FINANCIAL STATEMENTS 2017

Financial Statements of Covestro AG
for the fiscal year 2017

The management report of Covestro AG is combined with the management report of the Covestro Group. The Combined Management Report is published in Covestro's Annual Report for 2017. The financial statements and the Combined Management Report of the Covestro Group and Covestro AG for fiscal 2017 have been submitted to the operator of the electronic Federal Gazette in Germany and are accessible via the Company Register website.

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Forward-Looking Statements

This financial report may contain forward-looking statements based on current assumptions and forecasts made by the management of Covestro AG. Various known and unknown risks, uncertainties and other factors could lead to material differences between the actual future results, financial situation, development or performance of the company and the estimates given here. These factors include those discussed in Covestro's public reports, which are available on the Covestro website at **www.covestro.com**. The company assumes no liability whatsoever to update these forward-looking statements or to conform them to future events or developments.

This financial report was published in German and English. Only the German version is binding.

Statement of Financial Position of Covestro AG

Assets

	Dec. 31, 2016	Dec. 31, 2017
	€ thousand	€ thousand
Noncurrent assets		
Intangible assets	14	9
Property, plant and equipment	425	793
Financial assets	1,766,024	1,766,024
	1,766,463	**1,766,826**
Current assets		
Inventories		
Work in process	32	–
Receivables and other assets		
Trade accounts receivable	26,636	19,041
of which from affiliated companies	26,614	19,016
Receivables from affiliated companies	5,355,526	5,505,139
Other assets	82,759	57,471
	5,464,953	**5,581,651**
Deferred charges	**9,995**	**8,840**
Excess of plan assets over pension liability	**8,246**	**13,112**
	7,249,657	**7,370,429**

Equity and Liabilities

	Dec. 31, 2016	Dec. 31, 2017
	€ thousand	€ thousand
Equity		
Capital stock	202,500	202,500
Treasury shares	–	(1,668)
Issued capital	202,500	200,832
Capital reserves	4,918,524	4,777,348
Other retained earnings	220,143	268,896
Distributable profit	273,375	438,900
	5,614,542	**5,685,976**
Provisions		
Provisions for pensions	3,434	1,817
Provisions for taxes	15,713	79,421
Other provisions	52,884	59,098
	72,031	**140,336**
Liabilities		
Bonds	1,500,000	1,500,000
Trade accounts payable	7,481	7,148
of which to affiliated companies	441	320
Liabilities to affiliated companies	43,022	31,157
Other liabilities	12,581	5,812
of which taxes	1,299	1,418
	1,563,084	**1,544,117**
	7,249,657	**7,370,429**

Income Statement of Covestro AG

	2016	2017
	€ thousand	€ thousand
Income from investments in affiliated companies	589,018	704,353
Income from investments in affiliated companies	**589,018**	**704,353**
Other interest and similar income	10,717	2,715
of which from affiliated companies	10,253	2,546
Interest and similar expenses	(12,649)	(17,257)
of which expenses from unwinding of discount	(96)	(2,292)
Interest result	**(1,932)**	**(14,542)**
Other financial income	47	28
of which from currency translation	47	28
Other financial expenses	(12,091)	(3,741)
of which from currency translation	(22)	(34)
Other financial income and expenses	**(12,044)**	**(3,713)**
Financial result	**575,042**	**686,098**
Net sales	27,226	25,636
Cost of services provided	(24,296)	(26,730)
General administration expenses	(55,687)	(63,824)
Other operating income	2,810	1,070
Other operating expenses	(27,394)	(3,598)
Operating result	**(77,341)**	**(67,446)**
Result of operations	**497,701**	**618,652**
Income taxes	(43,344)	(130,999)
Result after tax/net income	**454,357**	**487,653**
Allocation to other retained earnings	(180,982)	(48,753)
Distributable profit	**273,375**	**438,900**

NOTES

Basis of Preparation

The financial statements of Covestro AG, Leverkusen, are prepared in accordance with the German Commercial Code (HGB) and the German Stock Corporation Act (AktG). The company, headquartered in Leverkusen (Germany), is registered in the commercial register of the Local Court of Cologne under No. HRB 85281.

The income statement has been prepared using the cost-of-sales method. In order to emphasize Covestro AG's role as a holding company, the aggregated items of the financial result are presented first, and this presentation deviates from the classification prescribed in Section 275, Paragraph 3 of the German Commercial Code. In addition, financial income and expenses, whose disclosure is not covered by a mandatory item, are reported under other financial income and expenses.

The declaration of conformity with the German Corporate Governance Code pursuant to Section 161 of the German Stock Corporation Act has been issued and made permanently available to shareholders on the internet. It also forms part of the Declaration on Corporate Governance pursuant to Section 289f of the German Commercial Code. It is available for download at www.investor.covestro.com.

The consolidated financial statements of Covestro AG represent both the largest and the smallest group of consolidated companies. The consolidated financial statements of Covestro AG are submitted to the operator of the electronic Federal Gazette in Germany and published on the website at http://investor.covestro.com.

Bayer AG and Covestro AG entered into an agreement on the non-exercise of control effective September 30, 2017, under which Bayer AG is obligated to waive certain voting rights. As of this date, the Covestro Group companies, including Covestro AG, are no longer fully consolidated in the Bayer consolidated financial statements.

Due to these changes in the group of consolidated companies, there are changes to the presentation of items in the statement of financial position as of fiscal 2017. These changes are described in detail in the section "Accounting Policies and Valuation Principles".

The management report of Covestro AG is combined with the management report of the Covestro Group pursuant to Section 315, Paragraph 3 in conjunction with Section 298, Paragraph 3 of the German Commercial Code.

Rounding differences between individual line items may arise due to reporting in thousands of euros.

Accounting Policies and Valuation Principles

Purchased intangible assets are recognized at cost and amortized on a straight-line basis over their estimated useful lives. Internally generated intangible assets are not recognized as assets. Writedowns are recognized if the impairment is expected to be permanent.

Items of property, plant and equipment are carried at cost less depreciation on a straight-line basis for depreciable assets over their expected useful lives. Amortization and depreciation are based on the following useful lives:

Useful Life

Intangible assets	1 to 20 years
Operating and office equipment	2 to 15 years
Information technology	2 to 15 years
Transportation equipment	2 to 12 years

Movable noncurrent assets that are subject to wear and tear and capable of being used independently are depreciated in full in the year of acquisition if their cost does not exceed €410. Writedowns are recognized if expected permanent impairment exceeds the carrying amount.

Investments in affiliated companies are recognized at cost, or at the lower fair value if permanent impairment is expected. Where impairment losses were recognized in previous years and the reasons for impairment no longer or only partially apply, the writedown is reversed, up to a maximum of the original cost.

Work in process is included in inventories and reported at cost.

Receivables and other assets are recognized at their principal amounts, less any valuation allowances. Valuation adjustments are based on the probable risk of default. Global valuation adjustments of 2% are recognized for general credit risk of third-party customers. Non-interest-bearing or low-interest receivables due after one year are discounted to their present value.

In order to meet various obligations related to pension plans and work-time credits of employees, corresponding funds are primarily invested in liquid international bonds, shares, investment funds and near-money-market products using separate pension-provision investment vehicles. These funds are held in trust for Covestro AG and are exempt from attachment by other creditors in the event that the employer declares insolvency. The investments are measured at fair value, which is derived from stock prices and market interest rates. The assets held in trust are offset against the underlying obligations. If there is an excess obligation, a provision is recognized. If the value of the securities exceeds the obligations, the difference is recorded in the statement of financial position under assets as "excess of plan assets over pension liability". Income from the trust assets is likewise offset against expenses relating to the interest component of obligations and to changes in the discount rate in the income statement, provided that income is available.

Deferred charges and deferred income include expenses incurred and income generated prior to the reporting date, which represent expenses and income for a specific period after that date; they are recognized at their nominal amounts. In addition, in application of the option pursuant to Section 250, Paragraph 3 of the German Commercial Code, deferred charges include the difference between the issue and settlement amount of the bonds issued. The differences are amortized over the maturity of the corresponding bond.

Deferred taxes are recognized for temporary differences between the assets, liabilities, deferred charges, and deferred income recognized in the German Commercial Code financial statements and the tax statement. For Covestro AG, this not only includes the differences relating to its own statement of financial position items but also those of tax-group subsidiaries and partnerships in which it holds an equity interest. In addition to temporary differences, tax-loss carryforwards are also recognized where necessary. Deferred taxes are calculated on the basis of the combined income tax rate for the tax group of Covestro AG, which is currently 32.02% (previous year: 32.09%). The combined income tax rate includes corporate income tax, trade tax, and the solidarity surcharge. However, deferred taxes relating to temporary differences for investments in partnerships are calculated on the basis of a combined income tax rate, which includes only corporate income tax and the solidarity surcharge; this remained unchanged from the previous year at 15.83%. Any resulting overall tax burden would be recognized as a deferred tax liability in the statement of financial position. In the event of tax relief, the option to recognize the deferred tax would not be exercised. In the fiscal year, there was a total of one unrecognized deferred tax asset.

The capital stock of Covestro AG is divided into 202,500,000 no-par-value bearer shares with a notional value of €1 per share.

Provisions for pensions and similar obligations are determined according to actuarial principles, using the projected unit credit method on the basis of biometric probability using the Heubeck 2005 G reference tables. Expected future salary and pension increases are taken into account when determining the obligations. We assume annual salary increases of 2.75% (previous year: 2.75%). We expect annual pension increases of 1.70% (previous year: 1.50%). However, for pension commitments granted as of January 1, 2000, an annual pension increase of 1.00% applies in line with what was promised to employees. The discount rate as of December 31, 2017, used for discounting pension obligations was 3.68% (previous year: 4.01%). This is the average market interest rate over the past 10 years for an assumed remaining term of 15 years calculated and published by Deutsche Bundesbank for December 2017.

The difference resulting from the change in the discount rate for pension obligations as defined by Section 253, Paragraph 2 of the German Commercial Code is subject to distribution restrictions pursuant to Section 253, Paragraph 6 of the German Commercial Code.

Other provisions cover all foreseeable risks and uncertain liabilities. They are measured on the basis of the settlement amount required according to sound business judgment. Future price and cost increases are taken into account as long as there are sufficient objective indications that they will occur. Provisions with a remaining maturity of more than one year are discounted using the average market interest rate over the past seven fiscal years appropriate to their remaining maturities. For long-term personnel-related provisions, such as those for long-term service awards, a rate of 2.80% (previous year: 3.24%) is used for an assumed remaining maturity of 15 years. Shorter-term personnel-related provisions for obligations under early retirement and partial-retirement agreements are discounted using a rate appropriate to their maturity. In 2017, the maturity was three years and the discount rate 1.43% (previous year: 1.81%). The interest rates at the time that the respective personnel-related provisions were determined are those expected for December.

