Conference Call Q1 2020
Transcript Q&A
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Andrew Stott (UBS): Martin, you mentioned you are not going to change the course in the capex in China nor indeed in battery materials. Two questions around that. One: Could you flex it? If you, obviously, remain fully committed, could you actually push some of those projects out?

Then, a second question is more around what you are seeing yourselves in China with regards to competitor behavior, especially upstream, if you are seeing any evidence of cancellations of some of the higher-cost producers?

The third question is a short term one. The oil & gas business, Wintershall Dea, has €1.7 billion of liquidity according to their own investor relations website. I guess, that burns reasonably quickly, given the current energy price environment. Does BASF have to inject cash into the vehicle considering the €5.7 billion of net debt?

Dr. Martin Brudermüller: It is important to mention that, even if we are in a difficult situation, we cannot cut off our legs for the time after corona. This is why we really prioritize and emphasize again that battery materials and China – in the new world post corona – are the major pillars of profitable growth for BASF.

We cannot significantly adapt capex now for the first step of battery materials in Europe because these are two projects you have to execute. What we will do is then the next steps which are in the mid-term plan. If electric vehicles would develop slower, we would also adapt the next steps.

This is a little bit different for the China project because you know it is US$10 billion until 2030, and we divide this anyway in phases. We are currently shaping the final scope. We also have some different scenarios, what could come in which phase. So, we have a certain opportunity to flex that out a little bit and to design the phases a little bit differently, which gives us some flexibility in the spending. However, the major part is certainly fixed because in a first step, which is the most heavy one, you have to invest in infrastructure and cracker and major downstreams, which is anyway the capital-intensive part.

Competitor behavior in China: It is a little bit too early to say. Before the crisis started – you know most of these numbers – for most of the downstreams there was also, at least in the longer run, let's say, a certain fit to the overall demand development. There is in some areas then a temporary oversupply if you look at the number of crackers planned. There is still an import need for certain chemicals.

I think it is too early now to say how the chemical market in China will proceed. We still think it will be a very attractive market because there is so much potential also on the domestic demand. But I think it is also fair to say, we have to see how the overall industrial output in terms of exports in China will develop. I would expect that there will be the one or the other policy change in countries to bring back certain parts of the value chain, which then also will trigger a shift in the pattern of who contributes which kind of material; that could be also a certain slowdown. On the other hand, you know, stimulus and a vast potential still in the domestic demand.

Overall, it is a little bit too early to talk about the long-term projects. But overall, I don't see so much changing. This might change the pattern in one or the other value chain. But the overall pattern, we think, is still viable. This is also why we hold on to our project in China. This is, no question, the largest market and also one of the fastest growing markets even in the future.

Dr. Hans-Ulrich Engel: On your Wintershall Dea question: First of all, Wintershall Dea has taken the necessary measures to improve its liquidity position in March and in April. It is standing financially on its own feet. There are no shareholder loans and there is also no obligation with respect to any type of financing coming from the shareholders.

Andrew Stott (UBS): Is the liquidity no longer €1.7 billion? Has that actually improved? Because that's the last number I saw.

Dr. Hans-Ulrich Engel: I think, compared to that, there is improvement. I don't have the Wintershall Dea liquidity figures handy. But I think when they do their earnings call in May, you will see that compared to the €1.7 billion there is a higher liquidity number.

Andrew Stott (UBS): So the way to think about this on your base case by the sounds of it: There is no dividend income and from a cash flow standpoint, that is the only thing to think about?

Dr. Hans-Ulrich Engel: There is no dividend income. To be very specific: There is no common dividend income. Other than that, from a cash flow perspective, there is nothing else really to think about.

Thomas Wrigglesworth (Citi): Martin, you talked about utilization rates above 60% for the Group at the end of April. Could you give us the regional color, Asia, US, Europe? Are you hoping that the Asian utilization rates are actually coming back up?

Dr. Martin Brudermüller: We don't have a breakdown into regional patterns, but maybe a little bit qualitatively: I mentioned in the speech that the demand pattern is very unequal. For example, ethylene oxide for the alcoxylation products for the care and detergents industry is still very high in demand. This is, e.g., why you see the cracker rates being still relatively high, also in Europe; in Nanjing, in the 90s even, before we now start to shut down the plant for the turnaround. So, it is a little bit a mixed picture, but overall, I would say, this is where it is.

If we look at April, we see in April a significantly lower level of sales. It is about, I would say, 20% lower than the average level before. We have also from the order entry coming in a little bit less, so somewhere like 30% less from the order entry. That will certainly also have an impact on the utilization rates which on average will go down. This is part of the projection of the Q2 picture which we have.

