
Changes in scope of consolidation	–	–	–	–
Amortization and write-downs in 2002 *of which write-downs*	1,058 *[249]*	205 *[11]*	– *[–]*	1,263 *[260]*
Write-backs	–	–	–	–
Retirements	(186)	(144)	–	(330)
Transfers	–	–	–	–
Accumulated amortization and write-downs, Dec. 31, 2002	**1,966**	**442**	**–**	**2,408**
Net carrying amounts, Dec. 31, 2002	**5,957**	**2,864**	**58**	**8,879**
Net carrying amounts, Dec. 31, 2001	3,997	975	42	5,014

The exchange differences are the differences between the carrying amounts at the beginning and the end of the year that result from translating the figures of companies outside the euro zone at the respective different exchange rates and changes in their assets during the year at the average rate for the year. This translation method generally also applies to acquisition-related goodwill and remeasurement amounts reflected in the statements of companies outside the euro zone.

[19] Property, plant and equipment

Property, plant and equipment is carried at the cost of acquisition or construction. Assets subject to depletion are depreciated over their estimated useful lives. Write-downs are made for any declines in value that go beyond the depletion reflected in depreciation. In compliance with IAS 36 (Impairment of Assets), such write-downs are measured by comparing the carrying amounts to the discounted cash flows expected to be generated by the respective assets. Where it is not possible to estimate the impairment loss for an individual asset, the loss is assessed on the basis of the discounted cash flow for the cash-generating unit to which the asset belongs. Assets are written back if the reasons for previous years' write-downs no longer apply.

The cost of construction of self-constructed property, plant and equipment comprises the direct cost of materials, direct manufacturing expenses, appropriate allocations of material and manufacturing overheads, and an appropriate share of the depreciation and write-downs of assets used in construction. It includes the shares of expenses for company pension plans and discretionary employee benefits that are attributable to construction.

If the construction phase of property, plant or equipment extends over a long period, the interest incurred on borrowed capital up to the date of completion is capitalized as part of the cost of acquisition or construction.

Expenses for the repair of property, plant and equipment are normally charged against income, but they are capitalized if they result in an enlargement or substantial improvement of the respective assets.

Property, plant and equipment is depreciated by the straight-line method, except where the declining-balance method is more appropriate in light of the actual utilization pattern.

When assets are closed down, sold, or abandoned, the difference between the net proceeds and the net carrying amount of the assets is recognized as a gain or loss in other operating income or expenses, respectively.

The following depreciation periods, based on the estimated useful lives of the respective assets, are applied throughout the Group:

Buildings	20	to	50	years
Outdoor infrastructure	10	to	20	years
Plant installations	6	to	20	years
Machinery and apparatus	6	to	12	years
Laboratory and research facilities	3	to	5	years
Storage tanks and pipelines	10	to	20	years
Vehicles	4	to	8	years
Computer equipment	3	to	5	years
Furniture and fixtures	4	to	10	years

In accordance with IAS 17 (Leases), assets leased on terms equivalent to financing a purchase by a long-term loan (finance leases) are capitalized at the lower of their fair value or the present value of the minimum lease payments. The leased assets are depreciated over their estimated useful life except where subsequent transfer of title is uncertain, in which case they are depreciated over their estimated useful life or the respective lease term, whichever is shorter. The future lease payments are recorded as financial liabilities.

Changes in property, plant and equipment in 2002 were as follows:

€ million	Land and buildings	Machinery and technical equipment	Furniture, fixtures and other equipment	Construction in progress and advance payments to vendors and contractors	Total
Gross carrying amounts, Dec. 31, 2001	**8,148**	**19,544**	**2,500**	**1,698**	**31,890**
Exchange differences	(538)	(1,691)	(233)	(110)	(2,572)
Changes in scope of consolidation	(139)	3	1	15	(120)
Acquisitions	411	401	62	54	928
Capital expenditures	98	516	196	1,138	1,948
Retirements	(521)	(901)	(369)	(78)	(1,869)
Transfers	602	718	88	(1,408)	–
Gross carrying amounts, Dec. 31, 2002	**8,061**	**18,590**	**2,245**	**1,309**	**30,205**
Accumulated depreciation and write-downs, Dec. 31, 2001	4,168	12,486	1,675	18	18,347
Exchange differences	(203)	(1,053)	(149)	–	(1,405)
Changes in scope of consolidation	(108)	(2)	–	–	(110)
Depreciation and write-downs in 2002	285	1,460	304	1	2,050
of which write-downs	*[11]*	*[238]*	*[1]*	*[–]*	*[250]*
Write-backs	–	(3)	(1)	–	(4)
Retirements	(157)	(654)	(280)	(18)	(1,109)
Transfers	67	(58)	(9)	–	–
Accumulated depreciation and write-downs, Dec. 31, 2002	**4,052**	**12,176**	**1,540**	**1**	**17,769**
Net carrying amounts, Dec. 31, 2002	**4,009**	**6,414**	**705**	**1,308**	**12,436**
Net carrying amounts, Dec. 31, 2001	3,980	7,058	825	1,680	13,543

The exchange differences are as defined for intangible assets.

Capitalized property, plant and equipment includes assets with a total net value of €504 million (2001: €588 million) held under finance leases. The gross carrying amounts of these assets total €1,106 million (2001: €1,229 million). These assets are mainly machinery and technical equipment with a carrying amount of €358 million (gross amount: €864 million) and buildings with a carrying amount of €105 million (gross amount: €140 million). In the case of buildings, either the present value of the minimum lease payments covers substantially all of the cost of acquisition, or title passes to the lessee on expiration of the lease.

Also included are products leased to other parties under operating leases with a carrying amount of €232 million (2001: €381 million). The gross carrying amount of these assets was €500 million (2001: €753 million); their depreciation in 2002 amounted to €83 million (2001: €52 million). However, if under the relevant agreements the lessee is to be regarded as the economic owner of the assets and the lease therefore constitutes a finance lease as defined in IAS 17 (Leases), a receivable is recognized in the balance sheet in the amount of the discounted future lease payments.

[20] Investments

Investments in non-consolidated subsidiaries and other affiliated companies are generally carried individually at cost. Where other affiliated companies or other securities included in investments are classified as held-to-maturity investments or available-for-sale financial assets, they are recognized in compliance with IAS 39 (Financial Instruments: Recognition and Measurement) at amortized cost or fair value. Where evidence exists that such assets may be impaired, they are written down as necessary on the basis of an impairment test. Investments are written back if the reasons for previous years' write-downs no longer apply.

The cost of acquisition of investments in companies included at equity is adjusted annually in line with any changes in these companies' total stockholders' equity.

In the first-time consolidation, differences between the cost of acquisition and the underlying equities at the dates of acquisition of the investments are allocated to assets or liabilities by the same method applied to fully consolidated subsidiaries.

Loans receivable that are interest-free or bear low rates of interest are carried at present value; other loans receivable are carried at amortized cost.

Changes in investments in 2002 were as follows:

€ million	Investments in subsidiaries	Loans to subsidiaries	Investments in other affiliated companies: Associated companies	Investments in other affiliated companies: Other companies	Loans to other affiliated companies	Other securities	Other loans	Total
Gross carrying amounts, Dec. 31, 2001	**182**	**–**	**1,290**	**1,341**	**13**	**196**	**207**	**3,229**
Exchange differences	(12)	–	(137)	(13)	(1)	(33)	(9)	(205)
Changes in scope of consolidation	(22)	–	–	1	3	–	(1)	(19)
Changes in fair value	–	–	–	(570)	–	(3)	–	(573)
Acquisitions	23	–	–	59	–	61	26	169
Other additions	4	–	107	75	–	101	345	632
Retirements	(28)	–	(55)	(496)	–	(84)	(165)	(828)
Transfers	(8)	–	–	(6)	(8)	14	8	–
Gross carrying amounts, Dec. 31, 2002	**139**	**–**	**1,205**	**391**	**7**	**252**	**411**	**2,405**
Accumulated write-downs, Dec. 31, 2001	14	–	58	–	–	3	9	84
Exchange differences	(5)	–	(2)	(1)	–	(7)	–	(15)
Changes in scope of consolidation	–	–	–	–	1	–	–	1
Write-downs in 2002	22	–	7	67	1	81	1	179
Write-backs	–	–	–	–	–	–	(1)	(1)
Retirements	(22)	–	(17)	–	–	(1)	(1)	(41)
Transfers	–	–	–	–	–	–	–	–
Accumulated write-downs, Dec. 31, 2002	**9**	**–**	**46**	**66**	**2**	**76**	**8**	**207**
Net carrying amounts, Dec. 31, 2002	**130**	**–**	**1,159**	**325**	**5**	**176**	**403**	**2,198**
Net carrying amounts, Dec. 31, 2001	168	–	1,232	1,341	13	193	198	3,145

The exchange differences are as defined for intangible assets.

The additions to investments in associated companies relate mainly to a manufacturing company being established jointly with Lyondell, which is included at equity. The difference between the equity interest in the underlying net assets of companies included at equity and their at-equity accounting values is €34 million (2001: €45 million). It mainly relates to goodwill. Retirements of investments in other companies mainly relate to the divestiture of the 30 percent interest in Agfa-Gevaert N.V., Belgium, which in 2001 was included at fair value under investments in other companies. Of the additions to other loans, €250 million relates to the granting of a loan to the financial investor EQT Northern Europe Private Equity Funds in connection with its acquisition of the Haarmann & Reimer group.

[21] Inventories

Raw materials, supplies, and goods purchased for resale are valued at the cost of acquisition; work in process and finished goods are valued at the cost of production. If the inventory values are lower at the closing date because of a drop in market prices, for example, the lower amounts are shown. Of the €6,342 million in inventories carried as of December 31, 2002 (2001: €5,818 million), €833 million (2001: €824 million) represents those included at their net realizable value.

Inventories are normally valued by the weighted-average method.

The cost of production comprises the direct cost of materials, direct manufacturing expenses, appropriate allocations of material and manufacturing overheads, and an appropriate share of the depreciation and write-downs of assets used for production.

It also includes the shares of expenses for company pension plans and discretionary employee benefits that are attributable to production. Administrative costs are included where they are attributable to production.

