BASF Q2, 2013 Analyst Conference Call

Transcript - Q&A session by Topic

July 25, 2013

1) <u>Group</u>

Tony Jones (Redburn): Good morning, everybody! Thanks for taking my question. It's about cost savings versus inflation. I have been having a look at the capex over the past quarters. If I add up all the different cost lines and then compare it year on year, operating costs actually increased by about 3 percent. Now I realize there are other M&A effects, but many of the acquisitions are not that sizeable at this point. So I am actually wondering whether a lot of the cost savings coming through from the STEP programme are just being offset by other inflationary effects. And I also noticed R&D continues to rise.

As this is something we are seeing for other companies, could you just help us reconcile this inflation? And how should we think about cost inflation versus STEP over the next year or so?

Kurt Bock: Thank you, Tony, for the question. With regard to STEP I think it's quite clear that this programme which ought to save about 1 billion euros until the end of 2015 will not directly go to the bottom line in some cases because it's simply offset, as you said, by price inflation. So we have never claimed that automatically just doing this programme we will improve our earnings by 1 billion. A large part of that initiative is necessary, absolutely necessary to offset continuous margin pressures which our industry has seen for many, many years and cost inflation at the same time.

So if we did not do the programme, then, obviously, our results would be by the end of 2015 one billion lower, but it's simply not possible to just add 1 billion to our current result and then say, okay, that's going to happen until 2015. There is cost inflation which is ongoing. Some of that cost inflation is warranted, for instance R&D. We have increased our R&D spending again a little bit, that's part of our long-term strategy, and this is absolutely necessary and helpful.

On the other hand, we have reduced headcount increase quite nicely, I'd say. If you look at the headcount increase of BASF Group in the first half of this year, it's almost entirely attributable to consolidation of acquired companies, but also to a changed scope of our consolidation of companies. If you exclude those effects, we had virtually almost no headcount increase globally. So we are really putting both feet on the brake here to contain cost development.

Paul Walsh (Morgan Stanley): Good morning, Maggie! Good morning, gentlemen! Thanks for taking my question. My question really was about the outlook around the second half. I guess that encompasses comments pretty much across each of the divisions. Q4 was a particularly tough quarter last year. How should we think about the year-on-year dynamics across the businesses, in particular relating to Q4?

In Chemicals, my understanding is: You saw a significant reduction in profit in Q2 because of the plant maintenance and downtime that was prolonged. Again, could you put that within the context of what you are seeing for the second half?

Kurt Bock: Paul, thank you for the question. First, let me state that what we see right now is pretty much a flat development going into the second half. And this is underlined by what we see in our daily sales numbers and our incoming orders. July actually is pretty slow. So there is really no tailwind from the overall economy which would propel our business.

We have said that we want to improve both sales and earnings for the entire year. We have achieved this in the first half, taking first and second quarter together. We had some special factors like the Other component or our famous LTI programme. On the other hand, in the second half – I think this is what you allude to – we compare against a relatively weak Q4. But I think we take nothing for granted right now. If you go through our segments, it's quite clear that we have to work very, very hard to improve further on.

We are, I think, on a good path in Functional Materials and Solutions.

Agro has done an incredible job over the last six months. Again, when you talk about Ag it's very interesting: We see an 18 percent increase in the second quarter of this year, compared to another 22 percent increase in the second quarter of last year. So there is continuous growth in Ag.

Oil&Gas is doing quite well, always a little bit difficult to forecast exactly what's going to happen in the fourth quarter in terms of weather etc. You know this.

Performance Products – ongoing restructuring in some of the businesses. Others are performing very well. And then I think we are up to a, let's say, challenging second half. Again, nothing is being taken for granted. We have to work very hard to achieve our goals and we are determined to do that.

Laurence Alexander (Jefferies & Company): Another way of asking about visibility: Do you have any end markets that have come in significantly better than you expected three to four months ago?

Secondly, as you think about the four-quarter to six-quarter view, can you compare the degree of visibility you have now, as you start thinking initially about next summer, compared to where you were in January thinking about the shape of this year? Has the level of visibility become any better?

Kurt Bock: Laurence, I don't think the level of visibility has become any better. For that reason, we give this kind of cautious outlook with regard to the development over the next couple of months and quarters.

