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BASF conference call on second quarter 2019, Ludwigshafen

News Release

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BASF Group sales slightly lower in second quarter; EBIT before special items considerably below prior-year quarter

Second quarter 2019:

- **Sales of €15.2 billion (minus 4%)**
- **EBITDA before special items of €2 billion (minus 27%)**
- **EBIT before special items of €1 billion (minus 47%)**
- **Net income of €6.5 billion resulting from deconsolidation of Wintershall (plus €5 billion compared with second quarter 2018)**

Presentations by

Dr. Martin Brudermüller, Chairman of the Board of Executive Directors, and

Dr. Hans-Ulrich Engel, Chief Financial Officer of BASF SE

The spoken word applies.

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Good morning ladies and gentlemen,

Hans Engel and I would like to extend a warm welcome to our conference call on the second quarter.

We already published the key figures in an ad-hoc release on July 8. As you know, our 2019 outlook that we presented in February of this year was based on a number of assumptions – macroeconomic and geopolitical. Unfortunately, many of these did not materialize. Today we will give you a comprehensive overview of our business development in the second quarter. We will also tell you about the measures we have introduced to stay on track in this challenging environment.

First of all, let me emphasize that we are operating in a business environment these days with high uncertainty, low visibility and poor predictability.

Consider our macroeconomic assumptions from the beginning of the year. And what these figures look like today.

Looking back, growth in our customer industries in the first half of the year was significantly below our expectations. Growth in industrial production slowed considerably around the world. This was very evident in automobile production. The overall forecast for 2019 was plus 0.8% but production in the first half declined worldwide by 6%. In China, the decline was even 13%.

Compared to the prior-year period, chemical production declined by 0.5% in our home market of Europe. The downturn in Germany was particularly pronounced at minus 3.5%.

North America has struggled with exceptionally unfavorable weather conditions in recent months. At the beginning of the year, we could not have predicted the prolonged heavy precipitation in the major agricultural growing regions. Flooding and extreme conditions literally lead to bad weather for our Agricultural Solutions business.

The trade conflicts, particularly between the United States and China, are also a serious concern. We had followed the common view that a solution would be found by the middle the year. But now it seems the situation will not ease for some time.

Turning to BASF, we had to lower some of our assumptions regarding the upstream businesses. For instance, isocyanates margins. They declined even more than we had originally assumed.

Steam cracker margins in the first half of 2019 were also weaker than we had expected. One main reason for this was overcapacities in North America, which also had spill-over effects on other regions.

And, finally, the scheduled turnarounds of our crackers in Antwerp and Port Arthur put a heavy burden on our earnings. We had however taken this into account in our planning.

Ladies and gentlemen,

Now, how did our performance in the first half of 2019 compare to the prior-year period?

Sales of €31.3 billion in the first half of 2019 nearly matched the prior-year level. Uncertainty in the market led to cautious ordering behavior among our customers in key industries.

Sales volumes decreased by 4% compared to the first half of 2018. All segments reported lower volumes, except for Nutrition & Care.

Prices decreased by 2% owing to declines in the Materials, Chemicals, Nutrition & Care segments and Other. Higher prices in the Surface Technologies, Agricultural Solutions and Industrial Solutions segments partially offset the decline.

Portfolio effects amounted to plus 4% and were related to the acquisition of the businesses from Bayer. The transfer of our paper and water chemicals business to Solenis at the end of January reduced this positive portfolio effect.

Currency effects amounted to plus 2%. These were mainly related to the appreciation of the U.S. dollar against the euro.

EBIT before special items came in at €2.8 billion, lower than in the first half of 2018. This decrease was primarily due to the considerably lower contributions of the Materials and Chemicals segments. We had already stated in February that a strong decline was expected in the first half, especially due to lower margins and volumes for isocyanates and cracker products. However, we had not expected such a sharp drop. The planned cracker turnarounds in the Petrochemicals division also had a negative effect on our earnings.

The Materials and Chemicals segments therefore account for nearly the entire earnings decline in the first six months of 2019.

