

BASF Conference Call Q&A Transcript October 13, 2017



Kurt Bock, Chairman of the Board of Executive Directors

Saori Dubourg, Member of the Board of Executive Directors

Hans-Ulrich Engel, Chief Financial Officer

Thomas Wrigglesworth (Citi): I have two questions. The first one is more strategic. Obviously, you are entering the seeds business now. Could you give us a little bit more sense of what your strategic ambitions are for this business? Are you going to remain in the three classes of product that you have just acquired access to today? Do you have ambitions to broaden the portfolio? Now that you are committed to seeds, how far and how quickly can you develop that business?

My second question is related to the cost of financing. We have seen some very low cost of financing from German corporations buying U.S. assets. What is the BASF cost of financing today and therefore, what is your WACC when you say that this deal provides a return on investment above WACC?

Kurt Bock: Strategic rationale and ambition: Clearly, we have always said that we have a very good crop protection business: above-average growth, very good profitability, yet the last two years were a little bit more bumpy as for everybody else in the industry.

We have also said that by and large we are looking for opportunities how to enhance and support our crop protection business, meaning crops and seeds where crop protection really plays an important role. I think this is definitely the case in the Bayer transaction. These are good and attractive crops and these are good and attractive market positions, especially with regard to canola.

Above all, there is a good research organization. For us, it was very, very important in our talks with Bayer to ensure that we also get a business which people might call fully enabled, which has the bells and whistles which you really need to grow the business continuously and to feed the monster, so to say, in terms of R&D expenses and future results.

That brings me to the second issue of ambition. I think we go here step by step. We now plan to enter this segment. This is kind of new for BASF, but it is not completely new because, as you know, for more than 15 years we have been very active and, I think, also very effective and very successful in trait research. The strategic decision we took 15 years ago was not to go into germplasm. Now we will have germplasm. The simple question is: How can we combine the scientific knowledge which we have at BASF, the expertise of the future colleagues from Bayer and our knowledge of the farming industry to grow this business successfully? I think there are lots of ideas. This is complementary to a certain degree, but it really enables us to build a stronger growth platform for that business.

It needs to be seen – that was also part of your question – whether we can further enlarge this business via acquisitions, simply because it takes two to tango. This was now, from our point of view, a good and attractive opportunity to acquire a sizeable, meaningful, sustainable and fully enabled business. If we can complement this in the future with additional markets or segments, we would certainly look at it; then it comes down to the same acquisition criteria which we already talked about: Does it make sense? Is BASF a good owner? Is it financially attractive? I think in this case we can demonstrate that BASF will be a very good owner of the business.

Hans-Ulrich Engel: On the financing: As Kurt has already mentioned, we have not yet made our final decision on how we will finance. It will be a combination of cash on hand, we will use bonds and we will use our commercial paper programme. During the course of the fourth quarter we will decide what we will actually do for the transaction that we expect to close in Q1 2018.

You also asked with respect to the WACC. I can assure you, we did not change what I would call our conservative approach. We stuck to that approach. The WACC overall for this transaction is in line with what we publish as WACC for the BASF Group. So that's what we use: order of magnitude 7.5 to 8 percent. On that basis, we will earn what needs to be earned and be EPS-accretive, as Kurt has already mentioned, in 2020 at the latest.

Thomas Wrigglesworth (Citi): Thank you. For modelling perspectives, we should think of maybe 100 basis points cost of financing; is that the right level?

Hans-Ulrich Engel: As I said, that depends in the end on what we will do. I probably would pick something in the range of 100 low, 200 max.

Christian Faitz (Kepler Cheuvreux): First of all, CFIUS: You are also buying Bayer assets for a good part based in the U.S. I would believe you have checked with Bayer before that if there are any upcoming CFIUS issues, right?

How smoothly do you believe you can integrate the R&D assets into your own R&D infrastructure on the agricultural science part?

You will be buying some assets, I believe, based in Knapsack and Frankfurt, on the production sites. How smoothly would you believe you can integrate those?

Kurt Bock: Christian, two important issues: integration. This was on everybody's mind when we had the negotiations because we simply want to do this very quickly and very efficiently. So, we have thought quite a bit and prepared ourselves for this upcoming process. The idea is, as we said in our presentation, to bring the non-selective herbicides into our crop protection business and then by and large to have a new business unit for seed. This then has to be implemented case by case and location by location, obviously.

