Overview & Investment Thesis:

- In our view, Bayer's business portfolio is uniquely positioned to take advantage of secular trends such as increase in world population, aging of the population and the resulting increasing need for food and healthcare; 65.9% (€3,030MM) of the Company's underlying EBIT is derived from their HealthCare business,17.1% (€787MM) is derived from the CropScience business and 17.0% (€780MM) is derived from the MaterialScience business.

- Unlike most large pharma companies, Bayer's healthcare business is very diversified with the top 5 drugs responsible for delivering only 43% of the pharmaceutical revenues or 27% of the Healthcare subgroup; diversification is also a strength in term of geographic distribution of the revenues, with 38% of the revenues being generated in Europe, 28% in North America, 19% in Asia Pacific and 15% in Latin America.

- Of significant note is the limited exposure to the U.S. markets where the on-going healthcare reforms are threatening the profitability of the drug manufacturers. On the contrary, Bayer enjoys an enviable position in terms of brand equity in a number of emerging countries, in particular China and Russia.

- Bayer has been leading the innovation in all business areas. The significant R&D commitments equal to 8.7% (€3.1 bn) of the revenues are paying results: over 20 projects are in phase III of the clinical trials while the CropScience business plans to introduce 6 more crop protection active ingredients to the market by 2012, representing an added sales potential of more than €1 billion. The anticoagulant Xarleto®, on the market in 2008, has been approved in over 75 countries and is being developed for a number of additional indications, showing signs of a blockbuster drug with peak sales of €2 billion as estimated by the Company.

- The healthcare industry has been reshaping with a number of mega mergers moving into the business integration stages over the past 3 years: Pfizer/Wyeth, Merck/Schering-Plough and Roche/Genentech. A number of other smaller deals are happening in the background. Bayer stands to grow its business as the main players are busy re-inventing themselves. With the assimilation of Schering complete (acquired in 2006), Bayer gives preference to smaller acquisitions, in particular in the Heathcare and BioScience (seeds) businesses.

Key Products:

Pharmaceuticals
- Betaferon®– Specialty Medicine – multiple sclerosis
- Kogenate® – Specialty Medicine – blood-clotting medication
- Nexavar® – Specialty Medicine - cancer
- Ultravist®/Magnevist® - Specialty Medicine - Imaging
- Mirena® – Women's Healthcare – hormone releasing device
- Yaz®/ Yasmin® – Women's Healthcare – oral contraceptives
- Adalat® – General Medicine – high blood pressure
- Avalox®/Avelox® – General Medicine – antibiotic
- Levitra® – General Medicine – erectile dysfunction treatment
- Aspirin Cardio® – General Medicine – myocardial infarction prevention
- Cipro®/Ciprobay® – General Medicine – antibiotic
- Glucobay® – General medicine – oral antidiabetic

Consumer Health
- Contour® – Medical Care – blood glucose meters
- Aspirin® – Consumer Care
- Aleve®– Consumer Care – analgesic
- Bepanthen® – Consumer Care – skincare
- One-a-Day® – Consumer Care – dietary supplements
- Supradyn® – Consumer Care – multi-vitamins
- Advantage® – Animal Health – flea, tick and worm control
- Baytril® – Animal Health – antibiotic

Crop Protection
- Folicur® – fungicide
- Flint® – fungicide
- Decis® – insecticide
- Confidor® – insecticide
- Basta® – herbicide/desiccant
- Puma® Super- herbicide

Business Description:

Bayer AG is a multinational concern with main interests in healthcare, agribusiness and high-tech materials through its Bayer HealthCare, Bayer CropScience and Bayer MaterialScience subgroups. The HealthCare segment provides pharmaceutical products in the field of women's healthcare, cardiovascular diseases, cancer and multiple sclerosis and consumer health products such as OTC medications, diabetes care and diagnostic products, nutritional supplements for humans and animals, as well as veterinary medications. The CropScience segment provides crop protection products including herbicides, fungicides, insecticides and seed treatment products, as well as public health products, plant biotechnology and conventional seeds. The MaterialScience segment provides polyurethanes, coatings, adhesives and polycarbonates. The Company, founded in 1863, employs 111,400 people globally and is headquartered in Leverkusen, Germany.

Industry Growth Drivers/Trends:

- In our view, both lifescience businesses are poised to grow - being lead by the overarching population trends. The HealthCare market is forecasted to grow at low to single mid digits in 2011 and faster afterwards (2012), with better performance in the Consumer Health segment (mainly OTC medication) than in Pharmaceuticals, still under significant regulatory pressure, while the CropScience is expecting at least mid single digit overall growth, mainly on volume improvements, which is suspected to be sustained into 2012, as per company management. While we believe the short term outlook to be encouraging, we are confident in the long term growth of the two lifescience divisions.
- The MaterialScience division and its specialized materials centered on environmental friendly solutions is a low cost, in demand, option to 'green' buildings, for wind power and for fuel efficient vehicles - as the global economy is recovering. The global economic recession which has affected all the aspects of economic life, has been particularly harsh on MaterialScience. Volumes have been drastically reduced in polyurethanes and polycarbonates, however prices are stable and the Company's internal efficiency has enabled the division to stay profitable. As certain regions, in particular the emerging markets in Asia, showed a strong rebound in activity, the MaterialScience division recovered with price improvements and robust volume growth, being a key earnings before interest and tax (EBIT) contributor in the fiscal 2010. The subsector continues to be on an ascendant path, with significant capacity additions being planned for all the business segments, in particular in China and Germany.