Liabilities are recognized at their settlement amount.

Short-term receivables in foreign currencies and short-term liabilities in foreign currencies with a remaining maturity of one year or less are translated at the average exchange rate applicable on the reporting date without taking into account the constraints of the realization and acquisition cost principles.

The disclosed contingent liabilities from sureties and debt guarantees for third-party liabilities correspond to the loan drawdowns and obligations of beneficiaries on the reporting date.

The year-on-year changes in the largest group of consolidated companies resulted in changes to the presentation of receivables and liabilities. As of the reporting date on December 31, 2016, the balances with companies of the Bayer Group were shown unchanged under the items related to affiliated companies. As of December 31, 2017, balances with companies of the Bayer Group were no longer included in these items.

Notes to the Statement of Financial Position

1. Intangible Assets

Intangible Assets

	Software licenses
	€ thousand
Gross carrying amounts, Jan. 1, 2017	17
Additions	–
Gross carrying amounts, Dec. 31, 2017	**17**
Accumulated amortization and writedowns, Jan. 1, 2017	3
Accumulated amortization and writedowns, in 2017	5
Accumulated amortization and writedowns, Dec. 31, 2017	**8**
Net carrying amounts, Dec. 31, 2017	**9**
Net carrying amounts, Jan. 1, 2017	14

2. Property, Plant and Equipment

Property, Plant and Equipment

	Operating and office equipment	Prepayments and assets under construction	Total
	€ thousand	€ thousand	€ thousand
Gross carrying amounts, Jan. 1, 2017	501	3	504
Additions	458	21	479
Gross carrying amounts, Dec. 31, 2017	**959**	**24**	**983**
Accumulated depreciation and writedowns, Jan. 1, 2017	79	–	79
Accumulated depreciation and writedowns in 2017	111	–	111
Accumulated depreciation and writedowns, Dec. 31, 2017	**190**	**–**	**190**
Net carrying amounts, Dec. 31, 2017	**769**	**24**	**793**
Net carrying amounts, Jan. 1, 2017	422	3	425

3. Financial Assets

Financial Assets

	Investments in affiliated companies
	€ thousand
Gross carrying amounts, Jan. 1, 2017	1,766,024
Additions	–
Retirements	–
Gross carrying amounts, Dec. 31, 2017	**1,766,024**
Accumulated writedowns, Jan. 1, 2017	–
Accumulated writedowns 2017	–
Accumulated writedowns, Dec. 31, 2017	**–**
Net carrying amounts, Dec. 31, 2017	**1,766,024**
Net carrying amounts, Jan. 1, 2017	1,766,024

4. Receivables and Other Assets

Receivables from affiliated companies include loans of €4,800,000 thousand and the receivable stemming the profit and loss transfer agreement of €704,353 thousand from Covestro Deutschland AG.

All receivables and other assets had a maturity of less than one year.

5. Excess of Plan Assets over Pension Liability

Obligations arising from work-time accounts as well as pension commitments are fully or partially covered by assets that were held in trust and invested using separate pension-provision investment vehicles (plan assets). The invested assets may only be used for the purpose of meeting obligations under specifically defined plans and are exempt from attachment by other creditors in the event that the employer becomes insolvent. They were offset against the underlying obligations. This resulted in a total excess of €13,112 thousand as of December 31, 2017, of which €515 thousand was attributable to obligations arising from work-time accounts and €12,597 thousand to pension commitments.

Excess of Plan Assets over Pension Liability

	Dec. 31, 2016	Dec. 31, 2017
	€ thousand	€ thousand
Settlement amount of obligations relating to credit balances on employees' long-term work-time accounts	459	326
Fair value of assets invested	633	841
Difference between assets and obligations relating to long-term work-time accounts (excess of plan assets)	**174**	**515**
Acquisition cost of assets invested	607	797

	Dec. 31, 2016	Dec. 31, 2017
	€ thousand	€ thousand
Settlement amount of pension commitments	13,369	24,783
Fair value of assets invested	21,441	37,380
Difference between assets and obligations relating to pension commitments (excess of plan assets)	**8,072**	**12,597**
Acquisition cost of assets invested	20,922	35,976

The plan assets are measured at fair value, which was €38,221 thousand as of December 31, 2017. Offsetting of total plan assets against the underlying obligations resulted in an overfunding asset. This item is reported as “excess of plan assets over pension liability”.

Up to October 5, 2017, Covestro AG made noncash contributions of €5,501 thousand to the trust assets.

6. Equity

During the fiscal year, equity changed as follows:

Equity

	Jan. 1, 2017	Share buybacks	Dividends	Net income	Dec. 31, 2017
	€ thousand	€ thousand	€ thousand	€ thousand	€ thousand
Capital stock	202,500	–	–	–	202,500
Treasury shares	–	(1,668)	–	–	(1,668)
Issued capital	202,500	(1,668)	–	–	200,832
Capital reserve	4,918,524	(141,176)	–	–	4,777,348
Other retained earnings	220,143	–	–	48,753	268,896
Distributable profit	273,375	–	(273,375)	438,900	438,900
	5,614,542	**(142,844)**	**(273,375)**	**487,653**	**5,685,976**

The capital stock of Covestro AG amounted to €202,500,000 and is divided into 202,500,000 no-par-value bearer shares with a notional value of €1 per share; it is fully paid up. As of the reporting date on December 31, 2017, Covestro AG held a total 1,668,512 treasury shares.

The difference between the notional value and cost of the treasury shares acquired was appropriated to capital reserves pursuant to Section 272, Paragraph 2, No. 4 of the German Commercial Code.

The Annual Stockholders' Meeting of October 2, 2015, resolved authorized capital of €101,250,000, expiring October 2, 2020. This may be used to increase capital stock through the issue of new no-par-value bearer shares against cash and/or noncash contributions. The stockholders are entitled to subscription rights. However, the Board of Management is authorized, with the consent of the Supervisory Board, to disapply stockholders' subscription rights where the subscription ratio gives rise to fractional amounts. Subscription rights may also be disapplied 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. The Board of Management is further authorized, with the consent of the Supervisory Board, to disapply subscription rights for stockholders if the capital increase is implemented to grant shares against noncash contributions or to grant a scrip dividend, in the process of which the stockholders are given the option of contributing their dividend rights to the company (either in full or in part) as noncash contributions in exchange for new shares being granted from authorized capital. The stockholders' subscription rights may also be disapplied 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 disapplied 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 counts toward 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. Furthermore, shares issued or to be issued to service bonds (including jouissance rights) with warrants or conversion rights or obligations 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.

The authorized capital, expiring on October 2, 2020, has not been utilized to date.

The Board of Management, with the consent of the Supervisory Board, decides on the substance of the share rights as well as the other terms and conditions of the share issue, including the issue price.

The Annual Stockholders' Meeting of September 1, 2015, passed resolutions on 2015 conditional capital, authorizing an increase in conditional capital stock by up to €70,000,000 by issuing up to 70,000,000 new no-par-value registered shares with a notional value of €1 per share. The conditional capital increase will 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 Annual Stockholders' Meeting of September 1, 2015, exercise their conversion or option rights or fulfill their conversion or option obligations, and to the extent that such warrants or conversion rights or obligations cannot be serviced by treasury shares, shares issued from authorized capital, or other forms of settlement.

The new shares will be issued at the warrant or conversion price to be determined in accordance with the authorizing resolution referred to above. The new shares will participate in 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 will participate in profit from the beginning of the fiscal year for which, at the time when the warrant or conversion rights are exercised or the exercise or conversion obligations are performed, the Annual 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.

In the event of a capital increase, the profit participation rules for the new shares may be specified in derogation from Section 60 of the German Stock Corporation Act.

The conditional capital has not been utilized to date.

Treasury shares

In October 2017, Covestro AG's Board of Management announced that the Company intended to buy back treasury shares totaling up to €1.5 billion (excluding transaction costs) until the middle of 2019, or up to 10% of the company's capital stock, whichever comes first. The resolution was adopted in accordance with the authorization granted by the Annual General Meeting on September 1, 2015. The share buy-back will be executed in Xetra® trading on the Frankfurt Stock Exchange in line with the requirements for share buy-back programs set forth in Article 5 of the Market Abuse Regulation and the associated Commission Delegated Regulation. Since the start of the share buy-back on November 21, 2017, to December 31, 2017, Covestro AG had acquired 1,668,512 shares.

This is equivalent to a nominal value of €1,668,512 or 0.82% of the capital stock.

During fiscal 2017, €142,844 thousand (excluding transaction costs) was spent on the share buy back; this is equivalent to a weighted average price of €85.61 per share. The acquisition was executed between November 21 and December 29, 2017, through a bank commissioned by Covestro AG exclusively in Xetra® trading on the Frankfurt Stock Exchange. The average volume acquired by Covestro on the trading days was 61,797 shares. During the buy-back, the purchase price per repurchased share (excluding transaction costs) was not allowed to be more than 10% higher or lower than the price of Covestro shares as determined by the opening auction in Xetra® trading on the trading day.

The repurchased treasury shares may be retired or reissued to employees as part of a share participation program.

Disclosures on Amounts Subject to Distribution Restrictions Within the Meaning of Sections 268, Paragraph 8 and 253, Paragraph 6 of the German Commercial Code

To cover pension obligations and credit balances on employees' work-time accounts, as part of a contractual trust agreement, funds have been transferred to the Metzler Fund, earmarked for this purpose and protected from insolvency. The funds are measured at fair value. As of the reporting date, these funds amounted to €38,221 thousand; they exceeded the cost of €36,773 thousand by €1,448 thousand. The excess of €1,448 thousand was offset by available reserves of €3,608,745 thousand, which means that this excess amount is subject to distribution restrictions.

Furthermore, the difference resulting from the change in the discount rate used to discount provisions for pension obligations, amounting to an additional €5,454 thousand of available reserves, was subject to distribution restrictions pursuant to Section 253, Paragraph 6 of the German Commercial Code.

The reported distributable profit of €438,900 thousand was not subject to distribution restrictions.

