

Analyst Conference Call Q1 2023

Transcript Q&A

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1 BASF Group

1.1 Current trading and Q2 outlook

Chetan Udeshi (J.P. Morgan): Looking at Q2: Can you maybe help us get some flavor of what you see in Q2 versus the low base of demand in Q1?

We all know that there is a seasonality in the Ag business, where Q2 typically is lower than Q1. But ex that seasonality, would you expect the BASF earnings in Q2 to be better than in Q1? Any sort of color on Q2 versus Q1 would be useful in terms of trajectory.

Dr. Martin Brudermüller: In the guidance we gave we said: a weak first half year and a better second half year. That includes Q2 as part of the first half year. I would say a challenging quarter is coming because if we look a little bit at the macro environment – and we also tested the ground with all our divisions –, I would say that the mood is getting a little bit better. But if you look into the details, and also at what consumers do – I think this is true around the world – there is very much a focus on services and less on buying goods. So, GDP is very much driven by services, which is not helping us.

If you go through the different industries, I would say that the overall consumer demand is still cautious. You see retail sales going up in China. But also there, if you ask people, they are still a little bit cautious in spending. If you look at the supply chain, I would say that several supply chains are still a little more loaded, also with finished goods, than is actually normal. So, a little bit more needs to flow out until people start to order and then start to produce again.

I would say: Don't expect too much from Q2. It is a challenging quarter. We hope that the China dynamics are already up in Q2. I think it might take Q3, so there will be a little bit more induction time.

For that reason, we do not expect that we see a major demand increase in Q2. With that: Q2 is a challenge because, as you rightly said, we cannot repeat the Ag performance, which is very much seasonally driven. So, I would say: Don't expect too much for Q2. We think we see more of the effect then in Q3.

Chetan Udeshi (J.P. Morgan): If I do my math, it seems that, on a BASF Group level, the net pricing – what I mean by net pricing is the selling price minus the raw material costs – seems to have been rather flattish. In general, BASF is seen to be one of those chemical companies where there is very limited pricing power. I'm just curious: Is there a difference in how you are managing the business in the current environment, maybe to demonstrate better pricing power as a group than in the past?

Or is it just a function of temporary benefit from lower energy prices that you think you will have to eventually pass through in the current context?

Dr. Hans-Ulrich Engel: With respect to price: Pricing in the current environment is obviously a key topic and a difficult one because the demand is significantly lower in most of our businesses than where we were last year around this time. With that, you see also a different kind of pricing power than where we were in Q1 of last year in particular, but also in the second quarter of last year.

Do we manage the businesses in a different way? I'd say no. We continue with a very diligent approach.

Markus Mayer (Baader Bank): You said there is a challenging Q2 ahead. Regarding the destocking you had in Q1, do you see that now this destocking has ended and that basically the underlying demand has not yet started to recover? Or is it an ongoing destocking you still see in Q2?

Dr. Martin Brudermüller: This is always difficult because you have to rely on what the customer tells you. Normally you have to go into their shops and look how many pallets are in there.

As I mentioned already, on the chemicals raw materials side, I don't think that there is so much space for destocking anymore in most of the customer industries. But I'm not so sure about finished goods. They first have to flow out before production really starts again.

In the consumer area, I think it is still a little bit above the normal average. This is most probably also why it needs Q2 to really pick up again. This is why we are a little bit cautious and have our question marks when it comes to Q2. It is not really super transparent at the moment. That's why I'm more prudent with my statements.

Jaideep Pandya (OnField Research): A little bit more short term around the price versus raw material dynamic for downstream. As raw materials are trending down, do you see further margin expansion scope in your downstream businesses, including Ag, if volumes stabilize at Q1 levels and don't drop further?

Dr. Martin Brudermüller: Downstream you have different pricing mechanisms: You don't have formula prices, but you have quarterly and half-year prices, where actually you sell also by value added. Then, yes, normally, when the raw materials go down you have an increase in margins. That is also, I think, something we have proven many times in the past.

If you now are in a period where you have low demand and a customer only gives you the volume if you reduce your selling price, then the environment is a little bit more difficult. So, the crucial part is that we see a pick-up in demand in the second half, because then the mechanism is really working: You have the long-term fixed prices for certain periods independent of the raw material development. So it's hard to predict. But I would say, overall, that I expect, from the margin side, there is not so much pressure on the downstreams, as I said, with the mechanism we have.