Competitive Advantages:

- Diversified healthcare portfolio is an effective market risk tool while allowing for growth in a market upturn.
- Strong product pipeline ensures business continuity on key markets and provides leadership opportunities.
- Strong balance sheet not affected by recent acquisitions provides opportunity for organic growth and allows for flexibility in the market place.

Competitors:

- **Europe**: Roche, Novartis, Sanofi-Aventis, Syngenta, BASF.
- **US**: Merck, Pfizer, Dow Chemical, DuPont, Johnson & Johnson, Procter & Gamble, Monsanto.
- **Rest of the World**: Takeda, Daiichi Sankyo, CSL.
- **HealthCare**: Roche, Novartis, Sanofi-Aventis, Merck, Pfizer, Johnson & Johnson, Procter & Gamble, Takeda, Daiichi Sankyo, CSL.
- **CropScience**: Syngenta, BASF, Dow Chemical, DuPont, Johnson & Johnson, Monsanto.
- **MaterialScience**: BASF, Dow Chemical, DuPont.

Barriers to Entry:

- **High Initial Capital Outlays**: Besides the very high requirements to develop new molecules, the manufacturing capacities are not easily scalable.
- **Regulatory Barriers**: The pharma industry is heavily regulated and drug developing cycles take a long time. The crop protection products have also expensive and time consuming developing cycles.

Customers:

- Bayer distributes its products through a multitude of super market chains, retailers, drugstores, pharmacies and hospitals, specialized distributors, as well as directly to end users.

Officers and Directors:

Leadership team: Chairman, Dr. Marijn Dekkers; CFO, Werner Baumann; Innovation, Technology & Environment, Dr. Wolfgang Plischke; Strategy & HR, Dr. Richard Pott.

Corporate Governance:

- **20 member board** – of which 13 are external, the Chairman of the Supervisory Board and the Chairman of the Management Board functions are separated.
- The Company scores above average (6) in the Governance Metrics International (GMI) Overall Global rating and also in the Institutional Shareholder Services Corporate Governance Quotient (ISS CGQ) Index (58.8) and ISS CGQ Industry (52.2).
- Bayer is a member of World Business Council for Sustainable Development since 1997, a member of Dow Jones Sustainability World Index and FTSE4Good Index.
- Bayer is a member of the Climate Disclosure Leadership Index and is a founding member of the Global Compact initiative of the UN.
- The Company has issued a sustainability report since 2004 using the Global Reporting Initiative (GRI) guidelines and the reports are audited by independent consulting firms.
- The value of the group level executive compensation was the equivalent of 0.6% of the operating income (adjusted EBIT) of the company.

Ownership:

Insiders own less than 1.0% of the outstanding shares.
Institutions own 34.95% of outstanding shares. Notable holders include: Blackrock Asset Management 5.03%, Capital Research Global Investors 3.0%, Dodge & Cox 1.96%, Union Investment Group 1.30%, and Allianz Global Investors, 1.08%.

Capital Allocation/Uses:

Bayer management's chief concerns are maintaining and improving its credit rating (targeting "A") and preserving its financial flexibility. Below is a list of actions the Company recently undertook or envisions in order to achieve its goals:

- Bayer reduced its net debt position in the 2010 fiscal year to €7.9 bn from the €9.7 bn level at the end of 2009, primarily due to an improvement in the operating cash flow, as the funds tied up in working capital were reduced by a substantial €1 bn.
- The Company is planning annual cost savings of €800 mm by 2013, with about half of this amount being earmarked for re-investment in the business. The cost of the program is estimated at about €1 bn, all to be spent by the end of 2012.
- The Company's capital expenditure came in slightly above €1.5 bn for the fiscal 2010, while for the current fiscal year, the company budgeted roughly €1.8 bn. Research and development expenditures are expected to match the 2010 level of €3.1 bn.
- A dividend payout of 30%-40% is targeted going forward. The Company declared a €1.50/share dividend and it paid out €1,240 mm in dividends to the shareholders for the fiscal year 2010. The dividend is 7% higher than the 2009 dividend level and it marks the 8th consecutive year that the Company increased or maintained its dividend level.

Business Segments:

	Revenues (%)		Operating Profit	
Business Mix	2009	2010	2009	2010
Pharmaceuticals	34.9	32.2	51.7	44.0
Consumer Health	18.4	17.7	25.5	21.9
Crop Protection	18.1	16.2	22.4	13.1
Environment, Science, Bioscience	3.6	3.9	3.6	4.1
Material Science	25.1	30.0	(3.2)	17.0

	Revenues (%)		Operating Profit	
Geographic Mix	2009	2010	2009	2010
Europe	41.6	39.2	61.8	47.8
North America	24.7	23.4	18.2	11.4
Asia Pacific	18.3	21.3	11.5	27.4
Latin America/Africa	15.3	16.0	8.5	13.4

Financial Statement Summary: (€MM, years ended December 31)

Income Statement	2008	2009	2010
Total Revenue	32,918	31,168	35,088
Normalized EBIT	8,884	6,017	5,696
Normalized Net Income (continuing ops)	2,386	1,916	2,545
Normalized Fully diluted EPU (continuing ops)	2.89	2.32	3.07
Return on Equity (continuing ops)	20.07%	15.64%	18.36%
Balance Sheet			
Net Debt	13,814	9,486	7,747
Common Equity	16,263	18,897	18,833
Net Debt: Common Equity	84.94%	50.20%	41.14%

Key Profitability Ratios and Figures:

Y/E December 31	2008	2009	2010
Operating Margin	27.0%	19.3%	16.2%
Interest Coverage	2.5x	2.9x	3.8x
Return on Equity (continuing ops)	20.1%	15.6%	18.4%
S&P Credit Rating	A-	A-	A-

Sourced from Thomson Reuters and 2010 Annual Report.

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