

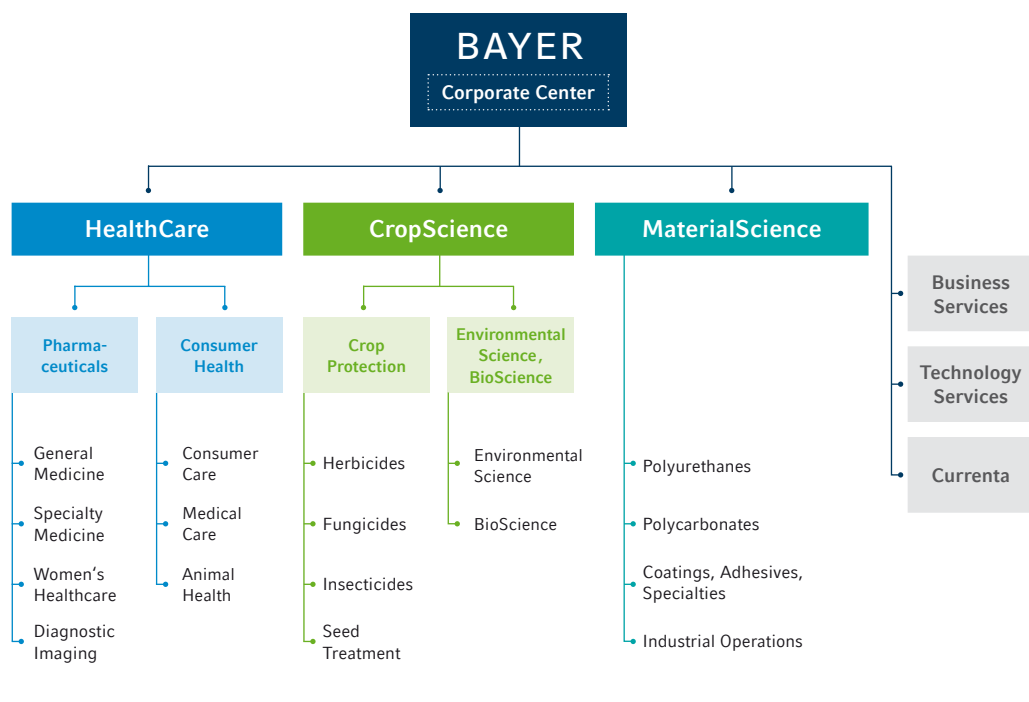
2. Business and Operating Environment

2.1 Corporate Structure

Bayer AG, headquartered in Leverkusen, Germany, is the strategic management holding company for the Bayer Group. Business operations are conducted by the HealthCare, CropScience and MaterialScience subgroups.

Bayer Group Structure

[Graphic 3.5]



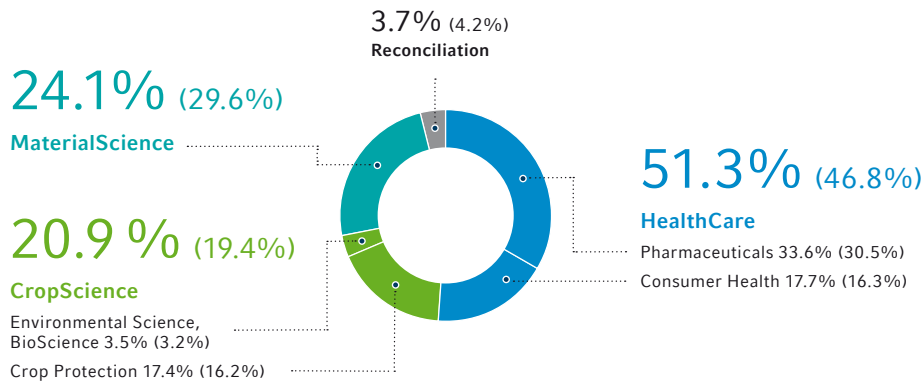
The globally operating HealthCare subgroup is divided into the Pharmaceuticals and Consumer Health segments. The Pharmaceuticals segment concentrates on prescription products in the fields of General Medicine, Specialty Medicine, Women's Healthcare and Diagnostic Imaging. Our Consumer Health segment comprises the Consumer Care, Medical Care and Animal Health divisions. The Consumer Care Division has businesses in non-prescription medicines and dietary supplements. Medical Care comprises the businesses with blood glucose meters, contrast-enhanced diagnostic imaging equipment, and mechanical systems for treating constricted or blocked blood vessels. The products of the Animal Health Division are destined for use in livestock and companion animals.

