Conference Call Q3 2020
Transcript Q&A
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1 BASF Group

1.1 Guidance

Thomas Wrigglesworth (Citi): Looking at the guidance you have kindly provided, what makes the difference between the high end and the low end of that range? I am specifically interested in your views on how the PGM metals trading business fits into that.

Dr. Martin Brudermüller: With regard to the guidance, there is not so much of the year left. Clearly the October business so far is running very strong. We also have an outlook now on orders. You know that about 50% of the orders at hand basically make up the next month. So we have a good overview on November.

Concerning PGM metal trading, we clearly expect that what we gained over there is consistent and remains. So, basically what we have here is the uncertainty on macroeconomic effects and slowdowns possibly in December. But I think, with this, we are relatively firmly positioned here.

Markus Mayer (Baader Bank): Maybe you can shed some light on what kind of lockdown buffer is included in your guidance. I understand that severe lockdowns are not included, but I guess this kind of lockdown light we might now get is included. Maybe you can help us on the effect of this baked in in your guidance.

Dr. Martin Brudermüller: We have an interesting discussion today here in Germany about what the next steps will be. But I think the overall findings from most of the governments is that in the first lockdown wave they learned a lot. I think everyone is refraining from doing or repeating something like this. This is why we said in our assumption: We don't expect that this is a total lockdown. I think, however, in France and in Spain we are close to this.

But, most of the other discussions are having actually more impact on the service industry. It is about restaurants; it is about events. That is not so much hampering industrial production. This is why we don't assume that it will have such a hard impact on us.

It can, however, certainly dampen the overall psychology of consumers. You never know whether this makes them a little bit more cautious on buying behavior. But we do not expect that this will be the general pattern. This is the assumption we have.

If we would now see escalations over the next one or two weeks that this really skyrockets, spins out of control and politicians would make harsher statements, then that could have an impact. But I think we made clear also how October is running, which so far has been really well, also looking at our orders at hand for November. Then not so much is left for December and December is anyway usually a weaker month because also customers do inventory management. Hence we should have home a more significant part for the fourth quarter.

I hope this gives you a framework on how we have put the assumptions into our numbers.

1.2 Capital expenditures, cashflow and dividend

Andrew Stott (UBS): You said at the end of your outlook that you are strictly reviewing your focus and spending on capex. I just wonder if you could add more to that, elaborate on specifically what you are looking at if you can, geographically, timelines and basically whether there is more flex to come, given that we have already seen a €600 million cut in 2020 capex.

Dr. Martin Brudermüller: I think we have clearly shown that we tightened everything this year. You can expect that this is going to prevail for the next years. We will be really sharp on that. I think we have shown you also one time that our strategic business units have been divided in so-called growth and core units. We have now kept the core part very, very tight. This is mainly to contribute cash, whereas we focus very much on units where we see growth.

But we also have to say, after those volumes we have lost in the markets, we have currently capacity for the next years to recover. We have quite some room over there. That also means we have taken postponements on adding further capacities. We will increase our opex budget again because that is always a good opportunity, with a relatively low amount of money, to debottleneck. That will give us some leeway. We are still prepared to contribute to the growth with capacities, but retard and postpone the expansion of these capacities.

That is something that will go beyond 2020. But let me make very clear that the pandemic does not change anything regarding our large growth opportunities which is battery materials and China. If you look, first of all, at the V-shaped recovery in China, which, I think, is very impressive and we benefit from that.

But if you do further analysis with the US decoupling from China and with their stronger focus on their domestic market, actually the market expectations for China look even better than before the pandemic. That gives us the confirmation that all the strategic long-term assumptions for China remain correct.

The same holds true for battery materials. While we have seen this strong decline in automotive. But it is also now a principal question that we drive more electric than with combustion engines. Actually, in the low numbers of new cars the share of electric-driven vehicles has actually increased which gives, I think, a certain proof that the assumptions are right.

Whether battery materials, which has an extreme growth predicted, grows a little bit slower maybe over the next two years does not change the fact that battery materials and the volumes needed for all the cars to be produced is a positive environment and a positive note for BASF.

That is why we still focus on them. We execute. But we are very strict with all the other businesses and very diligently go to those points where we have cost reductions and certain elements where we can diversify.

