150 years

BASF
We create chemistry

BASF 1st Quarter 2015 Analyst Conference Call

Transcript - Q&A Session by Topic
April 30, 2015

Contents

1. Group

Lutz Grueten (Commerzbank): Thanks for taking my question. It is regarding the operating cash flow, plus 36%. You have mentioned that inventories have been reduced in the first quarter. Is it fair to assume that there is a further reduction on the way on net working capital when the maintenance shutdowns will occur? Could you please remind us when these planned maintenance shutdowns will show up, in the second or third quarter?

Hans-Ulrich Engel: Lutz, thank you for your question. Yes, as you noted, we had a nice cash inflow as a result of what we announced, by the way, last year, the focus on management of our working capital. We have seen the inventory reductions that we wanted to achieve in Q1. We have set ourselves clear targets for the entire year with respect to working capital management. As I said, results of that you see already in Q1. Expect our turnarounds to be relatively evenly distributed over the four quarters of this year. Yes, of course, we will have to manage our inventories accordingly to prepare for the respective shutdowns. But you shouldn‘t expect anything there out of the ordinary.

Paul Walsh (Morgan Stanley): My question is pretty simple. If I look at the divisional beats across the first quarter, they are obviously very, very strong. I am just wondering what is holding you guys back from projecting a more positive message around margin development and EBIT development this year? I understand it’s early in the year. But I am just curious to know if any of that strength across the divisions is somewhat temporary or you are expecting it to fade?

Hans-Ulrich Engel: Paul, that is an excellent question. Let me answer it as follows: You have seen in Q1 a lot of what I call noise; you can also call it volatility. You look at raw material price developments and you know how our upstream segments are depending on raw material price developments. That has been very favourable in January, not so favourable in February, then again favourable in March; so there was an interesting development there. You have seen what the oil price has done. Yesterday the close was at 65 US dollars per barrel somewhere in that order of magnitude. We have seen naphtha prices all over the place – 370 USD/t as a low, 550 USD/t, which is the current price, as a high. So, what do I want to say with all of that? There is no room to actually change our guidance at this point in time. We have delivered what I would call a good first quarter in a volatile environment. We have seen actually that demand also showed an interesting pattern: January and February relatively weak and then we have seen an uptake in demand in March. That is an interesting one, because in, I would say, almost all prior quarters the development was a strong first month and then a weaker third month in the quarter. So there were a lot of factors out there that lead us to say: We stick to our guidance and we feel good with that.

Andreas Heine (Barclays Capital): My question is basically again on FX. You have given an FX sensitivity for the year, €50 million (EBIT impact of a USD 0.01 change p.a.). If we would use this sensitivity for the first quarter, would that give the right understanding what the FX impact in the various segments has been? Or have you seen different movements in the first quarter?

Hans-Ulrich Engel: The general answer is: Does Q1 reflect what we give as a general guidance for the US dollar? Be reminded, this is for the US dollar only. Yes, it

does clearly reflect that. But then, when you look into the various segments and the various operating divisions, the exposures can differ there, depending on where they have their respective businesses and in what currency they do their businesses. But we fully stick to one US dollar cent to the euro on a full year basis, equal to €50 million in EBIT.

James R. Knight (Exane BNP Parisbas): I may have a boring question. If you look at the cash flow, the notes to it, you mention higher provisions, especially for rebates. Is "Others" rebates concentrated in any segments? Am I being a bit too cynical maybe linking them with the very strong start in Ag?

Hans-Ulrich Engel: That is not at all cynical. You came to the right conclusion there. The rebate programmes are typical in the Ag business and there primarily in North America. I think that pretty much answers it.

James R. Knight (Exane BNP Parisbas): Okay. Are they significantly higher year on year? Why comment on it otherwise?

Hans-Ulrich Engel: They are not significantly higher, the rebates, than in prior years. They are slightly higher reflecting the higher sales and, again, the impact of foreign exchange.

Jeremy Redenius (Sanford C. Bernstein & Co.): Could you talk about the price developments throughout the quarter? I am particularly interested in Performance Products, Functional Materials & Solutions and in the Ag business.

Hans-Ulrich Engel: Price developments in Performance Products and in Functional Materials and Solutions: We have seen overall, Jeremy, slight price declines in Performance Products. It is what we explained already when we did our Annual Press and Analysts Conference in the end of February.