EBIT before special items was considerably higher in the Agricultural Solutions and Industrial Solutions segments and slightly higher in the Surface Technologies segment. However, this could only partially offset the decline in the other segments.

What were the driving forces behind the decrease in sales volumes?

Half of the negative impact on volumes resulted from the previously mentioned cracker turnarounds in Antwerp and Port Arthur.

Moreover, there was weak demand from the automotive industry and the negative development of the agricultural sector in North America. These two developments accounted for the other half of the volumes decline.

Excluding those effects, our volumes remained nearly stable.

Let us look at the regions: Sales volumes decreased globally, except for the region South America, Africa, Middle East.

The volume decline was most pronounced in North America. This was due to the cracker turnaround and the weak demand in the agricultural sector.

In Europe, the main factors were lower volumes in the Chemicals, Materials and Surface Technologies segments.

In Asia Pacific, all segments recorded lower volumes, except for Nutrition & Care.

By contrast, volumes increased by 2% in the region South America, Africa, Middle East.

As part of our strategy implementation, we have pushed forward with the rollout of a number of initiatives worldwide to further improve customer retention and foster volume growth.

Ladies and gentlemen,

Besides lower volumes, a key reason for the earnings decline was lower margins in isocyanates and cracker products. I would therefore like to take a closer look at these factors.

We will start with cracker economics in major regions. Feedstock prices are shown in blue, ethylene prices in red.

The low ethane feedstock costs in the United States have led to a significant capacity buildup in the region. This has pushed prices and margins to a 30-year low. Further capacities are coming on stream while domestic consumption is slowing. This increases the pressure to export – a challenge in view of the ongoing trade conflicts. This also leads to increasing margin pressure on global derivatives, such as ethylene glycol, in Asia and Europe. We do not expect this development to revert any time soon.

Now let’s look at the isocyanate margins. After hitting record highs at the beginning of 2018, the prices of TDI (shown in red) and MDI (shown in blue) experienced a sharp correction.

We had highlighted early on that such record margins could not be sustained. In addition, demand is waning across several downstream sectors, such as transportation. This also contributes to the negative market sentiment.

The temporary upward price momentum in Asia at the end of April was short-lived. It faded quickly after the trade conflicts escalated in May and June.

Ladies and gentlemen,

Let’s now look at the factors that we as a company can influence. And that we are systematically tackling. With our strategy, we defined six action areas where we are actively moving forward within BASF.

First: people. We are transforming our organization to be more agile and customer focused. Many changes were already implemented at the beginning of 2019. In June, we announced further important organizational changes.

Second: portfolio. We are executing the announced transactions to sharpen our portfolio. The most important ones are the merger of Wintershall and DEA along with the planned IPO as well as our plans for the construction chemicals business.

Third: digitalization. Using data and digital technologies, we are creating additional value. We are making our plants more efficient. We are accelerating innovation processes. And we are launching innovative business models.

Fourth: operations. To remain competitive, we are improving our production processes. We are continuously improving our plant availability. Technological leadership and operational excellence are the focus topics in this area.

Fifth: sustainability. It is a cornerstone of our strategy – a growth driver and an element in our risk management. We enhance our long-term competitiveness via carbon management and the circular economy.

And sixth: innovation. Effective and efficient research and development is a prerequisite for innovation. It is also another important growth engine for BASF. We strive to innovate with impact for our customers by connecting “R” and “D” even more closely.

The measures we defined in these six action areas were the right ones in November – and they are even more so today. Our environment is challenging. We are therefore implementing these measures with great speed and determination.

I will now share a few examples.

We are in the midst of reshaping the BASF organization. We are streamlining our administration. We are sharpening the responsibilities and roles of service units and regions. And we are simplifying procedures and processes.

In recent months, we have embedded significant parts of the functional services in the operating divisions. As of today, 15,000 colleagues are now working closer to our customers. More will make this move by October.

In addition, we have defined a lean corporate center. It supports the Board of Executive Directors in steering the BASF Group. Fewer than 1,000 employees will be working here. This represents less than 1% of our workforce.

