

Transcript

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BASF Investor Day Asia-Pacific Transcript Q&A session

“Creating a competitive advantages with a Verbund in China”
by Stephan Kothrade

and

“BASF Specialty Chemicals”
by MingWei Qin

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Joint Q&A

“Creating a competitive advantages with a Verbund in China”

by Stephan Kothrade “BASF Specialty Chemicals” by MingWei Qin

Topic: Expansion projects

Thomas Gilbert (UBS): Can I just explore what it means when chemical companies say that an expansion is “under consideration” on the C2 chain, the ethylene glycol, ethylene oxide chain? Is it under consideration because Akzo has added capacity in Ningbo, there is overcapacity, so you are waiting for the market to balance? Is that an opportunistic waiting or is it the joint venture partner disagreeing or is it a bottleneck of engineering? Why is it under consideration?

Stephan Kothrade: Obviously, there are various reasons and parameters you have to consider before you take the final decision for building a plant. You mentioned some. Unfortunately, please understand that I will not disclose now the current status and details of our internal decision making process. Obviously, the partner is also involved into that. I can only tell you: If we put on a slide that we are considering a certain project, we are considering it. It is not just a fancy idea that we created yesterday. So, there are some serious thoughts behind it, there is some strategy. But we are not yet that far that we can wholeheartedly say, we will build this plant. This also can have to do with the approval and permitting procedures related to government authorities etc. So, please understand that I cannot tell you more at this point in time. That is why we differentiated on the slide between the plants that are already under construction – they will come on stream next year – and the other plants and projects that are, again, only under consideration so far.

Thomas Gilbert (UBS): Permitting still also plays a role? Do you have to set up for each and every expansion a permit again from the local government or even from the NDRC, from the national authority?

Stephan Kothrade: Permitting in China - like in many countries - is not just a one-step process. You need several permits to start a project in China. We have a project application report. You need a construction permit, an environmental impact report. So you never get all the permits upfront and then you start construction. This goes in parallel. So, you never have at such an early stage all government permits. This is impossible. It is a standard procedure. We know very well how to do this. So we are on track.

Jeremy Redenius (Sanford C. Bernstein & Co.): Thanks for the presentation. For a couple of the expansions downstream I am just trying to understand the value crea-

tion model. Is this an example like SAP or the flocculants? Is this an example of backing out imports to increase your OMP? Or is it some other type of value creation you had in mind?

Secondly, where is the propylene coming from? It looked like you had a couple of different very propylene-heavy products.

Stephan Kothrade: Let's start with the first question. Indeed, when we invest e.g. into SAP, this is to have a local manufacturing base. We are following our global key accounts in this market with premium-quality SAP. They expect us to be present here as well. We have the full backward integration here at the Verbund site, so it is the perfect fit to build an SAP plant. Of course, currently we are already present in the market. We are importing. Later we will have local manufacturing.

Another example: neopentyl glycol, NPG. This is not only capacity we establish here in the Chinese market. It is also an addition to our Verbund because the key raw material to NPG, isobutyric aldehyde, is a side-product of our oxo-alcohol plant. So, we have the key raw material, we have the full integration and, again, a nice additional building block to bring our Verbund to the full potential and at the same time increasing the local manufacturing base for BASF.

The second part, the propylene: Yes, you are right. Well, we have an own steam cracker and we have some propylene that we can use to manufacture these downstream products. You are right, some of these activities would need a huge quantity of propylene and this is also part of the considerations we are making together with our partner, the raw material supply, the technical setup, timing etc.

Laurent G. Favre (Bank of America Merrill Lynch): It is a question on superabsorbents and the global footprint. You have talked about how you get a lot of dynamic growth internally and you want to reduce the OMP. But you are not the only one having capacity in the region. You also have the Middle East, Brazil yourself. I am just wondering what is happening in your capacity in Western Europe or in the US. Are you thinking about shifting some of that down? Or are you just hoping that there will be another demand growth?

Stephan Kothrade: Please understand: I am the President of BASF-YPC. I cannot speak now on behalf of BASF in Europe. But I don't think that we are about to shut down any of our capacity. I also used to work in Antwerp. This is also a fantastic site. We have full Verbund integration for the most important superabsorbent capacities we have world-wide, that is Antwerp, Freeport, in future Nanjing. So we have an outstanding cost position. We are cost leader in acrylic acid. So, we are in a growth mode. That would be my answer to that. If you need more details, I would ask Albert to comment.

Albert Heuser: When it comes to SAP, you heard that it is under construction. So obviously, we took a concise decision that there is a profitable project. I can add: It is not only the project under execution here in Nanjing. In parallel we took the blueprint of the acrylic acid plant and the SAP plant and the butyl acrylate plant, which is here under construction, took the blueprint to the same engineering office in Beijing and

made it to build in parallel in Brazil. This tells you something about the capability to look for a lot of synergies in how to have cost savings in the project design, in all that kind of engineering, detailed engineering, and have project execution in two different regions and have more or less a copy/paste situation.

