

## **Explanatory Report of the Board of Management of Covestro AG according to Paragraph 176 Section 1 Sentence 1 and Paragraph 175 Section 2 of the German Stock Corporation Act on Takeover-relevant Information accordance with Paragraph 289a Section 1 and Paragraph 315a Section 1 of the German Commercial Code as of the December 31, 2017 Reporting Date**

Pursuant to Paragraph 176 Section 1 Sentence 1 of the German Stock Corporation Act in conjunction with Paragraph 175 Section 2 of the German Stock Corporation Act the Board of Management of Covestro AG hereinafter reports on takeover-relevant information as of December 31, 2016, in accordance with Paragraph 289a Section 1 and Paragraph 315a Section 1 of the German Commercial Code.

### **Explanatory report pursuant to Section 289a, Paragraph 1 and Section 315a, Paragraph 1 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, 2017, and is composed of 202,500,000 no-par value 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 a direct interest of approximately 25%. 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. For information on Covestro's ownership structure, see: [www.investor.covestro.com/en/stock/shareholder-structure](http://www.investor.covestro.com/en/stock/shareholder-structure)

#### **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 (*Aktiengesetz*, AktG), Section 31 of the German Codetermination Act (*Mitbestimmungsgesetz*, MitbestG) 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 Chair 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 Chair and one member to be the Vice Chair 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 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 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. 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 value 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.

On October 24, 2017, Covestro AG's Board of Management resolved to buy back treasury shares totaling up to €1.5 billion, (excluding transaction costs) or up to 10% of the company's capital stock, whichever comes first. The buyback began in November 2017. As of February 28, 2018, the company held 4,507,752 treasury shares. This corresponds to 2.3% of the capital stock.

## **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 (*Kreditwesengesetz*), 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 by August 31, 2020 – 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 no-par value 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 to 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 within the meaning of Section 8 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 (or a comparable successor system) 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 convertible bonds, warrant bonds or jouissance rights or grants or guarantees other option rights and disappplies 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 or 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%, and 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 disappplied 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 disappplied pursuant to Section 186, 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**

One of the material agreements containing a clause for the event of a change of control pertains to a syndicated credit facility with a bank consortium. In September 2015, Covestro AG concluded a syndicated multicurrency term and revolving credit facilities agreement (facilities agreement) for €2,700 million with a consortium of banks. In the course of the successful bond placement in March 2016, Covestro AG dissolved the term loan facility of €1,200 million that was part of this facilities agreement, as planned. The multicurrency revolving credit facility of €1,500 million with a term until September 2022 remains in place. No loans had been drawn against this syndicated credit facility as of December 31, 2017. 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.

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.

Covestro AG

- The Board of Management -