Report on Future Perspectives and on Opportunities and Risks

19. Economic Outlook

Global economy

In 2019, a year marked by uncertainty, the global economy is projected to grow at a slightly slower rate than in the previous year. The key reasons for this development include increasing protectionism causing adverse effects on global supply chains, the slowdown in China's growth, geopolitical risks in the Middle East and political uncertainties in the eurozone.

In the European Union (EU), growth is anticipated to drop to approximately 1.3%. Despite domestic demand remaining solid thanks to further declines in unemployment figures and nonrestrictive fiscal policy, foreign economic factors such as a continued trade conflict with the United States and the ongoing negotiations on the United Kingdom's exit from the EU will have a dampening effect. These factors have an impact on export-oriented business in Germany, in particular; weaker growth of around 1.0% is therefore expected.

The U.S. economy's generally positive performance is expected to continue in 2019, driven by factors including a reduction in corporate/income taxes. However, further wage increases and stepped up import restrictions carry the risk of higher inflation rates in the medium term and the start of an economic downturn.

China's economy should continue to grow relatively robustly in 2019 – although at a somewhat slower pace than in 2018. There is also the increasing emergence of the conflicting goals of reducing macroeconomic imbalances and attempting to mitigate the negative effects of the economic dispute with the United States.

Economic Outlook

	Growth[1] 2018	Growth[1] forecast 2019
	%	%
World	**+3.1**	**+2.8**
European Union	+1.9	+1.3
of which Germany	+1.5	+1.0
NAFTA	+2.7	+2.4
of which United States	+2.9	+2.5
Asia-Pacific	+4.9	+4.7
of which China	+6.6	+6.3

[1] Real growth of gross domestic product, source: IHS (Global Insight), as of February 2019

Main customer industries[7]

In 2019, we anticipate the global automotive industry to grow somewhat, driven by a recovery in Asia. Our global growth forecast for this year is 1%.

For 2019, we anticipate that the global construction industry will see stable growth of slightly over 2% compared with the previous year. A continued recovery in Eastern Europe and Latin America, a stable investment climate in North America and the ongoing positive performance in Asia will contribute to this development despite significant weakening in Western Europe.

Growth in the global electrical, electronics and household appliances industry is predicted to weaken considerably in 2019 and to come in at only slightly above 2%. Equal growth is forecast for the industrialized and emerging economies.

We expect the global furniture industry to expand at around 3% in 2019. The main driver here continues to be the Asia-Pacific region with growth of approximately 4%. For Europe and Latin America, we also project a positive trend at the previous year's level. Following stagnation with zero growth in 2018, we anticipate that North America will once again see a positive growth rate of approximately 1%.

[7] Covestro's estimate, based on the following sources: LMC Automotive Limited, B+L, CSIL (Centre for Industrial Studies), Oxford Economics

20. Forecast for Key Data

Forecast

	2018	Forecast 2019
Core volume growth	+1.6%	Low-to-mid-single-digit percentage increase
Free operating cash flow	€1,669 million	Between €300 million and €700 million
ROCE	+29.5%	Between 8% and 13%

Covestro Group

The following forecast for the 2019 fiscal year is based on the business development described in this Annual Report and takes into account the following potential risks and opportunities:

The Board of Management of Covestro AG presumes that despite an increasingly challenging market environment, Covestro will maintain its profitable growth course in 2019 and achieve a premium above the costs of capital.

We expect core volume growth in the low-to-mid-single-digit-percentage range. This trend is projected for both the Covestro Group and for the Polyurethanes, Polycarbonates and Coatings, Adhesives, Specialties segments.

We expect free operating cash flow (FOCF) to be between €300 million and €700 million in fiscal year 2019. For the Polyurethanes segment, we anticipate an increase in cash outflows for additions to property, plant, equipment and intangible assets which the expected operating cash flow will be insufficient to offset. We also expect FOCF to decline in the Polycarbonates segment, although the trend here is likely to be much more positive than for the Group overall. For the Coatings, Adhesives, Specialties segment, we expect FOCF around the prior-year level.

In 2019, we expect ROCE between 8% and 13%.