The further upstream you are, the closer your pricing is related to raw materials. The further downstream you go, the lower the impact from raw material, in particular oil price related pricing. You see exactly that. In Performance Products we have a slight price decline of minus 3%, which can be explained with what we are seeing in raw material pricing. In Functional Materials and Solutions, we have a price decline of minus 1%.
When I take a closer look at what is happening there in Functional Materials and Solution, then that price decline is almost 100% driven by precious metal pricing. You have seen how precious metals have developed with platinum in the 1150 US$/troz (try ounce) range, so lower than where we were last year. That is what you see reflected in the price for the entire segment.
In Agricultural Solutions, which I would describe as the furthest downstream segment, you see a nice price increase there of 4%. I think that is what I can provide as an explanation.

Tony Jones (Redburn): I just wanted to go back to currency again. A quick calculation this morning suggests that the gain from euro/dollar was round about €250-260 million in the quarter and then offset by around €50 million from other currencies, so a strong net gain around €200 million dropping through to EBIT. Does that sound reasonable? Should we be modelling that sort of effect drifting also into Q2?

Hans-Ulrich Engel: The €250 million figure that you mentioned, Tony, I would say, sounds very reasonable to me.

Tony Jones (Redburn): And the offset, the €50 million offset from other currencies? Or is there no offset?

Hans-Ulrich Engel: The €250 million, I think, is a good figure for the entire EBIT effect that we see in Q1.

Christian Faitz (Kepler Cheuvreux): Could you give us a rough quantitative idea how the positive FX element contributed to the profit improvement in your three chemical divisions, so on the EBIT line?

Hans-Ulrich Engel: Christian, this is an excellent question. But I think the fact that we are providing the FX impact on an EBIT level for the Group should actually be sufficient. I would not like to go and break this down on the segments.

But let me say this: We provide by segment the FX impact on the top line and that may help you in doing the calculations.

Laurent G. Favre (Bank of America Merrill Lynch): I have two, I guess, boring questions; the first one is on the minority line. I was just wondering if the Q1 level of minorities is purely reflecting the profitability of Port Arthur and the Oil & Gas business or whether within that number there is a bit of an exceptional item as well. In other words, if we assume that the current profitability is here to stay, should we assume that the minority level is here to stay as well?
The second question is also on the tax rate. I am just wondering there again, at the Q1 level, if there was anything exceptional in that Q1 number? It's a little bit high, given the absolute level of profitability in Oil & Gas, at least to me.

Hans-Ulrich Engel: The first question on minorities: You see an increase there. Yes, that is driven by Port Arthur, but to a larger extent it is actually driven by our gas trading business and the participation there. When you look at our gas trading business, you see an increase in EBIT there of over €100 million. That is actually the explanation. Maybe one word with respect to that: I would say, in Q1 the stars aligned perfectly for our gas trading business. We also had an impact of price revisions there. Don't expect it to go forward on that level, in particular not because we are now entering the low season for the gas trading business. So, to make a long answer short: Yes, it is predominantly Oil & Gas and there gas trading. On the tax rate: We have an increase there of almost five percentage points. Keep in mind, please, that last year we had tax-free income from the divestiture of selected Oil & Gas activities of, if I recall that correctly, €130 million. We don't have that effect or a comparable effect in Q1 of this year. Then we also had, as a result of our increased Norwegian oil production activities, higher tax impacts and we will need to see how that will play out during the course of this year. It could well be that, as a result of the higher oil and gas production that we have, we see a slight increase in our tax rate. But, again, give us a quarter more and we will have a clearer picture of what is going to happen there overall.

Laurent G. Favre (Bank of America Merrill Lynch): Okay. So with this kind of EBIT, we should have this kind of EPS? Is it the other way to look at it?
I am just asking given that there was such a big delta on the EBIT and such a big delta on the EPS. This is consensus.

Hans-Ulrich Engel: I would say, not necessarily. Again, a tax rate of almost 30% seems to be a little bit on the high side.

2. Regions

Asia

Paul Walsh (Morgan Stanley): Did you see a good pick-up in China after New Year or not?

Hans-Ulrich Engel: The pick-up in China after New Year was actually – how do I put that? – maybe not as pronounced as we would have expected it.