What has improved slightly better than what we had expected is, from our point of view at least, agriculture. And I'd add also automotive. When you read the papers, obviously, you are aware that automotive, especially in Europe, is going very, very slowly. We are now at car volumes which we had produced about 20 years ago in Europe as an industry. Here, it is the case that BASF has a higher share in high-end cars and that serves us quite well. So the automotive industry for BASF has developed actually quite nicely, not just in Europe, but also in Asia where we have captured market share over the last couple of quarters as well.

Michael H. Rae (Goldman Sachs): Hi there! Thanks very much for taking the question. I was just wondering, in light of the market conditions that you have been experiencing so far this year, are there any areas of capital expenditure that you are thinking differently about, any projects that are delayed or deferred or even cancelled?

Kurt Bock: Thank you for the question, Michael. Actually, we are reviewing our capex budget continuously, whether there is anything we don't like and shouldn't do or should maybe delay. What I can tell you today: We haven't really identified any project where we think that our medium/long-term forecast for supply/demand – and that is really what counts, it's not the next six or twelve months – is not valid anymore and therefore we have not changed our capex plan.

Frankly, short-term measures in that respect, from our today's point of view, are completely unjustified. The long-term growth picture for our industry is okay. Again, growth might be a little bit lower than we had anticipated two, three years ago, but it's still growing quite nicely.

Here you have to be very, very specific about markets and products. To give you a precise example: We talked about caprolactam and the margin in caprolactam coming down. I think BASF has not invested in caprolactam capacity for the last 30 years. We have an installed capacity which is highly, highly cost-efficient and productive, but we were never really keen on growing in that specific segment because we see capro as a precursor for our polyamides business and then there is also a certain trading business on top of that. But it was never a focus of our attention.

So we really try to focus our investments on areas where we have competitive strength. In my little speech I talked about acrylic acid in China. At the same time we build an acrylic acid plant in Brazil which will be the first and only one, by the way, in Brazil, plus a superabsorbents plant. These types of investments make an awful lot of sense from our point of view.

Jaideep Pandya (Berenberg Bank): Just coming back to your 2015 targets and taking sort of all what you have said in this call into account: The fact that your STEP programme is basically an inflation hedge and the fact that you are seeing some margin pressure in some of the products, what gives you confidence that you can increase EBITDA margins by 4 percent in the portfolio, unless you plan to change your portfolio significantly?

Can you just walk us through what kind of macro assumptions you are taking for 2014/15? I know it's a bit too premature, but the target is out there and it's quite high compared to your current profitability.

Kurt Bock: I am not sure I am following your maths completely with the four percentage points, but what we have done over the last couple of years is: We have invested in new capacities – I think I spoke about that quite a bit – in very specific markets where we believe that BASF has a competitive strength and advantage. Those capacities will translate also in sales and earnings over time. So there is a kind of natural improvement of earnings.

Then we have to work very hard on the cost side. I have not said – to be very precise here – that the entire STEP programme is eaten up by cost inflation, but I have said: We have to be very cognizant that a major part of the programme is necessary to cope with cost inflation and margin developments some of our businesses have seen for many, many years. Actually, I think this is kind of also a natural development in almost all industries.

And then: We are now in 2013. We have two years to go. We work extremely hard. We have a little bit of a cyclical downturn in some businesses. It needs to be seen how this works out over time. So I think this is doable and achievable. But, again, we never said, not even when we announced these targets, that this would be a walk in the park and would come automatically without a major effort on our side.

Lutz Grueten (Commerzbank): Thank you for taking my question. On the 300 million euro target from STEP in 2013, can you give us a number which was already achieved in H1?

Kurt Bock: Pretty much half of that came in in H1, plus/minus 10/20 million euros.

2. Segments

2.1 Chemicals

Jeremy Redenius (Sanford C. Bernstein & Co.): Good morning! Thanks for taking my question. Looking at the Chemicals segment's volume growth, I am wondering if you could give us a sense of what the underlying trend is there. I recognize Antwerp was down in the quarter. Same time last year Port Arthur was down. Plus, I believe, there was an adjustment for the propylene swap, such that the volume growth picture on a year-over-year basis, I think, is a little bit challenging to reconcile.

So I am wondering if you could just try to do your best to give us a sense of the underlying volume trend there, please.

