

Analyst Conference Call Q1 2018 Transcript Q&A May 4, 2018



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BASF Group

Christian Faitz (Kepler Cheuvreux): Can you please shed some more light on the weak EBIT performance in North America where you state that all segments contributed negatively. I guess, part of it is ag/weather-related. Can you please elucidate this?

Hans-Ulrich Engel: In North America, we have four impacts that we need to consider. We have the weather-related issues, as everyone else who experienced freezing temperatures in the Gulf Coast. Plants there are prepared to take hurricanes up to levels 4 and 5. But they are not made for freezing conditions. And that's what we experienced, not only us, also our raw material suppliers. That led to extended outages that we experienced, in particular in our Freeport and Geismar sites. As you know, these are the two Verbund sites that we have. A second big impact that we have comes from currency. Look at what happened with the U.S. dollar. I think, the U.S. dollar on average in Q1 2017 was at 1.06 and we were at 1.23 in the first quarter of this year. The third impact that we have are cracker margins, which are significantly lower in Q1 2018 than where they were in 2017. So, outages/weather, ag – a big one, you mentioned that one already –, foreign exchange and cracker margins. These are the four explanations for the significant decline that we have in results in North America.

Neil Tyler (Redburn): On the cash flow working capital development. The tightening of the working capital balance in the quarter: Can you share your thoughts on how much of the drop in receivables particularly is down to timing effects in a later sales, perhaps in ag and the like?

Marc Ehrhardt: Regarding cash flow, yes, indeed, the delay in some ag business played somewhat of a role. However, I think, what we have shown over the past year is a very, very concentrated management of our cash flow. We have instituted a series of measures to make sure that we accelerate our cash cycle. That ends up also in the improvement of almost a billion in receivables.

Measures that we have taken, e.g., is also a clean-up in long-standing overdues, that we have systematically gone through all the regions in trying to get back. We have addressed issues like bank acceptance drafts in China to make sure that we accelerate a cash cycle there or report it under receivables for the longest time. It is a combination of both.

A little, slight delay in the uptick that we see in the first quarter due to the northern hemisphere ag season and the other is continued efforts to accelerate our cash cycle.

Thomas Wigglesworth (Citi): Just a point of clarification: You kindly gave us the insurance numbers. But the insurance claims, is that purely citral in the quarter? Or are there MDI claims as well? If you could just clarify what the group insurance covers.

Hans-Ulrich Engel: On your insurance question. What I gave you is purely the impact that we have from citral with this low double-digit million euro figure on a Group level. There is nothing in there for MDI, the outages that we had there in China due to natural gas curtailment – there is no insurance available. The weather-related impact that we have does not fall under a business interruption insurance. So there is nothing in for that. There is also nothing in for the North Harbour incident where we are expecting also some time in Q2 and Q3 a final payment. So what I have given you is purely citral.

Sebastian Bray (Berenberg): On the distribution of integration cost. I appreciate it is a bit early. But would you expect a significant proportion of these to fall into 2019 or will you try to book as many as possible upfront? What I am trying to get at is: Would you expect for the transactions that you have announced, for Solvay, for ag, for Solenis, for all of them, to potentially move integration costs into 2019? How much of these do you think will be in 2019 relative to 2018?

Hans-Ulrich Engel: It obviously depends on the point in time where we close. Let us take one at a time. For the ag transactions, we would expect to actually book a large chunk of integration cost already in 2018. There will be spill-over into 2019, there is no question about that. It depends on the point in time at which we will sell inventories and then cycle the – what I call – purchase price allocation cost through our P&L.

On Solvay, we are expecting to close that transaction in Q3, which then would also mean that there would be a large chunk already in 2018.

On Solenis, we are expecting a closing at the earliest in Q4. That depends then really on whether we will still be in a position to book something in Q4 of this year. Whatever we can, we will most probably book in the year where we acquire.

2 Segments

2.1 Chemicals

Andrew Stott (UBS): Where we are now with your polyurethanes capacity as we look out for this year and into 2019. Is Chongqing back on? Are you running at full production in China there? Do you expect the natural gas issues to have gone away?

I think last time we met the reactor for the TDI facility in Ludwigshafen had just arrived on site. The best guess is the sort of start-up of the TDI facility.

Hans-Ulrich Engel: Chongqing: Yes, natural gas supply started in the second half of March. So we are fully supplied again. We also overcame the winter-related issues that we had in the Gulf Coast. TDI Ludwigshafen: The reactor is in place and we expect to start up in a few weeks.

Andreas Heine (MainFirst): If you look on Chemicals, you most likely will have a much better availability of the high-margin plants in MDI and TDI.