From our point of view, there is an urgent need for these SAP capacities in China and in Brazil – for dedicated qualities; perhaps this is a trigger and a point which could answer your question. With our technology we are capable to produce a certain quality level which is urgently asked for by our key customers.

Stephan Kothrade: Now we are talking about fluffless diapers with a higher content of SAP and you need a premium quality. Not everybody in the market is capable of supplying that to global key accounts who are leaders in their market for superabsorbents for diapers. This in combination with a backward integration, which I also do not see with other players in China, I think we have a very unique position.

Topic: Partnership with Sinopec

Christopher H. Willis (Impala Asset Management): Could you just elaborate a little bit on your naphtha purchases? Do you have a cost advantage, given your relationship with Sinopec – you are buying at a discount – to a local index?

Stephan Kothrade: The first big advantage is that, because we get all the naphtha from Sinopec – 95% plus – we have a very stable and reliable supply. We have, as I said, a direct pipeline connection to the JPC refinery south of the Yangtze river. So there is a very reliable supply. And we have six other Sinopec refineries which can supply us by ship. This in itself is a huge value. Then there is also some cost advantage in logistics related to this situation which we benefit from as well. Yes, right, we have a cost and a reliability benefit because of our partnership.

Tony Jones (Redburn): Could you talk a little bit about the roles of engagement with your partner from the perspective of process technology? As you are moving downstream – you showed the acrylics example – you are introducing some of BASF's proprietary technology. So what are the ownership rights and what is the protection of BASF's own technology?

Stephan Kothrade: Well, it's the same situation as in other joint ventures in other parts of the world. We get a licence from BASF and this licence is respected by the joint venture. I tell you, if we would have the feeling that this is not the case, we would not keep on investing with our own technology at this site. So, there is a lot of trust.

That is why I said: It's not only a partnership; we have a grown partnership. You see that we are expanding this concept now also to other sites. You may have read about the INA investment at Maoming, another huge petrochemical and refinery site of Sinopec in Southern China. So it is really based on trust.

Timothy W. Jones (Deutsche Bank): Stephan, I apologize for this question. But your predecessor, Dr. Blumenberg, was a larger-than-life character. So, obviously, there are very large shoes you have to fill. How has the transition from Sinopec's perspective gone? Have they accepted you very quickly? Have there been any cultural transition issues? Or has it been incredibly smooth?

Stephan Kothrade: You are right: My predecessor is a living legend in this part of the world. The transition was very smooth. What I benefitted from is that Bernd is so well connected that when you show up somewhere with him all the doors are open. So basically his network – not fully, of course, because it is a personal thing – was from the very beginning open to me as well. So it was a smooth transition.

You can ask Sinopec how happy they are. I think they are very happy, especially with the performance we showed now in a difficult year 2012.

Jaideep Pandya (Berenberg Bank): If we stick to the example you gave, DMA3, could you tell us the output that you have in the Verbund site and the flocculants plant, the batch size? Is it connected?

Mingwei Qin: Yes.

Jaideep Pandya (Berenberg Bank): And you are only buying from the BASF Verbund site or are you buying from external players as well?

Mingwei Qin: For DMA3, we only get it from BASF-YPC.

Stephan Kothrade: The scale of the investment was made to make sure that there is a fit. So BASF-YPC is supposed to be the backward integration of the wholly-owned BASF site. There is a strategic rationale behind the investment. It was not the idea to sell DMA3 to the outside market, at least not in large quantities.

Topic: Economic environment

Alexander P. Scurlock (Fidelity Worldwide Investment): You referred through the presentation to waste products. Could you specifically address CO₂ and implications with regard to how much is produced? What happens if we start to see regulations of CO₂ either at provincial or state level, and from that, actually implications in terms of relative competitors' positioning?

Stephan Kothrade: First of all, the CO₂ topic is not only a topic for BYC here in Nanjing. It is a situation that is considered now across China. Some provinces and cities

like Shanghai, Tianjin, Chongqing etc. are pilots in this respect and they are now trying to figure out how an emission trading system could look like. We are at a very, very early stage.

Jiangsu province is not part of these pilot provinces, so we are not yet directly confronted with the situation. Of course, we observe that and we are part of a steering committee within BASF Group. The same of course within Sinopec Group - here again we benefit because we have two parent companies which are well connected.

If you would like to know now the current situation - because BASF China is now in the lead - I would pass on this question to Albert. But I can say, yes, we know about that – first answer. Second answer: There is not yet a clear picture what the authorities will ultimately do. So, thirdly, it is too premature to talk about consequences and measures.

What I can say, generally speaking, is: we have a huge Verbund site and integration does also mean energetic integration. So, per se a Verbund site is very efficient in terms of energy consumption and this will help.