Matthew Yates (Bank of America): I noticed today is the first time since the Second World War that Royal Dutch Shell has cut its dividend. So, I wanted to ask: Under what sort of circumstances would the BASF Board consider a cut to its dividend next year?

I saw you recently have been put on a negative credit outlook by the agencies. And you are obviously reducing your profit forecast today. So, from a strategic perspective: How are you balancing the dividend obligation versus your debt capacity?

Is the current strategy of sticking to a progressive dividend, almost irrespective of market conditions, preventing you from creating longer-term shareholder value from investing capex in the business?

Dr. Martin Brudermüller: We implemented the dividend strategy, the progressive dividend strategy, as part of our corporate strategy at the end of 2018. That was certainly a consideration for a long, for a mid-term path and considering the earnings opportunities and strengths of BASF.

We are not going away from that strategy now because of that crisis without any view on how the world will look after the crisis. It is also for that reason very clear: We have different scenarios about liquidity. And all these scenarios show that we have the strength to pay the dividend. It’s the dividend that is connected with the performance of 2019. And this is why we go for that.

To make any statement now about what the dividend will be in the future, without knowing how the future looks, is exactly what we do not want to do. Let’s just wait how the second half of the year will be and then how fast the recovery will be. Whether this will be a rather short one, coming back to where we have been before the crisis in 2021, or whether this takes two or three years. Deriving from that, we will look what the growth perspective is, what the earnings perspective of the company is mid-term. And then we will see.

That we have not come out with a progressive dividend strategy to basically row back when the first obstacle comes is also very clear. And I think this is also what the Board stands for. I leave it with this: We wait until we get out of the fog and have a clear idea how the development of chemical markets will be and what that means for BASF.

You saw in the first quarter a positive volume development. I can also tell you: Now, in this crisis situation, we have customers who come to BASF because they now realize that this is really a reliable company, in particular in the care segment. We have partially double-digit volume demand in addition to what our sales level is. And surprise, surprise, there are quite a few suppliers who are unable to deliver because they are facing lockdowns and production problems. And the one who can actually deliver is BASF. We also take this opportunity to strengthen some of the strategic relationships with the partners and drive this into a mid-term, long-term growth strategy with them.

So let’s collect all of this and then we will see what that means, but we will not give up that progressive dividend policy so easily.

Matthew Yates (Bank of America): Just to follow up: As you rightly say, I don’t think any of us knows what the second half of the year holds. How is your commitment towards protecting that strong A credit rating? Are you willing to take the downgrade, or will you be looking for raising capital from other disposals, for example?

Dr. Hans-Ulrich Engel: Matthew, the short answer to that is: We are certainly not interested in a downgrade. We have a clear target. That target is a solid A. And that is a target which we are actually trying to make the right moves to also support that.

Tony Jones (Redburn): With the lockdown and a lot of employees at home, I would have expected that we might have started to see opex falling. But in the income statement for this quarter just reported SG&A costs were actually slightly up year on year. Is that the sort of dynamic we should expect in Q2, Q3? Or is it a temporary effect and we should see expenses starting to decline?

Dr. Martin Brudermüller: Let me make one comment about remote working. It’s very remarkable that 40,000 people in BASF are in home offices. And I would say, from my perspective, BASF is functioning quite well. If you look at that, I think people now really focus on what they have to do. They leave all the inefficiency aside.

I think the learning out of this, looking forward, is actually catering to our topics we have addressed in the strategy for a leaner and more agile organization. I think that clearly shows there is further potential also to slim down even further. And that is what we will also drive long term.

I cannot imagine that we come back to old travelling schedules. There's much more you can do via increased digitalization. I think it encourages digitalization. I just want to mention that this is all further potential to bring costs down, also in the years to come. It's a positive aspect. I think it convinces also people by experiencing that you can organize certain things differently in BASF.

Dr. Hans-Ulrich Engel: Tony, with respect to SG&A, I'm not 100% sure that we're looking at the same numbers there. Mine show me a decline. So, the suggestion is that, after this call, we'll set up a quick review and then take a look at what you have and what we have. [Supplement: Selling, General and Administrative Expenses have declined year on year; please refer to BASF's Quarterly Statement Q1 2020, page 17, line items 4 and 5]

Chetan Udeshi (J.P. Morgan): Just going back to the previous question around Wintershall Dea: Are you ruling out any sort of bail-out of Wintershall Dea through a shareholder loan or shareholder equity contribution to Wintershall Dea?