On the dynamics we see in prices, what do you see going into the second quarter for Chemicals, which was at least in 2017 and in the first quarter the main driver of your earnings?

Hans-Ulrich Engel: On Chemicals: What do we currently see? I alluded already to significantly lower cracker margins, continued strong isocyanate prices, overall a good price situation and margin situation in Intermediates.

Petrochemicals: Cracker margins, in particular in North America, significantly below what we have experienced in Q1 2017. I think, since Q1 2017 roughly 3.5 million tons of C2 capacity was added in North America. This obviously has a significant impact on prices, but also on margins. In what we call industrial petrochemicals, be it acrylic acid, be it the oxo alcohols, there is actually a good, solid margin environment, a good, solid demand across or around the globe.

Isocyanates: We see what I would call a differentiated development by region. PMDI prices have come down quite a bit in Asia, in particular in China. If you compare it per end of Q3, early Q4, it looked like they peaked there and have come down from that point.

In Europe, MDI prices are slightly down compared to the highs that we have seen also there at the end of Q3, early Q4.

North America, MDI relatively stable. But the question is always with the new MDI capacity that is coming on stream, in particular the Sadara quantities that hit the market, what this will mean and how long we can actually enjoy this still very strong margin environment.

TDI is relatively stable at a very high level. It looks like April prices will roll over into May. But, also there, the question is what the additional volumes that come on stream will do. They include then also our TDI plant in Ludwigshafen.

That may be the quick outlook on Chemicals. Overall, if I think of Q1, Q2, we are, based on everything that I have seen in April, operating in an environment with respect to Chemicals that is very similar to what we have experienced in Q1 2018.

2.2 Performance Products

Paul Walsh (Morgan Stanley): Could you just help me understand a little bit more the year-on-year dynamics in Performance Products? It just seems you have had a very nice step-up in margin in Performance Products. I'd just like to dig a bit deeper into that.

Hans-Ulrich Engel: On Performance Products. Indeed, what you see is on a currency-adjusted basis an overall nice improvement. We had price increases across the board in Performance Products. The raw material price increase was actually lower than what we had expected going into the quarter. So that certainly helped.

Overall, if I add the impact of foreign exchange, we come out with better results in Q1 2018 in Performance Products than what we had in Q1 2017. Just to give you an indication there: In currency we took a real hit in Q1, not only the U.S. dollar, basically all the other major currencies that we have in our portfolio. You have seen the 8 percent on the Group's top line which equates to about 1.3 billion euros. On an EBIT level, we took a hit in the order of magnitude of 300 million euros due to the appreciation of the euro.

Thomas Wrigglesworth (Citi): On Performance Products: It looks to me like we are seeing pricing picking up over the last two to three quarters. How are you doing in terms of recouping the raw material impact that is coming through there? As we exit the first quarter and enter the second quarter, should we be anticipating further pricing acceleration? Is that being accepted by customers?

Hans-Ulrich Engel: As mentioned already, we have a margin improvement. If I adjust that for the FX impacts, which in other words means we were able to increase prices above the raw material impact that we had in Q1.

On the raw material side, please always keep in mind: We have in U.S.-dollar terms significant increases compared to Q1 of last year, but, again, currency-adjusted for a European company that reports in euros there is not much of an increase. We were able to compensate or even gain a little bit back compared to the situation that we were in, in particular in Q2 and Q3 of last year in Performance Products.

Price increases: There is a whole range of price increases that was announced in Q1. We will see now during Q2 what will stick and what will not stick.

Patrick Lambert (Raymond James): On citral and actually the EBIT on Performance Products. Was there any impact of any insurance payments due already to the force majeure? How do you see that panning out in Q2/Q3 in terms both of ramp up and also insurance contributions?

Hans-Ulrich Engel: On citral: Yes, we received an insurance payment. As always, this is an initial payment based on what the insurers currently see. We expect a further payment; it's not yet clear whether that will come in Q2 or whether that will come in Q3. It depends on when we will reach agreement with the insurers. To give you an order of magnitude of the insurance situation – I give that to you on BASF Group level since we are partially self-insured: The figure is a positive impact in the lower double-digit million euro range in Q1. As I said, it's not yet clear whether there will be another positive impact coming from the insurance either in Q2 or in Q3.

Patrick Lambert (Raymond James): And in terms of volumes ramp-up, how does it look?

