Presentation Industrial Solutions

Transcript Speech

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Anup Kothari

Member of the Board of Executive Directors

[Title slide: Industrial Solutions]

I'm now going to cover Industrial Solutions, which has the divisions Dispersions & Resins and Performance Chemicals.

[Slide 2: Industrial Solutions: Driving product performance for diversified end markets]

They go into various different markets; you see it here. But another way to think about this business is: It's like an additives platform. Our products are mostly a small amount that you need in a product but boost the performance of that entire product. That's essentially what this is.

We have different product lines, and they go into various different markets. Depending on the markets, you can also shift where you want to go, but we are providing similar functionality and fit-for-purpose products.

We like to think the way we create value is by providing these products along with application know-how and expertise. So, we can make the products fit for purpose. Many of our products actually tie back into our value chains; they're strongly connected to the value chain. This is why this segment belongs firmly in the core. I will show you this a bit with some of the examples.

The main role of this business in the portfolio is: It is a low-capex, high-ROCE business. It's been consistent across time and it's very good in terms of ROCE. That's how we look at it.

[Slide 3: Industrial Solutions has delivered strong earnings and high ROCE for BASF]

This has been the performance over the last five years. In this business, demand and supply were quite impacted by the pandemic. So, let me describe a little bit what happened in 2020/21/22. If you can imagine: In the pandemic, everybody was sitting at home, painting their houses, buying a lot of goods. This was driving a lot of demand for us, too, in this period.

At the same time, supply chains were very constrained. So, there was high volume demand as well as good margin possibilities there. And our teams really delivered during this time because we needed to make sure we could run the assets in this very difficult pandemic environment in a good way. If you were able to have a resilient supply chain, then you could do strong margin management. So, it was not that the pandemic only provided tailwinds. Our teams were able to run the assets, get the supply chain. You see the results – the blue bar – that we had for EBITDA during this time.

The second half of 2023 was where we suffered from very significant destocking. For this business, we were already seeing good improvement in the first half of 2024 and demand is beginning to normalize close to pre-pandemic levels.

So, that has been the dynamics of this business. You can see the average ROCE of 14% that I mentioned. Typically, this business has been above 10%. That is the main role of this portfolio with high cash conversion.

[Slide 4: We have built a strong, focused portfolio and are well positioned to accelerate value creation]

If you zoom out on this whole segment a little bit, we have been working on it for some time. The biggest part that we have done is: We have made it a very focused, coherent portfolio now, where we have very strong positions. You can see on the slide some of the portfolio moves we have made over the last years. I was in the Performance Chemicals division when we did the paper & water divestment, but we also did pigments – these were the two big ones – and then also smaller ones along the way.

Some of these businesses just did not fit the business model that I just described of products plus application know-how. Some were having structural cost issues. For some, there were just better owners out there.

So, we have done this and we now have a very focused, coherent portfolio. Going forward, you see the EBITDA before special items target that we have for 2028 from our 2023 baseline. It's a big number: 40%. Part of it is driven by this normalization of the demand because 2023 was a lower basis.

[Slide 5: Our strategic priorities for 2024 – 2028 will drive value creation for BASF Group]

The other things that are underpinning it are really these four.

First, again, our ability to grow with our leading market positions. These markets are growing faster than GDP. Our ambition is to capture the growth there. We will also gain some share. And you see, almost half of the value creation is coming from this growth with leading market positions; I will go a little bit deeper into this.

The second piece, which we have not highlighted as much before, is the focus play we have in electronic materials. This is becoming a good business for us. It has grown really well in the last years; I will talk a little bit about this. It is now roughly 10% of the total sales, but it's good growth and good EBITDA margin. We also see this business giving us a boost in growth.

A big part of the business model in this segment is constantly focusing on productivity and fighting against inflation. This is also built into how we do things.

You can see that our capex here is 80% of depreciation because, again, we have invested over the last years in certain growth areas and growth regions. I will show you that as well. It provides us with good leverage going forward.

[Slide 6: We have leading market positions in our key products]

What are our market positions? We have a very broad product portfolio here and I'm showing you only our key product lines, the big product lines.

This was something that Markus also mentioned in his keynote: For all these product lines, we are number one or number two. This gives us a very strong position. You can see, in dispersions and coating additives. In electronic materials, we have these focus positions and there we are also number two. You can see

down the line, they're all very different products. I would still characterize them as additives. And these are the applications they are used in.

You see our peers. It gets difficult to have a pure-play peer or a company you can compare us with. It depends a bit on which product lines you are talking about. Internally, what we do is: We try to create what we call a synthetic peer. So we try to figure out: Given our portfolio, if a company like Industrial Solutions existed elsewhere, what would it look like?