The remaining service activities will be assigned to four cross-functional service units: Global Engineering Services, Global Digital Services, Global Business Services and Global Procurement. They will initially comprise approximately 29,000 employees.

These are the cornerstones of BASF’s new organization: customer-focused operating divisions, technology platforms and new service units. As well as the more market-focused regional organizations and the corporate center.

The organizational measures required for this are part of our excellence program. Leaner structures and simplified processes should lead to savings of around €300 million annually.

A considerable contribution is anticipated from operational excellence measures in production, logistics and planning. Digitalization and automation will also make a significant contribution. Overall, we expect an EBITDA contribution of €2 billion annually from the end of 2021 onward.

As previously announced, we plan a reduction of around 6,000 positions worldwide by the end of 2021. This will result from organizational simplification and efficiency gains in administration, services and the operating divisions. In addition, central structures are being streamlined in the context of the announced portfolio changes in the construction chemicals and pigments businesses.

I can already provide you with one number today: At BASF SE in Ludwigshafen, more than 1,100 employees accepted an offer and signed termination agreements in the first half of the year. The relevant costs have been included as special items in the first half of 2019, mostly in the second quarter.

At this point, I would like to hand things over to Hans Engel, who will discuss the second-quarter figures.

Hans-Ulrich Engel

Good morning ladies and gentlemen,

Now let's look more in detail at BASF Group's financial figures for the second quarter of 2019 compared to the prior-year quarter:

Sales in the second quarter of 2019 decreased by 4% to €15.2 billion. Prices were down by 2%, mainly driven by the isocyanates and cracker products businesses. Sales volumes declined by 6%. All segments recorded lower volumes, except for Nutrition & Care. The decline was most pronounced in the Chemicals and Agricultural Solutions segments. In Chemicals, it was because of the previously mentioned planned cracker turnarounds. In Agricultural Solutions, it was the unfavorable weather conditions in North America.

Portfolio effects accounted for plus 2% and were related to the acquisition of the businesses from Bayer. Currency effects amounted to plus 2%.

EBITDA before special items decreased by 27% to €2 billion. EBITDA amounted to €1.6 billion, compared with €2.6 billion in the second quarter of 2018.

EBIT before special items came in at €1.0 billion, 47% lower than in the prior-year period.

Special items in EBIT amounted to minus €497 million compared to minus €66 million in the second quarter of 2018. The increase in special items is due in part to one-time costs for the excellence program. Moreover, there was an impairment of a natural gas-based investment on the U.S. Gulf Coast, which BASF is no longer pursuing. In addition, the integration of the acquired businesses and assets from Bayer led to special items in the Agricultural Solutions segment.

EBIT decreased from €1.9 billion in the prior-year period to €548 million in the second quarter of 2019.

The tax rate was 18% compared with 20.6% in the second quarter of 2018.

Income after taxes from our discontinued oil and gas operations increased from €162 million in the prior-year period to €6.2 billion in the second quarter of 2019. This was due to the book gain from the deconsolidation of Wintershall following the closing of the merger of Wintershall and DEA.

Net income amounted to €6.5 billion, compared with €1.5 billion in the second quarter of 2018.

Reported earnings per share increased from €1.61 to €7.03 in the second quarter of 2019. Adjusted EPS amounted to €0.82; this compares with €1.77 in the prior-year quarter.

The cash flows from operating activities came in at €1.9 billion, compared with €2.2 billion in the second quarter of 2018. The free cash flow decreased by 31% to €965 million.

Ladies and gentlemen,

In order to have more time for your questions, today I will only briefly touch on the segments. You can find further details in our Half-Year Financial Report 2019, which was published today.

I already explained the main drivers for the sales development in the second quarter of 2019 compared to the prior-year period. Therefore, I will focus on the earnings development.

As in the entire first half of 2019, earnings in the second quarter of 2019 suffered significantly from the lower margins and volumes in the Materials and Chemicals segments. In total, the two segments accounted for 83% of the overall earnings decline in the second quarter of 2019.