Hans-Ulrich Engel: A significant hit, obviously. You see this. I think, volume decline in the order of magnitude of 10+ percent in the operating division in Q1. We were able to bridge supply to our customers with quantities that came in from Kuantan, but nevertheless, there is a 10+ percent volume decline. We are ramping up as we speak. So, let's keep our fingers crossed that we are able to supply our customers as quickly as possible again.

Chetan Udeshi (JP Morgan): On Performance Products. Can you quantify the net negative impact you might have seen from the loss of production in the citral chain in Q1? You had some insurance payments, you benefited, as you mentioned in the release, from higher prices. Maybe you sold some volumes from inventory or your Malaysian plants. So the question I have is: Should we be expecting a sequential substantial improvement in Performance Products once citral is up and running by the end of this quarter? Just to know the exact – or some sort of quantifying the impact in Q1 would be helpful for that.

Hans-Ulrich Engel: On citral, as explained, we received a first insurance payment. Picture for the results in Performance Products overall a low double-digit million negative impact after this net insurance payment.

Peter Spengler (DZ Bank): On your joint venture with Solenis. You have a minority position and you have, I think, three out of seven Board Members there. Your business was smaller. Is there a timeline to change this setting or is the current setting permanent in the future?

Marc Ehrhardt: First and foremost, all we want to do is create a customer-focused global solutions provider for the paper and water treatment industry. We have now gone the first step in creating this entity. We are fully focused in bringing those two businesses together first. You know that CD&R is a private equity firm. At one point we will look what the next steps are. But for now, we are just concentrating on making sure that we set up this entity in the right way.

Sebastian Bray (Berenberg): A question on the agreement with Solenis. I just want to confirm: Is the right approach to modelling this to simply deduct the related revenues from the Performance Products segment for BASF for 2019 onwards?

Hans-Ulrich Engel: What is important to keep in mind with respect to Solenis: In 2018 – in other words in Q2 –, we will have to put that business in a disposal group as a result of that. However, revenues as well as results will initially stay where they are. Then, from the point in time on where we close, we will then have at-equity reporting, which means then we will not show sales any more for that business. We will show our share of the net profit. That will be shown as part of the EBIT line.

2.3 Functional Materials & Solutions

Paul Walsh (Morgan Stanley): For a relatively similar sales number, in the Functional Materials & Solutions business year-on-year, there seems to be a sort of sizeable decline in margin. Again, just to balance those two things, any insights you can give would be appreciated.

Hans-Ulrich Engel: Functional Materials & Solutions: I think you and I talked last time when we saw each other about the fact that we have a monomers business with isocyanates. We have a downstream business in Performance Materials. If I look at the improved results in the Chemicals segment which are to a large extent driven by the improvement in isocyanates, but also in caprolactam, that's where then our Performance Materials business takes a significant hit because they can't pass on the significant price increases that we are seeing in the isocyanate chain. That explains a part of the earnings decrease that we have in Functional Materials & Solutions. But overall in the isocyanates value chain, we have significant improvements.

We have, in addition to that, the currency hit which is equally significant as we have seen it in Performance Products. Keep that in mind.

A third bigger topic that we have: We had a turnaround of our styrene plant which also hits the result of Performance Materials.

These are the three key elements that lead to lower results, lower margin in Functional Materials & Solutions.

Peter Clark (Société Générale): I am coming back on Functional Materials & Solutions, on the margin. You made it quite clear: Performance Materials is particularly hard-hit. I think you had fixed costs rising again in the first quarter. The first question is: Is that the case? Performance Materials really makes that segment margin look a lot worse potentially.

In terms of the coatings business which has also been under a lot of pressure, particularly from raw materials: One of your major competitors on the auto side is pointing at potentially getting over the raw materials as they see it or making certain headway on it by the second half. I am just wondering if the progression is similar with what you see in the market and, going into the second half, that you are more confident that these margins can start stabilizing and turning on the coating side? That is excluding the deco in Brazil.

Hans-Ulrich Engel: Peter, on your first question: Indeed, Performance Materials for the reasons I mentioned earlier get the high raw material costs from the isocyanates, but also in the PA6 and PA6.6 value chains, where we have seen significant increases, not only quarter over quarter, but also Q4 compared with Q1. They can pass on part of that, but not all of it. That was one of the reasons. But if you look at the entire value chain, we are quite happy with the results that we are seeing there. In other words, there is a nice improvement.

The next thing that I already mentioned is: We had a turnaround of our styrene plant in Ludwigshafen, also hitting Performance Materials, and then overall the FX impact, as already mentioned several times. That is the explanation for Performance Materials in particular, but it also explains to a large extent what is happening in Functional Materials & Solutions overall.