That is how we benchmark ourselves and give ourselves insight into how we are doing.

[Slide 7: Key trends drive growing need for fit-for-purpose products]

What are the key trends driving these markets? They have growth roughly in line with GDP or higher. But you see in all of these markets, the trends are mostly driven by sustainability and resource efficiency.

The most important part is that all these markets are looking for products which fit for their use, for their application. For example, you see the picture of plastic additives. We were in Limburgerhof in our Ag group; there you can see the greenhouses and the plastic films. Farmers want these plastic films to last longer. That's the first part: durability. And they want something with good optical features, so you can get UV light protection in the right way.

That's what we do. We have an additive which increases durability while offering better UV protection with light stabilizers. That's what we provide.

Or in coatings: In decorative coatings, for example, we have customers looking for lower VOC (volatile organic compounds). This is what we provide.

I will go through more of these examples. This is what we do. This fits very well with our business model which I alluded to before.

[Slide 8: Our business model enables us to win and grow with our customers]

Maybe I'll start with the know-how part. We have 800+ technical experts with many years of experience in these different markets. We have front-end sales. They typically work with customers, trying to understand their applications, and then they connect with our regional R&D labs. We have R&D labs in all our regions, working on applications which are more focused on their markets. We have local production sites.

If we see some trends, we can tap into the BASF chemistry toolbox: our entire additives library, our formulation expertise, our understanding of the different applications. Then, of course, we can scale it because it's connected to our Verbund.

So, we can figure out which ones we can scale and provide as a solution. And that's our business model, which allows us to play with the trends I just showed you.

That is how we play this. It's a very nice business for us. It fits very well with our strengths and our expertise.

[Slide 9: Growth lever: New formulations that provide commercial and sustainability advantages for our customers]

I'll share a few archetypes – because it's such a diverse group of different markets and products – of how we actually do this.

There is one which is really interesting. Just imagine a construction site and a mortar bag: The bag has a lot of inorganic material inside, such as sand and filler. Then the additives – shown at the top – form a small part. By weight, it's a very small percentage. From a value perspective, the first bar you see is the orange part, which is our BASF additives, and the rest is all inorganic binders.

We have just launched this HyCon® construction additive. If this additive is used in the formulation, you can reduce many of the other inorganic binders, some of which are also very expensive. Overall, this lowers the total cost of the whole formulation while we have gained 20% of the value share.

That's what we try to do with innovation: reduce the total cost, reduce the formulation cost. But maybe our value share in the formulation goes up.

This one has also a fantastic benefit because you also reduce the CO_2 emissions by doing this. This is a big driver, also in the construction industry.

This is one example that I used here because it's so tangible. But this is being replicated again and again in different applications: We bring the formulation know-how and application know-how, provide our additive and maybe even bring the total cost down. Then you can value price in these situations.

[Slide 10: Growth lever: Product solutions for electrified powertrains based on our strong application expertise]

Another archetype that we use is driven by these megatrends. I'll use an automotive example; there was also a question how the automotive industry will look at us.

Here you see that electric cars also have a need for coolants. We have coolants right now for the ICE cars. We are able to provide these coolants right away. But an electric car requires two times the coolant of a normal ICE car. So, first of all, it's just a boost in terms of demand for these products.

But what these coolants do in the ICE car is prevent corrosion. That is also their main function. Preventing corrosion, from a chemistry standpoint, is increasing conductivity, which is not a good thing for an electric car. So, we are working on new coolants, and we have launched a safety-optimized solution. It brings the conductivity lower, so it's safer, while also bringing this functionality.

We believe this is where the regulations are also going. Many agencies are looking at making it a standard in terms of moving toward safer coolants.

This is another example of where we can use the trends, maybe bring products that we already had for some other applications and modify them for this new expertise.

There are other examples on the right-hand side. I'll also mention the anode binders. This is another thing our dispersion business is working on, where you can increase the capacity of the anode. So, there's a lot of playground for additives and formulations chemistry in all of these new applications.

[Slide 11: Growth lever: Enabling the green transformation by developing and supplying novel high-performance catalysts]

Now, a different example to show you a different kind of archetype. This is coming from our catalysts business. Just imagine nitric acid production. It's a bulk chemical and it has NOx emissions: 700,000 metric tons of NOx emissions from this nitric acid production. The global warming potential of NOx is 265 times that of CO_2. So, there is a very strong impact from NOx and a strong urgency to reduce these emissions.

Our partner Uhde has their EnviNOx® technology where they can reduce these emissions by 99% when they're using our catalyst. We have been working with them and they trust our capabilities in creating this high-efficiency catalyst. We have a pilot plant inside of BASF, so we can actually mimic the conditions, and we test there.

