

REPORT ON FUTURE PERSPECTIVES AND ON OPPORTUNITIES AND RISKS

Report on Future Perspectives

Economic Outlook

Global economy

The lingering coronavirus pandemic is likely to make the year 2021 remain a challenge for the global economy. On account of the increasing availability of vaccines and the resulting ability to wage a controlled fight against the pandemic, we expect all regions to return to positive growth rates, which should put overall global economic growth at around 4%.

Economic growth¹

	Growth 2020	Growth ¹ forecast 2021
	%	%
World	-4.1	+4.4
Europe	-6.7	+3.2
of which Western Europe	-7.2	+3.3
of which Germany	-5.3	+2.8
of which Eastern Europe	-4.8	+2.7
Middle East	-5.3	+4.5
Latin America	-7.5	+3.7
Africa	-3.6	+2.4
North America²	-4.0	+4.0
of which United States	-3.6	+4.0
Asia-Pacific	-1.6	+5.7
of which China	+2.1	+7.6

¹ Real growth of gross domestic product; source: IHS (Global Insight), as of January 2021.

² North America (not including Central America): Canada, Mexico, United States.

We believe growth in Western Europe will slightly underperform the global pace. Pandemic-related restrictions continue to pose challenges for the economy. In contrast, the stimulus provided by the EU recovery fund, still-expansive fiscal policy, and the investment pact agreed between the EU and China had a positive impact on growth. Germany's export-oriented economy should see growth of 2.8%.

In contrast, Eastern Europe and Africa are unlikely to be able to keep pace with this rate. Energy-producing countries in Eastern Europe, such as Russia, continue to face challenges in the form of low prices and production restrictions. In North Africa in particular, countries with a major tourism industry will remain under pressure, as this sector will stay below pre-pandemic levels in the first quarter of the year 2021 at a minimum. We anticipate that growth in the Latin America region will lie slightly below the global level. The reason for this is the expiration of economic stimulus programs.

Growth in the Middle East and North America will likely match that of the global economy, with the oil industry expected to be the driver of this expansion in the Middle East. Rising oil prices boost exporter income, which in turn will reduce the need for credit. An increasing number of coronavirus infections and the resulting measures implemented to curb the spread will hamper growth in the United States. The United States is nonetheless expected to recover relatively well due to new fiscal stimulus and could reach 2019 levels again by the end of the year 2021.

The Asia-Pacific region will probably succeed in controlling the pandemic with comparatively moderate restrictions. For this reason, it is expected to outpace the global economy earlier than other regions. Positive effects are expected from the new Regional Comprehensive Economic Partnership (RCEP) free trade agreement. In China, we project above-average economic growth of around 7.6% in the year 2021. However, the pace of recovery could be slowed by the expiration of economic policy measures.

Main customer industries*

We expect the automotive industry worldwide to return to positive growth of around 17% in the year 2021. Latin America will be the vanguard with the highest growth rate, but all other regions are expected to return to generating strong positive growth as well.

We anticipate positive growth of around 1% for the global construction industry. In Western Europe, growth is likely to be slightly positive. The construction industry in North America and the Asia-Pacific region should remain stable, whereas Eastern Europe and Latin America are expected to continue to report a mildly negative pace of growth.

In the year 2021, we project that the global electrical, electronics, and household appliances industry will grow by around 6%, again exceeding the prior-year level. All regions are expected to see strong positive growth rates, with Latin America and Asia-Pacific likely to somewhat outperform Europe and North America.

In the global furniture industry, fiscal year 2021 should bring growth of some 5%, mainly driven by expansion in the Asia-Pacific region. We expect an equally positive trend in Europe. In Latin America and North America, our forecast is for slightly positive growth rates.

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

Forecast for the Covestro Group and Covestro AG

Covestro Group

The following forecast for the 2021 fiscal year is based on the business development described in this Annual Report and takes into account the potential opportunities and risks. The completion of the acquisition, which is planned for the first quarter of fiscal year 2021, and integration of the Resins & Functional Materials (RFM) business of Koninklijke DSM N.V., Heerlen (Netherlands), into the Coatings, Adhesives, Specialties segment has been factored into this forecast. One-time costs that could arise in conjunction with the LEAP transformation program have not been considered.

Covestro AG's Board of Management expects the business situation to recover in fiscal year 2021, despite the coronavirus pandemic's continued influence on the market, and the company to see robust growth, in part thanks to the planned acquisition.