The second question was just a clarification on the numbers that I wasn't sure I heard correctly or clearly: It was just around what you've seen so far in terms of order development and sales development in April. I mean, if you have any regional or just group numbers it would be useful.

Dr. Martin Brudermüller: I repeat the numbers: I said, in April it's about 20% lower on sales and it's an order entry which is about 30% lower than the average of the previous month. This gives you an idea and it reflects also very much the lockdown situation; most of the decline was actually contributed by the automotive industry.

Dr. Hans-Ulrich Engel: On your bail-out question: As I said earlier, financially Wintershall Dea is standing on its own feet. It has taken the necessary measures to improve its liquidity. So I don't see a situation in which we would have to bail out Wintershall Dea, which is very solidly financed.

Andreas Heine (MainFirst Bank): On cash flow, net working capital had a strong outflow in the first quarter and you elucidated that that is not least due to the seasonality in the agro business. Going into the second quarter, is it fair to assume that you have a massive inflow from that working capital, helping your liquidity first by collecting the sales from the agro business, second by lower business activity which means lower inventories and thirdly by lower raw materials? So would it be fair to assume that at the end of the second quarter, net working capital will be below last year?

Related to the cash flow: Capex you outlined on the big projects mid to long term. How do you look on the capex in 2020 where you have probably also some smaller projects where you have a certain flexibility?

Dr. Martin Brudermüller: Lowering capex from €3.4 billion to €2.8 billion. What we actually do is: We look at each and every project. Certainly, you know that some are running. You can partly also stretch them a little bit. You can also postpone. If you just think about that level, more or less with each month you spread the whole spending, you have kind of €200 million to €250 million coming in.

I think there will be also quite some things anyway happening because some of the suppliers will have a lockdown, will have problems to deliver in time, which automatically will delay the one or the other investment project and with this also the spending pattern.

What we don't do is anything stupid. We don't cut off the legs where we depend on regarding future growth. Otherwise you will tell us post corona: Why have you actually not taken the right measures to ensure that you can grow?

On the other hand, with the demand pattern, currently there is for many of the product lines not the necessity to start capacity expansions. That doesn't mean that we give them up, but we adapt them from the timing perspective. So it is a bunch of things, everyone has to contribute. This is developed bottom up and thus a very consistent approach throughout BASF Group.

Last but not least: We have taken opex down a little bit because we have some opex projects which clearly address smart debottlenecking. This is the last thing we need at the moment when you still have enough capacities to grow. So we focus more on those projects that immediately contribute to cost reduction. It is a mix of smaller and larger contributions and postponements and time adaptions.

Dr. Hans-Ulrich Engel: What do we expect with respect to the net working capital? We expect a shrinking business to generate cash for us. That's a bit counterintuitive, but that's what's happening. When the business shrinks, your accounts receivable come down. As you rightfully mentioned, you are collecting or starting to collect in Q2 on the accounts receivable from the ag business, to a large extent also in Q3. But there will be significant cash generation as a result of lower inventories and lower accounts receivable.

What has driven the cash consumption up in Q1 of this year? Q1 is the quarter – as a result of the peak ag season – that generates the highest accounts receivable. We have a second development: Our overdue quota has gone up a little bit, to be specific: by about four percentage points. And you look at a base there of €11 billion in accounts receivable. You know what that does. It drives your net working capital also up, or the cash that you need in there. We have lower payables.

And last but not least, there is a book effect coming out of our precious metals. And that explains then what's going on and what's consuming the cash.

Your assumption I can only support: During Q2, we should see a significant decline in net working capital and, as a result of that, a significant amount of cash generation.

Peter Clark (Société Générale): It's just one extended question, actually, about the hit you're seeing. I think you alluded to the fact that the order entry is indicating sort of 30% down, being worse than April.

On the auto side, though, you made it clear that's the big slump. I think the consultants are looking at the build somewhere down 45%, 50% to Q2. And obviously, the refinish is very weak as well with less miles driven.

So if I look at a business like coatings, I am just wondering where you see the volumes there. Obviously, one of your peers with a lot more than just auto in their mix, is indicating volumes down 30%, 35% in Q2. I guess you are going to be worse than that on coatings.

How about this moving through into businesses like catalysts and performance materials as well? Just an indicator of where you see your auto exposure, meaning for Q2.

Dr. Martin Brudermüller: Well, automotive: You heard that all the OEMs say, they start up again. If you look more into detail, that is in many cases not really the full production of cars, but it is partly engines and assembly parts of that. Hence, we are far away from having fully loaded and fully functioning car production.

