Conference Call Q3 2019
Transcript Q&A
October 24, 2019

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1 BASF Group

Christian Faitz (Kepler Cheuvreux): Can you please give us an indication about current demand trends in China, potentially also by customer segment in your portfolio?

Dr. Martin Brudermüller: With respect to the sentiment in China: You saw that not all Q3 numbers have been published yet. But overall growth was slightly slowing down during Q3 in China, to 6.0 percent from 6.1 percent in the previous year.

On the other hand, Q4 is normally kind of a peak production season where some goods are finished for this year. This is why Q4 is not deteriorating further and might even be slightly better. However, what we see in the trade conflict, also including the latest developments of some appeasement in certain areas, is still not a major change. Also, if you look at pork and African swine fever affecting the pork life stock in China. There is a desperate need to buy meat. This is not giving a relief now to the conflict.

However, Chinese companies also have somehow learned a little bit to live with this conflict. They know which goods their customers buy and what they cannot buy and where they sell. Hence to a certain extent the situation stabilizes here.

On the other hand, we should not forget that also China is pushing towards energy efficiency, labor efficiency and also environmental protection. Overall, in the longer run, this provides business opportunities for BASF. Many customers, despite the current situation, actually come to us and talk about future projects and joint innovation. I would say, this is not a desperate situation, but it is typically Chinese. If you learn how to live with something, then this is also providing a different perspective on the future.

Charlie Webb (Morgan Stanley): In terms of some of the one-offs. You identify some kind of special income in ag, obviously, a kind of special payment in care chemicals and a revaluation of metal prices within your catalysis trading business. Perhaps you can just, either in totality or individually, give us some sort of quantum what that amounted to in the quarter.

Dr. Hans-Ulrich Engel: On your one-off questions: We have this kind of one-offs basically each and every quarter. If I look at the order of magnitude of the one-offs that we report in EBIT before special items in Q3 of this year and compare that to Q3 of last year, that’s pretty much the same order of magnitude.

Looking at ag as an example, there is a double-digit million in there in Q3 of this year, but there was also a double-digit million-euro one-off in there last year. If you take these out, the ag result, even without considering the one-offs, is significantly higher in Q3 of this year than it was in Q3 of last year.

With respect to the precious metal impact in Catalysts: The same is true there. As a result of the significant price increase that we have seen during Q3 – by the way, that continues in Q4, in particular for palladium and for rhodium – we have seen a positive valuation impact, but the results of catalysts without these positive effects from the precious metals are still quite a bit higher in Q3 of this year than they were in Q3 of last year.

So, if I look at the underlying business development without this type of one-offs both in Catalysts, but also in the rest of the Group, it is positive in the downstream segments.

It speaks for what we are doing there and also a little bit of benefit that we are getting from lower raw material prices.

Charlie Webb (Morgan Stanley): Just thinking about the order of magnitude: Are we saying, all in all, if you add it all up, it's very similar year-on-year in terms of those one-off effects? Just to be 100 percent sure: That includes also the negative effect of the Ludwigshafen cracker turnaround?

Dr. Hans-Ulrich Engel: That negative effect of the Ludwigshafen turnaround is also fully reflected in the underlying; it's not a special item. As I said in the beginning: If I compare Q3 to Q3, these one-offs in our underlying EBIT, it's about the same order of magnitude.

Chetan Udeshi (JP Morgan): Full-year guidance: decline by up to 30 percent, three quarters done, last remaining. How are you feeling about that range now? If you can give maybe some color, that would be useful.

Dr. Martin Brudermüller: First of all, we reconfirmed the outlook. It is clear, this makes us confident that we are able to reach it. Is this a walk in the park? No. I just mentioned that there are no signs of any revitalization of markets. So, it stays tight.

We also said the visibility is relatively low. Customers are very cautious in all the industries, not only in automotive.

However, what we also told you already at the beginning of the year is that our budget has two components. One part are all the self-help measures and our efforts to reduce costs and reap the benefits, also by reducing personnel. We are very happy with the current development. You also have this indication on chart 8 that we already benefit from the excellence program in the first year.

Next to these underlyings working very well, we do not see a further market deterioration, but also no positive signals. With that, we feel confident that we can make it.

Chetan Udeshi (JP Morgan): On free cash flow. If my calculation is correct, and I do take out the IFRS 16 impact, which comes on cash flow from operation, but probably offsetting these amounts, come from cash flow from financing – it seems the cash flow in the first three quarters is running around 1.5 billion euros or so run rate. How are you guys thinking about where it ends up by end of this year?