Production: I think we will achieve good agreements with Bayer how to be good neighbours. We have been good neighbours in the past and that should also be possible in the future if we have operations at joint sites.

R&D: For us, it was very important to get also the experts. We have experts, but we need more experts for this business, obviously. So, we do get the scientists and the people who are very good at, e.g., registering these products.

From a location point of view, we have a relatively strong position in North Carolina, in RTP (Research Triangle Park), Raleigh. Bayer has the same. So, there is also proximity of locations. I think this will also help.

I think we know how to run science organizations and R&D organizations. I am sure we are a good home for the scientists and technicians coming from Bayer.

As we said in our presentation, we need approvals by the relevant authorities. We have to check yet whether CFIUS really plays a role here. That is normally nothing you do on your own, but you are approached by them. That needs to be seen.

Andrew Stott (UBS): My first question is on the geographical bias of the assets. This is dominated by the Americas, 85 percent of sales are in North and South America. Is there anything you can do to globalize that revenue stream or is that just a function of the crops that you are predominantly dealing with here? That is the first question: expansion in Asia and Europe?

My second question is more straightforward. I think – I wanted to check the maths here – you get 80 million of licensing income from LibertyLink®. I wanted to check that number. Also, what is the outlook for that licensing income?

Can I get a clarity on the tax benefit you mentioned? I didn't quite pick up the number.

Saori Dubourg: Maybe I answer the first question that you have on the geographics. You are absolutely right with the acquired assets from Bayer: There is a 70 percent share in North America, 15 percent South America and 10 percent Asia. Only 5 percent is related to Europe. That has very much to do with the portfolio which is primarily also a big seed asset, which is also linked to GMO. This has a geographical reason because this is where the main markets for GMO-related seed assets are.

However, when you look at research and the opportunities, there is an expansion possible also geographically, because we also get a lot of R&D portfolio in various ways that we can spread. For example, in Europe, oilseed rape has a certain growth potential that we can use and there is certainly more from a technology perspective.

Hans-Ulrich Engel: The tax asset, as Kurt already explained, is a high triple-digit million figure. I would consider this in the very high triple-digit million figure. We use the same WACC, so also there a relatively conservative calculation.

Kurt Bock: The LibertyLink® license income, Andrew, is part of the deal. It is an income stream which we will maintain for as long as possible and then we try to nurture it again with hopefully future new license income coming then from BASF joint research activities.

Andrew Stott (UBS): The bottom line, that 80 million is maintainable, as you see it?

Kurt Bock: I am not sure we want to go into this detail of a business plan right now. It was a separate package being offered. But it was not really priced separately by us.

Jeremy Redenius (Bernstein): First of all, just a big-picture question. You had long talked about not wanting to be involved in owning germplasm. That changed today. Can you describe what was changing your thinking about owning this type of business?

Secondly, I wanted to check a few things to see if they were included or not included. I am wondering if the Balance™ GT soybean trait was included in the package and if not why not. I know wheat and vegetables were not included. I am interested to hear if you considered buying wheat and vegetables seeds and decided not to buy those.

Kurt Bock: We acquired what has been offered, to make a clear point here. So, these are questions you have to ask Bayer, obviously. We acquire what we deem to be interesting for BASF.

The big question about “why germplasm now?”: I think I tried to answer it a little bit earlier. We never ruled out that germplasm could be interesting if – if – it is really linked to crop protection and this would be a mutually reinforcing business proposition. So, there are certainly crops where we are not interested because it would simply be too far away from our crop protection business. We see actually no real synergies between crop protection and seed, at least from our point of view.

When you make such a step – you are right; this is a certain change – then the step has to be meaningful; it has to be sizeable. Again, this is the case with the Bayer business: It is relatively big, it is very innovative, it has excellent research. So, it is a sustainable business and those were very important criteria when we looked at what had been offered by Bayer.

Jeremy Redenius (Bernstein): Can I just clarify on what you actually did buy? Let’s exclude the explanation of what you didn’t buy. Within the soybean business, you mentioned traits and you specifically called out LibertyLink®. Could you say whether or not that includes Balance™ GT trait?

Saori Dubourg: We cannot comment on the Balance™ GT trait, but the general comment is that we concentrate on and acquired a fully enabled business here.