Work in process and finished goods are grouped together in light of the production sequences characteristic of the chemical industry.

Inventories are comprised as follows:

	Dec. 31, 2002	Dec. 31, 2001
€ million		
Raw materials and supplies	1,362	1,179
Work in process, finished goods and goods purchased for resale	4,963	4,626
Advance payments	17	13
	6,342	**5,818**

The changes in inventory write-downs are as follows:

	Dec. 31, 2002	Dec. 31, 2001
€ million		
Balance at beginning of year	(434)	(241)
Additions charged to expenses	(282)	(362)
Exchange differences	33	(2)
Changes in scope of consolidation	(82)	17
Deductions due to utilization	308	154
Balance at end of year	**(457)**	**(434)**

[22] Trade accounts receivable

Trade accounts receivable are carried at amortized cost, less write-downs of €345 million (2001: €222 million) for amounts unlikely to be recovered.

Trade accounts receivable as of December 31, 2002 include €5,529 million (2001: €5,413 million) maturing within one year and €13 million (2001: €2 million) maturing after one year. Of the total, €47 million (2001: €18 million) is receivable from subsidiaries, €60 million (2001: €66 million) from other affiliated companies and €5,435 million (2001: €5,331 million) from other customers.

Changes in write-downs of trade accounts receivable are as follows:

	Dec. 31, 2002	Dec. 31, 2001
€ million		
Balance at beginning of year	(222)	(204)
Additions charged to expenses	(101)	(94)
Exchange differences	49	(5)
Changes in scope of consolidation	(384)	5
Deductions due to utilization	313	76
Balance at end of year	**(345)**	**(222)**

[23] Other receivables and other assets

Other receivables and other assets are carried at amortized cost, less write-downs of €4 million (2001: €4 million).

They are comprised as follows:

	Dec. 31, 2002	Dec. 31, 2001
€ million		
Claims for tax refunds	677	448
Receivables from derivative financial instruments	502	72
Interest receivable on loans	98	19
Short-term loans	85	102
Short-term loans from clearing	51	41
Lease payments receivable	48	94
Payroll receivables	14	47
Other receivables	2,735	1,624
	4,210	**2,447**

Interest receivable on loans consists mainly of interest earned in the fiscal year but not due to be received until after the balance sheet date.

Total other receivables and other assets include €47 million (2001: €66 million) pertaining to subsidiaries and €60 million (2001: €124 million) pertaining to other affiliated companies.

Total other receivables and other assets in the amount of €711 million (2001: €444 million) mature in more than one year. Of this amount, €29 million (2001: €30 million) pertains to subsidiaries.

Other receivables in 2002 include €1.1 billion in assets earmarked for sale because the Bayer Group is mandated by regulatory conditions imposed in connection with the acquisition of Aventis CropScience Holding S.A., France, to divest certain insecticidal active ingredients businesses and related rights.

Lease agreements in which the other party, as lessee, is to be regarded as the economic owner of the leased assets (finance leases) give rise to accounts receivable in the amount of the discounted future lease payments. These receivables amount to €48 million (2001: €94 million), while the interest portion pertaining to future years amounts to €9 million (2001: €29 million). The lease payments are due as follows:

€ million	Lease payments	Of which interest	Account receivable
2003	20	3	17
2004	14	2	12
2005	10	1	9
2006	7	1	6
2007	4	1	3
after 2007	2	1	1
	57	**9**	**48**

[24] Liquid assets

€ million	Dec. 31, 2002	Dec. 31, 2001
Marketable securities and other instruments	29	52
Cash and cash equivalents	767	719
	796	**771**

As of 2001, securities are recognized at fair value in compliance with IAS 39 (Financial Instruments: Recognition and Measurement). Their total fair value at the closing date amounts to €29 million (2001: €52 million), which is €14 million less (2001: €13 million more) than their cost of acquisition. Financial instruments with original maturities of up to three months are recognized as cash equivalents in view of their high liquidity.

[25] Deferred charges

Total deferred charges include €261 million (2001: €183 million) that is expected to be used up in 2003.

[26] Stockholders' equity

The capital stock of Bayer AG amounts to €1,870 million, as in the previous year, and is divided into 730,341,920 no-par bearer shares of a single class.

Authorized capital totaling €250 million was approved by the Annual Stockholders' Meeting on April 26, 2002. It expires on April 26, 2007. The authorized capital can be used to increase the capital stock by issuing new shares against cash contributions. The Board of Management is authorized to exclude subscription rights with respect to €100 million of this authorized capital; however, in this case the issue price of the new shares must not be significantly below the market price. Exclusion of subscription rights for a further €150 million is only possible in specific cases.

Further authorized capital in the amount of €374 million was approved by the Annual Stockholders' Meeting on April 27, 2001. This authorized capital, which expires on April 27, 2006, can be used to increase the capital stock by issuing new shares against non-cash contributions. Subscription rights for existing stockholders are excluded.

Conditional capital of €83 million existed on December 31, 2002. This capital may only be utilized to the extent necessary to issue the requisite number of shares as and when conversion or subscription rights are exercised by the holders of convertible bonds or of warrants conferring subscription rights, respectively, that may be issued by Bayer AG or a wholly owned direct or indirect subsidiary through April 29, 2004.

Capital reserves include the paid-in surplus from the issuance of shares and subscription rights by Bayer AG.

The retained earnings contain prior years' undistributed income of consolidated companies.

Changes in fair values of financial instruments are recognized in miscellaneous items of other comprehensive income. Among other factors affecting these items in 2002 was the sale of our remaining interest in Agfa-Gevaert N.V., Belgium.

The changes in the various components of stockholders' equity during 2002 and 2001 are shown in the statements of changes in stockholders' equity.

The dividend per share paid for the 2001 fiscal year was €0.90 (2000: €1.40).

[27] Minority stockholders' interest

Minority stockholders' interest mainly comprises third parties' shares in the equity of the consolidated subsidiaries Sumika Bayer Urethane Co. Ltd., Japan; the Makroform GmbH group; Bayer (India) Ltd., Bayer ABS Ltd. and Bayer CropScience India Ltd., India; and Bayer CropScience Nufarm Ltd., United Kingdom.

[28] Provisions for pensions and other post-employment benefits

Group companies provide retirement benefits for most of their employees, either directly or by contributing to independently administered funds.

The way these benefits are provided varies according to the legal, fiscal and economic conditions of each country, the benefits generally being based on the employees' remuneration and years of service. The obligations relate both to existing retirees' pensions and to pension entitlements of future retirees.

Group companies provide retirement benefits under defined contribution and/or defined benefit plans.

In the case of **defined contribution plans**, the company pays contributions to publicly or privately administered pension insurance plans on a mandatory, contractual or voluntary basis. Once the contributions have been paid, the company has no further payment obligations. The regular contributions constitute net periodic costs for the year in which they are due and as such are included in the cost of goods sold, selling expenses, research and development expenses or general administration expenses, and thus in the operating result. In 2002, these expenses totaled €393 million (2001: €312 million).

All other retirement benefit systems are **defined benefit** plans, which may be either unfunded, i.e. financed by provisions (accruals), or funded, i.e. financed through pension funds. In 2002, expenses for defined benefit plans amounted to €521 million (2001: €301 million). These net periodic costs – except for the interest portion – are generally included in the cost of goods sold, selling expenses, research and development expenses, general administration expenses or other operating income. For the most important defined benefit plans, they are comprised as follows:

Defined benefit plans	Dec. 31, 2002	Dec. 31, 2001
€ million		
Service cost	302	265
Past service cost	12	10
Interest cost	727	669
Projected return on plan assets	(607)	(640)
Amortization of actuarial amounts	67	(34)
Plan curtailments and settlements	20	–
	521	**270**

The pension provisions for defined benefit plans are calculated in accordance with IAS 19 (Employee Benefits) by the projected unit credit method. The future benefit obligations are valued by actuarial methods on the basis of an appropriate assessment of the relevant parameters.

Benefits expected to be payable after retirement are spread over each employee's entire period of employment, allowing for future changes in remuneration.

The legally independent fund "Bayer Pensionskasse VvaG" (Bayer Pensionskasse) is a private insurance company and is therefore subject to the German Law on the Supervision of Private Insurance Companies. Since Bayer guarantees the commitments of the Bayer Pensionskasse, it is classified as a defined benefit plan for IAS and U.S. GAAP purposes.

All defined benefit plans necessitate actuarial computations and valuations. These are based not only on life expectancy but also on the following parameters, which vary from country to country according to economic conditions:

	Dec. 31, 2002	Dec. 31, 2001
Discount rate	2.5% to 7.0%	2.5% to 7.0%
Projected future remuneration increases	2.0% to 5.1%	2.0% to 4.8%
Projected future pension increases	1.7% to 3.3%	2.0% to 3.3%
Projected employee turnover (according to age and gender)	empirical data	empirical data
Projected return on plan assets	1.5% to 8.5%	2.0% to 8.5%

The status of unfunded and funded defined benefit obligations, computed using the appropriate parameters, is as follows:

	Dec. 31, 2002	Dec. 31, 2001
€ million		
Defined benefit obligation	(12,414)	(11,303)
Fair value of plan assets	7,506	8,126
Funded status	**(4,908)**	**(3,177)**
Unrecognized transition liability (asset)	2	3
Unrecognized actuarial (gain) loss	2,352	1,366
Asset limitation due to uncertainty of obtaining future benefits	(1,187)	(1,249)
Net recognized liability	**(3,741)**	**(3,057)**

Of the defined benefit obligation, €4,267 million (2001: €3,929 million) relates to unfunded benefit obligations and €8,147 million (2001: €7,374 million) to funded benefit obligations. The adjustments, as yet unrecognized in the income statement, represent the difference between the defined benefit obligation – after deducting the fair value of plan assets – and the net liability recognized in the balance sheet. They arise mainly from actuarial gains or losses caused by differences between actual and previously assumed trends in employee turnover and remuneration. Pension assets in excess of the obligation are reflected in other receivables, subject to the asset limitation specified in IAS 19 (Employee Benefits). In accordance with IAS 19, the amounts reflected in the balance sheet will be recognized in the income statement over the expected average remaining working lives of existing employees. The portion of the net actuarial gain or loss to be recognized in the income statement is determined by the corridor method. This procedure is also applied to the differences between the projected return on plan assets and the actual amount of minus €668 million (2001: minus €563 million).

