COMBINED MANAGEMENT REPORT

**Combined Management Report
of the Covestro Group and Covestro AG
as of December 31, 2015**

- All targets achieved: sales and profitability increase
- Free operating cash flow at record level of €964 million
- Adjusted EBITDA increases by 41.3% to €1,641 million
- Sound financing: repayments reduce net indebtedness by €1.9 billion
- Successful working capital management contributes to improved cash flow
- Outlook for 2016: further growth, free operating cash flow at a high level and ROCE above cost of capital

FUNDAMENTAL INFORMATION ABOUT THE GROUP

1. Corporate Structure

Corporate profile

Covestro is among the leading global suppliers of high-tech polymer materials and application solutions for many areas of modern life.

Covestro AG, headquartered in Leverkusen, Germany, was established on August 20, 2015, and is the parent company of the Covestro Group. The Board of Management of Covestro AG manages the operational businesses and defines and monitors corporate targets. In line with its product portfolio, Covestro is divided into three operational segments: Polyurethanes, Polycarbonates and Coatings, Adhesives, Specialties. They are supported by central functions.

Since October 6, 2015, the company has been listed in the Prime Standard on the Frankfurt Stock Exchange. It holds all the shares in Covestro Deutschland AG (formerly Bayer MaterialScience AG), which, until September 1, 2015, was a wholly-owned subsidiary of Bayer AG and the management company of the MaterialScience subgroup. By way of an agreement made between Bayer AG and Covestro Deutschland AG on August 24, 2015, the corporate functions and human resources were transferred to Covestro Deutschland AG effective September 1, 2015.

On September 18, 2014, Bayer AG, Leverkusen, announced its intention to place the business operations of Bayer MaterialScience in a stock corporation and to place shares of this company on the stock exchange. As of December 31, 2015, Bayer AG held 69% of the shares in Covestro AG and the free float was 31%.

Organizational structure and sites

Covestro has a presence at 30 sites worldwide. The company's eight largest production sites with world-scale facilities are in Germany (Brunsbüttel, Dormagen, Krefeld-Uerdingen and Leverkusen); Belgium (Antwerp); China (Shanghai); Thailand (Map Ta Phut), and the United States (Baytown). Additionally, there are a number of smaller sites providing individual support and tailor-made solutions for customers. The company also operates research laboratories, technical service centers and sales offices.

Business model

Covestro's innovative products are used in key sectors such as the automotive, construction, wood processing and furniture, sport and leisure, and electrical and electronics industries. The core portfolio mainly comprises raw materials for polyurethane foams, the high-tech plastic polycarbonate and raw materials for coatings, adhesives and sealants, as well as specialty products such as special films and elastomers. Covestro also manufactures important chemical by-products such as chlorine, styrene, sodium hydroxide solution and hydrochloric acid. Covestro operates in predominantly consolidated areas of the global polymer industry, which are characterized by stable structures and high entry barriers including high capital expenditure requirements, substantial innovation pressure and the need for a world-spanning presence. Differentiation is achieved by means of product and process innovations as well as the ability to develop customer-specific solutions.

Growth in the polymer industry is driven by factors such as the demand for energy-efficient mobility, sustainable buildings, comfort and convenience, a higher standard of living, and inexpensive and long-lasting materials. As a result, independent experts are forecasting that Covestro's products will see growth rates above the average for the global economy in the period between 2014 and 2020.

Covestro's end markets are largely cyclical in nature. Among the factors affecting our activity are economic development and the disposable incomes of end consumers. However, the degree of cyclicality varies between markets and regions.

Please see Chapter 21 „Opportunities and Risks Report" for other external factors.

Polyurethanes segment

In the Polyurethanes (PUR) segment, Covestro primarily produces toluene diisocyanate (TDI), diphenylmethane diisocyanate (MDI) and polyether polyols, all of which are precursors for polyurethanes and are subject to ongoing optimization. Flexible variants of polyurethane foam are used in products such as mattresses, upholstered furniture and car seats, thus making day-to-day life more comfortable. One of the applications of rigid polyurethane foam is as an efficient insulating material for buildings and refrigeration appliances. It thus contributes to reducing energy consumption. Covestro also markets thermoplastic polyurethanes for use in diverse product groups such as clothing, mobile electronic devices and sports equipment.

With a production capacity of 3.5 million tons in 2015, Covestro is the leading supplier of raw materials and systems in the global polyurethanes industry. In terms of this indicator, the company is the top-ranking producer of TDI and the second-largest manufacturer of MDI and polyether polyols. Production is spread across 18 facilities in Europe, the United States and Asia. In addition, the company has 12 systems houses for formulating and supplying customized polyurethane systems.

State-of-the-art processes ensure a high level of efficiency, safety and environmental compatibility. At the end of 2014, a new world-scale TDI plant was commissioned at the Dormagen, Germany, site. Thanks to Covestro's proprietary gas-phase technology, the last stage in the process uses up to 80% less solvent and 60% less energy than conventional processes.

Polycarbonates segment

The Polycarbonates (PCS) segment develops, manufactures and markets the high-performance plastic of the same name. This is particularly light, highly transparent, very robust and heat resistant; it can also be molded and colored in any way. Available as granules, composite materials and semi-finished products, the material is used in a wide variety of end products such as vehicles, buildings, electrical, electronic and household appliances, medical equipment and optical data storage media.

With an annual production capacity of 1.3 million tons, Covestro was one of the two leading suppliers of polycarbonate in 2015. The company has a total of five world-scale production facilities in Europe, the United States and Asia. Polycarbonate-based blends, composite materials and sheets are manufactured at other sites.

Covestro deploys efficient processes in the manufacture and use of this plastic. Melt condensation, for example, reduces specific electricity consumption by an average of around 20% compared with conventional processes. The specific wastewater volume is around 60% lower.

Coatings, Adhesives, Specialties segment

The Coatings, Adhesives, Specialties (CAS) segment develops, manufactures and markets mainly polyurethane-based raw materials for coatings, adhesives, sealants and specialties. Covestro is the world's leading supplier in this field. These materials include polymers and aqueous dispersions based on hexamethylene diisocyanate (HDI) and isophorone diisocyanate (IPDI), which are produced in facilities around the world. The main areas of application for CAS products are automotive and transportation, infrastructure and construction, wood processing and furniture. The materials serve to protect, bond, seal or functionalize a wide variety of surfaces, making them more resistant to weathering, stone chipping and abrasion or protecting them against corrosion. The segment's specialties include elastomers, high-quality films and raw materials for the cosmetics, textile and medical products industries.

Covestro is the leading supplier of aliphatic and aromatic isocyanates and their derivatives, polyurethane dispersions and thermoplastic films. Most of this segment's versatile products are manufactured in three large-scale facilities in Europe, the United States and Asia, supported by nine customer-focused technical service centers.

Covestro also works to develop new technologies, for example using bio-based raw materials. In 2015, for example, a new component for polyurethane coatings was introduced for which 70% of the raw materials are derived from biomass that does not compete with food production.

2. Strategy

Achieving long-term profitable growth is Covestro's primary goal and the foundation of its corporate strategy. Firstly, we are implementing coordinated measures in our quest to share in the growth predicted for our customer industries in the future. Secondly, the company is systematically focused on sustainability and innovation and on the continuous optimization of production and cost structures. We are pursuing this approach in all areas of the company.

Utilizing the growth potential of the polymer industry

According to independent experts, Covestro's customer industries will grow faster than the global economy in the years ahead. We see macro trends such as climate change, the diminishing availability of fossil resources, the expanding global population, urbanization and increasing mobility as the main drivers of growth. Through our products and solutions, we aim to help master these challenges in line with our vision: "To make the world a brighter place."

Focus on sustainability

Sustainability is one of our main priorities. Through our business activities, we aim not just to create economic value by growing profitably, but also to help protect the environment and achieve progress in society. This holistic approach defines operations along the entire value chain – from the procurement of raw materials through production, distribution and sales, to the use of our products and their disposal or recycling.

In particular, we firmly believe that the safety, health and satisfaction of our employees are as crucial to long-term success as the responsible use of nonrenewable resources. In this connection, we are endeavoring to find alternatives to the petrochemical derivatives we use and to diversify our raw material base. Covestro continuously reviews its production processes to identify reusable materials and works to achieve reductions in its specific CO_2 emissions and specific energy consumption. The safety of our production processes is a key priority for us and we aim to maintain our very positive safety record in the future as well. In this way, we are fulfilling central requirements specified by our customers.

Innovation as a core element

Through focused research and development, we aim to maintain and expand our position in the global competitive arena. Our activities are aimed at enhancing the performance of our products, developing solutions for new applications and improving production and business processes. To this end, we work closely with our customers and end users as well as with scientific partners.

Please see Chapter 7 "Research, Development and Innovation" for further information.

Efficient production

In order to sustainably improve profitability, we are continuously working to increase the efficiency of individual facilities while maintaining the highest technological standards with respect to safety, reliability and environmental compatibility.

Competitive costs

Covestro is continuously working to improve efficiency and effectiveness across the company and thus ensure competitive cost structures. It is our goal to rank among the cost leaders in our industry sector. We aim to achieve this, for example, by the further and consistent optimization of our service functions and the IT infrastructure and by streamlining the sales organization at segment level.

Covestro continuously reviews the structure of its production base. In the past year, for example, we closed the MDI production facility in Belford Roxo, Brazil. We also intend to discontinue MDI production in Tarragona, Spain, by the end of 2017. Moreover, in the polycarbonate sheet business, we have consolidated individual production sites and activities in several countries in recent years. In the polycarbonate sheets business, we will continue to review our cost structures.

Polyurethanes segment

In the Polyurethanes segment, Covestro is seeking to use its MDI and TDI production capacities to participate in the above-average growth in demand for polyurethanes. We are aiming to accelerate growth through broad participation in strategically important core markets and areas of application that are as yet not fully served.

Moreover, with a view to increasing efficiency, Covestro is constantly examining additional opportunities for collaborating with other companies and for further optimizing production plants and sites. As the segment mainly offers standardized products, cost management, innovation and business model development are of great importance.

Polycarbonates segment

With its extensive applications expertise and global focus, the Polycarbonates segment is in a good position to benefit from the demand for polycarbonates, which is also growing at an above-average pace.

Covestro is seeking to further extend its technological leadership in polycarbonates, particularly with a view to growing in high-end customer and application segments. Innovative fiber-reinforced composite materials are one focus here. At the same time, the segment is optimizing its production processes in order to maintain its cost leadership.

Coatings, Adhesives, Specialties segment

In the Coatings, Adhesives, Specialties segment we aim to secure and build our position in the main area of business: the production of raw materials for coatings and adhesives. To this end, we are working to achieve the highest possible level of vertical integration, customer-centric innovation and selective capacity expansions. In the specialties business, we are targeting accelerated growth on the basis of our extensive technological expertise and our formulation know-how, which allow us to develop new applications.

3. Internal Management System

One of the prime objectives of the Covestro Group is to steadily increase enterprise value. In order to plan, steer and monitor the development of our business, we use steering parameters which enable a comprehensive and holistic evaluation of the company's business performance. Covestro measures economic success in terms of growth, profitability and contribution to cash flow. We use core volume growth[1] as an indicator of growth. In 2015, for the first time, profitability was measured by the return on capital employed (ROCE). Adjusted EBITDA is used as an additional indicator of profitability. The contribution to cash flow is assessed using free operating cash flow (FOCF). Since the start of fiscal 2016, core volume growth, return on capital employed and free operating cash flow have been integral elements of all planning, management and control processes.

The growth of the Covestro Group is measured by the increase in core volume growth because this indicator, in contrast to sales, is less influenced by raw material prices or currency effects and excludes the company's noncore businesses.

The return on capital employed is the indicator used to assess the profitability of the Covestro Group. This measures the return the company achieves on the capital it uses and is then compared with the weighted average cost of capital (WACC), which is the minimum return expected by equity and debt capital providers. If ROCE is greater than WACC, then the company has created value. Adjusted EBITDA (earnings before interest, taxes, depreciation and amortization) is the other indicator used to assess the profitability of Covestro and its reporting segments. This is a meaningful indicator of operating performance since it is not affected by depreciation, amortization, impairment losses, impairment loss reversals or special items. It is intended to give a clear picture of the results of operations which is comparable over time. The ability to generate a cash surplus is measured by FOCF. This is an indicator of our company's capacity to finance itself and is calculated by subtracting outflows for property, plant and equipment and intangible assets from the operating cash flow. A positive FOCF serves in particular to pay dividends and interest and to repay debt.

Please see Chapter 8 "Integrated Sustainability Management" for further information about the alignment and management of Covestro's sustainability strategy.

[1] Core volume growth refers to the core products in the Polyurethanes, Polycarbonates and Coatings, Adhesives, Specialties segments. It is calculated as the percentage change from the prior year in externally sold volumes in thousand tons. Covestro also takes advantage of business opportunities outside its core business, for example the sale of raw materials and by-products such as hydrochloric acid, sodium hydroxide solution and styrene. These transactions are not part of the company's core business.

4. Procurement

Our procurement function ensures the timely, global supply of goods and services at suitable market conditions, in the required quality and in accordance with Covestro's ethical, ecological and social standards. The principles of our procurement policy are set down in a directive that is binding on all employees throughout the Covestro Group.

In 2015, goods and services were procured from some 15,100 (2014: some 14,100) suppliers in 69 (2014: 68) countries for approximately €8.2 billion (2014: €8.7 billion) and recorded in the Group-wide reporting system.

Main procurement products

The main precursors for our products are petrochemical substances such as benzene, toluene, phenol and acetone. In addition to petrochemical feedstocks, the operation of our production facilities also requires large amounts of energy, mostly in the form of electricity and steam.

In 2015, strategic raw materials accounted for a procurement spend of €2.4 billion (2014: €3.0 billion). This is equivalent to approximately 45% of our total expenditures for raw materials and energies in 2015, which amounted to around €5.3 billion (2014: €5.8 billion).

Procurement spends in Germany, the United States and China accounted for just under 78% of Covestro's global procurement spend in 2015. Most of this amount – around 77% – was accounted for by local suppliers in the individual countries.

Procurement at Covestro is centrally steered and managed by the Procurement unit.

Important raw materials are procured on the basis of long-term supply agreements and an active supplier management to minimize procurement risks such as supply shortages or substantial price fluctuations. In steam and electricity generation, we aim for market-based price indexing, a diversification of fuels and a mix of external procurement and captive production to minimize the price fluctuation risk for energies. Regular sustainability and quality audits of our suppliers ensure compliance with internal and external standards.

Covestro is seeking to reduce its dependence on petroleum-based raw materials and is developing specific substitution processes. In 2016, for instance, the company plans to start producing and marketing pentamethylene diisocyanate (PDI), an isocyanate based on a renewable raw material.

Sustainability in supplier management

Covestro regards adherence to sustainability standards within the supply chain as a crucial factor in value creation and also an important lever for minimizing risks. For this reason, we apply not just economic standards but also social, ethical, environmental and governance standards in selecting new suppliers and in our continuing relationships with existing suppliers. These standards are defined in Covestro's Supplier Code of Conduct, which is available online in 13 languages and provides the basis for collaboration. The Code is derived from the principles of the U.N. Global Compact and our Human Rights Position. It is integrated into electronic ordering systems and contracts across the Covestro Group. Furthermore, relevant new and renewed supply agreements contain special clauses requesting suppliers to observe the sustainability requirements contained in the Code of Conduct and entitling Covestro to monitor their compliance.

Covestro (deriving from its past as Bayer MaterialScience and part of the Bayer Group) is one of the six founding members of Together for Sustainability (TfS), a joint initiative of the chemical industry with a current membership of 16 companies that aims to harmonize the assessment and auditing of suppliers worldwide. Covestro supports the TfS principles concerning the areas of ethics, employee rights, health and safety and the environment, as well as the associated management systems.

In order to consistently drive sustainability in supplier management, Covestro has set ambitious targets. By 2020, we plan to evaluate all strategic suppliers and those suppliers with significant Covestro spend that are regarded as potential high-risk suppliers with respect to sustainability-relevant aspects. Another objective of our collaboration in the TfS initiative is the development and establishment of a new sustainability standard for the chemical industry.

Evaluating the sustainability performance of our suppliers

Covestro regularly verifies compliance with the specified sustainability standards through online assessments and on-site audits of suppliers. The assessments are carried out on Covestro's behalf by the established provider EcoVadis, which is accredited by TfS. Suppliers receive a web-based, modular questionnaire with accompanying verification documents that result in 360° screening. They are assessed in the areas of environmental protection, working conditions, social responsibility, fair business practices and sustainable procurement. Covestro conducts the on-site supplier audits – based on the TfS sustainability criteria – together with external, independent auditors accredited by TfS. In addition, our own procurement specialists and auditors monitor suppliers' performance in the areas of health, safety, environmental protection and sustainability. In 2015, 146 assessments of Covestro suppliers were performed by EcoVadis, in addition to eight audits. These include assessments initiated by Covestro and others shared via TfS (see www.covestro.com for further information).

In selecting the suppliers for these assessments, we consider a combination of country and material risks as well as strategic importance in accordance with our Group targets. The country and material group risk scales we use for our risk analysis are provided by EcoVadis.

Additionally, TfS members can exchange comparable, independent and high-quality supplier assessments and audits using a dedicated IT platform. In 2015, within the scope of the TfS initiative, a total of 2,580 supplier assessments were carried out by EcoVadis and 179 audits were successfully completed in countries including China, India and Brazil.

All online assessments and audits are comprehensively analyzed and documented so that – should results be unsatisfactory – specific improvement measures can be defined together with the suppliers. The corrective measures established together with the suppliers in 2015 mainly related to the areas of environmental protection, occupational safety and fair business practices.

In 2015, critical results were recorded for three suppliers (2% of those assessed), prompting Covestro to implement measures ranging from specific action plans to reducing its spend. In the reporting year, Covestro had no cause to terminate a business relationship because the assessment revealed an unsatisfactory sustainability performance or a serious sustainability deficit.

Training measures and dialogue on the issue of sustainability

Comprehensive understanding of the significance of sustainability in the supply chain is also important for our own procurement specialists. Covestro therefore provides Group-wide training to help them implement our sustainability requirements. Close collaboration is essential in enabling suppliers to successfully comply with Covestro's sustainability requirements. For them too, we offer a range of training and dialogue opportunities as the basis for building reliable relationships that enable us to identify and eliminate any obstacles to collaboration at an early stage.

For instance, the Supplier Days held by the global procurement functions are an important platform for dialogue at which Covestro's procurement specialists and suppliers can meet in person to discuss sustainability.

Supplier development and dialogue are also a particular focus of the aforementioned TfS initiative, which offers extensive supplementary information material and online training courses on its website.

Verification of management processes

All the processes discussed here are described in standard operating procedures and are incorporated in Covestro's management system. They are subject to ongoing review and continuous improvement and are regularly verified and certified on a global basis by both internal and external audits.

Further information about supplier assessments can be found on our website at www.covestro.com.

5. Production

Covestro operates a number of production sites in Europe, Asia and the United States, eight of which are world-scale production facilities that serve particularly to ensure efficient and reliable supply across national borders. The company also maintains dozens of smaller and more flexible technical centers around the world that offer customers individually tailored solutions. In this way, Covestro achieves a balance between highly efficient world-scale facilities and customer proximity – evidenced by short lead times, flexible service and competitive product offerings. Through extensive capital investment, Covestro has in recent years established state-of-the-art production facilities, thereby strengthening the company's long-term competitiveness. In its production operations, Covestro continues to pursue the ambitious goal of achieving and further expanding leadership positions in terms of volumes, quality, efficiency and safety. Innovative and environmentally friendly production processes are employed to ensure the ongoing technological optimization of the company's facilities. Selectively backwards-integrated production processes enable Covestro to procure critical raw materials such as chlorine and propylene oxide from within the company or through joint ventures so as to reduce the dependency on external supply sources.

Sites

The company's eight largest production sites with world-scale facilities are in Germany (Brunsbüttel, Dormagen, Krefeld-Uerdingen and Leverkusen); Belgium (Antwerp); China (Shanghai); Thailand (Map Ta Phut), and the United States (Baytown).

Key Production Sites

Site	Main activity
Leverkusen, Germany	Production for Coatings, Adhesives, Specialties; technical laboratories; chlorine production
Krefeld-Uerdingen, Germany	Production for Polycarbonates and Polyurethanes (MDI); chlorine production; CO facility
Dormagen, Germany	Production for Polyurethanes (TDI, polyether polyols) and Coatings, Adhesives, Specialties; chlorine and nitric acid production
Brunsbüttel, Germany	Production for Polyurethanes (MDI); chlorine production
Antwerp, Belgium	Production for Polyurethanes (polyether polyols) and Polycarbonates
Baytown, U.S.A.	Production for all segments (MDI, TDI, Polycarbonates, Coatings, Adhesives, Specialties); chlorine production
Shanghai Chemical Industry Park, China	Production for all segments (MDI, TDI, Polycarbonates, Coatings, Adhesives, Specialties); chlorine production
Map Ta Phut, Thailand	Production for Polycarbonates and Coatings, Adhesives, Specialties

Alongside these world-scale facilities, we operate production plants in selected countries that include systems houses where we formulate and supply customized polyurethane systems, as well as plants where we compound polycarbonate granules to meet specific customer requirements or manufacture semi-finished products (polycarbonate sheets). Additionally, the company operates regional production facilities for derivatives of the Coatings, Adhesives, Specialties segment and for polycarbonate and thermoplastic polyurethane films.

Quality management

Covestro has very high expectations when it comes to the quality of the raw materials it uses and sets standards for their processing into high-tech plastics and polymer precursors. A quality management system has been implemented for this purpose that is certified to the international standard ISO 9001. In terms of total energy consumption, 99.97% of Covestro's reporting production and nonproduction sites worldwide are certified. They are regularly evaluated in internal and external audits.

Capital expenditures for property, plant and equipment

We invest continuously in our global production network in order to maintain our production facilities and their infrastructure, to optimize manufacturing processes and to expand capacities in line with profitable growth. Following the significant expansion of our capacities in recent years, we plan to reduce our levels of investment through 2020 and focus on maintaining and improving existing production facilities.

In the reporting year, cash outflows for capital expenditures totaled €509 million and were primarily used in maintaining and optimizing production facilities and in ongoing expansion for Polycarbonates and Coatings, Adhesives, Specialties. The principal strategic capital expenditures for property, plant and equipment in the operational reporting segments during the past two years are listed in the following table.

Strategic Capital Expenditures by Segment

Segment	Description
Capital expenditures 2015:	
Polyurethanes	• Construction of a production line for CO_2-based polyols in Dormagen, Germany
Polycarbonates / Coatings, Adhesives, Specialties	• Continuation of capital expenditure projects from 2014 (see below)
Capital expenditures 2014:	
Polyurethanes	• Completion of capacity expansion for MDI in Shanghai, China • Completion of a world-scale production facility for TDI using gas phase technology in Dormagen, Germany
Polycarbonates	• Doubling of polycarbonate production capacity in Shanghai, China
Coatings, Adhesives, Specialties	• Doubling of HDI (aliphatic isocyanate) production capacity in Shanghai, China

6. Distribution and Logistics

Covestro has a regional distribution and marketing structure. Each operational reporting segment manages the distribution and marketing of its products, both through its own distribution organization and through trading houses and local distributors which are primarily responsible for business with small customers. Major customers with global operations are serviced directly by our key account managers. The sale and marketing of certain chemical by-products, such as hydrochloric acid, are managed centrally within the Covestro Group whereas the sale of other by-products, for example styrene, is the responsibility of the respective operational segment.

In marketing our products through regional and local distribution channels, three regional Supply Chain Centers for the EMLA, NAFTA and APAC regions serve as the central interface to customers. This is where all information streams come together – from order acceptance to dispatch planning, delivery and complaint acceptance. This organization enables us to process orders particularly smoothly and swiftly. We make use of channels such as e-commerce platforms for handling orders. Our customers can check the status of their orders at any time through the Order@Covestro online information platform.

In order to ensure a high level of customer satisfaction, error-free distribution is our foremost quality target. Customer satisfaction worldwide is systematically analyzed. To this end, we regularly evaluate customer complaints that are entered and processed in a global management system. We also request feedback from our customers from which we derive corrective and preventive measures in order to further increase quality and customer satisfaction and thereby lower the error rate and the incidence of complaints. In 2015, a total of 5,178 complaints from around 2,088 customers worldwide were recorded. This is a rate of 7.61 complaints per 1,000 deliveries, about the same as in 2014 (7.75 complaints per 1,000 deliveries).

Responsible business practices in sales and marketing

In the marketing of our products, we also take into account all the requirements of Covestro's directive on responsible sales and marketing. The importance of observing antitrust law and preventing corruption is regularly emphasized in training programs, internal communications and discussions with management. In 2015, export control and conflicts of interest were a particular focus of our training measures. Worldwide, 4,981 Covestro managers took part in web-based compliance training and supplementary face-to-face training for specific target groups.

Transportation

The transport of our products to customers is handled by logistics service providers that are selected and evaluated according to stringent safety, environmental and quality criteria. Alongside the protection of people and the environment, delivery reliability is particularly important. The preferred mode of transport is by rail or intermodal – in other words using a combination of different modes of transport. When selecting the mode of transport, we also consider resource efficiency and seek to minimize associated CO_2 emissions. Customers are supplied from close-to-production warehouses, wherever permitted by transport times and delivery reliability. In the case of longer distances, goods are temporarily stored in regional distribution centers and then dispatched at short notice.

7. Research, Development and Innovation

Research and development (R&D) are core elements of Covestro's corporate strategy so that the company can maintain and build on its own competitive position. We continuously work to evolve and improve our products and our manufacturing, processing and business procedures. Our continuous innovation process is managed uniformly and effectively across the company. In this way, we ensure that our ongoing projects and our project pipeline satisfy the current and future needs of our customers and user industries and ultimately the consumer markets.

The focus is on maintaining existing applications and developing more high-end uses. Other priorities are improved product performance, design flexibility, cost-reducing production processes and sustainability, whereby the company also endeavors to find alternatives to petrochemical raw materials.

Research and development expenses rose in 2015 by 21.2% to €257 million.

In 2015, around 1,000 people worked in Covestro's global research and development network, many of them at major innovation centers in Leverkusen, Germany; Pittsburgh, United States; and Shanghai, China. Through its global presence, Covestro is able to respond to regional market trends and customer requirements.

Alongside the company's close cooperation with customers and users, collaboration with external scientific institutions, start-ups and academic spin-offs is also very important. These collaborations are mainly based in Germany, the United States, China and Japan. Covestro's partners in Germany include RWTH Aachen University, while in China the company maintains a close alliance with Tongji University, and in the United States supports research activities at renowned universities.