Information on Stockholdings Pursuant to Section 21, Paragraph 1 of the German Securities Trading Act (WpHG)

During fiscal year 2017 and in the previous year, we received the following notifications of stockholdings in Covestro AG pursuant to Section 21, Paragraph 1 of the German Securities Trading Act. In cases where stockholdings reached, exceeded, or fell below the thresholds set out in this provision on several occasions and are reportable, only the most recent or last such notification is included:

Disclosures in Accordance with Section 160, Paragraph 1, No. 8 of the German Stock Corporation Act (AktG)

Entity subject to disclosure requirements	Date of notification	Share of voting rights reached on	Threshold	Voting rights		Attribution according to WpHG
			%	%	absolute	
The Goldman Sachs Group, Inc., Wilmington	Oct. 13, 2017	Oct. 5, 2017	3	0.61	1,230,116	Sec. 22, 25, Para. 1, No. 1, 2
Bayer AG, Leverkusen	Sep. 29, 2017	Sep. 27, 2017	40	40.37	81,750,000	Sec. 21, 22, 25, Para. 1 No. 2
BlackRock, Inc., Wilmington	Jun. 19, 2017	Jun. 9, 2017	3	3.49	7,065,155	Sec. 22, 25, Para. 1, No. 1, 2
Bayer Pension Trust e.V., Leverkusen	Jun. 12, 2017	Jun. 7, 2017	5	8.89	18,000,000	Sec. 21
Standard Life Investments Ltd., Edinburgh	Oct. 10, 2016	Oct. 4, 2016	3	2.94	5,958,554	Sec. 22
BlackRock Luxembourg Holdco S.à r.l., Luxembourg	Nov. 26, 2015	Nov. 24, 2015	3	2.98	6,039,615	Sec. 22
BlackRock (Luxembourg) S. A., Luxembourg	Nov. 26, 2015	Nov. 24, 2015	3	2.98	6,039,615	Sec. 22
BlackRock Global Funds, Luxembourg	Nov. 26, 2015	Nov. 24, 2015	3	2.96	5,984,212	Sec. 21
BlackRock Investment Management (UK) Limited, London	Oct. 9, 2015	Oct. 7, 2015	3	3.68	7,444,261	Sec. 22
BlackRock Group Limited, London	Oct. 9, 2015	Oct. 7, 2015	3	3.80	7,689,383	Sec. 22
BR Jersey International Holdings L.P., St. Helier, Jersey	Oct. 9, 2015	Oct. 7, 2015	3	3.80	7,691,608	Sec. 22
BlackRock International Holdings, Inc., Wilmington	Oct. 9, 2015	Oct. 7, 2015	3	3.80	7,691,608	Sec. 22
BlackRock Financial Management, Inc., Wilmington	Oct. 9, 2015	Oct. 7, 2015	3	3.85	7,802,680	Sec. 22
BlackRock Holdco 2, Inc., Wilmington	Oct. 9, 2015	Oct. 7, 2015	3	3.85	7,802,680	Sec. 22

7. Provisions for Pensions

Provisions for pensions include the benefit obligations for current and past employees. This item also includes obligations under early retirement arrangements.

Obligations arising from pension commitments are fully or partially covered by assets held in trust and invested using separate pension-provision investment vehicles (plan assets). The invested assets may only be used for the purpose of meeting pension obligations and are exempt from attachment by other creditors. They were offset against the underlying obligations.

Provisions for Pensions

	Dec. 31, 2016	Dec. 31, 2017
	€ thousand	€ thousand
Settlement amount of pension commitments	12,276	1,817
Fair value of assets invested	8,842	–
Net value of pension commitments (provisions)	**3,434**	**1,817**
Acquisition cost of assets invested	8,808	–

The **difference resulting from the change in the discount rate within the meaning of Section 253, Paragraph 6, Sentence 1 of the German Commercial Code** was €5,454 thousand on December 31, 2017 (previous year: €4,553 thousand).

8. Provisions for taxes

The increase in provisions for taxes by a total of €63,708 thousand as against the previous year included €24,901 thousand for current income taxes as a result of the positive business performance in the reporting year and €38,807 thousand in provisions from previous years.

In the previous year, this item did not include any provisions for current income taxes, as the prepayments made for fiscal 2016 exceeded the tax to be assessed.

9. Other Provisions

Other provisions were mainly recognized for personnel-related obligations (€28,201 thousand). Provisions to offset possible tax claims by Bayer AG in connection with the contribution, indemnification, and post-formation agreement were also included in provisions for other uncertain liabilities (€30,897 thousand).

10. Bonds

On December 31, 2017, bonds amounted to €1,500,000 thousand. They break down as follows:

Bonds

	Par value	Coupon rate	Effective interest rate	Dec. 31, 2017
		in %	in %	€ thousand
DIP bond 2016/2018	€500 million	variable	variable	500,000
DIP bond 2016/2021	€500 million	1.000	1.076	500,000
DIP bond 2016/2024	€500 million	1.750	1.782	500,000
				1,500,000

The differences between the issue and settlement amount of the bonds issued, which are reported under deferred charges in application of the option pursuant to Section 250, Paragraph 3 of the German Commercial Code, totaled €2,441 thousand on December 31, 2017 (previous year: €2,966 thousand).

11. Additional Disclosures on Liabilities

Liabilities were classified according to maturity as follows:

Maturity Structure of Liabilities

	Dec. 31, 2016			
	Due in 2017	Due in or after 2018	of which due in or after 2022	Total
	€ thousand	€ thousand	€ thousand	€ thousand
Bonds	–	1,500,000	500,000	1,500,000
Trade accounts payable	7,481	–	–	7,481
Liabilities to affiliated companies	43,022	–	–	43,022
Other liabilities	12,581	–	–	12,581
Total	**63,084**	**1,500,000**	**500,000**	**1,563,084**

Maturity Structure of Liabilities

	Dec. 31, 2017			
	Due in 2018	Due in or after 2019	of which due in or after 2023	Total
	€ thousand	€ thousand	€ thousand	€ thousand
Bonds	500,000	1,000,000	500,000	1,500,000
Trade accounts payable	7,148	–	–	7,148
Liabilities to affiliated companies	31,157	–	–	31,157
Other liabilities	5,380	432	–	5,812
Total	**543,685**	**1,000,432**	**500,000**	**1,544,117**

Notes to the Income Statement

12. Income from Investments in Affiliated Companies

Income from investments in affiliated companies of €704,353 thousand (previous year: €589,018 thousand) was solely attributable to income from the control and profit and loss transfer agreement with Covestro Deutschland AG.

13. Interest Result

In addition to expenses of €15,115 thousand (previous year: €12,544 thousand) for the bonds issued, the interest result includes primarily interest income for loans granted to Covestro Deutschland AG in the amount of €2,546 thousand (previous year: €10,253 thousand).

The expenses related to the interest cost allocated to pension provisions of €2,751 thousand (previous year: €214 thousand), which also included expenses from changes in the discount rate, were offset against income of €843 thousand (previous year: €678 thousand) from the investment with Metzler Trust e. V., Frankfurt am Main (Germany).

14. Other Financial Income and Expenses

The main item reported in other financial income and expenses was bank fees amounting to €3,550 thousand (previous year: €11,066 thousand). These include commitment fees for credit lines and amortization of the original issue discount on the bonds.

Income and expenses from foreign currency translation are also reported in this item.

15. Net Sales

Sales include income from services rendered by the Corporate Center divisions of Covestro AG for Covestro Group companies. Of the €25,636 thousand (previous year: €27,226 thousand) reported, sales generated with foreign Group companies accounted for €394 thousand (1.54%) (previous year: €507 thousand). Expenses incurred for providing the services are shown under cost of services provided.

16. Other Operating Income

Other operating income included prior-period income of €1,068 thousand (previous year: €2,747 thousand). A total of €679 thousand (previous year: €447 thousand) is attributable to the reversal of other provisions, in particular personnel-related provisions.

17. Other Operating Expenses

Other operating expenses included primarily expenses of €2,603 thousand (previous year: €27,265 thousand) in connection with the existing contribution, indemnification, and post-formation agreement between Bayer AG, Leverkusen, and Covestro AG described in the section 22 “Contingent Liabilities”.

18. Income Taxes

Income tax expense encompasses corporate income tax, trade tax, the solidarity surcharge, and income taxes paid outside Germany.

The tax expense does not include deferred taxes. As of December 31, 2017, Covestro AG expected a future tax relief of €119,244 thousand (previous year: €91,107 thousand) from temporary differences relating to itself as well as to companies within the tax group and partnerships. This is calculated on the basis of the combined income tax rate of 32.02% (previous year: 32.09%, Covestro AG and tax-group subsidiaries) or 15.83% (investments in partnerships; the tax rate includes only corporate income tax and the solidarity surcharge).

Deferred tax liabilities were mainly the result of the difference between the higher carrying amounts of both non-current assets and plan assets invested with Metzler Trust e. V., Frankfurt am Main – primarily to cover pension commitments – and the valuation in the tax statement. Deferred tax assets are mainly the result of higher amounts recognized for pension obligations in the financial statements in accordance with German commercial law compared with the tax balance sheet. Deferred tax assets also resulted from non recognizable provisions for anticipated losses and for pre retirement leave in the tax balance sheet. Other reasons for deferred tax assets included measurement differences, for example for provisions for early retirement arrangements and long-term service awards. Overall, deferred tax liabilities were more than offset by deferred tax assets. In application of the option under Section 274, Paragraph 1, Sentence 2 of the German Commercial Code, no deferred tax assets were recognized for the excess of deferred tax assets over deferred tax liabilities.

19. Other Taxes

Where other taxes could be allocated to general administration expenses, they are recognized there. Otherwise, they are included under other operating expenses. Other taxes totaled €69 thousand (previous year: €73 thousand).

20. Cost of Materials

Cost of Materials

	2017
	€ thousand
Cost of raw materials, consumables and supplies, and of purchased merchandise	129
Cost of purchased services	41
	170

21. Personnel Expenses/Employees

Personnel Expenses

	2017
	€ thousand
Wages and salaries	42,874
Social expenses and expenses for pensions and other benefits	4,672
of which pension expenses	3,700
	47,546

Personnel expenses do not include the interest cost allocated to personnel-related provisions, in particular to provisions for pensions, which are shown in the interest result.

On average, Covestro AG had 166 employees (previous year: 168) in the reporting year. They break down as follows:

Employees

	2017	
	Women	Men
Senior executives and senior managers	24	58
Junior managers and nonmanagerial employees	48	36
	72	**94**

These figures include part-time employees on a pro rata basis.