CropScience is active in the fields of chemical crop protection, non-agricultural pest and weed control, seed breeding and the improvement of plant traits. Organizationally, our CropScience business is divided into the Crop Protection segment and the Environmental Science, BioScience segment. Reflecting its product offering, Crop Protection is comprised of the Herbicides, Fungicides, Insecticides and Seed Treatment business units. Within the Environmental Science, BioScience segment, the Environmental Science business unit markets non-agricultural pest and weed control products while the BioScience business unit focuses on seeds and plant traits.

MaterialScience develops, manufactures and markets high-performance products in the areas of polyurethanes, polycarbonates, and coating and adhesive raw materials. This subgroup also manufactures and markets selected inorganic basic chemicals. MaterialScience is divided into the Polyurethanes, Polycarbonates, and Coatings, Adhesives, Specialties business units, and the Industrial Operations area.

Sales by Segment 2009 (2008 in parentheses)

[Graphic 3.6]



Our subgroups are supported by the Business Services, Technology Services and Currenta service companies, which are reported in the reconciliation under "All Other Segments." The reconciliation also includes the Corporate Center and consolidation effects.

The commentaries in this report relate exclusively to continuing operations, except where specific reference is made to discontinued operations or to a total value. We had no discontinued operations to report in 2009.

Key Data by Subgroup and Segment

[Table 3.3]

	Sales		EBIT before special items*		EBITDA before special items*		EBITDA margin before special items*	
	2008	2009	2008	2009	2008	2009	2008	2009
	€ million	€ million	€ million	€ million	€ million	€ million	%	%
HealthCare	15,407	15,988	2,764	3,012	4,157	4,468	27.0	27.9
Pharmaceuticals	10,030	10,467	1,760	2,018	2,920	3,193	29.1	30.5
Consumer Health	5,377	5,521	1,004	994	1,237	1,275	23.0	23.1
CropScience	6,382	6,510	1,084	1,017	1,603	1,508	25.1	23.2
Crop Protection	5,339	5,424	962	875	1,397	1,301	26.2	24.0
Environmental Science, BioScience	1,043	1,086	122	142	206	207	19.8	19.1
MaterialScience	9,738	7,520	586	(126)	1,088	446	11.2	5.9
Reconciliation	1,391	1,150	(92)	(131)	83	50	6.0	4.3
Continuing Operations	32,918	31,168	4,342	3,772	6,931	6,472	21.1	20.8

2008 figures restated

* for definition see chapter 4.2 "Calculation of EBIT(DA) Before Special Items," page 74

Changes in corporate structure

We implemented a number of organizational changes effective January 1, 2009 that affected our segment reporting and thus the presentation within the subgroups as described below. The prior-year figures have been restated accordingly. In the HealthCare subgroup, the dermatology business (Intendis) was integrated into the Consumer Care Division within the Consumer Health segment and thus is no longer part of the Pharmaceuticals segment. The Diabetes Care Division was combined with our medical equipment business Medrad – which previously formed part of the Diagnostic Imaging business unit in the Pharmaceuticals segment – to create the Medical Care Division. In the Pharmaceuticals segment we now conduct our business in the General Medicine (formerly Primary Care and Cardiology), Specialty Medicine (formerly Specialized Therapeutics, Oncology and Hematology), Women's Healthcare and Diagnostic Imaging business units. MaterialScience is reported as a single segment. The Thermoplastic Polyurethanes (TPU) business unit was dissolved. The TPU granules business was integrated into the Polyurethanes business unit, while the TPU films activities now form part of the Coatings, Adhesives, Specialties business unit (Functional Films). In light of organizational changes, the non-core businesses previously reported as "Other Systems" are now reported under Industrial Operations.

2.2 Operating Environment

Global economy

In 2009 the global economy was dominated by the financial and economic crisis, which led to a worldwide economic slump in the fall of 2008. The industrialized countries were particularly hard hit, with some of the emerging markets also experiencing major downturns or at least tangibly lower rates of growth.

The pace of the downswing slowed during the second quarter of 2009, in some countries more significantly than expected. This was substantially the result of extensive governmental stimulus programs. The financial markets also stabilized increasingly during the year following massive intervention by the central banks. The bottom of the cycle was reached in the summer months, and the world economy slowly recovered in the second half of the year. With business and consumer confidence continuing to improve, production in the industrialized countries expanded once more. The emerging economies again posted higher growth rates, albeit well below those of 2008. However, the worldwide recovery at year end was not nearly sufficient to offset the slump at the start of the year, with the result that global economic output in 2009 was well down on the previous year.

