Analyst Conference Call Q2 2019
Speech
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Chairman of the Board of Executive Directors

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Chief Financial Officer

The spoken word applies.

Martin Brudermüller

Ladies and gentlemen,

Good morning and thank you for joining us.

On July 8, BASF released preliminary figures for the second quarter and lowered its full-year outlook. Today, we will provide you with further information.

We have structured our presentation as follows:

- First, I will elaborate on the key drivers for the earnings decline and the adjustment of our outlook.
- Second, I will go into the strategic measures we are systematically implementing.
- Third, Hans will provide you with more financial details on the second quarter of 2019.
- And finally, I will reiterate our adjusted outlook and present the updated underlying macroeconomic assumptions.

[Chart 3: Key drivers for the earnings decline in H1 2019]

First, I would like to explain the main drivers for our earnings decline and the adjustment of our outlook. As you will remember, we conditioned our outlook for 2019 in the BASF Report 2018 on several assumptions. Many of them did not materialize:

- First of all, let me emphasize that we are operating in an environment with high uncertainty and very low visibility.
- Global industrial production has slowed down to around 1.5 percent in the first half of 2019. Growth in our customer industries, especially in automotive, was considerably lower than we had expected at the beginning of the year. Globally, automotive production declined by around 6 percent in the first half of 2019. In China, the decrease was more than twice as high, at around 13 percent.
- Compared to the prior-year period, chemical production declined by around 0.5 percent in our home market Europe. With around minus 3.5 percent, the decline was particularly pronounced in Germany.
- Furthermore, we did not expect the exceptionally severe weather conditions in North America which impacted our Agricultural Solutions business.
- Finally, the trade conflicts, particularly between the United States and China, did not ease as we had assumed – following the general view at the beginning of this year.

Looking at BASF, our assumptions regarding the upstream businesses only partially materialized as expected:

- Isocyanates margins declined even more than we had assumed.
- Steam cracker margins in the first half of 2019 were weaker than we had expected in February. Overcapacities in North America did not only affect that market but had significant spill-over effects on other regions.
- The heavy burden on our earnings from the scheduled turnarounds of our crackers in Antwerp and Port Arthur was considered in our planning.

[Chart 4: BASF Group H1 2019 – Sales and EBIT before special items]

Let’s now look at our performance in the first half of 2019 compared to the prior-year period:

- **Sales** in the first half of 2019 were at the prior-year level and amounted to 31.3 billion euros. As a result of the uncertainty in the market and the cautious ordering behavior of our customers, we did not experience a recovery in demand from key customer industries.
- BASF’s sales **volumes** decreased by 4 percent compared to the first half of 2018. All segments reported lower volumes, except for Nutrition & Care. I will comment on the volume development in more detail on the next slide.
- **Prices** decreased by 2 percent driven by 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 percent and were related to the acquisition of agricultural solutions businesses from Bayer. The transfer of BASF’s paper and water chemicals business to Solenis at the end of January 2019, reduced the positive portfolio effect.
- **Currency effects** amounted to plus 2 percent and were mainly related to the appreciation of the U.S. dollar against the euro.

- **EBIT before special items** came in at 2.8 billion euros, 35 percent lower than in the first half of 2018. As indicated during our full-year 2018 conference call in February 2019, we expected a strong decline in the first half driven by considerably lower contributions of the Materials and Chemicals segments. However, we had not expected such a sharp decline in margins of isocyanates and cracker products.
- In total, the Materials and Chemicals segments stand for 97 percent of the overall earnings decline in the first six months of 2019. Considerably higher earnings in Agricultural Solutions and in Industrial Solutions as well as slightly higher earnings in Surface Technologies could only partially offset the decline.
- Let me add that EBITDA before special items was down by 19 percent and amounted to 4.6 billion euros in the first half of 2019. The decline was less pronounced than in the EBIT before special items because depreciation and amortization in the first half exceeded the prior-year level due to the purchase price allocation following the transaction with Bayer.

[Chart 5: BASF Group H1 2019 – Volume development]

Turning to the sales volume development in more detail:

- Compared to the first half of 2018, sales volumes of BASF Group decreased by 4 percent.
- Half of the negative impact on volumes resulted from the planned cracker turnarounds in Antwerp and Port Arthur.
- The other half of the volume decline was driven by lower demand from the automotive industry and the weak development of the agricultural sector in North America.