The net liability under these defined benefit plans changed as follows:

€ million	Dec. 31, 2002	Dec. 31, 2001
Net liability recognized at the beginning of the year	(3,057)	(3,151)
Pension benefit (cost) income	(521)	(270)
Employer contributions	351	313
Divestitures	(25)	54
Changes in scope of consolidation	(500)	•
Plan curtailments and settlements	(10)	•
Changes in currency translation	21	(3)
Net liability recognized at end of year	**(3,741)**	**(3,057)**

Funds and benefit obligations are valued on a regular basis at least every three years. For all major funds, comprehensive actuarial valuations are performed annually.

Provisions are also set up under this item for the obligations of Group companies, particularly in the United States, to provide health care to their retirees. For health care costs, the valuation is based on the assumption that they will increase at an annual rate of 5 percent in the long term. Early retirement and certain other benefits to retirees are also included, since these obligations are similar in character to pension obligations. Like pension obligations, they are valued in line with international standards. In 2002, provisions for early retirement and other post-employment benefits amounted to €629 million (2001: €635 million). The resulting expenses for 2002 amounted to €114 million (2001: €63 million), comprising €87 million (2001: €23 million) for service cost, €57 million (2001: €58 million) for interest cost, €26 million (2001: €31 million) for projected return on plan assets and €4 million for actuarial gains (2001: €13 million for actuarial losses).

[29] Other provisions

Other provisions are valued in accordance with IAS 37 (Provisions, Contingent Liabilities and Contingent Assets) and, where appropriate, IAS 19 (Employee Benefits), using the best estimate of the extent of the obligation. Long-term portions of provisions are discounted to their present value.

The Group sets up and maintains provisions for probable and on-going litigation cases when a reasonable estimate can be made. These provisions include all estimated legal fees and costs of settlement. The amounts are based upon written notification and reasonable settlement cost estimates provided by the Group's attorneys. Periodically, but at least quarterly, the provisions are reviewed with the Group's attorneys and updated.

The breakdown of provisions is as follows:

	Dec. 31, 2002		Dec. 31, 2001	
€ million	Total	Maturing in 2003	Total	Maturing in 2002
Provisions for taxes	650	426	524	151
Provisions for personnel commitments	976	411	923	451
Provisions for environmental remediation	202	23	200	19
Provisions for restructuring	230	189	145	79
Provisions for trade-related commitments	694	649	438	426
Miscellaneous provisions	720	559	535	351
	3,472	2,257	2,765	1,477

Personnel commitments mainly include annual bonus payments, service awards and other personnel costs. Reimbursements to be received from the German government under the pre-retirement part-time work program are recorded as receivables and recognized in income as soon as the criteria for such reimbursements are fulfilled. Trade-related commitments mainly include rebates, as well as obligations relating to services already received but not yet invoiced.

Changes in provisions were as follows:

€ million	Jan. 1, 2002	Changes in scope of consolidation	Currency effects	Alloca-tion	Utiliz-ation	Reversal	Dec. 31, 2002
Provisions for taxes	524	91	(52)	453	(311)	(55)	650
Provisions for personnel commitments	923	113	(43)	486	(448)	(55)	976
Provisions for environmental remediation	200	31	(14)	35	(45)	(5)	202
Provisions for restructuring	145	65	(28)	196	(140)	(8)	230
Provisions for trade-related commitments	438	173	(40)	496	(336)	(37)	694
Miscellaneous provisions	535	108	(34)	717	(557)	(49)	720
	2,765	**581**	**(211)**	**2,383**	**(1,837)**	**(209)**	**3,472**

Stock compensation program

Bayer's three-tier stock compensation program was first launched in 2000. It consists of a Stock Option Program for the members of the Board of Management and senior executives, a Stock Incentive Program for middle management and equivalent employees, and a Stock Participation Program for junior management and other employees. To be eligible for the Stock Option Program, Stock Incentive Program or Module 1 of the Stock Participation Program, participants must place Bayer AG shares of their own into a special deposit account. Participants do not pay an exercise price for the shares they receive under these programs. Rather, they receive the shares as bonus shares. In the case of Module 2 of the Stock Participation Program, employees have the opportunity to purchase shares at a discounted price.

Stock Option Program

Members of the Board of Management and senior executives who wish to participate in the Stock Option Program must place Bayer AG shares of their own in a special deposit account. We determine on an individual basis the maximum number of shares each participant may deposit; the participant receives one option right for each 20 shares deposited. These deposited shares are blocked and may not be sold during the following three years. After the end of these three years, a two-year exercise period begins. During this period, the participant may exercise the option rights if he or she has fulfilled the performance criteria. Any unexercised option rights expire at the end of this two-year period. To determine whether the participant is eligible to exercise option rights and, if so, the number of shares received upon exercise, we apply three performance criteria. Two of these measure the relative performance of the Bayer AG share; the third measures the individual contribution of the participant. If the participant fails to meet minimum standards under these criteria, he or she receives no shares under the program. At December 31, 2002, no options were exercisable. No options expired, nor were any options canceled, during fiscal 2002.

If it is not possible to issue shares under the Stock Option Program to participants at the time they are entitled to exercise their option rights, the option rights would function as share appreciation rights. Instead of shares, the participant would receive the cash value of the shares to which the option rights would otherwise entitle him or her, based on the trading price of the Bayer AG share at the time of exercise.

Stock Incentive Program

Like the Stock Option Program, our Stock Incentive Program for middle management requires participants to deposit Bayer AG shares of their own in a special deposit account. Each participant may deposit shares with a maximum aggregate value of half his or her performance-related bonus for the preceding fiscal year. In fiscal 2002, the bonus payment for 2000 was used as the reference base where this was higher. The number of incentive shares the participant receives depends on the number deposited at the launch of the program as well as on the overall performance of Bayer stock. Unlike the Stock Option Program, the Stock Incentive Program does not block deposited shares. Participants may sell their deposited shares during the term of the program, but any deposited shares they sell are no longer counted in calculating the number of incentive shares for subsequent distribution dates. The Stock Incentive Program has a ten-year term. There are three incentive share distribution dates during this period. On these dates, the participant receives incentive shares as follows:

Issuance of incentive shares to employees in the Stock Incentive Program

Distribution date at end of	Incentive shares received (per 10 deposited shares)
Second year	2
Sixth year	4
Tenth year	4
	10

Participants receive incentive shares only if Bayer stock has outperformed the Dow Jones EURO STOXX 50[SM] index on the relevant distribution date, as calculated from the beginning of the program.

Stock Participation Program

Our Stock Participation Program has two components, Module 1 and Module 2. Employees not covered by the Stock Option Program or Stock Incentive Program may normally participate in both Module 1 and Module 2. The Module 1 program, like the Stock Incentive Program, requires participants to deposit Bayer AG shares of their own in a special account. As with the Stock Incentive Program, participants in the Stock Participation Program may sell their deposited shares during the term of the program; any shares they sell are no longer counted in calculating the number of bonus shares on subsequent distribution dates.

Module 1 has a term of ten years and entitles the participant to receive incentive shares on three distribution dates based on the number of shares he or she has deposited. Unlike the Stock Incentive Program, Module 1 does not impose a share performance criterion. The participant receives incentive shares as follows on the distribution dates:

Issuance of incentive shares to employees in the Stock Participation Program

Distribution date at end of	Incentive shares received (per 10 deposited shares)
Second year	1
Sixth year	2
Tenth year	2
	5

In addition, under Module 2 each participant may purchase 10 Bayer AG shares per year at a tax-free discount. In 2002 this comprised a discount of €15.40 (2001: €15.34) per share to the market price. Participants may not include shares that they purchase under Module 2 among the shares they deposit under Module 1. Each participant may take up both modules up to a maximum aggregate value of half his or her performance-related bonus for the year he or she participates in the program. In fiscal 2002, in the case of managerial staff, the bonus payment for 2000 was used as the reference base where this was higher.

The Stock Option Program, the Stock Incentive Program and Module 1 of the Stock Participation Program are accounted for as follows: Since participants are entitled to receive shares of Bayer AG stock bought in the capital market, subject to certain performance criteria, compensation expense for potential share distributions is recorded when there is a reasonable basis on which to estimate whether the performance criteria will ultimately be met. Compensation expense is recorded at each balance sheet date by estimating the number of rights outstanding multiplied by the current quoted market price of Bayer AG shares. The related personnel provisions on December 31, 2002 amounted to €9 million.

For Module 2 of the Stock Participation Program, the difference between the quoted market price of Bayer AG stock and the discounted price paid by participants at the date of purchase is expensed immediately. During the year ended December 31, 2002, participants in Module 2 received 195,412 shares at a total price of €3.7 million, resulting in personnel expenses of €3.0 million. The discount to the price of Bayer AG stock was 45.1 percent.

Environmental provisions

The Group's activities are subject to extensive laws and regulations in the jurisdictions in which it does business and maintains properties. Our compliance with environmental laws and regulations may require us to remove or mitigate the effects of the disposal or release of chemical substances at various sites. Under some of these laws and regulations, a current or previous owner or operator of property may be held liable for the costs of removal or remediation of hazardous substances on, under, or in its property, without regard to whether the owner or operator knew of, or caused the presence of the contaminants, and regardless of whether the practices that resulted in the contamination were legal at the time they occurred. As many of our production sites have an extended history of industrial use, it is impossible to predict precisely what effect these laws and regulations will have on us in the future.

As is typical for companies involved in the chemical and related industries, soil and groundwater contamination has occurred in the past at some of our sites, and might occur or be discovered at other sites. We are subject to claims brought by United States Federal or State regulatory agencies and other private entities and individuals regarding the remediation of sites that we own, formerly owned or operated, where materials were produced specifically for us by contract manufacturers or where waste from our operations was treated, stored or disposed. In particular, we have a potential liability under the U.S. Federal Comprehensive Environmental Response, Compensation, and Liability Act, commonly known as "Superfund," the U.S. Resource Conservation and Recovery Act and related state laws for investigation and remediation costs at a number of sites. At most of these sites, numerous companies, including Bayer, have been notified that the U.S. Environmental Protection Agency, state governing body or private individuals consider such companies to be potentially responsible parties under Superfund or related laws. At other sites, Bayer is the sole responsible party. The proceedings relating to these sites are in various stages. In most cases remediation measures have already been initiated.

