Transcript

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Transcript Q&A session

"BASF in China – A continuing growth story"
by Albert Heuser

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Topic: BASF business in China

Andreas Heine (Barclays): I have one question regarding the last slide on the sales and earnings. Looking on the growth you project for Asia and China – it was from 2010 to 2020. If I calculate the numbers from 2012 to 2020 from the market and the Asian growth is 5% and the Chinese growth is 6% and if I compare this with the growth target of BASF in the region, then it is substantially higher than the 2% above market growth, so 9% and 11%. Looking on what you said for this year, having difficulties to keep up with the growth, what makes you confident that you can change this - from what we have seen this and last year - onto growth? Could you elaborate a little bit what you call consistent increase in profits compared to the sales increase?

Albert Heuser: If we come back to these numbers, only to set perhaps one number in a different light: 7% we see as the growth of our strategic relevant markets. So for sure, we are first looking at GDP growth and then looking to the chemical markets and then we have a look to the strategic relevant markets, those being of interest for us. We do not look really into growth of polyethylene, polypropylene or whatever. So 7% is our starting point. Then we say we want to outperform this growth opportunity by 2%. That is somehow close to 9%. You would say it is still not the 11%. But as I mentioned, we see a lot of potential in specific in the automotive industry. Take that as an example, for businesses that we are able to outperform. We see the potential with our industry team approach to come to new businesses on top. That was indicated in the slide where you saw the three breakdowns, so to say, the organic path with all the investments, which are already under execution and being announced, then the ones, which are under consideration and then the final part is that we need for sure to define additional business opportunities. Then we come to the 11%.

The second part of your question relates to what we told you yesterday: We are currently behind our plans, looking at current numbers, second half of 2012, and now the first months of 2013. But you saw how volatile the development used to be over the last years.

Looking into different products, then we have a shortage in the one or the other product. From that we are very confident with new capacities being on stream soon that we will demonstrate that we come back to the planned growth path.

James Knight (Exane BNP Paribas): The growth targets have been described as challenging and ambitious. Could you give us an idea how you and your senior management are remunerated? Not details, but whether organic growth is an integral part of that, whether the targets match short or medium, long term versus those externally communicated targets?

Albert Heuser: That is a good question. Yes, we have such kind of remuneration aspects in place. So, when it comes to e.g. the bonus estimation, then it is part to look into the fulfillment of our growth aspiration. Therefore, we told you yesterday that we have made the very detailed kind of strategy in a bottom-up process, which means we have good numbers for each and every business. So, for the local operating managers of the business units acting here in China we have it on a very detailed level what we expect in the forthcoming years, what sales and earnings they should achieve.

From that the incentives are clearly in place to be focused on growth and profitability. It is not just one KPI, but for sure profitability is associated.

Bill Cross (Eaton Vance Management): This is really one and a half question. The first is perhaps a correction over typo on slide 22. If we look at it, it would suggest that your expectations for automotive chemicals sales in China are both under your 11% targets more generally for the country and also less than your global automotive chemical sales. The picture suggests this is not correct, but the number suggests… Is that a typo?

If it is not a typo, why would you, in this important focal growth market, be growing slower in automotive chemical sales in China than you would in your automotive chemical sales globally and in your overall sales?

Albert Heuser: This is the global picture; it is not the China picture. Therefore, I mentioned you know this already, because it was used in September 2012 for the Investor Day dedicated to our automotive business. So, this is a well-known picture. And I said, we will contribute to this target of €17 billion because the overall growth takes place in China. Therefore, we in China will over-proportionally contribute to fill that jump from €9.5 billion to the €17 billion. That is a global picture.

Bill Cross (Eaton Vance Management): Okay. You are not saying that China's growth in automotive chemical sales is at 6.7% compounded?

Albert Heuser: No. The yellow color indicates BASF automotive chemicals sales in China. It is somehow a smaller amount today and it will be a much bigger proportion in future.

Jeremy Redenius (Sanford Bernstein): Looking back in that chart that Bill pointed on page 22, I am just doing some rough very sophisticated analysis; I get you about 20% growth rate for that yellow area.

Magdalena Moll: Honestly, this was really only a guess. The yellow part is only an indication...

Jeremy Redenius (Sanford Bernstein): It is a big number. The fundamental question is: Where does that growth come from? Maybe you can dimensionalize it. Does it come from multinationals producing in China or more from Chinese producers? What would that mix look like? How much assuming about auto production growth versus material substitution versus more chemical usage in auto?

Albert Heuser: I indicated that we expect a lot of new chemical solutions in the Chinese automotive market. I made this comparison, 6% to 8% of the cars is plastic materials in China. For a European car it is double as much. It tells you what enormous potential exists in this market only by replacing in the existing volumes of automotive production. Then on top you have this dramatic increase in car production more or less coming from the 17 to the 30 million cars. This is the second part of your question…

What is our expectation? Will it be a different kind of split between Western brands and perhaps here the local brands? We expect that the Chinese automotive market, will see much less Chinese OEMs in future, but much bigger ones, because today you have more than 80 Chinese local OEM brands - -

There is a clear tendency supported by the government to have much less to create perhaps the one or the other global brand over time. We, for sure, try to identify the future winners of the Chinese OEMs and work closely together with them.

