



We create chemistry

# Capital Markets Day 2019 Strategy Implementation Transcript Q&A September 27, 2019



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## Keynote Strategy Implementation

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**Christian Faitz (Kepler Cheuvreux):** Martin, you talked a lot about July and August. What about September in terms of business conditions? What have you seen? Maybe you can mention some trends etc.

**Dr. Martin Brudermüller:** Actually, as September is not yet in the books, we did not talk about it. But I can tell you, it is a continuation of July and August.

**Peter Clark (Société Générale):** A follow-up on that: You talked about comparable earnings growth in July and August. I presume you are talking before the exceptionals you saw in Q2, because Q2 was down 47 percent. If you are doing July and August, of course, you are trending below your minus 30 percent for the year. So I am assuming you are excluding all the maintenance shutdowns etc.

**Dr. Hans-Ulrich Engel:** I think, what Martin has just answered was the general question on what the overall environment is. Clearly, in BASF's business, you have seen with the cracker turnarounds significant one-time costs in Q2. In Q3, we have now the turnaround of the smaller cracker in Ludwigshafen, but significantly less cost. In the overall environment, as Martin has described, we saw a deep summer lull, particularly in Europe. We came out of that with the to-be-expected seasonal improvement, but not more than that.

**Tim Jones (Deutsche Bank):** Firstly, about M&A: If you look to 2020 and all the changes you have going on at the group level, is BASF capable of doing any large acquisitions in 2020 or is the pace of change from a cultural perspective too high and will create too much disruption?

**Dr. Hans-Ulrich Engel:** If you look at what we have on the plate right now, it is not only a question of the financial resources. It is also the question, obviously, of management resources. With all these activities that we have currently going on, the Construction Chemicals divestiture, the carve-out that comes with that, the pigments divestiture, the carve-out that comes with that, there is significant work on our plate in 2020. So I think that will be a year with less activity. We will have what we have shown, but I don't expect a lot more to happen in 2020.

**Tim Jones (Deutsche Bank):** And then a second quick question: Post the profit warning that you had in the second quarter, do you think the organization internally really gets the need for change now, particularly in the specialty businesses where margins in many areas are still quite poor? And how much pressure are you applying to divisional heads?

**Dr. Martin Brudermüller:** You can imagine that Hans and myself make a lot of pressure. We talk about this intensively. We have the full transparency of the numbers. The guys in the business feel it, too. So, I think the sense of urgency is very clearly there. We are working on all these topics.

You know that I am more than 30 years with BASF. I have to tell you: I have never seen any phase in BASF where we have changed so many pieces so quickly at the same time. So I would say, the team is fully on board with this and they get it.

However, it is difficult to manage this complexity. I would say, the most difficult part is this turnaround part into organic growth. You know, we have now this transition year, which clearly has to go also to the mindset, to the hunting spirit in really going for volumes. That is certainly a thing that is more difficult in a depressed environment than in an environment where you have 3, 4 percent growth and your customers can more easily also distribute their growth opportunities.

I would say, that is a mentality shift that is difficult to achieve. But we push on that, we talk about this. We have activities at customers' level where also the full management is on board to really make an impact. So I would say, the team got it.

We have never planned that we do all this restructuring in a phase where we have also economic headwinds. But actually, now it is very clear to everyone that certain things in BASF have to change.

To a certain extent, this is more difficult, and the environment helps us to bring also the, let's say, harder believers in the organization now on track and to support.

**Andreas Heine (MainFirst):** The first question is on the financial leverage and the debt load you feel comfortable with. You hive off the Oil & Gas business, the Construction Chemicals and pigments business, which obviously lowers a little bit the earnings and the earnings are anyhow depressed. What is your view what the debt load is looking forward before you start thinking about share buybacks?

The second question: You initiated the cost saving program at a time where you could not predict that the market environment is as challenging as it is right now. We have seen quite some self-help action across the industry, but none of this self-help was because of the challenging environment. Do you have to do more if the environment stays as it is?

