Analyst Conference Call Q2 2022
Speech
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Martin Brudermüller

Chairman of the Board of Executive Directors

Hans-Ulrich Engel

Chief Financial Officer

The spoken word applies.

Martin Brudermüller

Good morning, ladies and gentlemen,

On July 11, BASF released preliminary figures for the second quarter of 2022. Today, Hans Engel and I will provide you with further details regarding our business development.

In the second quarter, BASF again delivered strong earnings – despite continued high raw materials and energy prices. To put the BASF team's performance into perspective, let's begin with a snapshot of the current macroeconomic environment.

[Slide 3: Snapshot of the current market environment]

Compared to Q1 2022, the uncertainty and intransparency regarding the short- and mid-term economic development have increased. The main reasons for this are the ongoing war in Ukraine, the risks associated with natural gas supplies in Europe and the resulting high prices for raw materials and energy as well as China's zero-COVID strategy and related lockdowns.

Despite these challenges, the demand from our customer industries remained generally solid. However, global automotive production in the second quarter of 2022 declined by 6 percent compared with Q1 2022. For 2022, IHS Markit has adjusted its forecast to about 80.8 million units. This is a reduction of around 2.1 million units compared with its forecast at the beginning of this year.

In the second quarter of 2022, China's economic growth was negatively impacted by the severe lockdowns in several large cities, particularly in Shanghai. In the second half of 2022, China's economic development is expected to improve, mainly due to a more differentiated strategy to tackle the coronavirus and dedicated financial stimulus measures by the Chinese government, particularly for the automotive industry.

To counter high inflation, central banks have started to raise interest rates. This will increasingly impact demand in the coming months and reduce growth in 2023.

[Slide 4: Global chemical production increased by 1.3% in Q2 2022]

Let’s now briefly look at chemical production by region in Q2 2022, before we turn to the financial performance of BASF.

According to the currently available data, global chemical production increased by just 1.3 percent. Despite a strong comparison base and the pandemic-related lockdowns, chemical production in **China** increased by 3.1 percent. With 2.5 percent, chemical production also grew in **North America**. By contrast, chemical production declined by 2.6 percent in **Europe** and by 0.6 percent in **Asia excluding China**.

[Slide 5: Q2 2022: BASF again with strong earnings despite continued high prices for raw materials and energy]

I will now move on to BASF’s business development in Q2 2022.

Our upstream and downstream businesses successfully implemented further price increases and largely passed on higher prices for raw materials and energy.

Due to the lockdowns in China, BASF’s sales volumes in the country declined by 17.4 percent in the second quarter of 2022 compared with an increase of 10.4 percent in Q2 2021. This change was driven by significantly lower sales volumes in April. Sequentially, however, sales volumes recovered again strongly in May and June.

In Q2 2022, EBIT before special items was at the level of the very strong prior-year quarter and amounted to 2.3 billion euros.

The high earnings were driven by the Agricultural Solutions, Nutrition & Care and Industrial Solutions segments. Other also contributed to the positive performance in Q2 2022.

I would like to add that the positive business development in the second quarter of 2022 continued in July.

[Slide 6: Emergency Plan for Gas of the German government]

Since we are often asked about this, I would like to stress once again: Currently, all of BASF's European sites are supplied with natural gas in line with demand. We are monitoring developments very closely, in particular at our largest site in Ludwigshafen, where we use considerable amounts of gas.

In this context, I will therefore briefly address the details of the alert level regarding gas supply declared by the German government on June 23, 2022. The second stage of the Emergency Plan for Gas comprises four key measures that leave responsibilities and market mechanisms intact:

- First, all market participants, such as gas suppliers, gas traders or network operators, are obliged to take coordinated action to avoid temporary and regional gaps in supply in Germany and to achieve the target fill level of 85 percent for German gas storage facilities on October 1. To this end, the market area manager Trading Hub Europe has received an additional credit line of 15 billion euros from the federal government to purchase gas.
- Second, market participants, including BASF, are obliged to participate in a crisis team that must report to the Federal Ministry for Economic Affairs on a daily basis.

- Third, the German government is taking legal measures to restart coal-fired power plants in Germany to contribute to electricity production and save gas in power production.
- And fourth, Germany's Federal Network Agency wants to open a market platform where gas that is not required by companies can be auctioned.

