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Conference Call Q1 2019
Transcript Q&A
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Tony Jones (Redburn): On the downstream divisions: Margins were much better than most expected and you called out better pricing and cost management. I just wanted to explore how sustainable you think that is over the year. Also relating to that: Is the improvement partly driven by some of the internal changes that you are making? Maybe you could give an update on that.

Dr. Hans-Ulrich Engel: On downstream, what we have seen overall, is some margin improvement. We have worked on pricing across the board; that has a positive effect. We have seen that raw material prices in Q1 also helped with this margin development. Volume did not necessarily support, but raw material prices in Q1 and our own price initiatives have driven the improvement that we are seeing there.

We expect this to continue and to improve. When you look at margin levels that we were at in Q4 of last year, as an example, we were definitely not satisfied with that. But when you look quarter over quarter, you see nice improvements across the board. We are fully committed to go along this line and further improve.

Andrew Stott (UBS): Coming back to the guidance and the Q1 base. My main question is: Is 1.73 billion a clean number? I am assuming you have got costs of operational excellence in there. And I am assuming you have got costs of Bayer integration in there. Is there a clean-clean number you can give us?

Dr. Hans-Ulrich Engel: Your question on guidance, Andrew, and: How clean is the 1.73 billion euros number that we have in EBIT before special items? There is a mid-double-digit million impact there from integration, in other words, the Bayer assets and businesses that we are integrating. Most of the cost resulting from PPA and restructuring is obviously special item and is sitting there. But it is a mid-double-digit million-euro figure that runs through the underlying EBIT in Q1.

I am just trying to think: Is there anything else? No insurance payment, nothing like that. So, other than that, this is really a clean figure.

Andrew Stott (UBS): Okay. Sorry, just a follow-up on that. The Q2 year-on-year, you are obviously saying: another tough quarter, but you have got Oil & Gas in there now for two months of the three. You are saying that April looks better on crop protection. Do we assume that you are going to be somewhat better than the minus 24%?

I know you don't guide quarterly, but it would be great if you could give us an idea. There are so many moving parts at the moment.

Dr. Hans-Ulrich Engel: As you and I know, BASF doesn't guide on quarters. But I will give you an idea there. Yes, it is correct that we will have our share of the net profits of Wintershall Dea from May 1 on in our EBIT. We roll that net profit, like we do for other at equity consolidated activities, in our EBIT. So EBIT will benefit from that.

There is a word of caution, though. When you think about Wintershall Dea and the results that we show for Wintershall for the year 2018 and for the first quarter of 2019, please keep in mind that when this was moved into discontinued business, we stopped depreciation and amortization. It is not that we stopped it, but this is what IFRS requires you to do. That is one thing.

The second thing that you need to keep in mind, please, is that this will be the year when Wintershall Dea does not only merge together, it also starts working on the integration and on the restructuring. As we said, the expectation is that the workforce will be reduced from the current level of ~4,000 to ~3,000. My assumption is that we will see a good part of the one-time cost related to that in the year 2019.

So, these are two things that you should please keep in mind.

Chetan Udeshi (JP Morgan): My question is just on clarification of the guidance. Correct me if I am wrong, but previously, Oil & Gas was expected to be included in your EBIT from the second half. Now it comes sort of earlier, two months early. You still haven't changed your full-year guidance. Just to confirm: There is no change in any of the overlying other segments in terms of guidance?

Dr. Hans-Ulrich Engel: No, there is not. As I tried to explain earlier, don't expect the impact from Oil & Gas being two months earlier than what you may have put into your model to be overwhelmingly high.

Sebastian Bray (Berenberg): In reaching the guidance for low EBIT growth during the year, a low single-digit percentage, is there any net benefit from cost savings included for the current year?

Dr. Hans-Ulrich Engel: Yes, there are net benefits included, but they are expected to come only in the second half of the year. It takes a little bit of time to implement these cost reduction measures, but we expect to have an impact there in the second half 2019.

Thomas Wrigglesworth (Citi): Net debt pre and post the divestiture of Oil & Gas. You haven't mentioned any transfer of debt into the new entity. But I think previously you talked about shareholder loans. What will net debt for BASF look like, once the JV is fully set up?