Other Information

22. Contingent Liabilities

Liabilities arising from debt guarantees and sureties amounted to €85,033 thousand. They were issued in favor of Group companies without exception. Due to the Group's excellent liquidity situation, all of the companies concerned are able to meet the underlying obligations; utilization is therefore not expected.

Debt Guarantees and Sureties

	Principal amount
	€ thousand
LyondellBasell Covestro Manufacturing Maasvlakte V.O.F, Rotterdam (Netherlands)	
due in 2031	25,000
Covestro LLC, Pittsburgh (United States)	
Principal amount: $71,998 thousand; maturing 2020	60,033
	85,033

In connection with the contribution, indemnification, and post-formation agreement between Bayer AG, Leverkusen, and Covestro AG, arrangements were made to settle possible claims for taxes, which may result in corresponding liabilities.

23. Other Financial Commitments

In addition to provisions, liabilities, and contingent liabilities, there are other financial commitments.

Effective September 1, 2015, Bayer-Pensionskasse VVaG, Leverkusen (Germany), and Covestro AG agreed to include Covestro AG as an additional guarantor in the initial fund previously agreed with Bayer AG. The purpose of the initial fund is to provide Bayer-Pensionskasse VVaG with repayable, interest-bearing loans, if necessary. Covestro AG has undertaken to provide a maximum of €208 million to the initial fund. As of the reporting date, Covestro AG had not yet made any contributions.

Obligations of €424 thousand were recognized for future lease and rent payments. Of the total rental obligations, €154 thousand is due in 2018 and €270 thousand in 2019 to 2021.

24. Related Party Disclosures

Related parties are legal entities or natural persons that are able to exert influence over Covestro AG or over which Covestro AG exercises control or has a significant influence.

Transactions with related parties include mainly those entered into with Bayer AG, and its subsidiaries as well as with pension plans. These mainly comprise rental, service, and financing transactions.

25. Total Compensation of the Board of Management and Supervisory Board and Advances and Loans Granted

The compensation of the members of the Board of Management in fiscal 2017 consisted of the following:

Total Compensation of the Board of Management

	Serving members of the Board of Management as of December 31, 2017		Former members	
	2016	2017	2016	2017
	€ thousand	€ thousand	€ thousand	€ thousand
Fixed annual compensation	2,150	2,254	680	288
Fringe benefits	150	828	21	615
Short-term variable compensation	5,374	5,222	1,700	659
Long-term variable compensation[1]	3,709	2,835	1,173	358
Aggregate compensation	**11,383**	**11,139**	**3,574**	**1,920**
Pension service cost[2]	725	756	240	94

[1] Fair value when granted
[2] Including company contribution to Bayer-Pensionskasse VvaG and Rheinischen Pensionskasse VVaG

The compensation comprises a non-performance-related component, an annual incentive, and a long-term stock-based component. The Covestro Group's compensation structure, based on average total annual compensation for a Board of Management member at 100% target attainment, has the following components: 30% fixed annual compensation, 30% short-term variable compensation, and 40% long-term variable compensation (excluding fringe benefits and pension entitlements).

The non-performance-related compensation comprises the fixed annual compensation, which reflects the responsibilities and performance of the Board of Management members, along with fringe benefits. The performance-related compensation comprises a short-term variable component, which depends on the attainment of the corporate performance targets and on the long-term variable compensation, the stock-based compensation program Prisma. This is linked directly to changes in Covestro's share price.

The individual performance-related components are capped at the grant date. To comply with the recommendation of the German Corporate Governance Code, a cap has also been agreed for the compensation as a whole (total of the annual fixed compensation and the variable components, along with fringe benefits). The cap is 1.9 times the respective target compensation (total compensation for a Board of Management member at 100% target attainment) and is determined annually by the Supervisory Board when the fixed compensation is set. In the context of the compensation structure outlined here, the target compensation therefore amounts to 3.3 times the fixed compensation. The maximum total compensation is therefore 6.3 times the fixed compensation.

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

The members of the Board of Management will still be participating in the final ongoing performance periods (2014–2017 and 2015–2018 tranches) of the "Aspire" long-term stock-based compensation program whose terms were set by Bayer. 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.

In order to break the link between the payout and the development of Bayer's share price, which can no longer be materially influenced by the members of the Board of Management, the Supervisory Board decided in 2015 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. In January 2018, this resulted in a payout for the 2014–2017 tranche of a distribution totaling 170% of the target value. 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). This was compensated for by increasing the target value for the first tranche of Covestro's own Prisma long-term compensation program launched in 2016 by 4/12. For the 2015–2018 Aspire tranche, however, the relevant average price as of year end 2015 remained below the required minimum hurdle. As a result, there will be no payout for this tranche.

The members of the Board of Management are eligible to participate in the Prisma compensation program as long as they remain in the service of the Covestro Group and acquire for their own account, and hold an individually determined number of Covestro shares according to defined guidelines. This program is based on a target opportunity set at 130% of the fixed annual compensation. When a member of the Board of Management retires, current tranches may be shortened, thus reducing their value.

The payout is determined by calculating two factors: The total shareholder return (TSR) factor is the return generated by a stock expressed as a percentage (total of the final price of the share and all dividends distributed per share during the performance period divided by the initial price). The outperformance factor is based on the performance of Covestro stock during the performance period relative to the performance of the STOXX® Europe 600 Chemicals index. It is determined by expressing the difference between the performance of Covestro stock and that of the index as a percentage. The factor is greater than 100% (less than 100%) if Covestro's stock outperforms (underperforms) the index.

The Prisma target opportunity of each participant is multiplied by the TSR factor and the outperformance factor to arrive at the total distribution figure. The total distribution is limited to no more than 200% of the target opportunity. The maximum payout is therefore 260% of the fixed annual compensation. If Covestro's shares were to significantly underperform the index (e.g. if the price of the stock went down while the index increased in value), the outperformance factor could amount to zero. As a result, there would be no payout.

The outstanding remuneration amount for Frank H. Lutz was established in the context of a termination agreement. Accordingly, he received his fixed annual compensation pro rata for five full months up to and including May 2017, as well as pro rata for two days in June up to his resignation from office on June 2, 2017. The long-term compensation for tranches of the years up to and including 2016 (remaining Aspire tranches as well as the Prisma program from 2016) is regarded as fully earned; a pro-rata target value for five of the twelve months is granted for Prisma in 2017. As part of the short-term variable compensation, there is an existing entitlement to the Covestro PSP for 2017 with a pro-rata target value for five of the twelve months. All variable compensation components shall be paid based on the actual targets set and achieved at the date of the respective maturity. The previously existing non-compete agreement was reduced from two years to one year. During the reporting period, Frank H. Lutz has not engaged in any activity which would have led to a deduction of the compensation for the non-compete period.

The fringe benefits for the reporting year 2017 include security facilities for Frank H. Lutz, Dr. Klaus Schäfer and Dr. Markus Steilemann in the amount of €905 thousand. In addition, Frank H. Lutz received a pro-rated compensatory payment of €393 thousand in fiscal 2017 for a post-contractual non-compete agreement that was limited to one year.

Expenses for pension commitments of €850 thousand were incurred for those members of the Board of Management who were in the service to the company during the reporting year. These included the current service cost for pension commitments and company contributions to Bayer-Pensionskasse VVaG and Rheinische Pensionskasse VVaG. The settlement amount for pension obligations for members of the Board of Management in service as of the reporting date amounted to €6,985 thousand. The settlement amount for pension obligations for former members of the Board of Management amounted to €404 thousand.

Total compensation for the Supervisory Board for the reporting year was €1,756 thousand. This includes attendance fees of €101 thousand.

As of December 31, 2017, there were no loans to members of the Board of Management or the Supervisory Board, nor were any loans repaid during the fiscal year.

Details of the compensation of the Board of Management and Supervisory Board can be found in the compensation report included in the combined management report of the Covestro Group and Covestro AG.

26. Governance Bodies

Board of Management

Name	Position	Areas of responsibility	Memberships on other supervisory boards
Patrick Thomas	Chair of the Board of Management Chief Executive Officer	• Corporate Office • Communications • Corporate Audit • Human Resources • Sustainability	• Member of the Supervisory Board of Akzo Nobel N.V. (since November 2017)
Frank H. Lutz (until June 2017) **Patrick Thomas** (temporarily since June 2017)	Chief Financial Officer Labor Director Chief Financial Officer	• Accounting • Controlling • Finance • Information Technology • Investor Relations • Law, Intellectual Property & Compliance • Portfolio Development • Taxes	
Dr. Klaus Schäfer	Chief Technology Officer Labor Director (since July 2017)	• Global Project Engineering • Health, Safety, Environment & Quality • Production & Technology • Procurement • Site Management NRW • Site Management Baytown • Site Management Shanghai	
Dr. Markus Steilemann	Chief Commercial Officer	• Polyurethanes • Polycarbonates • Coatings, Adhesives, Specialties • Innovation Management & Commercial Services • Strategy • Supply Chain Center EMLA • Supply Chain Center NAFTA • Supply Chain Center APAC	