Provisions for environmental remediation as of December 31, 2002 amounted to €202 million (2001: €200 million). The material components of the provisions for environmental remediation costs primarily relate to land reclamation, rehabilitation of contaminated sites, recultivation of landfills, and redevelopment and water protection measures. The provisions for environmental remediation costs are recorded on a discounted basis where environmental assessments or clean-ups are probable, the costs can be reasonably estimated and no future economic benefit is expected to arise from these measures. The above amount of provisions represents anticipated future remediation payments totaling €270 million (2001: €265 million), discounted at risk-free rates of 0.5 percent to 5.5 percent.

These discounted amounts will be paid out over the period of remediation of the relevant sites, which is expected to be 15 years. Costs are estimated based on significant factors such as previous experience in similar cases, environmental assessments, development of current costs and new circumstances with major influences on expenses, our understanding of current environmental laws and regulations, the number of other potentially responsible parties at each site and the identity and financial position of such parties in light of the joint and several nature of the liability, and the remediation methods expected to be employed.

It is difficult to estimate the future costs of environmental protection and remediation because of many uncertainties, particularly with regard to the status of laws, regulations and the information available about conditions in the various countries and at the individual sites. Subject to these factors, but taking into consideration our experience to date regarding environmental matters of a similar nature, we believe that the provisions are adequate based upon currently available information. However, given the inherent difficulties in estimating liabilities in this area, it cannot be guaranteed that additional costs will not be incurred beyond the amounts accrued. It is possible that final resolution of these matters may require us to make expenditures in excess of established provisions, over an extended period of time and in a range of amounts that cannot be reasonably estimated. Management nevertheless believes that such additional amounts, if any, would not have a material adverse effect on the Group's financial position, results of operations or cash flows.

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 procedings 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 risks include in particular litigation in the United States following the voluntary withdrawal of the statin Lipobay®/Baycol®. By mid-February 2003, approximately 7,900 suits had been filed with Federal and state courts, including approximately 160 class actions. The aim of these class actions is to achieve class status at global, U.S. or state level for all who allege their health has been damaged due to the use of Baycol®, all other former Baycol® users for the purpose of subsequent medical monitoring, and all purchasers of Baycol® for reimbursement of the purchase price. Claims for punitive damages have also been filed. By mid-February 2003, voluntary settlement agreements had been reached in approximately 450 individual cases without concession of liability.

As a result of the voluntary withdrawal of products containing PPA, approximately 1,000 cases have been filed against Bayer Corporation in the United States, including class actions. Similarly, the claims primarily relate to compensation for alleged damage to health, entitlement to subsequent medical monitoring and reimbursement of the purchase price. Claims for punitive damages have also been filed.

In the event plaintiffs substantially prevail despite existing defense arguments, it is possible that Bayer could incur charges in excess of its insurance coverage. Due to the considerable uncertainty associated with these proceedings, it is currently not possible to more accurately estimate potential liability. Depending on the progress of the litigation, we will continue to regularly reconsider the need to establish provisions which may have a negative effect on financial results.

Restructuring charges

Restructuring charges of €427 million were incurred in 2002 for closures of facilities and relocation of business activities, including €196 million in provisions that are expected to be utilized as the respective restructuring measures are implemented. The total charges include €193 million in severance payments, a total €166 million in accelerated amortization/depreciation and write-downs of intangible assets, property, plant and equipment, and €68 million in other expenses. Most of the charges taken for severance payments and other expenses in 2002 will lead to disbursements in 2003.

Restructuring was a major focus of activity in fiscal 2002. We continued the restructuring drives designed to improve the efficiency of our production sites in Hicksville, New York, and New Martinsville, West Virginia, U.S.A., taking €37 million in charges including €25 million in write-downs, €5 million in severance payments and €7 million in other expenses. Further charges of €30 million were incurred in connection with the closure of a production facility at our site in West Virginia. These comprised €10 million in write-offs of property, plant and equipment no longer utilized, €7 million in severance payments and €13 million in other charges.

The restructuring of our rubber production site in Sarnia, Ontario, Canada, resulted in write-downs of €41 million, severance payments of €7 million and other expenses of €19 million.

Of the restructuring charges incurred in 2002, €51 million related to the integration of the polyols business in the Polymers business area. This amount included €37 million in write-downs and €14 million in severance payments.

Further charges of €20 million relate to the restructuring of the Consumer Care Division in Elkhart, Indiana, U.S.A., including €8 million for write-downs of property, plant and equipment and €6 million for other expenses. A further €6 million comprised severance payments.

The restructuring of our styrenics business in North America led to charges of €9 million, including €5 million in write-downs and €4 million in other expenses.

Further ongoing restructuring programs to improve the profitability of the business areas and integrate acquisitions gave rise to total charges of €197 million, comprising €154 million in severance payments, €26 million in write-downs and €17 million in other expenses. The remaining charges relate to various small-scale restructuring programs.

Changes in provisions for restructuring were as follows:

€ million	Severance payments	Other costs	Total
Status, Jan. 1, 2002	**79**	**66**	**145**
Additions	193	68	261
Utilization	(99)	(49)	(148)
Exchange differences	(15)	(13)	(28)
Status, Dec. 31, 2002	**158**	**72**	**230**

The other costs are mainly demolition expenses and other charges related to the abandonment of production facilities.

[30] Financial liabilities

Financial liabilities that are not the hedged item in a permissible hedge accounting relationship are carried at amortized cost. They comprise the following:

	Dec. 31, 2002		Dec. 31, 2001	
	Total	Maturing in 2003	Total	Maturing in 2002
€ million				
Debentures	6,742	477	2,592	781
Liabilities to banks	1,023	873	1,122	829
Liabilities under lease agreements	708	121	881	99
Liabilities from the issuance of promissory notes	78	78	84	84
Commercial paper	1,084	1,084	1,365	1,365
Liabilities from derivative financial instruments	86	85	180	169
Other financial liabilities	438	123	1,156	982
	10,159	**2,841**	**7,380**	**4,309**

The maturities of financial liabilities existing at December 31, 2002 were as follows:

Maturing in	*€ million*
2003	2,841
2004	186
2005	427
2006	82
2007	3,231
2008 or later	3,392
	10,159

Financial liabilities in U.S. dollars amounted to €3.3 billion (2001: €5.1 billion) and account for 32 percent (2001: 69 percent) of total financial liabilities.

Short-term borrowings (excluding the short-term portion of debentures) amounted to €2.4 billion (2001: €3.5 billion) with a weighted average interest rate of 7.9 percent (2001: 5.4 percent). The Bayer Group's financial liabilities are primarily unsecured and of equal priority.

Debentures include the following:

Effective rate	Stated rate		Volume	Dec. 31, 2002 € million	Dec. 31, 2001 € million
		Bayer AG			
4.103%	5.375%	Eurobonds 2002/2007	EUR 3,000 million	3,081	-
5.160%	6.000%	Eurobonds 2002/2012	EUR 2,000 million	2,102	-
		Bayer Capital Corporation B.V.			
2.820%	2.500%	1987/2002 Bonds with Warrants Attached	CHF 250 million	-	169
		Bayer Corporation			
6.735%	6.500%	Notes 1995/2002	USD 400 million	-	454
5.410%	7.125%	Notes 1995/2015	USD 200 million	191	227
2.166%	2.250%	Bonds 1997/2002	CHF 200 million	-	135
1.200%	3.500%	Revenue Bonds 1997/2009	USD 20.6 million	20	23
4.000%	4.000%	Revenue Bonds 1997/2027	USD 25 million	-	28
6.288%	6.650%	Notes 1998/2028	USD 350 million	334	397
6.288%	6.200%	Bonds 1998/2028	USD 250 million	238	284
4.450%	4.450%	Money Market Puttable Reset Securities 2001/2011	USD 500 million	476	568
		Bayer Ltd., Japan			
1.270%	3.750%	Bonds 2000/2005	CHF 400 million	300	270
		Other debentures			37
				6,742	**2,592**

In April 2002 Bayer AG launched two Eurobond issues under its €8 billion European Medium Term Note (EMTN) program. One of these issues, in the nominal volume of €3,000 million, carries a 5.375 % coupon and has a term of 5 years, maturing in 2007. Interest is payable annually in arrears. The issue price was 99.402 %. The other Eurobond issue has a nominal volume of €2,000 million and a term of 10 years, so it matures in 2012. The bonds carry a 6 % coupon. Again, all interest is payable annually in arrears. The issue price was 99.45 %.

In July 1987, Bayer Capital Corporation B.V. issued CHF 250 million of 2.50 % Bonds with warrants in Switzerland. The Bonds had a term of 15 years and matured in July 2002.

In October 1995, Bayer Corporation issued USD 400 million of 6.50 % Notes to qualified institutional buyers. The Notes had a term of 7 years and matured in October 2002.

Also in October 1995, Bayer Corporation issued USD 200 million of 7.125 % Notes to qualified institutional buyers. The Notes have a term of 20 years and mature in October 2015. Interest is paid semi-annually in April and October. The Group recorded a discount of USD 2.4 million, which includes commissions paid to underwriters.

In March 1997, Bayer Corporation issued USD 20.6 million of Revenue Bonds to U.S. institutional buyers. The interest rate is reset daily with monthly interest payments. The Revenue Bonds have a term of 12 years and mature in May 2009.

In April 1997, Bayer Corporation issued CHF 200 million of 2.25 % Bonds in Switzerland. The Bonds had a term of 5 years and matured in April 2002.

In May 1997, Bayer Corporation issued USD 25 million of Revenue Bonds to U.S. institutional buyers. The interest rate was reset daily with monthly interest payments. The Revenue Bonds had a term of 30 years but were redeemed at the end of fiscal 2002.

In February 1998, Bayer Corporation issued USD 350 million of 6.65 % Notes to qualified institutional buyers. The Notes have a term of 30 years and mature in February 2028. Interest is paid semi-annually in August and February. The Group recorded a discount of USD 1.9 million, which includes commissions paid to underwriters. The Notes will be redeemable, in whole or in part, at the option of Bayer Corporation at any time, upon not less than 30 but not more than 60 days' notice, at a redemption price equal to the greater of (i) 100 % of the principal amount or (ii) as determined by an independent investment banker.