Polyurethanes segment

In the Polyurethanes segment, our developments include new materials such as microcellular foams for insulating buildings and refrigeration chains. We are also working to enhance the flame-retardant properties of polyurethane foams. Lightweight composite materials are a further focus. They have applications in the automotive industry, resulting in lower weight, greater productivity and improved comfort.

In the area of process development, we are progressing with the use of carbon dioxide as a new source of carbon in order to reduce dependence on petrochemical raw materials. In 2016, we aim to launch a novel CO_2-based polyol component for polyurethanes.

Polycarbonates segment

In the Polycarbonates segment we mainly develop products for the automotive, electrical and electronics industries with a view to reducing weight, improving energy efficiency and safety, and increasing design freedom.

One focus is lighting engineering, where we are seeking to advance LED technology. Light-emitting diodes require significantly less energy and last longer than traditional light sources. We have developed special materials for channeling, scattering and reflecting LED light and for discharging the generated heat. We are also working on the evolution of fiber-reinforced polycarbonate-based composite materials that can improve the performance especially of high-quality IT products and automotive components.

Coatings, Adhesives, Specialties segment

In the Coatings, Adhesives, Specialties segment we primarily develop polyurethane raw materials for high-performance coatings, adhesives, sealants and specialty products. One of our goals here is to access new potential applications and markets for our core products.

We are also working on solutions based on renewable raw materials. In 2015, for example, we launched an innovative curing agent for polyurethane coatings based on pentamethylene diisocyanate (PDI) for which 70% of the raw materials are derived from biomass that does not compete with food production.

We have also developed a thermolatent curing agent for automotive coatings that can be processed at significantly lower temperatures than standard products. This cuts energy consumption and shortens production times. For textiles and polyurethane synthetic materials, we offer a new generation of polyurethane dispersions that conserve natural resources and do not require the use of any organic solvents.

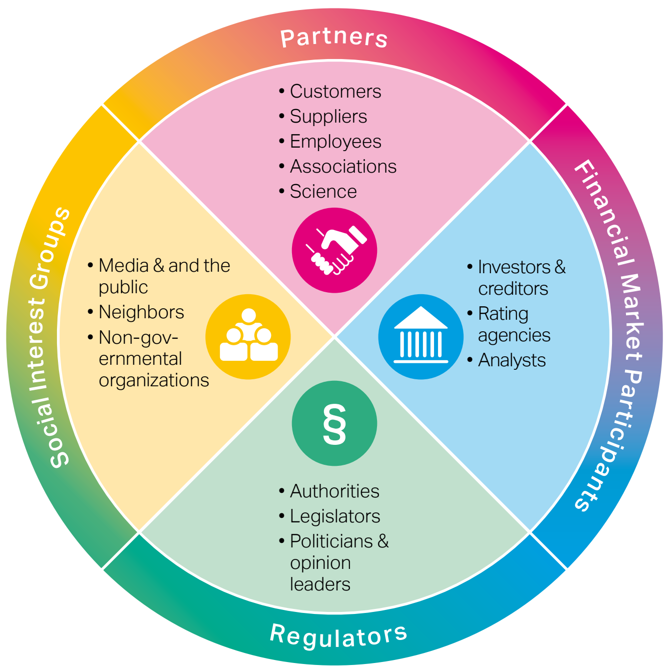
8. Integrated Sustainability Management

Sustainability is an element of Covestro's corporate strategy and underpins many of our activities in respect to our products, our processes and our conduct toward different stakeholders.

Social environment

As a commercial enterprise, Covestro is part of society – regionally, nationally and globally. Our stakeholders evaluate the company not only in terms of legal aspects but also with regard to our ethical behavior. For this reason, our business activities focus not only on commercial considerations but also on environmental and social factors. Evaluating stakeholders' interests and expectations provides significant impetus for the alignment of our business, our risk management and our reporting.

Covestro's Main Stakeholders



Integrating sustainability into corporate governance

By integrating sustainability into our corporate governance, we aim to help protect the environment, conserve our planet's limited resources, achieve progress in society and create value. These three objectives of people, planet and profit must be balanced at all times. They are the basis for our sustainability position, which applies in all our day-to-day working procedures.

A range of nonfinancial targets and indicators serves to ensure that our corporate strategy is implemented along the value chain and makes it measurable. When Covestro became independent in September 2015, we initiated a review of these targets. We expect to present an updated target program in the first half of 2016. In fiscal 2015, Covestro continued to apply the sustainability targets reported by the Bayer Group.

To underscore its identity as a sustainably operating company, in September 2015 Covestro signed up to the U.N. Global Compact and adopted its ten internationally recognized principles. We are also committed to the industry-led Responsible Care™ initiative and are involved in global sustainability forums such as the World Business Council for Sustainable Development (WBCSD).

The Chairman of the Board of Management and the head of Sustainability are responsible for developing and defining Covestro's corporate sustainability strategy. The Sustainability, Marketing and Sales Council (SMS Council), which is made up of representatives from the sales and marketing areas and the head of Sustainability, coordinates and optimizes individual strategies and targets.

The SMS Council also encompasses the segments and the three regions in which Covestro operates: EMLA, NAFTA and APAC. The Sustainability Community, which comprises the Sustainability department together with global and regional sustainability representatives from the segments, is responsible for implementation of the strategy. As the central coordinator of all Covestro's sustainability projects, the Sustainability Community drives and monitors targets and initiatives and supports the SMS Council. This integrated structure ensures that sustainability issues and projects throughout the orga-

Further information about Covestro's target program can be found on our website at www.covestro.com.

nization are optimized, communicated, reviewed and incorporated into day-to-day operations.

Alongside the Sustainability Community, the Health, Safety, Environment and Quality (HSEQ) Community is a further part of the organization. The task of developing and defining the HSEQ strategy lies with the Board member responsible for Industrial Operations, assisted by the HSEQ department which includes Product Safety and Regulatory Affairs. Targets, initiatives and management systems covering a range of issues are developed and defined in various HSEQ committees. Execution and monitoring in the business units and functions are the task of officers appointed by management who are responsible for occupational safety, environmental, energy and quality management. Support is provided by experts with responsibility for core issues such as process and plant safety.

Sustainability Management at Covestro

	Sustainability Community	HSEQ[1] Community
Direction and guidance for the sustainability strategy	• CEO • Sustainability department	• Chief Industrial Operations Officer • Central function HSEQ
Development and definition of targets and initiatives	Sustainability, Marketing & Sales (SMS) Council	Global Process Owner Council Quality, Environment & Safety Manager Meeting Safety Council
Implementation and monitoring in functions and business segments	• Segment sustainability officers • Regional sustainability representatives • Regional SMS teams	• Officers appointed by management for occupational safety, environmental, energy and quality management • HSEQ officers in business segments and regions

[1] Health, Safety, Environment and Quality

The sustainability principles are anchored in Group regulations. Appropriate management systems and processes ensure compliance with these regulations and their implementation in business operations.

The Group regulations include the Sustainable Development Policy and the Corporate Compliance Policy. Other regulations cover responsible lobbying, human rights and a Supplier Code of Conduct for governing the interaction with suppliers. HSEQ regulations deal with issues such as quality assurance, safety, environmental protection and waste management.

Core processes, which can be viewed by all employees on the Covestro intranet, set out clear rules and responsibilities for sustainability-related management processes, including product stewardship, environmental and energy management, and safety. Core processes are binding on all relevant areas of the organization. Compliance with our regulations and processes is regularly reviewed, for example, by means of internal and external audits whose findings are used in continuous management evaluations.

Material sustainability issues

We perform Group-wide analyses of stakeholders' expectations and requirements in order to identify at an early stage any opportunities and risks relevant to sustainability, along with key nonfinancial areas of activity, and to react to them.

The relevance for our external stakeholders regionally, nationally and internationally is determined using industry criteria from third parties such as the sector-specific sustainability indicators drawn up by the Deutsche Vereinigung für Finanzanalyse und Asset Management (DVFA) and the European Federation of Financial Analysts Societies (EFFAS) and the analysis of material issues produced by the Sustainability Accounting Standards Board (SASB). We also carried out a media analysis to identify relevant sustainability issues for Covestro. In addition, we plan in the future to involve our external stakeholders and proactively obtain their feedback for review purposes.

Compliance, innovation, employees, product stewardship, the reduction of greenhouse gas emissions, resource efficiency, energy management and safety have been identified as being of particular relevance. Our material issues are the basis for sustainability reporting, which is prepared in accordance with the international standard drawn up by the Global Reporting Initiative (GRI). They are applicable Group-wide and cover the issues of relevance to our stakeholders, which are described under "Social Environment."

More detailed information can be found in our Sustainability Reporting, which is available on our website at www.covestro.com.

9. Employees

Covestro's business success is based on the skills and commitment of our employees. Their curiosity in constantly searching out new solutions and their courage in leaving familiar paths are qualities that Covestro values in its employees and also seeks to find in new hires. The company's vision – To make the world a brighter place – serves to guide our employees in their day-to-day collaboration. This vision is closely tied to Covestro's three corporate values: curious, courageous and colorful.

The strategy at Human Resources (HR) is derived from Covestro's overarching corporate strategy. Efficient human resources management, expertise and customer-focused strategic advice form the basis of our services.

Present employee data

Employees per Corporate Function[1]

	Dec. 31, 2014	Dec. 31, 2015
Production	9,326	9,988
Marketing and distribution	3,566	3,528
Research and development	923	1,005
General administration	533	1,240
Total	**14,348**	**15,761**
Trainees	103	404

[1] The number of employees on either permanent or temporary contracts is stated in full-time equivalents, with part-time employees included on a pro-rated basis in line with their contractual working hours.

As of December 31, 2015, Covestro had around 15,800 employees worldwide. In fiscal 2015, headcount grew by 10%, mainly as a result of the separation from the Bayer Group. More than 1,200 new employees were hired worldwide. In addition, 404 trainees (2014: 103) worked at Covestro on the closing date.

Personnel Expenses and Pension Obligations

	2014	2015
	€ million	€ million
Personnel expenses	1,322	1,629
of which pension and social security contributions	251	310
Pension obligations[1]	1,395	1,462

[1] Provisions for pensions and other post-employment benefits as of December 31

In 2015, our personnel expenses amounted to €1,629 million (2014: €1,322 million). This increase was largely due to the expanded headcount, higher expenses for performance-related compensation and currency effects.

Recruitment

We are seeking to ensure that our company will remain in a position to attract skilled employees. In September 2015, a global campaign was launched to establish our new employer brand. It is based on our three corporate values and on the motto "WE MAKE the world a brighter place."

Our approach to the foreseeable consequences of demographic change differs from region to region. We are expanding measures to promote our employees' health and activities to recruit new people – especially promising career starters – as a means of safeguarding and transferring knowledge within the company.

Employees by Age Group as of December 31, 2015

	Women	Men	Total
Age in years			
< 20	1	8	9
20 – 29	561	1,324	1,885
30 – 39	1,284	3,138	4,422
40 – 49	967	3,562	4,529
50 – 59	625	3,588	4,213
> 60	89	614	703
Total	**3,527**	**12,234**	**15,761**

In keeping with our values, our corporate culture embraces diversity. We prize different ideas, experiences and viewpoints and support our employees on the basis of their individual strengths. We create an environment in which they can fulfill their potential. Through this culture we aim to appeal to potential new employees worldwide and to bind them to our company.

In our search for skilled employees, we focus on forward-looking human resources marketing in all the countries in which Covestro operates. For instance, we maintain close contact with leading universities in all regions in order to draw the opportunities offered by Covestro to the attention of students as early as possible. This enables us to selectively cover our recruitment needs.

Alongside our training programs, we offer school and university students an early insight into working for our company. Overall, Covestro provided around 346 demanding professional internships to university students around the world in 2015. We will sustain this commitment in the coming years in line with our needs.

Employee development in a high-performance culture

At Covestro we are convinced of the value of lifelong learning and build on individual development options. This is the only way to advance our company and to challenge and motivate our employees. We are seeking to create a high-performance culture characterized by effective communication, information, constructive criticism, the acceptance of errors and open feedback.

All our development programs and activities are guided by our corporate values. In the area of People Development, we have implemented a competency model with clearly defined core and leadership skills that serve as a reference in all fields of employee leadership. They ensure that supervisors and their reports speak the same language and apply uniform criteria in evaluating performance in everything from an interview to a Development Dialogue.

Based on corporate goals, employees and supervisors agree objectives. At the end of the fiscal year, they discuss the extent to which these objectives have been attained. In this way, they both also receive feedback from various perspectives on how well they have served our corporate goals.

In addition, employees and supervisors regularly engage in a Development Dialogue. This offers an opportunity for employees to discuss their personal strengths and development needs, career expectations and professional aspirations with their supervisors.

We aim to continue rolling out the Development Dialogue around the world and anchor it even more firmly in our high-performance culture.

Advancing specialist and leadership skills

Fostering employees' individual abilities, talents and strengths is a key factor for Covestro's success. We will achieve lasting success if we can create a working environment in which all employees can optimally apply their skills, contribute to innovation and thus safeguard our quality. That is why we actively encourage lifelong learning by our employees. Our aim is to empower them to broaden their knowledge and skills and keep up with the latest changes throughout their working lives. We provide optimal support for this learning process through our training and continuing education programs for all employees.

Direct dialogue with our employees is particularly important to us. It includes informing our staff promptly and extensively about any upcoming changes, in compliance with the applicable national and international regulations.

At the same time, we actively involve our employees in dialogue through a range of offerings and encourage open discussion. Employees from all levels, segments and sites around the world were also involved in evolving our corporate values.

Diversity and internationality

"Colorful" is one of Covestro's three corporate values and is an expression of the central role that diversity plays in our corporate culture. A large variety of backgrounds and competencies based on aspects such as different life experiences, educational backgrounds, talents, cultures and religions ensures a multicultural mix that fosters unconventional thinking, creative ideas and greater openness. And that is the lifeblood of an innovation-driven company such as Covestro.

Our activities in this area are brought together in our Diversity & Inclusion (D&I) program. Employees from all organizational units and functions around the world work together to develop global action plans for Covestro and to define the specific areas of responsibility.

Covestro employs people from 80 different countries. Of the members of the senior management level, in which 13 nationalities are currently represented, around 68% come from the country in which they are employed.

Work-life balance

Our employees' lifestyles are as diverse as they are. That is why Covestro offers a range of opportunities that enable them to balance professional interests with their private and family lives, going well beyond legal requirements in many countries. At our main sites in Europe, the United States and China, for instance, we offer solutions such as flexible working hours, part-time working and home office if this is compatible with operational requirements. In Germany, all employees are able to transfer salary and time components (converted into money) to a long-term account. The accumulated salary balance can be used at a later point in time for legally defined purposes such as caring for children or close relatives or pre-retirement leave.

Employee compensation and benefits

Covestro combines a base salary reflecting the duties of a position with performance-related compensation components and extensive additional benefits. In this way, we offer our employees working conditions that give them a high degree of security and reliability. We ensure that our compensation is internationally competitive. We also attach great importance not only to ensuring fair compensation for our employees worldwide but also to informing them transparently about the overall structure of their compensation.

At managerial level, the base salary is determined by uniform evaluation of all positions throughout the Group using the internationally recognized Hay method. We align our compensation with local market conditions in all countries. There is currently a uniform Group-wide, stock-based compensation program named Aspire for senior management. For members of senior management, an appropriate personal investment in Covestro stock is the prerequisite for participating in this program. In 2016, it will be replaced by a stock-based cash compensation program with four-year performance periods that is linked to the development of Covestro's share price.

Human rights and social responsibility

Covestro's social responsibility as a company and an employer is based on our corporate values and our unreserved commitment to supporting and fostering human rights in our sphere of influence.

In keeping with our human rights position, we pursue the goal of paying adequate salaries that ensure a suitable standard of living for our employees and their families.

Within the framework of Integrated Compliance Management (ICM), compliance risks are systematically identified and evaluated and compliance processes are defined. This also applies to the area of fair and respectful working conditions. If there are signs of violation, employees can contact their Compliance Officer at any time, anonymously if required. All suspected compliance cases are recorded worldwide in accordance with uniform criteria. That also applies to violations associated with working conditions. Any risks connected with legal disputes and litigations are published in Note 28 to the Consolidated Financial Statements.

Please see Chapter 24 "Compliance" for further information.

At Covestro, social responsibility includes ensuring safe working conditions which means creating an environment in which employees worldwide can work and move without fear. In 2015, the working conditions for around 54% of our employees worldwide were governed by collective or company agreements. The contractually agreed working hours of our employees did not exceed 48 hours per calendar week in any country.

At various country companies, the interests of the workforce are represented by elected employee representatives who have a right to receive information and / or be consulted on many personnel-related decisions. In Germany, Covestro practices codetermination in close collaboration with the trade unions and employers' associations. Our commitment to the collective bargaining agreements that apply to us, expressed in our membership of the relevant employers' associations, is coupled with an active codetermination policy at company level. There are employee representative bodies at all our sites in Germany. Respectful and open collaboration with these bodies is an essential element of our human resources policy.

Our sustainable human resources policy also includes ensuring a high level of social protection for our employees. As well as competitive compensation, we offer our employees numerous additional benefits. For example, nearly all our employees worldwide either have statutory health insurance or can obtain health insurance through the company. In 2015, Covestro expanded or improved the quality of the health benefits provided for employees in many countries. As of December 31, 2015, over 75% of the workforce had access to a company pension plan.

In addition, Covestro actively encourages awareness of healthy lifestyles, especially in view of the challenges facing us as a result of demographic change and the raising of the retirement age in many countries.

We have introduced workplace health management programs at all levels, which are consistently expanding offerings in this area in response to employee surveys. The intention is to ensure that employees have access to adequate and affordable health offerings such as sports programs, regular medical check-ups, help in overcoming illness and on-site medical care, varying across regions and localities. The nature and scope of the health promotion programs differ around the world depending on local circumstances and access to national health systems. In many places, the company's voluntary social welfare provision includes measures to prevent illness.

We want our employees to feel at home at Covestro from the outset, and offer them a modern working environment with a wealth of opportunities. We are determined to further improve what we do on an ongoing basis.

10. Product Stewardship

Product stewardship for Covestro means the comprehensive evaluation of health and environmental risks. It is imperative to minimize the risks our products present to health, safety and the environment throughout their life cycle – from research, production, marketing and use by the customer through to disposal. The safe application of our products has the highest priority for our company.

Transparent communication and the transfer of product safety information are important to ensure the safe handling and use of our products. For this reason, in addition to the legally required documentation, we also provide further safety information and offer corresponding training in line with the Global Product Strategy of the International Council of Chemical Associations (ICCA).

With a view to ensuring the safe handling of products, experts in all areas of the company work closely with customers, industry associations, distributors and the public. The aim is to ensure the effective communication and observance of health, safety and environmental information along the supply chain.

Management of product stewardship

Product stewardship involves both compliance with statutory requirements and voluntary commitment. Here, we also take into account the precautionary principle as explained in Principle 15 of the Rio Declaration of the United Nations and communiqué COM(2000) 1 of the European Commission.

The precautionary principle is a potential means of protecting consumers and the environment within the context of risk management. It may be applicable if, according to an objective and comprehensive scientific evaluation, material or irreversible harm to people and the environment may occur, but the risk of this cannot be established with sufficient certainty. In this, we follow the general principles of the European Commission for application of the precautionary principle. These are especially the proportionality of the measures taken, examination of the benefits and costs of all relevant options, and review of the measures taken in light of new scientific developments.

In particular, arbitrary decisions cannot be justified by invoking the precautionary principle.

We have established processes for addressing inquiries about product safety or indications of problems with our products. This feedback is systematically factored into our risk evaluation – as are the assessments of potentially hazardous substances by authorities and independent institutions.

As a contribution to the safe handling of chemicals, risk assessments are carried out applying recognized scientific principles such as those described by the ECHA (European Chemicals Agency) in its Guidance on Information Requirements and Chemical Safety Assessment.

Should the assessment or new findings reveal that it is not safe to use a certain chemical, we take the necessary steps to mitigate risks. Such measures can range from revised application recommendations through the withdrawal of support for a certain application to the substitution of a substance. In this case, a replacement substance must be sought whose manufacture is economically and technically feasible. The optimization of products and processes is basically a continuous task of the chemical industry. This is the basis of the REACH regulation (Registration, Evaluation, Authorisation and Restriction of Chemicals), and is also integral to our commitment to Responsible Care™. We are also actively involved in the further development of scientific risk assessment through our work in associations and initiatives.

International associations such as the European Chemical Industry Council, the International Council of Chemical Associations (ICCA) and the Organisation for Economic Co-operation and Development (OECD), as well as initiatives such as the European Centre for Ecotoxicology and Toxicology of Chemicals (ECETOC), are working to evolve the scientific assessment of chemicals, research new testing methods and monitor the implementation of statutory regulations. Covestro actively contributes to these efforts through its association activities. We are also involved in the Long-Range Research Initiative of the ICCA and endorse the goals of the World Health Organization (WHO) and EU action plans for improving health and the environment, for example with the further development of human biomonitoring through an alliance with the German Chemical Industry Association (VCI) and the German Federal Ministry of the Environment.

Implementation of regulations and voluntary programs pertaining to chemicals

We operate in accordance with the European chemicals regulation REACH. It affects all our activities as a manufacturer, importer and user. We have established Group regulations to adequately address the scope and complexity of the REACH requirements. The registration obligation under REACH applies irrespective of marketing activities for all substances that we produce or import in quantities of more than one metric ton.

Substances registered already are now being evaluated by the regulatory authorities. In the future, this could result, for example, in additional testing requirements, new risk management measures or inclusion in the authorization procedure.

A number of Covestro substances are also affected by the REACH authorization procedure, which restricts the use of particularly hazardous substances or can lead to their replacement or prohibition.

By 2020, Covestro intends to conclude the assessment of hazard potential for all substances used in quantities exceeding one metric ton per annum. In this way we exceed statutory requirements and are ensuring that substance assessments comparable to those established under REACH will also be applied at Covestro sites that are not subject to this European regulation. The relevant procedure is established in the Group Regulation “Substance Information and Availability.”

At the same time, we are implementing the Globally Harmonized System (GHS) for the classification and labeling of chemicals, which came into force in the European Union in 2009 and in the United States in 2015. The purpose of this regulation is to achieve a globally standardized system for classifying chemicals and labeling them appropriately on packaging and in material safety data sheets. We also require the same such declarations from our suppliers to ensure the availability of all relevant information concerning product safety, environmental compatibility and disposal.

Support for the Global Product Strategy

We also support the Global Product Strategy (GPS), a voluntary commitment by the chemical industry initiated by the ICCA. Its objective is to improve knowledge about chemical products, especially in emerging and developing countries, and thus increase safety in the handling of these products. The ICCA has established an information portal through which summarized details on products (GPS Safety Summaries) are made available. As part of this initiative, we are assessing substances we use. GPS is accessible at Covestro through the Product Safety First internet portal, and is available worldwide in seven languages. Through this website, we inform customers and other interest groups about our activities and product safety assessments.

A product safety assessment at Covestro takes place in several steps. First, chemicals that are subject to statutory regulations are identified and the corresponding regulation documented. We then examine our products in terms of their risk potential so as to provide a basis for the effective minimization of risks. Such steps can include proposals for technical measures such as protective clothing, or marketing restrictions. Finally, we produce the legally required material safety data sheets, technical information sheets and labeling for the chemicals. In this, we go beyond what is required and also compile these documents for chemicals that are not subject to this legal obligation. This process is applied for all product groups.

Substances that are the subject of public debate

With regard to substances that are the subject of public debate, Covestro is following the scientific discussion about the chemical bisphenol A (BPA), a feedstock for various plastics. Critics are concerned that health risks could result for users if traces of BPA are released from products. As documented by numerous scientifically valid studies, we are convinced that BPA can be safely used in its existing areas of application, particularly in applications involving contact with food. This assessment is consistent with evaluations by the authorities responsible for food safety in Europe, the United States, Australia, Japan and other countries. In cooperation with the PlasticsEurope association, we are working to make the discussion more objective based on all the scientific data. Covestro is itself actively involved in the debate, providing information to customers and the public.

Further information about the available scientific data can be found on our website at www.covestro.com.

11. Safety

Safety management and the continuous development of safety culture are a cornerstone of our corporate responsibility. In our work dealing with dangerous substances, we need the trust of society, the public and the authorities. All injuries and incidents we record are analyzed and evaluated in detail to enable appropriate measures to be put in place for the future. Preventing accidents and incidents in day-to-day work, when operating production facilities, and on work-related travel and transportation routes where people or the environment could suffer harm or damage has top priority for us. Responsibility for health, safety, environmental protection and quality (HSEQ) is thus directly assumed by the Board of Management. Our HSEQ activities are geared toward ensuring the occupational health and safety of our employees and contractors.

Management approaches to ensuring safety

An HSEQ policy and the associated regulations form part of Covestro's integrated management system, which defines globally applicable minimum requirements in line with internationally recognized standards such as OHSAS (Occupational Health and Safety Assessment Series) 18001.

In order to protect employees, suppliers and service providers and to ensure uninterrupted operations, we have defined detailed rules and regulations within the framework of global core processes. These cover the safety of production facilities and manufacturing processes, the reporting and analysis of accidents and environmental and transport incidents, health screening and occupational safety, and emergency management at Covestro. They are regularly reviewed by means of internal and external (certification) audits. The findings from these audits and any modifications to the management system they necessitate are included in regular management assessments. Within the context of a continuous improvement process, accidents and product releases are recorded and systematically evaluated in order to identify potential hazards and avoid them in the future. As a result, each core process is subject to ongoing monitoring. In 2015, this evaluation did not result in any changes to the management system.

Occupational health and safety

We record all injuries to Covestro employees and contractors requiring medical treatment that goes beyond simple first aid. Injuries to Covestro employees – both with and without lost workdays – are indicated by the Recordable Incident Rate (RIR). In 2015, this rate stood at 0.34 injuries per 200,000 hours worked (2014: 0.30), corresponding to 51 recordable incidents worldwide. This means that, in statistical terms, one recordable incident occurred for around every 588,000 hours worked. The corresponding value for contractors was 0.20 injuries per 200,000 hours worked (2014: 0.36)[2]. We recorded no accident-related fatalities in 2015.

As in previous years, we recorded very few sector-typical accidents involving contact with chemicals in 2015. The absolute number of injuries increased slightly. In order to prevent behavior-related accidents, Covestro is seeking to raise employee awareness through its Human Factor initiative. This teaches employees to derive the correct preventive measures from such accidents and near misses. The program was rolled out at all major sites in 2015.