Peter Clark (Société Générale): On the outlook, you're very clear. You see a weaker first half improvement to second half. But when I turn that around and look at auto OEM, obviously you've had a very strong help in the first quarter in things like surface tech, on the coatings side. I think the build rate suggests obviously a good second quarter, but in the second half there might be more questions over that. So, how do you see the auto OEM demand driver in the context of your group outlook?

Dr. Martin Brudermüller: Overall, we have a moderate growth of light vehicles, 3.8 percent was the number, from a global perspective. That's why we also gave you the regional numbers for Q1. The weakest part was actually China because some of the tax incentive went out. So, I would expect that China will have a bigger share than in the second half.

But I think we made this very clear: We are not so much worried about the automotive customer base this year. It is more the other customer industries, which I have pointed out, also in the consumer area. Also, construction is currently not very strong with the high interest rates everywhere. I think the worry is not with automotive. It will change a little bit from a regional perspective. Q1 was very strong in Europe and in North America; that will balance out a little bit going forward.

1.2 Natural gas

Christian Faitz (Kepler Cheuvreux): A question on your energy price delta: It looks like your energy supply mix has not really changed year-on-year as gas costs were down almost to the same amount as your overall costs. Is that a correct assumption?

What measures are you taking, particularly short term, to become less gas-dependent? I am obviously aware of your cracker electrification projects and gas-intensive plant shutdowns.

Dr. Hans-Ulrich Engel: With respect to energy prices and natural gas prices; in fact, €700 million less than last-year quarter. Out of that, roughly €600 million is coming from natural gas and there again predominantly from our European activities.

If I look at the split between impact from volume and impact from prices, considering the significant price decreases, there is a bit more coming from price than from volume.

Overall gas consumption reduced to prior-year quarter, by an order of magnitude of roughly 20%.

Mubasher Chaudhry (Citi): I assume that the gas price assumption for the year was a little bit higher at the start when you provided the guidance of 4.8 to 5.4. I just wanted to get a feel for how that gas price assumption is moving forward in FY 2023 and how we should be thinking about that for the full year positive impact if it is lower year-on-year, which I assume it is.

Dr. Hans-Ulrich Engel: As you know, we don't guide on the gas price. In fact, the gas price in Q1 is lower than what we had expected going into the first quarter.

Does that have, considering all the uncertainty that we have currently, an impact on our guidance at this point in time? No, it does not. You saw that we left the guidance unchanged, and I think that's a reasonable move considering, as I said, the overall uncertainty.

1.3 Capital expenditures and cash flows

Christian Faitz (Kepler Cheuvreux): What caused you to cut your capex plans by around €300 million versus your February view?

Dr. Martin Bruder Müller: It is a mixture. On the one hand, the orders and offers coming in for the China project are lower than we expected. I think this is a very positive message. We have also delayed the timescale for one or the other project, so it's a quarter back and forth, also in battery materials. This, I would say, are the major two components.

But as you can imagine, the signal we want to send is that we are always looking at our capex expenditure and the optimal rundown of our projects.

This year, there is a slightly bigger contribution in this difficult environment, which comes from the two big investment areas battery materials and China.

Chetan Udeshi (J.P. Morgan): The working capital is up almost 3 billion euros, which is a similar increase to what we saw in Q1 last year. Of course, the environment today is far weaker. So, can you talk about why we did not see a much milder seasonal working capital increase in Q1?

Dr. Hans-Ulrich Engel: With respect to inventories, we are sitting at almost exactly the same level of inventories where we were at the end of December. Are we satisfied with our inventory situation? No, we are clearly not, and we are addressing this.

With respect to accounts receivable, you see the usual increase that we have in Q1 due to the seasonality of the Ag business. But you also see another effect when you look back to Q4. Q4 was a very weak quarter. Compared to that, you see some improvement in Q1, which also has to do with the seasonality. But again, also in Q4, we experienced a low demand.

So, from that perspective, the increase in accounts receivable is nothing that worries me. In particular, if I compare March 31 of last year, where we were at €15.4 billion, with the current €14.3 billion, that is one billion euros lower than where we were at the end of the prior-year quarter.

From that perspective, accounts receivable are in line with overall business development, lower than last year around this time. On the inventory side, we are taking the measures to bring the inventories down.

1.4 Regional asset competitiveness

Jaideep Pandya (OnField Research): On China, longer term, we see a significant increase in the plant size for several products, right from crude to chemicals to caprolactam to acrylic acid. So how do you see the profitability of the European assets in this context? I know you have already taken some steps to address this, but as you build your China cracker, do you think that in the longer run you will have to reduce or rather shift focus more downstream for the European assets?