Andreas Heine (MainFirst): Usually, you mention three big projects, the battery materials, the Verbund site and the acrylic site in India. You haven't mentioned the acrylic site in India. Is that one on hold?

Dr. Martin Brudermüller: To be precise: We have at the beginning also talked about three projects in Asia because we have also the Nanjing expansion and have also India. But what I mentioned are the two projects where BASF can decide what we want to do. And this is China, the battery materials. So it is our decision.

The other parts always involve other parties which certainly also look into their planning. And this is why we have not talked about this because we also depend on what others do. We are looking into this. If there are news on it, we will certainly come back.

Andreas Heine (MainFirst): Last year, the cash flow was very strong in Q4, €2 billion. I would not expect this, but with the agro business having some volatility in net working capital towards year-end, is what you see in net working capital in Q4 in line with what you have given as a guidance for the full year? Does that reflect the free cash flow?

Dr. Hans-Ulrich Engel: Typically, this is the most difficult thing to forecast because it is fully dependent on: Will your business expand? Will it be on the same level or will it shrink?

A clear benefit that we had in Q2 and Q3 with our cash flow generation, as we had expected, it came with an overall shrinking business. The key question is now: What's going to happen here in Q4? Martin has already explained October; the development that we had in September continued. So, if we will see an expansion of the business, that will need some cash to be supported. But I think that would be fine because it would also then come with higher earnings that we would generate. So, from that perspective, that would be okay.

Overall, the expectation is: strong cash flow development, robust cash flow development for the full year 2020. Let's see where we will actually come out then with Q4, operating as well as free cash flow.

But I can also assure you that the measures that we have put in place, such as the cost reduction measures as well as the capital expenditure measures, the reduction there, that we expect this also to contribute in Q4.

Matthew Yates (Bank of America): You said in your introductory remarks something about the affordability of the dividend being based on mid-term earnings power. Should we infer from the write-downs taken today and the ongoing capacity build held in the industry by some of your competitors that you are indeed becoming less confident in the future earnings power of the business?

Dr. Martin Brudermüller: With regard to my statement on the dividend and the impairment part: Indeed, we have certainly made some assumptions, mainly for the commodity area and also for the automotive business which forced us basically to do these impairments. Hans has alluded to that. But that does not mean that this is an overly all depressive environment now for BASF going forward. This is why we have to substantiate this, really looking mid-term, longer-term: What does this mean?

I think, one part you just mentioned is Europe. The European Green Deal can be an opportunity, but it can also be a challenge. We have to get a better grip on that and to evaluate. Just remember that 40% of our business is today still in Europe. So, we depend on developing our business in Europe also positively.

This was why I would say: What we have now done for the impairment does not necessarily mean that this is the basis for certain conclusions about the dividend. I just mentioned this part on the dividend because several people have raised this topic. I would really like to reiterate: Give us the time to have the numbers for the cash flow, a clearer outlook which we will then explain in February and then we will take a decision at that point.

1.3 Excellence Program

Laurent Favre (Exane BNP Paribas): Slide 10 is pointing towards €600 million of incremental EBITDA contribution from the structural savings program in 2021. Can you talk about the temporary savings that you must have at this year-end and to what extent that will offset, I guess, the plus €600 million on structural savings?

Dr. Hans-Ulrich Engel: Temporary savings – a difficult topic. This is primarily on the side of the discretionary savings. As you can imagine, we have driven that down in a year like this wherever we could. So anything from T&E, travel and entertainment, to advertisement is down. What this will mean for the year 2021, I'd say, remains to be seen.

I think we are very clearly on a path, cost-wise at least, to do more with less, meaning: run the business on overall reduced fixed cost. You can expect us to be at least as disciplined in the year 2021 as we were in the year 2020.

Laurent Favre (Exane BNP Paribas): What an order of magnitude are we talking about? Lower three-digit, mid three-digit, high three-digit?

Dr. Hans-Ulrich Engel: I'd say, we are probably talking somewhere about lower triple-digit.

Dr. Martin Brudermüller: Maybe some of our people still think some postponement will come back. I tell you: It will not come back in 2021.