Supervisory Board

Name	Membership in the Supervisory Board	Position	Memberships on other Supervisory Boards
Dr. Richard Pott (Chair)	Member of the Supervisory Board since August 2015	• Former Member of the Board of Management and Labor Director of Bayer AG	• Chair of the Supervisory Board of Covestro Deutschland AG • Member of the Supervisory Board of Freudenberg SE • Member of the Supervisory Board of SCHOTT AG
Petra Kronen (Vice Chair)	Member of the Supervisory Board since October 2015	• Chair of the Works Council of Covestro at the Uerdingen site • Chair of the General Works Council of Covestro • Vice Chair of Covestro-European Forum • Employee of Covestro Deutschland AG	• Vice Chair of the Supervisory Board of Covestro Deutschland AG • Member of the Supervisory Board of Bayer AG (until September 2017) • Member of the Supervisory Board of Bayer Beistandskasse VVaG
Ferdinando Falco Beccalli	Member of the Supervisory Board since October 2015	• Chairman of the Board of Falco Enterprises AG	• Member of the Supervisory Board of Covestro Deutschland AG • Chair of the Supervisory Board of ENAV S.p.A. (until June 2017)
Dr. Christine Bortenlänger	Member of the Supervisory Board since October 2015	• Executive Member of the Board of Deutsches Aktieninstitut e.V.	• Member of the Supervisory Board of Covestro Deutschland AG • Member of the Supervisory Board of OSRAM GmbH • Member of the Supervisory Board of OSRAM Licht AG • Member of the Supervisory Board of SGL Carbon SE • Member of the Supervisory Board of TUV SÜD AG
Johannes Dietsch	Member of the Supervisory Board since August 2015	• Member of the Board of Management of Bayer AG	• Member of the Supervisory Board of Covestro Deutschland AG • Chair of the Supervisory Board of Bayer Business Services GmbH • Chair of the Supervisory Board of Bayer CropScience AG (until February 2017)
Dr.-Ing. Thomas Fischer	Member of the Supervisory Board until December 2017	• Chairman of the Managerial Employees' Committee of Covestro Deutschland AG (until June 2017) • Manager of Covestro Deutschland AG (retired since January 2018)	• Member of the Supervisory Board of Covestro Deutschland AG (until December 2017) • Member of the Supervisory Board of Bayer AG (until May 2017) • Member of the Supervisory Board of Bayer-Pensionskasse VvaG (until June 2017)
Peter Hausmann	Member of the Supervisory Board since October 2015	• Member of the Executive Committee of the German Mining, Chemical and Energy Industrial Union (IG BCE) (until October 2017)	• Member of the Supervisory Board of Covestro Deutschland AG • Member of the Supervisory Board of Henkel AG & Co. KGaA • Member of the Supervisory Board of Continental AG • Vice Chair of the Supervisory Board of 50Hertz Transmission GmbH • Vice Chair of the Supervisory Board of Vivawest GmbH • Vice Chair of the Supervisory Board of Vivawest Wohnen GmbH
Irena Küstner	Member of the Supervisory Board since October 2015	• Chair of the Works Council of Covestro at the Leverkusen site • Chair of the Group Works Council of Covestro • Vice Chair of the General Works Council of Covestro • Employee of Covestro Deutschland AG	• Member of the Supervisory Board of Covestro Deutschland AG
Prof. Dr. Rolf Nonnenmacher	Member of the Supervisory Board since August 2015	• Certified Accountant	• Member of the Supervisory Board of Covestro Deutschland AG • Member of the Supervisory Board of Continental AG • Member of the Supervisory Board of ProSiebenSat.1 Media SE

Supervisory Board

Name	Membership in the Supervisory Board	Position	Memberships on other Supervisory Boards
Regine Stachelhaus	Member of the Supervisory Board since October 2015	• Former Member of the Board of Management and Labor Director of E.ON AG	• Member of the Supervisory Board of Covestro Deutschland AG • Member of the Supervisory Board of CECONOMY AG (for the first time elected as member of the Supervisory Board of METRO AG in February 2017) • Member of the Supervisory Board of SPIE GmbH (until December 2017) • Member of the Supervisory Board of SPIE SAG GmbH (until December 2017) • Member of the Supervisory Board of SPIE Deutschland und Zentraleuropa HmbG (since December 2017) • Director of SPIE SA, France • Non-executive director of ComputaCenter plc, United Kingdom
Marc Stothfang	Member of the Supervisory Board since February 2017	• Chair of the Works Council of Covestro at the Brunsbüttel site • Chair of Covestro-European Forum • Employee of Covestro Deutschland AG	
Frank Werth	Member of the Supervisory Board since September 2016	• District Manager of the German Mining, Chemical and Energy Industrial Union (IG BCE) – district Leverkusen	• Member of the Supervisory Board Covestro Deutschland AG
Sabine Wirtz	Member of the Supervisory Board until February 2017	• Substitute Member of the Works Council of Covestro Deutschland AG • Chemical Laboratory Technician of Covestro Deutschland AG	• Member of the Supervisory Board of Covestro Deutschland AG
Dr. Ulrich Liman	Member of the Supervisory Board since January 2018	• Chair of the Managerial Employees' Committee of Covestro Deutschland AG (since June 2017) • Manager of Covestro Deutschland AG	• Member of the Supervisory Board of Covestro Deutschland AG (since January 2018)

27. Audit Fees

The total fee charged by the auditor for the reporting year within the meaning of Section 285, No. 17 of the German Commercial Code is broken down into auditing services, other assurance services, tax-advisory services, and other services as indicated in the corresponding statement in the consolidated financial statements.

The fees for auditing the financial statements mainly comprise those for the audits of the consolidated financial statements, the review of the interim consolidated financial statements as of June 30, 2017, process-related reviews as well as the audit of the single-entity financial statements of Covestro AG and German subsidiaries.

To a lesser degree, the auditor also performed other assurance services in the areas of compliance and sustainability as well as providing tax advice.

28. List of Shareholdings

Covestro AG directly or indirectly holds shares in the following companies (disclosures pursuant to Section 285, No. 11 of the German Commercial Code). The amounts stated for equity and net income or loss for the year relate to the amounts from the annual financial statements prepared in accordance with national law as of December 31, 2017; all amounts are rounded:

List of Shareholdings

Company name	Place of business	Equity interest	Equity	Net income/loss	Foot-note
		%	€ thousand	€ thousand	
EMLA					
Bayer Pearl Polyurethane Systems FZCO	Dubai (United Arab Emirates)	51.0	22,709	3,751	2
Bayer Pearl Polyurethane Systems L.L.C	Dubai (United Arab Emirates)	49.0	234	61	2
CleanTech NRW GmbH	Leverkusen (Germany)	100.0	32	(8)	2
Covestro (France) SNC	Fos-sur-Mer (France)	100.0	16,583	3,896	2
Covestro (Slovakia) Services s.r.o.	Bratislava (Slovakia)	100.0	232	227	2
Covestro (Tielt) NV	Tielt (Belgium)	100.0	36,366	2,588	2
Covestro A/S	Otterup (Denmark)	100.0	8,811	6,599	2
Covestro B.V.	Foxhol (Netherlands)	100.0	114,864	9,275	2
Covestro Brunsbüttel Energie GmbH	Brunsbüttel (Germany)	100.0	39	278	1, 2
Covestro Deutschland AG	Leverkusen (Germany)	100.0	1,782,685	704,353	1
Covestro Elastomers SAS	Romans-sur-Isère (France)	100.0	35,336	8,471	2
Covestro First Real Estate GmbH	Monheim (Germany)	100.0	41,348	21,155	2
Covestro GmbH	Leverkusen (Germany)	100.0	5,325	98	1, 2
Covestro Indústria e Comércio de Polimeros Ltda.	São Paulo (Brazil)	100.0	20,371	17,415	2
Covestro International SA	Fribourg (Switzerland)	100.0	199,623	196,046	2
Covestro NV	Antwerp (Belgium)	100.0	233,231	30,520	2
Covestro Oldenburg GmbH & Co. KG	Oldenburg (Germany)	100.0	11,257	4,978	2
Covestro Polímer Anoním Şírketí	Istanbul (Turkey)	100.0	213	111	2
Covestro Polyurethanes B.V.	Nieuwegein (Netherlands)	100.0	46,249	16,555	2
Covestro S.p.A.	Milan (Italy)	99.0	10,866	1,663	2
Covestro S.r.l.	Milan (Italy)	100.0	89,824	12,061	2
Covestro, S.L.	La Canonja (Spain)	100.0	118,021	62,648	2
Covestro Second Real Estate GmbH	Monheim (Germany)	100.0	21,713	8,131	2
Covestro Thermoplast Composite GmbH	Markt Bibart (Germany)	100.0	(440)	279	2
Covestro UK Limited	Cheadle (United Kingdom)	100.0	1,034	501	2
Covestro Verwaltungs GmbH Oldenburg	Oldenburg (Germany)	100.0	35	2	4
Epurex Films Geschäftsführungs-GmbH	Bomlitz (Germany)	100.0	87	7	4
Epurex Films GmbH & Co. KG	Bomlitz (Germany)	100.0	13,872	10,480	1, 2
LyondellBasell Covestro Manufacturing Maasvlakte V.O.F	Rotterdam (Netherlands)	50.0	38,063	(781)	2
MS Global AG	Köniz (Switzerland)	100.0	5,007	978	2
MS Holding B.V.	Nieuwegein (Netherlands)	100.0	1,527,498	368,451	2
OOO Covestro	Moscow (Russia)	100.0	3,116	2,873	2
Paltough Industries (1998) Ltd.	Kibbuz Ramat Yochanan (Israel)	25.0	76,928	1,536	2

List of Shareholdings

Company name	Place of business	Equity interest	Equity	Net income/loss	Footnote
		%	€ thousand	€ thousand	
NAFTA					
Covestro International Trade Services Corp.	Wilmington (United States)	100.0	385	35,234	2
Covestro LLC	Pittsburgh (United States)	100.0	1,144,532	382,628	2
Covestro PO LLC	New Martinsville (United States)	100.0	293,941	78,316	2
Covestro S. A. de C.V.	Mexico City (Mexico)	100.0	66,514	10,236	2
PO JV, LP	Wilmington (United States)	39.4	396,231	(52,701)	2
Technology JV, L. P.	Wilmington (United States)	33.3	259,576	–	2
APAC					
Covestro (Hong Kong) Limited	Hong Kong (China)	100.0	94,473	56,394	2
Covestro (India) Private Limited	Thane (India)	100.0	55,263	15,632	3
Covestro (Shanghai) Management Co., Ltd.	Shanghai (China)	100.0	6,317	3,945	2
Covestro (Taiwan) Ltd.	Kaohsiung (Taiwan)	95.5	34,423	2,509	2
Covestro (Thailand) Co., Ltd.	Bangkok (Thailand)	100.0	265,671	78,212	2
Covestro (Viet Nam) Company Limited	Ho Chi Minh City (Vietnam)	100.0	1,943	1,153	2
Covestro Far East (Hong Kong) Limited	Hong Kong (China)	100.0	307	197	2
Covestro Japan Ltd.	Tokyo (Japan)	100.0	5,704	1,812	2
Covestro Korea Corporation	Seoul (South Korea)	100.0	8,188	7,968	2
Covestro Polymers (China) Co., Ltd.	Shanghai (China)	100.0	1,733,644	826,867	2
Covestro Polymers (Qingdao) Co., Ltd.	Qingdao (China)	100.0	5,192	(187)	2
Covestro Polymers (Shenzhen) Co., Ltd.	Shenzhen (China)	100.0	11,244	1,819	2
Covestro Polymers (Tianjin) Co., Ltd.	Tianjin (China)	100.0	2,588	32	2
Covestro Pty Ltd	Cheltenham (Australia)	100.0	2,596	1,323	2
DIC Covestro Polymer Ltd.	Tokyo (Japan)	50.0	23,451	5,712	2
Guangzhou Covestro Polymers Co., Ltd.	Guangzhou (China)	100.0	20,896	2,698	2
PT Covestro Polymers Indonesia	Jakarta (Indonesia)	99.9	45,682	4,387	2
Shanghai Baulé Polyurethane Technology Co., Ltd.	Shanghai (China)	100.0	529	(1)	2
Sumika Covestro Urethane Company, Ltd.	Amagasaki (Japan)	60.0	41,079	20,492	2

[1] Result prior to takeover
[2] Preliminary result
[3] Net income as of March 31, 2017
[4] Net income as of December 31, 2016

29. Events After the End of the Reporting Period

Since January 1, 2018, there have been no events of special significance that we expect could affect the net assets, financial position and results of operations of Covestro AG.