Albert Heuser: Perhaps to add a bit: What happens right now is a kind of evaluation phase. Government and authorities want to learn what the CO₂ volumes are and they try to relight then what kind of production is associated with the CO₂ emissions. All that happens right now. So a clear scheme to have a price ticket on CO₂ is not yet established. But for sure, we expect something to come. As Stephan mentioned, it is not yet an all over China approach, it is dedicated to a few hot spots, very industrialized spots. But we all expect it will be broadened.

That comes later, perhaps, in a couple of years back to the discussion we had yesterday: What could it mean potentially for all these coal-based chemical projects? No answer yet. But we realize there is work in progress being started by Beijing.

Mingwei Qin: As a local guy I think you can also learn this information from some media. There are some discussions about the CO₂ emission. So, you can also get this information from the newspaper or some news release.

Topic: Financial performance

Ronald Köhler (MainFirst): I just have a financial question to BASF-YPC. Did you ever pay a dividend to the mothers? How is your strategy going forward with all the investments you are also planning?

Stephan Kothrade: For sure, we are paying dividends to our parent companies on a regular basis – yes, we do.

Ronald Köhler (MainFirst): Despite your capex you are now planning, you will continue to pay out a dividend?

Stephan Kothrade: Yes.

Ronald Köhler (MainFirst): Which means that the majority of capex is debt-financed?

Stephan Kothrade: It is a mix of both. The order of magnitude of the dividend is adjusted to the financing needs of the projects. It is quite balanced.

Thomas Gilbert (UBS): It is a modelling question. Obviously, at BASF-YPC we have to now look at, if any, the net income progression. You very kindly gave us sales and the EBITDA. Is it fair to assume that the net income trend will follow the EBITDA trend, so no funny things in terms of restructuring charges, depreciation, tax, financing? Is it fair to say that if the operating performance of the joint venture improves, what we will see in the consolidated results of the group, the net income contributions go up? Or were there tax benefits on the capex that are running out etc.?

Stephan Kothrade: As you said, there will be no fancy, unexpected, strange things. What I can tell you is that we are working very hard on the efficiency. So the bottom line will benefit from all these activities I mentioned around operational excellence for sure.

Thomas Gilbert (UBS): So basically the net income growth will even be faster than sales?

Stephan Kothrade: That's what we aim at.

Paul Walsh (Morgan Stanley): Mine is just a quick question, really. Has the profitability of the JV improved this year versus last year?

Stephan Kothrade: We are not yet through. What we saw is a margin squeeze during 2012 and basically the situation is still the same. So there is not much of an improvement. I am speaking now for BASF-YPC and petrochemicals.

Andrew Benson (Citi Investment Research): I have two things, if it is possible. You restated your sales and you are going from 5 to 12, wholly-owned sales. But you have taken out 1.6 billion of associates. I guess that some substantial part of the associates is this one. How significant will associates be in the growth through 2020, if you could kind of dimensionalize that?

The second point is: How do you determine whether a plant is going to be a BASF plant or a joint venture plant? How are you going to do that in the future to avoid disputes?

Albert Heuser: I am not pretty sure whether I got the question right. I understood that you wanted to know a little bit more about how the influence of this new IFRS

reporting has consequences looking forward with respect to BASF-YPC. As mentioned yesterday, BASF-YPC is a 50/50 JV. Neither of the two mother companies has full operational responsibility. Therefore, we are not able to consolidate, as Sinopec is not able to consolidate. Therefore, you will not find the sales of BASF-YPC back anymore, and we had to deduct this in our BASF reporting in the sales numbers. In the reporting of profitability, on the EBIT level, you can find it back, there BASF overall - but I think that was explained when we made the change of IFRS reporting - BASF decided not to show the earning return on the level of Others, but to show it one level up. So from that: Earnings we report, but not the sales. And looking forward, I do not see a change.

Andrew Benson (Citi Investment Research): Your wholly-owned sales on a restated basis are going from 5 to 12.

Albert Heuser: It went down to 5.1.

Andrew Benson (Citi Investment Research): On the old accounting standard. How much will associates play in your growth, even though we won't see it?

Albert Heuser: We had this question, I think, yesterday. Roundabout all over Asia Pacific we had to deduct from our target 2020 the 4 billion. You know the announcement: We wanted to achieve 29, now we say it is 25. So obviously €4 billion are gone. That is the overall effect for the entire region.

BASF-YPC is our biggest and most important joint venture in that. We have then two joint ventures in automotive catalysts, one in Korea, one in Japan. They are very important and show a remarkable effect as well. Then here in China we have some other 50/50 JVs, e.g. another one with Sinopec; we call it SGBD. It is near the site where we were yesterday. So these are the ones that go out. In total, they come up with 4 billion in 2020. That is the effect.

Andrew Benson (Citi Investment Research): How do you decide whether it is a wholly-owned plant or a JV plant?

Albert Heuser: There are clear structures how to come to a description: Are we controlling the joint venture or not? If we do not control, then we can't consolidate. In this case, as our joint venture contract says, we are not in full control of this joint venture.