In addition, as in previous years, Covestro invited all employees to submit their suggestions for the company's CEO Safety Award. All the ideas submitted were evaluated by an expert jury, which also included external safety specialists. The winners were presented with their awards by the Chairman of the Covestro Board of Management (CEO) Patrick Thomas.

Process and plant safety

We aim to ensure the safety of our processes and plants in a way that avoids unacceptable risks to our employees, the environment and our neighbors.

Within the context of continuously improving safety, we further optimized the training program for all Covestro employees who can influence process and plant safety in their professional environment. Comprising face-to-face and web-based training, the program addresses craftsmen and chemical technicians in the production facilities.

A globally standardized KPI for plant safety incidents, Loss of Primary Containment (LoPC), applies to all Covestro plants and is integrated into Group-wide safety reporting. LoPC refers to, for example, chemicals in amounts above defined thresholds leaking from their primary containers, such as pipelines, pumps, tanks or drums. We use the LoPC Incident Rate (LoPC-IR) to determine the number of LoPC incidents per 200,000 working hours in areas relevant to plant safety. In 2015, the rate was 0.68 (2014: 0.78).

The reporting level is set so low that even material and energy leaks that have no impact on employees, neighbors or the environment are systematically recorded and reported. This approach is in line with our commitment to maintaining the integrity of our facilities at all times.

Every LoPC incident as well as minor and near-miss incidents are carefully analyzed to determine their causes. The results of the cause analysis and the corrective measures taken are published Group-wide to improve employees' safety awareness.

Transportation safety

A Group Policy specifies how all transported materials must be handled in line with their hazard potential. Logistics service providers are selected following a defined procedure, and their fulfillment of safety and quality standards is regularly assessed. People are appointed in every organizational unit concerned to take responsibility for implementing the regulations.

[2] The figure for hours worked used to calculate the incident rate for contractors was based in part on estimates.

Covestro has drawn up a seven-point plan for transportation safety that focuses on the following topics: Behavior-Based Safety (BBS); transport risk assessment; learning from incidents; safety during unloading operations; service provider evaluation; training / interactive learning; sharing best practices. The Near Miss campaign launched at the start of 2015 is producing positive results. It encourages employees to report near-miss incidents as well, thus facilitating preventive action.

Environmental and transport incidents

In 2015, 13 incidents were reported of which 2 were classified as environmental incidents and 12 were classified as transport incidents. One incident fell into both categories.

We classify critical incidents during the transportation of our products as transport incidents. These are recorded according to specific criteria. Assessment is based on the leaked load and graded according to the volume and hazardous material class, personal injury and blocked transportation routes. We take into account both our own chemical transport movements and those we commission and pay third parties to perform on our behalf.

In 2015, Covestro recorded 12 transport incidents in relation to almost 800,000 units transported by road, rail, water and air.

We define environmental incidents as incidents which result in the release of substances into the environment. In line with our internal directive, we report such incidents for all sites operated by Covestro worldwide. Factors that determine whether there is a reporting obligation include, in particular, the nature and quantity of the substance, the amount of damage caused or any consequences for people and the environment. In accordance with our internal voluntary commitment, we report any leakage of substances with a high hazard potential from a quantity of 100 kg upward.

12. Environmental Protection

We are constantly working to lessen environmental impact and to develop innovative product solutions that support our customers in improving their resource efficiency and reducing emissions. Eco-efficient processes help to protect the environment and at the same time cut the costs associated with materials, energy, emissions and disposal.

Management approaches to implementing environmental requirements

For the operational implementation of this commitment, we have established an integrated management system and defined corresponding global minimum standards in the form of rules and regulations that comply with internationally recognized standards such as ISO 14001 (environmental management) and ISO 50001 (energy management).

Compliance with the relevant processes is regularly reviewed by means of internal and external (certification) audits. The findings from these audits and any modifications to the management system they necessitate are included in regular management assessments. As a result, each process is subject to ongoing monitoring. In 2015, this evaluation did not result in any changes to the global management system.

Energy consumption

Energy and material consumption and emission levels are highly dependent on production volumes.

In 2015, we reduced Covestro's total energy consumption by 0.9% to 58.5 petajoules although production volumes increased by 1.5%. Total equivalent primary energy consumption, calculated by translating all energy data into primary energy to achieve comparability, remained more or less at the prior-year level. Specific energy consumption, i.e. the total equivalent primary energy consumption for a given production volume, thus declined slightly compared with the previous year. This was attributable to our efficiency programs and the global STRUCTese™ energy management system, which will remain in place in the years ahead.

When recording energy consumption, we differentiate between primary energy consumption at our sites – mainly of fossil fuels for our own generation of electricity and steam – and secondary energy consumption that reflects the purchase of electricity, steam and refrigeration energy and the use of process heat. Primary energy consumption fell by 1.3% and secondary energy consumption by 0.8%.

Energy Consumption of Covestro

	2014	2015
Primary energy consumption for the in-house generation of electricity & steam (net, TJ)	7,439	7,345
Secondary energy consumption (net, TJ)	51,590	51,161
Total energy consumption (TJ)	**59,029**	**58,506**
Equivalent primary energy consumption[1] (TJ)	72,340	72,570
Production volume[2] (million metric tons)	13.0	13.2
Energy efficiency[3] (MWh / t)	**1.55**	**1.53**

[1] Sum of all individual energies used at our main production sites (responsible for more than 95% of our energy consumption), converted into primary energy
[2] All in-spec key products manufactured at our main production sites (responsible for more than 95% of our energy consumption)
[3] Quotient of equivalent primary energy and in-spec production volume at our main production sites

Greenhouse gas emissions

At Covestro, greenhouse gas emissions are caused mainly by the generation and consumption of energy. By constantly improving resource and energy efficiency, we can reduce both costs and emissions. We also offer market solutions aimed at protecting the climate and adapting to climate change.

Before Covestro was carved out of the Bayer Group on September 1, 2015, it already pursued ambitious targets as part of the Bayer Climate Program. For example, the company aims to cut its specific carbon dioxide (CO_2) emissions by 40% by 2020 and to improve its energy efficiency by 30% compared with 2005. In 2015, specific greenhouse gas emissions amounted to 0.421 metric tons of CO_2 equivalents per metric ton of product and energy efficiency was 1.53 mWh of primary energy equivalents per metric ton. These figures equate to reductions of 38.7% and 30.4%, respectively, compared with 2005. We have thus already achieved our energy efficiency target for 2020. The targets will be updated, probably in the first half of 2016, as part of our review of our sustainability targets.

More efficient production

We are reducing emissions at our own production facilities by increasing energy efficiency and by developing and utilizing new, innovative technologies.

Covestro developed STRUCTese™ (Structured Efficiency System for Energy) which has been introduced progressively since 2008 and compares actual energy consumption in production with the realistic potential optimum. In this way, production plants can be operated at their optimum, yielding average energy savings of 10%.

Energy efficiency projects derived from the STRUCTese™ energy management system result in annual reductions. Taking into account all sustainable effects achieved since the introduction of STRUCTese™ in 2008, these had amounted to 1.55 million mWh in primary energy consumption and 450,000 metric tons in CO_2 emissions by year end 2015. STRUCTese™ is now actively deployed in 58 energy-intensive production plants worldwide. The system is soon to be introduced in other facilities, including the aniline and nitrobenzene plants in Baytown, United States, which were acquired at the beginning of 2014.

In 2015, Covestro implemented projects that resulted in an overall reduction of 317,000 mWh in primary energy consumption and 109,000 metric tons in CO_2 emissions. Measures implemented within the context of STRUCTese™ accounted for 73,000 MWh of the reduction in primary energy consumption and 22,000 metric tons of the lower CO_2 emissions. The energy management system at all Covestro's German sites was successfully certified to ISO 50001 for the fourth time in 2015.

Direct and indirect greenhouse gas emissions

Covestro reports Group greenhouse gas emissions in line with the requirements of the Greenhouse Gas Protocol (GHG Protocol). Direct emissions from our own power plants, waste incineration plants and production facilities (corresponding to Scope 1 of the GHG Protocol) are determined at all production locations and relevant administrative sites. To calculate indirect emissions (corresponding to Scope 2 of the GHG Protocol), the energy consumption at a given production site is multiplied by its specific emissions factor, which corresponds to the individual electricity mix for the site, in line with the method specified by the GHG Protocol until 2015. If no specific factor is available, an average emissions factor is used, such as the one produced by the International Energy Agency (IEA).

Dual reporting was introduced in 2015 with the updating of the GHG guidelines for Scope 2. Indirect emissions must now be reported using both the location-based and the market-based method. The location-based method uses regional or national average emissions factors, while the market-based method takes into account the provider- or product-specific emissions factors. From 2015, in order to ensure comparability of the data, we will be reporting on the basis of the system used to date and in line with the new guidelines.

While direct emissions increased by 9.8%, indirect emissions declined by 1.1%. Relative to the production volume at our main sites, the specific volume of greenhouse gases was just below the prior-year level.

Group Greenhouse Gas Emissions[1]

	Million metric tons of CO_2 equivalents		
	Base year: 2005	2014	2015
Direct greenhouse gas emissions[2]	–	1.93	2.12
Indirect greenhouse gas emissions[3] (until 2014 calculated by the GHG Protocol method)	–	3.73	3.69
in accordance with the location-based method (GHG Protocol 2015)	–	–	4.99
in accordance with the market-based method (GHG Protocol 2015)	–	–	5.14
Total greenhouse gas emissions	**6.57**	**5.66**	**5.81**
Specific greenhouse gas emissions (metric tons of CO_2 equivalents per metric ton of production volume)[4]	0.687	0.423	0.421
Production volume (million metric tons)[5]	**8.9**	**13.0**	**13.2**

[1] Portfolio-adjusted in accordance with the GHG Protocol; financial control approach; GWP (Global Warming Potential) factors in accordance with the IPCC 2nd Assessment Report; no valid calculation of direct and indirect emissions possible for the base year
[2] In 2015, 78.3% of emissions were CO_2 emissions, 21.1% N_2O emissions, just under 0.6% partially fluorinated hydrocarbons and 0.02% methane.
[3] Typically, CO_2 in incineration processes accounts for more than 99% of all greenhouse gas emissions. We therefore base our calculation of indirect emissions on CO_2 only. The method previously used for this calculation has been applied here as it would not have been possible to produce a valid calculation of total emissions for the base year using the new guideline.
[4] Total greenhouse gas emissions (5.56 million metric tons of CO_2 equivalents in 2015) at the main production sites (responsible for more than 95% of our energy consumption) divided by the in-spec production volume
[5] All in-spec key products manufactured at our main production sites (responsible for more than 95% of our energy consumption)

Use of water and wastewater

The continuous availability of clean water is of elementary importance for humankind and industry. However, it is a challenge in many parts of the world. In addition to cooling water, the availability of clean water is essential for our production operations. We work to ensure that our water usage does not lead to local problems, i.e. water shortages.

Covestro regulates the efficient use of water in its HSEQ Policy (see Integrated Sustainability Management). We have used the Global Water Tool™ from the World Business Council for Sustainable Development (WBCSD) to screen all Covestro's environmentally relevant sites in terms of water scarcity. As a result, we identified sites whose location in water-scarce areas exposes them to particular risks in terms of water availability and quality. These sites are to establish water management with local targets by 2017.

Water consumption and usage

In 2015, total water consumption in the Group fell by 4.1% to 236 million cubic meters. Significant reductions were recorded at the sites in South Charleston, United States, and in Brunsbüttel and Uerdingen, both Germany. Production at the Anyer, Indonesia, site was discontinued.

Net Water Intake of Covestro

	2014	2015
Water consumption (million m³ p.a.)	246	236

81.8% of all water used by Covestro is once-through cooling water. This water is only heated and does not come into contact with products. It can be returned to the water cycle without further treatment in line with the relevant official permits. The total volume of once-through cooling water was 193 million cubic meters in 2015.

Wastewater

The total volume of process wastewater decreased by 8.1% in 2015. All wastewater is subject to strict monitoring and analysis before it is discharged into disposal channels. 82.2% of Covestro's process wastewater worldwide was purified at wastewater treatment plants (Covestro or third-party facilities). Following careful analysis, the remaining 17.8% was categorized as environmentally safe and returned to the water cycle.

Volume of Process Wastewater

	2014	2015
Volume of process wastewater (million m³ p.a.)	37	34

Waste and recycling

Systematic waste management minimizes material consumption and disposal volumes at Covestro. Safe disposal channels with separation according to the type of waste and economically expedient recycling processes serve this purpose. Production fluctuations, building demolition and refurbishment, and land remediation also influence waste volumes and recycling paths.

The total volume of hazardous waste generated was almost at the same level as in the previous year.

Hazardous Waste[1] Generated by Type of Disposal

	2014	2015
Total waste generated[2] (1,000 metric tons p.a.)	**110**	**110**
thereof removed to landfill	2	2
thereof incinerated	108	108

[1] Waste generated by Covestro only
[2] Definition of hazardous waste in accordance with the local laws in each instance

Recycling

Covestro supports the recycling and treatment of its materials, seeking to satisfy economic and environmental criteria and to comply with legal requirements. This is part of our sustainability strategy and our stance on the end-of-life product phase.

In its own production operations, too, Covestro uses material recycled from plastic waste. These kinds of high-quality secondary raw materials are used to manufacture certain grades of engineering thermoplastics, such as a flame-retardant plastic compound for television set housings that is produced using 30% material from recycled PET water bottles.

Furthermore, Covestro supports recycling through its involvement in associations such as PlasticsEurope and as a shareholder of BKV GmbH, the German industry's competence platform for plastics recycling. We also embrace PlasticsEurope's Zero Pellet Loss initiative, with the goal of preventing the loss of plastic pellets on the way from production to the finished article. In 2015, we pursued a range of measures in this connection. They included especially introducing further measures to eliminate potential sources of pellet loss, strengthening our employees' awareness of the issue, integrating the campaign in established HSEQ processes and working with PlasticsEurope to include external partners.

REPORT ON ECONOMIC POSITION

13. Economic Environment

Global economic growth in 2015 was at the level of the previous year and therefore below expectations. The U.S. economy fared better than had been anticipated at the start of 2015, posting stronger growth than the average for the past four years. However, development was very volatile, with widely differing growth rates in each quarter. The pace of growth in the European Union accelerated substantially in the first half of 2015 before weakening in the second half of the year. The positive effects of the weaker euro were partly canceled out by reduced demand in the emerging economies. There, the pace of growth slackened due in particular to recessions in the two major economies of Russia and Brazil. China continued to record a comparatively high, though weaker, rate of growth. Positive stimuli for the world economy came mainly from ongoing expansionary monetary policies in the industrialized countries and the drop in the oil price, which strengthened private consumption.

Economic Environment

	Growth[1] 2014	Growth[1] 2015
	%	%
World	**2.7**	**2.5**
European Union	1.4	1.8
of which Germany	1.6	1.5
United States	2.4	2.4
Asia	4.7	4.7
of which China	7.3	6.9

[1] Real growth in gross domestic product, source: IHS (Global Insight). As of January 2016

Slower growth in the global automotive industry in 2015 was attributable in particular to a temporary decline in demand in China. There, the automotive industry recovered in the fourth quarter thanks to a government subsidy program. Strong demand across all vehicle segments led to robust growth in North America and Western Europe. By contrast, demand in Latin America fell again, particularly in Brazil and Argentina.

Growth momentum in the global construction industry slackened slightly in 2015 compared with previous years. This was mainly due to significantly slower growth in China and negative growth in Latin America. In Western Europe, on the other hand, the construction sector continued its recovery; the North American market also saw ongoing positive development.

The global electrical / electronics industry posted robust but weaker growth in 2015. The slowdown affected the consumer electronics and household appliance segments in particular. Sales of notebooks, tablets and conventional cellphones fell and growth in demand for smartphones slowed yet remained in the double-digit range.

The global furniture industry posted slightly slower growth in 2015 than in the previous year; however, development overall was still positive. The ongoing recovery in the North American and European markets contrasted with negative growth in Latin America. In Asia, market growth slowed somewhat but remained positive due to the weaker economy, especially in China, and lower consumer spending in particular.

Economic Environments of Main Customer Industries

	Growth[1,2] 2014	Growth[1] 2015
	%	%
Automotive	3	2
Construction	3	2
Electrical / electronics	4	3
Furniture	4	4

[1] Covestro's estimate based on the following sources: LMC Automotive Limited, IHS (Global Insight), B+L, CSIL (Centre for Industrial Studies)
[2] Growth rate for construction in 2014 restated following change to calculation model. As of January 2016

14. Business Development

Covestro Group Key Data

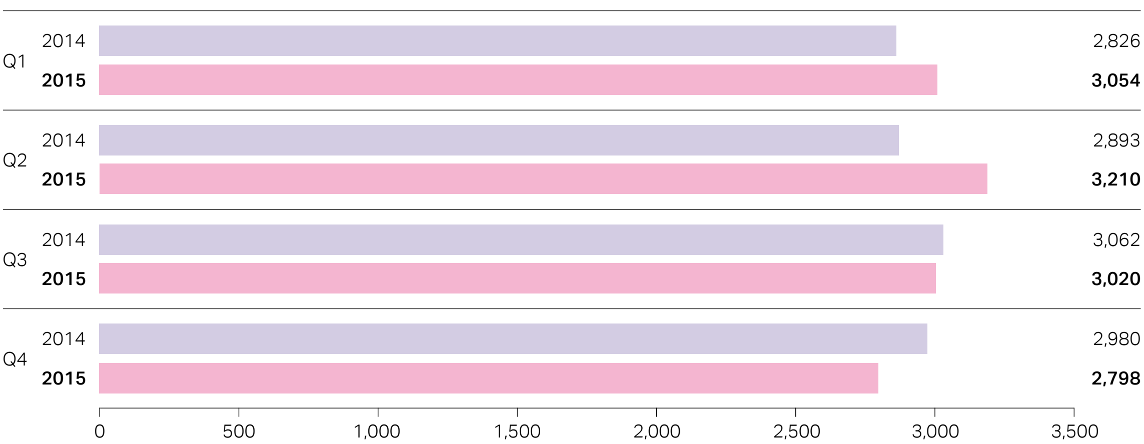
	4th quarter 2014	4th quarter 2015	Change	2014	2015	Change
	€ million	€ million	%	€ million	€ million	%
Sales	**2,980**	**2,798**	**–6.1**	**11,761**	**12,082**	**+2.7**
Change in sales						
Volume		+1.5%			+2.6%	
Price		–12.4%			–7.7%	
Currency		+4.8%			+7.8%	
Portfolio		0.0%			0.0%	
Core volume growth	**+1.9%**	**+3.3%**		**+4.8%**	**+2.7%**	
Sales by region						
EMLA	1,307	1,217	–6.9	5,493	5,357	–2.5
NAFTA	789	785	–0.5	3,022	3,356	+11.1
APAC	884	796	–10.0	3,246	3,369	+3.8
EBITDA	**188**	**132**	**–29.8**	**1,122**	**1,419**	**+26.5**
Adjusted EBITDA	**210**	**256**	**+21.9**	**1,161**	**1,641**	**+41.3**
EBIT	**28**	**(80)**	**.**	**517**	**680**	**+31.5**
Adjusted EBIT	**51**	**59**	**+15.7**	**561**	**942**	**+67.9**
Financial result	**(45)**	**(32)**	**+28.9**	**(136)**	**(175)**	**–28.7**
Net income	**(5)**	**(84)**	**.**	**272**	**343**	**+26.1**
Gross cash flow	**188**	**116**	**–38.3**	**1,016**	**1,155**	**+13.7**
Operating cash flow (net cash flow)	**414**	**550**	**+32.9**	**925**	**1,473**	**+59.2**
Cash outflows for capital expenditures	**239**	**157**	**–34.3**	**612**	**509**	**–16.8**
Free operating cash flow	**175**	**393**	**>100**	**313**	**964**	**>200**
Net financial debt[1]	**4,101**	**2,211**	**–46.1**	**4.101**	**2,211**	**–46.1**
ROCE				**6.2%**	**9.5%**	

[1] As of December 31, 2015 compared with December 31, 2014

Full year 2015

Fiscal 2015 was very successful for Covestro and the company achieved all its objectives.

Covestro Group Quarterly Sales



Group sales in 2015 increased by 2.7% against the prior-year period to €12,082 million (2014: €11,761 million). Volumes expanded in all three operational reporting segments. Currency effects also had a positive impact, which overall more than offset the decline in selling prices, especially at Polyurethanes. Selling prices were down on the prior year, mainly as a result of lower raw material prices.

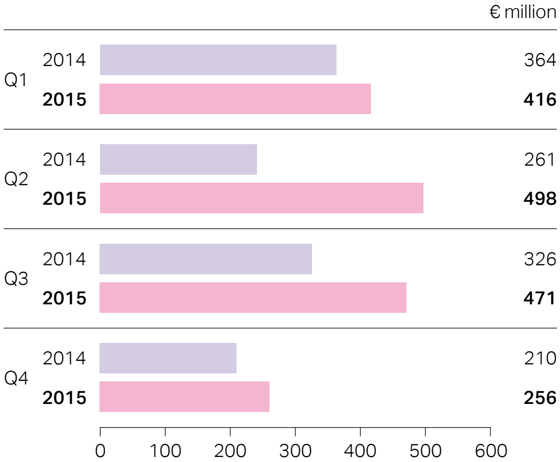
Sales in the Polyurethanes segment decreased by 3.1% to €6,088 million (2014: €6,282 million). The Polycarbonates segment raised sales by 12.4% to €3,172 million (2014: €2,822 million). Sales in the Coatings, Adhesives, Specialties segment advanced by 8.6 % to €2,093 million (2014: €1,928 million).

Growth of the Covestro Group is also measured in terms of core volume growth. The percentage increase in this parameter, in contrast to sales, is influenced less by raw material prices or currency effects and is therefore more suitable for assessing growth. From fiscal 2016, the Covestro Group will use core volume growth as a further significant key performance indicator for controlling the Group.

At Group level, the core volume increased by 2.7%. This was mainly attributable to the Polycarbonates segment, which posted strong growth of 5.2%. For the Coatings, Adhesives, Specialties segment, core volume growth was 2.7% and for the Polyurethanes segment 1.8%.

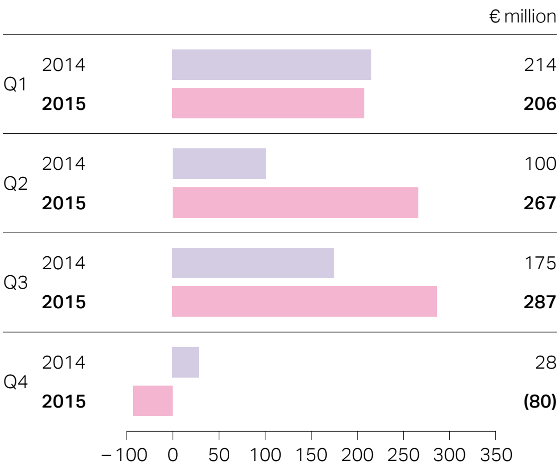
Adjusted EBITDA at Group level climbed by 41.3% in 2015 to €1,641 million (2014: €1,161 million). This was due to a more advantageous supply and demand situation along with expanded volumes, particularly at Polycarbonates. Currency effects of some €230 million also had a positive impact on earnings.

Covestro Group Quarterly Adjusted EBITDA



In the Polyurethanes segment, adjusted EBITDA rose by 5.4% to €624 million (2014: €592 million). The Polycarbonates segment more than tripled adjusted EBITDA to €560 million (2014: €160 million). Adjusted EBITDA for the Coatings, Adhesives, Specialties segment was €491 million, 12.4% higher than the prior-year figure of €437 million.

Covestro Group
Quarterly EBIT



In fiscal 2015, the Covestro Group improved EBIT by 31.5% to €680 million (2014: €517 million). Special items amounted to minus €262 million (2014: minus €44 million). They comprised special charges in connection with the consolidation of production sites as well as expenses for and proceeds from the stock market flotation of Covestro. Also included was reimbursement from Bayer AG for termination of the agreement on the joint use of Bayer trademarks. Adjusted EBIT came to €942 million (+67.9%; 2014: €561 million).

After a financial result of minus €175 million (2014: minus €136 million), income before income taxes climbed to €505 million (2014: €381 million). After tax expense of €153 million (2014: €104 million), income after income taxes was €352 million (2014: €277 million). After noncontrolling interests, net income amounted to €343 million (2014: €272 million).

Gross cash flow in fiscal 2015 rose by 13.7% to €1,155 million (2014: €1,016 million) and operating cash flow (net cash flow) by 59.2% to €1,473 million (2014: €925 million). This figure reflected income taxes paid (excluding amounts for accruals and provisions) of €194 million (2014: €73 million).

From fiscal 2016, the Covestro Group will use free operating cash flow as a further significant key performance indicator for controlling the Group. This parameter reflects the company's internal financing capability.

In 2015, free operating cash flow reached a record of €964 million (2014: €313 million).

Net financial debt was substantially reduced to €2,211 million (2014: €4,101 million). Cash inflows from a capital contribution and subsequent capital increase by Bayer AG and the net proceeds from the stock market listing at the beginning of October were used to repay loans from the Bayer Group.

Target Attainment 2015

Target Attainment 2015

	2014	Forecast 2015[1]	Target attainment 2015
External sales	€11,761 million	Slight increase	Increase by 2.7%
Core volume growth	+4.8%	Low-single-digit percentage growth	Increase by 2.7%
Adjusted EBITDA	€1,161 million	Substantial increase	Increase by 41.3%
Free operating cash flow	€313 million	Substantial increase	Increase by 208.0%

[1] Published in November 2015

2015 was therefore a very successful year for Covestro and the company achieved all the objectives it had set. Sales increased slightly by 2.7% in line with expectations. Core volume growth, at 2.7%, also confirmed our forecast. Both adjusted EBITDA – up 41.3% – and free operating cash flow, which tripled, exceeded expectations of a substantial increase.

Additionally, we earned a substantial premium on our capital costs in 2015. In fiscal 2015, Covestro determined profitability on the basis of the return on capital employed (ROCE[2]) for the first time. At 9.5%, ROCE was substantially higher than the capital costs of 7.2%.

In 2016, we will continue to measure Covestro's economic success on the basis of growth, profitability and cash flow contribution. To this end, core volume growth, return on capital employed and free operating cash flow became integral elements of all planning, management and control processes at the start of 2016. Covestro forecasts attainment of the target values for these indicators in 2016.

Please see Chapter 20. "Report on Future Perspectives" for further information.