30. Proposal for the Appropriation of Distributable Profit

The financial statements of Covestro AG show distributable profit of €438,900 thousand. We recommend that distributable profit be used to pay a dividend of €2.20 per no-par-value share carrying dividend rights and that the amount from distributable profit attributable to non dividend bearing no-par-value shares be carried forward.

Responsibility Statement

To the best of our knowledge, and in accordance with applicable reporting principles for financial reporting, the annual financial statements give a true and fair view of the net assets, financial position, and results of operations of Covestro AG, and the management report, which has been combined with the management report of the Covestro Group, includes a fair review of the development and performance of the business and the position of the Covestro Group and Covestro AG, together with a description of the principal opportunities and risks associated with the expected development of the Covestro Group and Covestro AG.

Leverkusen, February 14, 2018
Covestro AG

The Board of Management

Patrick Thomas (Chairman)	Dr. Klaus Schäfer	Dr. Markus Steilemann

Independent Auditor's Report

To Covestro AG, Leverkusen

Report on the Audit of the Annual Financial Statements and of the Management Report

Audit Opinions

We have audited the annual financial statements of Covestro AG, Leverkusen, which comprise the balance sheet as at 31 December 2017, and the statement of profit and loss for the financial year from 1 January to 31 December 2017, and notes to the financial statements, including the recognition and measurement policies presented therein. In addition, we have audited the management report of Covestro AG, which is combined with the group management report, including the non-financial statement pursuant to § [Article] 289b Abs. [paragraph] 1 HGB [Handelsgesetzbuch: German Commercial Code] and § 315b Abs. 1 HGB for the financial year from 1 January to 31 December 2017. We have not audited the content of the statement on corporate governance pursuant to § 289f HGB and § 315d HGB in accordance with the German legal requirements.

In our opinion, on the basis of the knowledge obtained in the audit,

- the accompanying annual financial statements comply, in all material respects, with the requirements of German commercial law and give a true and fair view of the assets, liabilities and financial position of the Company as at 31 December 2017, and of its financial performance for the financial year from 1 January to 31 December 2017 in compliance with German Legally Required Accounting Principles, and

- the accompanying management report as a whole provides an appropriate view of the Company's position. In all material respects, this management report is consistent with the annual financial statements, complies with German legal requirements and appropriately presents the opportunities and risks of future development. Our audit opinion on the management report does not cover the content of the statement on corporate governance referred to above.

Pursuant to § Article 322 Abs. 3 Satz [sentence] 1 HGB, we declare that our audit has not led to any reservations relating to the legal compliance of the annual financial statements and of the management report.

Basis for the Audit Opinions

We conducted our audit of the annual financial statements and of the management report in accordance with § 317 HGB and the EU Audit Regulation (No. 537/2014, referred to subsequently as "EU Audit Regulation") and in compliance with German Generally Accepted Standards for Financial Statement Audits promulgated by the Institut der Wirtschaftsprüfer [Institute of Public Auditors in Germany] (IDW). Our responsibilities under those requirements and principles are further described in the "Auditor's Responsibilities for the Audit of the Annual Financial Statements and of the Management Report" section of our auditor's report. We are independent of the Company in accordance with the requirements of European law and German commercial and professional law, and we have fulfilled our other German professional responsibilities in accordance with these requirements. In addition, in accordance with Article 10 (2) point (f) of the EU Audit Regulation, we declare that we have not provided non-audit services prohibited under Article 5 (1) of the EU Audit Regulation. We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our audit opinions on the annual financial statements and on the management report.

Key Audit Matters in the Audit of the Annual Financial Statements

Key audit matters are those matters that, in our professional judgment, were of most significance in our audit of the annual financial statements for the financial year from January 1, to December 31, 2017. These matters were addressed in the context of our audit of the annual financial statements as a whole, and in forming our audit opinion thereon; we do not provide a separate audit opinion on these matters.

In our view, the matter of most significance in our audit was as follows:

(A) Measurement of shares in affiliated companies

Our presentation of this key audit matter has been structured as follows:

(1) Matter and issue
(2) Audit approach and findings
(3) Reference to further information

Hereinafter we present the key audit matter:

A Measurement of shares in affiliated companies

A.1 Matter and issue

In the Company's annual financial statements shares in affiliated companies amounting to € 1.77 billion (24% of total assets) are recognized under the balance sheet item "Financial assets" . Shares in affiliated companies are measured in accordance with German commercial law at the lower of cost and fair value. The fair values of the material indirect and direct investments are calculated using discounted cash flow models as the present values of the expected future cash flows according to the planning projections prepared by the executive directors. Expectations relating to future market developments and assumptions about the development of macroeconomic factors are also taken into account. The discount rate used is the individually determined cost of capital for the relevant financial asset. On the basis of the values determined and supplementary documentation, no write-downs were required on the Company's direct investments for the fiscal year. The outcome of this valuation exercise is dependent to a large extent on the estimates made by the executive directors of the future cash flows, and on the respective discount rates and rates of growth employed. The valuation is therefore subject to material uncertainty. Against this background and due to the highly complex nature of the valuation and its material significance for the Company's net assets and results of operations, this matter was of particular importance in the context of our audit.

A.2 Audit approach and findings

As part of our audit, we assessed the methodology employed for the purposes of the valuation exercise, among other things. In particular, we assessed whether the fair values of the material indirect and direct equity investments for which there were indications that impairment write-downs may have to be recognized or reversed had been appropriately determined using discounted cash flow models in compliance with the relevant measurement standards. We based our assessment, among other things, on a comparison with general and sector-specific market expectations as well as on the executive directors' detailed explanations regarding the key planning value drivers underlying the expected cash flows. In the knowledge that even relatively small changes in the discount rate applied can have a material impact on the fair values calculated in this way, we also focused our testing in particular on the parameters used to determine the discount rate applied, and evaluated the measurement model. Taking into consideration the information available, we believe that the valuation parameters and underlying assumptions used by the executive directors are appropriate overall for the purpose of appropriately measuring shares in affiliated companies.

A.3 Reference to further information

The Company's disclosures regarding financial assets are contained in note 3 of the notes to the annual financial statements.

Other Information

The executive directors are responsible for the other information. The other information comprises the statement on corporate governance pursuant to § 289f HGB and § 315d HGB.

The other information comprises further the remaining parts of the publication "Annual Financial Statements" – excluding cross-references to external information – with the exception of the audited annual financial statements, the audited management report and our auditor's report .

Our audit opinions on the annual financial statements and on the management report do not cover the other information, and consequently we do not express an audit opinion or any other form of assurance conclusion thereon.

In connection with our audit, our responsibility is to read the other information and, in so doing, to consider whether the other information

- is materially inconsistent with the annual financial statements, with the management report or our knowledge obtained in the audit, or
- otherwise appears to be materially misstated.

Responsibilities of the Executive Directors and the Supervisory Board for the Annual Financial Statements and the Management Report

The executive directors are responsible for the preparation of the annual financial statements that comply, in all material respects, with the requirements of German commercial law, and that the annual financial statements give a true and fair view of the assets, liabilities, financial position and financial performance of the Company in compliance with German Legally Required Accounting Principles. In addition, the executive directors are responsible for such internal control as they, in accordance with German Legally Required Accounting Principles, have determined necessary to enable the preparation of annual financial statements that are free from material misstatement, whether due to fraud or error.

In preparing the annual financial statements, the executive directors are responsible for assessing the Company's ability to continue as a going concern. They also have the responsibility for disclosing, as applicable, matters related to going concern. In addition, they are responsible for financial reporting based on the going concern basis of accounting, provided no actual or legal circumstances conflict therewith.

Furthermore, the executive directors are responsible for the preparation of the management report that as a whole provides an appropriate view of the Company's position and is, in all material respects, consistent with the annual financial statements, complies with German legal requirements, and appropriately presents the opportunities and risks of future development. In addition, the executive directors are responsible for such arrangements and measures (systems) as they have considered necessary to enable the preparation of a management report that is in accordance with the applicable German legal requirements, and to be able to provide sufficient appropriate evidence for the assertions in the management report.

The supervisory board is responsible for overseeing the Company's financial reporting process for the preparation of the annual financial statements and of the management report.

Auditor's Responsibilities for the Audit of the Annual Financial Statements and of the Management Report

Our objectives are to obtain reasonable assurance about whether the annual financial statements as a whole are free from material misstatement, whether due to fraud or error, and whether the management report as a whole provides an appropriate view of the Company's position and, in all material respects, is consistent with the annual financial statements and the knowledge obtained in the audit, complies with the German legal requirements and appropriately presents the opportunities and risks of future development, as well as to issue an auditor's report that includes our audit opinions on the annual financial statements and on the management report.

Reasonable assurance is a high level of assurance, but is not a guarantee that an audit conducted in accordance with § 317 HGB and the EU Audit Regulation and in compliance with German Generally Accepted Standards for Financial Statement Audits promulgated by the Institut der Wirtschaftsprüfer (IDW) will always detect a material misstatement. Misstatements can arise from fraud or error and are considered material if, individually or in the aggregate, they could reasonably be expected to influence the economic decisions of users taken on the basis of these annual financial statements and this management report.

We exercise professional judgment and maintain professional skepticism throughout the audit. We also:

- Identify and assess the risks of material misstatement of the annual financial statements and of the management report, whether due to fraud or error, design and perform audit procedures responsive to those risks, and obtain audit evidence that is sufficient and appropriate to provide a basis for our audit opinions. The risk of not detecting a material misstatement resulting from fraud is higher than for one resulting from error, as fraud may involve collusion, forgery, intentional omissions, misrepresentations, or the override of internal controls.

- Obtain an understanding of internal control relevant to the audit of the annual financial statements and of arrangements and measures (systems) relevant to the audit of the management report in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an audit opinion on the effectiveness of these systems of the Company.