Peter Clark (Societe General): It's just looking at the Asian margin again. Obviously, it has had a lot of focus. For the first time, you are up year on year for quite a while. I have heard what your comments are about the volatility, what has happened in China, slightly weaker than expected after the New Year, but obviously very strong into it. I am just wondering how you see that moving ahead. I am just wondering, within that, actually: Was there some forex benefit on the reported Asian margins?

Hans-Ulrich Engel: The margin in Asia: First of all, we see in certain areas margin improvement. If I think e.g. about the cracker margin, that has developed nicely in Asia in 2014. When I say "nicely", I look at the improvement. Are we happy with the cracker margins in Asia? No, we are not. But they have improved through the course of 2014. They are higher in Q1 than they were in prior-year quarter. They are actually a bit lower than what we have seen in Q4.

There are other areas – and this is in particular in the downstream areas, so in our Catalysts business, but also in our Coatings and in Performance Materials business – where we see margin improvement. Currency plays a role also in the margin improvement, but does not fully explain what we have seen. So there is also the market and the demand supporting overall the margin improvement that we have experienced in Asia.

Peter Clark (Societe General): And you are confident that this sort of thing can continue?

Hans-Ulrich Engel: We are certainly working on that.

Asia & North America

Laurence Alexander (Jefferies & Company): The comments around elevated MDI margins. Were there any regional differences?

Hans-Ulrich Engel: Yes, there are regional differences. Asia I would describe as weak. In Europe, we saw a strengthening of the MDI margin. In North America, the margin continues to be on a relatively high level.

3. Segments

3.1 Chemicals

Laurence Alexander (Jefferies & Company): Can you clarify two of your segment comments? You mentioned North America cracker margins being down. Was that just Port Arthur? Then on the comment about MDI margins: Was there any regional diversion there?

Hans-Ulrich Engel: Yes, the comment on North America relates to the Port Arthur cracker. In fact, there are two impacts that were caused by the cracker in Port Arthur. We had technical issues for about four weeks with the cracker. We couldn't run it at full capacity. Then we have experienced an environment where cracker margins came down significantly from the high they had in, if I recall it correctly, Q3 of last year. Cracker margins are, compared to the high, in the order of magnitude of 55 to 60%. These are the two impacts from the Port Arthur cracker.

Mutlu Gundogan (ABM AMRO Bank): A question on the petrochemicals business: You had some production issues in ELLBA – that is known – and also in Port Arthur. Could you give us the impact on EBIT of those production issues?
Relating to the plant in Moerdijk: When will you expect that plant to restart again?

Hans-Ulrich Engel: On the ELLBA plant in Moerdijk: As you may know, we are not the operator of the plant. That is why I just want to make sure that I stick to whatever guidance was given there by the operator. – Here I have the information: end of Q1 2016, beginning of Q2 2016.

Please understand that I will not give you details on the impact of the outage in Moerdijk and the Port Arthur cracker. Expect that in combination of the two it will probably be something like, I call that, mid-double digits.

3.2 Performance Products

Jeremy Redenius (Sanford C. Bernstein & Co.): Sorry, I was also asking about pricing with respect to Performance Products, was there a deterioration through the quarter or was it straight down 3%? I am just more interested in the trajectory through the quarter.

Hans-Ulrich Engel: You know we didn’t see price decreases through the quarter. No, I wouldn't say, any type of significant price movement there.

3.3 Functional Materials & Solutions

No discussions or questions on Functional Martials & Solutions.

3.4 Agricultural Solutions

Andrew Benson (Citigroup): I just want to explore the agriculture a little bit more because your performance has been a stand-out relative to others. I was wondering how you would see the rest of the year or whether there is any particular aspect of phasing which drives the business to the first quarter as opposed to the first half or whether you simply think that the new products are helping outperform.

