



Board of Management Report

**Report by the Board of Management to the
Annual Stockholders' Meeting on Agenda Item 5
in accordance with Section 71, Paragraph 1,
No. 8 of the AktG in conjunction with Section 186,
Paragraph 4, Sentence 2 of the AktG**

Section 71, Paragraph 1, No. 8 of the AktG gives stock corporations the option to acquire own shares up to a total of 10 percent of their capital stock based on an authorization granted by the Annual Stockholders' Meeting. Agenda Item 5 contains a proposal to grant such an authorization. The aim is to enable the Board of Management, in the interests of the Company and its stockholders, to acquire own shares up to a total of 10 percent of the Company's current capital stock either via the stock exchange or by means of a public offer to purchase or exchange shares. The acquisition of own shares by means of a public exchange offer is designed to enable the Company to offer shares of a publicly listed company as specified in Section 3, Paragraph 2 of the AktG as consideration – instead of a cash consideration. For stockholders, the possibility of exchanging their shares in whole or in part for shares of such companies can be an attractive alternative to a public purchase offer.

It will also be possible for the acquisition to be carried out by group companies that are dependent on the Company within the meaning of Section 17 of the AktG, or by third parties on behalf of the Company or such group companies. The term of the authorization to acquire own shares is to be in line with the legal provisions, which allow for a term of up to five years.

If the acquisition takes place by means of a public offer addressed to all stockholders to purchase or exchange shares, the principle of equal treatment set out in Section 53a of the AktG must be complied with at the outset, in the same way as when acquiring shares via the stock exchange. If the public offer to purchase or exchange shares is oversubscribed, then it shall be possible under the proposed authorization to make the purchase in proportion to the number of shares tendered (tender ratios). Generally, the acquisition process can only be performed in an economically sensible manner if acquisitions are made according to tender ratios rather than equity interest ratios. In addition, it will be possible to provide for the preferential acceptance of smaller numbers of shares up to a maximum of 50 shares per stockholder. On the one hand, this option serves to avoid small, generally uneconomic, residual holdings and the resulting potential disadvantage for small stockholders in practice. On the other hand, it also serves to simplify the technical settlement of the acquisition process. Finally, rounding in accordance with commercial principles will be provided for in all cases so as to avoid notional share fractions. This also serves to simplify technical settlement. The Board of Management, in agreement with the Supervisory Board, considers the disapplication of any further stockholder tender rights entailed by this to be objectively justified and reasonable towards stockholders.

The own shares acquired by the Company may be resold via the stock exchange or by means of a public offer to all stockholders. In this way, the principle of equal treatment of stockholders is complied with when the shares are resold. Insofar as the shares are sold by means of an offer to all stockholders, the Board of Management is to be authorized to disapply stockholders' subscription rights to own shares for fractions. The option to disapply subscription rights for fractions serves to ensure a technically executable subscription ratio. The own shares counting as fractions for which stockholders' subscription rights have been disappplied will be sold at best for the Company either via the stock exchange or in another way. The potential dilutive effect is minor due to the restriction to fractions.

In addition, the Company may, under the proposed authorization, also sell the acquired own shares over the counter against cash consideration without making a public offer to all stockholders, if the selling price is not significantly lower than the market price at the date of sale. This authorization makes use of the ability to exercise the simplified disapplication of subscription rights permitted under Section 71, Paragraph 1, No. 8 of the AktG in accordance with Section 186, 3, Sentence 4 of the AktG, with the necessary modifications. It serves the interests of the Company in achieving the best possible price when selling own shares. This enables the Company to take advantage of the opportunities offered by the stock exchange situation quickly, flexibly and cost-effectively as they arise. The sale proceeds achievable by setting a market-driven price generally lead to a significantly higher inflow of funds per share sold than in the case of a share placement with subscription rights, where the discounts on the market price are generally not insignificant. Avoiding the lengthy and costly process of settling subscription rights also allows capital requirements to be met quickly by taking advantage of short-term market opportunities. Stockholders' interests in the assets and voting rights are adequately safeguarded in the process. The authorization based on Section 186, Paragraph 3, Sentence 4 of the AktG to disapply subscription rights when selling own shares is – including any other authorizations concerning the issue or sale of shares or bonds with warrants or conversion rights or obligations while disapplying subscription rights – limited to a maximum total of 10 percent of the Company's capital stock in accordance with Section 186, Paragraph 3, Sentence 4 of the AktG or in application of it with the necessary modifications.