**Dr. Hans-Ulrich Engel:** Andreas, your question on debt: Where are we right now? We are running at a net debt level of 18.5 billion euros. That is quite a bit more than what we had prior to the acquisition of the Bayer assets in August of last year. An increase in the order of magnitude of 7 billion euros. We target actually to bring this back to a level of, let's say, roundabout 15 billion euros. That is something that we would feel very comfortable with. That then should also fully support what we are striving for with respect to rating, which is a solid A rating.

**Dr. Martin Brudermüller:** Andreas, as I mentioned, we have so many things on the plate that we can hardly take anything on top of that. But what we try to do certainly is to accelerate as much as we can. The 6,000 people we have mentioned: There is a share certainly coming out of the new structure of the service units we are creating, but also of the lean Corporate Center.

But there is also a significant part of that coming out of the businesses. This is always mentioned as a gross number. Certainly, if we build a plant in China, we need new people in that China plant. But they have also to look into their structures.

To be very honest, the one or the other was a little bit more hesitant in terms of restructuring, e.g., marketing or the sales structure or whatever. But that is now clearly pushed to accelerate.

I would say, we go now as quickly as we can for the 6,000 and for the structures which we have there. That should have a significant impact because we have thought this through to bring also down our cost basis, but also – what is at least as important as the cost basis – that we are quick and agile to respond on the customer side.

Let's see where we are then. Then we have to see what we do. So we bring that home now as quickly as we can.

**Oliver Schwarz (Warburg Research):** Just a quick one on the net debt level: With the ever-declining interest rates, obviously, the burden of the pension provision is bound to increase. Any plans to put money into pension assets to stem the tide of what policy is currently doing to BASF and other companies?

**Dr. Hans-Ulrich Engel:** We are continuously funding our pension plans, particularly in Germany, because we simply have to.

Our pension provisions, over the last four years, have moved between 10 billion euros and 6 billion euros, and are currently standing at roughly 9 billion euros.

Do we have any plans to do some extraordinary funding of the pension plans? No, we don't have any such plans by now.

**Andrew Stott (UBS):** A question for Martin: Given your long experience in China, if you look at the next few years and think about some of the ambitions in certain chemistries, obviously, polyurethanes is top of the page still, but even ethylene, how do you feel about that as it looks as a prospect compared to what we saw, say, in 2012 to 2015 when it was a different battle ground? It was acrylic acid, it was caprolactam, different streams.

Do you think the motivation of China overall is the same, it is just: we want to be bigger and more self-sufficient? Or do you think it is different?

**Dr. Martin Brudermüller:** I could talk now for hours about that because I have also several contacts in China. This whole trade conflict makes them also think about how they go into the future. One or the other thing changes. They go even more now for a domestic development. They really de-emphasize the export. When you talk to some of these people, they say: Well, we are too dependent also on the US. Let's take these 20 percent of our exports to the US either to other countries or basically bring it down and reinvest into domestic demand.

So, there is a lot of focus how they can stimulate their own demand. That gives me actually more confidence that the demand is even more solid because they depend less on exports in the future and it's more about their own society.

I talked to one of these people and he was saying with a smile: I leave it to you whether 300 million indebted US consumers or 1.5 billion Chinese who just start to consume have the better perspective for the future.

In that respect, it makes even more sense for our endeavors and our investments we have in the future in China. I think that does not change our picture.

What is very clear from the political side what you also read everywhere: If the two superpowers don't get along and there is more tension and you have more of a political divide "either or", then this might create a different environment. But overall, the growth rates will come down in China a little bit; we have factored that in. The crazy numbers of double digits are a thing of the past because this is also a question of the basis you have.

But if you look forward into this, this still makes a lot of sense. There will also be a stronger drive towards sustainability. We should not underestimate that. They are not principally on another agenda than we are. With all these incidents you had in our industry, there is also very high attention now to shut down the companies that don't stick to the rules. For companies like us, with high ethics and with a good EHS system and corporate responsibility, this makes the world even better.

Overall, it still stays a very positive picture for China in the future.

**Chetan Udeshi (JP Morgan):** The first question on the Verbund concept: Has it evolved in BASF over the past few years in the light of challenges that the business has faced? I think the question is more around the need to do a big cracker in China, in this age when you have got so much already being planned by other parties.