Hans-Ulrich Engel: I think, Andrew, first of all I should reiterate what we always say: Looking at just one quarter doesn't give you the full picture. We had a very good start into the season in Europe, but also in North America. We have seen a volume increase, we have seen price increases. But I would say, to really come to conclusions here, it is too early to say. The season in the Northern hemisphere is in full swing. Let us take the first two quarters and then take a look at what kind of development we see overall. But we are definitely happy about the performance that we have seen in Q1. Let me maybe say one more thing with respect to not just looking at one quarter. You may remember that we had not such a great performance in Q3 of last year. We got actually hammered for that. Then we had a very good Q4 and we have what looks in comparison to competition like a good to very good Q1 2015. So that forms a solid basis for what we had said with respect to our expectations for the full year, which is to see a nice increase in earnings in our Ag business. What is certainly contributing to that are launches that we made in the relatively recent years. Xemium comes to mind, Kixor comes to mind. So we have good product offerings, in particular good product offerings in herbicides with Kixor, but also with Dicamba. That seems to be a good basis to go forward with. We certainly keep investing and funding R&D in our Ag business. In addition to that, seeing the overall development with respect to soft commodity prices, we will take the measures that we need to take to make our business as effective and as efficient as possible and that will also include fixed cost containment measures.

3.5 Oil & Gas

Patrick Lambert (Nomura): A quick question on Oil & Gas in particular: I think, here again a very good business. I think you talked about the gas trading. Would you comment a bit more on the increase of production on the exploration part of your business and what you see for the full year in terms of goal for production that you are targeting in that segment?

Hans-Ulrich Engel: Sure, I am happy to do that. We had a production of 136 million barrels of oil equivalent last year. The guidance that we are giving for the year 2015 is: We are targeting 160 million barrels of oil equivalent for the year 2015.

What are our expectations or what's driving that? The following factors: As you may know, we have done a transaction with Statoil in the fourth quarter of last year, which comes with a nice amount of new reserves, but it also included ~25,000 barrels per day additional production. We were able to start up our production in Libya in the middle of February. We are currently producing there, I would say, roughly 30,000 barrels per day. The assumption is that we can continue on that level or even increase it, but in all honesty, the situation there is so difficult that I can only tell you: We have that in our forecast, but we will need to see what's going to happen during the course of the year. And then, what's also driving the increase in production is the

development of the Achimov 1A field in Western Siberia in our Achimgaz joint venture, which should also give us additional volume in the year 2015. That then builds the bridge from the 136 to the 160 that we are targeting for 2015.

Patrick Lambert (Nomura): In Q1 2015, were you above the quarterly run rate with these 160 because of Libya in particular?

Hans-Ulrich Engel: We were above the quarterly run rate that we had in 2014. Libya was contributing to that, but also the additional production that we have in Norway and to a smaller extent incremental production in Western Siberia.

Patrick Lambert (Nomura): I was talking more about the 40 million BOE, run rate in Q1 2015. Were you above that run rate?

Hans-Ulrich Engel: We need to move that run rate up a little bit in order to achieve our 160 as a target. But as I mentioned, we were only able to start production in Libya either on 22 or on 24 February, let's say, towards the end of February. So we didn't produce the first seven weeks.

Andreas Heine (Barclays Capital): It is basically on Oil & Gas again. If I refer to what you just said, then Q1 was pretty normal in Oil & Gas. So if we look on how the environment of oil price, rouble and what have you is, then the Q1 gives us a clean number what we can expect per quarter if volume would not change. That's the first.

Hans-Ulrich Engel: On Oil & Gas, Andreas: Is that a normal quarter? I think, if I recall that correctly, our average oil price in Q1 was 54 dollars. So we saw a decline there compared to prior-year first quarter of 50%. In euros, I believe, it was at 80 and dropped to 49. We have seen some improvement in the meantime in the oil price and I think with all the volatility that we have experienced there in the first three months, it is difficult to give you something where you really can say: Okay, that's what Hans told me, and now I can put my money in the bank on that basis.

Andreas Heine (Barclays Capital): That's not what I was looking for. It was just that we have so many moving parts. Even if you have given us a guidance for the full-year, impact of the oil price, the gas price has changed a lot and we do not know exactly how the split is in Russia between domestic and export and how the binding is there. Then we have the US dollar movement, the oil price. Basically, to call this a worst case scenario if everything comes together, the outcome is the earnings of Q1. That's basically what I wanted to know or whether there is any "funny" in there which I have to have in mind if I do the forecast for the coming quarters.

Hans-Ulrich Engel: I think what's clearly helping us is the split that we have between Oil & Gas which is roughly 25% oil, liquids and 75% gas. What you have in the segment – I alluded to that carefully – is certainly an extremely strong development in our gas trading business. I call that perfect alignment of the stars. Don't expect that to repeat itself! When we talk about Q1 next year, don't hold my feet to the fire because Q1 next year will not be as strong in the gas trading business as the exceptional first quarter that we have seen in gas trading this year.