Kurt Bock: Overall, in Chemicals we had a slight volume increase of 1 percent. Actually, in petrochemicals volumes were stable. In monomers they decreased slightly. Intermediates: also a slight decline, almost zero, I'd say. So what we see is pretty much a stable development going forward. There is not much volume volatility in that segment at this point in time.

Jeremy Redenius (Sanford C. Bernstein & Co.): Can you tell us if that was consistent through the quarter? For example, I am looking at naphtha cracker margins in Asia. I see them improving through the quarter and into the third quarter. Is that consistent with your view as well?

Kurt Bock: What we saw is really: We were able to improve our cracker margins in Europe and North America. In Asia, they were negatively affected by a relatively weak demand.

Thomas Gilbert (UBS): Thank you for taking my question. It's a very simple one on the earnings of the Chemicals segment in the second quarter. I understand the year-over-year rationales of polyamide and caprolactam that you are providing us. What I do not understand is the 300 basis points margin down versus what you had in the first quarter. And the trading activity has been pretty much the same, yet the EBIT is down 150 million euros.

I understand year-over-year is monomers. But what, versus the first quarter, went down in the second? Is that intermediates, monomers or petrochemicals?

And if I dare ask on a seven-year view, do you think this segment is closer to trough or mid-cycle or peak?

Kurt Bock: Thomas, thank you for your question. Let's go through the divisions quickly: In Petrochemicals, we had better cracker margins in North America and Europe, weaker margins actually in Asia. Compared with Q2 of 2012, EBIT rose by about 19 million.

Monomers: lower results due to a steep decline in caprolactam and polyamides; I think you alluded to that. And there is a steep decline in profitability both compared to Q1 and Q2 of last year.

In Intermediates, we saw a slightly weaker demand for amines and a slight reduction with regard to last year.

Thomas Gilbert (UBS): Thank you very much. Caprolactam and polyamide markets were weak in the first quarter on a spot basis. Do I understand that you have some contracts that rolled off into the second quarter?

Kurt Bock: It's both contract pricing and spot pricing. I think it's simply a decline in trading conditions and that led to a further deterioration of margins in caprolactam.

Michael H. Rae (Goldman Sachs): Can you just give us a progress update on the MDI complex in Chongqing? Is that progressing okay?

Kurt Bock: Our plant is progressing as planned. There is always a little bit of a surprise in China, as you can imagine. But overall, our investment is on track. We are not completely independent of adjacent investments which happen around our facility where we have partners who also provide then precursors for MDI. This is something we certainly have to watch carefully to make sure that they also are on track.

Geoffrey R. Haire (HSBC Bank): Thank you very much for taking the question. I just have a quick question on the Chemicals business looking into the second half of the year. Clearly, caprolactam impacted in the second quarter. So could you talk a little bit about the impact the butadiene prices may have in the second half on the margins in petrochemicals and maybe the rest of the Group as well?

Kurt Bock: That is a very specific question, I have to say. We don't see any major change, frankly, if I look at the data we have seen so far in Q1 and Q2. Again, it's one of the products which we produce in petrochemicals. It's a Verbund production obviously, so it's not completely independent of what we produce as well.

Ronald Köhler (MainFirst): Hello, it's once again on the planned and unplanned shutdowns you had in Chemicals. I reckon you had several, let's say, unplanned and plus the planned, obviously, in Antwerp. I just wanted to find out: Was it, let's say, a burden which was clearly above what you would expect for the second half in the Chemicals part? Can you a little bit elaborate on this cost of maintenance shutdowns or unplanned shutdowns?

Kurt Bock: Overall, the charge due to unplanned and planned shutdowns is at about the level of last year, no major deviation.

Ronald Köhler (MainFirst): And looking forward to the second half? Would that mean it will come down versus Q2?

Kurt Bock: Same. For the second half, we only have planned shutdowns and that is what we try to do. I cannot talk about unplanned shutdowns from today's point of view, but if you compare what we know today about our turnarounds and shutdowns in the second half of this year, this is pretty much at the level of what we have seen last year. So there is no major deviation, nothing you should factor into your models actually.

Ronald Köhler (MainFirst): And also not sequentially, I mean, in Q3 versus Q2 and Q4?

Kurt Bock: Q3 might go a little bit lower than Q2.