HealthCare

In 2009 the **market for prescription medicines** posted growth in the mid-single digits. Expansion slowed in the United States and the major European countries, partly as a result of more restrictive health care policies, which are leading to stricter cost controls and limiting access to certain types of treatment. Growth continued in the emerging countries, where health services are becoming available to more and more people and the need for treatment options for chronic diseases is increasing.

While growth in the global **consumer health market** ebbed slightly in 2009, it proved relatively stable overall thanks to some price increases. Inventory adjustments by traders had a negative effect in the first half. Market expansion in the emerging economies did not fully offset the low growth rates in the industrialized countries.

CropScience

Following the positive trend in 2008, conditions in the global **seed and crop protection market** deteriorated markedly during 2009. Declining prices for the major agricultural crops, lower insect and disease infestation pressure and adverse weather patterns led to a tangible drop in demand for crop protection products, particularly in the second half.

The economic situation of farmers in Latin America worsened overall in the wake of extreme drought conditions in the first half of 2009. The region's farm economy was also hampered by an unfavorable exchange rate for the U.S. dollar and by the financial crisis. In North America, the use of crop protection products declined mainly due to above-average rainfall in the first half and a sharp drop in producer prices. In many European countries, comparatively low infestation by insect pests and fungal diseases in crops such as cereal, potatoes or grapes reduced the demand for crop protection products. Many farms in eastern Europe cut back spending on inputs due to a lack of liquidity caused by the financial crisis. In Asia/Pacific, too, business conditions in 2009 were predominantly unfavorable, especially in the region's growth markets. Infestation pressure in China was low, particularly in rice. The erratic monsoon in the second half of the year held back growth, especially in India. By contrast, Australian agriculture saw a modest recovery from the prolonged drought of recent years.

MaterialScience

The customer industries of importance to MaterialScience experienced a slump in business in 2009 that varied in intensity from one region to another. In the first quarter, particularly, demand plummeted. The difficult economic conditions gradually improved as the year went on, mainly as a result of the extensive stimulus programs introduced throughout the world.

The **automotive markets** of many countries stabilized initially thanks to the governmental stimulus programs. Although production declined substantially in 2009 as a whole, these programs prevented an even worse situation. Currently, only China appears on course for sustained growth.

The **electrical/electronics sector**, which as a supplier industry is closely interlinked with all other industry sectors, saw a mid-single-digit decline in production worldwide in 2009. The picture varied widely from one region to another. Production in the industrialized countries fell sharply, while the emerging countries continued to show robust growth.

The global **construction industry** shrank in 2009 for the first time since the early 1990s. While there were clear signs of stabilization in the United States as the year progressed, some markets in western Europe slumped dramatically. Other major markets such as China and India were less affected by the crisis and continued growing at slightly slower rates.

The **furniture industry** suffered from a sharp drop in business, especially in the first half of 2009, with the market gradually bottoming out in the second half. In the United States and several European countries in particular, weaker consumer confidence had an adverse effect on demand. In the Asian markets, which were stabilized by extensive stimulus programs, part of the decline in exports was offset by an increase in domestic consumption.

2.3 Procurement and Production

Uniform Group directives on procurement are in place. Our production-specific procurement activities, like production itself, are organized on a decentralized basis in light of the diverse nature of our business activities. The procurement of indirect goods and services that are not relevant to production – such as consultancy services, business travel and fleet management, computer hardware and software, laboratory and workshop equipment, safety devices and office supplies – is centrally organized within our service companies.

HealthCare

An organizational unit of HealthCare steers the subgroup's entire supply chain, from raw material procurement to manufacturing to product shipment, utilizing a global production network consisting of its own sites and those of subcontractors. In this way we aim to steadily reduce costs, increase our flexibility and delivery reliability, and maintain high standards of quality, safety and environmental protection on a global basis. The manufacture of pharmaceuticals is subject to exceptionally stringent quality requirements defined by the term "Good Manufacturing Practices" (GMP). Compliance with these requirements is regularly audited by internal experts, regulatory authorities and external consultants.

Production network creates advantages

The Pharmaceuticals segment generally procures the starting materials for the active ingredients of its prescription pharmaceuticals from external suppliers. To prevent supply bottlenecks and to mitigate major price fluctuations, these starting materials and the intermediates we do not produce ourselves are generally purchased under global contracts and/or from a number of suppliers we have audited and approved.