Covestro AG

The earnings of Covestro AG, as the parent company of the Covestro Group, largely comprise the earnings of that company's subsidiaries. The earnings of the subsidiaries in Germany, especially Covestro Deutschland AG, are transferred to Covestro AG under profit and loss transfer agreements. The earnings of Covestro AG are therefore expected to reflect the business development anticipated in the Covestro Group. We want our stockholders to adequately participate in the Covestro Group's earnings for fiscal 2019. We aim to increase the dividend annually, or at least to keep it at the previous year's level. For 2019, we expect a net income of Covestro AG that will enable us to pay a corresponding dividend. The Board of Management and the Supervisory Board are proposing a dividend of €2.40 per share carrying dividend rights for the 2018 fiscal year to the Annual General Meeting.

21. Opportunities and Risks Report

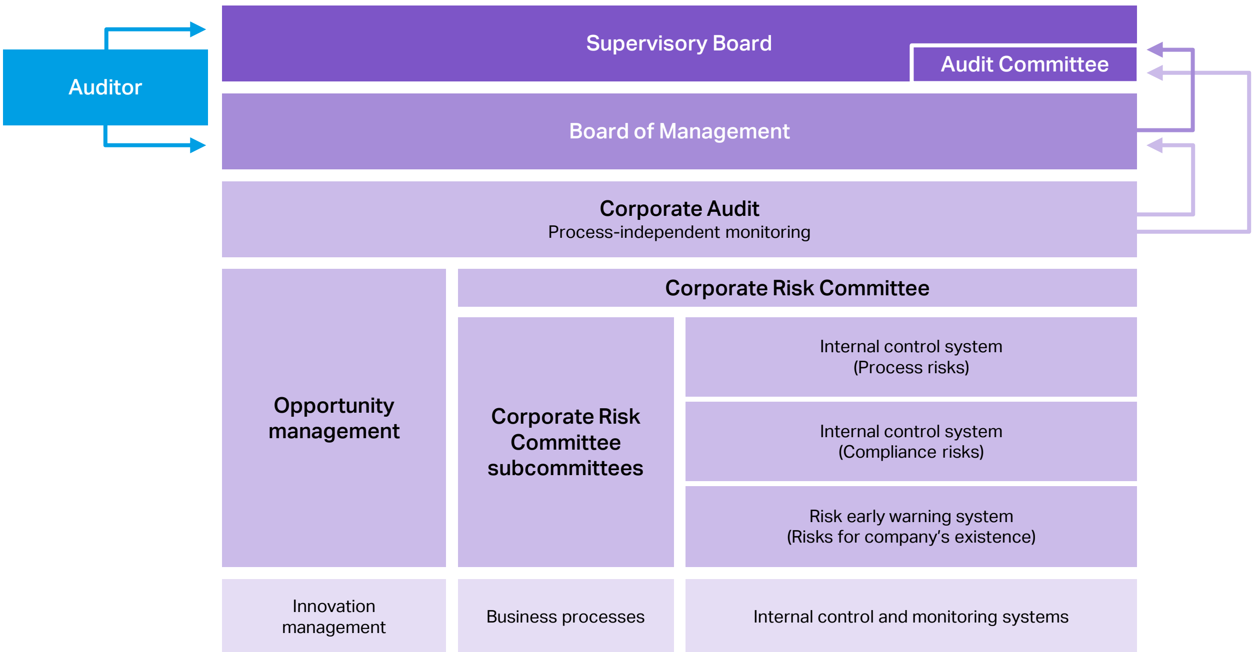
As a company with global operations, Covestro is exposed to opportunities and risks on a daily basis. Addressing these opportunities and risks therefore represents an integral part of our business operations. We regard a risk as a development or event in or outside the company that could lead to a negative deviation from forecasts or the Group's targets. Conversely, an internal or external development or event that could cause a positive change in forecasts or targets is considered an opportunity.

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

Group-wide opportunities and risk management system

Conscientious management of risks and opportunities is part of responsible corporate governance and forms the basis for sustainable growth and financial success. This includes the ability to systematically identify and take advantage of opportunities while avoiding risks to the company's success. The entrepreneurial decisions we make daily in the course of business processes are based on balancing opportunities and risks. We therefore regard the management of our opportunities and risks as an integral part of our business management system rather than as the task of a specific organizational unit.