In the following, I also want to comment on the third and final emergency stage of the Emergency Plan for Gas. This stage comes into force when there is an exceptionally high demand for natural gas, a significant disruption in natural gas supplies or other significant deterioration in the supply situation. Then, according to the regulations, non-market-based measures must be taken to ensure natural gas supplies, in particular to protected customers. According to the Ministry for Economic Affairs, the Federal Network Agency will then become the "federal load dispatcher" and will regulate the distribution of natural gas in coordination with the network operators. In this process, certain consumer groups are particularly protected. These groups include households, social institutions such as hospitals, and gas-fired power plants that also supply heat to households. But they also include industrial companies that manufacture products that are crucial for society. In this case, gas is allocated according to the relevance of the company to society.

We are coordinating closely with government agencies, suppliers and network operators. Should the German government declare the third and final emergency stage, we currently expect that BASF would still receive sufficient natural gas to maintain operations at the Ludwigshafen site at a reduced load. We are also confident with regard to Schwarzheide, our second largest site in Germany.

Here, for example, we are able to generate 100 percent of our power and steam demand using fuel oil. For BASF production sites outside of Europe, we expect hardly any impact in the event of a European gas shortage.

[Slide 7: Update on mitigation measures to reduce natural gas demand]

I will now provide you with further details regarding our natural gas demand in Europe and give an update on our mitigation measures in the event of natural gas supply shortages.

In 2021, BASF's natural gas demand in Europe amounted to 48 terawatt hours. Thereof 37 terawatt hours were consumed in Ludwigshafen. In Europe, we use around 60 percent of our natural gas demand to produce power and steam; the remaining 40 percent is used as feedstock. At our Verbund site in Ludwigshafen the split is around 50 percent for each of the two categories. If the natural gas supply does not fall below around 50 percent of our maximum demand, we will be able to operate the Verbund in Ludwigshafen at a reduced load.

Our mitigation measures include the following:

- Where technically feasible, the preparations to substitute natural gas – for example, with fuel oil – are progressing well and technical optimizations are in place.
- In addition, we have developed scenarios and implemented measures to optimize production at our European sites. We are reducing production at facilities that require large amounts of natural gas, such as ammonia plants. This is standard practice in the chemical industry, for example, when margins are not economically viable.

The graph on the slide shows the largest consumers of natural gas at the Ludwigshafen site. Ammonia is the largest natural gas consumer with around 25 percent of total demand as feedstock. In contrast to some other gas consumers at the Ludwigshafen site, external sourcing of ammonia is possible. Externally sourced ammonia is therefore an important element of our risk mitigation considerations in the event of a major curtailment of natural gas volumes.

The second biggest consumer is the acetylene plant, followed by syngas production. Together, both plants account for almost another 25 percent of the total natural gas demand as a feedstock.

Power and steam production in Ludwigshafen can partially be switched to fuel oil, thus substituting around 15 percent of the natural gas otherwise needed for this.

[Slide 8: Natural gas prices in Europe remained at a very high level]

Compared with Q1 2022, natural gas prices declined slightly in the second quarter of 2022 but remained at a very high level. In Q2 2022, the additional costs for BASF's European sites amounted to 800 million euros compared with the same quarter of 2021. In comparison with the second quarter of 2020, the increase was 1 billion euros. To mitigate these higher costs, we have implemented and will continue to implement further price increases.

[Slide 9: Q2 2022: Sales volumes declined by 4.4% but were almost stable excluding precious metals volumes]

I will now move on to the volume development by segment.

In the second quarter of 2022, sales volumes of BASF Group declined slightly. This was mainly due to lower precious metals volumes, which accounted for 99 percent of the volume decline in the Surface Technologies segment. Excluding this effect, BASF Group sales volumes were almost stable with minus 0.2 percent compared with the second quarter of 2021. On a segment level, Agricultural Solutions and Nutrition & Care saw a positive volume development.

Now I would like to hand over to Hans for further details.

Hans-Ulrich Engel

Good morning, ladies and gentlemen.