In February 1998, Bayer Corporation issued USD 250 million of 6.20 % Bonds to qualified institutional buyers. The Bonds have combined call and put options giving the lead manager the right to repurchase them, and the investors the right to cash them, after 10 years. At that time the lead manager can reset the interest rate and remarket the Bonds for a further period of 20 years such that they would mature in 2028. If the lead manager does not exercise its call option and the investors exercise their put option, the Bonds will be redeemed in 2008. Interest is paid semi-annually in August and February. The Group recorded a discount of USD 0.6 million which includes commissions paid to underwriters. The redemption provision on the 1998 6.65 % Notes also applies for these Bonds.

In April 2000, Bayer Ltd., Japan, issued CHF 400 million of 3.75 % Bonds in Switzerland. The Bonds have a term of 5 years and mature in April 2005. Interest is paid annually in April. The Group recorded a discount of CHF 1.2 million. The debt was swapped into yen at a floating interest rate.

In March 2001, Bayer Corporation issued USD 500 million of 4.45 % Money Market Puttable Reset Securities to qualified institutional buyers, due in 2011. The Bonds have combined call and put options giving the lead manager the right to repurchase them, and the investors the right to cash them, on each anniversary date of the original marketing of the securities.

At December 31, 2002, the Group had approximately €6.2 billion (2001: €6.2 billion) of total lines of credit, of which €1.0 billion (2001: €1.1 billion) was used and €5.2 billion (2001: €5.1 billion) was unused and available for borrowing on an unsecured basis.

Liabilities under finance leases are recognized as financial obligations if the leased assets are capitalized under property, plant and equipment. They are stated at present values. Lease payments totaling €899 million (2001: €1,174 million), including €191 million (2001: €293 million) in interest, are to be made to the respective lessors in future years.

The liabilities associated with finance leases mature as follows:

€ million	Lease payments	Of which interest	Liability
2003	151	30	121
2004	103	28	75
2005	100	26	74
2006	71	17	54
2007	53	15	38
After 2007	421	75	346
	899	**191**	**708**

Lease payments in 2002 in connection with operating leases amounted to €191 million (2001: €244 million).

The other financial liabilities include €4 million (2001: €85 million) to non-consolidated subsidiaries.

[31] Trade accounts payable

Trade accounts are payable mainly to third parties; they are carried at amortized cost. As last year, the entire amount is due within one year.

Trade accounts payable as of December 31, 2002 include €2,534 million (2001: €1,991 million) maturing within one year and €0 million (2001: €2 million) maturing after one year. Of the total, €4 million (2001: €8 million) is payable to subsidiaries, €18 million (2001: €7 million) to other affiliated companies and €2,512 million (2001: €1,978 million) to other suppliers.

[32] Miscellaneous liabilities

Miscellaneous liabilities are carried at amortized cost.

They are comprised as follows:

	Dec. 31, 2002		Dec. 31, 2001	
€ million	Total	Maturing in 2003	Total	Maturing in 2002
Payroll liabilities	422	330	443	320
Tax liabilities	346	346	281	280
Liabilities for social expenses	170	170	144	144
Accrued interest on liabilities	308	308	125	125
Advance payments received	20	20	25	25
Liabilities from the acceptance of drafts	17	17	17	17
License liabilities	57	57	56	56
Other miscellaneous liabilities	890	890	881	865
	2,230	2,138	1,972	1,832

Tax liabilities include not only Group companies' own tax liabilities, but also taxes withheld for paying over to the authorities on behalf of third parties.

Liabilities for social expenses include, in particular, social insurance contributions that had not been paid over by the closing date.

The other miscellaneous liabilities comprise mainly guarantees, commissions to customers, and expense reimbursements.

The total of miscellaneous liabilities includes €53 million (2001: €42 million) to non-consolidated subsidiaries and €4 million (2001: €3 million) to other affiliated companies.

[33] Further information on other liabilities

Other liabilities (financial liabilities, trade accounts payable and miscellaneous liabilities) include €6,593 million (2001: €1,779 million) maturing in more than five years.

Of the total, €146 million (2001: €334 million) was secured, mainly by mortgages totaling €90 million.

Included is €308 million (2001: €125 million) in accrued interest, representing expenses attributable to the fiscal year but not due to be paid until after the closing date.

[34] Deferred income

In accordance with IAS 20 (Accounting for Government Grants and Disclosure of Government Assistance), grants and subsidies that serve to promote investment are reflected in the balance sheet as deferred income. The amounts are gradually reversed during the useful lives of the respective assets and recognized in income.

Deferred income as of December 31, 2002 includes €97 million (2001: €111 million) in such grants and subsidies received from governments; the amount reversed and recognized in income was €19 million (2001: €17 million).

[35] Discontinuing operations

The wholly owned subsidiary Haarmann & Reimer was sold to EQT Northern Europe Private Equity Funds effective September 30, 2002. Assets and liabilities as of December 31, 2002 therefore do not include any amounts pertaining to discontinuing operations.

In 2001, assets of €820 million and liabilities of €233 million related to this business group. The assets comprised €419 million in noncurrent assets, €384 million in current assets and €17 million in liquid assets, while the liabilities consisted of €74 million in pension provisions, €43 million in other provisions, €12 million in financial liabilities and €104 million in miscellaneous liabilities.

[36] Commitments and contingencies

Contingent liabilities as of December 31, 2002 – nearly all of which exist toward third parties – amount to €245 million. They result from:

€ million	Dec. 31, 2002	Dec. 31, 2001
Issuance and endorsement of bills	6	22
Guarantees	104	53
Warranties	135	118
	245	**193**

The respective items refer to potential future obligations where the occurrence of the future events would create an obligation, the existence of which is uncertain at the balance sheet date. The warranties mainly relate to contractual terms encountered in the ordinary course of business.

In addition to provisions, other liabilities and contingent liabilities, there are other financial commitments resulting primarily from long-term lease and rental agreements.

Minimum non-discounted future payments relating to operating leases total €619 million (2001: €557 million). The respective payment obligations mature as follows:

Maturing in	*€ million*
2003	191
2004	140
2005	85
2006	61
2007	49
2008 or later	93
	619

Financial commitments resulting from orders already placed under purchase agreements related to planned or ongoing capital expenditure projects total €286 million (2001: €354 million). The respective payments are due almost entirely in 2003.

Under collective agreements on part-time work arrangements for certain older employees, we have to accept applications for such arrangements from a certain quota of the workforce. Other financial obligations that may arise from such work arrangements in the future cannot be quantified, since the quota has already been exceeded.

In addition, the Group has entered into research agreements with a number of third parties under which Bayer has agreed to fund various research projects or has assumed other commitments based on the achievement of certain milestones or other specific conditions. The total amount of such funding and other commitments is €570 million (2001: €732 million). At December 31, 2002, the remaining payments expected to be made to these parties, assuming the milestones or other conditions are met, were as follows:

Maturing in	*€ million*
2003	208
2004	153
2005	89
2006	74
2007	36
2008 or later	10
	570

[37] Related parties

Transactions with related persons and companies, which are invariably performed on an arm's length basis, are mainly trade transactions. The related receivables and payables have been included in the respective notes to the financial statements as required by European Union directives. The revenue and expenses related to these transactions are immaterial to the consolidated financial statements as a whole.

[38] Financial instruments

Financial instruments entail contractual claims on financial assets. Under IAS 32 (Financial Instruments: Disclosure and Presentation), financial instruments include both primary instruments, such as trade accounts receivable and payable, investments, and financial liabilities; and derivative financial instruments, which are used to hedge risks arising from changes in currency exchange and interest rates.

Primary financial instruments

Primary financial instruments are reflected in the balance sheet. In compliance with IAS 39 (Financial Instruments: Recognition and Measurement), asset instruments are categorized as "held for trading," "held to maturity," or "available for sale" and, accordingly, recognized at fair value or amortized cost. Changes in the fair value of available-for-sale securities are recognized in stockholders' equity. In the event of impairment losses, the assets are written down and the write-downs are recognized in income. Financial instruments constituting liabilities are carried at amortized cost.

Fair value

The fair value of a primary financial instrument is the price at which it could be exchanged in a current transaction between knowledgeable, willing parties in an active market. The fair values of other securities included in investments and of marketable securities are derived from their market prices and reflected in the financial statements. Financial liabilities are valued mainly by discounting future cash flows, or in some cases on the basis of quoted prices. Their total fair value reflected in the consolidated financial statements is €24 million less than their carrying value. The remaining receivables and liabilities and the liquid assets have such short terms that there is no significant discrepancy between their fair values and carrying amounts.

Credit risk

Credit risk arises from the possibility of asset impairment occurring because counterparties cannot meet their obligations in transactions involving financial instruments.

Since we do not conclude master netting arrangements with our customers, the total of the amounts recognized in assets represents the maximum exposure to credit risk.

Currency risk

Currency risk is the potential decline in the value of financial instruments due to exchange rate fluctuations. Exposure to currency risk arises mainly when receivables and payables are denominated in a currency other than the company's local currency or will be denominated in such a currency in the planned course of business.

Such risks may be naturally hedged, as when a receivable in a given currency is matched, for example between Group companies, by one or more payables in the same amount, and having an equivalent term, in the same currency. They may also be hedged using derivative financial instruments.

All currency risks arising on financial transactions, including interest, are generally fully hedged. The instruments used are mainly currency swaps, interest and principal currency swaps and forward exchange contracts. Currency risks relating to operating activities are systematically monitored and analyzed. The level of hedging is regularly reviewed.

