BASF

We create chemistry

Analyst Conference Call Q2 2023

Transcript Q&A

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1.1 Demand environment

Andreas Heine (Stifel): Could you elaborate a little bit on the demand trend in China going into Q3?

Dr. Martin Brudermüller: What is a surprise to the world is that it seems that China is also not able to walk on water. That became very evident when Prime Minister Li Qiang visited Berlin and asked for recommendations and advice on how to kickstart the Chinese economy in his interactions with CEOs. It is very obvious that there are some nervous reactions over there because the classical instruments are no longer working.

What is the reason behind that? I think it is exactly the same as everywhere in the world: People are uncertain in this environment. Chinese people are not so happy and confident with their own government. They spent a lot of money for the education of their kids. They have a 20% unemployment rate of young people now. They have lost a lot of money in real estate, and they are simply cautious about spending money. This is why it is not so easy to come back to consumer confidence and spending. You see that caution in retail sales and elsewhere.

That doesn't change the fundamentals. If you compare the per capita consumption of Chinese with the rest of the world, we cannot wish that they consume as much as we do. But with 1.4 billion people, there is actually so much room to get closer to us that I think the fundamentals for the next decades are not changing. But that is not kicking in in the second half as it did during the financial crisis where China bailed out the world. That is why everyone experienced a pretty similar situation in China as BASF did.

Chetan Udeshi (J.P. Morgan): Martin, you mentioned you don't expect further demand weakening. I don't know whether this was based on the statistical data that you referred to in terms of manufacturing industry inventories. Or is this something you see actually in your order book?

If I look at Q3, we all know there is a seasonality in the agricultural chemicals division. I don't know if you want to give us any feel for it, but Q3 typically break-even is sort of a number. Maybe it comes down by €200 or €300 million.

Ex that business, would you expect your rest of the business to be at least at the same level as Q2, given that you are saying that you don't expect the demand to fall further?

Dr. Martin Brudermüller: We have spent an awful lot of time in understanding this whole demand pattern. I have been on the Board for 17 years and have never seen such a situation. I think it is not comparable with what we saw in Covid times and also during the financial crisis because this time it is really affecting all regions in a similar way all over the globe. That was usually not the case in the past because one of the regions did better than the others.

But looking into this and also looking at our own numbers, we can see that the orders were declining, but they are bottoming out now at a certain level where they currently are. Over the recent weeks, we haven't seen a further decline in orders. That said, orders at hand are slowly going up, but they also seem to be in a trough. We have seen that over the recent weeks. So it is not only a qualitative thing, but I see this reflected also in the numbers. Is this now a V-shaped development? Certainly not. But we see that we are somehow in the trough and are bottoming out.

That also fits with what we hear from customers. Let me give some examples. We see particularly in Asia that MDI and also the intermediates business are starting to stabilize.

In the chemical and refinery catalyst arena we actually see a rather good outlook. That was also why I mentioned that earlier when we spoke about the development in the catalysts business. We see also a certain stability building in the customer care areas and in several other businesses.

So that gives us the confidence that things are bottoming out. Does this now mean that everything goes up steeply? No. This is also why we had to adjust our outlook. But I think it is fact-based and it is also based on a lot of discussions with customers.

If you look at this destocking – we talk always about restocking, destocking – this is always the magic explanation. If you can't explain something, you talk about destocking and restocking. Actually, you can never really know what customers' stock levels are. The only thing you can do – and once in a while I do that when I visit a customer – is to see how many pallets are in the warehouse, is it empty or is it full? This gives you a kind of "seeing is believing" proof.

But we have now been seeing destocking for many months. At a certain point, this has to come to an end. I think we are at that point in many of the industries. So that gives us a little bit the different spin in today's call than maybe the very depressed tone you have seen elsewhere. You know us for being conservative and cautious. So take the words we used now, in the explanation and also in the speech, at face value.

Jaideep Pandya (On Field Investment): If I was to say that you guys will get 10% more volume next year, would that make any meaningful impact on spreads, given how low utilization is right now? Do you think that tightening towards 75 or 80% brings some pricing momentum or, conversely actually, does more volume mean more pricing pressure because there's just so much competitive pressure in the system?

Dr. Martin Brudermüller: It's a tough call. I would say 10% is a meaningful demand increase. That would clearly totally change the dynamics. Because let's be very clear: The availability, the supply side is high. The demand is low. The upstream products and commodities react so fast – basically on a daily basis – that you can almost see it in the formula prices.