Excluding those effects, our volumes remained flat.

From a regional perspective, sales volumes by location of customer decreased globally, except for the region South America, Africa, Middle East:

- The volume decline was most pronounced in North America driven by the cracker turnaround and the weak demand in the agricultural sector.
- In Europe, the decline was particularly driven by lower volumes in Chemicals, Materials and Surface Technologies.
- In Asia Pacific, all segments recorded lower volumes, except for Nutrition & Care.
- In the region South America, Africa, Middle East volumes increased by 2 percent.

As part of our strategy implementation, we roll out specific global customer initiatives to foster volume growth.

[Chart 6: Historically low North American cracker margins with global repercussions]

Besides lower volumes, key drivers for the earnings decline were lower margins in isocyanates and cracker products. Therefore, I would like to show you the margin development in cracker products and isocyanates on the following two slides. We start with cracker economics in major regions based on market data. Feedstock prices are shown in blue, ethylene prices in red.

Given the low ethane feedstock costs in the United States, there has been a significant capacity buildup in the region, pushing prices and margins to a thirty-year low. Further capacities coming on stream coincide with a slowing domestic consumption. This increases the pressure to export – a challenge in view of the ongoing trade conflicts. Falling margins for global derivatives, such as ethylene glycol, in Asia and Europe are a result. This development is not likely to revert any time soon.

[Chart 7: Isocyanate margins on subdued level below historical averages]

This slide illustrates the sharp price corrections in TDI (shown in red) and MDI (shown in blue) after hitting record levels at the beginning of 2018. We highlighted at that time already that such margin levels could not be sustained. Waning demand across several downstream sectors, especially transportation and industrial, contributed to the negative market sentiment.

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

[Chart 8: Strategy announced in November 2018 is being implemented with speed and determination]

Let's now look at the factors that we as a company can influence.

With our strategy, we defined **six action areas** where we are actively moving forward within BASF:

1. **People**: We are transforming our organization to be more agile and customer focused. Many changes were already implemented at the beginning of this year. In June, we announced further important organizational changes.
2. **Portfolio**: We are executing the announced transactions to sharpen our portfolio – with the Wintershall Dea merger and the planned IPO as well as our plans for Construction Chemicals being the most prominent ones.
3. **Digitalization**: Using digital technologies and data, we are creating additional value, ranging from higher efficiency in our plants to accelerated innovation processes and innovative business models.
4. **Operations**: To remain competitive, we continuously improve our operations. Technological leadership and operational excellence are the focus topics in this area.
5. **Sustainability**: Sustainability is a cornerstone of our strategy – a driver for growth and an element of our risk management. We drive our long-term competitiveness via carbon management and circular economy.
6. **Innovation**: Effective and efficient R&D is a prerequisite for innovation and an 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 the six areas I just described were the right ones in November – and they are even more so today. In the currently challenging environment, we are implementing them with high speed and determination.

In the following, I will illustrate this.

[Chart 9: BASF to reshape organization – Leaner structures and simplified processes]

We are in the midst of reshaping our organization. We are streamlining our administration, sharpening the roles of services and regions and simplifying procedures and processes.

- First, we have embedded significant parts of our functional services in our **operating divisions**. As of today, 15,000 colleagues have already moved closer to our customers. The embedding will be completed by October.
- Second, we have defined a lean **corporate center** to support the Board of Executive Directors in steering the BASF Group. Less than 1,000 employees – this is less than 1 percent of BASF's workforce – will be working in these corporate units.
- The remaining service activities with initially approximately 29,000 employees will be assigned to four cross-functional **service units**: Global Engineering Services, Global Digital Services, Global Business Services and Global Procurement.

Customer-focused operating divisions and technology platforms, the new service units and more market-focused regional organizations as well as the lean corporate center are the cornerstones of BASF's new organization.

[Chart 10: Excellence program 2019-2021]

The organizational measures I just described are part of our excellence program.

We expect savings of around 300 million euros annually from leaner structures and simplified processes associated with this new organization. A considerable contribution is also anticipated from operational excellence measures in production, logistics and planning. Digitalization and automation will contribute as well. Overall, we expect an EBITDA contribution of 2 billion euros annually from the end of 2021 onward.