Chetan Udeshi (JP Morgan): Looking at the personnel expenses in the third quarter: Based on what you have reported, it seems it's flat year-on-year. I am just trying to understand: Where is the benefit from the ongoing improvement programs visible in terms of numbers?

Dr. Hans-Ulrich Engel: Let me start with the overall development in the first nine months of the year because if you look at the first nine months of the year, you see a decline in personnel cost. I think that is the much more meaningful number because looking only at one quarter, you always have special developments in there, as we had, e.g., in Q3 as a result of the decline of interest rates. With these discount rates, our pension obligation increased. That is reflected to a certain extent then also in the personnel cost in Q3.

So, overall: First nine months a reduction of 3% despite the fact that we had the usual personnel increases in 2020 or salary increases in 2020. We also had, as you may recall, the acquisition of the assets and businesses from Solvay, closing there on January 31. That came with a personnel increase. So, I think the take-home message is really: over the first nine months a reduction in personnel cost despite these developments, as explained, by 3%.

1.4 Regions and technologies

Charlie Webb (Morgan Stanley): You had an exceptionally strong Q3. I am just wondering what you are seeing as the main drivers of that. How sustainable do you think this very strong bounce-back in demand is in China? How sustainable, do you think, will that be through the start of next year? Are you seeing any stocking effects in Q3 and perhaps going into Q4, in China in particular? Or is this all just improved demand?

Dr. Martin Brudermüller: Charlie, I take your question on China. If I call our team over there, they just tell me how overwhelming the positive spirit is in this country. We have seen for months that the increase in volumes and demand was very strong and very consistent.

I mentioned more than once before that you have to look long-term whether the retail development and the industrial production are in sync. That is not yet fully the case. Retail is getting better but is still a little bit more cautious.

I think the consequence out of that is that some goods are produced into stock. This is why I always said, if that should be a strong long-term development, they both have to come into sync. But with every additional month, I think, there is reason for getting more optimistic.

And it is extremely dynamic. What my people tell me: decision-making and going forward with projects is just amazing if you are here in Europe and you compare the situation.

So, we have no indication that this is just a blip. It really looks like they manage this overall very consistently and to make this a very concise development. I think that the Chinese government is refocusing from export-driven towards domestic. They have a better toolbox to stimulate that. That is what we see actually.

So, we are very bullish and very positive about the development in China to go on over the next months and quarters.

Matthew Yates (Bank of America): You recently made some quite interesting comments at the European Industry Conference on the political backdrop in Europe and the ambitious political goals on carbon reduction that we have seen coming out of the crisis. I don't want to misquote you, but there was something along the lines of politicians not necessarily recognizing the financial impact on corporates and society of meeting those goals.

Can you maybe just elaborate on that from a BASF context, how you think your position in Europe could affect your cost base and competitiveness in the industry over the mid-term?

Dr. Martin Brudermüller: The European Green Deal is certainly a very, very high ambition. What you read now and what you hear from the politicians: They are almost in a race to drive the ambitions and the vision up and up and up. No one talks about how to do it. That is why I pledge very much that we need an intensive collaboration and a dialogue by detailing down: What does such an ambitious vision need in terms of day-to-day measures and framework conditions to really make it happen?

We have spent a lot of time in BASF to look at how we can electrify BASF. Because this is the only opportunity to get rid of the CO_2. I tell you very confidently by saying, technically, I think we are very clear on how to do that. It is actually possible.

But not everyone of these measures has a price tag where you can say, it is competitive in today's world. This is why we have to talk about the framework conditions.

We will also take certain measures and those are hundreds of measures to decarbonize BASF, which are already from today's point of view economic. These are the first ones to take.

But we also have to start with some of the newly developed technologies. To start pilot plants and really prove whether first of all technologically this is possible in large scale and then also use that to discuss with politicians about the framework conditions we need to make this happen.

Overall, the European Green Deal has to connect the ambition with keeping the industry competitive. I think there is a lot of work to do. Chemistry will contribute to the European Green Deal which, I think, is not doable without BASF and the chemical industry. But we also need the conditions to do that in a healthy manner.