Markus Mayer (Kepler Cheuvreux): One question remaining, again on capro and polyamides. It seems that the overcapacities there will stay with us for a longer period of time. Do you have the intention to restructure the capro and polyamide units in Asia? What are exactly the measures you under take to improve earnings there?

Kurt Bock: Markus, actually, we don't have capro capacity in Asia. We have a capacity in Europe and in North America and we are partially exporting from those locations into Asia. As I said before, we have not invested into capro for the last 25 years at least. We have pruned and improved our capacities and our plants consistently and continuously. So they are, I think, competitive.

Margins are now going down. That is not completely unexpected because we are coming from record margins in 2011, which were certainly not sustainable, at least not at that level. We will now manage through this trough. And we have done this before quite successfully.

What is important is that even in a trough period you still make consistent money in that particular business. And that is possible from our point of view. But still: Margins are not where they should be from our point of view.

2.2 Performance Products

Andreas Heine (Barclays Capital): Good morning! I'd like to know more about the Performance Products segment. Basically, at the beginning of the year you strived to increase earnings in each and every segment. Looking at the first half in Performance Products which is down 13 percent, do you still see this as realistic?

What do you expect from restructuring coming in the second half of 2013? Is there anything like the insurance income that we have seen in the second quarter of last year which we have to take into consideration in Performance Products?

Kurt Bock: I don't think there is any special effect like this relatively small insurance payment which we received for the Fukushima incident in the second quarter of last year in this segment.

Again, when you look at Performance Products, it's a mixed bag. Some of the businesses developed quite nicely. Care Chemicals had a relatively strong development in Q2. Nutrition and Health certainly benefitted from the Pronova acquisition which is doing very well, by the way. The integration is right on track.

We are certainly facing tough times in Paper Chemicals. I think this is well understood and restructuring measures are being implemented.

In Dispersions and Pigments, the pigments piece is a challenging part of our business. Here, again, we have announced restructuring measures in early May which essentially affect our operations in central Europe and namely in Switzerland.

What has impaired the result in Q2 actually is the currency development. We have quite some strong exports into Japan and we got really hit pretty hard by the Yen devaluation which was quite high, as we all know. That is a special factor and it needs to be seen how this will develop going into the second half.

Coming more specifically to your question about the outlook, what I said this morning at the press call is: It's very challenging and it's possible that we will not achieve outperformance above last year in Performance Products, which was then quoted by the news agency that we said: It's impossible. – It's certainly not impossible, but it's certainly much more challenging to achieve today than, let's say, six months ago when we had expected slightly better trading conditions – put it that way.

2.3 Functional Materials and Solutions

Andrew Stott (Bank of America Merrill Lynch): Good morning! On Functional Materials and Solutions, the margin gain that you see year on year: You seem pretty pleased with every single business unit in terms of margin trend. I just wonder if you could give us a feel for the sustainability of that margin as you move into the second half – I get the seasonality, but in terms of the progress you are making.

Kurt Bock: I will cover Construction, Coatings and Performance Materials and then Hans will talk about catalysts. Construction is, let's say, a seasonal business but, more importantly, our restructuring measures here become effective. This should help us going into Q3 as well.

Coatings and Performance Materials are both heavily leveraged to the automotive industry. And both are very well positioned with the automotive industry. So it very much depends on the development of that industry, which I just talked about when Laurence asked the question.

So there is not a guarantee for continuously good performance, but I think we have put a lot of self-help measures into place as well to improve our bottom line. Just to give you one example here: Performance Materials is a newly created division which we have started on January 1, where we now combined the polyurethane, specialties plus the, what we call, engineering plastics which is essentially polyamides. Both go very much into automotive, construction etc.

And we see very positive results from putting these two businesses now into one division where you can really capture synergies in terms of how you penetrate markets, how you do sales and marketing and pricing. So this has worked out very nicely so far. – With that, Hans, catalysts.

Hans-Ulrich Engel: On catalysts: We have seen a good second quarter. If I look at the three industrial businesses, the mobile emission catalyst business, the chemical catalyst business and the refinery catalyst business, they all performed well – chemical catalysts not quite at the record level that we have seen in Q1 and Q2 of the year 2012, but that actually was not to be expected. If I look at that based on historic averages, that business has done well.