- Evaluate the appropriateness of accounting policies used by the executive directors and the reasonableness of estimates made by the executive directors and related disclosures.

- Conclude on the appropriateness of the executive directors' use of the going concern basis of accounting and, based on the audit evidence obtained, whether a material uncertainty exists related to events or conditions that may cast significant doubt on the Company's ability to continue as a going concern. If we conclude that a material uncertainty exists, we are required to draw attention in the auditor's report to the related disclosures in the annual financial statements and in the management report or, if such disclosures are inadequate, to modify our respective audit opinions. Our conclusions are based on the audit evidence obtained up to the date of our auditor's report. However, future events or conditions may cause the Company to cease to be able to continue as a going concern.

- Evaluate the overall presentation, structure and content of the annual financial statements, including the disclosures, and whether the annual financial statements present the underlying transactions and events in a manner that the annual financial statements give a true and fair view of the assets, liabilities, financial position and financial performance of the Company in compliance with German Legally Required Accounting Principles.

- Evaluate the consistency of the management report with the annual financial statements, its conformity with German law, and the view of the Company's position it provides.

- Perform audit procedures on the prospective information presented by the executive directors in the management report. On the basis of sufficient appropriate audit evidence we evaluate, in particular, the significant assumptions used by the executive directors as a basis for the prospective information, and evaluate the proper derivation of the prospective information from these assumptions. We do not express a separate audit opinion on the prospective information and on the assumptions used as a basis. There is a substantial unavoidable risk that future events will differ materially from the prospective information.

We communicate with those charged with governance regarding, among other matters, the planned scope and timing of the audit and significant audit findings, including any significant deficiencies in internal control that we identify during our audit.

We also provide those charged with governance with a statement that we have complied with the relevant independence requirements, and communicate with them all relationships and other matters that may reasonably be thought to bear on our independence, and where applicable, the related safeguards.

From the matters communicated with those charged with governance, we determine those matters that were of most significance in the audit of the annual financial statements of the current period and are therefore the key audit matters. We describe these matters in our auditor's report unless law or regulation precludes public disclosure about the matter.

Other Legal and Regulatory Requirements

Further Information pursuant to Article 10 of the EU Audit Regulation

We were elected as auditor by the annual general meeting on 3 May 2017. We were engaged by the supervisory board on 3 August 2017. We have been the auditor of the Covestro AG, Leverkusen, without interruption since the financial year 2015.

We declare that the audit opinions expressed in this auditor's report are consistent with the additional report to the audit committee pursuant to Article 11 of the EU Audit Regulation (long-form audit report).

German Public Auditor Responsible for the Engagement

The German Public Auditor responsible for the engagement is Dietmar Prümm.

Essen, February 15, 2018

PricewaterhouseCoopers GmbH
Wirtschaftsprüfungsgesellschaft

Petra Justenhoven
Wirtschaftsprüferin
(German Public Auditor)

Dietmar Prümm
Wirtschaftsprüfer
(German Public Auditor)

REPORT OF THE SUPERVISORY BOARD

Dear Stockholders,

During the reporting period, the Supervisory Board of Covestro AG performed its duties with due care in accordance with the law, the Articles of Incorporation, and the rules of procedure. During fiscal 2017, it monitored the conduct of the company's business by the Board of Management with regular frequency based on detailed written and oral reports received from the Board of Management, and also acted in an advisory capacity. The discussions between the Supervisory Board and Board of Management were always constructive and were conducted in the spirit of openness and trust.

The Supervisory Board Chair was in regular contact with the Board of Management outside of Supervisory Board meetings and remained informed about current developments in the company's business performance and material transactions. In addition, the Chair of the Supervisory Board was in close contact with the Board of Management Chair to discuss important questions and decisions one on one. The full Supervisory Board was informed in detail about the content of these discussions no later than during the next meeting. In this way the Supervisory Board was kept continuously and fully informed about the company's intended business strategy, corporate planning (including financial, investment, and human resources planning), earnings performance, the state of the business, and the situation of the Company and the Group (including the risk situation, risk management, and the compliance situation).

Where Board of Management decisions or actions required the approval of the Supervisory Board during the reporting period, whether by law, or under the Articles of Incorporation or the rules of procedure, the draft resolutions were inspected and thoroughly discussed by the members at the meetings of the full Supervisory Board, sometimes after preparatory work by the responsible committees, or approved on the basis of documents circulated to the members. The Supervisory Board was always directly involved in decisions of material importance to the company. It discussed at length the business trends described in the reports from the Board of Management and the prospects for the development of the Covestro Group as a whole, the individual business areas, and the regions. The Supervisory Board also assured itself that the actions of the Board of Management were lawful, due and proper, and appropriate.

Changes to the composition of the Supervisory Board during the fiscal year

Sabine Wirtz's term of office ended after February 10, 2017, when the election of employee representatives to the Supervisory Board of Covestro AG was completed. Marc Stothfang was elected as her successor effective February 11, 2017. In addition, Dr.-Ing. Thomas Fischer stepped down from the Supervisory Board and the Human Resources Committee of Covestro AG effective December 31, 2017. He will be replaced by Dr. Ulrich Liman as of January 1, 2018.

Meetings of the full Supervisory Board and member attendance

In fiscal year 2017, the Supervisory Board held a total of six regular meetings, all of which were also attended by at least one member of the Board of Management except where issues were discussed that required them to be absent.

The average attendance rate by Supervisory Board members at the 2017 meetings of the full Supervisory Board and of its committees was nearly 99%. No member of the Supervisory Board attended fewer than half of the meetings of the full Supervisory Board and of the committees to which he or she belonged.

Specifically, attendance at the meetings of the Supervisory Board and its committees by the members of the Supervisory Board was as follows:

Name	Meeting attendance (including committee meetings)	Attendance rate (%)
Dr. Richard Pott (Chair)	15/15	100
Ferdinando Falco Beccalli	6/6	100
Dr. Christine Bortenlänger	6/6	100
Johannes Dietsch	13/14	92.9
Dr.-Ing. Thomas Fischer	10/10	100
Peter Hausmann	9/10	90
Petra Kronen (Vice Chair)	14/14	100
Irena Küstner	10/10	100
Prof. Dr. Rolf Nonnenmacher	10/10	100
Regine Stachelhaus	7/7	100
Marc Stothfang (since February 11, 2017)	6/6	100
Frank Werth	6/6	100
Average attendance rate		**98.6**

There was only one regular meeting of the Supervisory Board at which a member was absent; that member submitted written votes on the resolutions in advance.

In addition to the aforementioned meetings of the Supervisory Board and its committees, some of its members met as the "Effectiveness and Efficiency of Supervisory Board Activities" working group at two special meetings in order to discuss the results of the efficiency review conducted in 2017.

Based on its composition, the Supervisory Board as a whole has in-depth industry expertise in the polymer sector in which Covestro operates.

Personal continuing education was a key component of the activities of the Supervisory Board and its members once again in the 2017 reporting period. A highlight was an all-day workshop on the foundations and key elements of the new Group strategy as well as training on corporate governance and compliance to address the material changes in the German Corporate Governance Code as amended on February 7, 2017, and guidelines for the future dialog between investors and the Chair of the Supervisory Board.

Principal topics discussed by the Supervisory Board

The deliberations of the Supervisory Board focused on the Board of Management's regular reports on business activities, which contained detailed information on the development of the sales and earnings, both for the Group and its business areas, on the company's opportunities and risks, as well as on Covestro's strategy and personnel matters. The Supervisory Board also concentrated on the following topics in its individual meetings:

In its meeting on February 17, 2017, the Supervisory Board considered the changes to its rules of procedure required as a result of changes to existing laws and the reassignment of responsibilities in the four Board of Management portfolios. Moreover, the Supervisory Board discussed the financial statements of Covestro AG and the consolidated financial statements of the Covestro Group for fiscal 2016, the proposal for the use of the distributable profit, and the agenda for the 2017 Annual General Meeting. In addition, the Supervisory Board reviewed the risk report, which sets out the material risks for the Group and current developments in this regard as well as the relevant countermeasures. Furthermore, the organization, statistics, training efforts and processes relating to the Group's compliance management system and its effectiveness were reviewed in depth. The Supervisory Board additionally deliberated on the background and business rationale for the sale of Covestro LLC's polyurethane spray foam systems house in North America. The Board also extensively discussed possible options for the implementation of the planned closure of the MDI production facility in Tarragona (Spain). Lastly, the Supervisory Board determined the specific variable compensation components for the members of the Board of Management based on the targets set and achieved in fiscal 2017, and was given a comprehensive overview of the status of the project to develop the future strategy for the Group.

The Supervisory Board meeting on May 3, 2017, focused mainly on the topics for the upcoming Annual General Meeting of Covestro AG.

Succession planning with a view to appointing the next Chief Executive Officer (CEO) was the main topic of the May 24, 2017, Supervisory Board meeting. After extensive deliberations, the Supervisory Board unanimously selected Dr. Markus Steilemann, the current Chief Commercial Officer (CCO), who is the Board of Management member responsible for innovation, marketing and sales.

On June 30, 2017, Chief Technology Officer (CTO) Dr. Klaus Schäfer, who is responsible for production and technology on the Board of Management, was named Covestro's new Labor Director by way of a resolution passed unanimously in writing.

In its meeting on September 29, 2017, the Supervisory Board specified a target of 40% women for the composition of Covestro AG's Board of Management to be implemented by June 30, 2022. Additionally, the Supervisory Board discussed the skill profile developed for the Board as a whole and the status of the selection process with regard to filling the positions of Chief Financial Officer (CFO) and CCO. Moreover, the Group's future strategic plan was a topic of intense debate by the board in view of the discussions and deliberations during the strategy workshop completed the day before.

In its meeting on November 17, 2017, the Supervisory Board unanimously appointed Dr. Thomas Toepfer as a new member of the Board of Management and CFO of Covestro AG effective April 1, 2018. In addition, the full Supervisory Board considered changing the cap on Board of Management compensation.