Opportunities and risk management system



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

To enable the Board of Management and the Supervisory Board to monitor material business risks as legally required, the following systems are in place: an internal control system ensuring proper and effective financial reporting pursuant to Section 289, Paragraph 4 and Section 315, Paragraph 4 of the German Commercial Code (HGB); a compliance management system; and a risk early warning system pursuant to Section 91, Paragraph 2 of the German Stock Corporation Act (AktG).

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

The various systems are described below.

Internal control system for (Group) accounting and financial reporting (Report pursuant to Section 289, Paragraph 4 and Section 315, Paragraph 4 of the German Commercial Code)

The purpose of our internal control system (ICS) is to ensure proper and effective accounting and financial reporting in accordance with Section 289, Paragraph 4 and Section 315, Paragraph 4 of the German Commercial Code.

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

The ICS concept is based on the Committee of the Sponsoring Organizations of the Treadway Commission (COSO) Internal Control – Integrated Framework (2013) and the Control Objectives for Information and Related Technology (COBIT) framework and addresses the risk of misreporting of the consolidated financial statements. Risks are identified and evaluated, and steps are taken to counter them. Mandatory ICS standards such as system-based and manual reconciliation processes and functional separation have been derived from these frameworks and promulgated throughout the Covestro Group by Group Accounting.

The management of each Covestro Group company holds responsibility for implementing the ICS standards at the local level. Bayer Shared Service Centers continued to handle certain activities in the first half of 2018 on account of several fixed-term transitional agreements in the scope of the carve-out. These services are no longer used, however, and all accounting activities have been handled in-house since May 2018.

The effectiveness of the ICS processes for accounting and financial reporting is evaluated on the basis of a cascaded self-assessment system that starts with the persons directly involved in the processes, then involves the principal responsible managers and ends with the Board of Management. In addition, an external audit is performed to ensure and attest to its proper functioning. An IT system in use throughout the Covestro Group ensures the uniform and audit-proof documentation and transparent presentation of the risks, controls, and effectiveness evaluations associated with all ICS-relevant business processes. It should generally be noted that, however carefully designed, an internal control system cannot provide absolute assurance that material misstatements in the accounting will be avoided or identified in a timely manner.

The Chief Financial Officer of Covestro AG has confirmed the criteria and the effective functioning of the internal control system for accounting and financial reporting for fiscal 2018.

Internal control system to ensure compliance

Compliance risks are systematically identified and assessed as part of Covestro's Group-wide risk management. Risk owners assess the compliance risks that have been identified. A risk matrix is used to define focal points of compliance tasks at Covestro. The findings of a risk-based analysis enabled Covestro to identify three key topics: antitrust law, corruption, and foreign trade law. The General Counsel /Chief Compliance Officer is the risk owner responsible for the risks of "breaches of antitrust law" and "corruption"; the Export Control Officer is the risk owner of "breaches of foreign trade law." With respect to corruption, areas including gifts/invitations, contributions/sponsoring and working relationships with certain business partners such as customs officials/sales agents were identified as being especially risk-relevant.

Many controls have been implemented at both the Group-wide and local levels to reduce the number of compliance risks. To the extent possible, we integrate the compliance controls into our internal control system. In the reporting period, the controls aimed at preventing corruption were globally standardized and, where necessary, additional controls were integrated into business processes.

The effectiveness of the compliance controls is evaluated – as are the ICS processes for accounting and financial reporting – on the basis of a cascaded self-assessment system. The results of the effectiveness evaluations are documented in the global system for the ICS processes. In addition, Corporate Audit carries out dedicated compliance checks