Dr. Hans-Ulrich Engel: Oil & Gas, Wintershall Dea: What is going to happen there? Before May 1, Wintershall repaid the shareholder loans. This is an amount for BASF in the order of magnitude of a low-single-digit billion-euro figure. I look at Marc; I think Marc will use that to work on our current net debt level which is slightly above 19 billion euros.

Andrew Stott (UBS): Perhaps you can help me on cash flow, to start with, the 400-million-euro swing year-on-year. I just wondered how much of that is structural. You mentioned that the seeds business obviously takes a bit more in Q1. Just try and help me a bit on how you see working capital developments this year.

Staying in the cash flow: a 300 million swing as well in miscellaneous items. Is there any guidance for the full year? What is that 300 million? I assume it has to do with the restructuring.

Marc Erhardt: Andrew, first of all to your second question regarding the cash flow, those 300 million euros we have got in “Miscellaneous items”: Those are reclassification effects in the P&L due to the Solenis transaction and due to the divestments we had to do, that the authorities required us to do, so we could consummate the Bayer acquisition. So I would see them as one-offs that should not be coming back.

Regarding our overall cash flow, it is a shift in seasonality that you see because of the seeds business being so strong in the first quarter that we have that part in the rise of the accounts receivable.

That should give you a good idea where we will come out.

Andrew Stott (UBS): So there is no material effect from building inventory for the turnarounds in that Q1 inventory number? Or is there?

Dr. Hans-Ulrich Engel: There is a little bit in there because with the two cracker turnarounds that we have, we obviously have a bit more inventory sitting there.

We also go through turnarounds in other parts of the Petrochemicals business, in particular in the acrylic acid chain. If you look at inventory development, the balance sheet shows an increase there in the order of magnitude of 300 million euros since end of 2018. Yes, that is partially driven by the preparation for the big turnarounds that we have in Q2.

Charlie Webb (Morgan Stanley): A question just on the Rhine comments, after we have heard, or we have seen some news that the Rhine is still at fairly low levels. Obviously, it hasn’t been impacting in Q1 and you are guiding that it won’t be an impact this year, but it was last year. Do you have any sense on where these levels are? Is there a degree of risk that we should be aware of as we think about a potential impact for 2019?

Dr. Hans-Ulrich Engel: On the Rhine water levels. I’ll try to address that. What have we done in the meantime? We have done the preparation that we could do in a relatively short period of time.

Rhine water levels have two impacts on BASF. One is the impact that the Rhine water level and the temperature of the Rhine water can have on our cooling water situation. We have used the time since last summer to improve that overall and to reduce the dependency on the intake of water from the river Rhine. That’s one mitigation measure that we have taken.

We have also invested in additional storage capacity at the Ludwigshafen site to be able to cope better with situations like we have experienced them in Q3 and Q4 of last year.

That is what we can do. There is not much more what we can do, other than looking at the transportation situation. What we have done there is: We made additional reservations for barges and that should all help if we would find ourselves in a similar situation again in 2019 or one of the following years.

Markus Mayer (Baader Bank): You already said the one-offs you had from the positive side in Q1. Maybe you can split up the one-offs into the incomes from divestments versus the integration and restructuring costs in Q1. That would be very helpful.

Dr. Hans-Ulrich Engel: The very short answer on this is: You see that we are generating positive special items, which means that the restructuring costs are more than compensated by the income that we had from the divestitures. This is the deconsolidation gain that we had from moving our water and paper treatment business into Solenis where we are now at 49% participation. Then it's the divestitures that we had to do in order to comply with the EU divestiture request, so Bayer assets that we had to divest. Those generated nice gains, the order of magnitude there in both cases: low triple-digit millions.

Tony Jones (Redburn): Could you provide a bit of colour on how things are going for divestments, things like construction chemicals and other asset sales?

Marc Erhardt: On the status of our divestment projects, first of all, construction chemicals: There we are fully on track to achieve our goal of reaching a definitive agreement with a buyer at the end of this year. We are putting finishing touches on the materials to start going out to the market. We expect that to be later this month.

On the pigments business: There we are still in the preparation phase of getting all our ducks in a row to drive the finishing touches on the carve-out and then seeing how we are going to bring that asset to the market. Process-wise, we are behind Construction Chemicals. However, we still confirm that we hope to have a transaction some time at the end of next year.