We even have our own nitric acid plant, which can serve as a reference plant inside of BASF. That's often the business model for our chemical catalysts: We have the capabilities, we have the know-how and sometimes BASF is even a customer, creating a reference plant.

For the last five years, we have been working with Uhde and this technology has been deployed in more than 20 plants.

An interesting statistic you see there: In 2023, as a result of this technology that uses our catalyst, emissions were reduced by the equivalent of 7 million metric tons of CO_2. If you remember –Markus, you mentioned it in your keynote – BASF's entire emissions are roughly 17 million metric tons. So, the 7 million metric tons is almost 40% of this emission. This is a perfect example of enabling the green transformation of our customers, the lever we have. If we can go from 20 to 40 plants – this is what we plan to do as we go forward – the impact on CO_2 reduction that we are having through this catalyst technology is fantastic.

This is yet another example of how we can use the sustainability trends and the new applications that are coming as drivers for our catalysts business.

[Slide 12: We accelerate our growth in electronic materials by leveraging our global footprint close to key markets]

Now I want to move from the different archetypes in our additives business to electronic materials. This is a market which you see on the left-hand side. It is a proxy of the semiconductor market in terms of projected growth rates. This is basically chip production.

A lot of investments are coming online. People have announced hundreds of billions of investments that will be needed. In this market, a few steps are needed in chip production. One is the photo lithography step. In this step, essentially, the circuit is set, which requires ultrapure chemicals. This is one place where we play. Then there is etching, cleaning and wet deposition. These are also all steps where you need formulation additives.

So, we have a very focused play on these ultrapure chemicals and these formulation additives in chip production.

On the right-hand side, you see what we have done in the last years. You see all these symbols: R&D, QC lab, production and sales. But I would like to draw your attention to production and QC lab because they go together. We have locations in Taiwan, Korea, China, Singapore, Malaysia, Europe and the United States because there are customer locations there. So, we have a really good footprint now with customers, with production, QC labs and R&D applications in many places.

Now we can continue to leverage this as these customers also expand and grow.

[Slide 13: Our core capabilities differentiate and create value for our customers and for BASF]

The business model here is: Once you are with the chip maker, they're always working on the next generation, a faster chip, smaller and smaller. We start working with them already on the next generation. Then you are already in. You are essentially supplying the current generation. You're working on the next generation. We are able to tap into BASF's additives library and do very fast-cycle R&D development because you need feedback very fast. So, you are constantly in this fast-speed innovation cycle. Our customers now have a very high confidence in us in terms of executing on our investments.

I just showed you our footprints. Now we have gained expertise. We have dedicated teams who are able to build these plants, on time and reliably. This is also a necessary core strength. You can imagine the reliability that is needed, the quality that is needed here. This is what we have now: a really good track record working with our customers.

It's showing up in our P&L. You can see the nice 15% sales growth and the EBITDA increase that we have seen in the period from 2019 to 2023. It is still a small business given the overall size of the segment. But we are talking here about a triple-digit million EBITDA. So, it's a good growing business. We can further take it forward. This will be one of the growth boosters in this segment in the future.

[Slide 14: We drive cost efficiencies to reduce the impact of inflation]

I also mentioned that, as part of our business model, we are constantly looking at driving cost efficiencies and increasing productivity to reduce the impact of inflation because the markets are growing GDP+. So, we are always mindful that we have to drive productivity all the time.

You see here many different levers. There are a lot of small measures. As Stephan also mentioned: The opex is a big lever that we have in our assets, but digitalization in labs, in testing, in quality is also something that we do. Lean organization is also something we constantly look at if we need to further de-layer certain things or get closer to the market.

So, we use all the levers that we can – because it's all these small things that ultimately add up to fight inflation.

[Slide 15: We leverage recent investments in growth markets and drive capital efficiencies]

There is one final point, the final lever that I wanted to mention. You can see from the map where we invested in the last years; this is from the Factbook, so you have all the locations and capacities and where they are. As you can see, they're all in growth markets: in China, Malaysia, Indonesia, India, Turkey, and in certain assets in Ludwigshafen where we can de-bottleneck. So, it's a very smart way to de-bottleneck and release capacity.

We can now leverage these capacities as the growth comes. We are there; we can fill it. You also see that our capex allocation is below depreciation. Most of it is on optimization, business continuity. So, it's really at a good level. This is why this business is able to deliver this high ROCE.

[Slide 16: We are accelerating value creation in Industrial Solutions]

So, this is a business we like. It's a very focused core and portfolio that we have. It has good pieces that we can boost in terms of trends, and also electronic materials. Our aim is to now normalize our 2023 earnings and then go for this EBITDA improvement through 2028.