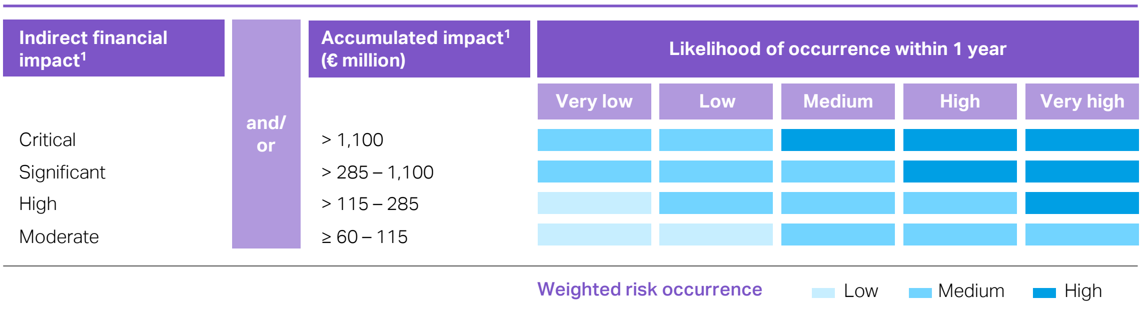
Risk early warning system (Report pursuant to Section 91, Paragraph 2 of the German Stock Corporation Act)

Covestro implemented a structured process for the early identification of any potentially disadvantageous developments that could have a material impact on the company or endanger its continued existence. This process satisfies the legal requirements regarding an early warning system for risks pursuant to Section 91, Paragraph 2 of the German Stock Corporation Act. Covestro's risk management process is based on the international risk management standard COSO II Enterprise Risk Management – Integrated Framework (2004). A central unit defines, coordinates, and monitors the framework and standards for this risk early warning system.

Throughout the year, various global subcommittees provide new and updated information about identified risks. The Covestro Corporate Risk Committee meets four times a year to review the risk landscape as well as the various risk management and monitoring mechanisms that are in place, and to take any necessary measures.

Risks are evaluated using estimates of the potential impact, the likelihood of their occurrence and their relevance for our external stakeholders. All material risks and the respective countermeasures are documented in a company-wide database. The risk early warning system is reviewed regularly over the course of the year. Significant changes must be promptly entered in the database and reported to the Board of Management. In addition, a report on the risk portfolio is submitted to the Audit Committee several times a year and to the Supervisory Board at least once a year. The following matrix illustrates the financial and indirect financial criteria for rating a risk as high, medium or low.

Rating Matrix



[1] An individual risk that could have both a financial and indirect financial impact of different severities and is always classified based on the higher level of risk.

Criteria of the Classification of Indirect Financial Impact

Indirect financial impact			
Moderate	High	Significant	Critical
Moderate effect on achieving outcome objectives/national reporting	High effect on achieving outcome objectives/national reporting	Significant effect on achieving outcome objectives/major outlets reporting internationally	Critical effect on achieving outcome objectives/major outlets constantly reporting internationally

Process-independent monitoring

The effectiveness of our management systems is audited and evaluated at regular intervals by the Corporate Audit unit, which performs an independent and objective audit function focused on verifying compliance with laws and policies. Corporate Audit also supports the company in achieving its goals by systematically evaluating the efficiency and effectiveness of governance, risk management and control processes, and helping to improve them. The selection of audit targets follows a risk-based approach. Corporate Audit performs its tasks according to internationally recognized standards and delivers reliable audit services. This was confirmed in an external audit conducted in accordance with Auditing Standard 983 of the Institute of Public Auditors in Germany (IDW) in fiscal 2017. A report on the internal control system and its effectiveness is presented annually to the Audit Committee of the Supervisory Board.

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

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

Opportunities and risks

Overall assessment of opportunities and risks

The overall opportunity position and overall risk position facing the Group have not changed as against the previous year. The risks reported in the following do not endanger the company's continued existence, nor could we identify any risk interdependencies that could combine to endanger the company's continued existence.

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

Opportunities and risks in general and in the company's business environment

Risks are outlined below that have material effects on the business situation, net assets, financial position, and results of operations of our Group. In this context, risks are deemed material if the potential loss to Covestro is estimated at €60 million or more, or – regardless of their likelihood of occurrence – they have at least a moderate potential indirect financial impact. The likelihood of occurrence of the risks is used in internal control to define focus areas for the Corporate Risk Committee. The risks are more highly aggregated in this report than in our internal documentation. The following chart shows the levels of risk allocated to the individual risks within each category. The order in which the risks are listed does not imply any order of significance.