I think that would mean a fundamental change, and that prices would turn around. Would that bring us to top margins? No, but it would clearly improve the margins because I think everyone would be sure to have enough stuff at the right time. And then it depends also on where it happens. Is the volume growth globally distributed or is it in a specific region? But it would definitely help us to get the prices up and certainly load the plants much better.

Peter Clark (Société Générale): Around the trends into the second half and particularly automotive. I know you're very confident on automotive, it's holding up well. But on the third quarter, I seem to remember there's quite a tough year-on-year comparison, particularly in Asia Pacific, where China was ramping up again after the shutdowns, I think, in Q2 2022. Am I right in thinking that, in the third quarter on automotive OEM, you have a tough comparison?

Dr. Martin Brudermüller: I think we clearly said these 15% that we were seeing now, but we also said 5% over the whole year. This shows you exactly the effect that you referred to with a base effect in China. And you also see the dynamic slowing down a bit.

I think what we clearly see: On the one hand, the semiconductor shortage is over and the orders at hand are declining because consumers are getting more cautious about buying a car. I think there is still some uncertainty about when is the right point to buy a BEV.

So this is going much slower with the exception of China. Overall, let's say that people don't have the money to buy cars now. So all of that is contributing a bit and basically making us a little bit more cautious. But it's still a growing industry this year.

Sebastian Bray (Berenberg): The automotive sector has been a source of relative strength over the last two years. There may be some lead indicators when demand is starting to slip a little. You mentioned earlier, Martin, the comments around the slight pick-up in orders on a near-term basis for the industry. But is this also the case for automotive or is it more appropriate to talk about a slight weakening there? Is there any change?

Dr. Martin Brudermüller: Overall, the order income from automotive, I would say, is rather stable. When I said weakness or getting maybe a little bit weaker, that has also to do a lot with the base effect in China. So I actually see automotive as rather stable. Particularly the emission catalyst business is also stable.

You see also that we have a very strong coatings business. Currently, it's performing very well. There will be no car produced or sold that is not painted. So that's always a very good indicator.

I regard automotive and agriculture as still being the most stable parts in our portfolio.

1.2 Cash management and cost savings

Matthew Yates (Bank of America): In the press release it is mentioned that you're planning to have a sharper focus on cash management. As you're probably aware, there is a lot of anxiety from your shareholders around the balance sheet as we go through this period of tough trading combined with high capex spending.

Can you talk a little bit more about the different levers you think you can pull to improve the cash management of the group?

Are we talking about cost-cutting, capex plans, working capital management, disposals or all of the above? I think there is an anxiety from investors that BASF doesn't have a plan B if the cycle doesn't quickly turn for sustaining that dividend.

Dr. Dirk Elvermann: First of all, you see the focus on the cash management already in the second-quarter results, which we have just explained.

So, what are the levers that we are pulling? Capex we talked about; we started with a €6.3 billion expectation for this year. We first trimmed this down to a little bit below €6 billion, as you know, and now we are at €5.7 billion. This is attributable to savings in the base capex, which is the maintenance and funding of our overall asset footprint.

But we have also come down with regard to our growth projects. This is a little bit of an FX effect, certainly, but this is also due to smart negotiations with partners in China. So we are not just postponing capex to the outer years, but we are really reducing it to €5.7 billion. This is, I think, a comfortable number which will not be higher. I think that is a step in the right direction.

Cost savings I mentioned. There are various dimensions. We have the cost savings program focusing on Europe with a €500 million run rate from non-operating activities. Until 2026 we also have the streamlining of the Verbund in Ludwigshafen with a further €200 million in savings. And then we have the ongoing programs for the service units. So, altogether, it is a little bit more of a €1 billion run rate as of 2026, at the latest.

Then inventories is also close to my heart. You know the typical inventory profile of the Group. We normally peak around late summer. This year, we stayed very focused on inventory build-down. Just to give you an idea: In June alone, we are more than €400 million lower than in May in terms of our inventories. If you compare it with June last year, we are more than €550 million lower. This shows you the direction in which we want to go.

Last but not least, accounts receivable. There we will see, of course, the build-down in the second half when the cash collection from the agricultural business is at its peak. Also here, we see some cash release.

In a nutshell, we are pulling all the levers that we have.

Matthew Yates (Bank of America): If you're cutting your full-year sales guidance by the best part of €10 billion, is there a rule of thumb for what that means for the size of working capital release?

