

**We invest in winners.** That means we invest in strong companies that create value for their shareholders with sustainable business models, solid balance sheets and high margins. We keep the risks low and invest when our position is fuelled by a positive event. We refer to that as the combination of value and event.

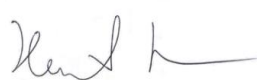
### **Bayer AG Exchangeable Bond 2017 (20)**

After Bayer spun off its chemicals division in 2004 and floated it on the stock market under the name Lanxess, the final step was taken in 2015 with the spin-off of Covestro, a plastics division with sales of EUR 14 billion, allowing the Group to focus on its agricultural chemicals and pharmaceuticals business going forward. Bayer floated Covestro on the stock market in October 2015 at an issue price of EUR 24 per share. After that, the price climbed steeply. High demand from the construction and automotive industries for light plastics with good insulating properties, as well as production problems at competitors, allowed Covestro's profits to soar and the share price to rise. The price quadrupled, reaching a record high of EUR 96 in January 2018. In March 2018 it was even included in the DAX index of leading German shares. Bayer took advantage of high prices to divest nearly all its shares in Covestro. Bayer retained only 7% of the shares in order to service an exchangeable bond issued in 2017 and maturing in 2020.

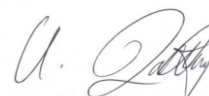
Euphoria was followed by sobriety. In November 2018, Covestro shocked the markets with a profit warning. Due to strong competition, rising costs and new provisions, an operating result (EBITDA) slightly below the prior-year figure of EUR 3.4 billion was forecast for 2018 as a whole. An increase was previously forecast. The share fell to EUR 41 and market

capitalisation to EUR 7.5 billion. This led us to take another look at the exchangeable bond backed by Covestro shares, which had since fallen from 130% to just below the nominal value of 100%. It was issued in June 2017 with a volume of EUR 1 billion. It bears interest at 0.05% p.a. A reduction of the nominal value or a default of the coupon is excluded by the prospectus if Bayer should experience a one-year loss. The initial exchange price was set at EUR 80.93. Because of dividend it now stands at EUR 80.11. In the event of exchange, Bayer is entitled to settle the bond in cash, in Covestro shares or a combination of both. We seized the moment to acquire the BBB-rated bond at an average price of 99.75%. Until it is repaid in June 2020, 100% in cash or 101% in shares, it will pay us a positive money market substitute return. We also have the chance of a significant increase in the share price if the Covestro share recovers and the capital market assigns a value to the conversion option once more. The low P/E ratio of 5 makes this possible. Moreover, if Covestro becomes an acquisition target, a takeover protection clause ensures that the conversion price is adjusted downwards depending on the date the acquisition takes effect. It now stands at EUR 71. A takeover could therefore significantly boost the bond price.

Sincerely yours



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