Dr. Martin Brudermüller: With respect to the free cash flow, we have the dividend commitment. We reiterated that. Mathematically this brings you to a point where you say, okay, your free cash flow should be in the area of paying the dividend. That is definitely also what we are aiming for. Where we will be at the very end also has to do with the volume development and how we can push that.

Over the last one or two months and looking at the overall portfolio, particularly downstream, the business development turns with the volumes. This is now a momentum we have to hold for the fourth quarter. It depends very much on managing this, also in the context of inventories.

But this is definitely the way we want to go and what is the target within the company. We are confident that we will reach that.

Georgina Iwamoto (Goldman Sachs): I have a question on capex. I was wondering if you could remind us what your plans are for 2020 and beyond and how you are thinking about your capital expenditure in light of the macro developments and also what you are seeing in terms of focus on cash generation to cover the dividend for the end of the year.

Dr. Martin Brudermüller: On capex: We will end up this year most probably a little bit lower than indicated. We always said that we have an eye on capex, but also told you that there are limits in terms of short-term adjustments because you have obligations from the projects you started.

But certainly, with each and every single project we basically launch, we always look at the market expectation and development. If some of the markets slow down, there is also a deferred need for additional capacity. Hence if the environment is slowing down for a longer time, then this also has an impact on capex. With this, I think it is most probable that we are lower in capex than indicated previously.

Thomas Wrigglesworth (Citi): On your investment in India: Could you just clarify what BASF's capex commitment is to that project and where you participate? I think you will only own and operate downstream assets rather than upstream assets here. Some clarity around that would be helpful.

Dr. Martin Brudermüller: On the India project: First of all, we are very happy that two partners have joined, because this gives us the opportunity in the first step of this whole concept to build a world-scale plant for PDH, propane dehydrogenation. This gives us economies of scale and propylene is then used on the one hand for polypropylene, but also for us, for acrylic acid.

We have indicated our investment will be around 2 billion US dollars. Please understand that this project is still in the feasibility study and will be detailed out later. So just to remind you that this is the first CO_2-neutral petrochemical plant and, with this, significantly contributing to our plans of a CO_2-neutral growth.

Thomas Wrigglesworth (Citigroup): If the Indian project is in its pre-feasibility phase, is it in your capex forecast you have given out to 2025 or is it yet to be included?

Dr. Martin Brudermüller: Yes, it is included.

Laurent Favre (Exane BNP Paribas): You just alluded to, I guess, a rethinking on innovation. From memory, you have got a 2.3-billion-euro ongoing R&D budget. I am wondering, are you hinting that this budget might be reduced? Or are you saying that you would be doing things differently and try to get more output out of the innovation centre?

Dr. Martin Brudermüller: If you look at slide 8, we talk about the excellence program, you see also R&D cost reduction via focusing budgets.

The 2.3 billion euros is the highest we ever had, certainly also because we bought the innovation-intensive Bayer business. We already started to bring the R&D organizations together and will certainly identify synergies.

Let me just remind you, as part of our organizational renewal, we have put the development and the research part in the divisions under one leadership of a Divisional Technology Officer. That streamlines the whole innovation chain. We have sharpened the innovation strategies on SBU level. We have also other excellence measures, e.g., from the supercomputing where we expect that the average project time goes down.

These are all measures to bring the R&D budget down a little bit and consolidate it. As I said earlier, there is no automatism for an increased budget. This gives us some leeway, definitely in 2020 and, let's see, beyond, to streamline on the R&D cost.

Tony Jones (Redburn): Regarding the same slide 8, how much of 2020 is likely to drop through to EBIT if there are additional costs, so other investments to capture and squeeze out these savings?

Dr. Hans-Ulrich Engel: What we are giving you there on slide 8, which is the excellence program slide, are the annual EBITDA contributions. If you ask how much of that drops through, well, you have line 1. You subtract line 2 and there you are.

Which means, in 2019 you have pretty much a wash between what the positive EBITDA impact is, then with the one-time costs. In 2020, we expect to see in the P&L roughly half of what the total program has to deliver as run rate by the end of 2021.

Tony Jones (Redburn): The one-time costs in 2019, are any of the 400 to 500 million euros above the line in EBIT before special items?

Dr. Hans-Ulrich Engel: Yes, roughly 50 million euros out of that is in the underlying EBIT.

Thomas Wrigglesworth (Citi): For clarification on the statement of cash flows: Net working capital looks to be a positive in the quarter, but there are miscellaneous items of negative 603 million euros. Could you just identify what of those are one-time in nature?