Peter Spengler (DZ Bank): My first question is on the size of the acquisition. This is the biggest acquisition in history. It tends to be financed without problems. Can we expect portfolio transactions in the near future to at least partially refinance the deal?

My second question is a follow-up on the asset deal. Can you elaborate a bit more – it was very fast when you talked about it – on the large parts and the timeline for depreciation and amortization? With large parts I mean what you have in goodwill and in certain assets which you have to depreciate in the future.

Kurt Bock: I think we look at each and every transaction individually. Based on the merits of the specific transaction we make a decision whether it really reinforces competitiveness of the BASF business and thereby also of the BASF portfolio.

Now trying to acquire or going to acquire the Bayer business is for us not a reason to have a different look at other businesses of BASF. They are evaluated on an ongoing basis and then we make up our own mind whether they still fit into our portfolio. But it is clearly unrelated to any – if this is the background of your question – financing concerns, for instance with regard to the balance sheet.

Hans-Ulrich Engel: With respect to your question on purchase price allocation and what will end up in the balance sheet, the statement that I can make at this point in time is that you can expect the purchase price to be reflected in the balance sheet because this is an asset deal. So, the step-ups that will happen in this type of asset deal will in the end reflect the purchase price – so different from share deals where you typically see significant values above what is paid as a purchase price in the balance sheet. That gives you the order of magnitude.

With respect to the specific allocation in asset classes, I would be careful at this point in time. We have obviously done our preliminary purchase price allocation. But the real purchase price allocation we will only be able to do once we acquired the asset and then in the first quarter after that you will see what we have done. But I think it will be preliminary to give you ranges and orders of magnitude here. But what you can expect is that you find the 5.9 billion euros then also in the balance sheet.

Tony Jones (Redburn): Firstly, could you talk a little bit about the competitive bidding process, maybe in terms of how the process worked and some of the parties involved?

Going back to the licensing income, do you know if there are any pre-existing Bayer licensing agreements? Does this transaction mean that they need to be renegotiated at all? Or should we just exclude any of that?

Kurt Bock: The only thing I can say is that it was a very professional, very constructive process. We actually don't know who was participating in that process. We have no visibility here. The only thing I can say is that Bayer conducted the process extremely professionally and in a quite impressive way if I may add that.

Saori Dubourg: Regarding the licences, maybe just a comment here: They are part of that deal and will be fully transferred. So, we are not aware of any other negotiation necessity.

Markus Mayer (Baader Helvea): Firstly, can you say something on the integration cost you expect for this deal? Secondly, you talked about the revenue synergies. Do you expect any kind of cost synergies as well, even if it is a very small amount?

Saori Dubourg: For the integration cost for the deal, I think it is too early to comment at this stage because we are in the middle of putting the concept together.

Kurt Bock: The idea is clearly, Markus, to conduct the integration process as professionally as possible. There might be some cost synergies in, let's say, more administrative type of operations where we can then merge activities and create additional economies of scale.

But what the real drivers of the business are in terms of market, sales, R&D, technology, development, this is by and large very, very complementary and we are very much looking forward to welcoming the new employees to BASF and to create then an even stronger team together.

Paul Walsh (Morgan Stanley): My first question is whether or not this transaction has any impact on your existing relationships with Monsanto around R&D and product development. My second question is pretty straight forward, a financial one: Is there any Verbund benefit to integrating these assets into your portfolio? Are the businesses growing at the same pace this year as you demonstrated since 2014?

Kurt Bock: Clearly, crop protection and therefore also now the seed business are integral parts of the BASF business. We have been a very, very good owner of that business and we will continue to be a very good owner for that business. There is also a technical Verbund and a know-how transfer within BASF, which I think, by and large, has benefited the crop protection business as part of BASF.

The Monsanto relationship: We have a development relationship, a collaboration, as you know. This is ongoing based on the current contracts. At this point in time, actually, we can say nothing about it because this is now all up in the air and it needs to be seen when the Bayer/Monsanto transaction has been concluded, what we are going to do. This will be up for talks and conversations then.

The growth-rate question: by and large the same which you saw in the 2014–2016 timeframe.

Laurence Alexander (Jefferies): Just a quick clarification: For the targeted synergies, is there any incremental investment required above and beyond the step-up in R&D that you flag?

Kurt Bock: No, not really. This is all immaterial, given the size of the deal and the P&L of the deal. No.