Furthermore, subject to a new authorization by a subsequent Annual Stockholders' Meeting to disapply subscription rights, the Board of Management will not exercise the authorization to sell own shares while disapplying stockholders' subscription rights in the amount of the proportionate interest in the capital stock attributable to shares issued or sold while disapplying stockholders' subscription rights on the basis

of other authorizations granted to the Board of Management, insofar as the proportionate interest in the capital stock attributable to these shares exceeds 10 percent of the Company's current capital stock. The Board of Management will be bound by this condition until a future Annual Stockholders' Meeting again resolves to authorize the Board of Management to implement capitalization measures while disapplying stockholders' subscription rights. This inclusion will no longer apply and the original authorized volume will again be available once a subsequent Annual Stockholders' Meeting again authorizes the Board of Management to issue or sell shares while disapplying stockholders' subscription rights, or to issue bonds with warrants or conversion rights or obligations for shares of the Company.

Protection of stockholders from dilution is taken account of by the fact that the shares may only be sold at a price which is not significantly lower than the applicable market price. Final determination of the selling price for the own shares takes place shortly before the sale. The Board of Management will thereby endeavor – taking account of the current market situation – to minimize any discount on the market price. Interested stockholders may maintain their equity interest ratios at essentially the same terms by making additional purchases in the market.

In addition, the Company is to be given the ability to transfer own shares as consideration to third parties, provided this is done for the purpose of acquiring companies, parts of companies, equity interests in companies, or other assets, or to effect business combinations. Stockholders' subscription rights will also be disappplied in the process. The Company competes on a global basis. It must at all times be in a position to act quickly and flexibly in national and international markets. This also includes the ability to merge with other companies to improve its competitive position, or to acquire companies, parts of companies, and equity interests in companies. Particularly in connection with the acquisition of companies or parts of companies, it may, in addition, make sense from an economic perspective to also acquire other assets such as those which make an economic contribution to the company or part of the company. In individual cases, the optimal implementation in terms of the Company's interests involves executing a business combination or acquisition by providing shares in the acquiring company. Experience also shows that the provision of shares in the acquiring company is often demanded as consideration in business combinations and for attractive acquisition targets, both in international and national markets. The ability to grant shares for these purposes is already provided for by Authorized Capital I in Article 4 of the Articles of Incorporation. In addition, however, the aim is to permit the option to grant Company shares for these purposes without having to implement a capital increase, which takes

longer and is also associated with higher administrative costs, due in particular to the requirement to record the transaction in the commercial register. Furthermore, the Board of Management's authorization to make use of Authorized Capital I will expire on April 28, 2019. The proposed authorization is intended to give the Company the necessary scope to allow it to exploit any opportunities which may arise for business combinations or acquisitions quickly and flexibly. This would not be possible if subscription rights are granted; neither would the associated advantages for the Company be achievable. Should such plans become more specific, the Board of Management will examine carefully whether or not it should make use of the authorization to grant own shares. When determining relative valuations, the Board of Management will ensure that stockholders' interests are adequately safeguarded. Generally, when valuing the shares being granted as consideration, the Board of Management will be guided by the market price of the Company's shares. It is not, however, the intention to have an automatic link to the market price, especially so as not to call the results of negotiations into question because of market price fluctuations.

In addition, it shall be possible to disapply stockholders' subscription rights in order to satisfy obligations to creditors to whom the Company or its Group companies have issued bonds with conversion rights or warrants and/or conversion obligations. This may be expedient in the case of a capital increase for using own shares to fully or partially settle conversion rights or warrants and/or conversion obligations. In this context, it should be noted that – unless otherwise specified in a resolution by the Annual Stockholders' Meeting – bonds may be issued only in observance of stockholders' subscription rights, with the consequence that, indirectly, the stockholders' subscription rights are preserved.