Risk Categories

	Weighted risk occurrence		
	Low	Medium	High
Business environment			
Competition	●	●	
Cooperations/acquisitions	●		
Market growth	●	●	
Regulations/policies	●	●	
Company-specific environment			
Product stewardship	●	●	
Procurement	●	●	
Production and supply chain	●	●	
Employees	●	●	
Information technology	●	●	
Law and compliance	●	●	

Business environment

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

Negative economic developments typically have a negative impact on the sales markets for our products, which usually results in decreases in sales volumes and adversely impacts earnings. However, the extent of the impact of economic developments on sales volumes and earnings also depends on capacity utilization rates in the industry, which in turn, depend on the balance between supply and demand for the industry's products. Decreases in demand lead to lower sales volumes and, ultimately, to reduced capacity utilization, which negatively impacts margins. Conversely, a positive economic environment characterized by growth and upward trends usually leads to improved business success.

Historically, the markets for most of our products have experienced periods of tight supply, causing prices and profit margins to increase. Periods of significant capacity additions, however, resulted in oversupply and declining prices and profit margins. The cycles in demand are often caused by capacity additions of new world-scale production facilities or the expansion of existing production facilities, which are necessary to create or sustain economies of scale in the industry segments, and the decline of industry-wide utilization rates that often follows capacity additions.

An economic downturn, changes in competitors' behavior or the emergence of new competitors can lead to greater competition and, as a result, overcapacities in the market or increased pressure on prices.

The international nature of Covestro's business exposes it to substantial changes in economic, political and social conditions, and the resulting statutory requirements of the countries in which Covestro operates. The associated opportunities and risks can have both a positive and negative effect on the company's business and significantly influence its prospects.

Where it appears strategically advantageous, we supplement our organic growth by acquiring companies or parts of companies. Exploiting potential synergies or economies of scale can positively impact the company's success. However, failure to successfully integrate a newly acquired business or unexpectedly high integration costs could jeopardize the achievement of qualitative or quantitative targets and adversely impact earnings. To avoid this, both the due diligence and integration processes are supported by teams of experts. Due diligence also includes, for example, reviewing risk-relevant factors such as compliance with applicable environmental regulations and occupational health and safety standards at production sites.

The main conditions for economic success in developing countries are political stability, prosperity and a secure income. Based on the improved economic fundamentals in developing countries, we expect that the rising standard of living will lead to higher sales figures and better business prospects for our products in the medium to long term.

Further opportunities and risks may also arise if actual market developments vary from those we predict in section 19 "Economic Outlook." Where macroeconomic developments deviate from forecasts, this may either positively or negatively impact our sales and earnings expectations. Continuous analysis of the economic environment and of economic forecasts enables us to utilize the identified opportunities and to mitigate risks by adjusting our business strategy.

Innovation

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

One example of the opportunities created by innovation is additive manufacturing, also known as 3D printing. This is a new market with considerable growth potential for our products. Covestro is an established player in the polymer industry segment and has in-depth technological expertise in this area. This makes us well positioned to generate added value for our company through advances in additive manufacturing.

Customers are increasingly choosing sustainable products as a result of a growing environmental awareness and interest in environmental protection. A key focus of Covestro's strategy is sustainability and efficient production. Our product portfolio offers sustainable solutions for different areas of everyday life. We therefore see an opportunity here to expand our relevant market shares and to grow in this segment.

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

Ongoing technological advancements are changing the world we live in and the way we do business. By utilizing cutting-edge digital technologies, we expect to holistically add value across the value chain by optimizing supply chain, leveraging growth, and developing new business models.

Product stewardship

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

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

Procurement

Our Supplier Code of Conduct sets forth our sustainability principles and explains what we expect from our partners along the value chain. The Code requires that our suppliers observe environmental regulations as well as occupational health and safety rules, respect human rights and therefore, for example, not employ child labor in any form. Violations of the Code may harm our company's reputation. Through supplier assessments and audits, we verify whether our partners along the supply chain actually implement and adhere to our Code of Conduct. Covestro's Supplier Code of Conduct is based on the principles of the United Nations Global Compact and our human rights position.