Earnings in the Agricultural Solutions segment considerably decreased as well. This was mainly due to the seasonally negative earnings of the acquired businesses and lower volumes in our crop protection business.

EBIT before special items also declined in Other because of currency effects and valuation effects for our long-term incentive (LTI) program.

Significantly higher earnings in Industrial Solutions and slightly higher earnings in the Surface Technologies and Nutrition & Care segments could only partially offset the decline. I would like to point out that in this difficult environment, our three downstream chemical segments reported higher earnings than in the prior-year quarter.

Now, the cash flow: In the first half of 2019, cash flows from operating activities amounted to €2.3 billion, €1.1 billion below the figure for the first half of 2018. This was primarily due to the lower net income after the reclassification of the book gain from the deconsolidation of Wintershall to cash flows from investing activities.

Cash flows from investing activities amounted to plus €452 million in the first half of 2019, compared with minus €1.7 billion in the prior-year period. This increase was largely attributable to net payments received, primarily in connection with the merger of the oil and gas businesses of Wintershall and DEA. Payments made for intangible assets and property, plant and equipment increased by €273 million compared with the first half of 2018.

Cash flows from financing activities amounted to minus €3.2 billion in the first half of 2019, compared with minus €518 million in the prior-year period. The decrease was primarily driven by changes in financial and similar liabilities.

Free cash flow declined from €2 billion in first half of 2018 to €597 million, mainly as a result of lower cash flows from operating activities.

And I will give the floor back to Martin Brudermüller for the outlook.

Martin Brudermüller

Ladies and gentlemen,

The global economic risks have increased significantly during recent months. This has been driven by geopolitical developments and the ongoing trade conflicts between the United States and its trading partners. These conflicts will not be resolved in the near future.

The G20 meeting showed once again that the trade conflict is just one aspect of the story. There are many other issues – including fundamental issues – relating to the two superpowers' dealings with each other. All this is causing a noticeable slowdown in macroeconomic growth around the world, particularly in China.

We had feared this might happen. But we followed the general assessment that the conflicts would be resolved by the middle of 2019. We currently do not expect a solution until sometime in 2020 at the earliest.

We therefore have significantly adjusted our macroeconomic assumptions for the 2019 outlook downwards.

We significantly lowered our 2019 growth expectations for global industrial production and for global chemical production – from 2.7% to around 1.5% in both cases.

The automotive industry – an important customer industry for BASF – will not recover this year. We now expect a global decline of minus 4.5% in 2019.

Customers in all industries are currently very cautious with projections and ordering. Our visibility on demand development is also very low.

Overall, we expect continued low growth in industrial and chemical production in the second half of 2019. The upturn we had expected is not occurring.

From today's standpoint, we expect low margins in our isocyanates and cracker products businesses to persist. In the third quarter, we have to shut down our smaller steam cracker in Ludwigshafen for a planned turnaround. This will negatively affect our volumes and earnings.

With a view to the challenging macroeconomic environment, on July 8 we adjusted BASF Group's outlook for 2019: BASF now anticipates a slight decline in sales.

For EBIT before special items, we expect a considerable decline of up to 30%.

Return on capital employed (ROCE) for the full year 2019 is anticipated to decline considerably compared with the previous year.

Let me nonetheless reiterate that we stand by our progressive dividend policy. We want to increase our dividend per share each year.

Ladies and gentlemen,

The macroeconomic environment has become very challenging. Uncertainty is high and predictability is low. Our second-quarter results clearly reflect this.

We had to lower our outlook. It was ambitious but seemed achievable under the prevailing conditions at the beginning of the year. Today we have given you a detailed explanation of the reasons for this. Our response to this cannot be to forego ambition in the future simply to avoid corrections. BASF's management team remains committed to BASF's ambitious development.

Despite these challenges, we will implement our strategic growth initiatives rapidly, thoroughly and rigorously. We will also rigorously and decisively implement our measures around customer focus. For a strong, efficient and productive BASF that continues to grow profitably in the future. And is THE preferred partner of our customers.

And now Hans Engel and I will be glad to take your questions.