Jeremy Redenius (Sanford Bernstein): Can you give us a sense where you are starting from now:

90/10 multinational versus Chinese producers or closer to 50/50?

Albert Heuser: This is hard to say. This is too much of gut feeling, I would say. That is a question perhaps more to an automotive expert from Volkswagen or whomever; or a consultant group. But, there will be a clear tendency that the cake of the Chinese OEM will be much broader in 2020 than it is today.

Jaideep Pandya (Berenberg): Can you give us a feeling in your current setup excluding the cap ex projects, what is the potential for you to grow the five billion sales to? If you exclude all the investments that you were talking about in your current setup, what can that €5 billion be in the next five years or until 2020? I just want to know what is your current utilization?

Albert Heuser: For sure, this is now that I do not have one single number. You have to look into each and every detail. As I said yesterday – and you will hear more about it by Stephan –, the petrochemical industry just right now in China looks different than e.g. everything that goes into the automotive industry. Automotive industry for us is a bigger double-digit number. Therefore somebody derived a number. It is not the 10%, it is more how we grow with that industry.

If we look into petrochemicals, for sure, it is a different picture. Sinopec, Petrochina were not earning money in the first quarter with their petrochemicals. So that is a

proxy for the market. If you look in BASF's nutrition and health business, we are on a very good track just right now in China.

So you really have to go business by business. If you look to construction chemicals, it looks a bit different as well, as we decided to switch over to more high sophisticated products and that has a few consequences: we give up one or the other product and by this reduce perhaps even sales for a certain period of time.

Therefore I can't give you one single number.

Topic: BASF profit performance

Bill Cross (Eaton Vance Management): Then also another slide related question. On slide 12 you observe that the profit growth has been more rapid than the sales growth for the eight year period. But looking over the last couple of years it would appear that the profits have plateaued. So, can you give us a sense of the margin outlook? You have talked a lot about the sales outlook. But what is the margin outlook? To the extent that you expect margins to expand, how do you intend to do that?

Albert Heuser: I think this goes back to a point, which was already discussed yesterday. Yes, we feel more competition. Therefore, there is a certain pressure. But nonetheless, with our development going more downstream, going more to establish ourselves as a solution provider, we see that looking forward we can at least keep or improve the margins. For that we need the one or the other investment. Therefore investments - in specific for downstreams - are important. However, all the downstream developments we do here in China need somehow the well-established raw material supply from the upstreams. Therefore, here in China, what you see and what we do is to invest not only in the downstreams, but doing in the upstreams as well.

Later we have a good example: Mingwei Qin will talk about one plant, which we will inaugurate tomorrow, which is then using raw materials from BASF-YPC. So, without these raw materials it would have been hard to come to a project and to an investment. That is how it is working and how it is connected.

Paul Walsh (Morgan Stanley): Mine was something on observation as well relating to that chart. I understand that the competition is increasing and the Chinese EBITDA has been somewhat stable. But the charts you showed yesterday showed Asia Pacific suffering a €300 million decline in EBITDA. So, it doesn't look like it is China that is responsible for the absolute decline. So, can you just talk a bit about which markets have actually faced the bigger drops in profitability?

Albert Heuser: Obviously, as we discussed yesterday, in other markets in Asia Pacific where we do not have to the full extent an own manufacturing within the market, there we suffer a bit that we do a good business. But the earnings and the profitability is shown elsewhere. As we have meanwhile have done investments with

more or less €6 billion over the last 20 years, we have already an established footprint of own manufacturing here in China. We do not suffer the same like perhaps other parts of the entire region.

Paul Walsh (Morgan Stanley): You mean Japan, India…

Albert Heuser: Sure, parts of it is Japan, where you have this extra burden of currency effects. It is partially India where we import a lot of materials, where, by the way, the growth rates are not terrific just right now. So, sure, it is in those markets.

Lutz Grüten (Commerzbank): I have a follow-up on page 12 again. The EBITDA growth rate, which was indexed there, is it based on the EBITDA number as you see them here in your local reporting or are they adjusted for imports and the lower trading margin related to that? That is the first part of the question.

On page 15 you give a growth rate for sales and now you are saying EBITDA margin should be stable at least, saying that the CAGR for that EBITDA then should be at least 11%.

Albert Heuser: Coming to the first part, it is a local company EBITDA plus the margin, which is coming from elsewhere on top.

Lutz Grüten (Commerzbank): That's important. If you are saying your margin should be at least stable that means that the CAGR you are looking for 2012/2020 EBITDA should then be at least 11% as well, as the top-line forecast?

Albert Heuser: For sure, as mentioned yesterday, we want to and have to contribute to the group's overall target. That is what we have announced. As we do anyhow our investment decisions based on what is the profitability - and you learned yesterday we have more project ideas on global scale than money - then it is very clear that we have to deliver profitability and earnings in sense of EBIT and EBITDA, which is competing to other regions. In other words: It has to be more or less on the same level.