Dr. Martin Brudermüller: First of all, let me say that all the capacities we build in China are for the Chinese market. So, there's nothing planned to be exported. It will even stay within the province of Guangdong. There is a similar situation in Nanjing, where 85% of the products are consumed within 200 km of the site. So we expect basically something similar in Guangdong.

We have looked at the pre-marketing for the plants and the business plans – not just at the volumes, but also at volumes per customer. So, the customer base is actually there, and we have also partially negotiated pre-contracts, etc. So, I'm not really worried about the products you mentioned. Acrylic acid is maybe a prominent one, and it is also a prominent one for our plants in Guangdong. I'm not really worried that we cannot sell this stuff over there because there are very strong, customers that consume large volumes.

There's also not so much flowing of the volume overall. The major points, I think, for Europe is on the one hand energy prices – it's gas prices and raw material prices that we have to consider. On the other hand, we have to look at what our customers are doing and how competitive our customers are with their business. From the customer side, there is most probably more going into the global market. When we sell to them here, it is not always easy for us to see where they actually sell their product.

So, I would say, generally, Europe has to work hard on its competitiveness. If energy prices are not coming down anymore – we know structurally they will be higher – we have to look at other factor costs. We have to look at efficiency. We have to look at productivity to partially compensate this.

So, I would leave it with that. We have these two logics, and I'm not too much worried that now our products are spreading. You know, we are building China for China.

Charlie Webb (Morgan Stanley): We've obviously been hearing lots about industrial power pricing, and there's been lots of commentary in the German media, I guess, around supporting industry more. I just wondered what your thinking on that in terms of conversations you're having. Do you expect some action to come there?

Dr. Martin Brudermüller: It's not so easy to give a quick answer on that. Let me say, it started with the IRA coming out. As the Cefic President, I see people being more nervous when I'm in Brussels. I think the IRA is clearly seen as an attack from the U.S. on competitiveness.

On Monday, I was at the North Sea Conference. Seven state leaders and 120 business people met to discuss using the North Sea as the largest wind energy producing region in the world, stepping up to 130 gigawatt by 2030 and more than 300 gigawatt by 2050. Countries are now getting together. They see that a more European policy is needed to enable the countries to strengthen themselves.

So, I would say, there is a high awareness that more action is needed on energy and renewables. I'm a little bit more positive in terms of European politics – they are counteracting and engaging and finding the right answers for Europe and also particularly for Germany, the largest industrial country.

We need some more time. But I would say, I'm not pessimistic about Europe. Usually, I have to say, don't mess with Europe and don't give up on Europe. In the end, they usually also come and defend themselves. That's also what I expect this time.

1.5 Cost savings program and adaptation of Verbund structures

Matthew Yates (Bank of America): I'd like to ask you about the restructuring that was announced with the full-year results and the plan to reduce headcount by 2,600 jobs. I think that equates to just over 2% of your workforce.

This week, actually, I saw Dow announced a 2,000 headcount reduction, which is more like 5% of their workforce. In the context of the challenges European chemicals face to be competitive, does the Dow announcement suggest that BASF actually isn't being radical enough in its restructuring? Your 1-billion-euro fixed cost target is not really so different to their 1 billion bullet target. They are obviously a much smaller company than you. So, I'd appreciate any further thoughts on that.

Dr. Hans-Ulrich Engel: I think we explained our plans with respect to the restructuring that we intend to do. The one billion is a figure that is related to the program in itself. As always, ongoing cost reduction is part of blocking and tackling; that is something that you do on an ongoing basis. What we've provided you with is really this restructuring package and the related cost reductions that we're expecting and the related headcount reductions.

So, from my perspective, I think, as mentioned, this is a program, but it is supported by a number of additional initiatives that you keep doing on an ongoing basis as an enterprise.

Markus Mayer (Baader Bank): On the adaption of your Verbund structure. Have you meanwhile any kind of view on the timing of the plant closures?

Dr. Martin Brudermüller: I think we mentioned that the last part will be in 2026, but there are some plants that are actually down now. So, TDI is down, ammonia is down. That depends on how you do that. But I would say, the major plants are basically down now.

1.6 Wintershall Dea

Andrew Stott (UBS): Can you comment at all on plans for Wintershall at this stage?