Dr. Dirk Elvermann: Forgive me for not giving you an exact number here. Of course, there is also a natural effect, as we both know, from the working capital. On the other hand, you then also have less EBITDA. It is mainly a price question. So, it is a little bit too early to predict that completely, but I think the direction is clear.

Chetan Udeshi (J.P. Morgan): Coming back to the discussion around cost-cutting and fixed cost savings. Is any of that in the numbers already in the first half? Because Q2 was quite tough, when we look at the earnings across divisions. I don't see any evidence of any of these cost savings coming through. But I was just curious whether you've seen any of these benefits in the first half. Or are they more second-half loaded?

Dr. Dirk Elvermann: First of all, we mentioned the €300 million that we're expecting for this year. I think we can safely say that round about €260 million is already in our pockets. Where do you see it in the P&L? You cannot see everything directly, but if you look at the personnel expenses, then you see that they are down by 3.6%. But it's €260 million now and €300 million for the year and a little bit more than €1 billion overall from the savings programs.

1.3 Capital expenditures and dividend policy

Jaideep Pandya (On Field Investment): Currently, BASF has basically sixish billion of capex and €3 billion plus of dividend outflow in a €9 to €10 billion world of EBITDA. So how prudent is it to keep the dividend at the current level? Or conversely, at what point would you consider cutting the dividend for actually building a long-term future for BASF on a capex front if we don't see a meaningful recovery in the cycle?

Dr. Dirk Elvermann: As you know, shareholder value and specifically an attractive dividend is of high importance for the BASF Board. And we showed in the past that this is also true in difficult years.

I don't have to repeat our dividend policy; you know it well. But you know that also in years like 2020 and 2022, which were difficult years, we kept the dividend stable. And I have to say, I am also proud of that.

So, now 2023, we are all seeing the numbers. We see that, at least in parts of the world, there are also recessionary elements which hit the chemical industry particularly hard. You see that also in earnings and in the fact that we had to reduce our full-year outlook.

And you also see that we are committed to our large capital projects to enable our future profitable growth. But we are also prudent and are making some cuts to capex where possible.

And then, also as part of the equation, you have to consider BASF's free cash flow. I think that was a positive surprise to the financial community. It was very strong in the second quarter 2023, and this will also support an attractive dividend going forward.

Taking all of these factors into account, maintaining our dividend per share for the year 2023 will strongly depend on how the rest of the year now goes. This is what I can respond to your question right now.

Jaideep Pandya (On Field Investment): Just to say you're comfortable with a net debt to EBITDA around 2 or would you mind taking it even higher to maintain dividend?

Dr. Dirk Elvermann: You saw our debt, now going up on different elements. Our debt management is very much driven by our rating. I don't think many companies in the chemical sphere have a solid A rating. I think this is also a guiding principle here.

So, again, in the end, it all has to fit together. On a debt level, we are working of course: we talked about working capital management, etc.

Peter Clark (Société Générale): I'm getting the clear message on capex that it's not postponed and a delay. So when I look at the five-year plan of €28.8 billion, I'm assuming that you're looking to get that down.

Subsidiary to that: In terms of the North American exploration of a new venture with Yara, I'm assuming that's not actually in that five-year budget or is it? Perhaps you can clarify that.

Dr. Martin Brudermüller: As we always said, we are very cautious on capex. We look into everything two and three times. In the currently difficult times, we have really taken an extra look at how to get capex down.

We are very happy about the development of our large capital investment in China. That is coming in very, very well because of negotiations with contractors, also cost of materials. I would say, excellence in execution really brings costs down, not only for this year. We are hopeful regarding the overall investment over there. They are performing very well. And we took money out of running projects. We are also postponing some projects because you don't need to decide on new capacities when you are in shrinking markets.

Your assumption that Yara is not included is absolutely right. I would also remind you that this would be a minority position of BASF. It's an at-equity consolidation and you will not see it in the capex numbers anyway. I'll leave it at that. But rest assured that we will be very diligent on capex, also in the years going forward.

1.4 European competitiveness

Georgina Fraser (Goldman Sachs): I think this morning you've been quoted in the media as saying that politicians should be alarmed at the stock valuations and industry challenges that chemicals companies are facing. BASF last year acted very early and decisively to make energy-intensive plant closures in Europe. Do you think the bulk of these structural changes in the region for the chemical industry is behind us, or do you think it's a trend that's only just underway? And what does that mean for the region's ability to deliver on net zero or energy transition ambitions compared to regions like China, for example?