Topic: BASF investment projects

Jean de Watteville (Nomura): My question is actually on the first presentation. It is on the capex budget that you presented. I just wonder if you can help me to understand and reconcile it with what has been said yesterday. If I understand it correctly, you are telling us that in China you expect to grow sales by €7 billion, which is more than half of the growth that the group expects in Asia Pacific.

You also said in your presentation that capex in China is expected to be €4 to €5 billion with partners, so probably BASF's share being lower than that. So it clearly

seems that the capital intensity of the growth you expect in China is much lower and therefore a lot of leverage from existing assets which we can quite understand based on which you presented.

But that also means that the capital intensity outside China is incredibly high. Is that something I am missing? Or can you help us to reconcile or is there a huge Verbund site that you plan to build in Mongolia or somewhere around China to just supply China? Just help us to reconcile, please.

Albert Heuser: That's a good question and a good observation. But for sure, in China, as you have learned today, we have a lot of assets in place. So we are able to do investments by letting the assets sweat; with small money achieve some additional capacities. So, therefore, the money needed per capacity is less than building something grass-roots.

The second point in China is: We look much more for downstream investments because we have this Verbund site. In Caojing, a another important site, we get a lot of the raw materials for downstream activities as well from existing other potential suppliers. So such sites exist here in China. Therefore, the investment capital needed here in China is less – right observation – than we need e.g. in ASEAN or India to build up a higher footprint in production there.

Then it comes to the effect already discussed yesterday. If we look e.g. to India – take that as a proxy – if we would build acrylic acid, butyl acrylate, SAP and all that, it somehow needs a step in front where the propylene is coming from. If we do the investment potentially by ourselves or with a partner then you will not find any sales from that kind of raw material supply because it is within the company, it does not generate sales.

Therefore, we have this typical thing very often in the company: We spend a lot of money, but you do not find back the sales immediately on that step. You only find it back in the downstreams. So, capital intensity, therefore, is looking higher for the other parts of the region. Does that make sense?

Timothy W. Jones (Deutsche Bank): Forgive me for my pronunciation, but is it Xinjing, the investment that you are doing with Markor?

Albert Heuser: Xinjiang, this is the province. The place, the city is Korla.

Tim Jones (Deutsche Bank): That's probably easier. Yesterday you talked a lot about you look for preferential raw materials and you trade that against your technology. So, I can sort of understand that with Chongqing and MDI. But I am a bit more confused about what you are offering in technology for BDO, PolyTHF and things. You yourself said they have an established chemical platform. So, what is BASF bringing to that platform in terms of technology?

Albert Heuser: We bring the technology for PolyTHF that is not known to Markor. They have already running an acetylene, BDO and THF complex. In the first part we

will jointly build new BDO capacities. In the final stage we will bring PolyTHF as our technology to them. That is perhaps the trigger.

Timothy W. Jones (Deutsche Bank): But you are not the only producer of PolyTHF that can offer technology? So, I understand Verbund and engineering and things like that, but I am still struggling with what do you offer that another company doesn't offer. Is it the view longer term further downstream, down to a – let's say specialty chain, that you can further develop or is it just a cost issue?

Albert Heuser: First of all, you are right. There are other PolyTHF producers in China. They do not license their technology, like we don't do. We do not license this technology. Therefore, Markor had either to develop themselves or find a partner. We partner now up with them. That is step number one.

Step number two is: If you go there, then you understand, that much more is feasible. It could be a starting point even for doing more, not talking about BDO downstream value chains only, but other value chains as well.

Therefore, I mentioned, it is a very well established production already that they have built in a phase 1 and in a phase 2. Now together with us, they come into a phase 3. They already have ideas for a phase 4. Honestly, for sure we will look into potentially teaming up even more deeply in that phase 4.

Norbert Barth (Baader Bank): I had a question on this joint venture in the West with Markor. Is that planned to be 50/50, too?

Albert Heuser: We will establish two joint ventures, one joint venture where we have a clear majority to be able to consolidate. It will be 51% owned by BASF for the PolyTHF. That was, I think, one question by Tim: What do we bring to that relationship and to that partnership? That is what we really want to own because it is our technology. In the other joint venture, we will form, we are in a minority position. There we have only 49%. That will be for THF.

<u>Topic: miscellaneous</u>

Norbert Barth (Baader Bank): The second question: You mentioned this railway connection. Can you give us a little bit of an indication what that means from the cost side compared to shipping it, then also from the time you need, so that we can a little bit have a feeling on that?

Albert Heuser: Then the railway connection. What is of interest: To bring material from Chongqing to e.g. Rotterdam takes less than two weeks. So roundabout they target 10 to 15 days. That is remarkably faster than any shipping route. For sure, if you think about shipping routes, normally from Rotterdam to Shanghai or to Hong Kong would take you four or five weeks, only for the cruise and then bringing it out of

the customs area. Then you have to bring it inland to Chongqing. From that you see the big advantage when it comes to lead time.

Cost: I am not pretty sure to give you a good number. But I gave you the examples. Other companies start using it. It will be established. Let’s see how this develops over time. We watch out very carefully because we think that, at a certain point in time, it could be of interest for us as well.