I would say: There is some pressure on us, the whole industry. But without going into the details, also some opportunities come with it because we will have new markets. You also saw we launched the product carbon footprint. We will reduce the carbon footprint and accompany our customers to reduce their footprint. These are all new business models and with that opportunities.

But this is also new territory which we are chartering to, so a very, very interesting thing. We will keep you updated on the opportunities and also some of the challenges.

Tony Jones (Redburn): How do you think about the opportunities for chemical companies in hydrogen? And maybe more importantly: Do you think BASF should be playing a role in that market over the medium term?

Dr. Martin Brudermüller: I could take a long time now to talk about that. In principle, let me say: Hydrogen as an energy carrier and as one to actually store electrical energy from renewables, I think there is not much choice than hydrogen. If you look at the periodic table: It is a very small high-energy molecule; that is really the right choice.

However, if you look at the economics of it, I would doubt that anyone quickly earns money with it. You know that the focus is on green hydrogen. That is water cleavage. Water is unfortunately a very stable molecule in nature. That means you have to apply a lot of electrical energy to cleave that molecule into hydrogen and oxygen and renewable energy is also not cheap in today's time and a scarce resource. That means, green hydrogen will be very expensive. It is about three to four times more expensive than it is from steam reforming which is the usual process the chemical industry applies.

Steam reforming comes with ten times the CO_2 which certainly can leverage the two because when there are CO_2 costs, the grey hydrogen is getting more expensive. But taking investments and taking operating costs into account, this will be a burden without public funding. That is definitely needed to kickstart that. So, I think, many will contribute and would like to contribute to that, but not really earning money with it.

We explain this to you once we have more time for that, maybe during one of the Capital Market Days, what we want to do with this. For us, hydrogen is not a business opportunity, but hydrogen is one part of our way to decarbonize and to get rid of our CO_2 footprint, not only using hydrogen in products, but also using hydrogen partly to, e.g., convert CO_2, store CO_2 and to use it as an energy carrier. For us, this is an integral part, and this is also why we do research on that, particularly on methane pyrolysis. But it is not a business area for us.

1.5 Portfolio measures

Markus Mayer (Baader Bank): When you say the IPO is linked to market conditions, does this relate to the equity market conditions or also to the oil and gas price? In other words, what is more important, the overall business environment for Wintershall Dea or the equity market?

Dr. Hans-Ulrich Engel: When we talk about market conditions, this includes the oil and gas market as well as the equity market. We want to make that move at the point in time where both markets cooperate, and we think that in the course of 2021 we will find ourselves in an environment that would allow for an IPO that meets our expectations.

Tony Jones (Redburn): On the balance sheet, I see nearly €12 billion of non-integral investments. Could you indicate how much of that can be Oil & Gas and maybe how you get to that number?

Dr. Hans-Ulrich Engel: Your question on the non-integral investments, €11.9 billion. More than 90% of that is our Wintershall Dea financial participation. The remainder is pretty much the participation that we have in Solenis. Reflected in this number is obviously the impairment of around €800 million on Wintershall Dea that we had in Q2.

Andrew Stott (UBS): Pigments Q1 next year, Oil & Gas IPO whenever the markets allow. Is that it to that point? Do you feel that portfolio-wise you are done? Or is there more to do?

Dr. Martin Brudermüller: With regard to the portfolio, Wintershall is next. Hans said this: We are looking to IPO in 2021, certainly depending on market conditions. We have to look at that. But that is still something to do. The pigments we have to bring home finally.

If you do the math on what we have told you when we launched our corporate strategy, then there is a little bit left in sales. But these are no big chunks that are comparable with what we have done so far, and we have no urgent need on that.

We will focus very much now on organic growth and, I think, over the next one or two, three years you don't have to expect further very big portfolio measures. But you also know that in the smaller parts there is always work that has to go on.

Christian Faitz (Kepler Cheuvreux): Just a question on portfolio, maybe potential future portfolio measures, small business. Your key competitor in the decorative coatings business in Brazil is claiming to have won significant market share apparently quite recently. Can you confirm this?

Deco Brazil is pretty much the only business to consumer activity or engaging in it, besides agriculture obviously. How much sense does it make for you to continue to own this rather small activity in the bigger context of the BASF portfolio?