Forecast key management indicators

	2020	Forecast 2021
Core volume growth	-5.6%	Between 10% and 15%
Free operating cash flow	€530 million	Between €900 million and €1,400 million
ROCE	+7.0%	Between 7% and 12%

We anticipate that core volume growth for the Covestro Group will be between 10% and 15%, with around 6 percentage points attributable to the acquisition of the RFM business. Accordingly, we project growth for the Coatings, Adhesives, Specialties segment significantly above the corridor expected for the Group. In contrast, we expect growth in the mid- to high-single-digit percentage range in the Polyurethanes and Polycarbonates segments.

The Covestro Group's free operating cash flow (FOCF) is forecast to total between €900 million and €1,400 million. Owing to one-time expenses in conjunction with the planned acquisition, we expect FOCF in the Coatings, Adhesives, Specialties segment to be significantly below the prior-year value. In contrast, FOCF in the Polyurethanes and Polycarbonates segments will be significantly above the prior-year level.

We anticipate that return on capital employed (ROCE) will be between 7% and 12%.

Covestro AG

The earnings of Covestro AG, as the parent company of the Covestro Group, largely comprise the earnings of that company's subsidiaries. Covestro Deutschland AG's earnings from equity investments in Germany and abroad are transferred to Covestro AG under a profit and loss transfer agreement. The earnings of Covestro AG are therefore expected to reflect the business development anticipated in the Covestro Group. On the whole, Covestro AG should generate a net income significantly over the level of the previous year. This forecast includes the acquisition and integration of the RFM business, which is scheduled for completion in the first quarter of fiscal year 2021. One-time costs that could arise in conjunction with the LEAP transformation program have not been considered.

Opportunities and Risks Report

As a company with global operations, Covestro is exposed to opportunities and risks on a daily basis. Addressing them is 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 opportunities and risks is part of responsible corporate governance and is the foundation of sustainable growth and financial success. This includes the ability to systematically identify and take advantage of opportunities while managing risks at the same time. 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 corporate function.

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 aim 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. We consciously accept and bear manageable and controllable risks that are in reasonable proportion to the anticipated opportunities. Covestro regards these 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 characteristics, 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 intranet. Covestro's Board of Management is primarily responsible for supervising the Group's risk management. The Chief Financial Officer of Covestro AG is responsible for the effectiveness and appropriateness of the system as a whole in accordance with the areas of responsibilities.

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

The management of each Covestro Group company is responsible for implementing the ICS standards at the local level.

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 managers responsible for accounting and financial reporting, and ends with Covestro AG's Board of Management. The IT systems in use throughout the Covestro Group ensure 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.

Continually ensuring the effectiveness and suitability of our ICS considering process changes, new business models, and technical specifications requires regular reviews and updating of the controls applied. We identified possible potential for improvement by analyzing our existing ICS from various perspectives in the 2020 fiscal year.

In fulfillment of the Chief Financial Officer's responsibilities, the CFO of Covestro AG has confirmed the criteria and the effective functioning of the internal control system for accounting and financial reporting for fiscal 2020.

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 breaches of antitrust law and corruption, while the Export Control Officer is responsible for the risk of breaches of foreign trade law. With respect to corruption, areas including gifts and invitations, relationships with government officials, and relationships with certain business partners such as sales agents were identified as being especially risk-relevant. A corruption risk analysis was performed for all Covestro companies. During the reporting period, we specifically worked on implementing in operations the policies governing gifts and invitations that were revised the previous year as well as restructuring the compliance review process with a focus on corruption in the context of business partners.

Many controls have been implemented at both the global and local levels to reduce the number of compliance risks. To the extent possible, we integrate the compliance controls into our internal control system (ICS). The effectiveness of the compliance controls is evaluated on the basis of a cascaded self-assessment system, as are the ICS processes for accounting and financial reporting. The results of the effectiveness evaluations are documented in the global system for the ICS processes. Corporate Audit carries out dedicated compliance checks at regular intervals in the larger companies. In the smaller companies, compliance aspects are part of a general review.

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

Covestro has implemented a structured process for the early identification of any potentially disadvantageous developments that could have a material impact on our business or endanger the continued existence of the company. 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, and is aligned with 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 met four times in fiscal 2020 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. Additionally, we conduct an ad-hoc process for newly identified risks throughout the year so that these are immediately incorporated into the risk management system. These ad-hoc risks are identified and their handling is determined based on risk assessments and depending on the defined thresholds.