Andreas Heine (MainFirst): One question on the R&D. For the seed business, an enormous platform of technologies is required. Do you have access to all of these technologies Bayer runs, whether it's markers, the breeding and the DNA knowledge and libraries for these crops etc., so that all the technologies and all the capabilities you need you can completely run separately and would it therefore be possible also to add if you get access to the gene pool of any other crop to broaden this business with this technology platform?

The second question is: Bayer probably made this deal early, as an accelerator to get the approval. It might not be everything Bayer has to do to get the approval from the antitrust authorities. If there is more to come from Bayer, either in crop protection or in seed, would you be also interested in looking at that?

Kurt Bock: To your second question: I think it's a good rule never to answer hypothetical questions. At this point, this is what is being offered, obviously. We found it attractive. We will certainly follow the process and see again how it develops and then we have to make up our mind. But I think it's simply too early to speculate about this at this point in time.

Saori Dubourg: From a technology perspective, first of all, BASF is familiar with many of the necessary technologies already. But you can rest assured: The research we receive here is highly enabled. It has genetic libraries, computational life science, microbiology, cloning expressions etc. So, we feel really comfortable that we can build on that expertise.

Peter Clark (Société Générale): Two big-picture questions: Looking at slide 6, where you have got the growth rates for both seeds and crop protection in the market going out, obviously, you are still very heavily weighted in crop protection, different portfolios across the industry etc. Where do you see your growth rate relative to that now you have got the Bayer seeds business within the portfolio? 3 percent, I think, for crop protection, 5 percent for seeds, perhaps it's some mid-single-digit you are aiming at for the portfolio.

On the financial situation of BASF: Obviously, you have announced 7.5 billion euros of deals. From my numbers, you still actually have quite a bit of financial flexibility. Can you remind me of the acquisition criteria, the headroom that you see on the balance sheet accepting that you have just announced two big deals? You are probably not going to announce another one next week, but effectively where do you see the balance sheet criteria again, as a reminder on acquisitions?

Hans-Ulrich Engel: Peter, with respect to the balance sheet: As you know us, we are – I am repeating myself – relatively conservative. We will use the balance sheet capacity for the two transactions that you were mentioning. One was Solvay's polyamide business that we announced recently, the other one we are announcing today.

But as I said, we have a strong balance sheet and I don't see major restrictions. But then there is something else that you need to think about, despite your balance sheet, and these are the management resources that it takes to integrate acquisitions. That takes a certain period of time. I think I will leave it at that.

Kurt Bock: Peter, it probably doesn't come as a surprise if I tell you that we want to grow slightly above market, which is probably true for all of our competitors. So, if you add this up, the market is supposed to grow much faster. I think this is called competition.

Laurent Favre (Evercore): I have a quick question on slide 10 and on the base case. When you think about the base case of the acquired assets, is it fair to assume that there is growth at a pace that the business has been delivering from 2014 to 2016 and that the potential of the triple-digit number that you told us, potential for top-line synergies, comes on top of that?

The second related question is around the profitability of the asset. You have talked about above 25 percent. Even excluding LibertyLink®, I think it is clearly above 25 percent. I am just wondering: Are you reluctant to call it 30 or near 30 because there is something else in the number you have provided in terms of other earnings, in terms of an exceptional growth margin that happened in 2016 in the 385 million euros?

Kurt Bock: Clearly, that leverage which we are publishing here is above 25 percent. Our ambition is certainly to grow profitability and to keep it at that level or to even increase that level. I am a little bit cautious now to give you precise numbers here at this point in time.

The underlying, let's say, market attractiveness and willingness of farmers to pay for innovation can lead to EBITDA margins which are even higher, clearly higher. And we see this also in selected products and applications. That is how we see it at this time.

Saori Dubourg: For the last three years, as you saw on the slides you mentioned, for the seed part there was a big growth of 14 percent and the chemistry about 17 percent. That is robust growth; it's reflecting basically population growth. We are very confident, also 2017, that the results, at least from what we know so far, look rather stable and robust going forward.

Of course, we have the ambition to combine synergies and look into keeping a robust growth going forward. As you know, weather conditions vary dramatically among different geographies. So, there will be differences always across the globe. But, generally, I can say: The robust trend of world population growth, the necessity for improvement in food and the yield improvement for farmers will further fuel growth going forward.