Dr. Hans-Ulrich Engel: First of all, what do we see in our South American deco business? We see a very good business development there in Q3, we are very happy. Sometimes, when competitors refer to market share and the development there and I add this all up and look at my own figures, I come to the conclusion that the market must have significantly more than 100%. I'll leave it at that.

On the portfolio question: It’s a business that both from an earnings as well as from a cash flow perspective is an interesting business for BASF. Yes, it’s stand-alone, that’s right. But if you look at the Suvinil brand and the value that it has, not only on a stand-alone basis, but also overall for the reputation of BASF Group, I want to say: It’s a good and attractive business that we have there. So, no need to rethink its positioning.

2 Segments

2.1 Chemicals

Sebastian Bray (Berenberg): It's on the impairment in upstream chemicals. Is there either a geographic or value-chain focus to where the impairment is implied? How do the assumptions either in terms of value chain and time horizon that flow into this impairment differ from those related to the investments in Guangdong site?

And to be more specific: Is it that you think Chinese capacity, supply-demand will recover on a four to five-year view, but the impairment refers primarily to a shorter period of time or is it mainly geographical?

Dr. Martin Brudermüller: Overall, it is a perception and an estimation of a commodity business and its supply-demand. I think, we have talked more than once about that this certainly all is looked at in detail by value chain, but it is an overall pattern that is relevant for many of the big chains over there. This is why several of the commodity lines are part of that impairment and certainly also plants and business cases in certain regions. But it's not one thing, it is a broader picture.

If you look at China, then this is certainly something where supply-demand is a challenge, but it is also at the same time the only market that has significant growth rates. And that is actually the market, particularly with what I said earlier, with a strong focus on domestic demand and even higher growth rates in the Chinese market. That is usually the market, because of its size, that also can digest these imbalances much more quickly than others. This is why, if it makes at all sense to build commodities somewhere, then it is in China.

We have reduced all of our capex expectations for commodities in most areas of the world and chains. But certainly in China, if you build a Verbund site, where you also need the first step of the value chain to build up these chains and these networks, and you look then on the different markets, then you see some markets where within 12 months, 15 months this market can digest one world-scale plant. So I think if you have the right concept in place, embedded in the Verbund idea, then it makes sense. If you are more stand alone, I would doubt that this will make sense.

We will talk in detail about what we do in China a little bit later and give you the frame around that. But that's roughly what is behind these thoughts. The commodity markets in China long-term are still interesting because of size and growth rates.

2.2 Materials

– no specific questions –

2.3 Industrial Solutions

– no specific questions –

2.4 Surface Technologies

Chetan Udeshi (JP Morgan): Can you maybe help us understanding if there was a material benefit from PGM price revaluation games in the third quarter in Surface Technologies?

Dr. Hans-Ulrich Engel: I start with the question on the impact of PGMs on Surface Technologies. There is a significant impact that comes from the PGM prices in the sales increase that you see. That simply has to do with: if you look at the development of rhodium prices, if you look at the development of palladium prices during the course of the year 2020, but also then, in particular, during the course of the third quarter 2020, as Martin has already mentioned. The expectation is: That will stay at this price level also then in Q4 and certainly the first four weeks in October support that statement.

Chetan Udeshi (JP Morgan): Can I follow up quickly on the first point: Are you seeing the impact on PGM prices only on sales, but not so much on earnings?

Dr. Hans-Ulrich Engel: No, that's not what I am saying. What I say is: significant impact in sales, but also a significant impact on the earnings. Without this kind of EBIT contribution, Surface Technologies would not have delivered the results it delivered in Q3.

Charlie Webb (Morgan Stanley): You talked us around the PGM piece. But maybe that aside: What have you seen in the other parts of Surface Technologies that led the sharp snap back in profitability? Is that caused by catalysts or was it more on the coatings side? Just as an understanding on what's the driving force beyond PGM you commented on, why: was it better year-on-year. Just sequentially, to understand what the other improvements were. That would be helpful.

Dr. Hans-Ulrich Engel: Charlie, I am happy to shed a little bit more light on the developments in Surface Technologies compared to prior-year quarter. Compared to prior-year quarter, we have improved earnings in the precious metal trading business; that we mentioned already.