Dr. Hans-Ulrich Engel: On Wintershall Dea, have plans changed? No, plans have not changed. The strategic decision is crystal clear. The implementation requires, as you know, a solution for the Russian part of the business. That is what Wintershall Dea is working actively on.

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

Laurent Favre (Exane BNP Paribas): Can you talk a little bit more about the carve-outs of auto catalysts and metals management? I'm assuming this must be close to completion now. What are the intentions for the business? Have you started a sale process?

Dr. Martin Bruder Müller: When it comes to the automotive catalysts, you're right: We are getting closer to finalizing the carve-out. I think, a wonderful job was done by both sides, by the new team, but also by our team. When you think about construction chemicals, we have some experience in handling this. They are on a lighter footing because, when we decided about the carve-out and the conditions they have, I think we brought a setup that makes them very agile on the market and very well positioned.

The business is developing very nicely, I have to say, from a volume side, certainly with precious metal prices a little bit lower. Overall, I think, the business is very well positioned.

We have not started anything in terms of a sale. I don't want to comment further because the prime focus we have now is ensuring that they can stand on their own two feet, optimize and get the maximum out of this business. I'm very confident that the team is doing this. They are highly motivated people under the current circumstances. I think the business numbers speak for themselves.

Andreas Heine (Stifel): I was surprised to see that battery materials saw lower earnings. I thought that this is a business with strong growth – and that basically each and every year. Maybe you can give me an update on opening up the facilities and the trading conditions you see in battery materials in 2023.

Dr. Hans-Ulrich Engel: On battery materials: We had a strong impact from favorable lithium supply in the first quarter of last year, which we don't have in the same way in the first quarter of this year. That's one reason.

The second reason that we have is: In particular, the Chinese battery materials business was weaker in Q1 of this year than it was in Q1 of last year. And that goes hand in hand with the production figures for both light vehicles and in particular EV in China, where penetration has clearly gone up but the production numbers in Q1 were relatively low.

Sebastian Bray (Berenberg): When exactly are your battery facilities coming online? There's a precursor facility that I believe was delayed in Finland. When is the cathode facility now due to be completed and start adding to earnings?

Dr. Martin Bruder Müller: Yes, there will be some delay at the Finland plant, which has to do with the permitting situation. But that is not hindering the in-time operations in Schwarzheide. We will have one of the lines starting up now in the coming weeks and then the second line towards the second half of the year.

Basically, construction of these facilities has finished and they are preparing for startup. They will be then fed with PCAM from other sources, from our basically global supply grid, and not out of Finland. So that will not have any impact on the operations in Schwarzheide.

Jaideep Pandya (OnField Research): Could you give us some color these days how strongly you have penetrated into the Chinese OEMs versus your traditional customers in Europe and the U.S.? Has that share increased significantly for BASF?

Dr. Martin Bruder Müller: Yes, it got stronger, Jaideep. When we went to China, we went with the European OEMs or the international OEMs building up their facilities in China as their established supplier. Over the recent decade, we have reached out to the local OEMs, and they have been very eager and interested in working with us because they also expect that they get insights into innovation in the industry and what the other OEMs are doing.

So, we have stepped up our share in the local OEMs very significantly. We are moving in this direction even more strongly. What is also visible when it comes to electric cars: The traditional OEMs, the Europeans, are more challenged than with the combustion engine. We see that in the numbers from BYD, and BYD is replacing Volkswagen as the strongest producer in China.

So, I'm not so worried, but we have to push that even further going forward. We already have customer relationships and are selling to the major Chinese OEMs to a quite significant extent. You know that in China, our share in automotive is even a little bit higher than on a global basis.

2.5 Nutrition & Care

Andrew Stott (UBS): I see Nutrition volumes are down 16%, which just looked like a particularly large drop. Could you detail that? Are there any sort of production-related issues there?

Dr. Martin Bruder Müller: On the volume development in Nutrition & Care: I would say that almost everything except personal care suffered from weaker demand. I don't think that there is anything related to our production situation. We are ramping up our vitamin A volumes again. The plants are all fine. But I would say, there is also really a strong drop on the pricing side with vitamins, which makes us cautious, also in terms of how we play with volumes and prices. So, I would say, there is no BASF-specific element in there. I would say, it is generally a very weak market.

Georgina Fraser (Goldman Sachs): Do you think that part of the reason for the pricing weakness in Nutrition & Care is also that we're seeing your competition now appearing with larger capacities in China? How do you think the production landscape for the vitamin supply chains will look five to ten years from now? Do you think we'll still have such a Europe-centric base or is that something that is also going to shift to other regions?