Dr. Martin Brudermüller: I am worried about competitiveness and the situation the European chemical industry is in. You see on the one hand the volume loss. It's about 17% year to date in Germany,13% in Europe. Another 5% to 6% was already lost last year. So that basically means that 20% to 25% of the production volume in Europe has gone. That shows you low utilization rates.

You may now ask, where is this coming from? No one has the exact numbers but, as much as one can understand it, I would make a rough guess that half is actually lost exports, where Europe is simply not competitive enough to sell to the world. The other half is most probably the lack of competitiveness of our customers. So, looking at this and at the same moment looking into the overregulation we get from Brussels – the 14,000 pages that have so far been released that affect the chemical industry, and it's not the end – it is actually really worrying.

In terms of energy costs and the availability situation, I think we are seeing ourselves as too safe in Europe because we had a mild winter. The situation can deteriorate very easily if we have a cold winter and other factors change.

I would say that politics is not reacting in the right way to take the issue seriously and look for ways to relieve it – either a moratorium on some of the regulation or, on the German side, looking in particular at energy prices and electricity prices for industry.

We have done our homework, as always. We are fast. We led the way by cutting €500 million in non-production costs. We got a lot of headlines, and then afterwards everyone else did the same. So, I would say, BASF is always a bit faster than the others here.

I think the closure of the plants is absolutely necessary. We did this diligently. I can only assure you: There's nothing more to come now from our side, as much as we can foresee in the medium term. But I am absolutely sure that other companies will make similar announcements.

When I talk to other people in the industry, I hear that people are considering this and are questioning whether it makes sense to produce in Europe. So we absolutely have to think about structural changes in the industry, some of which will also be permanent.

It is a kind of a wakeup call, and we need support from the politicians to safeguard this industry. This is the fourth largest industry in Europe. It generated €50 billion of trade surplus for many decades. With the increase in gas prices last year, this has gone. Europe is today importing more chemicals than it's exporting. So something has to be done.

If you look at market capitalizations and share prices and also, without commenting on others, that some non-European players are now looking into acquisitions in the European chemical sector, then I would say that is something that should be addressed by the politicians.

Maybe one final thing: Yes, all this might slow down the one or the other contribution to the transformation on the energy side. I would say there will be a shift within the regions. Most chemical companies, like BASF, have global targets. If the conditions in Europe are not good, we will try to decarbonize faster in other regions.

You saw that the China wind farm investment is one element. We get great support in China to do that. Zhanjiang will be a mega, super modern site, totally digitalized, with the lowest carbon footprint. And companies will look into investing more in the U.S. with the IRA where you have a business case for transformation.

So, all that is, I think, an urgent call for support for the chemical industry in Europe.

2 Segments

2.1 Chemicals

– No specific questions –

2.2 Materials

– No specific questions –

2.3 Industrial Solutions

– No specific questions –

2.4 Surface Technologies

Christian Faitz (Kepler Cheuvreux): On the elucidation of the battery materials in China. Why has this decreased so much? What is going on there? Has this improved in the meantime?

Dr. Martin Brudermüller: The lower earnings in the battery materials business in Q2 as well as in the first half of 2023 are mainly attributable to a significant decline in the lithium price. The decline was actually more than 40% since January 2023.

There is also very weak market demand in global consumer electronics. The BASF Shanshan operations and JV are still very much exposed to this sector.

For the second half year, we expect an increase in earnings compared to the first half, and will likely be supported by an increase in volumes and implemented cost-saving measures.

We should also not forget that the traditional catalyst business – the refinery catalysts and the chemical catalysts – which is consolidated here, is also expecting to grow earnings in the second half of this year compared to the second half of last year.

Andreas Heine (Stifel): On the battery material plant in Schwarzheide. You are sold out for several years, but it takes some time to ramp it up. When can we expect on EBIT level that this plant will be profitable?

Dr. Martin Brudermüller: Yes, we are sold out. We are ramping up now and getting the whole process running. But you have also to understand that there are certain steps in the approval process. You have so-called C and D samples which have to come from a certain number of batches that are then approved with the customer. That also takes some time. We are in the middle of that process and, so far, we have had no unpleasant surprises.

In terms of when this will be positive, I cannot give any answer, and we normally don't do that on a plant level. But having said that, loading the plant and being in sync with the customer should bring the plant into positive territory.