The position at the end of 2002 was as follows:

€ million	Dec. 31, 2002	Dec. 31, 2001
Primary asset instruments exposed to currency risk	3,564	3,657
Primary liability instruments exposed to currency risk	3,154	2,314
Amount naturally hedged	(3,621)	(3,011)
Amount hedged through derivative financial instruments	(2,720)	(2,527)
Residual unhedged currency exposure	**377**	**433**

In some cases forecasted transactions are also hedged to further reduce the related anticipated currency risk. At December 31, 2002 the total notional amount of the hedging instruments concerned – mainly forward exchange contracts for the sale of U.S. dollars or Japanese yen and all maturing before December 31, 2003 – was €498 million, which is not included in the hedged amount of €2.7 billion. These hedging relationships amount to cash flow hedges as defined in IAS 39. The contracts are concluded monthly so that they run for one year and mature in the middle of each month. On these dates the results of the transactions are recognized in income. In 2002, the differences resulting from fair value measurement and initially recognized in equity, but not in net income, amounted to €16 million.

On the asset side, 56 percent of currency risks relate to the U.S. dollar and 5 percent to the Japanese yen. On the liabilities side, 52 percent of foreign currency risks relate to the U.S. dollar. The remaining exposure involves liabilities in British pounds (11 percent), Japanese yen (2 percent) and a number of other currencies outside the dollar and euro zones. The U.S. dollar accounts for 68 percent of the asset volume hedged through derivative financial instruments, followed by the yen which accounts for 6 percent. Of the hedged liabilities, 54 percent are in U.S. dollars, 24 percent in British pounds and the remaining 22 percent in other currencies. The need for hedging within the euro zone ceased at the beginning of 1999 due to the permanent fixing of exchange rates. When economically hedging exchange rate risk on recorded foreign currency operating items, we do not aim for hedge accounting treatment. Changes in the fair values of the respective hedging instruments are therefore recognized immediately in income.

The other securities included in investments are almost exclusively denominated in the currency used by the Group company making the investment, so no currency risk is involved. Similarly, the other loans are made only to borrowers in the same currency zone. Where intragroup loans are exposed to currency risk, they are hedged through derivative financial instruments.

Interest rate risk

An interest rate risk – the possibility that the value of a financial instrument will change due to movements in market rates of interest – applies mainly to receivables and payables with maturities of over one year.

Items with such long maturities are not of material significance on the operating side but are relevant in the case of investments and financial liabilities. Here, derivative financial instruments are used as the main method of interest rate hedging, though in some cases interest rate risk is not hedged if attractive fixed interest rates can be obtained.

The other securities included in investments are mostly floating rate investments at market rates of interest. Interest rate swaps are not used to convert floating rate investments into fixed rate investments.

The other loans chiefly comprise loans to employees, generally at market-oriented, fixed interest rates. Such loans are exposed to an interest rate risk which, however, is not hedged since it was entered into for specific reasons. More than three quarters of employee loans are for terms of more than five years.

Derivative financial instruments

The derivatives we use are mainly over-the-counter instruments, particularly forward foreign exchange contracts, option contracts, interest rate swaps, and interest and principal currency swaps. We deal only with banks of high credit standing. The instruments are employed according to uniform guidelines and are subject to strict internal controls. Their use is confined to the hedging of the operating business and of the related investments and financing transactions. "Regular way" purchases and sales of financial assets are recorded at the settlement date in compliance with IAS 39. The main objective in using derivative financial instruments is to reduce fluctuations in cash flows and earnings associated with changes in interest and foreign exchange rates.

Market risk

Market risk arises from the fact that the value of financial instruments may be positively or negatively affected by fluctuating prices on the financial markets. The fair values quoted are the current values of the derivative financial instruments, disregarding any opposite movements in the values of the respective hedged transactions. The fair value is the repurchase value of the derivatives on the closing date, based on quoted prices or determined by standard methods. The notional amount is the total volume of the contracted purchases or sales of the respective derivatives.

The notional amounts and fair values of the derivative financial instruments held at the closing date were as follows:

	Notional amount		Fair value	
	Dec. 31, 2002	**Dec. 31, 2001**	**Dec. 31, 2002**	**Dec. 31, 2001**
€ million				
Forward foreign exchange contracts	2,979	2,749	105	(28)
Currency options	239	279	9	•
Interest rate hedging contracts (including interest and principal currency swaps)	5,799	4,485	365	(60)
	9,017	**7,513**	**479**	**(88)**

Gains and losses from changes in fair values are immediately recognized in income, except where the strict conditions for the recognition of a hedge accounting relationship are present. This is also the case with fair value hedges, where the gain or loss on both the hedging contract and the hedged item are recognized in income. However, gains or losses incurred through cash flow hedge accounting are recognized initially in equity and subsequently in the income for the year in which the term of the respective hedging contract is completed.

Credit risk

Credit risk exposure is €578 million (2001: €139 million), this amount being the total of the positive fair values of derivatives that give rise to claims against the other parties to the instruments. It represents the losses that could result from non-performance of contractual obligations by these parties. We minimize this risk by imposing a limit on the volume of business in derivative financial instruments transacted with individual parties.

Currency risk

Exchange hedging instruments in the notional amount of €3.2 billion (2001: €2.7 billion) mature within one year, while instruments in the amount of only €8 million (2001: €0.3 billion) have longer remaining terms.

Interest rate risk

Short-term interest rate hedging contracts (including interest and principal currency swaps) total €0.5 billion (2001: €2.0 billion). Those maturing after more than one year total €5.3 billion (2001: €2.5 billion).

Hedge accounting

Most interest rate swaps and interest and principal currency swaps are performed to allow the company to maintain a target range of floating rate debt. All swap contracts amount to permissible hedge accounting relationships and there is no ineffectiveness related to these hedges. Changes in the fair values of derivatives that hedge interest rate risk are recorded as interest expense for the respective periods, as are offsetting changes in the fair value of the related hedged debt items. Fair value hedge accounting is not used in any other circumstances. Some interest rate or interest and principal currency instruments involve a swap from variable to fixed interest rates. Such contracts are accounted for as cash flow hedges as defined in IAS 39. However, most of the cash flow hedges are entered into to protect future operating revenues against currency fluctuations, as explained earlier.

NOTES TO THE STATEMENTS OF CASH FLOWS

[39] Net cash provided by operating activities

The cash flow statement starts from the operating result. The gross cash flow for 2002 of €3.0 billion (2001: €2.9 billion) is the cash surplus from operating activities before any changes in working capital. Breakdowns of the gross cash flow by segment and region are given in the table on pages 72-73. The net cash flow of €4.4 billion (2001: €3.9 billion) takes into account changes in working capital.

[40] Net cash used in investing activities

Additions to property, plant and equipment and intangible assets in 2002 resulted in a cash outflow of €2.2 billion (2001: €2.6 billion). Cash outflows for acquisitions, primarily that of Aventis CropScience, amounted to €7.8 billion (2001: €0.5 billion). Sales of property, plant and equipment led to a cash inflow of €2.2 billion (2001: €0.5 billion), while the cash inflow from the sale of investments and from interest and dividend receipts, including marketable securities, amounted to €1.3 billion (2001: €0.4 billion). Further information on acquisitions and divestments can be found on pages 10-12.

[41] Net cash provided by (used in) financing activities

The main factor in the net cash inflow of €2.2 billion from financing activities in 2002 (2001: net cash outflow of €1.5 billion) was €3.5 billion in net borrowings. Dividend payments for 2001 and interest payments totaled €1.4 billion (2001: €1.5 billion).

[42] Discontinuing operations

Discontinuing operations affected the Group cash flow statements as follows:

	Haarmann & Reimer		Erdölchemie	Total	
	2002	2001	2001	2002	2001
€ million					
Net cash provided by operating activities	87	118	13	87	131
Net cash provided by (used in) investing activities	1,286	(164)	474	1,286	310
Net cash provided by financing activities	1	77	0	1	77
Change in cash and cash equivalents	**1,374**	**31**	**487**	**1,374**	**518**

[43] Cash and cash equivalents

Cash and cash equivalents as of December 31, 2002 amounted to €0.8 billion (2001: €0.7 billion). In accordance with IAS 7 (Cash Flow Statements), this item also includes financial securities with original maturities of up to three months. The liquid assets of €0.8 billion (2001: €0.8 billion) shown in the balance sheet also include marketable securities and other instruments.

TOTAL REMUNERATION OF THE BOARD OF MANAGEMENT AND THE SUPERVISORY BOARD, ADVANCES AND LOANS

The remuneration of the Board of Management for 2002 amounted to €5,700,737 (2001: €8,153,562). Emoluments to retired members of the Board of Management and their surviving dependents amounted to €14,383,353 (2001: €8,355,270).

Pension provisions for these individuals, amounting to €106,152,766 (2001: €69,341,493) are reflected in the balance sheet of Bayer AG.

The remuneration of the Supervisory Board amounted to €1,293,750 (2001: €1,293,750).

There were no loans to members of the Board of Management or the Supervisory Board outstanding as of December 31, 2002, nor any repayments of such loans during the year.

Leverkusen, February 26, 2003
Bayer Aktiengesellschaft
The Board of Management

Report of the Supervisory Board

Dear stockholders:

During 2002 the Supervisory Board monitored the conduct of the company's business and acted in an advisory capacity. We performed these functions on the basis of detailed written and oral reports received from the Board of Management. In addition, the Chairman of the Supervisory Board and the Chairman of the Board of Management maintained a constant exchange of information and ideas. In this way the Supervisory Board was kept continuously informed about:

- *the company's business strategy;*
- *corporate planning, including financial, investment and human resources planning;*
- *the company's earnings performance; and*
- *the general state of the business.*

The documents relating to Board of Management decisions or actions requiring the approval of the Supervisory Board were inspected by the Supervisory Board at its plenary meetings, sometimes after preparatory work by its committees. In certain cases the Supervisory Board gave its approval on the basis of documents circulated to its members. The Supervisory Board was involved in decisions of material importance to the company.

We discussed at length the business trends described in the reports from the Board of Management and the prospects for the development of the Bayer Group as a whole, the individual organizational units and the principal affiliated companies in Germany and abroad.

Dr. Manfred Schneider,
Chairman of the Supervisory Board

Figuring prominently in these discussions was the ongoing corporate reorganization decided upon by the 2002 Annual Stockholders' Meeting. Further stages in the reorganization process are due to be completed this year. Another major focus of our deliberations was the progress of the acquisition of Aventis CropScience Holding S.A. and the integration of its global crop protection activities into the existing business. In-depth discussions took place concerning the strategic options for the pharmaceuticals business following the withdrawal of Lipobay®/Baycol® from the market.