Our active ingredients for prescription medicines are manufactured primarily at the sites in Wuppertal and Bergkamen, Germany, as well as Berkeley and Emeryville, California, United States. These substances are processed into finished products and packaged worldwide using sophisticated technologies. Our medicines come in a wide range of delivery forms, including solids (coated or uncoated tablets, powders), semi-solids (ointments, creams) and liquid pharmaceuticals used in injections or infusions, for example. Our hormonal contraceptives are supplied as sugar- or film-coated tablets or used in intrauterine systems (coils), for example. These manufacturing and packaging activities take place in Berlin, Leverkusen and Weimar, Germany; Garbagnate, Italy; Beijing, China; São Paulo, Brazil; Turku, Finland; and various other sites in Europe, Asia and Latin America. The hemophilia drug Kogenate® is manufactured by a biotechnological process at Berkeley, California, United States. Betaferon®/Betaseron® for the treatment of multiple sclerosis is produced in Emeryville, California, United States.

In the Consumer Health segment, the Consumer Care Division procures certain active substances, such as acetylsalicylic acid and clotrimazole, from within the Bayer Group. The principal raw materials we purchase from third parties are naproxen, citric acid, ascorbic acid and other vitamins, and paracetamol. To minimize business risks, we diversify our raw material procurement sources worldwide and conclude long-term supply agreements. Among the division's largest production sites are the facilities in Myerstown, Pennsylvania, United States; Cimanggis, Indonesia; Gaillard, France; Bitterfeld-Wolfen and Grenzach-Wyhlen, Germany; and Madrid, Spain.

Some four fifths of the Diabetes Care products (such as blood glucose meters) of our Medical Care Division are procured from original equipment manufacturers (OEMs). Material prices and availability are covered in most cases by long-term contracts and therefore are not subject to major fluctuations. We hold strategic reserves of certain direct materials or finished products in order to be able to supply our customers consistently and reliably. Our largest production site for Diabetes Care products is located in Mishawaka, Indiana, United States. Most of the materials needed for our medical equipment business, too, are procured from external suppliers, their availability, quality and price stability being ensured by way of long-term agreements, careful choice of suppliers and active supplier management. The majority of our medical devices are manufactured at the u.s. sites near Pittsburgh, Pennsylvania, and at Coon Rapids, Minnesota.

The Animal Health Division procures the pharmaceutical active ingredients for its veterinary medicines both from within the Bayer Group and from external suppliers throughout the world. Our animal health products are manufactured mainly at the sites in Kiel, Germany, and Shawnee, Kansas, United States, and marketed worldwide.

CropScience

CropScience procures most of its raw materials for the manufacture of crop protection products externally. These raw materials are mainly basic chemicals such as chlorine, sodium hydroxide solution and sulfuric acid, or synthesis components. The cost of some raw materials depends on oil and energy prices and freight charges. Key products are usually procured on the basis of long-term supply agreements. We reduce the risk of supply failure by diversifying our raw material sources and holding strategic reserves of important raw materials. Another major factor in ensuring supplies is that we buy primarily from certified suppliers with defined quality standards for their production and for the raw materials to be procured.

Global production network for agrochemical and seed products at CropScience

CropScience has 36 production sites and formulating facilities of its own around the world where its Crop Protection and Environmental Science products are manufactured. Among the largest are the facilities in Dormagen and Frankfurt am Main, Germany; Kansas City, Missouri and Institute, West Virginia, United States; and Vapi, India. In addition to a number of central locations for the manufacture of our active ingredients, a network of decentralized formulation and filling sites

enables us to respond rapidly to local market needs. At these facilities the active ingredients are processed into herbicides, fungicides, insecticides, seed treatments and Environmental Science products according to local requirements and application areas. We continued to invest in our global production network in 2009, selectively expanding our capacities for important products such as the herbicide Basta®/Liberty®/Ignite® and the fungicide Proline®/Input®/Prosaro®.

In the BioScience business unit, we produce our seeds close to the customer in Europe, Asia, and North and South America. Our canola, cotton, rice and vegetable seed is bred in our own centers or grown under contract on an area of more than 90,000 hectares.