At its meeting on December 6, 2017, the Supervisory Board reviewed in depth the appropriateness of Board of Management compensation, including long-term compensation for the period from 2018 to 2021. Furthermore, the Supervisory Board talked over the details of the Board of Management contracts as a result of the appointment of Dr. Markus Steilemann as the future CEO and the contract extension for CTO Dr. Klaus Schäfer. The Supervisory Board again deliberated on specific targets for its future composition and skill profile. Further discussions focused on the Group's MDI investment program, including the long-term continuation of production at the MDI facility in Tarragona (Spain). The Supervisory Board dealt with the 2018 financial plan proposed by the Board of Management as well as the medium- and long-term outlook, both of which were presented in detail. The Supervisory Board additionally approved the proposed financial framework for fiscal 2018. Moreover, the Supervisory Board voted to issue an unqualified declaration of conformity with the German Corporate Governance Code as amended on February 7, 2017. Lastly, the Board added more detail to the possible improvement potential regarding its future working methods, which was developed as part of the efficiency review by a six-person working group during two meetings in 2017. Key results in this context included the introduction of a fifth regular Supervisory Board meeting with focus on strategy and an increase in the number of members and meetings of the Nominations Committee. The Supervisory Board was fundamentally open to the option of subjecting its activities to an external efficiency review regarding its working methods in due time.

Committees of the Supervisory Board

In the past fiscal year, the Supervisory Board once again had four committees set up for the purpose of exercising its duties efficiently. The committees prepared resolutions by the full Supervisory Board and provided information on other topics to be discussed by this body. Moreover, certain decision-making powers of the Supervisory Board were assigned to the committees to the extent legally permissible. The Supervisory Board currently has a Presidial Committee, an Audit Committee, a Human Resources Committee and a Nominations Committee. The tasks and responsibilities of the committees are described in greater detail in section 24 "Corporate Governance" under "Committees of the Supervisory Board". The current composition is shown at the end of this report.[1]

The meetings and decisions of the committees, and especially the meetings of the Audit Committee, were prepared on the basis of reports and other information provided by the Board of Management. The committee chairs regularly provided comprehensive reports on the work of the committees to the full Supervisory Board.

In 2017, the **Presidial Committee** was not required to convene in its capacity as the mediation committee.

The **Audit Committee** met four times in the reporting year on February 16, April 24, July 24 and October 23, 2017, with the (interim) CFO present at all four meetings, and the auditor attending two of them. The committee conducted a preparatory review for the Supervisory Board of the financial statements of Covestro AG, the consolidated financial statements of the Covestro Group, the combined management report, the proposal for the use of the distributable profit, and the related parties report. Additionally, it also thoroughly discussed, in particular, the audit report and the oral report by the auditor on the material findings of the audit. The management report also included the Group's nonfinancial statement. In conducting its review, the Audit Committee found no grounds for objections. In addition, the Audit Committee discussed with the Board of Management the half-year financial report in light of the results of the review by the auditor, and the Q1 and Q3 interim statements prior to their publication.

[1] The sections mentioned and the other references are based on the Covestro Group's Annual Report.

In monitoring the company's financial reporting, a particular focus of the committee's work in the reporting year was the presentation of the pension asset structure, including possible risks and protective mechanisms; the current status of implementation and the effects of the new International Financial Reporting Standards IFRS 15 (Revenue from Contracts with Customers) for 2018, and IFRS 16 (Leases) for 2019; and the requirements of the CSR Directive Implementation Act (CSR-RUG) and the associated controls for nonfinancial reporting.

The Audit Committee monitored the accounting and financial reporting process and the effectiveness of the internal control system and the risk management system based on reporting by the head of the internal audit department and the auditor of the financial statements. No material weaknesses were identified by the auditor in the internal control system applicable to the accounting and financial reporting process or the risk early warning system.

During the fiscal year, external audits were conducted of the internal audit system in accordance with Audit Standard 983 of the Institute of Public Auditors in Germany (IDW) and the requirements of the DIIR guidelines (Deutsches Institut für interne Revision e. V.) and of the compliance management system in accordance with IDW Audit Standard 980 for the areas antitrust law, corruption and export control. These audits provided unqualified confirmation of the effectiveness of both systems. At the request of the Audit Committee, the Board of Management also reported on the strategy and implementation plan for cybersecurity.

The Audit Committee additionally undertook preparations for the Supervisory Board's proposal for the appointment of the financial statement auditor by the Annual General Meeting, the engagement of the auditor and agreement on the auditor's fee. It monitored the effectiveness of the audit and the independence of the auditor as well as the supplementary non-audit services provided by the auditor in addition to the financial statement audit.

The Audit Committee continually exchanged information with the auditor about the material audit risks and the necessary focus of the audit. It developed an internal regulation governing services provided by the auditor but not related to the audit itself, and was informed regularly by the auditor and the Board of Management about corresponding services and the fees incurred.

Furthermore, the Audit Committee obtained information on an ongoing basis on enhancements to the compliance management system, the handling of suspected compliance violations, legal and regulatory risks, and the risk situation, risk tracking and risk monitoring at the company. The internal audit department provided regular reports about risk assessments, its resources and audit planning.

The heads of the relevant departments also participated in meetings of the Audit Committee on selected agenda items, reported on these and answered questions. In addition, the Chair of the Audit Committee discussed important matters between meetings, particularly with the Supervisory Board Chair, the (interim) CFO and the auditor. The key results of these discussions were reported regularly to the Audit Committee and the Supervisory Board.

The **Human Resources Committee** held a total of four meetings in the reporting year, on February 17, May 16, September 28 and December 6, 2017. The first two meetings dealt primarily with the achievement of targets set for Board of Management members, the reassignment of responsibilities in the individual Board of Management portfolios, and succession planning for the position of CEO. In the next two meetings, the Human Resources Committee mainly deliberated on filling the vacant position of CFO, determining the new target and implementation date for the proportion of women on the Board of Management, reviewing Board of Management compensation, and going over the details of the Board of Management contracts in connection with the nomination of the future CEO Dr. Markus Steilemann and the contract extension for CTO Dr. Klaus Schäfer.

The **Nominations Committee** met once in the reporting year, on July 19, 2017. At that meeting, the Committee thoroughly considered the specific composition of the current Supervisory Board and subsequently developed a basic list of qualifications for future Supervisory Board members, taking into account the Articles of Incorporation, the rules of procedure, the German Corporate Governance Code, best practice criteria and the special circumstances of the Covestro Group's business activities and strategy. Moreover, the Committee discussed relaxing the rules on the term of office of stockholder representatives to enable the Board to react in a suitable and timely manner to possible changes in the qualifications required for Covestro AG Supervisory Board members.

Financial statements/audits

The financial statements of Covestro AG were prepared according to the requirements of the German Commercial Code (HGB) and German Stock Corporation Act (AktG). The consolidated financial statements of the Covestro Group were prepared according to the German Commercial Code and the International Financial Reporting Standards (IFRSs) as adopted by the European Union (EU). The combined management report including the Group's nonfinancial statement was prepared according to the German Commercial Code. The auditor, PricewaterhouseCoopers GmbH Wirtschaftsprüfungsgesellschaft, Essen, audited the financial statements of Covestro AG, the consolidated financial statements of the Covestro Group, and the combined management report. The conduct and results of the audit are explained in the Auditor's Reports. According to the auditor's findings, Covestro has complied with the German Commercial Code, the German Stock Corporation Act and/or the IFRS regulations as adopted by the EU, and issues unqualified opinions on the financial statements of Covestro AG and the consolidated financial statements of the Covestro Group. The financial statements of Covestro AG, the consolidated financial statements of the Covestro Group, the combined management report and the audit reports were submitted to all members of the Supervisory Board. They were discussed in detail by the Audit Committee and at a meeting of the full Supervisory Board. The auditor submitted a report on both occasions and was present during the discussions.

The Supervisory Board examined the financial statements of Covestro AG, the proposal for the use of the distributable profit, the consolidated financial statements of the Covestro Group, and the combined management report including the Group's nonfinancial statement. It had no objections and thus concurred with the result of the audit.

The Supervisory Board approved the financial statements of Covestro AG and the consolidated financial statements of the Covestro Group prepared by the Board of Management. The financial statements of Covestro AG are thus confirmed. The Supervisory Board is in agreement with the combined management report and, in particular, with the assessment of the future development of the enterprise. It also concurs with the dividend policy and the decisions concerning earnings retention by the company. It assents to the proposal for the use of the distributable profit, which provides for payment of a dividend of 2.20 euro per share.

Audit of the related parties report by the Board of Management

As of the end of fiscal 2017, Bayer AG directly held 24.6% of the shares of Covestro AG. In addition, Bayer Pension Trust e. V. held 8.9% of Covestro shares. Bayer AG and Covestro AG entered into an agreement on the non-exercise of control effective September 30, 2017, under which Bayer AG is obligated to waive the right to exercise certain voting rights at Covestro's Annual General Meeting. As of September 30, 2017, Covestro AG is no longer included in full as a subsidiary in the consolidated financial statements of Bayer AG.

For this reason, the Board of Management prepared a report on the company's relationships with related companies for the period from January to September 2017 in accordance with Section 312 of the German Stock Corporation Act (related parties report) and submitted this to the Supervisory Board in a timely manner. The related parties report was audited by the Company's auditor, which issued the following report in accordance with Section 313, Paragraph 3 of the German Stock Corporation Act:

"In accordance with our mandate, we have audited the report by the Board of Management pursuant to Section 312 of the German Stock Corporation Act in respect of the relationships with related companies in accordance with Section 313 of the German Stock Corporation Act for the period from January 1 to September 30, 2017. Since the definitive result of our audit led to no reservations, we hereby issue the following report in accordance with Section 313, Paragraph 3, Sentence 1 of the German Stock Corporation Act: After due consideration and assessment, we confirm that

1. the actual information in the report is correct, and

2. the company's consideration in the legal transactions described in the report was not inappropriately high."

The related parties report and the Auditor's Report were submitted to the Audit Committee and the Supervisory Board for their review. No objections were raised as a result. There were also no objections to the declaration by the Board of Management at the end of the related parties report. The Supervisory Board concurred with the result of the audit of the related parties report conducted by the auditor.

Corporate governance and declaration of conformity

During the reporting year, the Supervisory Board again addressed the German Corporate Governance Code in depth and, together with the Board of Management, submitted an unqualified declaration of conformity in accordance with Section 161 of the German Stock Corporation Act in December 2017 based on the Code as amended on February 7, 2017. The declaration of conformity was subsequently made permanently available to stockholders on the company's website.

Expression of appreciation for the Board of Management and employees

The Supervisory Board would like to thank the Board of Management and all of Covestro's employees for their dedication and achievements in the 2017 fiscal year. We wish you all every success in implementing our strategic goals.

Leverkusen (Germany), February 19, 2018

For the Supervisory Board

Dr. Richard Pott

Chairman

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