Other major topics reported to us and discussed during the year were the divestments made to optimize the business portfolio and reduce debt, and the steps taken to contain costs and increase efficiency. Apart from the projects already initiated in the previous year, such as *the divestment of Haarmann & Reimer GmbH, the sale of Consumer Care's household insecticides business to S.C. Johnson & Son, Inc. and of the 30 percent interest in Belgian imaging technologies company Agfa-Gevaert N.V. deserve special mention. The acquisitions we discussed included that of Visible Genetics, Inc., based in Toronto, Canada.*

At two of its meetings the Supervisory Board dealt with the continuing development of corporate governance at Bayer. Although material changes to existing practice were not necessary, modifications were made in line with recent trends. The review took into account the recommendations and suggestions of the German Corporate Governance Code presented in 2002.

Internal deliberations concerning the future work of the Supervisory Board resulted in the establishment of an Audit Committee to assume certain tasks previously performed by the Presidial Committee. The Audit Committee also deals with a number of other topics, particularly accounting and risk management. It prepares the decisions of the Supervisory Board concerning the financial statements and management report of Bayer AG, the proposal for distribution of the profit, the consolidated financial statements and management report of the Bayer Group and the agreements with the auditors. The Audit Committee also takes appropriate steps to verify and monitor the auditors' independence.

The Presidial and Human Resources Committees continue to exist. The Presidial Committee assumes the function of the "mediation committee" under Article 31, paragraph 3, sentence 1 of the German Co-Determination Act and lays the groundwork for the plenary meetings of the Supervisory Board. The Human Resources Committee makes preparations for personnel decisions of the plenary meetings and, in particular, takes decisions on behalf of the Supervisory Board relating to the service contracts of the members of the Board of Management. It also discusses long-term succession planning for the Board of Management.

At its meeting on December 5, 2002, the Supervisory Board issued revised Rules of Procedure for its own activity.

During the fiscal year there were five plenary meetings of the Supervisory Board, and in two further instances decisions were made after circulation of documents to the members. There were two meetings of the Presidial Committee, one meeting of the Human Resources Committee and one meeting of the Audit Committee.

The consolidated financial statements of the Bayer Group were drawn up according to the International Accounting Standards (IAS). These statements, as well as the financial statements of Bayer AG and the management reports of the Bayer Group and Bayer AG, have been examined by the auditors PwC Deutsche Revision Aktiengesellschaft Wirtschaftsprüfungsgesellschaft, Essen. The conduct of the audit is explained in the Independent Auditors' Report. The auditors find that Bayer has fully complied with the International Accounting Standards and issue an unqualified opinion on the consolidated *financial statements of the Bayer Group. The financial statements and management report of Bayer AG, the consolidated financial statements and management report of the Bayer Group, and the audit reports were submitted to all members of the Supervisory Board. They were discussed in detail by the Audit Committee and at a plenary meeting of the Supervisory Board. The auditors submitted a report on both occasions and were present during the discussions.*

We examined the financial statements and management report of Bayer AG, the proposal for distribution of the profit, and the consolidated financial statements and management report of the Bayer Group. We found no objections, thus we concur with the result of the audit.

We have approved the financial statements of Bayer AG and the consolidated financial statements of the Bayer Group prepared by the Board of Management. The financial statements of Bayer AG are thus confirmed. We are in agreement with the management reports of Bayer AG and the Bayer Group and, in particular, with the assessment of the future development of the enterprise.

We also concur with the dividend policy and the allocations to retained earnings. We assent to the proposal for distribution of the profit, which provides for payment of a dividend of €0.90 per share.

The Annual Stockholders' Meeting on April 26, 2002 marked the end of the term of office of the previous Supervisory Board. Its long-serving Chairman, Hermann J. Strenger, was voted Honorary Chairman in recognition of his valuable service to Bayer and especially his work on the Supervisory Board. Our thanks go to all the retired members for their constructive and dedicated service – including Karl-Heinz Huchthausen, who relinquished his seat on October 1, 2002. He is succeeded by Thomas Hellmuth.

Our thanks also go to Dr. Frank Morich and Dr. Gottfried Zaby, both of whom left the Board of Management during 2002. Dr. Attila Molnar was appointed Senior Bayer Representative for North America and Chief Executive Officer of Bayer Corporation Holding, U.S.A., effective July 1, 2002, following his successful and valuable service on the Board of Management of Bayer AG.

The Supervisory Board would like to thank the Board of Management and all employees for their dedication and hard work in 2002.

Leverkusen, March 2003
For the Supervisory Board

Manfred Schneider

Dr. Manfred Schneider
Chairman

Corporate Officers

→ Overall Contents
→ Quick Links

Supervisory Board

Prof. Dr. Herbert Grünewald †
Honorary Chairman, Leverkusen

Hermann Josef Strenger
Honorary Chairman, Leverkusen

Members of the Supervisory Board – in addition to performing individual supervising functions at companies affiliated to those in which they hold legal offices – hold or held offices as members of the supervisory board or a comparable supervising body of the corporations listed (as at December 31, 2002 or the date on which they ceased to be members of the Supervisory Board of Bayer AG):

Dr. Manfred Schneider
Chairman of the Supervisory Board effective April 26, 2002, Leverkusen
* Dec. 21, 1938
Allianz AG
DaimlerChrysler AG
Linde AG
Metro AG
RWE AG
TUI AG (effective April 11, 2002)

Erhard Gipperich
Vice Chairman of the Supervisory Board; Chairman of the Group and Central Works Councils of Bayer AG, Leverkusen
* April 30, 1942
THS GmbH (effective May 1, 2002)

Dr. Paul Achleitner (effective April 26, 2002)
Member of the Board of Management of Allianz AG, München
* Sept. 28, 1956
Allianz Immobilien GmbH *(Chairman)*
MAN AG
RWE AG
ÖIAG

Dr. Josef Ackermann (effective April 26, 2002)
Spokesman of the Board of Managing Directors and Chairman of the Group Executive Committee of Deutsche Bank AG, Frankfurt am Main
* Feb. 7, 1948
Linde AG
Eurex Frankfurt AG (until May 27, 2002)
Eurex Clearing AG (until May 27, 2002)
Stora Enso Oyi
Vodafone Group Plc. (until Feb. 19, 2002)
Eurex Zürich AG (until May 27, 2002)
The Nasdaq Stock Market, Inc. (until July 24, 2002)

Petra Brayer (until April 26, 2002)
Chemical Laboratory Assistant, Dormagen
* Jan. 20, 1967

Karl-Josef Ellrich
Chairman of the Works Council, Dormagen site
* Oct. 5, 1949

Thomas Hellmuth (effective October 2, 2002)
Agricultural Engineer, Langenfeld
* May 29, 1956

Prof. Dr. Ing. e. h. Hans-Olaf Henkel
(effective April 26, 2002)
President of the Leibniz Association, Vice President of the Federation of German Industry, Berlin
* March 14, 1940
Continental AG
Deutsche Industriebank AG (IKB)
Econia AG (until Sept. 2002)
European Aeronautics and Defense Systems AG
IBM Deutschland GmbH (until Sept. 2002)
SMS AG
Ringier AG
ETF
Orange SA

Karl-Heinz Huchthausen
(from April 26, 2002 until October 1, 2002)
Chairman of the Works Council of Haarmann & Reimer GmbH, Holzminden
* Jan. 26, 1947

Dr. h.c. Martin Kohlhaussen
Retired bank director and Chairman of the Supervisory Board of Commerzbank AG, Frankfurt am Main
* Nov. 6, 1935
Heraeus Holding GmbH
Hochtief AG
Infineon Technologies AG
Karstadt Quelle AG
Linde AG
Schering AG
ThyssenKrupp AG
Verlagsgruppe Georg von Holtzbrinck GmbH

Hilmar Kopper (until April 26, 2002)
Chairman of the Supervisory Board of Deutsche Bank AG, Frankfurt am Main
* March 13, 1935
Akzo-Nobel N.V.
DaimlerChrysler AG
Solvay S.A.
Unilever N.V.
Xerox Company

John Christian Kornblum
(effective April 26, 2002)
Chairman of Bankhaus Lazard, Berlin
* Feb. 6, 1943
ThyssenKrupp Technologies AG

Petra Kronen
Chairman of the Works Council, Uerdingen site
* Aug. 22, 1964

Dr.-Ing. Manfred Lennings
(until April 26, 2002)
Management Consultant, Essen-Kettwig
* Feb. 23, 1934
Deutsche Post AG
Gildemeister AG
Heitkamp-Deilmann-Haniel GmbH
IVG Holding AG

Dr. h.c. André Leysen (until April 26, 2002)
Chairman of the Board of Directors of Gevaert N.V., Mortsel, Belgium
* June 11, 1927
Agfa-Gevaert AG
Agfa-Gevaert N.V.
Deutsche Telekom AG
e.on AG
Schenker AG

Dr. h.c. Helmut Oswald Maucher
(until April 26, 2002)
Honorary Chairman of Nestlé S.A., Frankfurt am Main
* Dec. 9, 1927
Koc Holding A.S.
Qualiclick.com AG
Ravensburger AG
Union Bancaire Privée S.A.