Laurent Favre (Evercore): Thank you. I guess, when you talk about covering the cost of capital based on similar profitability to what has been published, you do need a double-digit sales growth CAGR to get anywhere near cost of capital, at least on my numbers. Am I missing something, beyond the NPV of the tax synergies which you quantify at two times the EBITDA number?

Kurt Bock: I don't want to speculate, Laurent, on this growth rate and precise numbers. What you should keep in mind, probably, is that the combination of the businesses also enables us to grow other applications and other products which we have in our portfolio faster. This also, by the way, includes the non-selective herbicides which we are going to include in our portfolio. These are additional growth opportunities. I think in the past BASF has proven to be quite skilful in exploiting these opportunities in the market. This also has been built into the case.

Clearly, we expect that the business will have a continuous high profitability. And that has to be fuelled by ongoing innovation. This is an innovation-driven business. As I said before, farmers are essentially willing to pay for innovation and then, if you can enhance this by having, e.g., mixtures with BASF products, I think all of this offers additional growth opportunities.

So, we are quite happy with the deal, both from a strategic point of view and also from a value creation point of view.

Li Dunlop (JP Morgan): Just two interrelated questions: Firstly, I just wanted to understand your confidence on being able to close this early next year. I am just alluding to your view on the regulatory process and why you don't think it should take too long.

The second question is on the slide 9. I think you might be able to describe in a bit more detail why glufosinate, the non-selective herbicide, is complementary. Is that because your current portfolio is mostly selective herbicides?

Kurt Bock: The closing process: I think we have our ducks in a row, so to say, to move as quickly as possible. I mentioned earlier on that an integration team has been appointed and that we clearly align as much as possible with Bayer to ensure a smooth and, let's say, elegant transition process.

The timeline, clearly, will finally be determined by the Monsanto/Bayer transaction. We think this is going to happen in Q1. And that is what we are preparing for.

Saori Dubourg: To your question on the herbicides market: It requires multiple modes of action. So glufosinate is an exciting new tool for BASF, as we do not have non-selective herbicides. This is why glufosinate is a very attractive mixing partner that we can use for multiple formulations.

Li Dunlop (JP Morgan): Sorry, just on the first question: I understand you have to go through your own regulatory processes as well. I just wanted to understand why you are confident that your own regulatory processes should be expedited quickly.

Hans-Ulrich Engel: If you look at the business that we are acquiring and what we have in our portfolio, as Saori just mentioned, we don't have non-selective herbicides in our portfolio. We don't have seed in our portfolio. So, as a result of that, we actually do not see any type of regulatory issues.

As Kurt mentioned, the closing of our transaction will depend on the closing of the Bayer/Monsanto transaction, but it should follow immediately from our point of view. So, we expect to close our transaction in Q1 2018.

Kurt Bock: We will certainly work as closely as possible with the antitrust authorities and provide them with all the necessary information.

Andrew Noel (Bloomberg): The first question is whether you have sort of written off Europe in terms of GM crops as a market.

The second one is: Our understanding has been that there is another fairly obvious buyer for this. As you headed into these negotiations, did you feel that having no exposure to this area was a strength in the bidding process? Was it bidding strength?

Just the other little half one is: Are you outgrowing your "We create chemistry" strategy for the company? It's probably 10 years old.

Kurt Bock: I think I mentioned that this fits our “We create chemistry” strategy by and large because that really is all about getting closer to customers, innovation-driven, technology-driven business where we can clearly differentiate ourselves in the market based on our own BASF strengths. I think this fits nicely with the very research and customer-centric business which we want to acquire.

Have we written off Europe? Never say “never”. Europe is difficult with regard to genetically modified crops, certainly. Parts of the package are also non-genetically modified crops – please keep that in mind – which we can and will certainly cultivate in Europe. But with regard to genetically modified crops, Europe will remain an uphill battle.

Frankly, we haven’t put anything into our business plan in terms of opening up, conquering the European market. That is, I think, not reasonable at this point in time. It might change over time. You never know. People might get smarter, as the rest of the world already is. But we will find out about it then.

Negotiations: Again, it’s difficult for me to comment here on anything specific. I think we put our best leg forward. We tried to demonstrate that BASF can be a good owner who will drive this business successfully, based on innovation, based on our knowledge of the industry.

Apart from that, again, it’s up to the seller to make up his mind what he likes and what he doesn’t like. Apparently, at the end of the day, we could come together.