MaterialScience

The basic raw materials for our MaterialScience products are petrochemical feedstocks such as benzene, toluene and phenol. We generally purchase these materials on the procurement markets under long-term contracts. The operation of our production facilities also requires large amounts of energy, mostly in the form of electricity or steam, making energy costs a significant factor for the MaterialScience business. To minimize the price fluctuation risk, we aim for a balanced diversification of fuels for steam production and a mix of external procurement and captive production for power generation. We also employ commodity swaps and commodity options in the case of long-term, fixed-price supply contracts, for example.

The largest production facilities of MaterialScience for the European market are located in Dormagen, Krefeld and Brunsbüttel, Germany; Antwerp, Belgium; and Tarragona, Spain. The major production site for the North American market is at Baytown, Texas, United States, while customers in the Asia/Pacific region are supplied chiefly from Map Ta Phut, Thailand, and Shanghai, China. In the field of commodities we endeavor to reduce costs by operating world-scale production facilities that enable us to supply markets across national borders. We also have a large number of production facilities close to local markets in 17 countries to serve our diverse businesses. Of these facilities, our systems houses formulate and supply customized polyurethane systems under the trade name BaySystems®, while others carry out compounding of polycarbonate granules (brand name: MakroColor®) close to the customer or manufacture our semi-finished products (polycarbonate sheet). We also operate regional production facilities for functional films made of polycarbonate or thermoplastic polyurethane.

2.4 Products, Distribution and Markets

Marketing activities within the Bayer Group are decentralized due to the diversified business portfolio.

HealthCare

HealthCare supplies more than 20,000 articles to meet the needs of patients and consumers in the various markets. The high number is due to the size of the product range and the various delivery forms, dosages, pack sizes, and language versions of individual products and their packaging.

More than 20,000
articles worldwide

In the Pharmaceuticals segment we supply prescription products in the areas of General Medicine, Specialty Medicine, Women's Healthcare and Diagnostic Imaging. In the field of General Medicine we supply products such as Adalat® to treat high blood pressure and coronary heart disease, and Avalox®/Avelox® to fight infectious diseases. Our offering in the area of Specialty Medicine includes the multiple sclerosis treatment Betaferon®/Betaseron®, the hemophilia A treatment Kogenate® and the cancer drug Nexavar®. Women's Healthcare markets contraceptive products, such as YAZ®/Yasmin®/Yasminelle® and Mirena®, and hormone replacement therapies such as Angeliq®. Our contrast agents, which are used in diagnostic imaging, include Ultravist® and Magnevist®. In the pharmaceuticals market we are among the world's top 15 companies in terms of sales.

Partnerships optimize distribution

Our pharmaceutical products are primarily distributed through wholesalers, pharmacies and hospitals. Co-promotion and co-marketing agreements serve to optimize our distribution network. For example, the agreement with Johnson & Johnson subsidiary Ortho-McNeil concerning the joint further development and marketing of the anticoagulant Xarelto® ensures optimum progress in this area, conferring regional marketing rights that enable both partners to share in the product's expected success. Another example is the strategic alliance with Schering-Plough (now Merck & Co., Inc., United States) under which that company markets selected primary care products in the United States. We also co-market Zetia®, a product of Merck & Co., Inc., in Japan.

The Consumer Health segment offers chiefly non-prescription (over-the-counter = OTC) medicines. The Consumer Care Division has brands in most OTC categories, such as Aspirin® and Aleve® (analgesics) or Canesten® (dermatologicals). The product range also includes nutritionals such as Supradyn® and One-A-Day®, antacids, skin care products such as Bepanthen®/Bepanthol®, and cough-and-cold products. Consumer Care is a leading player in the OTC market. The division also includes prescription dermatology products. While the division's sales and distribution channels outside Europe are typically supermarket chains, drugstores and other large retailers, pharmacies are the usual distribution channel in Europe.

In the Medical Care Division we offer user-friendly blood glucose monitoring devices such as the single-strip Contour® system or the multi-strip Breeze® system. We generally market these products to consumers outside Europe through pharmacies, drugstores, mass merchants, hospitals and wholesalers. In Europe, they are sold mainly through pharmacies. We are among the top three companies in the market for blood glucose meters. Additionally we offer medical equipment such as contrast injection systems for diagnostic and therapeutic medical procedures in computed tomography, magnetic resonance imaging and molecular imaging, along with mechanical systems for the treatment of constricted or blocked blood vessels. These products are marketed to cardiologists, radiologists and vascular surgeons in hospitals and out-patient clinical sites through a global direct sales organization that is supplemented in certain regions by local distributors. We are the global market leader in contrast agent injection systems.