2 Segments

2.1 Chemicals

Thomas Wrigglesworth (Citi): Following on to your comments around Q2: You have guided in Chemicals to a slight increase in EBIT before special items. Obviously, at some point you are going to have to achieve the level of absolute EBIT that you achieved in the prior year. Q1 is well below in 2019. Should we expect Q2 to be a similar level? If not, what kind of step-up should we expect in the second half?

You suffered from the Rhine water levels. Could you remind us exactly what the impact for Chemicals was in that? The required component to get growth beyond that, how are you going to achieve that specifically in Chemicals?

Dr. Hans-Ulrich Engel: On Chemicals: As you rightly say, we are guiding for Chemicals on a full-year basis for a slight increase. What we see in Q1, as we had expected, is a decrease. I already mentioned that Q2 will also be tough for the Chemicals segment. This is in particular due to the fact that we have two cracker turnarounds in Q2. The Port Arthur cracker in the US goes to a full five-year turnaround and the same happens in Antwerp. That was factored in when we gave the guidance for the Chemicals segment. We are expecting a second half that will be significantly stronger than the first half of the year 2019 in Chemicals.

You asked with respect to the effects from the low Rhine water level. We had a total negative effect of 250 million euro for the year 2018. The vast majority of that was in the Chemicals segment; obviously, we are not expecting this to repeat in the year 2019.

As a result of that, we stick to the guidance that we gave at the end of February also for the Chemicals segment, despite the rough start that we are having there. But as I said, this was fully expected.

What's going to happen during the course of the year obviously remains to be seen. You know that we think that trade conflicts will ease. We think that there is a good chance that there is an agreement between the US and China in particular. We have also seen in the meantime that China has implemented a number of measures to stimulate the economy, not the least the introduction of a reduction of value added tax from 16% to 13% as of April 1. It is still too early to say what this actually means, but it should work as a stimulus for the economy. I hope this helps to put things into perspective.

Thomas Wrigglesworth (Citi): Okay. I want to just clarify your comments. When you talk about the improving economy and the trade elements, is that because it is a volume driver that you expect to improve the second half? Or are you expecting a margin component as well? I mean that from a kind of spread, so price over cost rather than fixed cost absorption. Or is it volume growth in the second half?

Dr. Hans-Ulrich Engel: We would expect this to be a volume driver, definitely. When you look at supply and demand balances, this should also have a positive impact on margins.

Charlie Webb (Morgan Stanley): You have just touched on the turnaround effects that you expect. I think most of them fall in Q2 or a large proportion falls in Q2. Can you remind us what the impact is for the full year and how we should think about the phasing of that for the remainder of the year?

Dr. Hans-Ulrich Engel: Your question on turnarounds. The heavy load of turnarounds will come in Q2. It will expand into Q3. I have to look at the effect quarter-over-quarter. Based on my recollection, the cost related to the turnarounds in Q2 is expected to be in the range of 100 to 150 million euros higher than it was in Q2 of last year.

2.2 Materials

Peter Clark (Société Générale): The inflection points of Performance Materials' EBIT: I see the margin, obviously, turned a while ago. You are hit by the volume declines. I realize these are macro, what you believe on this sort of macro stimulus thing in China and also a lot of auto because, I believe, your auto forecast is probably remaining, but transportation to be slightly up this year including in China.

Dr. Hans-Ulrich Engel: As you already stated, Peter, it obviously depends on demand which then depends on sentiment and the overall economic development.

The isocyanate prices coming down significantly benefitted our Performance Materials business. Yes, there is a margin improvement, but then there is an EBIT decline as a result of the volume situation that we have in Performance Materials. That's one of the divisions that is a big supplier to the automotive industry. Once we see demand picking up there, this will also have an impact obviously not only on margin, but also on EBIT in absolute terms.

I haven't seen the April figures. I am watching closely. As soon as they are out, I study and analyze them. That was not a lot of fun in January, February and March. If you look at production figures, in particular in China, they are down in automotive in the double digits. That hurts.

But listening to our customers, reading what they have to say: I think, all three big German producers came out with statements where they see improvement in the second half and some are already speaking about some green shoots they are seeing in Asia and particularly in China. For me, it's too early to say that there are green shoots, but once I have my April figures, I am in a better position to comment on what we have as current developments.