Risks are evaluated using estimates of the potential impact after taking into account countermeasures (net impact), the likelihood of their occurrence, and their relevance for our external stakeholders. The potential economic losses are projected using the expected EBITDA loss. In certain cases, the impact on free operating cash flow (FOCF) is used as an alternative. 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.

Risk management has been assigned a continuously high priority primarily due to the global coronavirus pandemic. For this reason, during the reporting year we revised the criteria for assessing risks at Covestro. This mainly resulted in changes in the likelihood of occurrence of risks and cumulative loss amounts. As a result, in the future all risks with a cumulative loss totaling €50 million or more will be considered material; the previous materiality threshold was €60 million. This modification did not change the estimated weighted risk occurrence of the individual risks.

 See "Opportunities and risks."

The following matrix illustrates the direct financial and indirect financial criteria for rating a risk as high, medium or low.

Rating matrix

Indirect financial impact ¹	and/or	Accumulated impact ¹ (€ million)	Likelihood of occurrence within 1 year				
			Very low	Low	Medium	High	Very high
Critical		>1,000					
Significant		>300 – 1,000					
High		>150 – 300					
Moderate		≥50 – 150					

Weighted risk occurrence ■ Low ■ Medium ■ High

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

Criteria for 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 evaluated at regular intervals by the Corporate Audit corporate function, which performs an independent and objective audit 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. The Supervisory Board's Audit Committee is regularly informed about the results of these audits, and receives an annual report on the internal control system and its effectiveness.

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

The external auditor assesses the early warning system for risks as part of its audit of the annual financial statements, focusing on whether the system is fundamentally suitable 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 Covestro AG's 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 and risk position of the Group, including pandemic-related risks, has not changed significantly compared to the previous year. The risks reported in the following paragraphs 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

The risks outlined below have material effects on EBITDA and, in individual cases, the FOCF of our Group. In this context, risks are deemed material if the potential loss to Covestro is estimated at €50 million (previously €60 million) or more, and/or they have at least a moderate potential indirect financial impact regardless of their likelihood of occurrence. 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. Various individual risks are combined into risk categories we have defined for this purpose. The following overview shows the levels of risk allocated to the individual risks within each category. A risk category can therefore include more than one weighted risk occurrence level. The order in which the risk categories are listed does not reflect their significance.

Risk categories by weighted risk occurrence

Risk categories...	Weighted risk occurrence		
	Low	Medium	High
...in the business environment			
Partnerships/acquisitions	●	●	
Market growth	●	●	
Regulations/policies	●	●	
Competition	●		
...in the company-specific environment			
Procurement	●	●	
Information technology	●	●	
Employees	●		
Production/value creation	●	●	
Product stewardship	●	●	
Law/compliance	●	●	

● The risk category includes at least one individual risk with this weighted risk occurrence.

Business environment

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, Covestro makes use of support by teams of experts for the due diligence and integration processes, if needed. 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. Acquisition risks with respect to the acquisition of the Resins & Functional Materials (RFM) business of Koninklijke DSM N.V., Heerlen (Netherlands), announced in the third quarter of 2020 are reflected in the corresponding risk category.

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

Negative economic developments triggered by a variety of events (e.g., worldwide pandemics) may have a negative impact on the global economy and international financial markets in general. As a rule, this also adversely affects the sales markets for our products, which then usually decreases Covestro's sales volumes and 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. Downturns in demand lead to reduced sales volumes and, ultimately, to reduced capacity utilization, which negatively impacts margins. Conversely, a positive economic environment characterized by growth and upward trends normally leads to improved business success.

Changes in Covestro's risk situation compared with the previous year resulted primarily from the current worldwide coronavirus pandemic, whose consequences for the global economy cannot be foreseen. Covestro has already developed a far-reaching pandemic plan that is being implemented by global crisis management teams. These teams immediately initiated a number of direct countermeasures to keep the virus from spreading among our employees. The pandemic's effects are still being felt and are expected to continue to affect the economic situation worldwide and therefore the business performance of Covestro as well. We rated this a mid-level risk in our Half-Year Financial Report 2020, and, based on our assessment matrix, continue to consider it a mid-level risk and currently one of Covestro's greatest challenges.