[2]The return on capital employed (ROCE) is calculated as the ratio of adjusted operating result after taxes to capital employed. The capital employed is the capital used by the company. It is the sum of noncurrent and current assets less noninterest-bearing liabilities such as trade accounts payable.

14.1 Calculation of Adjusted EBIT(DA)

Alongside the key indicators of core volume growth, return on capital employed (ROCE) and free operating cash flow (FOCF), Covestro also determines adjusted EBIT and adjusted EBITDA. In order to facilitate a more accurate assessment of business operations, EBIT and EBITDA are adjusted for special items (see table). The special items comprise effects that are nonrecurring or do not regularly recur or attain similar magnitudes. EBITDA, EBIT, adjusted EBITDA and adjusted EBIT are not defined in the International Financial Reporting Standards and should therefore be regarded only as supplementary information. Adjusted EBITDA allows the comparison of operating performance over time since it is not affected by depreciation, amortization, impairment losses, impairment loss reversals or special items.

Depreciation, amortization and impairments for the full year 2015 increased by 22.1% to €739 million (2014: €605 million). They comprised €43 million (2014: €51 million) in amortization and impairments of intangible assets and €696 million (2014: €554 million) in depreciation and impairments of property, plant and equipment. The impairments reflect no impairment loss reversals (2014: €1 million). Impairments totaled €67 million (2014: €11 million), of which €40 million (2014: €5 million) was included in special items.

Please see Chapter 14.2 "Return on Capital Employed" for details of Covestro's value management system.

Special Items Reconciliation

	EBIT 4th quarter 2014	EBIT 4th quarter 2015	EBIT 2014	EBIT 2015	EBITDA 4th quarter 2014	EBITDA 4th quarter 2015	EBITDA 2014	EBITDA 2015
	€ million	€ million	€ million	€ million	€ million	€ million	€ million	€ million
Before special items	**51**	**59**	**561**	**942**	**210**	**256**	**1,161**	**1,641**
Polyurethanes	(7)	(102)	(9)	(175)	(6)	(85)	(8)	(137)
Polycarbonates	(15)	–	(29)	(2)	(15)	(1)	(28)	(2)
Coatings, Adhesives, Specialties	–	–	(5)	(9)	(1)	(1)	(2)	(7)
Others / Consolidation	(1)	(37)	(1)	(76)	–	(37)	(1)	(76)
Total special items	**(23)**	**(139)**	**(44)**	**(262)**	**(22)**	**(124)**	**(39)**	**(222)**
of which cost of goods sold	(9)	(98)	(19)	(197)	(8)	(84)	(18)	(157)
of which selling expenses	(10)	–	(15)	(1)	(10)	–	(15)	(1)
of which research and development expenses	3	–	2	(1)	3	–	2	(1)
of which general administration expenses	(2)	(38)	(4)	(131)	(2)	(37)	(4)	(131)
of which other operating income / expenses	(5)	(3)	(8)	68	(5)	(3)	(4)	68
After special items	**28**	**(80)**	**517**	**680**	**188**	**132**	**1,122**	**1,419**

14.2 Return on Capital Employed

Value management

The foremost objective of the Covestro Group is to steadily increase enterprise value. Value is generated if Group earnings exceed the cost of capital. Covestro uses the return on capital employed (ROCE) as the central value-based management metric.

Return on capital employed and value contribution

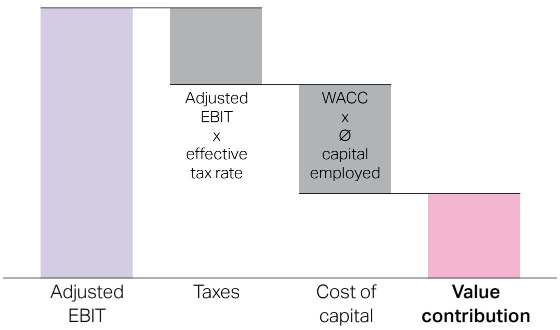
ROCE measures profitability and is calculated as the ratio of adjusted operating result (adjusted EBIT) after taxes (NOPAT= Net operating profit after taxes) to the average capital employed. Taxes are determined by multiplying the effective tax rate by adjusted EBIT. The capital employed is the capital used by the company. It is calculated from operating noncurrent and current assets less non-interest-bearing liabilities. Interest-free liabilities include, for example, trade accounts payable and current provisions. If ROCE exceeds the weighted average cost of capital (WACC), the company is earning a premium on its cost of capital.

Calculation of the Return on Capital Employed

$$\text{Return on capital employed (ROCE)} = \frac{\text{Net operating profit after taxes (NOPAT)}}{\text{Capital employed}}$$

The absolute value generation of the company is measured by the metric value contribution (VC). This is the difference between NOPAT and the cost of capital. The latter is calculated by multiplying the average capital employed by WACC. A positive VC means that value has been generated. At the beginning of 2016, ROCE as the main value management indicator became an integral part of all Covestro's planning, management and control processes.

Calculation of the Value Contribution



Calculating WACC

WACC reflects the expected return on the company's capital comprising both equity and debt. The cost of equity factor used in WACC is calculated by addition of the risk-free interest rate and the risk premium for an equity investment. We derive this risk premium from capital market information for comparable listed companies. The cost of debt factor is calculated by addition of the risk-free interest rate and a risk premium. Covestro uses the returns on long-term German government bonds as the risk-free interest rate. The risk premium is calculated from the financing costs for comparable companies. Calculation of WACC generally has a long-term perspective; short-term fluctuations are evened out. The capital cost factor for value management purposes for the Covestro Group in 2015 was 7.2%.

Covestro earned a premium on its capital costs in 2015. At 9.5%, ROCE was substantially higher than WACC of 7.2%. VC was positive at €159 million.

Covestro Value Management Indicators at a Glance

	2014	2015
	€ million	€ million
NOPAT	407	654
Average capital employed	6,525	6,883
WACC	6.9%	7.2%
ROCE	6.2%	9.5%
VC	(43)	159

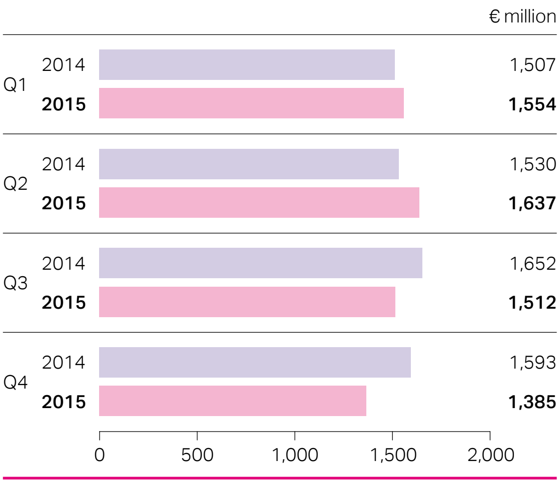
15. Business Development by Segment

15.1 Polyurethanes

Polyurethanes Key Data

	4th quarter 2014	4th quarter 2015	Change	2014	2015	Change
	€ million	€ million	%	€ million	€ million	%
Sales	**1,593**	**1,385**	**–13.1**	**6,282**	**6,088**	**–3.1**
Change in sales						
Volume		+2.7%			+2.1%	
Price		–20.0%			–12.4%	
Currency		+4.2%			+7.2%	
Portfolio		0.0%			0.0%	
Core volume growth	**– 0.9%**	**+4.9%**		**+3.9%**	**+1.8%**	
Sales by region						
EMLA	695	583	–16.1	2,866	2,631	–8.2
NAFTA	463	453	–2.2	1,817	1,956	+7.6
APAC	435	349	–19.8	1,599	1,501	–6.1
EBITDA	**95**	**(22)**	**.**	**584**	**487**	**–16,6**
Adjusted EBITDA	**101**	**63**	**–37.6**	**592**	**624**	**+5.4**
EBIT	**2**	**(157)**	**.**	**233**	**26**	**–88.8**
Adjusted EBIT	**9**	**(55)**	**.**	**242**	**201**	**–16.9**
Operating cash flow (net cash flow)	**194**	**407**	**>100**	**405**	**863**	**>100**
Cash outflows for capital expenditures	**94**	**80**	**–14,9**	**280**	**209**	**–25.4**
Free operating cash flow	**100**	**327**	**>200**	**125**	**654**	**>400**

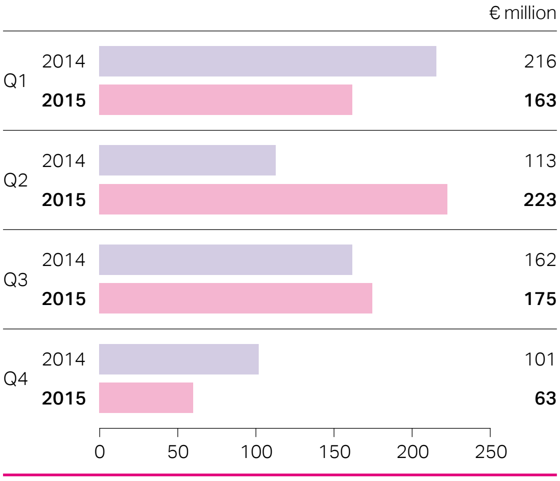
Polyurethanes Quarterly Sales



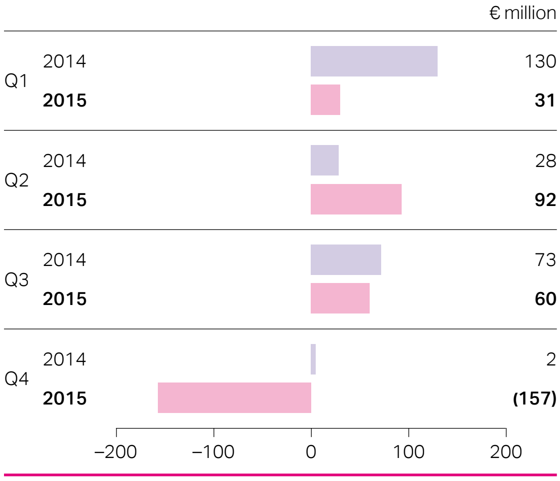
Sales at Polyurethanes for the full year 2015 declined by 3.1 % to €6,088 million. Exchange rate developments had a positive impact on sales.

Core volume growth amounted to 1.8 %. Higher volumes raised sales by 2.1 % overall. Volumes had a positive impact on sales in the TDI and polyether polyols product groups, and a slightly negative impact on MDI owing to lower noncore volumes. Volumes rose somewhat in EMLA, which was attributable in particular to expanded TDI capacities at the Dormagen production site in Germany. The increase in volumes in NAFTA was mainly the result of an expansion in sales of polyether polyols. In the APAC region, demand contracted slightly compared with a year earlier. This was mainly due to a reduction in polyether polyol volumes in connection with global margin optimization measures.

Polyurethanes
Quarterly Adjusted EBITDA



Polyurethanes
Quarterly EBIT



Selling prices at Polyurethanes were down 12.4% on the prior year. The decline in raw material prices was the principal cause of lower selling prices in the MDI, TDI and polyether polyols product groups across all regions. In the case of TDI, the lower price level was also attributable to increased competition owing to higher product availability.

In EMLA, sales declined by 8.2% to €2,631 million on account of lower selling prices at slightly higher margins. By contrast, NAFTA saw sales expand by 7.6% to €1,956 million. Favorable exchange rate developments and higher volumes offset the substantial price declines. Despite the positive impact of currency effects, sales in APAC decreased by 6.1% to €1,501 million. This was due to slightly lower volumes and a substantial drop in selling prices.

Adjusted EBITDA rose by 5.4% to €624 million (2014: €592 million). Alongside the improvement in earnings from currency effects, increased margins in the polyether polyols product group – particularly for the by-product styrene – had a positive impact in Europe. However, these effects were more than offset by slimmer margins for TDI. Maintenance costs were reduced to below the prior-year level as planned. Owing to Covestro's increased headcount and its successful business performance, the costs for performance-related compensation grew. In addition, prior-year earnings had been positively influenced by insurance reimbursements. These were lower in 2015.

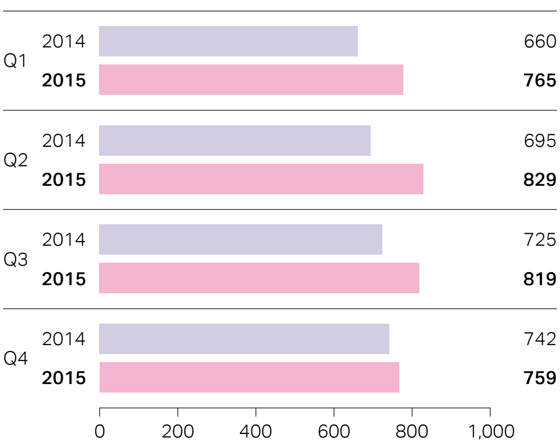
EBIT decreased by 88.8% to €26 million (2014: €233 million), reflecting special charges of €175 million for restructuring (2014: €9 million) relating particularly to the closure of the production site at Belford Roxo, Brazil, and the announced closure of MDI production in Tarragona, Spain, at the end of 2017.

15.2 Polycarbonates

Polycarbonates Key Data

	4th quarter 2014	4th quarter 2015	Change	2014	2015	Change
	€ million	€ million	%	€ million	€ million	%
Sales	**742**	**759**	**+2.3**	**2,822**	**3,172**	**+12.4**
Change in sales						
Volume		– 0.3%			+4.6%	
Price		– 3.9%			– 2.6%	
Currency		+6.5%			+10.4%	
Portfolio		0.0%			0.0%	
Core volume growth	**+8.5%**	**+0.8%**		**+9.0%**	**+5.2%**	
Sales by region						
EMLA	261	268	+2.7	1,065	1,134	+6.5
NAFTA	177	185	+4.5	646	765	+18.4
APAC	304	306	+0.7	1,111	1,273	+14.6
EBITDA	**18**	**122**	**>500**	**132**	**558**	**>300**
Adjusted EBITDA	**33**	**123**	**>200**	**160**	**560**	**>200**
EBIT	**(24)**	**70**	**.**	**(32)**	**374**	**.**
Adjusted EBIT	**(9)**	**70**	**.**	**(3)**	**376**	**.**
Operating cash flow (net cash flow)	**118**	**179**	**+51.7**	**186**	**328**	**+76.3**
Cash outflows for capital expenditures	**87**	**39**	**–55.2**	**210**	**190**	**–9.5**
Free operating cash flow	**31**	**140**	**>300**	**(24)**	**138**	**.**

Polycarbonates Quarterly Sales

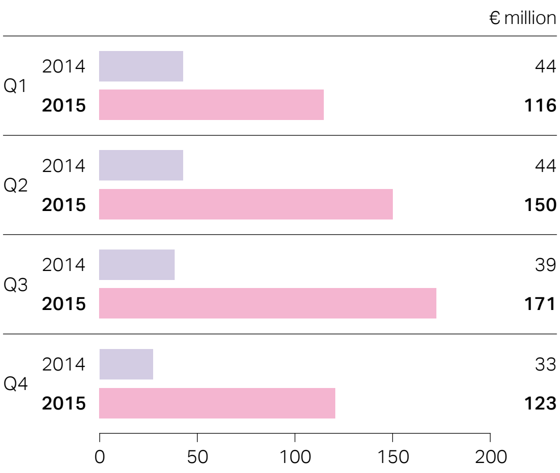


In the Polycarbonates segment, sales in fiscal 2015 rose by 12.4% against the prior year to €3,172 million (2014: €2,822 million). Shifts in exchange rates had a positive effect on sales.

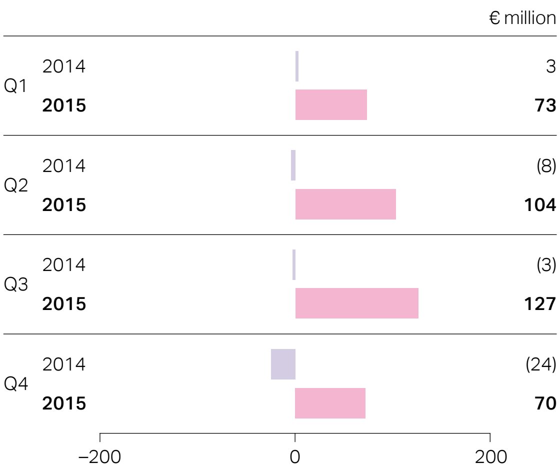
Core volume growth amounted to 5.2%. The expansion in volumes added 4.6% overall to sales. Sales improved in all three regions, due especially to higher demand from the automotive industry. In NAFTA, demand from the construction industry also expanded substantially. In APAC and NAFTA, in particular, volumes for intermediates were down on the prior year.

Selling prices decreased 2.6% overall compared with the prior year because of lower prices in NAFTA and APAC. This decline reflected the substantial drop in raw material prices. Selling prices in the EMLA region remained at the same level as 2014 despite the drop in raw material prices.

Polycarbonates
Quarterly Adjusted EBITDA



Polycarbonates
Quarterly EBIT



Sales in EMLA rose by 6.5% to €1,134 million, mainly on account of larger volumes. The NAFTA region improved sales by 18.4% to €765 million. Both the movement in exchange rates and volumes had a positive impact on sales, outweighing the effect of lower selling prices. Sales in the APAC region increased by 14.6% to €1,273 million as the result of positive currency effects and slightly larger volumes, which made up for price reductions.

Adjusted EBITDA for Polycarbonates more than tripled in 2015 to €560 million (2014: €160 million). This increase resulted from a more favorable supply and demand situation that enabled us to improve our margins as well as from currency effects and higher volumes. Owing to Covestro's increased headcount and its successful business performance, the costs for performance-related compensation grew.

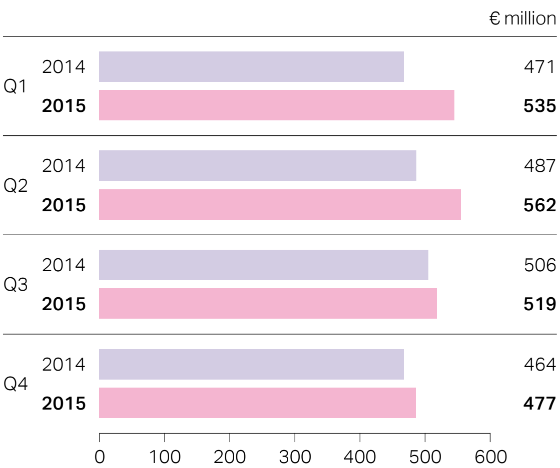
EBIT advanced very substantially to €374 million (2014: minus €32 million). This figure reflected special items of minus €2 million (2014: minus €29 million).

15.3 Coatings, Adhesives, Specialties

Coatings, Adhesives, Specialties Key Data

	4th quarter 2014	4th quarter 2015	Change	2014	2015	Change
	€ million	€ million	%	€ million	€ million	%
Sales	**464**	**477**	**+28**	**1,928**	**2,093**	**+8.6**
Change in sales						
Volume		0.0%			+2.1%	
Price		–2.2%			–1.1%	
Currency		+5.0%			+7.6%	
Portfolio		0.0%			0.0%	
Core volume growth	**+4.2%**	**+0.2%**		**+1.3%**	**+2.7%**	
Sales by region						
EMLA	230	229	–0.4	1,034	1,043	+0.9
NAFTA	99	112	+13.1	394	486	+23.4
APAC	135	136	+0,7	500	564	+12,8
EBITDA	**90**	**83**	**–7.8**	**435**	**484**	**+11.3**
Adjusted EBITDA	**91**	**84**	**–7.7**	**437**	**491**	**+12.4**
EBIT	**70**	**60**	**–14.3**	**354**	**397**	**+12.1**
Adjusted EBIT	**70**	**60**	**–14.3**	**359**	**406**	**+13.1**
Operating cash flow (net cash flow)	**103**	**155**	**+50.5**	**307**	**426**	**+38.8**
Cash outflows for capital expenditures	**49**	**38**	**–22.4**	**113**	**107**	**–5.3**
Free operating cash flow	**54**	**117**	**>100**	**194**	**319**	**+64.4**

Coatings, Adhesives, Specialties Quarterly Sales

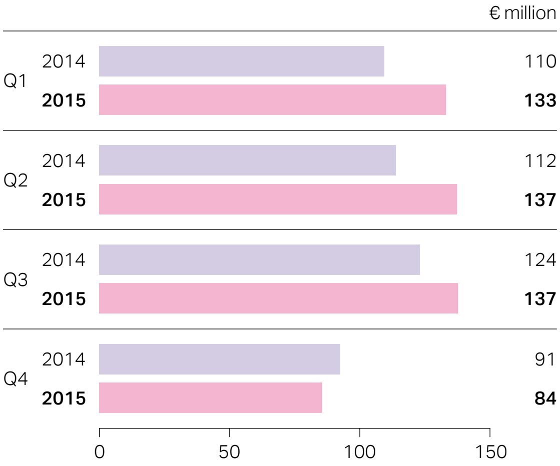


Sales at Coatings, Adhesives, Specialties for the full year 2015 rose by 8.6% to €2,093 million. This reflected positive exchange rate effects.

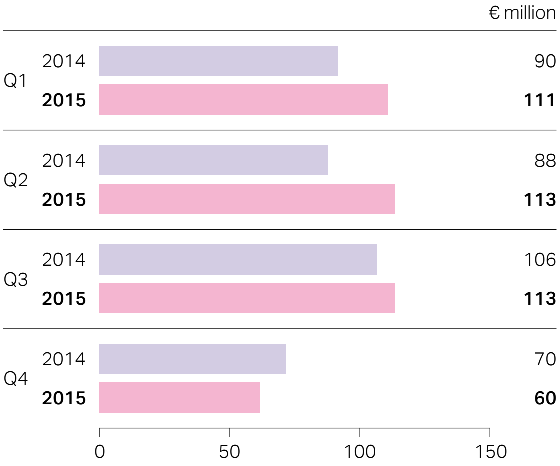
Core volume growth for the segment as a whole amounted to 2.7% on the prior year. Higher volumes raised sales by 2.1% overall, mainly due to volume growth in the NAFTA region. Volumes in EMLA and APAC rose slightly. Selling prices were 1.1% lower on average than a year earlier. This was due to a lower price level in APAC; the price level in NAFTA and EMLA remained stable.

Overall, sales in EMLA rose by 0.9% to €1,043 million due to slightly higher volumes and a stable price level. In NAFTA, the favorable development of exchange rates and higher volumes, along with stable selling prices, improved sales by 23.4% to €486 million. Sales in APAC increased by 12.8% to €564 million as a result of positive

Coatings, Adhesives, Specialties
Quarterly Adjusted EBITDA



Coatings, Adhesives, Specialties
Quarterly EBIT



exchange rate effects and slightly higher volumes coupled with lower average selling prices.

Adjusted EBITDA at Coatings, Adhesives, Specialties improved by 12.4% in 2015 to €491 million (2014: €437 million). Lower raw material prices had a positive impact. Currency effects and expanded volumes also contributed to earnings growth. Additional costs in connection with planned maintenance shutdowns and capacity expansions diminished earnings. Owing to Covestro's increased headcount and its successful business performance, the costs for performance-related compensation grew.

EBIT rose by 12.1% to €397 million (2014: €354 million), reflecting special items of minus €9 million for restructuring (2014: minus €5 million).

16. Earnings Performance

Covestro Group Summary Income Statements

	2014	2015	Change
	€ million	€ million	%
Sales	11,761	12,082	+2.7
Cost of goods sold	(9,609)	(9,438)	–1.8
Selling expenses	(1,097)	(1,257)	+14.6
Research and development expenses	(212)	(257)	+21.2
General administration expenses	(343)	(480)	+39.9
Other operating expenses (-) and income (+)	17	30	+76.5
EBIT	**517**	**680**	**+31.5**
Financial result	**(136)**	**(175)**	**–28.7**
Income before income taxes	**381**	**505**	**+32.5**
Income taxes	(104)	(153)	+47.1
Income after income taxes	**277**	**352**	**+27.1**
of which attributable to noncontrolling interest	5	9	+80.0
of which attributable to Covestro AG stockholders (net income)	**272**	**343**	**+26.1**

Group sales in 2015 grew by 2.7% to €12,082 million (2014: €11,761 million). Currency changes increased the functional costs of manufacturing, marketing, research and development, and general administration. Overall, the cost of goods sold declined by 1.8% to €9,438 million (2014: €9,609 million) due to lower raw material costs. The ratio of the cost of goods sold to sales thus decreased to 78.1% (2014: 81.7%). This figure included special items for restructuring measures of €197 million (2014: €19 million).

Selling expenses rose by 14.6% to €1,257 million (2014: €1,097 million), yielding a ratio of selling expenses to sales of 10.4% (2014: 9.3%). Research and development expenses increased by 21.2% to €257 million (2014: €212 million) for a ratio to sales of 2.1% (2014: 1.8%). These funds were mainly deployed in accessing new areas of application for our products and in optimizing process technologies and products.

General administration expenses rose by 39.9% to €480 million (2014: €343 million), which equates to a ratio of these expenses to sales of 4.0% (2014: 2.9%). The €137 million increase was primarily attributable to special items associated with restructuring measures amounting to €131 million (2014: €4 million). Other operating income exceeded other operating expenses by €30 million (2014: €17 million). The reason for this was a reimbursement from Bayer for termination of the agreement on the joint use of Bayer trademarks.

EBIT for the reporting year increased by 31.5% to €680 million (2014: €517 million), thus improving more strongly than sales. As a consequence, Covestro achieved a significantly higher EBIT margin of 5.6% (2014: 4.4%).

After a financial result of minus €175 million (2014: minus €136 million), income before income taxes rose by 32.5% to €505 million (2014: €381 million). Despite the increased income tax expense of €153 million resulting from higher earnings (2014: €104 million), net income after taxes and income attributable to noncontrolling interests was up by 26.1% to €343 million (2014: €272 million).

16.1 Calculation of Adjusted Earnings per Share

Core earnings per share is not a direct internal steering parameter. It is not defined in the International Financial Reporting Standards and should therefore be considered here as supplementary information.

Core earnings per share is determined by eliminating special items from net income to ensure comparability over time.

In 2015, core earnings per share amounted to €2.66 calculated from core net income of €538 million and 202,500,000 outstanding shares.