The authorization also offers the possibility, while disapplying stockholders' subscription rights, to distribute the own shares to employees of the Company and affiliated companies, including managers at affiliated companies, and to utilize them for the fulfillment of rights or obligations to purchase Company shares that have been conferred or will be conferred to employees of the Company and affiliated companies, including managers at affiliated companies. As a result, it shall be possible to make Company shares available to respective beneficiaries in the scope of any potential share option programs, and to do so without utilizing conditional capital. The distribution of own shares to employees and managers of the Company – particularly in the context of long-term compensation components geared toward the sustainable success of the company – may be in the interests of the Company and its stockholders, as it substantially boosts the identification of employees and managers with their company as well as

enterprise value in itself. The use of existing own shares instead of the utilization of conditional capital may also constitute an economically sensible alternative.

Under the proposed authorization, the Board of Management may also use the acquired own shares to issue Company shares on stock exchanges outside Germany on which the Company is not yet listed. This gives the Company the ability to quickly and flexibly respond to advantageous stock exchange situations. It also enables the Company to expand its stockholder base outside of Germany as well. Stockholders' interests in the assets and voting rights are adequately safeguarded in the process. Protection of stockholders from the dilution of their shareholdings is taken account of by the fact that the shares may be issued on stock exchanges outside Germany only at a price which is not considerably lower than the applicable market price. Final determination of the price for the own shares takes place shortly before Company shares are issued on stock exchanges outside Germany. The Board of Management will thereby endeavor – taking account of the current market situation – to minimize any discount on the market price. Interested stockholders may maintain their equity interest ratios at essentially the same terms by making additional purchases in the market. The restriction in Section 186, Paragraph 3, Sentence 4 of the AktG that is explained above will apply in the event that the Board of Management intends to use the own shares acquired as per the proposed authorization in order to issue shares on stock exchanges outside Germany.

Furthermore, the proposed resolution contains an authorization for the Company to retire own shares without a further resolution by the Annual Stockholders' Meeting. The authorization allows the Company to react to the applicable capital market conditions in an appropriate and flexible manner. The proposed authorization thereby provides, in accordance with Section 237, Paragraph 3, No. 3 of the AktG, that the Board of Management may also retire the shares without reducing the capital. Retiring shares without reducing the capital increases the proportionate interest of the remaining no-par value shares in the Company's capital stock. The Board of Management is authorized to this extent to amend the Articles of Incorporation in relation to the changed number of no-par value shares.

Finally, the proposed resolution provides for the option to use own shares to pay scrip dividends. In this connection, the Board of Management is to be authorized to disapply stockholders' subscription rights to be able to pay a scrip dividend at optimal conditions. In a scrip dividend using own shares, stockholders are given the option of contributing their claim to a dividend payment that arises with the resolution on the

appropriation of earnings by the Stockholders' Meeting to the Company in return for own shares.

The payment of a scrip dividend using own shares can be implemented as an offer to all stockholders, applying their subscription rights and in compliance with the principle of equal treatment (Section 53a of the AktG). In each case, stockholders can only subscribe for whole shares; they are entitled to receive cash dividends for that portion of the dividend entitlement that is less (or more) than the subscription price for a whole share and cannot subscribe for shares to this extent. There is no plan to offer fractional interests or establish trading of subscription rights or fractions thereof. This is also considered to be justifiable and appropriate to this extent as the stockholders receive a proportionate cash dividend instead of subscribing for own shares.

Depending on the capital market situation, it may be preferable in individual cases to pay a scrip dividend using own shares such that the Board of Management offers all stockholders entitled to dividends the option to subscribe for own shares against the contribution of their dividend claims in compliance with the principle of equal treatment (Section 53a of the AktG) while formally disapplying stockholders' subscription rights in full. Implementing a scrip dividend while formally disapplying subscription rights enables the scrip dividend to be implemented at more flexible conditions. Given the fact that all stockholders are offered the own shares and that surplus fractional dividend amounts are settled by paying a cash dividend, the disapplication of subscription rights to this extent is also considered to be justifiable and appropriate.