In the course of the strategy implementation, we plan a reduction of around 6,000 positions worldwide by the end of 2021, thereof roughly half in Germany. This decrease in positions will result from organizational simplification and from efficiency gains in administration and services as well as in the operating divisions. In addition, central structures are being streamlined in the context of the announced portfolio changes.

At BASF SE in Ludwigshafen, more than 1,100 employees signed termination agreements by the end of June 2019. The related costs have been included as special charges in the first half of 2019, mostly in Q2.

This shows you that we are executing at a high speed and with determination.

[Chart 11: Active portfolio management]

With our active portfolio management, we are moving forward towards higher value and more focus. This is an ongoing task.

Currently, we are executing the announced portfolio measures. On January 31, 2019, BASF and Solenis completed the transfer of BASF's paper and water chemicals business to Solenis. The merger of Wintershall and DEA became effective on May 1 and the IPO is planned in the second half of 2020, subject to market conditions. The structured processes and related carve-outs regarding our construction chemicals business and our pigments business are fully on track. We expect substantial cash inflows from these transactions in 2020.

At this point, I would like to hand things over to Hans.

Hans-Ulrich Engel

Good morning ladies and gentlemen,

[Chart 12: BASF Group Q2 2019 – Sales decreased slightly; EBIT before special items considerably below prior-year quarter]

Let me turn to BASF Group's financial figures for Q2 2019 compared to the prior-year quarter in more detail:

- **Sales** in the second quarter of 2019 decreased by 4 percent to 15.2 billion euros. Prices were down by 2 percent, mainly driven by isocyanates and cracker products. Sales volumes of BASF Group declined by 6 percent. All segments recorded lower volumes, except for Nutrition & Care. The volume decline was most pronounced in the Chemicals segment because of the planned cracker turnarounds and in the Agricultural Solutions segment due to the severe weather conditions in North America. Portfolio effects accounted for plus 2 percent and were related to the acquisition of agricultural solutions businesses from Bayer. Currency effects amounted to plus 2 percent.
- **EBITDA** before special items decreased by 27 percent to 2.0 billion euros. EBITDA amounted to 1.6 billion euros compared to 2.6 billion euros in Q2 2018.
- **EBIT before special items** came in at 1.0 billion euros, 47 percent lower than in Q2 2018.

- **Special items** in EBIT amounted to minus 497 million euros compared to minus 66 million euros in Q2 2018. The increase in special charges is mainly due to one-time costs for the excellence program and the 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 charges in the Agricultural Solutions segment.
- **EBIT** decreased from 1.9 billion euros in Q2 2018 to 548 million euros in Q2 2019.
- The tax rate was 18.0 percent compared to 20.6 percent in the second quarter of 2018. This was mainly a result of lower earnings, especially in countries with higher tax rates.
- Income after taxes from our discontinued oil and gas operations increased from 162 million euros in Q2 2018 to 6.2 billion euros in Q2 2019. This is due to the book gain from the deconsolidation of Wintershall with the closing of the merger of Wintershall and DEA.
- **Net income** amounted to 6.5 billion euros compared to 1.5 billion euros in Q2 2018.
- **Reported earnings per share** increased from 1.61 euros to 7.03 euros in Q2 2019. Adjusted EPS amounted to 0.82 euros; this compares with 1.77 euros in the prior-year quarter.

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

[Chart 13: BASF Group Q2 2019 – Sales and EBIT before special items]

During today's conference call, we want to offer you an extensive Q&A. Therefore, let me only briefly touch on the segments. The detailed slides on the segments can be found in the backup of our presentation. I already explained the main drivers for the sales development compared to the prior-year quarter. Therefore, I will focus on the earnings development:

- As in the first half of 2019, earnings in Q2 2019 significantly suffered from the lower margins and volumes in the Materials and Chemicals segments. In total, both segments accounted for 83 percent of the overall earnings decline in Q2 2019.
- Earnings in the Agricultural Solutions segment considerably decreased as well, mainly due to the seasonally negative earnings of the acquired businesses and lower volumes in our crop protection business, especially in North America.
- EBIT before special items also declined in Other because of a swing in the currency result and in the provisions for our LTI program.
- Significantly higher earnings in Industrial Solutions and slightly higher earnings in Surface Technologies and in Nutrition & Care could only partially offset the decline. It is noteworthy, though, that our three downstream chemical segments delivered higher results in a difficult environment versus the prior-year quarter.