Adjusted Earnings per Share

	2014	2015
	€ million	€ million
EBIT (as per income statements)	**517**	**680**
Impairment losses / loss reversals on property, plant and equipment	7	67
Special items (other than amortization and impairment losses / loss reversals)	39	222
"Adjusted operating result"	**563**	**969**
Financial result (as per income statements)	(136)	(175)
Special items in the financial result	–	–
Income taxes (as per income statements)	(104)	(153)
Tax effects related to impairment losses / loss reversals and special items	(15)	(94)
Adjusted income after income taxes	**308**	**547**
Income after income taxes attributable to noncontrolling interest (as per income statment)	(5)	(9)
Adjusted net income	**303**	**538**
	Shares	Shares
Number of issued ordinary shares[1]	202,500,000	202,500,000
Adjusted earnings per share (€)	**1.50**	**2.66**

[1] As of December 31, 2015

17. Financial Condition

Covestro Group Summary Statements of Cash Flows

	4th quarter 2014	4th quarter 2015	2014	2015
	€ million	€ million	€ million	€ million
Gross cash flow	**188**	**116**	**1,016**	**1,155**
Changes in working capital / other noncash items	226	434	(91)	318
Net cash provided by (used in) operating activities (net cash flow)	**414**	**550**	**925**	**1,473**
Capital expenditures	239	157	612	509
Free operating cash flow	**175**	**393**	**313**	**964**
Net cash provided by (used in) investing activities	**(226)**	**(216)**	**(585)**	**(380)**
Net cash provided by (used in) financing activities[1]	**(37)**	**(147)**	**(192)**	**(645)**
Change in cash and cash equivalents due to business activities	**151**	**187**	**148**	**448**
Cash and cash equivalents at beginning of period	**36**	**424**	**37**	**201**
Change due to exchange rate movements and to changes in scope of consolidation	14	31	16	(7)
Cash and cash equivalents at end of period	**201**	**642**	**201**	**642**

[1] This line includes all financial transactions with Bayer Group companies in the fourth quarter and full year of 2014.

Gross cash flow for the reporting year rose by 13.7% to €1,155 million (2014: €1,016 million) because of the substantial increase in EBITDA. Operating cash flow (net cash flow) climbed 59.2% to €1,473 million (2014: €925 million), primarily due to a decrease in cash tied up in working capital. This figure included income tax payments of €194 million (2014: €73 million).

From fiscal 2016, the Covestro Group will use free operating cash flow as a further significant key performance indicator for controlling the Group. This parameter reflects the company's internal financing capability.

Free operating cash flow more than tripled to €964 million (2014: €313 million).

Net cash used in investing activities declined substantially to €380 million (2014: €585 million).

Net cash used in financing activities rose considerably to €645 million (2014: €192 million). A capital contribution and subsequent capital increases in connection with the legal independence and formation of Covestro AG resulted in cash inflows of €1,855 million. In addition, net proceeds from the stock market listing amounted to €1,485 million. These were offset by payments entailed by the contractual transfer of assets and liabilities made in 2015. In the reporting year, financial debt of €4,241 million was assumed and financial debt of €6,310 million was repaid. These liabilities largely pertained to loans from the Bayer Group. Moreover, the net income of Covestro Deutschland AG for fiscal 2014 and that company's net loss for fiscal 2015 amounting to €5 million in total (2013: net loss of €20 million) was paid out to Bayer AG under the profit and loss transfer agreement. On account of the termination of the control and profit and loss transfer agreement between Covestro Deutschland AG and Bayer AG on August 31, 2015, the profit transferred in 2015 was for a period of eight months.

Please see Chapter 5 "Production" for further information about major capital expenditures for property, plant and equipment.

The liquidity and financing of the Covestro Group were ensured at all times in the reporting year. Future liquidity bottlenecks are not foreseeable.

Net Financial Debt

	Dec. 31, 2014	Dec. 31, 2015
	€ million	€ million
Liabilities to banks	516	482
Liabilities under finance leases	307	298
Liabilities from derivatives	5	31
Other financial liabilities	3,894	2,070
Positive fair values of hedges of recorded transactions	(2)	(27)
Financial liabilites	**4,720**	**2,854**
Cash and cash equivalents	(201)	(642)
Current financial assets	(418)	(1)
Net financial debt	**4,101**	**2,211**

Net financial debt decreased by €1,890 million in fiscal 2015 to €2,211 million (2014: €4,101 million). As of December 31, 2015, Covestro had available cash and cash equivalents of €642 million (2014: €201 million) and current financial assets of €1 million (2014: €418 million). Financial liabilities decreased by €1,866 million to €2,854 million (2014: €4,720 million).

The other financial liabilities largely pertained to loans from the Bayer Group. These serve to cover the shortterm financing of the Covestro Group's day-to-day operations. The refinancing of the financial liabilities due to mature has already been secured by way of the credit facilities concluded in September 2015.

17.1 Financial Management

The main purpose of financial management is to ensure solvency at all times, continuously optimize capital costs and reduce the risks of financing measures. Until August 31, 2015, these tasks were performed by the Finance department of the Bayer Group. Since September 1, 2015, financial management for the Covestro Group has been performed centrally by Covestro AG.

On October 7, 2015, a day after its stock market listing, Covestro received a rating of Baa2 with stable outlook from rating agency Moody's, which confirmed the company's creditworthiness on the international capital market.

As of December 31, 2015, the Covestro Group was financed by loans (Inter-Group Loan Agreements) with a total volume of €2.1 billion from Bayer Antwerpen NV, Diegem, Belgium. These serve to cover the short-term financing of day-to-day operations.

A syndicated multicurrency term and revolving credit facilities agreement with a volume of €2.7 billion – consisting of a revolving credit facility and a bullet loan – was concluded in September 2015 and serves to provide general corporate finance and ensure an adequate liquidity reserve. The syndicate is made up of Covestro's main banks.

The revolving credit facility for €1.5 billion has a term until September 2020, with two one-year extension options. It may be drawn in various currencies and serves primarily to provide a liquidity reserve and to finance liquidity peaks.

The facilities agreement also includes the option of taking out a bullet loan for €1.2 billion with a term until September 2018. It is available as an alternative source of refinancing to replace existing financial liabilities to Bayer.

No loans had been drawn against the syndicated credit facility as of December 31, 2015.

In the medium and long terms, the Covestro Group will be pursuing a prudent debt management strategy to ensure flexibility, drawing on a balanced financing portfolio. Following replacement of the Inter-Group Loan Agreements, this portfolio will be based for the most part on bonds, syndicated credit facilities and bilateral loan agreements.

As a global enterprise, the Covestro Group is exposed to financial opportunities and risks which are continuously monitored within the context of financial management. Derivative financial instruments are used to minimize risks.

Please see Chapter 21 "Opportunities and Risks Report" for further details of financial opportunities.

18. Statement of Financial Position

Covestro Group Summary Statements of Financial Position

	Dec. 31, 2014	Dec. 30, 2015
	€ million	€ million
Noncurrent assets	6,011	6,294
Current assets	4,381	4,237
Total assets	**10,392**	**10,531**
Equity	**1,787**	**3,612**
Noncurrent liabilities	2,567	2,355
Current liabilities	6,038	4,564
Liabilities	**8,605**	**6,919**
Total equity and liabilities	**10,392**	**10,531**

Total assets as of December 31, 2015, increased by 1.3% to €10,531 million (2014: €10,392 million). Noncurrent assets rose by 4.7% to €6,294 million (2014: €6,011 million), and accounted for 59.8% of total assets (2014: 57.8%). Current assets declined by 3.3% to €4,237 million (2014: €4,381 million), and their ratio to total assets was 40.2% (2014: 42.2%).

Equity as of December 31, 2015, increased by €1,825 million to €3,612 million (2014: €1,787 million). The equity ratio at the reporting date was 34.3% (2014: 17.2%). This increase resulted from the cash contribution made in establishing Covestro AG and the subsequent capital increases, together totaling €1,855 million, as well as from the net proceeds of the stock market listing. It was counteracted by contributions and withdrawals made by stockholders in connection with the legal transfers of assets and liabilities.

Liabilities decreased by 19.6% to €6,919 million (2014: €8,605 million). The debt ratio at the reporting date was 65.7% (2014: 82.8%). Noncurrent liabilities fell by 8.3% to €2,355 million (2014: €2,567 million), while current liabilities dropped by 24.4% to €4,564 million (2014: €6,038 million). One reason for the reduction in liabilities was the repayment of loans to the Bayer Group. The ratio of noncurrent liabilities to total liabilities thus increased to 34.0% (2014: 29.8%).

Net Defined Benefit Liability for Post-Employment Benefits

	Dec. 31, 2014	Dec. 31, 2015
	€ million	€ million
Provisions for pensions and other post-employment benefits	1,395	1,462
Net defined benefit asset	(7)	0
Net defined benefit liability for post-employment benefits	**1,388**	**1,462**

In the reporting year, the net defined benefit liability for post-employment benefits increased by €74 million to €1,462 million (2014: €1,388 million), primarily due to the transfer of pension obligations from the Bayer Group to Covestro in connection with transfers of undertakings and the mutually agreed transfer of employees. This effect was counteracted by the slight increase in the capital market interest rate for high-quality corporate bonds.

19. Earnings; Asset and Financial Position of Covestro AG

Covestro AG was established on August 20, 2015, and has been the parent company and strategic management holding company of the Covestro Group since September 1, 2015. The principal management functions for the entire Group are performed by the Board of Management of Covestro AG. These include strategic planning, resource allocation, executive management and financial management. The performance of Covestro AG is largely determined by the business performance of its subsidiaries.

The financial statements of Covestro AG are prepared in accordance with the German Commercial Code (HGB) and Stock Corporation Act (AktG).

Since Covestro AG was first established in 2015, no prior-year figures are given.

On the basis of an agreement on the transfer of shares dated August 27, 2015, Bayer AG, Leverkusen, Germany, contributed all shares in Covestro First Real Estate GmbH, Monheim am Rhein, Germany, to the capital reserves of Covestro AG. The value of the contribution was equivalent to the carrying amount determined for the shares as recorded in the commercial balance sheet of Bayer AG, Leverkusen, Germany.

With economic effect from September 1, 2015, Bayer AG, Leverkusen, Germany, contributed its shares in Covestro Deutschland AG (formerly Bayer MaterialScience AG), Leverkusen, Germany, to the capital reserves of Covestro AG. The value of the contribution was equivalent to the carrying amount determined for the shares of Covestro Deutschland AG, Leverkusen, Germany, as recorded in the commercial balance sheet of Bayer AG, Leverkusen, Germany. With effect from September 1, 2015, a control and profit and loss transfer agreement was also concluded between Covestro AG and Covestro Deutschland AG, Leverkusen, Germany.

In the course of legal restructuring, the Finance, Taxes, Portfolio & Project Management, Law, Patent Administration and Compliance functions together with the Corporate Office were consolidated in Covestro AG. In this connection, the company acquired the assets and liabilities of Covestro Deutschland AG, Leverkusen, Germany, effective September 15, 2015. The employees assigned to these functions transferred to Covestro AG effective the same date.

19.1 Earnings Performance

Covestro AG Summary Income Statements according to the German Commercial Code

	Aug. 21 – Dec. 31, 2015
	€ million
Income from investments in affiliated companies – net	231
Interest expense – net	1
Other financial income – net	(17)
Net sales	9
Cost of services provided	(9)
General administration expenses	(10)
Other operating expenses	(7)
Income before income taxes	**198**
Income taxes	(17)
Net income	**181**
Allocation to retained earnings	(39)
Retained earnings brought forward from prior year	–
Distributable profit	**142**

In the abbreviated fiscal year from August 21, 2015, to December 31, 2015, Covestro AG posted net income of €181 million. This resulted primarily from investments in affiliated companies of €231 million, which were solely attributable to income achieved on the basis of the control and profit and loss transfer agreement with Covestro Deutschland AG, Leverkusen.

General administrative expenses totaling €10 million primarily consisted of personnel expenses for the employees of the holding company. Other operating expenses of €7 million included special items incurred in the course of the legal separation of the Covestro Group. Other financial expenses amounting to €17 million resulted mainly from underwriting fees paid to banks in connection with the initial public offering. Other income and expense items had no notable effect on earnings. Income before income taxes was €198 million and resulted in income taxes of €17 million. An allocation of €39 million was made to other retained earnings, leaving a distributable profit of €142 million.

19.2 Asset and Financial Position

Covestro AG Summary Statements of Financial Position according to the German Commercial Code

	Dec. 31,2015
	€ million
ASSETS	
Noncurrent assets	**1,766**
Intangible assets, property, plant and equipment	0
Financial assets	1,766
Current assets	**3,608**
Receivables from subsidiaries	3,577
Remaining receivables, other assets	31
Cash and cash equivalents, marketable securities	0
Total assets	**5,374**
EQUITY AND LIABILITIES	
Equity	**5,302**
Provisions	**45**
Liabilities	**27**
Bonds and notes, liabilities to banks	–
Payables to subsidiaries	21
Remaining liabilities	6
Total equity and liabilities	**5,374**

The asset and liability structure of Covestro AG is dominated by its role as a holding company in managing the subsidiaries and financing corporate activities. This is primarily reflected in the high carrying amount of the interest in affiliated companies and of the receivables from, and payables to, Group companies.

Total assets of Covestro AG as of December 31, 2015, were €5,374 million. They were principally made up of receivables from subsidiaries (66.6%) and financial assets (32.9%). All receivables and other assets had a term of less than one year.

Property, plant and equipment and intangible assets were of secondary importance. Including the deferred charges, other receivables reflected in current assets amounted to €11 million, while other assets totaled €20 million. These, too, were of secondary importance in relation to total assets.

Covestro AG had equity of €5,302 million, giving an equity ratio of 98.7%. The company was therefore almost fully financed by equity.

In the abbreviated fiscal year 2015, the following capital procurement measures affected the company's capital stock and capital reserves. On October 2, 2015, the Stockholders' Meeting of Covestro AG approved a capital increase of €63 million to €203 million through the issue against cash contributions of 63 million new no-par bearer shares, each with a proportionate interest of €1 in the capital stock. In addition, a total of €4,919 million was paid into the capital reserves in the form of noncash and cash contributions as other additional contributions.

Equity was diminished by provisions amounting to €45 million and other liabilities of €27 million.

Provisions were made up of pension provisions (€12 million), tax provisions (€21 million) and other provisions (€12 million). All liabilities had a term of less than one year and 79.4% of the total was payable to affiliated companies.

REPORT ON FUTURE PERSPECTIVES AND ON OPPORTUNITIES AND RISKS

20. Future Perspectives

20.1 Economic Outlook

Economic Outlook

	Growth[1] 2015	Growth[1] forecast 2016
	%	%
World	**2.5**	**2.8**
European Union	1.8	1.9
of which Germany	1.5	2.0
United States	2.4	2.7
Asia	4.7	4.6
of which China	6.9	6.3

[1] Real growth of gross domestic product, source: IHS (Global Insight), As of January 2016.

The global economy will probably grow more quickly in 2016 than in the previous year, supported as before by a generally expansionary monetary policy. The persistently low oil price is expected to buoy the economy by reducing costs to private households and encouraging consumption. On the other hand, growth will probably continue to be hampered by the high level of private and public indebtedness in many countries.

We expect the economic recovery in the European Union to continue. Alongside low inflation and the depreciation of the euro, the main factors in this recovery are likely to be the ongoing upswing in the United Kingdom and stronger growth in Germany.

In the United States, we anticipate continued solid growth in 2016 that is likely to be driven mainly by private consumption and increased public spending.

A slight recovery is forecast for the emerging economies for 2016. In light of industry overcapacities and a high level of indebtedness, China is likely to post slower growth. We expect slightly stronger development in India. The recessions in Russia and Brazil look set to continue in 2016. Raw material prices are likely to bottom out and support growth in the other emerging economies.

Economic Outlook for Main Customer Industries

	Growth[1] 2015	Growth[1] forecast 2016
	%	%
Automotive	2	4
Construction	2	2
Electrical / electronics	3	4
Furniture	4	4

[1] Covestro's estimate based on the following sources: LMC Automotive Limited, IHS (Global Insight), B+L; CSIL (Centre for Industrial Studies), As of January 2016.

We expect automotive industry growth to return to a normal level of between 3% and 4% in 2016, with Asia and North America probably remaining the drivers of this growth. The automotive sector in Russia is likely to face continuing challenges, while South America is believed to have reached the bottom of the cycle.

The global construction industry is likely to post slight growth in 2016. We expect continued recovery in Europe. North America and Asia, excluding China, should benefit from a stable investment climate. In Latin America and China, we anticipate a slight improvement in the construction sector in 2016.

We expect the global electrical / electronics industry to post stronger growth in 2016 on the back of product innovation. On this basis, Asia will remain the primary growth driver in the consumer electronics and household appliance segments, with India and the countries of Southeast Asia likely to become the principal contributors to growth. European demand for IT equipment should recover, while the very mature U.S. market is expected to record only slow but stable growth in 2016. Weak purchasing power means that the environment in South America is likely to remain difficult.

We are expecting slightly slower growth in the global furniture industry in 2016. In North America, we anticipate a robust increase in demand from which furniture manufacturers in Asia should also continue to benefit. Development of the Asian furniture market will probably be slightly weaker, with demand in China in particular impacted by slower economic growth. We expect ongoing recovery in the European furniture industry and a less challenging situation in Latin America.

20.2 Forecast for Key Data

Sales and Earnings Forecast

	2015	Forecast 2016
Core volume growth	+2.7%	Mid-single-digit percentage increase
Free operating cash flow	€964 million	At a high level, above the average for past years
ROCE	+9.5%	Premium on the cost of capital (but lower than in 2015)

Covestro Group

The following forecast for the Covestro Group is based on the business development described in this Annual Report and the assumption that the exchange rate between the euro and the U.S. dollar will remain at a similar level to that seen since the start of 2016, taking into account the potential risks and opportunities.

We expect core volume growth in the mid-single-digit-percentage range, largely driven by development in the Polyurethanes and Polycarbonates segments. Growth in the Coatings, Adhesives, Specialties segment is likely to be held back by the contractual termination of trading operations. Adjusted for these effects, we would also expect core volume growth in the mid-single-digit-percentage range for Coatings, Adhesives, Specialties.

In fiscal 2016, we anticipate that free operating cash flow will again be at a high level and above the average seen in past years. We expect a substantial increase for the Polycarbonates segment and a substantial decrease for the Polyurethanes segment. The development in these two segments is primarily due to changes in working capital and expenditures for property, plant and equipment.

In 2016, we again expect ROCE to exceed our capital costs. However, it will be below the level for 2015.

Covestro AG

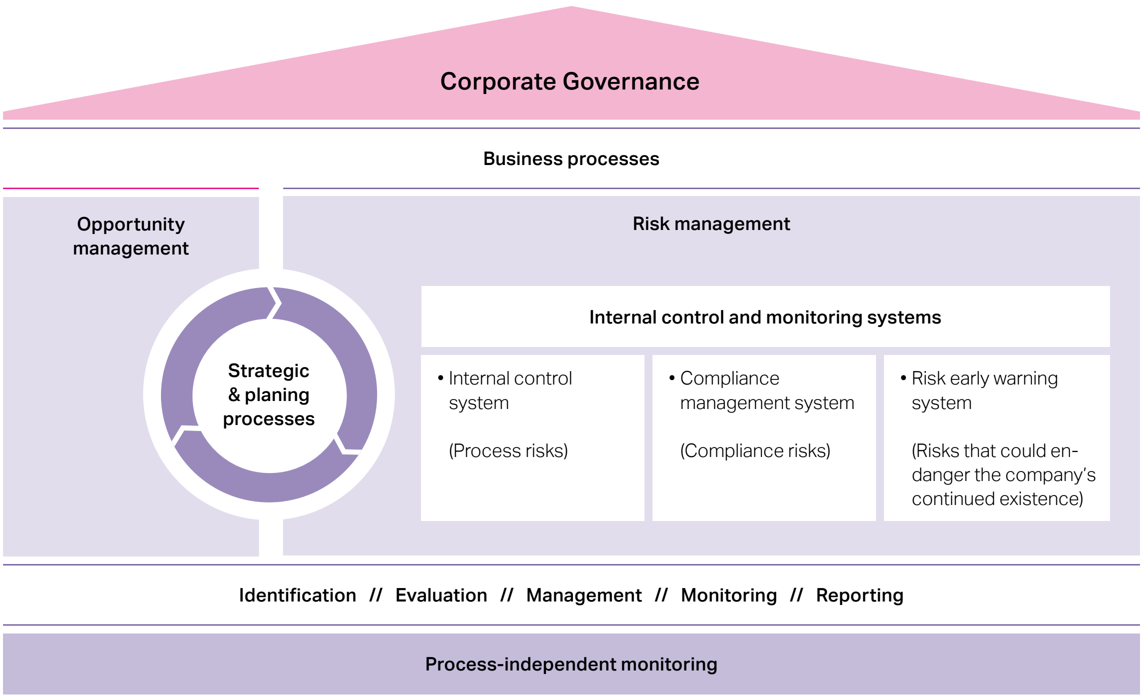
The earnings of Covestro AG, as the parent company of the Covestro Group, largely comprise the earnings of that company's subsidiaries. The earnings of the subsidiaries in Germany, especially Covestro Deutschland AG, are transferred directly to Covestro AG under profit and loss transfer agreements. The earnings of Covestro AG are therefore expected to reflect the positive business development anticipated in the Covestro Group. Based on these factors, we expect Covestro AG to report a distributable profit that will again enable our stockholders to adequately participate in the Covestro Group's earnings for fiscal 2016. The company's dividend policy envisages the payout of between 30% and 50% of net income (in accordance with IFRS) from 2016. The company assumes that its efficient capital structure and strong free operating cash flow will enable it to sustain this policy. The Board of Management and the Supervisory Board are proposing a dividend of €0.70 for the 2015 abbreviated fiscal year to the Annual Stockholder's Meeting.

21. Opportunities and Risks Report

Risk management is integral to Covestro's Group-wide corporate governance system.

No risks that could endanger the Covestro Group's continued existence are currently identified.

Corporate Governance



21.1 Group-Wide Opportunities and Risk Management System

Corporate governance forms the basis for sustainable growth and economic success. One factor for corporate governance is the ability to systematically identify and take advantage of opportunities while avoiding risks to the company's success.

The entrepreneurial decisions we make daily in the course of business processes are based on balancing opportunities and risks. We therefore regard risk management as an integral part of our business management system rather than the task of a specific organizational unit. Our risk management begins with our strategy and planning processes, from which relevant external and internal opportunities and risks of an economic, ecological or social nature are derived. Opportunities and risks are identified by observing and analyzing trends along with macroeconomic, industry-specific, regional and local developments. The identified opportunities and risks are subsequently evaluated and incorporated into our strategic and operational frameworks. We attempt to avoid or mitigate risks by taking appropriate countermeasures, or to transfer them to third parties (such as insurers) to the extent possible and economically acceptable. We consciously accept and bear manageable and controllable risks that are in reasonable proportion to the anticipated opportunities. We regard them as a general risk of doing business. Opportunities and risks are continuously monitored using indicators so that, for example, changes in the economic or legal environment can be identified at an early stage and suitable countermeasures can be initiated if necessary.

To enable the Board of Management and the Supervisory Board to monitor material business risks as legally required, the following systems are in place: an internal control system ensuring proper and effective financial reporting pursuant to Section 289, Paragraph 5 and Section 315, Paragraph 2, No. 5 of the German Commercial Code; a compliance management system; and a risk early warning system pursuant to Section 91, Paragraph 2 of the German Stock Corporation Act.

The various management systems are based on different risk types, risk levels and timelines. Different processes, methods and IT systems are therefore applied to identify, evaluate, manage, and monitor risks. The principles underlying the various systems are documented in Group directives that are integrated into our central document control process and are accessible to all employees via the Covestro intranet. The overall responsibility for the effectiveness and appropriateness of the systems lies with the Chief Financial Officer. The various systems are described below.

Internal control system for (Group) accounting and financial reporting (Report pursuant to Section 289, Paragraph 5 and Section 315, Paragraph 2, No. 5 of the German Commercial Code)

Covestro has an internal control system (ICS) in place for the (Group) accounting and financial reporting process. This process comprises defined structures and workflows implemented throughout the organization and corresponds to the ICS of the Bayer Group. The purpose of our ICS is to ensure proper and effective accounting and financial reporting in accordance with Section 289, Paragraph 5 and Section 315, Paragraph 2, No. 5 of the German Commercial Code.

The ICS is designed to guarantee timely, uniform and accurate accounting for all business processes and transactions based on applicable statutory regulations, accounting and financial reporting standards and the internal Group directives that are binding on all consolidated companies.

The ICS is based on the COSO I (Committee of the Sponsoring Organizations of the Treadway Commission) and COBIT (Control Objectives for Information and Related Technology) frameworks and addresses misreporting risks in the consolidated financial statements. Risks are identified and evaluated, and steps are taken to counter them. Mandatory ICS standards such as system-based and manual reconciliation processes and functional separation have been derived from these frameworks and promulgated throughout the Covestro Group by the Accounting unit of Covestro Deutschland AG.

The management of each Covestro Group company holds responsibility for implementing the ICS standards at the local level. Using Bayer's and Covestro's own shared service centers, the Covestro Group companies prepare their financial statements locally and transmit them with the aid of a data model that is standardized throughout the Covestro Group and based on the Group accounting directive. This ensures the regulatory compliance of the consolidated financial statements.

The effectiveness of the ICS processes for accounting and financial reporting is evaluated on the basis of a cascaded self-assessment system that starts with the persons directly involved in the processes, then involves the principal responsible managers and ends with the Board of Management. The system also makes use of external audits. An IT system in use throughout the Covestro Group ensures the uniform and audit-proof documentation and transparent presentation of the risks, controls and effectiveness evaluations associated with all ICS-relevant business processes. However, it should be noted that an internal control system, irrespective of its design, cannot provide absolute assurance that material misstatements in the accounting will be avoided or identified.

The Board of Management of Covestro AG has confirmed the criteria and the effective functioning of the internal control system for accounting and financial reporting for fiscal 2015.

Compliance management system

Until August 2015, the Covestro Group participated in the compliance system of Bayer AG. After carve-out from the Bayer Group, Covestro established its own compliance system that to a large extent corresponds to the Bayer AG system.

Our compliance management system is aimed at ensuring lawful, responsible and sustainable conduct by our employees. It is designed to permit the advance identification of potential violations and the systematic prevention of their occurrence. The compliance management system thus contributes significantly to the integration of compliance into our business. This holistic system enhances the systematic and preventive identification and assessment of risks. Based on risk assessment, compliance risk mitigation measures are defined. To ensure risk awareness and successful implementation of these mitigation measures, extensive face-to-face and web-based training has been conducted for our employees. Some issues, such as conflicts of interest, were addressed to a large number of employees. Others were relevant only to those employees exposed to a high level of risk, including those at the management level. To date this compliance management system has been implemented in large areas of the Covestro Group to prevent breaches of antitrust law, corruption, insider trading and violations of foreign trade and payments legislation. Our compliance regulations and processes are regularly evaluated with a view to continuous improvement.