In emission catalysts, as already mentioned, we have won quite a few platforms over the last years and we are now harvesting the fruit coming from that. In the refinery catalysts, we were burdened with high rare earths cost last year which we do not see to the same extent this year. So I am cautiously optimistic with respect to the second half.

2.4 Agricultural Solutions

Christian Faitz (Macquarie Capital): Good morning, gentlemen and Maggie! Agricultural Solutions, you have published strong earnings in the second quarter. Could you highlight how you were impacted by adverse weather conditions in Europe. Is that all? I guess your strong fungicide portfolio helped. And if at all, how much inventory do you have on your own box because of adverse weather conditions? You will have seen the comments from Syngenta yesterday.

Kurt Bock: Christian, thanks for your question. I don't really think we got hit by any adverse weather conditions. At least our people are not reporting on that. With regard to product on the ground, we are measuring this very carefully because otherwise you would, let's say, not see the full picture. We are not aware of any excess inventory on the ground. Quite on the contrary: The product which we have sold is being sprayed as we speak.

2.5 Oil & Gas

Norbert Barth (Baader Bank): Good morning! Kurt, you mentioned that the Statoil deal is now already to close. Am I right that your outlook for the second half also includes the effect? Or asking the other way round: Can you give us a feeling or indication, especially on an EBIT basis, what that means for the last five months from that point and perhaps also give us a little bit an update on the swap with Gazprom, when we can expect the closing there and the impacts?

Kurt Bock: Norbert, let's start with the swap with Gazprom. As we said today, as we speak we are filing the documents necessary with the EU Commission. That's probably going to happen within the next couple of weeks. And then the EU Commission has time to review those documents and then come to a conclusion.

Our expectation has been that we can conclude this by year-end. That needs to be seen. It really depends on how this process now develops. I think we are doing everything to provide all necessary information and documentation for approval by the EU Commission.

With regard to Statoil: Yes, your observation is correct. The Statoil result from those producing fields is included in our forecast for Oil & Gas and it will contribute. I don't think we talk about specific contribution levels, but I can tell you: It's highly earnings positive and also cash flow positive – as we had explained when we announced the acquisition about a year ago.

Hans just reminds me – I think this is easy to calculate: We basically said, it will add another 35,000 barrels per day in Norway. So the rest is then a little bit of maths.

Andrew Benson (Citi Investment Research): Just a minor question: In natural gas trading, there is a huge increase in sales and somewhat lower EBIT. You are talking about competitive pressure. Can you just explain what's going on in that subdivision, please?

Hans-Ulrich Engel: Yes, I am happy to do so. Overall, Q1 was driven by significantly higher sales, weather-related, as we all followed in the Northwestern part of Europe. In Q2, we had slightly higher spot sales than we had in prior year's quarter. So that leads to a volume increase.

But we are all fully aware of the margin environment for natural gas. That is rather compressed and then leads to lower earnings compared to prior year's quarter in the natural gas trading business.

Andrew Benson (Citi Investment Research): Is that likely to be ongoing, that margin pressure?

Hans-Ulrich Engel: We do not expect that margin pressure to seize.

Jean de Watteville (Nomura International): Good morning, everyone! Just a simple question to understand the sales bridge in exploration and production. The sales are down 10 percent year-on-year and you are talking about volumes being slightly up, mainly thanks to Achimgaz. So I just would like to understand: What's the mix effect and the construction of the price effect?

Clearly, Brent oil was down, but that was only a 7-percent decline. As far as I understand, gas prices in Europe were broadly flat. Can you just go through: What's the reason of that decline and any specifics in terms of your contracts or the mix effect or any other factors?

Hans-Ulrich Engel: Jean, the first explanation is: You are looking at the US dollar brent price. If you look at it from a Brent price in euro perspective, the decline is actually higher than the 5 percent. Explanation number one.

Explanation number two: a slightly different mix, gas/oil. And that gets you then to the overall 10 percent.

3. Regions

3.1 Asia

James R. Knight (Exane BNP Paribas): Good morning! Thanks for taking my question. It's on China, Asia, kind of related to Jeremy's question. Could you give us your perception of how much of the lower demand is destocking-related, adjusting to a lower level of growth going forward, so destocking? And if it is a significant amount of that, then what is your feel for how long this period of destocking in China and Asia could last?

Kurt Bock: Jeremy, thank you for the question. I think we have talked about slow growth in our business in China since the fourth quarter of 2011. And this has continued now going into the second quarter. We were able to grow our business, but at rates which are definitely lower than what we had seen in the past.