[Chart 14: Cash flow development H1 2019]

Let’s now turn to our cash flow in the first half of 2019:

- **Cash flows from operating activities** amounted to 2.3 billion euros, 1.1 billion euros 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 euros in the first half of 2019, compared with minus 1.7 billion euros in the first six months of 2018. This reflects the cash received in connection with the Wintershall Dea merger. Payments made for intangible assets and property, plant and equipment increased by 273 million euros.
- **Financing activities** led to a cash outflow of 3.2 billion euros in the first half of 2019, compared to a cash outflow of 518 million euros in the first half of 2018. Dividends of 2.9 billion euros were paid to shareholders of BASF SE in the first half, 92 million euros more than in the prior-year period. Changes in financial and similar liabilities amounted to minus 215 million euros in the first six months of this year; the repayment of financial liabilities exceeded the additions to financial liabilities.
- **Free cash flow** declined from 2.0 billion euros in first half of 2018 to 597 million euros, mainly as a result of lower cash flows from operating activities.

[Chart 15: Balance sheet remains strong]

Turning to our balance sheet on June 30, 2019 compared to the year end 2018:

- Total assets rose by 2.2 billion euros to 88.8 billion euros. Roughly half of this increase comes from the implementation of the new IFRS 16 standard on leases. In addition, higher accounts receivables related to the acquired agricultural solutions businesses from Bayer contributed to the increase.
- Noncurrent assets increased by 16.0 billion euros. The main driver for this increase was the recognition of our participating interests in Wintershall Dea and Solenis at fair value. We are now reporting our shares in Wintershall Dea and in Solenis as “investments accounted for using the equity method.” Current assets declined largely due to the derecognition of assets of the disposal groups.
- Net debt increased by 675 million euros to 18.9 billion euros.
- Our equity ratio was 46 percent at the end of June 2019.

And with that, back to Martin for the outlook.

Martin Brudermüller

[Chart 16: Underlying assumptions for H2 and full year 2019]

Global economic risks increased during recent months, driven by geopolitical developments. The ongoing trade conflicts between the United States and its trading partners are not likely to be settled quickly. The G20 summit has shown that the trade conflict is just one of many aspects regarding the future relationship between the United States and China. This conflict is causing a noticeable slowdown in the overall economic growth, particularly in China. We feared this might happen but followed the general opinion of a reasonable settlement within 2019. We now expect a settlement of the trade conflicts during 2020 at the earliest.

As a consequence, and due to the slowdown in global economic growth and industrial production, we adjusted our macroeconomic assumptions for the full year. We have reduced our 2019 growth expectations significantly, for global industrial production and for global chemical production, both from 2.7 percent to around 1.5 percent.

The automotive industry – an important customer industry for BASF – is no longer expected to grow in 2019. Growth in the second half compared to the prior-year period is projected to stay negative. We thus expect a global volume decline of minus 4.5 percent in the full year. Customers in all industries are very cautious with projections in these times. Our visibility on demand development is currently very low. The previously assumed acceleration in the second half will not happen.

For the time being, we expect low margins in our isocyanates and cracker products businesses to persist. Let me also mention that we will have a planned turnaround at our smaller steam cracker in Ludwigshafen. This will negatively affect our volumes and earnings in Q3 2019.

[Chart 17: Outlook 2019 for BASF Group]

As a result of this challenging macroeconomic environment, we adjusted BASF Group's outlook for the full year 2019 on July 8. BASF anticipates a slight decline in sales. For EBIT before special items, we expect a considerable decline of up to 30 percent. 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 dividend policy of increasing our dividend per share each year.

Ladies and gentlemen,

To conclude, the macroeconomic environment has become challenging, uncertainty is high and predictability low. Our second-quarter results clearly reflect this.

At the beginning of July, we had to adjust our ambitious outlook, which seemed achievable in the global economic environment assumed at the beginning of the year. We explained the reasons in more detail today. The consequence cannot be to stop being ambitious in the future. The BASF team remains fully committed to an ambitious profitable growth path.

Despite the current challenges, we will not lose sight of our strategic growth initiatives. We will rigorously and decisively implement our well-defined measures around customer focus, efficiency and effectiveness with the aim to be the preferred partner for our customers.

And now, Hans and I are glad to take your questions.