Dr. Hans-Ulrich Engel: On your question regarding the cash flow: What happens in the “miscellaneous items” line? That is the reclassification of the income from disposals; the largest part in that is the Basel real estate transaction that I already addressed in my brief speech.

Thomas Wrigglesworth (Citigroup): Can you quantify that?

Dr. Hans-Ulrich Engel: Unfortunately, the way the contract is written, no, I can’t. But I am trying to give you a little bit of guidance: It happens in “Other” and “Other” shows a special item. If you take a look at that, it gives you at least an indication.

Matthew Yates (Bank of America Merrill Lynch): It looks like the pension deficit there or the provision has gone past 10 billion euros. Can you talk about whether for next year that has any implications in terms of P&L interest expense or cash flow top-ups?

Dr. Hans-Ulrich Engel: On the pension: We have seen interest rates coming down for the major geographies where we have pension plans, i.e. the US and then Western Europe, order of magnitude 100 basis points. That has driven up our provision to this level of above 10 billion euros. We are now sort of in the same territory that we were in some time mid-2016.

Impact of that and whether that will require cash contributions in 2020, still remains to be seen. We have seen in 2019 year-to-date very strong returns from the pension assets. All of that needs to be taken into consideration when we go into 2020.

2 Segments

2.1 Chemicals

Sebastian Bray (Berenberg): It's on the Chemicals segment. The volume declines over Q2 and Q3 have been fairly substantial. If I try and knock out a few impacts of one-off effects in Q2 and Q3, it looks as if EBIT was pretty close to flat, if not maybe slightly down in Q3.

Is it right to assume that the entirety of these volumes swings back next year, given that the once every five-year maintenance is done, or are you going to ramp the volumes that were lost more slowly, given that the underlying end market seems to be weak?

Dr. Martin Brudermüller: In general, yes, this is a substantial volume drop, which is simply connected to the big machines at the very beginning of the chains. With a world-scale cracker being out for several weeks, you end up in double-digit less volume territory.

What usually is the case, if you run these assets, you try to run them as flat out as you can. On the other hand, you have an environment which, if it provides overcapacities, is difficult because you either push volumes very hard and then you have a margin problem or you somehow try to strike a balance between the two.

Definitely, what we suffered from: If you don't have the building blocks at the very beginning of the chain, you also have some problems with availability in industrial petrochemicals and intermediates. So, this is connected with respect to availability.

The plan is certainly to run all the crackers next year, as we always do, at a higher utilization rate. How that finally translates, we have to see depending on the underlying market developments. But you should expect in that respect a certain compensation for the volumes lost in Chemicals, like we did, e.g., in Nutrition & Care with the outage of the citral plant.

2.2 Materials

Laurence Alexander (Jefferies LLC): Could you give us some color on what drove the volume gains of 4 percent for Monomers?

Dr. Hans-Ulrich Engel: The plus 4 percent in Monomers: That is higher sales of both TDI and MDI, in particular in Asia.

Georgina Iwamoto (Goldman Sachs): I have seen a headline on TDI turnaround being used to adjust capacity. Can you just confirm that that's downwards and which plant you mean? And is that because of market conditions or because you are having trouble operating your vapor-phase technology?

Dr. Martin Brudermüller: Regarding TDI, we mentioned that we have a scheduled turnaround in our Ludwigshafen TDI plant. There is an obligation to do that in certain periods. This plant has improved significantly in its reliability over the recent months, also in terms of utilization rates that we achieved. In this TAR, there is a list of things we do to further improve the plant.

Obviously, this is also connected with the market demand which is currently rather muted. On the other hand, particularly in Asia, there is a push from additional volumes into the market. So actually, it is pretty good to do your maintenance work in times when the volume demand is not so strong. This all follows a normal business logic.

2.3 Industrial Solutions

– no specific questions –

2.4 Surface Technologies

Andrew Stott (UBS): Surface Technologies seems to be easily the best downstream performer versus the other segments. How do I have to think about the contribution of each of the three divisions? I wonder if you can just give a broad percentage split of the growth there.

When I look at last year in Surface Technologies, you had a huge Q4 on EBIT. I just wonder if you could remind me of whether there are any one-offs in there or whether that is just a firm base to model from.

Dr. Hans-Ulrich Engel: In Surface Technologies, all three operating divisions contributed nicely to the increase that we have. In very rough terms, it's 40 percent each in Catalysts and in Coatings. Then there is 20 percent, roughly, in our Construction Chemicals business.