After sharp declines in demand in the second quarter of 2020, we were able to ascertain a strong, continual improvement in demand in our markets in the second half of 2020. In view of this development, we now consider the likelihood of negative economic performance, which we had rated a high-level risk in the Half-Year Financial Report 2020, to have lessened somewhat, and now rate this as a mid-level risk overall.

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. These shifting supply cycles 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. These are followed by a decline of industry-wide utilization rates.

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.

An economic downturn, changes in competitor 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. These risks are rated lower at the moment than in the previous year.

Further opportunities and risks may also arise if actual market developments vary from those we predict in the "Economic Outlook" section. 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.

Company-specific environment

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 comply with environmental regulations as well as occupational health and safety rules, respect human rights and therefore, for example, avoid 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 position on human rights.

Covestro requires significant quantities of different energy forms and petrochemical raw materials for production processes. Procurement prices for these forms of 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.

We purchase important raw materials based on long-term supply agreements and pursue 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.

Information technology (IT)

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 and information 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.

In addition, we named a Chief Information Technology Security Officer (CISO) and set up a department specially focused on this issue. They drive development and implementation of the IT security strategy for the Group. These measures are designed to guarantee optimum protection based on state-of-the-art technology.

Innovation

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

One example of the opportunities created by innovation is additive manufacturing, also known as 3D printing. This is a new market with 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 as well as increasing demands for fair working conditions. Our product portfolio offers such solutions for different areas of everyday life. We therefore see an opportunity here to expand our relevant market shares and to grow in these segments. A key focus of Covestro's strategy is sustainability and efficient production with the goal of making Covestro fully circular. To this end, we are developing new technologies, products, and business models that unlock opportunities for Covestro by lowering energy usage and carbon emissions.

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 of the need to use resources sustainably. Covestro is therefore developing new materials that help to further increase energy efficiency and lower emissions. For example, the polyurethane we manufacture is used in the construction industry for thermal insulation, thus improving its positive energy balance, while our 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. The use of cutting-edge digital technologies will help us add value along the entire value chain by optimizing the supply chain, stimulating growth, and developing new business models.

Employees

Skilled and dedicated employees are essential for the company's success. In countries with full employment, there is keen competition among companies for highly qualified personnel and employees in key positions in particular. 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. The risk of not knowing precisely when employees could leave the organization can potentially result in there not being sufficient run-up time for finding suitable replacements. We currently consider this a low-level risk.

Covestro has introduced 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 position on human rights, 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 restructuring programs, and amend existing collective agreements, and to negotiate reasonable and fair wages as well as other key working conditions.

Production and value creation

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, and safety management. If these risks were to materialize, this could result in personal injury, property and environmental damage, production stoppages, business interruptions and 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 equally 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 external influences such as natural disasters, fires/explosions, sabotage, or supply shortages for our principal raw materials or intermediates. We mitigate this risk by distributing production of certain products among multiple sites and by building up safety stocks to the extent possible and economically feasible. Furthermore, a security and crisis management system has been implemented for all our production sites as a mandatory component of our HSEQ management activities. It is aimed at protecting employees, neighbors, the environment, and production facilities from the risks described. The "Corporate Security" and "Crisis Management" Group Regulations forms the foundation for this.

Covestro operates in markets in which the long-term trend is toward a balance between supply and demand. 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 capture more of the market in terms of profitability and growth in the short to medium term.

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 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.

Product stewardship

The Covestro Group is exposed to the risk of negative publicity, press speculation, and potential or actual legal proceedings in connection with 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 additionally 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 of Covestro's products and operations, the viability of certain products, its reputation, and its ability to attract and retain employees. Due to the technical expertise required to fully understand the possible effects 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 governmental regulations even before any harm is scientifically substantiated and possibly despite scientific evidence to the contrary.

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 committed to sustainable development in all areas of its commercial activity. Any violations of this corporate 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 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 sales methods, may result in the imposition of civil or criminal penalties – including substantial monetary fines – and/or other adverse financial consequences. They can also harm Covestro’s reputation and ultimately hamper our commercial success.

Legal proceedings currently considered to involve material risks are described in the Notes to the Consolidated Financial Statements.

 See note 28 “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. This was renewed and increased in fiscal 2020.

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. 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' credit-worthiness 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 given the corresponding master netting agreements.

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 pension obligations.