The second question is: How much are actual one-off items this year which might not be present next year? Would you maybe be able to quantify that?

**Dr. Hans-Ulrich Engel:** On the one-offs: We have a lot of moving pieces in 2019. I think we will end up with a total amount of special items in the order of magnitude of half a billion. In that half billion, already 500 million euros, as you have seen, are coming from the restructuring program. But we also have significant positive special items that come from things like the divestiture of our water and paper chemicals business, or a real estate transaction that we have done recently in Switzerland etc.

The net I expect to be in the order of magnitude of 500 million euros on special items. In that, you have, as mentioned, the restructuring program. You have seen that for this year we have targeted about 500 million euros, for next year about half of that amount.

We have about 300 million euros in integration cost that come with the integration of the Bayer assets. The amount will be significantly lower than that next year.

What else is there? I think these are the major special items that we have in 2019.

Then on the one-off side: That goes into the underlying result. We already mentioned the significant cost that we had from the three cracker turnarounds in the year 2019. That will not repeat itself in the year 2020. So we expect turnaround cost significantly lower in 2020 than it is in 2019.

**Dr. Martin Bruder Müller:** When it comes to upstream structures like crackers, you know that we are not the company to build one cracker after the other. If you look at the set-up we have in Nanjing, we are actually very happy that we have a light asset set-up because the major part will be Sinopec with 50 percent and the other 50 percent is the JV. So at the very end, it's 25 percent BASF and 75 percent Sinopec.

That takes from us the capex load on these structures and we can basically focus on the materials to do downstreams.

The only place where we really think about this cracker is the new Verbund site in Guangdong, because this is where we want to unfold the full power of building a new Verbund. That means that we really need economies of scale and also the full ownership of where everything starts with the raw materials and the basic materials in the basic chemistry arena.

So we are very sensitive about that, and we have not planned other crackers all over the world.

**Sebastian Bray (Berenberg):** The first technical question is: After the reduction in scope of the Solvay acquisition, what is the implied EV-to-EBITDA for that takeover?

The second, more open-ended question on the source of the 2 billion euros of cost savings: BASF has run large programs in the past and it has been perhaps difficult to see the impact on the bottom line. Could you perhaps break down the 2 billion euros between things like personnel reductions, process efficiencies and that sort of thing?

**Dr. Hans-Ulrich Engel:** On your first question, Sebastian, it was the EV-to-EBITDA ratio on the Solvay acquisition. Order of magnitude, as we have said before, for the full business: below ten.

**Dr. Martin Bruder Müller:** When it comes to the 2 billion euros, we have not given you the detailed structures of this. I think we have mentioned a sum of 300 million euros for the part now coming from the global business services and the corporate center restructuring. I have mentioned that production is a certain part of that, and this is actually a very big part because of operational excellence, where we spend much more. This is actually a super lever. If you reduce variable cost and also fixed cost, this is going directly into your cost structure. But there is also certainly a growth part included. If you have additional capacities, you have to sell these capacities. If you don't sell these capacities, you don't see it in the P&L.

This is the crucial part, why also the excellence program comes here together with our growth ambitions. If we do not manage the growth, this will be difficult to deliver. So that has to come together.

**Chris Counihan (Credit Suisse):** I know there are a lot of moving parts when it comes to working capital. But under your guidance assumptions and where we are at today and saying there is no improvement in Q3, are you able to give us maybe a ballpark number, Hans, as to what your working capital inflow might be by year-end as to how much that could contribute to the cash flow? That's question one.

Again, today, you reiterate the potential to do a buyback, but then, obviously, very organic growth focused, dividend growth focused. So even with divestments and the potential deleveraging coming up over the next 12 to 18 months, I suppose in the current market conditions, how realistic is that even into 2020?

**Dr. Hans-Ulrich Engel:** Your capital allocation question first, Chris: If you look at the priorities that we have on how to spend our cash, you have seen that the fourth priority is the one that deals with share buybacks. There is obviously a reason for that. There is also a clear link that we have established there. We said, we will consider it in the context of the cash inflows that we will have as a result of the divestitures.