I think we have a very big question mark also on the demand side because the current crisis is a trust crisis and a demand crisis and a supply crisis at the same time. Who is now really going out over the next weeks to order a car in times of economic uncertainty? You have friends getting unemployed. So you keep your money together. You still have a working car. Is that the time to buy a new one? I think there's a big question mark.

Looking to China, car production is definitely ramping up. But if you listen to those reports closely, then you see they are not where they have been before in the crisis; they are still significantly below the previous numbers. There is just a huge number of question marks.

What we, however, can see in China is certainly that the orders go up again. We see that in coatings, also in other areas, that actually the OEMs start to order materials across all divisions again. So that shows you that China, which is ahead of these lockdowns and the first one coming out and normalizing, is giving kind of an example. Whether this is being replicable to all the other countries in the regions, I am not so sure.

I really leave it with that because I think beyond that we can really not see. I mentioned that a lot of the actually lower sales and the lower order entry have to do with the automotive industry.

Laurence Alexander (Jefferies): As you think through the degree of disruption here and the impact of the low oil environment, how does this affect your innovation cycles and customer adoption of new products and the sales in the selling cycle? Are you going to see sort of a little bit of a lingering effect in 2021 and 2022 as people adjust to new value propositions and don't put as much of a premium on what they valued last year?

Dr. Martin Brudermüller: It's much too early to say this. What I hear from a lot of customers, and this also applies to BASF: We are not going to change our sustainability approach on CO_2 emissions, neither our commitment to Accelerator products, to work with our customers to bring the carbon footprint down.

Actually, the customers have not changed anything in their innovation projects yet. Whether this might happen if they have worse projections and their growth rate goes down and they can afford less, I cannot exclude that to happen at the one or the other customer. But overall, I would say, this is much too early to say.

The innovation projects are basically running, and also in our own carbon management projects where we have some hard nuts to crack in terms of developing new low-emission technologies, we don't change anything now because of the crisis. I think we have to just give it a little bit more time.

But if a company gets in trouble financially and has to reengineer and restructure and to shrink, I would expect that this has the one or the other effect on innovation. But that is not coming now; we might talk about that in three, six or nine months.

Markus Mayer (Baader Bank): On this effect from the change in reporting: Have I understood you rightly that the majority of the effect was in the “Other” line? Could you also maybe elucidate how the effect was for the other divisions as well or for the divisions as such?

On the efficiency projects: Has the current crisis affected the projects, either delayed or accelerated them?

Dr. Hans-Ulrich Engel: No impact on any of the other divisions. We are moving what was reported at equity in “Other”, the non-integral ones we are moving out of “Other” and moving that into the financial participations. That does not affect any of the other segments.

Dr. Martin Brudermüller: I would say, the efficiency program is on track. Wherever we can, we accelerate certain things. The composition may change a little bit because one part, you know, is coming from production, from opex, which is also then the contribution margin coming from additional volumes we generate. But we have to sell the volumes. Consequently, if we don’t sell them, we cannot generate that part.

But on the other hand – I mentioned that earlier – I think confidence in digitalization goes up. We clearly go for the maximum attainable cost reduction, even maybe beyond what we have on the list. We have also very clear plans and can only reiterate that we reduce the 6,000 people as much as we can until the end of the year and wherever possible go beyond that.

To summarize: The efficiency program changes a little bit in the composition, but the overall achievements and where we want to go to, are still valid. We bring home as much as we can in this environment.

2 Segments

2.1 Chemicals

Thomas Wrigglesworth (Citi): You talked about ramp-up costs and inventory write-downs impacting the upstream chemicals business. Any color or quantification of that would be helpful to understand the underlying level of profitability.

Dr. Hans-Ulrich Engel: Thomas, I am afraid I can't give you all the specifics that you would like to have. There are three drivers for fixed cost increases in the upstream segments, in Chemicals and in Materials.

As you mentioned, there is the new acetylene plant; there is also now the fixed cost that came in as a result of the acquisition of Solvay, which we closed on January 31, 2020. There is the inventory impairment. The inventory impairment figure I have readily available is in the order of magnitude of €30 million. The others we are happy to provide you with after the call as one aggregate figure. [Supplement: Fixed cost increases related to the startup of the acetylene plant and the acquisition of Solvay's polyamide business were in the order of magnitude of €20 million overall.]

Tony Jones (Redburn): We've got Brent below US$30. The global cost curve for upstream petrochemicals is collapsed and really flat. What does that mean for BASF's margins, maybe regionally? Is that going to start to impact some of your investment decisions?