The Animal Health Division focuses on the health of companion animals and livestock, for which we offer pharmaceuticals and grooming products. The largest product line is Advantage® to treat flea infestation in dogs and cats, followed by Baytril® for the control of infectious diseases, the wormers Drontal® and Drontal Plus®, and Baycox® for the treatment of coccidiosis in pigs. We occupy leading positions in individual countries and product segments, and are the world's fourth-largest animal health company in terms of sales. Depending on local regulatory frameworks, animal health products may be available to end users with a prescription issued by a veterinarian or over the counter from retail stores, drugstores and pharmacies.

CropScience

The CropScience business is subject to the growing seasons for the relevant crops and the respective distribution cycles.

Integrated, sustainable product portfolio offers solutions from seed to harvest

Our Crop Protection business is based on a broad, balanced portfolio of highly effective herbicides, fungicides, insecticides and seed treatment products. Thanks to our innovative capability and many years of experience with pest control products, we are the global market leader in the insecticides market. Fungicides prevent or cure diseases caused by fungal infestation that can significantly impair harvest yields and quality. CropScience is the world's second-leading supplier in the fungicides market and occupies a strong number three position in the global market for weed control products (herbicides), including plant growth regulators. Our Seed Treatment business unit focuses on the use of crop protection active ingredients specially developed for the protection of seeds and seedlings. Its broad, balanced range of insecticides, fungicides and combination products makes CropScience the leading company in the seed treatment market in terms of sales. Our Crop Protection products are marketed either via wholesalers or directly through retailers by means of a two- or three-step distribution system, depending on local market conditions.

The products of our Environmental Science business unit are based on our crop protection active ingredients and are specially designed for non-agricultural uses. In terms of sales, Bayer is among the world's leading suppliers of non-agricultural pest control products. The business unit is divided into Consumer Products, which markets plant care products and lawn, home and garden brands specifically to consumers, and Professional Products, which offers solutions for professionals in the green, pest control and vector control industries. The Environmental Science products are marketed through various distribution channels. Our home and garden products are sold to consumers via both wholesalers and specialist retailers. Products for professional users are sold either directly to customers or via wholesalers. In the vector control field, particularly, much of our business takes place in response to tendering by government agencies and non-governmental organizations.

In the BioScience business unit, our activities are focused on seed production in the four core crops of cotton, canola, rice and vegetables, where we offer high-quality seed based on our own research and breeding expertise. We have achieved strong market positions in these four crops and are globally represented. We market our canola seed primarily in North America, our cotton seed in North and Latin America, India and southern Europe, and our hybrid rice seed in Asia and, since 2009, in the United States. Our vegetable seed varieties are sold in more than 100 countries throughout the world. Our seed is distributed to farmers, breeders, specialist retailers and the processing industry. Traits developed using modern breeding methods and plant biotechnology are either incorporated into our own seed varieties or licensed to other seed companies for use in their products. In some cases, traits are also provided to other companies for research purposes.

MaterialScience

MaterialScience is among the world's leading manufacturers and suppliers of polyurethanes and polycarbonates and of raw materials for coatings and adhesives. The subgroup holds leading competitive positions in these product groups in all regional markets. We also produce and market selected inorganic basic chemicals such as chlorine, sodium hydroxide solution, hydrogen, hydrochloric acid, nitric acid and carbon monoxide, which serve either as raw materials (such as chlorine) for our primary products or are generated as by-products (such as sodium hydroxide solution) and sold to external customers.

Our primary products are used mainly in the automotive, construction, electronics, data communications, furniture, timber, chemical, sports equipment, leisure goods, textile, medical technology and manufacturing industries. Our polyurethane raw materials, such as diphenylmethane diisocyanate (MDI), toluene diisocyanate (TDI) and polyether, and the polyurethane systems based on them that are offered in the market are used, for example, in the production of mattresses, refrigerator insulations, automotive bumpers and shoe soles. Examples of applications for our polycarbonates, which we market under the Makrolon®, Bayblend®, Makroblend® and other trademarks, include housings for electrical appliances, CDs/DVDs, car headlamps, stadium roofs and water bottles for water dispensers. The Coatings, Adhesives, Specialties business unit manufactures raw materials for coatings and adhesives used in the automobile and commercial vehicle industries, and for adhesives used in footwear.

We market our products mostly through regional and local distribution channels, making increasing use of e-commerce platforms for order processing. We also work with trading houses and local distributors who are responsible for business with small customers. Major customers with global operations are serviced directly by our key account managers.