2.3 Industrial Solutions

Andreas Heine (MainFirst): A question on Dispersions & Pigments which was also above last year: Your competitor in pigments has given very weak comments on that one. So could you for this time differentiate a little bit between these two, dispersions and pigments, as pigments is kind of non-core, as you are in the process of getting rid of it? I would like to understand how the dispersions performance was.

Dr. Hans-Ulrich Engel: On Dispersions & Pigments. What do we see there, sitting in our Dispersions & Pigments division? The dispersions business in Q1 was okay. We saw a slight volume decline there and an EBIT which was slightly below the level of Q1 2018. In the pigments business, we had a similar development. You know that many of its customers are located in Asia. As a result of that, we also saw volume declines there. There was a bit of a price increase in that business, but EBIT overall declined.

Then we have a third business that sits in that operating division, that's the resins. In resins, we had volumes slightly below, but prices significantly up and, as a result of that, strong growth in our EBIT compared to the prior-year quarter.

2.4 Surface Technologies

Christian Faitz (Kepler Cheuvreux): I am just trying to put my head around your statement of a considerable decline in automotive OEM coatings while the overall Coatings division saw a volume decline of only 2%. My understanding always was that the OEM business is the key driver in this division, clearly also outweighing the refinish business. Which sub-division performed so well?

Dr. Hans-Ulrich Engel: On volumes in Coatings: Yes, automotive OEM coatings play a strong role and we have seen a decline in volumes there. Our automotive refinish business did okay in Q1. We experienced what we would like to see in our Chemetall business which is good, solid volume growth. Then we have a small decorative paints business in Brazil. That, compared to prior year, does definitely better than where we were in the first quarter of 2018.

I hope that explains why you don't see the decline in our coatings business overall that we are experiencing in the automotive industry where production globally declined by minus 6%.

Peter Clark (Société Générale): On inflection points again: The Coatings margins should probably be getting a decent price even in the OEM business. Now, I am just wondering where you see that is.

Dr. Hans-Ulrich Engel: The same we see in Performance Materials is true by and large for Coatings. As I said earlier, OEM coatings obviously are in a difficult situation. The Chemetall business, the refinish business and also our decorative paints business in Brazil are compensating to a certain extent, but they are not fully able to compensate what we are losing in our OEM coatings business. As you are, we are hoping that the situation in automotive will improve quickly.

Andreas Heine (MainFirst): On the Surface Technologies which had a strong outcome, I just want to confirm whether this is really sustainable or whether you had extra profit in precious metal trading. There was quite some volatility in precious metals and in the trading, you can usually make profit of this.

Marc Ehrhardt: On the metals trading. I think you diagnosed it correctly that the trading business is a volatile business. We have seen the swing also affecting the precious metal prices. Right now, we have got a backwardation situation on palladium. That is negatively impacting the trading results. But I'd say that trading was slow, with the swing of the precious metals moving forward.

Andreas Heine (MainFirst): Was it then a benefit in Q1 and it is a negative in Q2? Is it that what you are saying?

Marc Ehrhardt: In Q1, we had a slight improvement in the EBIT in precious metals trading compared to Q1 2018.

Dr. Hans-Ulrich Engel: I think it's important to put this in the overall perspective, Andreas. When you look at the businesses that we have in Catalysts, you have the precious metals trading business. Trading, obviously, has a very low margin. You have the automotive catalysts business. You have our chemical catalysts business. You have the refinery catalysts business and you have the battery materials business.

Automotive suffered in Q1 which was not a surprise. The chemical catalysts business developed very well. Our refinery business was fine or delivered what it was expected to do. Battery materials is a growth business for us. It developed in line with expectations.

When I look at the Catalysts division, then I come to the conclusion that the earnings improvement is not driven by precious metals. The earnings improvement is driven by the good results that we generated in particular in the chemical catalysts business.

What's going to happen in Q2, looking at the current price development in precious metals, remains to be seen. Right now, it looks like we find ourselves in a different environment than we did throughout the year 2018 when precious metal prices kept increasing, in particular the palladium price going through the roof. Had somebody told me five years ago that we would see palladium prices above 1,500 US$ per troy ounce, I would have said: "Dream on!" An interesting development there.