Covestro requires significant quantities of energy and petrochemical feedstocks for production processes. Procurement prices for energy and raw materials may fluctuate significantly due to market conditions or legislation. Experience from the past has shown that higher production costs cannot always be passed on to our customers through price adjustments. Conversely, lower raw materials prices that do not directly reduce the selling price by the full amount can lead to improved margins.

Important raw materials purchased based on long-term supply agreements and an active supplier management to minimize procurement-related risks such as supply shortages or substantial price fluctuations. In steam and electricity generation, we aim for market-based price indexing, a diversification of fuels and a mix of external procurement and captive production to minimize the risk of fluctuating energy prices.

Production and supply chain

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

Covestro uses large quantities of hazardous substances, generates hazardous wastes and emits wastewater and air pollutants in its production operations. Consequently, its operations are subject to extensive environmental, health and safety (EHS) laws, regulations, rules and ordinances at the international, national and local levels in multiple jurisdictions. The company must dedicate substantial resources to complying with these EHS regulations and the additional voluntary commitments. Costs relating to the implementation of and compliance with EHS requirements are part of Covestro's operating costs and must therefore be covered by the prices at which the company is able to sell its products. Competitors of Covestro that are not affected by equually strict EHS requirements to the same extent may have lower operating costs and, as a consequence, their products may be priced lower than those of Covestro.

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

Covestro operates in markets with a relatively balanced supply and demand situation. However, in the event of planned or unplanned closures, interruptions or even the elimination of one of our competitors, Covestro may have the opportunity to take over customers and cover their demand.

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

Organic growth through investment may involve risks as it relates to the overall project scope, location, and timing. These risks are addressed through established processes that involve a variety of internal and external stakeholders. A specific risk is posed by the transfer of services formerly provided by Bayer companies to other external partners in order to plan, construct and coordinate capital investment projects. This risk is being addressed through a targeted project focusing on this shift. A robust investment assessment process helps to ensure that we are capitalizing on organic growth opportunities at the right time. These projects are reviewed throughout the project timeline so that any potential changes in the market situation are considered, enabling us to react in a timely manner, if necessary.

Employees

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

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

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

Information technology

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

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

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

Law and compliance

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

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

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

Legal proceedings currently considered to involve material risks are described in note 26 under “Legal Risks” in the Notes to the Consolidated Financial Statements.

Financial opportunities and risks

The Covestro Group is exposed to liquidity risks, foreign currency and interest-rate opportunities and risks, credit risks and risks resulting from obligations for pensions and other post-employment benefits. Appropriate processes to manage financial opportunities and risks have been established and documented. One component of this is financial planning, which serves as the basis for establishing liquidity needs and foreign currency risk. Financial planning comprises a planning horizon of 12 months and is regularly updated.

The section below presents the financial risks material to the Covestro Group – independent of their likelihood of occurrence.

Liquidity risk

Liquidity risk is the risk of not being able to meet existing or future payment obligations. The liquidity status of all material Group companies is continuously planned and monitored. Liquidity is secured by cash pooling agreements as well as internal and external financing. A syndicated revolving credit facility offers additional financial flexibility.

Foreign currency opportunities and risks

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

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

Anticipated foreign currency exposures were not hedged in the reporting year since they did not exceed the limit defined for the Group. These exposures are also hedged using forward exchange contracts if the foreign currency risk increases significantly.

Interest rate opportunities and risks

Interest rate opportunities and risks for the Covestro Group result from changes in capital market interest rates, which could lead to changes in the fair value of fixed-rate financial instruments and in interest payments in the case of floating-rate instruments. To minimize adverse effects, interest rate risk is managed centrally based on an optimized debt maturity structure.

Credit risks

Credit risks arise from the possibility that the value of receivables or other financial assets of the Covestro Group may be impaired because counterparties cannot meet their payment or other performance obligations.

To manage credit risks from receivables, credit managers are appointed who regularly analyze customers' creditworthiness and set credit limits. The Covestro Group does not conclude master netting agreements with its customers for nonderivative financial instruments. Here, the total value of the financial assets represents the maximum credit risk exposure. In the case of derivatives, positive and negative market values may be netted under certain conditions.

Risk to pension obligations from capital market developments

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

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