Georgina Fraser (Goldman Sachs): Now that you've recently completed the carve-out of ECMS, the auto catalyst business, could you maybe talk about the strategic options that you see for that business now it's on a kind of standalone basis?

Dr. Dirk Elvermann: We are very proud of our teams – the ECMS team, but also our teams in Corporate and Services – that they have delivered the full carve-out within 18 months, on time and on budget.

So how do we see this business now? This business is fully invested, well positioned, hunting for additional market share and very cash return rich. So we can enjoy the focus this business has on its markets and receive the cash it generates. Or we can take the stance to find another strategic option if there is somebody who attributes greater value to the cash flows. But this is absolutely not yet decided.

I think the carve-out itself was a very important step for the crystallization of the value of that business within the BASF Group.

Sebastian Bray (Berenberg): My question is on the emissions control business, together with the precious metal activities that have been carved out. Could you give us any idea of the economics of this business, either in terms of its absolute sales or profitability currently?

Dr. Dirk Elvermann: If we look from Q2 2023 to 2022 and just take the Catalysts business out of the Surface Technologies segment, then you see a decline of course. This is on the back of particularly lower prices and volumes in precious metals services. But altogether the business is holding up nicely. The best performing business in the automotive sector is our Coatings business, where you see an increase both in volumes and prices on the back of quite a nice market development.

2.5 Nutrition & Care

Andreas Heine (Stifel): I guess that nutrition in the Nutrition & Care business is loss-making on current vitamin prices. Could you elaborate how you see this subdivision going forward in the second half and 2024?

Dr. Martin Brudermüller: Vitamin A and vitamin E are in a difficult situation. Prices are very low, almost historically low. But demand is also going down. Both in animal nutrition and human nutrition, there is extremely low demand. So, it is a volume effect, and it is a margin effect.

Without talking too much about competitors: If you look at the announcements of our major competitors, you can see that this is not a BASF problem. It is actually something that the whole industry is facing. We are responding by taking out fixed costs, by now putting our new investments into operation and ramping them up, and, with that, going through this difficult phase.

This has traditionally been an area, particularly for vitamin A, where BASF was always the cost leader. So I'm absolutely convinced that we will get out of this situation. How long that will take will also depend on the general demand recovery.

Andreas Heine (Stifel): As you said, you believe that BASF is cost leader. Is that still true in the current environment of high energy prices, as your assets in vitamins predominantly are in Germany?

Dr. Martin Brudermüller: That has certainly been more challenging when the energy prices were high. But prices have come down, even if they are structurally still higher and remain higher. Even so, with the new assets we are putting into operation – increased capacity, more efficiency – we are absolutely sure that we can maintain our cost advantage in the future.

2.6 Agricultural Solutions

Christian Faitz (Kepler Cheuvreux): How do you plan to deal with the channel inventories that have been building up during Q2 on the back of probably unfavourable weather for spray applications? Are you in the process of buying volumes back?

How has the Brazilian applications season started in terms of demand?

Lastly on Agricultural Solutions: I am positively surprised to see how well your pricing has held up in Q2, given that one of your more prominent herbicides, glufosinate, significantly decreased in price, at least if I look at Chinese growth. Any comments on that?

Dr. Dirk Elvermann: Indeed, the Agricultural Solutions division had a fantastic first half of the year. It maintained high prices. Now, the second quarter compared to the second quarter last year is a little bit slower. But if you take the first half year 2023 compared to the first half of 2022, it’s a fantastic result. I am also optimistic that we will maintain the high performance for the entire year.

So, what do we see in more detail? We had high prices. We don’t have any effects taken into the first half of the year that belong to the second half of the year. So, this is a true result for the first half of the year.

The glufosinate ammonium effect: This is negative, but it is relatively small compared with the size of the market. It is a one-digit percentage number that is part of the equation here.

If we take the outlook, indeed, we see that things should also work nicely in terms of product on the ground in the second half of the year. The distribution channels are indeed full. This has to be managed. Whether this will lead to a significantly lower demand, we will still have to see. The business for the second half of the year is still in the making. But it is not about product on the ground; it is rather distribution channels.

As you rightly said, Brazil will now be the decisive question. So far, I’d say, so good. We have a high level of demand. But now also the pressure on prices is increasing. So, we still have to wait and see. But overall, we have a confident view for the entire year for the Agricultural Solutions business.