In accordance with section k) of the proposed resolution, the Board of Management is to be permitted to make use of the following authorizations only with the consent of the Supervisory Board:

the authorization to sell the acquired own shares over the counter against cash consideration without making a public offer to all stockholders;

the authorization to transfer the own shares to third parties, provided this is done for the purpose of acquiring companies, parts of companies, equity interests in companies, or other assets, or to effect business combinations;

the authorization to distribute the own shares to employees of the Company and affiliated companies;

the authorization to use the own shares to satisfy obligations to creditors to whom the Company or

affiliated companies have issued bonds;

the authorization to use the own shares to issue shares on stock exchanges outside Germany;

the authorization to use the own shares to pay a scrip dividend.

Moreover, the Supervisory Board will be able to determine that measures taken by the Board of Management on the basis of the proposed Annual Stockholders' Meeting resolution may only be implemented with its consent.

Without prejudice to the option to use the own shares acquired on the basis of the proposed authorization in accordance with sections c) to i) of the proposed resolution, the authorizations for the use of own shares in sections c) to i) are also to apply, with the necessary modifications, to those shares acquired as a result of an authorization to acquire shares previously granted by the Annual Stockholders' Meeting. Stockholders' subscription rights will also be disappplied to this extent. The information provided above also applies to the reasons for disapplying subscription rights, with the necessary modifications. With regard to the requirement for the consent of the Supervisory Board, section k) of the proposed resolution will apply, with the necessary modifications.

The Board of Management, in agreement with the Supervisory Board, considers the disapplication of subscription rights in the cases described to be objectively justified and reasonable towards stockholders for the reasons mentioned – also taking account of a potential dilutive effect. The Board of Management will inform the next Annual Stockholders' Meeting of the utilization of the authorization.

The acquisition of own shares may, where appropriate, be optimized by using derivatives in the form of put and call options. Here too, the principle of equal treatment of stockholders is to be taken into account. The supporting nature of the use of derivatives to acquire own shares finds its expression, among other things, in the fact that they are limited to a maximum of 5 percent of the capital stock. The term of the options amounts to a maximum of 18 months and must be selected so that the acquisition of the shares on exercising the options takes place at the latest on April 25, 2024. There is to be no difference in the use of shares acquired using derivatives compared to those acquired directly.

It can be advantageous for the Company to use put or call options to acquire own shares. By selling put options, the Company grants the purchaser the right to sell shares in the Company to it at a set price

(exercise price). In return, the Company receives an option premium. If the put option is exercised, the option premium paid by the purchaser of the put option reduces the total consideration paid by the Company to acquire the shares. From the Company's perspective, the advantage of using put options to buy back shares is that the exercise price is already defined when the option transaction is entered into, whereas the cash outflow does not happen until the exercise date. Using put options to buy back shares can make sense if the Company intends to buy back its own shares when the price is low but is not sure of the best time to do so, for example. If the option is not exercised, the Company cannot acquire its own shares in this way. However, it keeps the option premium. By purchasing a call option, the Company receives the right – against payment of an option premium – to buy its own shares from the seller of the option (the option writer) at a set price (exercise price). Exercising the call option makes economic sense for the Company if the price of its shares is higher than the exercise price, because it can then buy the shares from the writer at the lower exercise price. This allows the Company to hedge against rising share prices. It also preserves the Company's liquidity, since the predefined purchase price for the shares only has to be paid when the call option is exercised.

The authorization does not entitle stockholders to enter into such option transactions with the Company. This, and that fact that the Company can only enter into option transactions with a financial institution, enable Management – in contrast to the case of an offer to all stockholders to enter into option transactions – to enter into option transactions at short notice and, in this way, react quickly to market situations.

The terms set out in the resolution prevent stockholders from suffering a material financial disadvantage if the Company uses put or call options to acquire its own shares. Since the Company receives or pays a market-driven price as a result of the provisions on the size of the option premium set out in the authorization, stockholders that do not participate in the option transactions in particular do not suffer any material pecuniary disadvantage. The position of the stockholders largely corresponds to their position when shares are bought back via the stock exchange and not all stockholders are actually able to sell shares to the Company. Not granting stockholders the right to enter into option transactions with the Company is therefore justified.

Taking into account all of these circumstances, the exclusion of any stockholder right of tender is objectively justified and appropriate for stockholders. The Board of Management will notify the next

Annual Stockholders' Meeting of the utilization of the authorization to use derivatives.

Leverkusen, February 26, 2019

Bayer Aktiengesellschaft

The Board of Management

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