On the raw materials for coatings, I have to say I am not yet sure what is going to happen there in the second half of the year. Yes, we have seen that raw material price increases are much lower than what we experienced. During the year 2018, on an ongoing basis, the foreign exchange is helping there. But whether or not that could lead to a margin expansion in the second half of the year, frankly, that is too early to tell.

Laurence Alexander (Jefferies): Could you clarify a little bit the margin pressure that you are seeing in Construction Chemicals and the degree to which you believe you either lost demand for the year or you saw demand get pushed into Q2?

Secondly, just more broadly across your downstream chemicals, so Functional Materials & Solutions and Performance Products: Have you seen any real slackening in underlying order trends or has that remained pretty consistent?

Hans-Ulrich Engel: On the margin pressure in Construction Chemicals. We have what I would call two businesses which tend to be impacted by weather. One is the ag business, the other is the Construction Chemicals business. So also there, we have seen a late start to the season, both in commercial and in residential. The expectation is that – April has shown that to a certain extent – demand will pick up in Q2.

On Functional Materials & Solutions. Your question was: Do you see a flattening somewhere? I would say, no. I just explained what is happening in Construction Chemicals. We have seen a slight growth in automotive. These are the two key industries, automotive and construction, that we supply out of the Functional Materials & Solutions segment – so a slight growth in automotive, a bit below what we are expecting for the full year, in particular in North America, a slower start than what we had actually expected, which may also be weather-related.

But overall demand patterns were pretty much in line with what we thought we would see in 2018 and in line with what we explained earlier in the year during our call in February. In other words: no change.

Chetan Udeshi (JP Morgan): In your catalyst business, earnings are down significantly, primarily because of FX. But even underlying it seems the margin was down. Can you explain what is happening in that business, given that the metal prices are more favourable? That should have probably been a tailwind on margin as well.

Marc Ehrhardt: On the Catalysts division. Remember, we have got four areas in that division. We have got the chemical catalysts, refinery catalysts – those are doing very well, with volumes developing in the right direction; battery materials is obviously coming from a low level, also looking good. Trading: also with healthy numbers.

Where we are seeing volumes coming down is in fact in the mobile emission catalysts business, there especially due to the turmoil in the European sector. A lot of the OEMs are shuffling their platforms back and forth in the light-duty diesel segment. The number of components that are in a diesel exhaust gas treatment system is almost fourfold of what you have in a light-duty gasoline system. So obviously then, if there is a shift in platforms, that has an impact on our business.

Chetan Udeshi (JP Morgan): Is it just a diesel share mix as an overall percentage of the sales? Or is it also because of some share gains between your sales and your competitors, which is maybe impacting you more at the moment?

Marc Ehrhardt: It is a little bit more complicated, because usually you win a platform three years before you implement. So here you have got a combination of both. The actual sales of certain platforms are moving in a way different than what was maybe planned in the past and what you did in the competition performance four years ago. So I think it is a little bit too complicated to sort that out, but I wouldn't say that we have lost market share in the short-term.

2.4 Agricultural Solutions

Andrew Stott (UBS): First of all, the guidance specifically for ag for this year: If you think back to March, I guess what has changed here are two important things: You have probably lost some pre-emergent business due to the weather. And now you have got to see the vegetable seed asset on top. So, when you think about those two influences, are you still thinking for this division that guidance is as we were, but with those two changes?

Hans-Ulrich Engel: The ag guidance is unchanged. If we look at the BASF legacy business, we still expect a slight improvement in results, compared to prior year.

Weather was quite interesting in the northern hemisphere in the first quarter. So, we have a significantly delayed start into the season. Depending on where you are, which geography you look at, we are talking about two to four weeks. Based on everything that I hear from the guys in the ag business, they think that they can catch up.

So, as always, we have to look at the full season in the northern hemisphere. In other words, the first half will give us then the answer to your question. But at this point in time, we don't see a need to change our guidance.

Christian Faitz (Kepler Cheuvreux): Coming back to ag, are you worried about any inventory levels in ag, given this two to four weeks delay in the crop season? Are we talking about a shortened application season maybe here?

Hans-Ulrich Engel: On ag: Overall, I'd say, no significant issues with the distribution channels. I think, end of the season in South America now, looking at products on ground, in particular in Brazil, there shouldn't be an issue there, with all the measures that we have taken in 2017. North America: A compressed season may play a role. That could very well have an impact on the distribution channels and the level of product in the channels. I cannot exclude that. We will see what's going to happen there during the season.

Europe overall looks okay, but in France we see relatively high levels in the distribution channel. Eastern Europe looks okay.