We have an automotive catalysts business which is at the level of the prior-year quarter. That is driven in particular by a very strong business in Asia and there, again, as we explained also for the second quarter, predominantly by the business in China due to the new China 6 regulation and being there with the right product at the right point in time.

In the chemical catalysts business as well as the refinery catalysts business, that is weaker than it was in the prior-year quarter in both businesses. We see in both businesses that catalysts are typically run over a longer period of time. So the customers come back more slowly than they do under normal circumstances which obviously also has to do with lower run rates, in particular in refinery.

Last but not least, our battery materials business contributes higher earnings in 2020 in Q3 than it did in 2019.

On the coatings side of things, we see overall weaker numbers than in Q3 of last year. That should not be a big surprise. I think the important take-home message here is: significant improvement compared to Q2.

Peter Clark (Société Générale): It's just going back to the impairment, particularly on the Surface Technologies side. I heard your comments about auto and Europe; I think, also metal coatings was mentioned. I am just wondering: Is there a definitive split between the coatings and the catalyst business? I am presuming that there is an element of the charge for Chemetall, the deal in 2016. So just some feel for your change in assumptions on the Surface Technologies side.

Dr. Hans-Ulrich Engel: Yes, there is an element of surface treatment in there. If you think about the surface treatment business, that business has an auto exposure in the order of magnitude of 50% to 60%. It has an aviation exposure in the order of magnitude of, let's say, 10% to 20%. And looking at the overall development there, the business will not be able to generate in the early years now, so in the years 2021, 2022, most probably 2023, the kind of cash flows that we had expected.

Our expectation is that we will see a clear recovery in both markets, but it will take us till the end of 2022, 2023, for aviation maybe even a little longer, to get back to where we were in 2019. That we had to reflect then also in this kind of impairment.

Peter A. Clark (Société Générale): Is there some charge element allocated to Chemetall?

Dr. Hans-Ulrich Engel: That's what I tried to say. There is an element that relates to the surface treatment, i.e. to the Chemetall business.

2.5 Nutrition & Care

– no specific questions –

2.6 Agricultural Solutions

Thomas Wrigglesworth (Citi): A German competitor of yours gave quite a bearish outlook for ag chem for 2021. I was wondering if you could share your views on how you see that market shaping up in the light of rising crop prices and the competition in soybean seeds.

Dr. Hans-Ulrich Engel: Maybe I will start with talking about 2020 first. If you look at the first three quarters of 2020, you see overall a good business performance, a slight improvement in earnings compared to the first three quarters of the year 2019, so overall what I would call a robust development in a still difficult environment.

Business in Q4 is shaping up, I would say, okay. This is business in South America predominantly. Volumes develop nicely and we have obviously the currency headwinds both from the Brazilian real, but also the Argentinian peso that we will have to deal with and that will have an impact on the results of the business in Q4. A certain extent of that could also be seen already in Q3.

Then the question is: How will the environment be going into the year 2021? There is a bit of concern because channel inventories both in North America and in Europe are relatively high. That may have an impact on the northern hemisphere business in 2021. But I want to say: too early to say. We are in the midst of our budgeting round. We will have a clearer picture then at the beginning of December.

But one thing is for sure: We are not deeply concerned about that business going into the year 2021.

Laurent Favre (Exane BNP Paribas): On the impairments in Ag, compared to all the other questions you have had on impairments. I am bit surprised by the magnitude of these impairments. Is it just glufosinate? Anything on dicamba e.g.? Why do you now think that there is overcapacity in your network on glufosinate and therefore why do you need to rationalize capacity?

Dr. Hans-Ulrich Engel: It is exclusively glufosinate-ammonium. If we look at the generic competition there and the cost position that competitors have, we came to the conclusion: We must rationalize our production footprint. This means, we will have to close the plant in Muskegon. We will have to close one of the lines in Germany and then produce the active ingredient in the remaining two lines in Germany. That should improve our cost position significantly.

We are also taking a number of other measures to put this business overall in a better position. But the short answer to what you have asked is: exclusively glufosinate-ammonium.

Laurent Favre (Exane BNP Paribas): And not related to intangibles on LibertyLink, on the Liberty platform?

Dr. Hans-Ulrich Engel: No, as I said.