We think that a good chunk of that deceleration is really due to a destocking effect. And this is compounded now by the continuous reduction of growth rates which really means: People are adjusting inventory levels to lower expectations. It's very hard for us to say when this is going to stop. I think an awful lot depends on whether we will achieve the 7.5 percent GDP growth in China and whether the government is going to do something about the relatively low growth and will start to inject some stimulation into the economy which then could reverse expectations. Because right now – and you just saw the PMI number – I think, expectations are still that a further slowdown is possible.

Peter Clark (SG Securities): One question regarding China and Asia. You made the point, of course, that a further slowdown is possible. Akzo didn't make the point. They had actually seen that at the very end of Q2 into Q3 as a step down. And these are in businesses that feed a lot of sectors, some of which you overlap with actually. I just want to clarify that that's not something you saw at the end of the quarter in terms of China and Asia, a further step down in underlying trade?

Kurt Bock: I cannot comment specifically on China here. But what we have seen now – this started about a year ago – is that at the end of each quarter so far, there is a slowdown of activity. I think it's the case that our customers are really cleaning up their supply chains and their inventories coming to the end of the quarter. So there is always a noticeable slowdown in activity and then they come back after the closure of the quarter.

In July, this might be a little bit a delayed effort because, as we know, in the northern hemisphere, July and August are kind of low or slow months in general.

Peter Clark (SG Securities): Thank you. I think you have said that before, actually, on China. A couple of years ago it happened, I think last year as well. I appreciate the comment, thank you.

3.2 South America

Neil C. Tyler (Redburn Partners): Good morning! A quick question on investments in South America, please. They are quite specific. Firstly, on the acrylic acid plant that you referred to earlier: Where do you have signed any longer term take-off agreement for that facility and, therefore, sort of the extent of exposure you will have to the merchant market?

Secondly, again referring to one of the comments you made earlier: There is a government scheme to encourage oil and gas investments. You have made plenty of comments in the past on how oil and gas investment in Argentina wasn't attractive. Now I wonder whether that altered your view to any extent.

Kurt Bock: Neil, let me start by talking about Argentina first. It is still a, let's say, complicated or complex country to operate within. I think in Oil & Gas we have quite some experience how to do that. We have now a scheme in place, offered by the government, which essentially supports E&P activities, which I think was a big problem of Argentina.

They have quite some high consumption. Exploration and development of new fields was really financially not very attractive. Therefore, there was a lack of supply. I think the government has realized this by now and is actually stimulating additional exploration and development activities and we are taking advantage of that as well.

Then, going to Brazil, where we invest into acrylics and superabsorbents: Yes, we will be the only local producer of superabsorbents. We have a growing middle-class in Brazil. So these families are e.g. buying now baby diapers. We certainly, before we made the investment, made sure that we have customers for those products. So we are very comfortable with regard to the market development. And actually our customers – many of them are global companies we have been working with for many, many years in all parts of the world – are really keen to have the capacities in Brazil available.

Neil C. Tyler (Redburn Partners): Okay. But they have not signed take-off agreements? It's a sort of level of comfort regarding relationships …

Kurt Bock: We really don't go into any specifics, but you can be assured that we don't have a completely open position or sales risk here. We have hedged our market exposure quite effectively, I'd say.

4. Automotive Industry

Peter Spengler (DZ Bank): Good morning! I have a question on the automotive demand situation in Europe, Asia and the United States. It seems to me that it was quite good or stable at least. Maybe you can give us some more details.

Hans-Ulrich Engel: Automotive development overall in light vehicle, we see globally a growing market somewhere in the order of magnitude of 2.5 to 3 percent; that's our expectation. Strong growth in North America, good growth also in Asia Pacific, weakness, as we all know, in Europe.

If I look in our business and there in particular in the mobile emissions catalysts, into engineering plastics and obviously also into OEM coatings, we see business increases, volume increases across all three regions. I'd say these are driven by 1) the innovation that we have in our respective parts of the portfolio and 2) in particular in Europe – that may be the astonishing part of the news that we have an increase there in our automotive business – I think it's the strong relationship that we have there with the manufacturers of the premium brand which are obviously benefiting from their exports and through that we benefit from it.