Asia, based on everything that I heard: no issues.

Markus Mayer (Baader Helvea): On the negative pricing effect in agro; maybe I have missed the answer. But did this mainly come from product mix effects?

Hans-Ulrich Engel: Indeed, that is predominantly the impact that comes from product mix and overall slightly lower prices in North America. These are the two contributors.

Patrick Lambert (Raymond James): On ag again: When I look at the potential size of the platform post the acquisitions, would you help us, qualitatively and quantitatively, if possible, to think about the synergies you can extract from both acquisitions, both in terms of R&D and also in terms of crop protection production?

Hans-Ulrich Engel: Actually, what we do is not the typical acquisition where you look at harvesting significant synergies, in particular on the cost side. These are complementary businesses that we are acquiring. As a result of that, we look primarily – not to say exclusively – at growth synergies and not necessarily for cost synergies.

Peter Spengler (DZ Bank): I have a follow-on question on the Bayer crop science business you acquired. Are there also facilities and land you acquire from Bayer in Germany and especially in the U.S.? Do you still have an own seeds business and sizeable research experts and facilities which you can add to the BASF business or is it basically that you buy the Bayer business and keep it and add some experts from your side?

Hans-Ulrich Engel: Ag: What we are acquiring are actually fully enabled businesses. The first part of the transaction comes with five chemical production and formulation sites, ten R&D sites, the second part of the transaction with a further seven research and development sites and then, obviously, a lot of regional seed production and breeding facilities.

With respect to personnel: Out of the different parts of this deal, total number of employees: order of magnitude 4,300 that come with the transactions. So you see: fully enabled businesses, be it on the production side, be it the R&D side, be it in sales, marketing, breeding and seed production facilities. What you need to run the business comes with these transactions.

Neil Tyler (Redburn): Sticking with ag and, I suppose, further to Andrew's question earlier: The EBIT impact from acquiring those seasonal businesses mid-way through the year, presumably, I would assume, would be negative for the second half of the year because of the lack of sales in the last six months. Is that a right assumption to make?

Hans-Ulrich Engel: On the EBIT impact, your assumption is correct. Overall, what we are expecting is a negative EBIT impact a) due to the seasonality of the business and b) as a result of the significant integration cost that we will have to book in 2018.

Neil Tyler (Redburn): Excluding the integration costs, you would still expect a negative contribution?

Hans-Ulrich Engel: We would still expect a negative contribution because the seed season is more or less gone. For the crop protection products and the seed treatment products, the season in the northern hemisphere we will miss. That will be compensated for by way of an adjustment of the purchase price, obviously. But that you will not see in the P&L, you will see that in the balance sheet.

Markus Mayer (Baader Helvea): On this acquired digital farming, xarvio, of Bayer. Did I understand it rightly that basically Bayer still has a licence? Maybe you can shed some light on how this works with this licence. Maybe also, as I understood it so far, this is a kind of open data business. How does this kind of business model work from this digital farming for you?

Marc Ehrhardt: At the beginning, we were to purchase a licence to the digital farming platform that Bayer has, but that then turned into a full divestment. So now we will own the digital farming platform that Bayer built up. So we are really happy that that really accelerates also our efforts in that space. It is a great outcome for us in the overall deal.

2.5 Oil & Gas

Paul Walsh (Morgan Stanley): The D&A reduction in Oil & Gas, Hans, should we be seeing the 200 million euros as the ongoing run rate for D&A in Oil & Gas, please?

Hans-Ulrich Engel: We have a significant reduction in Oil & Gas in depreciation, as a result of higher reserves, in particular in Norway. You should continue to see that in the year 2018.

Andreas Heine (MainFirst): Could you shed a little bit more light on the discussions you have with LetterOne on the Oil & Gas joint venture? I thought the negotiations come to an end much earlier than they seem to do. What is the issue? Why does it take that long to come to a final agreement?

Hans-Ulrich Engel: On Oil & Gas. Your question is: Why does it take longer? If I think about the fact that we have signed a Letter of Intent in early December and we are now at the beginning of May, I don't see a significant delay. What you have to factor in is that you need a consent from one of your partners in each and every geography that you are operating in because in Oil & Gas you are typically not alone. You are always in a consortium, in a joint venture. You can provide data only once your partners have provided you with the necessary consent. That actually took a bit longer than what we had expected in certain geographies, which then overall leads to what I would call a delay, but nothing where one needs to be concerned about. Both parties are well aware of what is happening in Oil & Gas and have done a number of transactions. The lessons on that is, it typically takes a little bit longer than in the ambitious way that we typically think.