The cash inflows we are expecting there in the second half of next year will give us sufficient room and time to actually think about where we will be. Frankly, predicting the economic environment ... In the past, Martin and I would have said, we feel quite comfortable to give you a relatively clear view on what is going to happen during the next three to six months because that is what our order book allowed us to do.

Today, we can give you a relatively good idea of what is happening in our business for the next one to two months. 55 percent of our order book are month one, 75 to 80 percent are months one and two. And there is an awful lot of volatility in the system. That is, unfortunately, the situation we are in. But, again, it is priority number 4 as we have defined it and we have clearly linked it to the cash inflows that we expect to have then from the divestitures in the second half of 2020.

On inventories and the cash inflows to be expected there. That's an area that we are working on intensely. You have seen us with a gross working capital level that is higher per end of Q2 2019, that is higher than where we usually are in Q3 and Q4, despite the fact that in the ag business we will see the usual build-up for the beginning season then in the northern hemisphere. The clear target is to see a sizeable amount of cash inflow coming out of our working capital.

**Laurent Favre (Exane BNP Paribas):** It is a question on the capex budget through 2023. The fact that you did not change this, is it because you are still working on the usual cycle and then you will talk to us in February?

**Dr. Martin Brudermüller:** Yes. We will talk about that in February. This is the number we have given to you. You can imagine, given the times we are in, that we look now twice and three times on that, how to develop that.

**Charlie Webb (Morgan Stanley):** On carbon and the cost of carbon: You mentioned a few times that you are taking a kind of a bold move on this in terms of decarbonizing. Have you gauged what the cost would be for BASF and how do you see that over the next 5, 10, 15, 20 etc. years out? How big a cost is that? How does that fit into the capex budgets? How do you think about that as well?

**Dr. Martin Brudermüller:** I cannot give you a real number on that. But certainly, we look at this. We also started a senior project to look at this even more in detail to understand this whole landscape, also of renewable energy. There are so many factors coming in.

First of all, let me tell you: We have several opportunities now to really cater to this target over the next years by different measures: optimizing the Verbund, buying in some other mix of energy from the outside. All this is not so difficult. I think, it will not come with much higher cost.

If you look at it long-term, we might substitute bigger parts of our energy supply from fossil structures to renewables. The interesting thing is: If you look at the generation cost of renewables like, e.g., in offshore wind parks, the cost per kilowatt hour is in the same ballpark as a good gas-fired power plant. It is not a big difference anymore.

What comes with it is taxes, EEG [Erneuerbare-Energien-Gesetz] – this is the special regulation we have in Germany – and then the cost for transportation through the grids. That is a very strong cost driver. How that develops, how the political framework develops to facilitate ... Believe me, I spend a lot of time to tell also politicians clearly: We will be technologically fit to do that move. But if politics and the society are not moving with the framework conditions, it will not be economic.

But that is a totally different discussion now over the next years to come. Instead of saying “not possible, not possible, not possible”, we say, it is possible if you provide that and that framework. This is why it is very difficult to say how that impacts. That will also depend on how the speed is and what the schemes finally will be on the CO<sub>2</sub> price, whether it is an additional CO<sub>2</sub> price. We clearly say: reduce the taxes and the energy cost, make electrical energy as cheap as possible so that people can use more energy.

It's strongly incentivized today, in Germany at least, that you have high cost in order to bring people to not using much. You could reduce that and say: If you use electrical energy that produces CO<sub>2</sub>, then you have to pay.

If they would generate over the next, let's say, four, five, six years such an environment, you would actually have an economic case to change.

So we look into all of this and we certainly don't talk only about Germany. We have much better conditions in Belgium if you look at the framework. Antwerp is a seaport. You could connect that much more straightforwardly into an offshore wind park or something like that. You have to look very detailed into each and every site. This is what we do and then we will come up with the right roadmap in order to go forward, certainly to keep us on the cost side as good as possible at where we are. But if it has some additional costs, we have either to talk about it, whether it is worth to do that, or we have then to compensate it with other measures which I told you already. Then we have to be better than others in innovation and everything in order to come out where we have to be.

So, this is an equation. I think it is too early to say something about that. It gives you a little bit an idea what kind of impact factors we look into. We study this in very great detail.