Dr. Martin Brudermüller: If we're looking at Q2 for Nutrition & Care, I think it still stays rather soft. I think when it comes to the demand, don't expect that there will be a huge uptick. When it comes to volumes, I think it is fair to say that we also contributed ourselves with higher vitamin capacities, which certainly stressed the market a bit in terms of supply/demand.

It is also true that there is pressure from Asia with additional capacity – this is also something that has been going on for years. In the past, it has traditionally been a European business, and all the capacities have been in Europe. So, that has changed quite a bit. But I think it is also fair to say that the consumption pattern has changed. It has a lot to do with habits of people, meat consumption – that is always a major part of the vitamins business – which is also not very strong at the moment.

So, I would say, overall, yes, that might be a little bit stressed. But I think the main component here is demand, which as far as we can see in Q2, is still a little bit soft.

2.6 Agricultural Solutions

Mubasher Chaudhry (Citi): Around the price increases in ag chem: How much of those price increases should we expect to stick in the coming years? Or is that mainly driven by the tightness in the market and, therefore, we should expect an unwind, should the crop prices come down?

Dr. Martin Brudermüller: I think in ag chem we have a good environment from the market perspective. I think it will be a solid year if you take out the surprises that could come from weather. From the crop price side, this is a little bit down from the high, but above average. That means farmers have a good income.

We have brought through price increases without pushing volume too much because volume is basically flat. For that reason, I think we have a good chance that the price increases will stick for the rest of the year.

Laurent Favre (Exane BNP Paribas): Can you give us a bit more color on the dynamics between seeds and crop protection, please? The price and volume details you have given us at divisional level: Is it the same for seeds and crop protection?

Dr. Hans-Ulrich Engel: We've seen actually similarly strong developments in both parts, both in the seeds and in the crop protection business. So, both are very satisfying in the first quarter and also now going into Q2. This is looking good overall.

But, as always, we'll look at the full six months for the northern hemisphere to assess the overall development. But, again, in both parts of the business, we have a good, strong development.

Andreas Heine (Stifel): If I look at the increase in the first quarter, in relative terms, it's obviously most difficult to increase earnings in the seasonal strength. If I look at the wording for Q2, which is also strong, and that the second half is rather light in earnings, then I would assume that overall, with these trends, the earnings increase might be even higher percentage-wise as what we have seen in the first quarter. Maybe you can comment on this.

Dr. Hans-Ulrich Engel: Ag saw a very strong Q1. What's going to happen now in Q2, frankly, remains to be seen. You know my view of the world. I always say: You need to look at Ag in the first half of the year, not just in the first quarter. There's always seasonality in that business.

Our sales in Eastern Europe were significantly higher in Q1 of last year than they were in Q1 of this year, in particular in Ukraine. This year, it looks like the sales will be closer to the actual application time. Last year, we saw a certain amount of pre-buying, which, I think, had to do with the assessment of the overall situation in Ukraine. Last year, farmers just came to the conclusion to buy earlier than they do under normal circumstances.

The season in the northern hemisphere will depend on weather developments. Overall, the northwestern part of Europe and Eastern Europe look pretty good, in particular with respect to the fungicide business. Southern Europe is very dry at this point in time. It remains to be seen what kind of an impact that has. So, lots of moving pieces which lead me to say: a very strong first quarter, no indications really for a decline other than a seasonal decline of the business.

Now, in the second quarter, soft commodity prices are holding. So, from that perspective, I would think this should be a good business environment for Ag, also in the second quarter.

Sebastian Bray (Berenberg): On seeds pricing in agriculture: I don't think seeds have ever been more expensive than they are now, and historically it's been quite rare to see deflation. But if we go back to an environment, and I appreciate corn is not really relevant for BASF, but let's say we have 4 dollars a bushel corn: Can the company envisage a scenario where seed pricing turns significantly deflationary?

Dr. Hans-Ulrich Engel: I don't have all the details in front of me here, but if I look at this, as I said before, a strong business there, driven also by pricing. What happens with respect to deflationary developments remains to be seen. I think, as mentioned before, soft commodity prices stay on what I would call an elevated level, if you look at the five-year average, the last five years' average. That should provide a good background. If that changes significantly, that may then obviously have an impact on seed prices, too. But I don't want to speculate here. We're operating in a nice environment currently.