You alluded to Q4 and the effects that we had in Q4 2018. You may recall that in Q4 of last year, the precious metal prices increased significantly. That certainly contributed quite a bit to the very strong Q4 that we had in Catalysts in Q4 2018.

Christian Faitz (Kepler Cheuvreux): How do you explain the discrepancy in automotive demand between your upstream divisions, which is more aligned with what we hear from the car industry itself, and downstream, particularly Coatings OEM? Did you win some new contracts in the latter one?

Dr. Hans-Ulrich Engel: On automotive OEMs: I think, in general, we see obviously what is happening in automotive production. What we also experience is continuation of what we had in prior years. You recall and you know that slide that shows how our automotive business has done overall, compared to the development in the automotive industry. And you know that we outperformed at a level of roughly 200 percent if you look over the last six to eight years. In other words, the automotive industry is growing at 2 percent, BASF automotive business is growing at 6 percent.

What we have at this point in time in Q3 is one particular development in catalysts, which is primarily driven by the China VI regulation that kicks in in 2020. We have seen a nice uptick there in our business. This is a market demand that we now can support out of the new capacities that we have built in China. A bit of the same experience we currently have in India – a new emission regulation. Our capacities that we have built there over the last three years are there and we fill them and that helps us to generate – even in a situation where there is a significant downturn, we are expecting somewhere between minus 4 and 5 percent in automotive production – that helps to drive our Asian results in automotive emission catalysts.

In OEM, we have a, I want to say diplomatically, flat volume development, which is also better than market. Nothing to really write home about, but better than market development. From that point of view, we are quite satisfied with what we are seeing there. In addition, new platforms, new business that we won certainly plays a role. We have to factor in that the end of Q3 was affected by the GM strike which still continues into Q4. We will have to see how that actually will work out.

Gunther Zechmann (Bernstein): On Catalysts, can you just give some color on where you see the strong volume growth on the emission catalysts coming through and what is driving that growth? You briefly mentioned China VI. But if you could explain a little bit further where that comes from. How much of the growth within the catalysts business comes from cathode active materials?

Dr. Hans-Ulrich Engel: As mentioned before, we have this increased demand, in particular in Asia, for catalysts and that is driven by the new standards in China, China VI. It is also driven by a new standard in India, also to be implemented from 2020 on. This is for light-duty vehicles.

We have a good, strong development in heavy-duty diesel as well, also and again in Asia, so a bit of a similar story like I just told with respect to the automotive refinish business: We invested in new capacities and also had a bit of inorganic growth by way of acquisition. In the catalysts area, it is predominantly the new capacities we have put into China and into India which we are now filling.

Battery materials on the volume side also contribute, no question about that. We see double-digit volume growth figures there, as we had in the prior years. This is simply driven by a market that currently grows at a rate of somewhere between 20 to 25 percent, most probably also in the very difficult year 2019.

Gunther Zechmann (Bernstein): Just on the cathode material: Umicore had that announcement about a large take-or-pay contract. Can I just ask you if that is the direction, you are pushing for contractual agreements with your customers as well? Or how does the pricing work for BASF in that business?

Dr. Hans-Ulrich Engel: Are we pushing for contractual agreements with customers? Absolutely.

Gunther Zechmann (Bernstein): How many in a take-or-pay context?

Dr. Hans-Ulrich Engel: Since we are in the midst of negotiating agreements, at this point in time, we will be careful on commenting that.

Peter A. Clark (Société Générale): Encouraging performance in Surface Technologies, particularly in coatings, admittedly from a low base. You mentioned that the OEM business was flattish on volume, which is a bit better than the market. Partly, that might be platforms and geography. I am just wondering on that.

Then, also on the refinish where you seem to have been doing a little better than some of your competitors. Collisions were slightly down, actually we saw some of the big distributors destocking. So, I am guessing – you saw volumes up there – that you saw less of these effects.

Dr. Hans-Ulrich Engel: OEM coatings, I think, I covered already. On the automotive refinish side, we also saw improvement in our P&L. That is predominantly driven by our Asian business. You are aware of the fact that we invested in this Asian business over the last two to three years and that is simply paying back and looks, in the current environment, overall quite encouraging.

2.5 Nutrition & Care

Laurence Alexander (Jefferies): Could you give us some color on what drove the volume gains of 12 percent for Nutrition & Health? Was that a capacity coming on? Can you give us some extra color on what is driving that?