2.5 Nutrition & Care

– no specific questions –

2.6 Agricultural Solutions

Laurent Favre (Exane BNP Paribas): On your legacy ag business: volumes down 8%. I think, two of your three largest competitors have published in the past days volumes that were a lot closer to zero, minus 2, slightly up.

I appreciate that you don't make a season out of Q1. But I am just wondering where you think you have underperformed or whether you think that this could be coming back in the second quarter.

The second question is on the Bayer legacy business or the acquired Bayer assets. Could you give us a bit of context as to the performance of Q1? I don't know what is the best on your side in terms of disclosure – organic growth in Q1 year-on-year or usual seasonality pattern between Q1 and Q2 of the acquired assets? Basically, anything we can work with to think about the next quarters for the acquired Bayer assets.

Dr. Hans-Ulrich Engel: First on your volumes: If I see that correctly, I think there is at least one competitor who has stated very, very recently that their decline in volumes was significantly more than what we have. I think it has to do with the geographic footprint.

We have experienced obviously a very, very slow start in our Agricultural Solutions business for crop protection products in North America. This is driven by the inclement weather conditions, a lot of snow on the ground, arctic chill then followed by floods. What we will face there will be a compressed season. That had a significant impact on sales of both herbicides and fungicides in Q1.

But as you rightfully said, Q1 gives you an indication. Let's see what Q2 will look like. Then we can talk about the business in the northern hemisphere.

Yes, there is an 8% volume decline that we have. At the same point in time we had a 4% price increase in our legacy business. Overall, we are still calm, collected and fully prepared for the business in Q2, in our legacy ag business. Let's see how that will develop.

In North America, it definitely was a weak start in Q1 for the reasons already explained. In Q2, based on what I have seen so far, in the month of April, where I do not yet have the final figures, volumes definitely have picked up compared to what we have experienced in February and in March.

Now on your question with respect to the Bayer business: The problem is that I can't give you the comps there for Q1 2018. What I can tell you – this is a qualitative statement – is that what the business has generated in Q1 was better than what we had planned for. So we have seen a very strong canola business both in Canada and in the US. We have seen a very good development in the cotton business. From that perspective – you see what the contribution is that business brings – there is a structural effect in our ag business of 56%.

If I look at the profitability of that business, that is fully in line with what we had expected. I want to say, to be very honest with you: When you buy a business in the second half of the year and you sit there and you produce nothing but cost, then as a CFO you get a little bit concerned.

You look at the forecast and the planning for Q1 and Q2 and you tell the business people: Show me, bring the numbers. They definitely brought the numbers in Q1.

Christian Faitz (Kepler Cheuvreux): An agricultural question pertaining to your remarks that herbicides saw weaker sales in the US. Is this more your dicamba product or also glufosinate?

Dr. Hans-Ulrich Engel: Herbicides in general and in particular in North America had a very slow start. This refers to dicamba and then also to glufosinate. But, as I said, it remains to be seen how the season will develop overall.

Sebastian Bray (Berenberg): The first is more of a reporting one. Why is it that seeds and crop protection are not split separately in agriculture, given that the majority of peers splits these two categories separately?

Just to understand: Am I right in saying that of the assets acquired from Bayer the vast majority of growth was actually from seeds? I think that is consistent with what has been mentioned earlier.

Dr. Hans-Ulrich Engel: Where does the growth actually come from in the acquired businesses? This is clearly in seeds. As I said, we had a very strong start in the seeds business, particularly in the North Americas. But it is interesting to see when I compare how the seeds business is developing and our legacy crop protection business in North America, these are two ends of the spectrum, one performing very well and the other having its challenges.

I think your first question was on the crop protection or Agricultural Solutions segment and why we don't split between seeds and crop protection. This is for BASF one cash-generating unit and that was the reason why we kept it and show it that way.

It also has to do with the fact that we run our businesses in a way where they are typically linked very closely to each other. We want to achieve full synergies between a crop protection portfolio and a seeds portfolio. As a result of that, we came to the conclusion to show it this way. But if you look as an example at our Annual Report, page 80, we are providing you there with the respective businesses: fungicides, herbicides, insecticides, functional crop care as well as seeds & traits. We hope that will create the necessary transparency that you would like to see.