Rolf Nietzard (until April 26, 2002)
Chemical Laboratory Technician, Leverkusen
* Oct. 19, 1945

Supervisory Board (continued)

Dr. Heinrich von Pierer
President and Chief Executive Officer of Siemens AG, Munich
* Jan. 26, 1941
Hochtief AG
Münchener Rückversicherungs-Gesellschaft AG
Volkswagen AG

Dr. Wolfgang Reitzle (effective April 26, 2002)
Chairman of the Executive Board of Linde AG, Wiesbaden
* March 7, 1949
Allianz Lebensversicherungs-AG (effective Dec. 2002)

Wolfgang Schenk (effective April 26, 2002)
Graduate Engineer, Leverkusen
* Sept. 24, 1953

Waltraud Schlaefke (until April 26, 2002)
Chemical Laboratory Technician, Bomlitz
* Sept. 26, 1944
Wolff Walsrode AG

Hubertus Schmoldt
Chairman of the German Mine, Chemical and Power Workers' Union, Hannover
* Jan. 14, 1945
Buna Sow Leuna Olefinverbund GmbH
e.on AG
RAG Coal International AG
BP Aktiengesellschaft (effective Nov. 2002)

Dieter Schulte
Former Chairman of the German Unions Federation, Duisburg
* Jan. 13, 1940
ThyssenKrupp AG

Hermann Josef Strenger
(until April 26, 2002)
Chairman of the Supervisory Board, Leverkusen
* Sept. 26, 1928

Dr. Eugen Velker (until April 26, 2002)
Chemist, Dormagen
* May 1, 1942

Lodewijk Christiaan van Wachem
(until April 26, 2002)
Chairman of the Supervisory Board of Royal Dutch Petroleum Company, The Hague, Netherlands
* July 31, 1931
Akzo Nobel N.V.
ATCO Ltd.
BMW AG
IBM Corporation
Philips Electronics N.V.
Zürich Financial Services

Siegfried Wendlandt
North Rhine District Secretary of the German Mine, Chemical and Power Workers' Union, Düsseldorf
* July 27, 1947
RWE Rheinbraun AG (until May 2002)
Rütgers AG
HT Troplast AG

Reinhard Wendt (effective April 26, 2002)
Printer, Walsrode
* March 6, 1945
Wolff Walsrode AG

Thomas de Win (effective April 26, 2002)
Commercial Clerk, Pulheim
* Nov. 21, 1958

Prof. Dr. Ernst-Ludwig Winnacker
University Professor, Bonn
* July 26, 1941
MediGene AG
NascaCell AG

Dr. Hermann Wunderlich
Former Vice Chairman of the Company's Board of Management, Odenthal
* April 29, 1932
Freudenberg & Co.

Board of Management

Members of the Board of Management – in addition to performing individual supervising functions at companies affiliated to those in which they hold legal offices – hold or held offices as members of the supervisory board or a comparable supervising body of the corporations listed (as at December 31, 2002 or the date on which they ceased to be members of the Board of Management):

Werner Wenning
Chairman of the Board of Management effective April 26, 2002
* Oct. 21, 1946
Dresdner Bank Lateinamerika AG
Gerling-Konzern Versicherungs-Beteiligungs-AG

Klaus Kühn (effective May 1, 2002)
* Feb. 11, 1952
Agfa-Gevaert N.V. (until June 11, 2002)

Dr. Attila Molnar (until June 30, 2002)
* Aug. 17, 1948

Dr. Frank Morich (until June 30, 2002)
* Oct. 4, 1953

Dr. Udo Oels
* Jan. 2, 1944
Agfa-Gevaert AG (until June 11, 2002)
Haarmann & Reimer GmbH (until Sept. 30, 2002)
Wolff Walsrode AG

Dr. Richard Pott (effective May 1, 2002)
* May 11, 1953

Dr. Manfred Schneider (until April 26, 2002)
* Dec. 21, 1938

Werner Spinner (until Feb. 28, 2003)
* Oct. 30, 1948

Dr. Gottfried Zaby (until March 7, 2002)
* Dec. 30, 1950

→ Overall Contents
→ Quick Links

Ten-Year Financial Summary

Bayer Group (€ million)	1993	1994	1995	1996	1997
Net sales	20,967	22,200	22,793	24,853	28,124
Sales outside Germany	81.0%	81.6%	80.5%	82.2%	83.9%
Sales of foreign consolidated companies	64.5%	65.3%	63.4%	65.4%	67.0%
Operating result	1,200	1,656	2,102	2,306	3,077
Income before income taxes	1,204	1,684	2,140	2,282	2,611
Income after taxes	701	1,029	1,238	1,405	1,509
Noncurrent assets	**8,256**	**8,563**	**9,437**	**10,689**	**12,230**
Intangible assets	164	386	488	729	1,051
Property, plant and equipment	7,506	7,548	7,966	8,974	10,307
Investments	586	629	983	986	872
Current assets	**12,283**	**13,097**	**13,211**	**14,593**	**15,467**
Inventories	4,176	4,261	4,762	5,144	5,424
Receivables	5,427	5,881	5,787	7,028	7,588
Liquid assets	2,680	2,955	2,662	2,421	2,455
Stockholders' equity	**9,089**	**8,488**	**9,109**	**10,531**	**12,009**
Capital stock of Bayer AG	1,715	1,772	1,803	1,851	1,867
Capital reserves and retained earnings	6,695	5,709	6,082	7,287	8,638
Net income	679	1,007	1,224	1,393	1,504
Minority stockholders' interest	**220**	**232**	**248**	**234**	**223**
Liabilities	**11,230**	**12,940**	**13,291**	**14,517**	**15,465**
Provisions	6,003	6,788	6,923	7,057	7,275
Other liabilities	5,227	6,152	6,368	7,460	8,190
Total assets	**20,539**	**21,660**	**22,648**	**25,282**	**27,697**
Proportion of total assets					
Noncurrent assets	40.2%	39.5%	41.7%	42.3%	44.2%
Current assets	59.8%	60.5%	58.3%	57.7%	55.8%
Stockholders' equity	44.3%	39.2%	40.2%	41.7%	43.4%
Liabilities	54.7%	59.7%	58.7%	57.4%	55.8%
Financial liabilities	2,691	3,209	3,205	3,520	3,896
• Long-term	1,319	1,259	1,436	1,615	2,150
• Short-term	1,372	1,950	1,769	1,905	1,746
Interest income (expense) – net	(26)	45	6	(44)	(157)
Noncurrent assets financed by stockholders' equity	110.1%	99.1%	96.5%	98.5%	98.2%
Noncurrent assets and inventories financed by stockholders' equity and long-term liabilities	123.0%	114.9%	110.7%	113.4%	114.2%
Return on sales	5.7%	7.5%	9.2%	9.3%	11.0%
Return on stockholders' equity	7.7%	11.4%	13.7%	14.0%	13.1%
Operating cash flow (gross)	2,481	2,529	2,751	2,959	3,313
Capital expenditures	1,614	1,794	1,620	1,931	2,331
Depreciation and amortization	1,374	1,243	1,184	1,326	1,479
Depreciation and amortization in percent of capital expenditures	85.2%	69.3%	73.1%	68.7%	63.4%
Personnel expenses (including pension expenses)	7,315	7,392	7,477	7,718	7,895
Number of employees (year end)	150,400	146,700	142,900	142,200	144,600
Research and development expenses	1,614	1,624	1,666	1,845	1,983

Bayer AG					
Income after taxes/Net income	418	476	592	695	746
Allocation to retained earnings	41	15	51	66	36
Total dividend payment	377	461	541	629	710
Dividend per share (€)	0.56	0.66	0.77	0.87	0.97

*) continuing operations

Bayer Group (€ million)	1998	1999	2000	2001	2002
Net sales	8,062	27,320	30,971	30,275	29,624
Sales outside Germany	83.6%	84.3%	85.6%	85.6%	86.0%
Sales of foreign consolidated companies	67.5%	68.3%	69.0%	70.9%	72.2%
Operating result	3,155	3,357	3,287	1,611	1,574
Income before income taxes	2,728	2,836	2,990	1,115	956
Income after taxes	1,615	2,018	1,842	961	1,063
Noncurrent assets	**13,981**	**15,614**	**20,344**	**21,702**	**23,513**
Intangible assets	1,909	2,213	4,843	5,014	8,879
Property, plant and equipment	10,970	11,986	13,345	13,543	12,436
Investments	1,102	1,415	2,156	3,145	2,198
Current assets	**15,396**	**15,665**	**16,107**	**15,337**	**18,179**
Inventories	5,781	4,992	6,095	5,818	6,342
Receivables	7,894	7,533	9,308	8,748	11,041
Liquid assets	1,721	3,140	704	771	796
Stockholders' equity	**12,568**	**15,006**	**16,140**	**16,922**	**15,335**
Capital stock of Bayer AG	1,867	1,870	1,870	1,870	1,870
Capital reserves and retained earnings	9,087	11,134	12,454	14,087	12,405
Net income	1,614	2,002	1,816	965	1,060
Minority stockholders' interest	**211**	**176**	**237**	**98**	**120**
Liabilities	**16,598**	**16,097**	**20,074**	**20,019**	**26,237**
Provisions	7,271	6,714	7,163	7,172	8,397
Other liabilities	9,327	9,383	12,911	12,847	17,840
Total assets	**29,377**	**31,279**	**36,451**	**37,039**	**41,692**
Proportion of total assets					
Noncurrent assets	47.6%	49.9%	55.8%	58.6%	56.4%
Current assets	52.4%	50.1%	44.2%	41.4%	43.6%
Stockholders' equity	42.8%	48.0%	44.3%	45.7%	36.8%
Liabilities	56.5%	51.5%	55.1%	54.1%	62.9%
Financial liabilities	4,730	4,466	6,665	7,380	10,159
• Long-term	2,404	2,359	2,803	3,071	7,318
• Short-term	2,326	2,107	3,862	4,309	2,841
Interest income (expense) – net	(179)	(196)	(311)	(349)	(449)
Noncurrent assets financed by stockholders' equity	89.9%	96.1%	79.3%	78.0%	65.2%
Noncurrent assets and inventories financed by stockholders' equity and long-term liabilities	105.0%	111.5%	93.0%	93.9%	96.8%
Return on sales	12.6%	11.2%	11.2%*	6.3%*	3.4%*
Return on stockholders' equity	12.9%	14.4%	11.7%	5.8%	6.6%
Operating cash flow (gross)	3,394	3,192	4,164	2,923	3,012
Capital expenditures	2,703	2,632	2,647	2,617	2,383
Depreciation and amortization	1,521	1,744	2,122	2,464	2,814
Depreciation and amortization in percent of capital expenditures	56.3%	66.3%	80.2%	94.1%	118.1%
Personnel expenses (including pension expenses)	8,106	7,549	7,735	7,849	8,176
Number of employees (year end)	145,100	120,400	122,100	116,900	122,600
Research and development expenses	2,045	2,252	2,393	2,559	2,577
Bayer AG					
Income after taxes/Net income	1,095	1,076	1,702	657	1,162
Allocation to retained earnings	348	127	680	0	505
Total dividend payment	747	949	1,022	657	657
Dividend per share (€)	1.02	1.30	1.40	0.90	0.90

*) continuing operations

Financial Report 2002
Quick Links