Dr. Hans-Ulrich Engel: Your question on the margin side is also a difficult one to answer. We've seen towards the end of Q1, as a result of the steep decline in oil prices, naphtha following. Naphtha spot prices at US$85/mt are something that's very surprising. I think, on average, we are now in the range of US$140/mt to US$150/mt for naphtha. It's not only us seeing that, it's also our customers seeing that. And in this kind of low-demand environment, it is very difficult to hold on to any type of raw material price advantages. You have to pass them on almost immediately because demand is so low under normal circumstances.

We tend to think in a way where in our upstream segments, raw materials are an important part in the price formulas – that we pass that on with 30 to 60 days. In the current environment, it's almost immediate.

2.2 Materials

– no specific questions –

2.3 Industrial Solutions

– no specific questions –

2.4 Surface Technologies

Laurence Alexander (Jefferies): On the mobile emissions catalysts, can you peel back a little bit what's going on there? Were there any timing effects that pulled forward results from Q2 into Q1?

Dr. Hans-Ulrich Engel: We have not experienced any type of pre-buying in that business in Q1. What we have experienced, though, is a strong demand for our China 6 catalyst, a new standard in China introduced at the beginning of the year. Apparently, we are there with the right product at the right point in time and are enjoying the demand that we have there for the product.

2.5 Nutrition & Care

– no specific questions –

2.6 Agricultural Solutions

Christian Faitz (Kepler Cheuvreux): Do you see any logistical challenges in your agro business, particularly in seeds? How do the inventory channels look like in agrochemicals in Europe?

Dr. Hans-Ulrich Engel: Very nice results in ag in Q1, as we said. Maybe there is a little bit of pre-buying, but as always, you need to have the full six months to actually assess the business on the northern hemisphere.

Are we facing any type of supply chain issues that have an impact on the business? No, we don’t. We are watching the situation there very closely. There is here and there a little bit of firefighting that needs to happen. But that is true for the other businesses, too. So actually, no major concerns there at this point in time.

Could this change? Yes, this could change. I mean, there are precursors coming out of India, as an example. You know that India is pretty much under lockdown since March 24. There was enough in inventory. There are also still precursors which are on the water right now. There could be an issue.

There could also be an issue with packaging material coming out of India. To give you an idea: India is the biggest producer of big bags which are an important packaging material in the chemical industry. More than 80% of the world’s big bags are produced in India. So, that could cause an issue, but hasn’t caused an issue so far.

Sales channels and channel inventories: Actually, I’ll start with South America because that is end of the season there. Based on everything that we can see, ending inventories there in the channels at a comparatively low level, which should be a good basis for a solid business then in the second half of the year, in the season in South America.

Sales or distribution channels in North America: You may recall that we said last year around this time that we are getting basically a double whammy because two things were happening. One: Awful, dreadful weather conditions, which had a significant impact on our business as also on the businesses of our competitors. But then also something that we saw was that distributors were cleaning up their inventories significantly, which led to an overall good situation now in Q1. It doesn’t look to us like channels are being filled.

The inventory situation in Europe, based on what the colleagues in Agricultural Solutions told me yesterday, looks relatively normal. But we are in the midst of the season here. There is always the concern about drought. Today, it is raining in Ludwigshafen and not only in Ludwigshafen. So let’s see how all of that develops.

I want to say: Other than currency in South America, with the decrease of the Brazilian Real and the Argentinian Peso, at this point in time, no major watch-outs that we see.

2.7 Other

Andreas Heine (MainFirst Bank): Some more clarification on the “Other” line which has seen an increase. In the “miscellaneous” line, you have minus €249 million, much higher than in the year before. Could you explain this a little bit? I would have assumed, with the lower share price, a relief of long-term incentive programs, basically resulting in a better outcome than in the year before. What do we have to assume on these lines in the coming quarters, please?

Dr. Hans-Ulrich Engel: What’s going on in “Other”? In “Other”, we have a decline in EBIT before special items by roughly €40 million. If you look at our quarterly report, what you see is: This is almost exclusively coming out of the “miscellaneous” line, “miscellaneous income and expenses”, or in other words: “other” in “Other”. That makes it always difficult.

What’s happening there is: It’s really a hotchpotch of things that lead to the decline there, among other things, personnel-related measures which we have not yet allocated to the operating divisions.

And then something else: As you know, we have a captive insurance company. That captive insurance company has investments on which it has to do a mark-to-market and the mark-to-market on these investments leads to a loss. All of that is reflected in the “other businesses” line of Other.