An externally hosted, anonymous whistle-blower hotline exists for reporting potential violations. Furthermore, all employees may report violations, anonymously or openly, to the company's compliance organization. All suspected compliance cases are recorded and processed in accordance with uniform criteria applicable across the Covestro Group. The Compliance Officer reports on a monthly base to Covestro's Board of Management and to the management committees of the business and service units.

Risk early warning system pursuant to Section 91, Paragraph 2 of the German Stock Corporation Act

A structured process has been implemented to enable the early identification of any potential disadvantageous developments that are material and / or could endanger the company's continued existence. This process satisfies the legal requirements regarding an early warning system for risks pursuant to Section 91, Paragraph 2 of the German Stock Corporation Act. A central unit defines, coordinates and monitors the framework and standards for this risk early warning system.

A group of global subcommittees are responsible for continuously reporting new and updated information on a defined range of risks throughout the year. The Covestro Corporate Risk Committee meets several times a year to review and discuss the risk landscape as well as the various risk management and monitoring mechanisms that are in place.

Risks are evaluated using estimates of the potential loss, the likelihood of their occurrence and their relevance for our external stakeholders. All material risks and the respective countermeasures are documented in a company-wide database. The risk portfolio is continually reviewed throughout the year. Significant changes must be promptly entered in the database and reported immediately to the Board of Management. A report on the risk portfolio is submitted to the Supervisory Board at least once a year. The following matrix illustrates the financial criteria for rating a risk as high, medium or low.

Rating Matrix According to Financial Criteria

	Likelihood of Occurrence Within 1 Year				
	Very Low	Low	Medium	High	Very High
Accumulated impact (€ million)					
≥ 116	M	M	M	H	H
61–115	L	M	M	H	H
≤ 60	L	L	L	L	L

H = high risk, M = medium risk, L = low risk

Process-independent monitoring

The effectiveness of our management systems is audited and evaluated at regular intervals by the Corporate Audit unit, which performs an independent and objective audit function focused on verifying compliance with laws and directives. Corporate Audit also supports the company in achieving its goals by systematically evaluating the efficiency and effectiveness of governance, risk management and control processes and helping to improve them. The selection of audit targets follows a risk-based approach. Corporate Audit performs its tasks according to internationally recognized standards and delivers reliable audit services. A report on the internal control system and its effectiveness is presented annually to the Audit Committee of the Supervisory Board.

Risks in the areas of occupational health and safety, plant safety, environmental protection and product quality are assessed through specific HSEQ (health, safety, environment and quality) audits.

In addition, the external auditor, as part of its audit of the annual financial statements, assesses the basic suitability of the early warning system for identifying at an early stage any risks that could endanger the company's continued existence. The auditor regularly reports to the Board of Management and the Supervisory Board on the identification of any weaknesses in the internal control system. Audit outcomes are taken into account in the continuous enhancement of our management processes.

21.2 Opportunities and Risks

The following outlines risks that have material effects on the business situation, financial position and results of operations. Risks are deemed material if the potential loss to Covestro is estimated at more than €60 million, even if in some cases the likelihood of their occurrence is assumed to be very low. The sequence in which the risks are listed does not imply any order of significance. The risks are more highly aggregated than in our internal documentation.

Business environment

Ethical conduct is a matter of essential importance for society. Many stakeholders evaluate companies according to whether they conduct themselves not just "legally" but also "legitimately." The Covestro Group is dedicated to sustainable development in all areas of its commercial activity. Any violations of this voluntary commitment can result in adverse media reporting and thus lead to a negative public perception of the Covestro Group. We counter this risk through responsible corporate management that is geared toward generating not only economic but also ecological and societal benefit.

General economic conditions worldwide and, in particular, in the geographic regions in which Covestro operates are a key factor affecting the company's earnings given that their effect on the industries in which Covestro's direct and indirect customers operate impacts demand for the company's products.

Negative economic developments typically have a negative impact on the sales markets for our products, which usually results in decreases in sales volumes and negatively impacts earnings. However, the extent of the impact of economic developments on sales volumes and earnings also depends on capacity utilization rates in the industry, which, in turn, depend on the balance between supply and demand for the industry's products. Decreases in demand lead to lower sales volumes and, ultimately, to reduced capacity utilization, which negatively impacts margins.

An economic downturn, changes in competitors' behavior or the market entry of new competitors can lead to a more intense competitive situation characterized by overcapacities and increased pressure on prices.

The international nature of Covestro's business exposes it to substantial changes in economic, political and social conditions and related risks that may be detrimental to its business and have a material adverse effect on the company's prospects. Historically, the markets for most of our products have experienced alternating periods of tight supply, causing prices and profit margins to increase, followed by periods of significant capacity additions, resulting in oversupply and declining prices and profit margins. The cycles are often caused by the capacity additions of new world-scale production facilities or the expansion of existing production facilities, which are necessary to create or sustain economies of scale in the industry segments, and the decline of industry-wide utilization rates that often follows capacity additions.

Where it appears strategically advantageous, we supplement our organic growth by acquiring companies or parts of companies. Failure to successfully integrate a newly acquired business or unexpectedly high integration costs could jeopardize the achievement of qualitative or quantitative targets and adversely impact earnings. Teams of experts therefore manage both the due diligence process and the integration itself. Due diligence includes, for example, reviewing risk-relevant factors such as compliance with applicable environmental regulations and occupational health and safety standards at production sites.

Further opportunities and risks may also arise if actual market developments vary from those we predict in "Economic Outlook." Where macroeconomic developments deviate from forecasts, this may either positively or negatively impact our sales and earnings expectations. Continuous analysis of the economic environment and of economic forecasts enables us to pursue the identified opportunities and to mitigate risks by adjusting our business strategy.

Innovation

We analyze global trends and develop innovative solutions to address them, thereby mastering the challenges and taking advantage of the opportunities they provide.

Conserving natural resources and protecting the climate

The finite nature of natural resources and efforts to protect the climate are boosting the demand for innovative products and technologies that reduce resource consumption and lead to lower emissions. This trend is being reinforced by increasingly stringent regulatory requirements and growing consumer awareness for the need to use resources sustainably. Covestro is therefore developing new materials that help to raise energy efficiency and reduce emissions. For example, the company's polyurethane is used in the construction industry for thermal insulation, giving a positive energy balance, while its polycarbonate is used in the automotive industry to reduce vehicle weight.

Products and product stewardship

The Covestro Group is exposed to the risk of negative publicity, press speculation, and potential or actual legal proceedings concerning its business, which may harm its reputation. The development of a negative social perception for the chemical industry in general or Covestro's processes or products in particular could also have a negative impact on the company's reputation. The incorrect use and handling of our products by third parties can also harm the company's reputation.

In addition, concerns about product safety and environmental protection could influence public perceptions regarding Covestro's products and operations, the viability of certain products, its reputation, and the ability to attract and retain employees. Due to the technical expertise required to fully understand the possible impacts of the chemical compounds used in the products manufactured by Covestro and in their production, the company's reputation may suffer due to claims, which may prove unsubstantiated, that such compounds are of a harmful nature. Such claims may lead to changes in consumer preferences or additional government regulations even before any harm is scientifically substantiated and possibly despite scientific evidence to the contrary.

Procurement and production

Our Supplier Code of Conduct sets forth our sustainability principles and explains what we expect from our partners along the value chain. The Code requires that our suppliers observe environmental regulations as well as occupational health and safety rules, respect human rights and therefore not employ child labor in any form. Violations of the Code may harm our company's reputation. Through supplier assessments and audits, we verify whether our partners along the supply chain actually implement and adhere to our Code of Conduct. Covestro's Supplier Code of Conduct is based on the principles of the United Nations Global Compact and our Human Rights Position. The Code forms the general basis for our collaboration. It is legally binding and integrated into electronic ordering systems and contracts throughout the Covestro Group.

Covestro requires significant quantities of energy and petrochemical feedstocks for its production processes. Procurement prices for energy and raw materials may fluctuate significantly due to market conditions or legislation. Experience has shown that higher production costs cannot always be passed on to our customers through price adjustments.

We place great importance not only on product safety but also on protecting our employees and the environment. Risks associated with the manufacturing, filling, storage or shipping of products are mitigated through an integrated quality, health, environmental protection and safety management. The materialization of such risks may result in personal injury, property and environmental damage, loss of production, business interruptions and / or liability for compensation payments.

Covestro uses large quantities of hazardous substances, generates hazardous wastes and emits wastewater and air pollutants in its production operations. Consequently, its operations are subject to extensive environmental, health and safety (EHS) laws, regulations, rules and ordinances at the supranational, national and local level in multiple jurisdictions across APAC, EMLA and NAFTA. EHS regulations apply to most of Covestro's activities and the company must dedicate substantial resources to complying with them. The cost of compliance with EHS regulations is part of Covestro's operating cost and, ultimately, must be covered by the prices at which the company is able to sell its products. Competitors of Covestro which do not face EHS regulations to the same extent may have lower operating costs and, as a consequence, their products may be priced lower than those of Covestro.

Operations at our sites may be disrupted by natural disasters, fires or explosions, sabotage or supply shortages for our principal raw materials or intermediates. We counter theses risks by distributing production for certain products among multiple sites or by building up safety stocks. Furthermore, an emergency response system has been implemented for all our production sites as a mandatory component of our HSEQ management. It is aimed at protecting employees, neighbors, the environment and production facilities from the risks described. The Group Regulation "Security and Crisis Management" forms the basis for this.

Increased ecological awareness creates opportunities for Covestro in two ways. On the one hand, the development of innovative materials for our customers opens up market potential. On the other hand, if we succeed in increasing the energy efficiency of our own production processes, we can mitigate environmental impacts and achieve cost savings at the same time. By developing new production technologies and applying internationally recognized energy management systems, we aim to help meet increasing environmental requirements, further reduce emissions and waste, and increase energy efficiency. In this way we not only contribute to sustainable climate protection and the conservation of natural resources, but also achieve cost and competitive advantages.

Employees

Skilled and dedicated employees are essential for the company's success. There is keen competition among companies for highly qualified personnel, particularly in countries with full employment. If we are unable to recruit a sufficient number of employees in these countries and retain them within Covestro, this could have significant adverse consequences for the company's future development.

We are planning appropriate employee recruitment and development measures based on the analysis of future requirements. We aim to convince our target groups of the advantages of working for Covestro through comprehensive human resources marketing, including an employer branding campaign. Our human resources policies are based on the principles enshrined in our Human Rights Position, our Corporate Compliance Policy and our corporate values. Essential elements include competitive compensation containing performance-related components as well as an extensive range of training and development opportunities. In addition, our focus on diversity enables us to tap the full potential of the employment market.

Covestro depends on good relations with its employees, unions and employee representatives to avoid industrial action, implement restructurings, amend existing collective agreements and facilitate the negotiation of reasonable and fair wages, as well as other key working conditions.

Information technology

Business and production processes and the internal and external communications of the Covestro Group are increasingly dependent on global IT systems. A significant technical disruption or failure of IT systems could severely impair our business and production processes. Technical precautions such as data recovery and continuity plans are defined and continuously evolved in close cooperation with our internal IT organization.

The confidentiality of internal and external data is of fundamental importance to us. A loss of data confidentiality, integrity or authenticity could lead to manipulation and / or the uncontrolled outflow of data and expertise. We have measures in place to counter theses risks, including an authorization system.

Furthermore, a Group-wide committee has been established to determine the fundamental strategy, architecture and safety measures for the Covestro Group. These measures are designed to provide optimum protection based on state-of-the-art technology.

Law and compliance

The Covestro Group is exposed to numerous risks from legal disputes or proceedings to which we are currently a party or which could arise in the future, particularly in the areas of product liability, competition and antitrust law, patent law, tax law and environmental protection.

Investigations of possible legal or regulatory violations, such as potential infringements of antitrust law or the use of certain marketing and / or distribution methods, may result in the imposition of civil or criminal penalties – including substantial monetary fines – and / or other adverse financial consequences, harm Covestro's reputation and ultimately hamper our commercial success.

Legal proceedings currently considered to involve material risks are described in the Notes under "Legal Risks."

Financial opportunities and risks

The Covestro Group is exposed to financial opportunities and risks in the form of market price changes, liquidity risks, credit risks and risks resulting from obligations for pensions and other post-employment benefits. The management of financial opportunities and risks takes place using established, documented processes. One component of this is financial planning, which serves as the basis for establishing liquidity needs and future currency risk. Financial planning comprises a planning horizon of 12 months and is regularly updated.

As of September 1, 2015, the management of financial opportunities and risks was transferred in full to the Finance department of the Covestro Group.

Liquidity risk

Liquidity risk, which is managed centrally, is the risk of not being able to meet existing or future payment obligations due to a lack of cash or cash equivalents. In order to ensure the solvency of all Group companies at all times, liquid assets are provided through cash pooling agreements or internal loans so that all planned payment obligations can be met on their due date.

Foreign currencies

For the Covestro Group, foreign currency opportunities and risks in financial transactions result from changes in exchange rates and the related changes in value.

Material receivables and payables in liquid currencies from operating activities and financial items are generally fully hedged through forward exchange contracts.

Anticipated exposure from planned and transacted payment receipts and disbursements in the future was hedged by the Finance department of the Bayer Group until August 31, 2015. Hedging took place through forward exchange contracts and currency options. Since September 1, 2015, the planned and transacted exposure has continued to be measured but is not hedged at present. Should the exchange rate risk increase significantly, hedging of planned and transacted future payment receipts and disbursements will be resumed.

Market price changes

Opportunities and risks result from changes in market currency rates and interest rates. Until August 31, 2015, these were managed centrally by the Finance department of the Bayer Group. As of September 1, 2015, this function was also transferred to the Finance department of the Covestro Group. Risks are eliminated or mitigated partly through the use of derivative financial instruments.

Interest rates

Interest-rate opportunities and risks result for the Covestro Group through changes in capital market interest rates, which in turn could lead to changes in the fair value of fixed-rate financial instruments and changes in interest payments in the case of floating-rate instruments. Interest-rate risk is managed by equalizing interest rate and cash outflows on an annual basis.

Credit riks

Credit risks arise from the possibility that the value of receivables or other financial assets of the Covestro Group may be impaired because counterparties cannot meet their payment or other performance obligations. The Covestro Group does not conclude master netting agreements with its customers for nonderivative financial instruments. Here, the total value of the financial assets represents the maximum credit risk exposure. In the case of derivatives, positive and negative market values may be netted under certain conditions.

To manage credit risks from trade receivables, credit managers are appointed who regularly analyze customers' creditworthiness and set credit limits. Some of these receivables are collateralized, and the collateral – including, in particular, advance payments, letters of credit, guarantees and title retention – is used according to local conditions. All credit limits for debtors where total exposure is more than €10 million are also evaluated by local credit management and submitted to the Group Financial Risk Committee.

Risk to pension obligations from capital market developments

The Covestro Group has obligations to current and former employees related to pensions and other postemployment benefits. Changes in relevant measurement parameters such as interest rates, mortality rates and salary increase rates may raise the present value of these obligations, resulting in increased costs for pension plans. A proportion of our pension obligations is covered by plan assets. Declining or even negative returns on the investment of the plan assets may adversely affect their future fair value. Both these effects may negatively impact the company's earnings and / or may necessitate additional payments by the company.

We address the risk of market-related fluctuations in the value of plan assets through balanced strategic investment and by constantly monitoring investment risks with regard to obligations.

Overall assessment of opportunities and risks

The risks reported above do not endanger the company's continued existence. Nor could we identify any risk interdependencies that could combine to endanger the company's continued existence.

Based on our product portfolio, our know-how and our innovation capability, we are convinced that we can use the opportunities resulting from our entrepreneurial activity and successfully master the challenges resulting from the risks stated above.

EVENTS AFTER THE END OF THE REPORTING PERIOD

No events of special significance took place after January 1, 2016 that we expect to materially affect the financial position of the Covestro Group.

TAKEOVER-RELEVANT INFORMATION

Explanatory report pursuant to Sections 289, Paragraph 4 and 315, Paragraph 4 of the German Commercial Code (HGB)

Composition of the capital stock

The capital stock of Covestro AG amounted to €202,500,000 as of December 31, 2015 and is composed of 202,500,000 no-par bearer shares. Each share confers equal rights and one vote at the Stockholders' Meeting.

Investments in the capital exceeding 10% of total voting rights

At the closing date, Bayer AG held an interest of 69%. We have received no notification nor are we otherwise aware of other direct or indirect investments in the capital equal to or exceeding 10% of the voting rights.

During the lockup period ending six months after the first day of trading in Covestro shares, Bayer AG has undertaken to not sell any further shares.

Appointment and dismissal of members of the Board of Management; changes to the Articles of Incorporation

The appointment and dismissal of members of the Board of Management are subject to the provisions of Sections 84 and 85 of the German Stock Corporation Act, Section 31 of the German Codetermination Act and Section 6 of the company's Articles of Incorporation. Pursuant to Section 84, Paragraph 1 of the German Stock Corporation Act, the members of the Board of Management are appointed and dismissed by the Supervisory Board. Since Covestro AG falls within the scope of the German Codetermination Act, the appointment or dismissal of members of the Board of Management requires a majority of two thirds of the votes of the members of the Supervisory Board on the first ballot pursuant to Section 31, Paragraph 2 of that act. If no such majority is achieved, the appointment is resolved pursuant to Section 31, Paragraph 3 of the Codetermination Act on a second ballot by a simple majority of the votes of the members of the Supervisory Board. If the required majority still is not achieved, a third ballot is held. Here again, a simple majority of the votes of the members suffices, but in this ballot the Chairman of the Supervisory Board has two votes pursuant to Section 31, Paragraph 4 of the Codetermination Act. Under Section 6, Paragraph 1 of the Articles of Incorporation of Covestro AG, the number of members of the Board of Management is determined by the Supervisory Board but must be at least two. The Supervisory Board may appoint one member of the Board of Management to be its Chairman and one member to be the Vice Chairman pursuant to Section 84, Paragraph 2 of the German Stock Corporation Act and Section 6, Paragraph 1 of the Articles of Incorporation.

Any amendments to the Articles of Incorporation are made pursuant to Section 179 of the German Stock Corporation Act and Sections 10 and 17 of the Articles of Incorporation. Under Section 179, Paragraph 1 of the German Stock Corporation Act, amendments to the Articles of Incorporation require a resolution of the Stockholders' Meeting. Pursuant to Section 179, Paragraph 2 of the German Stock Corporation Act, this resolution must be passed by a majority of three quarters of the voting capital represented at the meeting, unless the Articles of Incorporation provide for a different majority. However, where an amendment relates to a change in the object of the company, the Articles of Incorporation may only specify a larger majority. Section 17, Paragraph 2 of the Articles of Incorporation of Covestro AG utilizes the scope for deviation pursuant to Section 179, Paragraph 2 of the German Stock Corporation Act and provides that resolutions may be passed by a simple majority of the votes cast or, where a capital majority is required, by a simple majority of the capital represented. Pursuant to Section 10, Paragraph 9 of the Articles of Incorporation, the Supervisory Board may resolve on amendments to the Articles of Incorporation that relate solely to their wording.

Authorized capital

Provisions of the Articles of Incorporation concerning an authorized capital are entered in the commercial register of Covestro AG. With the approval of the Supervisory Board and until October 2, 2020, the Board of Management may use the authorized capital to increase the capital stock by up to a total of €101,250,000. New shares may be issued against cash contributions and / or contributions in kind. If the authorized capital is used to issue shares in return for cash contributions, stockholders must normally be granted subscription rights. However, the Board of Management is authorized – with the consent of the Supervisory Board – to exclude subscription rights for stockholders:

(a) Where the subscription ratio gives rise to fractional amounts.

(b) To the extent necessary to grant holders or creditors of bonds (including jouissance rights) with warrants or conversion rights or obligations issued by the company or its group companies the right to subscribe to new shares to the extent to which they would be entitled after exercise of their warrants or conversion rights, or performance of their exercise or conversion obligations.

(c) If the capital is increased by granting shares against contributions in kind.

(d) If the new shares are issued at a price that is not significantly below the stock market price and the total interest in the capital stock attributable to the new shares for which subscription rights are excluded pursuant to Section 186, Paragraph 3, Sentence 4 of the German Stock Corporation Act (AktG) does not exceed 10% of the existing capital stock either on the date this authorization takes effect or the date it is utilized. The sale of own shares shall count towards this limit if they are sold during the term of this authorization and subscription rights are excluded pursuant to Section 71, Paragraph 1, No. 8, Sentence 5 in conjunction with Section 186, Paragraph 3, Sentence 4 of the German Stock Corporation Act. Further, shares issued or to be issued to service bonds (including jouissance rights) with warrants or conversion rights or obligations shall also count toward this limit where such bonds or jouissance rights were issued during the term of this authorization and stockholders' subscription rights were excluded in analogous application of Section 186, Paragraph 3, Sentence 4 of the German Stock Corporation Act.

(e) To issue a scrip dividend in which stockholders are given the option of contributing their dividend entitlements to the company (either in full or in part) as a noncash contribution in return for the granting of new shares in the company out of the authorized capital.

Conditional capital

The company's capital stock shall be conditionally increased by up to € 70,000,000, divided into up to 70,000,000 no-par bearer shares (conditional capital). The conditional capital increase shall only be implemented to the extent that the holders of warrants or conversion rights attached to bonds (including jouissance rights) issued or guaranteed by the company or its group companies up to August 31, 2020 on the basis of the authorization of the Stockholders' Meeting of September 1, 2015 exercise their warrant or conversion rights or perform their warrant or conversion obligations, and to the extent that such warrants or conversion rights or obligations cannot be serviced by own shares, shares issued out of the Authorized Capital or other forms of settlement.

The new shares shall be issued at the warrant or conversion price to be determined in accordance with the authorizing resolution referred to above. The new shares shall participate in the profit from the beginning of the fiscal year in which they come into existence; however, the Board of Management, with the consent of the Supervisory Board, may decide that the new shares shall participate in the profit from the beginning of the fiscal year for which, at the time when the warrants or conversion rights are exercised or the exercise or conversion obligations are performed, the Stockholders' Meeting has not yet adopted a resolution on the use of the distributable profit. The Board of Management is authorized, with the consent of the Supervisory Board, to set further details of the terms of the conditional capital increase.

Acquisition and use of the own shares

By a resolution adopted by the Stockholders' Meeting on September 1, 2015, the Board of Management is authorized to acquire and use own shares, also using derivatives. The individual details of the resolution are as follows:

1. Authorization granted to the Board of Management to acquire and use own shares

1.1 The Board of Management is authorized until August 31, 2020, to acquire own shares with a proportionate interest in the capital stock totaling up to 10% of the company's capital stock existing at the date of the resolution, subject to the proviso that the shares acquired as a result of this authorization, together with other shares of the company that the company has already acquired and still holds, or which are attributable to it under Sections 71d and 71e of the German Stock Corporation Act, at no time exceed 10% of the capital stock of the company. The provisions in Section 71, Paragraph 2, Sentences 2 and 3 of the German Stock Corporation Act must be complied with.

The acquisition may only take place via the stock exchange or by means of a public purchase offer and must satisfy the principle of equal treatment of stockholders (Section 53a of the German Stock Corporation Act). If the acquisition takes place via the stock exchange, the purchase price paid by the company (excluding transaction costs) may neither exceed, nor be lower than, the company's share price, as determined by the opening auction in XETRA® trading (or a comparable successor system) on the Frankfurt Stock Exchange on the trading day, by more than 10%. If the acquisition takes place by means of a public purchase offer, the offer price paid by the company (excluding transaction costs) may neither exceed, nor be lower than, the company's share price, as determined by the closing auction in XETRA® trading (or a comparable successor system) on the Frankfurt Stock Exchange on the last trading day before the publication of the purchase offer, by more than 10%. If the total number of the shares tendered in response to a public purchase offer exceeds the offer volume, purchases may be made in proportion to the number of shares tendered (tender ratios); in addition, preferential acceptance of small numbers of shares (up to 50 shares per stockholder), as well as rounding in accordance with commercial principles to avoid notional share fractions, may be provided for. Any further stockholder tender rights are disapplied to this extent.

1.2 The authorization may be exercised in full, or in a number of partial amounts split across several acquisition dates, until the maximum purchase volume has been reached. The acquisition may also be carried out by group companies that are dependent on the company within the meaning of Section 17 of the German Stock Corporation Act, or by third parties on behalf of the company or such group companies. The authorization may, subject to compliance with the statutory requirements, be exercised for any purpose permissible in law, especially in pursuit of one or more of the purposes listed in 1.3, 1.4, 1.5 and 1.6. Trading in own shares is not permitted.

If the own shares acquired are used for one or more of the purposes described under 1.3 or 1.4, the stockholders' subscription rights are disapplied. The Board of Management is authorized to disapply subscription rights if the own shares acquired are used for the purpose specified in 1.6. Stockholders also do not have any subscription rights if the own shares acquired are sold via the stock exchange. In the event that the own shares acquired are sold by means of a public offer to stockholders and this public offer complies with the principle of equal treatment, the Board of Management is authorized to disapply the stockholders' subscription rights for fractions.

1.3 The Board of Management is authorized to also sell the own shares acquired under the above authorization in a manner other than via the stock exchange or via an offer to all stockholders, provided that the sale takes place against cash consideration and at a price which, at the date of sale, is not significantly lower than the market price for the same class of shares in the company. This authorization concerning the use of shares is restricted to shares whose proportionate interest in the capital stock may not in total exceed 10% of the capital stock either at the date when this authorization becomes effective or, if this amount is lower, at the date when the present authorization is exercised. The upper limit of 10% of the capital stock is reduced by the proportionate interest in the capital stock which is attributable to those shares which are issued or sold while disapplying subscription rights under or in accordance with Section 186, Paragraph 3, Sentence 4 of the German Stock Corporation Act on or after September 1, 2015. The upper limit of 10% of the capital stock is further reduced by the proportionate interest in the capital stock which is attributable to those shares which are to be issued to service bonds with warrants or conversion rights or obligations, provided that these bonds are issued while disapplying subscription rights in application of Section 186, Paragraph 3, Sentence 4 of the German Stock Corporation Act, with the necessary modifications, on or after September 1, 2015.

1.4 The Board of Management is authorized to transfer the own shares acquired under the above authorization to third parties, provided this is done for the purpose of acquiring companies, parts of companies, equity interests in companies, or other assets, or to effect business combinations.