Dr. Hans-Ulrich Engel: The volume increase in Nutrition & Care actually happens primarily in Nutrition and has to do with the fact that we last year had issues with our citral plant in Ludwigshafen and with the entire citral value chain. This year, we are up and running. We also have the capacities available now from the new citral complex in Kuantan in Malaysia. That drives the volume development there. Thus to a certain extent a base effect and then the new capacities.

2.6 Agricultural Solutions

Charlie Webb (Morgan Stanley): In terms of crop protection and your ag business in total: Clearly, a decent quarter in terms of demand in Latin America. How is North America shaping up? Do you have any sense on how the inventory channels are looking today in North America as we start to think about next year and how the season is going to pan out? How do you see those inventories in North America and particularly in crop protection?

Dr. Hans-Ulrich Engel: Agricultural Solutions development, inventories: We had a bit of a discussion in the Q2 earnings call: What was happening in our business compared to what you heard from competitors? We said all along, we used the anyhow very weak year 2019 in North America to also clean up inventories.

So as a result of that: If we look at our inventory situation in the channel, we are quite okay with it. It could be a little lower, but it's not at a level where we are concerned. As I said, we took quite a few measures to address the inventory situation.

What's also quite good to see – we had that talk both in the Q2 call as well as during the Capital Markets Day in Ghent: In the meantime, the on-ground figures are out and they are actually as favorable for us and should give you a clear indication of what happened there from a market share perspective.

Andreas Heine (MainFirst): It's on agro where you have outpaced what at least I have expected by quite a margin. As it is quite tricky to talk about one quarter only, maybe you can highlight a little bit: What do you see as a strong start in Latin America, is that an early start? So, is it a phasing effect or can we take this as earned and Q4 should be then also up on last year, these strong trends in Latin America continuing?

Dr. Hans-Ulrich Engel: What we have is indeed a very strong start to the season in South America. Demand came in actually earlier than what we had expected. Inventory channels are at very low levels. This is completely different from what we experienced two, three years ago. There is a lot of clean up that has taken place in the meantime. So, customers came early this year. Whether and how this will develop during Q4, obviously depends on how the season will go, what kind of weather impacts we will have. You know the story.

But what I can say is that also in October demand is solid to strong. It seems like we will look at a good season in South America.

2.7 Other (participation in Wintershall Dea)

Andrew Stott (UBS): On Oil & Gas, can you remind me of the dividend income timing? My understanding was: It is an annual payment from Letter One to BASF. I therefore assume that comes in Q4, but I just wanted to check that. Also, the same point: All the various exceptional items that have happened with the JV, does that impact at all on the dividend?

Dr. Hans-Ulrich Engel: On Wintershall Dea and the dividend payments there. What happened so far is: Wintershall Dea repaid the shareholders' loans. In addition to that, there was excess cash sitting in Wintershall Dea which was also returned to the shareholders. You see that when you look at our cash flow statement: order of magnitude of 3 billion euros, as expected, were returned to the BASF Group.

Dividend payments do not come from Letter One. Dividend payments come to the two shareholders of Wintershall Dea from Wintershall Dea. About more than 70 percent of that goes to BASF. The dividend payment for the year 2019 we expect then some time in the first half of the year 2020. What that will be will in the end be determined by the full-year result.

Andrew Stott (UBS): No impact from the various one-offs because they are non-cash. Is that fair?

Dr. Hans-Ulrich Engel: The results roll into our results by way of equity consolidation and the equity result in 2019 is obviously heavily impacted by the significant integration and restructuring cost. I think I addressed that already in one of the earlier calls. So please don't use in your models what you had for Wintershall in 2018 as net income. That would be by far too high, consider the fact that, among other things, we book provisions for reducing the workforce from 4,000 to 3,000 people. As I said: significant restructuring cost and integration cost in the year 2019.

Laurent Favre (Exane BNP Paribas): Following up on this Oil & Gas point, given all the moving parts: Could you give us an order of magnitude of what an underlying, either net income or EBIT or EBITDA, would that be in using Q3 prices in a normal year without all those negatives? Is it low double digit, high double digit, low triple digit? That would be helpful for us when we forecast 2020.

Dr. Hans-Ulrich Engel: On your Oil & Gas question, Laurent: I don't want to avoid the answer. But I think it is important to understand where we are currently. This is now five months after forming the joint venture. We are in the midst of the budgeting process for the year 2020. So, we have got to get through the year 2019, have a clear view then on 2020. If you allow me, I would feel much more comfortable if you agree that we go through the budgeting process and I give you then some guidance once we are through with that.