Oliver Schwarz (Warburg): Could you elaborate a bit more on the gas trading business? I may be the only one but I still have problems forecasting right numbers for the gas trading business. After the decline in Q4 2014 numbers, as you said, driven by the Goldilocks scenario, Q1 2015 clearly excels. Is there any, let's say, limit to the volume increase you could do over the next years to come, or is that basically kept by the capital you want to allocate to that business, as it is a trading business?

Hans-Ulrich Engel: We have seen very strong volume increase in Q1. I think it's fair to say that what we have seen there is an exception. I don't think that we will see this really repeating itself. We had the opportunity to enjoy certain constellations here. I think, the only explanation that I can give on that are exceptionals. So don't expect that to repeat itself.

Oliver Schwarz (Warburg Research): But is there an underlying volume we would or could expect for the next year, for the full year e.g., to use as a basis of the calculation, or is that just too choppy over the years or the quarters?

Hans-Ulrich Engel: It depends on the opportunities out there. We have increased our spot business significantly in Q1 due to these opportunities that presented itself. So giving you a guidance here, Oliver, would actually not make a lot of sense.

4. Development in 'Other'

Thomas Gilbert (UBS): On the currency side, is it fair to say that the segments get the fully unhedged benefit of the currency, while you lump all the unfavourable hedging of the company in the "Other" line? Will you reallocate that back at the end of the year? If the exchange rates prevail, how are the hedges rolling off this year? How does this affect the "Other" line? Sorry for this very technical question.

Manfredo Rübens: To the first part of your question, whether the segments get the unhedged results: That is not right. Think about it like this: The segments or our operating divisions can basically internally hedge their exposures the way they deem right. So at the end of the day we take those exposures then against the corporate exposure and from a corporate perspective we then hedge what we believe the hedging position of BASF should be overall. So the segments are basically running also their exposures. Some of those aspects you then see reflected in "Other", as you rightfully stated. But be reminded that all booked exposures that we have are fully hedged and the effects that you see at the end of the day in "Other" relate predominantly to our planned exposure hedging that we also have described at earlier times.

Jaideep Pandya (Berenberg Bank): Just a question on the "Other" line: If I just strip out the Long-Term Incentive programme, then the "Other" line was around minus €327 million and *my modelling should minus €650 million before the numbers came out*. Could you just tell us or help us model the "Other" line for the full year basically? You have basically done your whole year last year in Q1 this year. So I just want to understand how this year is going to pan out in the "Other" line.

Manfredo Rübens: The guidance that we have given, the outlook, was a slight decrease in earnings in the year 2015 compared to the last year. We stick to our guidance. Last year we had about €570 million in the EBIT line. So expect something between minus €600 and minus €700 million for the year.

Jaideep Pandya (Berenberg Bank): Sorry, just to make sure: So you are basically guiding for like minus €80 million for the rest of the year in the “Other” line?

Hans-Ulrich Engel: Take out the special effects that we have. I would consider the LTI provision to – We don’t show that as a special item, but it is a special development that we have. We always said we can't forecast what is happening with respect to LTI since it does not just depend on share price development. It also depends on the relative development of our share price to MSCI Chemicals/World Index. That is extremely difficult to forecast.

Oliver Schwarz (Warburg Research): Thank you for taking my question. I wonder if you could shed some light on the increase in other expenses in general and administration expenses which were both up by roughly 10%.

Hans-Ulrich Engel: Oliver, there is an easy explanation for that – we have not stopped with our strict fixed cost management. It’s simply the result of foreign exchange. If you think about where outside of the euro zone we have sales cost and where we have SG&A cost, in particular in North America and also in Asia – and you have seen the currency development there – that is the explanation.

Andreas Heine (Barclays Capital): …Maybe also referring to the “Others” line and what you have answered there: My understanding would be, from your answer before, that the “Others” line without any stock option and without any FX hedges is roughly minus 150 million a quarter. Is that right?

Hans-Ulrich Engel: … Yes, that is about right. As always in “Other”, it’s difficult to say, but without the LTI impact roughly 600 million p.a. looks like a good figure.