1.5 The Board of Management is authorized to retire the own shares acquired under the above authorization without a further resolution by the Stockholders' Meeting. The shares may also be retired without reducing the capital by adjusting the proportionate interest of the remaining no-par value shares in the capital stock of the company. In this case, the Board of Management is authorized to amend the number of no-par value shares in the Articles of Incorporation.

1.6 The Board of Management is authorized to use the own shares acquired as a result of the above-mentioned authorization to pay a scrip dividend.

1.7 The Board of Management may only use the authorizations in 1.3, 1.4 and 1.6 with the consent of the Supervisory Board. Moreover, the Supervisory Board can determine that the measures taken by the Board of Management on the basis of this Stockholders' Meeting resolution may only be implemented with its consent.

1.8 Overall, the above authorizations concerning the use of shares may be utilized on one or several occasions, individually or together, in relation to partial volumes of the own shares or all own shares held in total.

2. Authorization for acquisition using derivatives

2.1 Own shares being acquired as part of the authorization under 1.1 may also be acquired using put or call options. In this case, the option transactions must be entered into with a credit institution, or a company which operates in accordance with Section 53, Paragraph 1, Sentence 1 or Section 53b, Paragraph 1, Sentence 1 or Paragraph 7 of the German Banking Act, that is independent of the company (financial institution), provided that this financial institution, when the option is exercised, only delivers shares which were previously acquired via the stock exchange at a market-driven price in compliance with the principle of equal treatment.

2.2 The acquisition of shares using put or call options is limited to a maximum of 5% of the capital stock in existence as of the date of the resolution by the Stockholders' Meeting or, if this value is lower, as of the date when the authorization is exercised.

2.3 The option premium paid by the company in the case of call options and received in the case of put options may not be materially lower than the theoretical fair value of the options concerned calculated using accepted valuation techniques. The exercise price agreed in the option transaction (in each case not including transaction costs, but taking into account the option premium received or paid) may not be more than 10% higher or lower than the price of the company's shares as determined by the opening auction in XETRA® trading (or a comparable successor system) on the Frankfurt Stock Exchange on the trading day on which the option transaction was entered into.

2.4 The term of the individual derivatives may not, in each case, exceed 18 months; it must end at the latest on August 31, 2020, and must be selected so that the acquisition of the shares using derivatives does not take place after August 31, 2020.

2.5 The provisions under 1.1 also apply to the use of company shares that have been acquired on the basis of this authorization.

3. Authorization to issue convertible bonds, warrant bonds and / or profit-participation rights and to disapply subscription rights to these convertible bonds, warrant bonds and / or profit participation certificates

3.1 Authorization period; object; nominal value; term; number of shares

The Board of Management is authorized, with the approval of the Supervisory Board, to issue – in one or more installments – warrant bonds, convertible bonds and / or profit-participation rights (collectively referred to as **"bonds"**) – as either registered or bearer bonds – with a total nominal value of up to €1,500,000,000, with or without limited maturity, and to grant to the creditors of these bonds warrants or conversion rights in respect of up to 70,000,000 bearer shares of the company representing a total pro-rated increase of up to €70,000,000 in the company's capital stock (hereinafter referred to as **"shares of the company"**) on the terms to be defined for these bonds (hereinafter referred as the **"terms of the bond"**). The authorization can be used in one or more installments. Bonds may also be issued against consideration in kind.

3.2 Currency; issue by Group companies

The bonds may be issued in euros or in the legal currency of any OECD country up to the equivalent value in euros. If bonds are issued in a currency other than the euro, the value shall be calculated using the European Central Bank's reference price for that currency on the date the resolution concerning the bond issue was taken.

The bonds may also be issued by a Group company as defined in Section 18 of the German Stock Corporation Act. In such case, the Board of Management is authorized, with the approval of the Supervisory Board, to assume the guarantee for redemption of the bonds and to grant to the creditors of these bonds warrants or conversion rights to shares of the company.

3.3 Conversion rights / obligations; conversion ratio

In the case of bonds with conversion rights, creditors may exchange their bonds for shares of the company in accordance with the terms of the bond. The proportionate interest in the capital stock upon conversion into shares may not exceed the nominal value or a lower issue price for the bond with conversion rights. The conversion ratio is the nominal value of a bond with conversion rights divided by the conversion price for a share in the company. This applies analogously if the price of the bond with conversion rights is lower than the nominal value. The conversion ratio may be rounded up or down to the nearest whole number. Moreover, an additional cash payment may be determined. It may also be determined that fractions are aggregated and / or paid out in cash. The terms of the bond may provide for a fixed or variable conversion ratio.

The terms of the bond may also specify a conversion obligation. Moreover, they may entitle the company to grant the creditors of bonds with conversion rights upon or before maturity shares in the company in full or partial place of the cash amount due (company's substitution right).

The terms of the bond may also authorize the company to compensate by cash in full or in part any difference between the nominal value of the bond with conversion rights and the product of the conversion ratio and a price for the share at the time of conversion that is to be specified in the terms of the bond. The share price used in the calculation in accordance with the preceding sentence must be at least 80% of the share price relevant for the lower limit of the conversion price in accordance with the following No. 3.6.

3.4 Warrants / exercise obligations

In the case of bonds with warrants or exercise obligations, one or several warrants are attached to each bond entitling the creditors to subscribe to shares in the company in accordance with the terms of the bond that are to be defined by the Board of Management. The subscription ratio is the nominal value of a bond with warrants divided by the subscription price for a share in the company. The proportionate interest in the capital stock represented by the shares of the company to be issued on exercise of the options may not exceed the nominal value of the bonds. The terms of the bond may also provide for subscription to a variable number of shares on exercise of the warrants. They may also permit settlement of the subscription price by way of a transfer of bonds and, if necessary, an additional cash payment.

3.5 Granting of new or existing shares; cash payment

When warrants or conversion rights are exercised or exercise or conversion obligations performed, the company may choose to either grant new shares issued from conditional capital or existing shares in the company or shares in another listed corporation. The terms of the bond may entitle the company, in the case that warrants or conversion rights are exercised or exercise or conversion obligations performed, to pay the cash value instead of granting shares.

3.6 Conversion / exercise price

The conversion / exercise price must be at least 80% of the volume-weighted average closing price for the company's shares in XETRA® trading (or a comparable successor system) on the Frankfurt Stock Exchange on the last ten trading days before the day on which the Board of Management passes the resolution concerning the bond issue or at least 80% of the average closing price for the company's shares in XETRA® trading (or a comparable successor system) during the days on which the subscription rights are traded on the Frankfurt Stock Exchange, with the exception of the last two trading days of subscription rights trading.

In the case of bonds that are subject to mandatory conversion or if the company exercises its substitution right, the conversion price for one share must be either the aforementioned minimum price or at least the average closing price for the company's shares in XETRA® trading on the ten trading days before the day on which the conversion takes effect.

The terms of the bond may provide for changes to the conversion or exercise price over the course of its term, taking account of the minimum prices as described above within a range specified by the Board of Management depending on the development of the share price.

The terms of the bond may include dilution clauses for the case that, during the conversion or exercise period, the company increases the capital stock with subscription rights for its stockholders or issues further conversion bonds, warrant bonds or jouissance rights or grants or guarantees other option rights and disapplies the subscription rights to which the holders of warrants or conversion rights would be entitled on exercise of their warrants or conversion rights or on performance of their conversion obligations. The terms of the bond may also allow a value-preserving adjustment of the conversion or exercise price or of the option ratio or payment of a cash component in the event of other measures taken by the company or events which entail an economic dilution of the value of the warrants or conversion rights (e.g. dividends). Under no circumstances may the proportionate interest in the capital stock per share attached to a bond exceed the nominal value of the bond itself.

This shall not affect Section 9, Paragraph 1 and Section 199 of the German Stock Corporation Act.

3.7 Other terms of the bond

The Board of Management is authorized, with the consent of the Supervisory Board, to set further details for the issue and class of the bonds.

3.8 Subscription rights; disapplying subscription rights

When bonds are issued, stockholders must be granted subscription rights as a matter of principle. The bonds may be taken up by one or more banks with the obligation to offer them for subscription to stockholders. However, when issuing bonds, the Board of Management is authorized – with the consent of the Supervisory Board – to disapply stockholders' subscription rights:

3.8.1 For fractions.

3.8.2 Insofar as it is necessary to grant the holders of warrants or conversion rights to shares in the company or the creditors of bonds with conversion obligations attached a subscription right to the extent to which they would be entitled if they were to exercise their rights or perform the conversion obligation.

3.8.3 Insofar as the bonds are issued against cash and the issue price does not substantially exceed the theoretical market value of the bonds as determined in accordance with recognized financial principles. However, this authorization to disapply subscription rights relates only to bonds with rights to shares with a total proportionate interest in the capital stock of no more than 10%, neither at the time when this authorization becomes effective nor at the time it is exercised. The sale of own shares shall count towards this limit if they are sold during the term of this authorization and subscription rights are disapplied pursuant to Section 71, Paragraph 1, No. 8, Sentence 5 in conjunction with Section 186, Paragraph 3, Sentence 4 of the German Stock Corporation Act. Those shares issued during the term of this authorization from authorized capital and on which subscription rights are disapplied pursuant to Section 181, Paragraph 3, Sentence 4 of the German Stock Corporation Act shall also count towards this limit.

3.8.4 Insofar as they are issued against considerations in kind and the value of these considerations in kind is in reasonable proportion to the market value of the bonds determined according to the preceding No. 3.8.3.

Material conditional agreements

Material agreements containing clauses for the event of a change of control pertain to the syndicated credit facility with a bank consortium and two loans from Bayer Antwerpen NV, a Bayer Group company.

The syndicated credit facility with a total volume of €2,700 million is split into two tranches – a revolving credit facility of €1,500 million with a term until September 2020 and two one-year extension options, and a maturity loan of €1,200 million with a term until September 2018 – both of which remain undrawn by Covestro to date. In the event of a change of control, defined as the acquisition of more than 50% of the voting shares by a third party not associated with the Bayer Group or by a consortium of third parties, the participating banks are entitled to terminate the credit facility and demand repayment of any loans that may have been granted up to that time.

The same clauses have been agreed for the event of a change of control for the two loans totaling €2,060 million concluded with Bayer Antwerpen NV, one loan for €1,250 million due by March 30, 2016, and another loan for €810 million due by June 29, 2016.

Agreements exist for the members of the Board of Management in compliance with Section 4.2.3 of the German Corporate Governance Code to cover the eventuality of a takeover offer being made for Covestro AG. Under these agreements, payments promised in the event of early termination of the service contract of a Board of Management member due to a change of control are limited to the value of three years' compensation and may not compensate more than the remaining term of the contract.

DECLARATION BY THE BOARD OF MANAGEMENT CONCERNING RELATED COMPANIES

Bayer AG holds around 69% of the shares in Covestro AG. There is no control and / or profit and loss transfer agreement between these two companies. For this reason, the Board of Management of Covestro AG prepared a report on the company's relationships with Related companies in accordance with Section 312 of the German Stock Corporation Act (related parties report) for the period from August 20, 2015, to December 31, 2015. This report was audited by the company's external auditors.

At the end of related paties report, the Board of Management made the following declaration concerning relationships with related companies:

"The Board of Management declares that Covestro AG, under the conditions known to the Board of Management at the time at which legal transactions were made, received an appropriate consideration for every legal transaction. No measures in the interest or at the instigation of the controlling company or its affiliated companies have been taken or refrained from."

CORPORATE GOVERNANCE REPORT

This Corporate Governance Report also constitutes the report pursuant to Section 3.10 of the German Corporate Governance Code.

22. Declaration of conformity* (in accordance with the German Corporate Governance Code)*

*Not part of the audited management report

DECLARATION BY THE BOARD OF MANAGEMENT AND SUPERVISORY BOARD OF COVESTRO AG

concerning the German Corporate Governance Code (May 5, 2015 version) pursuant to Section 161 of the German Stock Corporation Act

Under Section 161 of the German Stock Corporation Act (AktG), the Board of Management and the Supervisory Board of Covestro AG are required to issue an annual declaration that the company has been, and is, in compliance with the recommendations of the "Government Commission on the German Corporate Governance Code" as published by the Federal Ministry of Justice in the official section of the Federal Gazette (Bundesanzeiger), or to advise of any recommendations that have not been, or are not being, applied and the reasons for this. The shares of Covestro AG were admitted for the first time for trading on the stock exchange on October 5, 2015. Before that time, no annual declaration was issued.
With respect to the past and to present and future corporate governance practices at Covestro AG, the following declaration refers to the recommendations in the May 5, 2015 version of the Code.

Pursuant to Section 161 of the German Stock Corporation Act, the Board of Management and Supervisory Board of Covestro AG hereby declare as follows:

1. The company has been in compliance with the recommendations of the Code since October 2015, the date on which its shares were admitted for the first for trading on the stock exchange.

2. All the recommendations of the Code are now being complied with in full.

Leverkusen, December 2015

For the Board of Management

Patrick Thomas   Frank H. Lutz

For the Supervisory Board

Dr. Richard Pott

23. Governance*

Covestro places great importance on responsible corporate governance.

In 2015, the Board of Management and Supervisory Board addressed the question of compliance with the German Corporate Governance Code, including the Code amendments of May 5, 2015. The resulting declaration of conformity was issued in December 2015 and posted on Covestro's website.

In 2015, Covestro AG was in compliance with all the recommendations of the "Government Commission on the German Corporate Governance Code" as published by the Federal Ministry of Justice and Consumer Protection in the official section of the Federal Gazette (Bundesanzeiger), and will remain so in the future.

Covestro AG also complies with all the suggestions contained in the German Corporate Governance Code.

Duties and activities of the Board of Management

The Board of Management runs the company on its own responsibility with the goal of sustainably increasing the company's enterprise value and achieving defined corporate objectives. In doing so, it takes account of the interests of stockholders, employees and other stakeholders. The Board of Management performs its tasks according to the law, the Articles of Incorporation and the Board's rules of procedure, and the recommendations of the German Corporate Governance Code as stated in the declaration of conformity. It works with the company's other governance bodies in a spirit of trust.

The Board of Management defines the long-term goals and strategies for the company and sets forth the principles and directives for the resulting corporate policies. It coordinates and monitors the most important activities, defines the company's portfolio, develops and deploys managerial staff, allocates resources and decides on the financial steering and reporting of the Covestro Group.

The members of the Board of Management bear joint responsibility for running the business as a whole. However, the individual members manage the areas assigned to them on their own responsibility within the framework of the decisions made by the full Board. The allocation of duties among the members of the Board of Management is defined in a written schedule appended to its rules of procedure.

The full Board of Management makes decisions on all matters of fundamental importance and in cases where a decision of the full Board is prescribed by law or otherwise mandatory. The rules of procedure of the Board of Management contain a list of topics that must be dealt with and resolved by the full Board.

Meetings of the Board of Management are held regularly. They are convened by the Chairman of the Board of Management. Any member of the Board of Management may also demand that a meeting be convened, notifying the other members of the matter for discussion. The Board of Management makes decisions by a simple majority of the votes cast, except where unanimity is required by law. In the event of a tie, the Chairman has the casting vote.

According to the Board of Management's rules of procedure and schedule of duties, the Chairman bears particular responsibility for coordinating all Board of Management areas. The Chairman represents Covestro in dealings with the public and other third parties. Furthermore, in the reporting year he bore particular responsibility for certain departments of the Corporate Center units and their fields of activity as well as for Covestro's Polyurethanes, Polycarbonates and Coatings, Adhesives, Specialties segments.

The responsibilities of the members of the Board of Management were redistributed by a resolution dated August 20, 2015. Under the schedule of duties as of that date, each Board member has held particular responsibilities that mainly relate to strategy, sustainability, human resources and the Polyurethanes, Polycarbonates and Coatings, Adhesives, Specialties segments; finance (this member also serving as the Labor Director), portfolio management, law and intellectual property (IP) management; production, technology and procurement as well as innovation.

As the Board of Management comprises only four members, no committees have been established.

Establishment of targets and deadlines for promoting the appointment of women and men to managerial positions pursuant to Section 76, Paragraph 4 and Section 111, Paragraph 5 of the German Stock Corporation Act

The German Law on Equal Participation of Women and Men in Leadership Positions in the Private and Public Sectors of May 2015 requires certain companies in Germany to define target quotas for appointing women and men to their Supervisory Boards and Management Boards and the two management levels below them and to establish dates by which these quotas are to be achieved in each case. The companies concerned were required to have defined their targets and implementation periods by September 30, 2015. By law, the first implementation period must end no later than June 30, 2017. Up to five years may exist between this and the subse-

*not part of the audited management report quent implementation period. The law envisages an exception for the proportion of women and men on the Supervisory Boards of companies like Covestro AG which are both listed and codetermined. In these cases, mandatory minimum quotas of 30% women and 30% men already apply.

The Supervisory Board of Covestro AG decided on a target quota of at least 0% for women on the Board of Management of Covestro AG and an implementation period through June 30, 2017. This reflects the current situation.

The Board of Management of Covestro AG decided on target quotas of at least 10% and 20%, respectively, for women on the first and second management levels of Covestro AG and an implementation period through June 30, 2017.

The implementation period is in line with the maximum permissible first implementation period.

Supervisory Board: oversight and control functions

The 12-member Supervisory Board advises and oversees the Board of Management. Under the German Codetermination Act, half the members of the Supervisory Board are elected by the stockholders and half by the company's employees. The Supervisory Board is directly involved in decisions on matters of fundamental importance to the company, regularly conferring with the Board of Management on the company's strategic alignment and the implementation status of the business strategy. The Chairman of the Supervisory Board coordinates its work and presides over the meetings.

Through regular discussions with the Board of Management, the Supervisory Board is kept constantly informed of business policy, corporate planning and strategy. The Supervisory Board approves the annual budget and financial framework. It also approves the financial statements of Covestro AG and the consolidated financial statements of the Covestro Group, along with the combined management report, taking into account the reports by the auditor.

Committees of the Supervisory Board

The Supervisory Board currently has the following committees:

Presidial Committee: This comprises the Chairman and Vice Chairman of the Supervisory Board along with a further stockholder representative and a further employee representative. The Presidial Committee serves primarily as the mediation committee pursuant to the German Codetermination Act. It has the task of submitting proposals to the Supervisory Board on the appointment of members of the Board of Management if the necessary two-thirds majority is not achieved in the first vote at a plenary meeting. Certain decision-making powers in connection with capital measures, including the power to amend the Articles of Incorporation accordingly, have also been delegated to this committee.

Audit Committee: The Audit Committee comprises three stockholder representatives and three employee representatives. The Chairman of the Audit Committee in 2015, Prof. Dr. Rolf Nonnenmacher, satisfies the statutory requirements concerning independence and expertise in the field of accounting or auditing that at least one member of the Supervisory Board and the Audit Committee is required to possess. The Audit Committee meets regularly four times a year. It monitors the accounting process and is responsible for examining the financial statements, consolidated financial statements and management reports and for discussing the interim financial statements with the Board of Management. On the basis of the auditor's report, the Audit Committee develops proposals for resolution by the Supervisory Board relating to the confirmation of the financial statements, the approval of the consolidated financial statements and the use of the distributable profit.

The Audit Committee is also responsible for the company's relationship with the external auditor. It submits a proposal to the full Supervisory Board concerning the auditor's appointment and is authorized to award the audit contract to the audit firm appointed on behalf of the Supervisory Board and to agree the auditor's remuneration. It also suggests areas of focus for the audit and monitors the quality of the audit as well as the independence and qualifications of the auditor.

In addition, the Audit Committee monitors the effectiveness of the internal control system, the risk management system, the internal audit system and the compliance function.

Human Resources Committee: On this committee, too, there is parity of representation between stockholders and employees. It consists of the Chairman of the Supervisory Board and three other members. The Human Resources Committee prepares the personnel decisions of the full Supervisory Board, which resolves on appointments or dismissals of members of the Board of Management. The Human Resources Committee resolves on behalf of the Supervisory Board on the service contracts of the members of the Board of Management. However, it is the task of the full Supervisory Board to resolve on the total compensation of the individual members of the Board of Management and the respective compensation components, as well as to regularly review the compensation system on the basis of recommendations submitted by the Human Resources Committee. The Human Resources Committee also discusses the long-term succession planning for the Board of Management.

Nominations Committee: This committee carries out preparatory work when an election of stockholder representatives to the Supervisory Board is to be held. It suggests suitable candidates for the Supervisory Board to propose to the Annual Stockholders' Meeting for election. The Nominations Committee comprises the Chairman of the Supervisory Board and another stockholder representative on the Presidial Committee.

Objectives for the composition of the Supervisory Board

The Supervisory Board should be composed in such a way that its members together possess the necessary expertise, skills and professional experience to properly perform their duties and are sufficiently independent. The Supervisory Board assesses the independence of its members according to the recommendation contained in Section 5.4.2 of the German Corporate Governance Code. In assessing independence, the Supervisory Board also takes account of the criteria given in the recommendation of the European Commission of February 15, 2005.

The following objectives for composition apply:

The Supervisory Board shall not include more than two former members of the company's Board of Management. Supervisory Board members may not perform executive functions or consulting activities for major competitors of the company or any Group company, and they must not be exposed to other significant conflicts of interest. The Supervisory Board has also resolved that 75% of its members and more than half of the stockholder representatives on the Supervisory Board are to be independent.

At least 30% of the Supervisory Board members shall be women and at least 30% shall be men.

Absent special circumstances, a Supervisory Board member shall not serve more than three full terms of office and shall not hold office beyond the end of the next Annual Stockholders' Meeting following his or her 68th birthday.

Taking into account the specific situation and international operations of Covestro and its affiliated companies, the Supervisory Board shall strive to ensure sufficient diversity among its members. Moreover, at least three members should have managerial experience in an international enterprise.

The objectives described refer to the Supervisory Board as a whole unless resolved otherwise. However, since the Supervisory Board can only nominate candidates for election as stockholder representatives, it can only consider the objectives in making these nominations.

Please see the Report of the Supervisory Board for detailed information about the work of the Supervisory Board and its committees.

Implementation status of the objectives

Taking into account the appointments made in 2015, the Supervisory Board has several members with international business experience and an international background. The objectives that, absent special circumstances, a member should step down from the Supervisory Board at the Annual Stockholders' Meeting following his or her 68th birthday and that a member shall not serve more than three full terms of office are being met.

The objectives pertaining to independence are being met. The Chairman of the Supervisory Board, Dr. Richard Pott, who was elected to serve until the Annual Stockholders' Meeting in 2020, was a member of the Board of Management of Bayer AG until 2013. One member of the Supervisory Board, Johannes Dietsch, is currently Chief Financial Officer of Bayer AG. However, neither Richard Pott nor Johannes Dietsch has any personal or business relationship with the company or a governance body of the company that in the opinion of the Supervisory Board gives rise to a material conflict of interest of more than a temporary nature.

The mandatory minimum quotas of 30% women and 30% men on the Supervisory Board beginning January 1, 2016 were already achieved in fiscal 2015.

Disclosure of securities transactions by members of the Board of Management or Supervisory Board

Members of the Board of Management and Supervisory Board and their close relatives are legally required to disclose all transactions involving the purchase or sale of Covestro stock where such transactions total €5,000 or more in a calendar year. Covestro publishes details of such transactions immediately on its website and also notifies the German Federal Financial Supervisory Authority accordingly. This information is provided to the company register for archiving. The following transactions in 2015 were reported to Covestro AG:

Securities Transactions by Members of the Board of Management or Supervisory Board

Date / Place	Name / Function	Financial instrument	ISIN	Transaction	Price / Currency	Quantity	Total transaction volume
Oct. 2, 2015 / Frankfurt	Johannes Dietsch, Supervisory Board	Shares	DE0006062144	Purchase	€24.00	2000	€48,000.00
Nov. 11, 2015 / XETRA®	Dr. Klaus Schäfer, Board of Management	Shares	DE0006062144	Purchase	€30.50	500	€15,250.00
Dec. 17, 2015 / Munich	Dr. Markus Steilemann, Board of Management	Shares	DE0006062144	Purchase	€34.20	1000	€34,200.00

Information filed with the company by members of the Board of Management and Supervisory Board shows that, on the closing date for the financial statements, their total holdings of Covestro AG stock or related financial instruments were equivalent to less than 1% of the issued stock. Beside the aforementioned transacations, Falco Holding SA c / o VIRUM Investimenti SA acquired 1500 Covestro shares at a price of €34.06 each. Ferdinando Falco Beccalli is a member of the Supervisory Board of Covestro AG and member of the board of Falco Holding SA.

Common values and leadership principles

Covestro is guided by three values that reflect the way people at the company think and act:

Curious: Covestro is proud of its past but it doesn't stop there. Its people are always seeking to do better, so curiosity drives them to listen to customers and suppliers and respond with creative and unexpected solutions.

Courageous: Covestro sees opportunities where others see limitations. The company stands on a platform of knowledge and experience that gives it the courage to push the boundaries of innovation.

Colorful: Covestro values different viewpoints and diverse ideas. The company is optimistic and resourceful, striving to create solutions and solve problems in innovative ways.

Systematic risk management

Our enterprise risk management system ensures risk-aware business conduct by enabling early identification of any financial or nonfinancial risks. We attempt to avoid or mitigate risks by taking appropriate countermeasures, or to transfer them to third parties (such as insurers) to the extent possible and economically acceptable.

The established internal control system enables the timely monitoring of risks, ensuring the proper accounting of business transactions through the prevention or immediate rectification of potential errors. It thus ensures the availability of reliable data on the company's financial situation.

However, the control and risk management system cannot provide absolute protection against losses arising from business risks or fraudulent actions.

Detailed reporting

To maximize transparency, we provide regular and timely information on the Covestro Group's position and significant changes in business activities to stockholders, financial analysts, stockholders' associations, the media and the general public. Four times a year we report to our stockholders about the company's business performance, its financial position and results of operations, and the risks it faces. Our company's reporting thus complies with the provisions of the German Corporate Governance Code.

In line with statutory requirements, the members of the company's Board of Management provide an assurance that, to the best of their knowledge, the financial statements of Covestro AG, the consolidated financial statements of the Covestro Group and the combined management report provide a true and fair view.

The financial statements of Covestro AG, the consolidated financial statements of the Covestro Group and the combined management report are published within 90 days following the end of each fiscal year. During the fiscal year, stockholders and other interested parties are kept informed of developments by means of the half-year financial report and additional interim reports for the first and third quarters. The half-year financial report is voluntarily subjected to an audit review by the auditor appointed by the Annual Stockholders' Meeting.

Covestro additionally provides information at regular news conferences and analysts' meetings. The company uses the internet as a platform for the timely disclosure of information, including the dates of major publications and events, such as the annual report, interim financial reports and the Annual Stockholders' Meeting.

In line with the principle of fair disclosure, all stockholders and other main target groups are treated equally as regards the communication of valuation-relevant information. All significant new facts are disclosed immediately to the general public. In addition to our regular reporting, we issue ad-hoc statements on developments that otherwise might not become publicly known but have the potential to materially affect the price of Covestro stock.

24. Compliance

Covestro manages its businesses in an ethically responsible way and in compliance with the statutory and regulatory requirements of the countries in which it operates. The way each employee conducts the company's business can affect Covestro's public image. Covestro does not tolerate any violation of applicable laws or internal regulations.

The Board of Management is unequivocally committed to the company's Corporate Compliance Policy. Covestro will forgo any business that would only be possible by violating the law or company rules. Our Corporate Compliance Policy defines the principles and rules for our conduct within the company and in relation to our external partners and the general public. This document details our commitment to fair competition, integrity in business dealings, the principles of sustainability and product stewardship, the upholding of foreign trade laws and insider trading laws, the separation of business and private interests, proper record-keeping and transparent financial reporting, and fair, respectful and nondiscriminatory working conditions. Every employee is required as a matter of principle to immediately report any infringement of the Corporate Compliance Policy unless this is not permitted by national law.

Managerial employees have a vital part to play in implementing the Corporate Compliance Policy. As role models, they must help to ensure that this important code of conduct is adhered to in practice. Managers may lose their entitlement to variable compensation components and be subject to disciplinary measures if systematic violations of applicable law entailing loss or damage to Covestro have occurred in their sphere of responsibility and could have been prevented if they had taken appropriate action. Compliant and lawful conduct forms part of the performance evaluations of all managerial employees.

Until August 2015, Covestro was included in the Bayer AG compliance management system. After its carve-out from the Bayer Group, Covestro established its own compliance management system which essentially mirrors Bayer's system.

The Chief Compliance Officer is in charge of all compliance activities at Covestro. In this function, this person reports directly to the Board of Management. A central Compliance department coordinates compliance activities throughout the Covestro Group. A local Compliance Officer has been appointed for each country in which Covestro has employees. This person serves as a local point of contact for employees on all questions regarding legally and ethically correct conduct in business situations.

Covestro is also continuing the Integrated Compliance Management (ICM) project started by Bayer. Within the framework of ICM, compliance risks are systematically identified and evaluated, and compliance processes are defined and integrated as far as possible into business processes. ICM is focused on the areas of antitrust law, anticorruption measures, export controls, conflicts of interest, insider trading and antidiscrimination policies. A local risk assessment covering antitrust law and anticorruption measures has been conducted for each country in which a Covestro Group company is domiciled. With regard to anticorruption, gifts and invitations, tenders, donations and collaboration with certain business partners such as customs agents have been identified as high-risk areas. As well as introducing compliance processes, Covestro is helping employees to become permanently aware of the issue and the associated risks through extensive communication and training activities.

We have established a central hotline and email address for reporting compliance violations – anonymously if desired. Alternatively, the local Compliance Officers can be notified of suspected compliance violations. These are recorded and processed Group-wide in accordance with uniform criteria.

Any risks connected with legal disputes and litigations are published in the Notes to the Consolidated Financial Statements.

Covestro's Corporate Audit department verifies adherence to the Corporate Compliance Policy. Audit targets are prioritized and selected on the basis of risk-based audit planning, which covers aspects including corruption risks. In addition to regular audits, dedicated compliance program audits are also conducted to monitor implementation of the compliance management system in the local units. The head of Corporate Audit attends the meetings of the Audit Committee of the Supervisory Board in respect of selected agenda items and provides it with a list of conducted audits and their outcomes at least once a year.

25. Compensation Report

The Compensation Report describes the essential features of the compensation system for the members of the Board of Management and the Supervisory Board of Covestro AG and explains the compensation of the individual members. The report conforms to the requirements of the German Commercial Code of May 5, 2015, including the principles of German Accounting Standard No. 17 (DRS 17) and to the recommendations of the German Corporate Governance Code. It also complies with the International Financial Reporting Standards (IFRS).

Covestro AG was founded as a subsidiary of Bayer AG on August 20, 2015. On September 1, 2015, the control and profit and loss transfer agreement between Covestro Deutschland AG (formerly Bayer MaterialScience AG) and Bayer AG was terminated and Covestro Deutschland AG became a subsidiary of Covestro AG. It was at this time that the Covestro Group was founded under the new parent company Covestro AG. Unless otherwise stated, all the following information concerning the compensation of the Board of Management and the Supervisory Board refers to the period from September 1, 2015 to December 31, 2015.

25.1 Compensation of the Board of Management

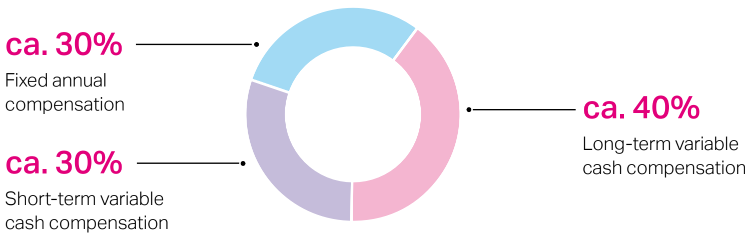
Objectives

The structure of the compensation system for the Board of Management of Covestro AG is aimed at ensuring a long-term increase in the company's value and the performance-oriented remuneration of management. The core elements of the system include fixed compensation, which takes into account the tasks and duties of the Board of Management members, and an annual incentivized component – the short-term incentive (STI) – which depends on the attainment of the corporate performance targets. From 2016, in addition to the compensation directly related to each year of service, there is a long-term stock-based component that is directly related to the development of Covestro's share price over time and thus is intended to create an incentive for a sustained commitment to the company. Furthermore, we aim to position Covestro as an attractive employer in the competition for highly qualified executives, and ensure statutory and regulatory compliance. Board of Management compensation is in line with the basic principles of the compensation structure for managerial employees in the Covestro Group. The appropriateness of the system and the compensation level are regularly reviewed by the Supervisory Board, which then makes any necessary adjustments.

Compensation structure

The compensation structure, based on average total annual compensation and 100% target attainment, is as follows:

Board of Management Compensation Structure (German Commercial Code)[1]



[1] excluding fringe benefits and pension entitlements

The non-performance-related compensation comprises the fixed annual compensation along with fringe benefits. The performance-related compensation partly comprises a short-term variable component (STI), which depends on the attainment of the corporate performance targets. The other performance-related compensation component serving as a long-term incentive is the stock-based cash compensation program Prisma, which is directly related to the development of Covestro's share price over time and will be granted from fiscal 2016.

The individual performance-related components are capped at the grant date. To comply with the recommendation of the German Corporate Governance Code, caps have also been agreed for the performance-related components and for the compensation as a whole (total of the annual fixed compensation and the variable components). The cap on the total compensation is 1.8 times the respective target compensation and is determined annually by the Supervisory Board when the fixed compensation is set.

The members of the Board of Management also receive pension entitlements for themselves and their surviving dependents.

Non-performance-related components

Fixed annual compensation

The level of the non-performance-related, fixed annual compensation for members of the Board of Management takes into account the functions and responsibilities assigned to them as well as market conditions. The fixed compensation is regularly reviewed by the Supervisory Board in light of factors such as the consumer price index and adjusted if necessary. It is paid out in twelve monthly installments.

Fringe benefits

Fringe benefits mainly comprise a company car with driver or the use of the company carpool, payments toward the cost of security equipment, and reimbursement of the cost of annual health screening examinations. They are reported at cost or the amount of the pecuniary advantage gained.

Performance-related components

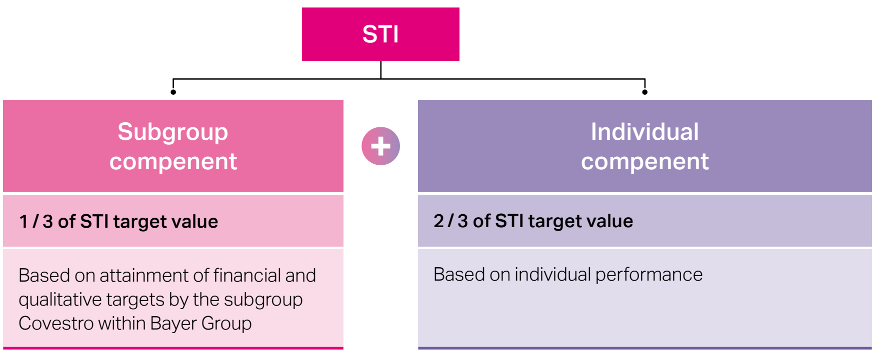
Short-term variable cash compensation

The short-term variable compensation (STI) is based on a set percentage of the fixed annual compensation (target value). This amount is adjusted in line with target attainment.

The pro-rated STI payment for 2015 is still based on a modified version of the short-term variable compensation system in place at Bayer AG. Accordingly, two-thirds of the payout is dependent on the attainment of individual targets and one-third is linked to target attainment by the Covestro subgroup or reporting segment in the Bayer Group financial statements. Target attainment by the subgroup is measured in terms of the cash flow return on investment (CFROI). It also takes into account qualitative objectives including safety, compliance and sustainability. The target attainment for the individual component of the variable compensation is determined by the Supervisory Board of Covestro AG, taking into account factors including the placement volume achieved in the stock market listing of Covestro in 2015.

From fiscal 2016, a short-term variable compensation system based solely on the attainment of financial targets will apply to all Covestro Group employees entitled to STI payments, including members of the Board of Management. This will be based on the same performance indicators used to steer the company. In the new system, one-third each of the payout will be based on target attainment in respect of growth (core volume growth), liquidity (free operating cash flow) and profitability (ROCE).

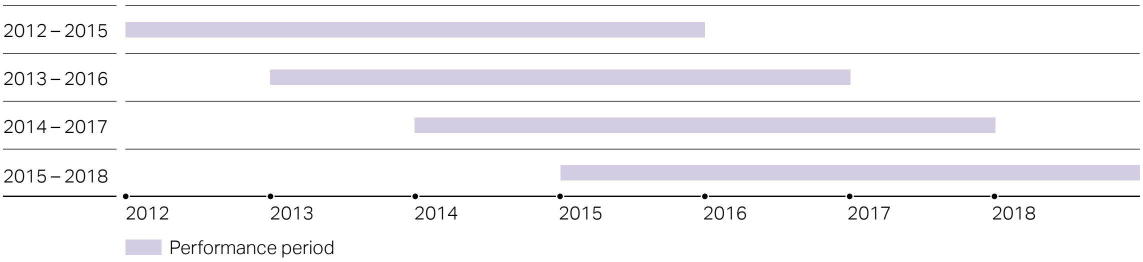
Short-Term Variable Compensation (STI) Components



Long-term stock-based cash compensation

For four years in total, the members of the Board of Management will still be participating in the ongoing performance periods of Bayer's long-term stock-based compensation program "Aspire" (the 2012–2015, 2013–2016, 2014–2017 and 2015–2018 tranches). The payments made under this program are based on the Aspire Target Opportunity, which is a contractually agreed percentage of fixed annual compensation. Depending on the performance of Bayer stock, both in absolute terms and relative to the Euro STOXX 50 benchmark index, participants are granted an award of between 0% and 300% of their individual Aspire Target Opportunity at the end of the respective performance period. The payout / performance matrix according to the absolute and relative development of Bayer's share price is explained at http://www.investor.bayer.com/en/stock/stock-programs/aspire/. In order to break the link between the payout and the future development of Bayer's share price, it was decided that the average price of Bayer stock and the benchmark index calculated from the closing prices for the last 30 trading days of 2015 would be used as the closing price for all current tranches and that the payout amount would be frozen accordingly. Provided an amount greater than zero has been calculated, the payouts will be made at the start of 2016, 2017, 2018 and 2019 on termination of the respective tranches. The target value for the 2015–2018 tranche was reduced to 8 / 12 of the full value (pro rata for the period from January to August 2015). In recompense for this, the target values for the members of the Board of Management for the new 2016 tranche under Covestro's own long-term compensation program (described below) will be increased by 4 / 12.

Tranches of the Aspire Program



From 2016, the members of the Board of Management are eligible to participate in the long-term stock-based compensation program Prisma on condition that they purchase a certain number of Covestro shares – determined individually according to defined guidelines – and for as long as they remain in the service of the Covestro Group. This program is likewise based on a target opportunity, which is a contractually agreed percentage of fixed annual compensation. Depending on the total shareholder return of Covestro stock (absolute price performance plus the dividend distributed during the four-year performance period) and the relative performance against the DJ STOXX Europe 600 Chemicals benchmark index, participants will be granted an award of between 0% and 200% of the Prisma target opportunity at the end of the respective performance period. When a member of the Board of Management retires, current tranches may be shortened, thus reducing their value.

Pension entitlements (retirement and surviving dependents' pensions)

The members of the Board of Management are entitled to receive a lifelong company pension after leaving the Covestro Group, though not before the age of 62. This pension is paid out in the form of a monthly life annuity.

The arrangements for surviving dependents basically provide for a widow's pension amounting to 60% of the member's pension entitlement and an orphan's pension amounting to 12% of the member's pension entitlement for each child.

The annual pension entitlement is based on contributions. Starting September 1, 2015, Covestro provides a hypothetical contribution amounting to as much as 33% of the respective fixed compensation each year. This percentage is comprised of a 6% basic contribution and a matching contribution of up to 27% – three times the member's maximum personal contribution of 9%. The total annual contribution is converted into a pension module according to the annuity table for the applicable tariff of the Rheinische Pensionskasse VVaG pension fund. The annual pension entitlement upon retirement is the total amount of the accumulated pension modules including an investment bonus, which is determined annually by the representatives' meeting of the Rheinische Pensionskasse VVaG and approved by the German Financial Supervisory Authority. Dr. Klaus Schäfer has been granted, in addition, a vested entitlement to a fixed annual pension of €126,750.

The actual pension entitlement cannot be precisely determined in advance. It depends on the development of the member's compensation, the number of years of service on the Board of Management and the return on the assets of the Rheinische Pensionskasse VVaG.

Certain assets are administered under a contractual trust agreement (CTA), providing additional insolvency protection for pension entitlements resulting from direct commitments for the members of the Board of Management in Germany.

As a rule, future pension payments are adjusted by at least 1% per year. Depending on the pension obligation, an additional adjustment may be made if the investment bonus of the Rheinische Pensionskasse VVaG or the consumer price index exceeds 1% per year.

Benefits upon termination of service on the Board of Management

Post-contractual noncompete agreements

Post-contractual noncompete agreements exist with the members of the Board of Management, providing for compensatory payments to be made by the company for the duration of these agreements (two years). The compensatory payment amounts to 100% of the average fixed compensation in the twelve months preceding termination of service.

Change of control

Agreements exist with the members of the Board of Management providing for severance payments to be made in certain circumstances in the event of a change in control. The amount of the severance payments, including any ancillary benefits, in the case of early termination of service on the Board of Management as a result of a change in control is limited to the value of three years' compensation in line with the recommendation in Section 4.2.3 of the German Corporate Governance Code. Such payments do not exceed the compensation payable for the remaining term of the service contract.

Unfitness for work

In the event of temporary unfitness for work, members of the Board of Management continue to receive the contractually agreed compensation. Covestro AG may terminate the service contract early if the member has been continuously unfit for work for at least 18 months and is likely to be permanently incapable of fully performing his duties (permanent incapacity to work). A disability pension is paid in the event of contract termination before the age of 60 due to permanent incapacity to work. The amount of this disability pension corresponds to the entitlement accrued on the date of contract termination, taking into account a fictitious period of service between that date and the member's 55th birthday where applicable.

Compensation of the Board of Management in 2015

The following paragraphs report the compensation of the Board of Management of Covestro AG for fiscal 2015. The members of the Board of Management of Covestro AG are the same as the members of the Board of Management of Covestro Deutschland AG, which became a subsidiary of Covestro AG on September 1, 2015. Since that date, no compensation has been paid for the members' work on the Board of Management of Covestro Deutschland AG.

In the period from September 1 to December 31, 2015, the aggregate compensation for the members of the Board of Management totaled €3,280 thousand, comprising €1,278 thousand in non-performance-related components and €2,002 thousand in performance-related components. The pension service cost (German Commercial Code) amounted to €312 thousand.

The following table shows the total compensation of the individual members of the Board of Management who served in 2015 according to the German Commercial Code and DRS 17.

Board of Management Compensation (German Commercial Code) for the Reporting Period from September 1, to December 31, 2015

	Fixed annual compensation	Fringe benefits	Short-term variable cash compensation	Aggregate compensation	Pension service cost[1]
	€ thousand	€ thousand	€ thousand	€ thousand	€ thousand
Patrick Thomas (Chairman)	317	97	811	1,225	121
Frank H. Lutz	227	7	525	759	78
Dr. Klaus Schäfer	183	34	333	550	58
Dr. Markus Steilemann	183[2]	230[3]	333	746	55
Total	**910**	**368**	**2,002**	**3,280**	**312**

[1] Including company contribution to Bayer-Pensionskasse and Rheinische Pensionskasse VVaG
[2] Payment was made outside Germany in local currency on the basis of a theoretical net salary in Germany.
[3] Benefits in kind and other benefits for Dr. Steilemann include expenses associated with an international assignment, e.g. payment of rental costs in line with customary local rates.

Fixed annual compensation

The fixed compensation of the members of the Board of Management was adjusted in 2015. The total fixed compensation of all the members was €910 thousand..

Short-term variable cash compensation

In the period from September 1 to December 31, 2015, the total short-term variable cash compensation (STI) for all the members of the Board of Management in 2015 totaled €2,002 thousand after deduction of the solidarity contribution. The solidarity contribution is made by all employees of the companies covered by the respective agreements with the employee representatives to help safeguard jobs at the German sites. For 2015 reporting period, it amounted to 0.2% of each member's total STI award.

Long-term stock-based cash compensation (Aspire)

Total compensation (German Commercial Code) does not include any stock-based cash compensation (Aspire) as no new tranches were offered in the reporting period.

According to IFRS, the aggregate compensation includes the fair value of the partial entitlement earned in the respective year. Grants of stock-based compensation with a four-year performance period are therefore expensed at their respective fair values over four years starting with the grant year. The associated expense is a part of compensation according to IFRS. The aggregate compensation according to IFRS also includes the change in the value of existing entitlements under ongoing Aspire tranches granted in prior years.

Board of Management Compensation – Aspire Program (IFRS)

	Patrick Thomas (Chairman)	Frank H. Lutz (Finance)	Dr. Klaus Schäfer (Production and Technology)	Dr. Markus Steilemann (Innovation)	Total
	€ thousand	€ thousand	€ thousand	€ thousand	€ thousand
Stock-based compensation entitlements earned in the reporting period[1]	233	14	53	30	330
Change in value of existing entitlements in the reporting period[2]	155	6	35	20	216
Total	**388**	**20**	**88**	**50**	**546**

[1] The newly earned entitlements are derived from the 2012, 2013, 2014 and 2015 tranches of the Aspire program because this compensation was or is being earned over four-year periods. They are stated at their pro-rata fair values in 2015.
[2] This line shows the change in the value of the entitlements already earned in 2012, 2013 and 2014.

Provisions of €2,801 thousand were established for the Aspire entitlements of the members of the Board of Management serving as of December 31, 2015.

Pension entitlements

The pension service cost recognized for the members of the Board of Management in the reporting period was €312 thousand according to the German Commercial Code, while the current service cost for pension entitlements recognized according to IFRS was €436 thousand.

The service cost and the settlement or present value of the pension obligations attributable to the individual members of the Board of Management are shown in the following table.

The pension service cost differs on account of the different principles applied in measuring the settlement value of pension obligations in accordance with the German Commercial Code and the present value of defined pension obligations in accordance with IFRS.

Pension Entitlements (German Commerical Code and IFRS) for the Reporting Period from September 1, to December 31, 2015

	German Commerical Code		IFRS	
	Pension service cost[1]	Settlement value of pension obligation as of December 31	Service cost for pension entitlements	Present value of defined pension obligation as of December 31
	€ thousand	€ thousand	€ thousand	€ thousand
Patrick Thomas	121	2,784	154	3,514
Frank H. Lutz	78	106	114	146
Dr. Klaus Schäfer	58	1,864	82	2,735
Dr. Markus Steilemann	55	421	86	778
Total	**312**	**5,175**	**436**	**7,173**

[1] Including company contribution to Bayer Pensionskasse or Rheinische Pensionskasse VVaG

25.2 Disclosures Pursuant to the Recommendations of the German Corporate Governance Code

The following tables show the compensation and fringe benefits paid for 2015, including the maximum and minimum achievable variable compensation, and the allocation of compensation for the reporting period in the line with the recommendations in the May 5, 2015 version of the German Corporate Governance Code.

Compensation and Benefits Granted for the Reporting Period from September 1, 2015 to December 31, 2015

	Patrick Thomas (Chairman)			Frank H. Lutz (Finance)			Dr. Klaus Schäfer (Production and Technology)			Dr. Markus Steilemann (Innovation)		
€ thousand	Target value	Min.	Max.	Target value	Min.	Max.	Target value	Min.	Max.	Target value	Min.	Max.
Fixed annual compensation	317	317	317	227	227	227	183	183	183	183[1]	183[1]	183[1]
Fringe benefits	97	97	97	7	7	7	34	34	34	230[2]	230[2]	230[2]
Total fixed compensation	**414**	**414**	**414**	**234**	**234**	**234**	**217**	**217**	**217**	**413**	**413**	**413**
Short-term variable cash compensation	350	–	933	227	–	605	183	–	488	183	–	488
Total	**764**	**414**	**1,347**	**461**	**234**	**839**	**400**	**217**	**705**	**596**	**413**	**901**
Benefit expense	154	154	154	114	114	114	82	82	82	86	86	86
Total compensation	**918**	**568**	**1,501**	**575**	**348**	**953**	**482**	**299**	**787**	**682**	**499**	**987**

1 Payment was made outside Germany in local currency on the basis of a theoretical net salary in Germany.
2 Benefits in kind and other benefits for Dr. Steilemann include expenses associated with an international assignment, e.g. payment of rental costs in line with customary local rates.

Allocation of Compensation for the Reporting Period from September 1, to December 31, 2015

	Patrick Thomas (Chairman)	Frank H. Lutz (Finance)	Dr. Klaus Schäfer (Production and Technology)	Dr. Markus Steilemann (Innovation)
	€ thousand	€ thousand	€ thousand	€ thousand
Fixed annual compensation	317	227	183	183[1]
Fringe benefits	97	7	34	230[2]
Total fixed compensation	**414**	**234**	**217**	**413**
Short-term variable cash compensation	811	525	333	333
Total	**1,255**	**759**	**550**	**746**
Benefit expense	154	114	82	86
Total compensation	**1,379**	**873**	**632**	**832**

1 Payment was made outside Germany in local currency on the basis of a theoretical net salary in Germany.
2 Benefits in kind and other benefits for Dr. Steilemann include expenses associated with an international assignment, e.g. payment of rental costs in line with customary local rates..

25.3 Compensation of the Supervisory Board

The Supervisory Board is compensated according to the relevant provisions of the Articles of Incorporation.

The members of the Supervisory Board each receive fixed annual compensation of €100 thousand plus reimbursement of their expenses.

In accordance with the recommendations of the German Corporate Governance Code, additional compensation is paid to the Chairman and Vice Chairman of the Supervisory Board and for chairing and membership of committees. The Chairman of the Supervisory Board receives fixed annual compensation of €300 thousand, the Vice Chairman €150 thousand. These amounts also cover membership and chairmanship of committees. The other members of the Supervisory Board are entitled to additional compensation for membership or chairmanship of committees. The chairman of the Audit Committee receives an additional €50 thousand, the other members of the Audit Committee €25 thousand each. The chairmen of the remaining committees receive €30 thousand each, the other members of those committees €20 thousand each. No additional compensation is paid for membership of the Nominations Committee. A Supervisory Board member who is a member of more than two committees receives compensation only for the two committees with the highest compensation. If changes are made to the Supervisory Board and / or its committees during the year, members receive compensation on a pro-rated basis. The members of the Supervisory Board also receive an attendance fee of €1 thousand each time they personally attend a meeting of the Supervisory Board or a committee. The attendance fee is limited to €1 thousand per day.

The members of the Supervisory Board have given a voluntary pledge that they will each purchase Covestro shares for 25% of their fixed compensation, including any compensation for committee membership (before taxes), and hold these shares for as long as they remain members of the Supervisory Board. This does not apply to members who transfer at least 85% of their fixed compensation to the Hans Böckler Foundation in accordance with the rules of the German Trade Union Confederation or whose service or employment contract with a company requires them to transfer such compensation to that company. If less than 85% of the fixed compensation is transferred, the voluntary pledge applies to the portion not transferred. By voluntarily pledging to invest in and hold Covestro shares, the Supervisory Board members reinforce their interest in the long-term, sustainable success of the company.

Compensation of the Supervisory Board in 2015

The following table shows the components of each Supervisory Board member's compensation for 2015.

Compensation of the Members of the Supervisory Board of Covestro AG for the Reporting Period from September 1, 2015 to December 31, 2015

	Fixed compensation	Attendance fee	Total
	€ thousand	€ thousand	€ thousand
Ferdinando Falco Beccalli[1]	25	3	28
Dr. Christine Bortenlänger[1]	25	2	27
Johannes Dietsch (Vice Chair until Sept. 30, 2015)	49	6	55
Dr.-Ing. Thomas Fischer[1]	30	3	33
Peter Hausmann[1]	37	3	40
Petra Kronen[1] (Vice Chair since Oct. 1, 2015)	38	3	41
Irena Küstner[1]	32	3	35
Michael Mostert[1]	25	3	28
Prof. Dr. Rolf Nonnenmacher	46	6	52
Dr. Richard Pott (Chair)	100	6	106
Regine Stachelhaus[1]	30	3	33
Sabine Wirtz[1]	25	3	28
Total	**462**	**44**	**506**

[1] Member of the Supervisory Board since October 1, 2015

In addition to their compensation as members of the Supervisory Board, those employee representatives who are employees of Covestro Group companies receive compensation unrelated to their service on the Supervisory Board. The total amount of such compensation in 2015 was €144 thousand.

No compensation was paid or benefits granted to members of the Supervisory Board for personally performed services such as consultancy or agency services. The company has purchased insurance for the members of the Supervisory Board to cover their personal liability arising from their service on the Supervisory Board.

25.4 Other Information

There were no advances or loans to members of the Board of Management or the Supervisory Board outstanding as of December 31, 2015.