[Slide 10: Q2 2022: Sales increased considerably; EBIT before special items at the high level of the prior-year quarter]

Let me start with our sales and earnings development in Q2 2022.

Sales increased by 16 percent to 23 billion euros, primarily due to 13 percent higher sales prices. All divisions increased prices, except for Catalysts, where lower prices for precious metals led to a decline in sales prices. Currency effects of plus 7 percent also contributed to the positive sales development and were mainly related to the U.S. dollar. Lower sales volumes, mainly due to reduced precious metals volumes, had a slightly offsetting effect.

As already mentioned, EBIT before special items reached 2.3 billion euros, matching the level of the very strong prior-year quarter.

At segment level, Agricultural Solutions and Nutrition & Care considerably increased EBIT before special items compared with the prior-year quarter, and Industrial Solutions slightly increased earnings. The Chemicals, Materials and Surface Technologies segments recorded considerably lower EBIT before special items in Q2 2022. In the two upstream segments, we saw a normalization in margins compared with the prior-year quarter that was more pronounced in Materials than in Chemicals. In the Materials segment, lower demand from the automotive industry contributed to the decline in earnings.

In the following, I will comment on the business development of the downstream segments in more detail and give some additional information.

[Slide 11: Surface Technologies]

I will start with Surface Technologies.

Sales in the Surface Technologies segment declined by 8 percent and amounted to 5.4 billion euros. Lower volumes and lower prices in the Catalysts division were the main driver for this development. Positive currency and portfolio effects had an offsetting effect. The Coatings division achieved considerable price increases and slightly higher volumes. EBIT before special items declined from 289 million euros in Q2 2021 to 227 million euros in the second quarter of 2022 on account of lower earnings in the Coatings division.

In the light of the strong and increasingly dilutive impact of precious metal sales on BASF’s KPIs, we will start disclosing additional information. As of Q2 2022, sales in the Surface Technologies segment will be broken down to reflect sales excluding precious metal trading and precious metal sales in mobile emissions catalysts.

Using the adjusted Q2 2022 sales figure for the Surface Technologies segment as a basis, the segment’s EBITDA margin before special items increases by 10.1 percentage points to 16.8 percent and for the first half of 2022 by 11.2 percentage points to 18.2 percent.

For the BASF Group, the EBITDA margin before special items based on the adjusted sales figure for Surface Technologies excluding precious metals increases by 2.4 percentage points to 16.7 percent in the second quarter of 2022 and by 2.6 percentage points to 17.9 percent in the first half of the year.

We believe that this enhanced disclosure helps investors to better understand the earnings profile of the business. For more information, please refer to BASF's Half-Year Financial Report, page 49.

[Slide 12: Nutrition & Care]

In the Nutrition & Care segment, sales increased considerably because of significantly higher prices and positive currency effects. Volumes declined slightly in the Care Chemicals division and increased slightly in the Nutrition & Health division. EBIT before special items increased considerably due to significantly higher earnings in the Care Chemicals division.

Let me also address the changes in our Nutrition & Health division that we have recently announced: The division will strengthen its commitment as a leading ingredients partner to the nutrition and flavor and fragrance industries. Going forward, Nutrition & Health will consist of three focused global business units for nutrition ingredients, aroma ingredients and pharma solutions.

The next slide provides more details.

[Slide 13: Nutrition & Health will have three pillars – nutrition, aroma, pharma – with a focus on key ingredients]

In Nutrition Ingredients, we will act as a strong ingredients partner to the animal and human nutrition industries. We will strengthen our core product platforms, which are deeply rooted in the BASF Verbund, and invest in vitamins and feed enzymes.

Our food and health performance ingredients portfolio, which is produced at our site in Illertissen, Germany, plays a vital role in addressing growing trends in human nutrition. However, the business has limited portfolio synergies and integration into the BASF Verbund.

Therefore, strategic options will be evaluated to identify suitable opportunities for this business.

In Aroma Ingredients, we will further build on our strong ingredients position to address sustainability trends in the flavor and fragrance industries. We will focus on growth investments in the citral value chain and on innovation to support the sustainability needs of our customers.

In Pharma Solutions, we will continue to offer our broad portfolio of excipients based on core value chains and selected active ingredients. For biopharmaceuticals we will focus on growth and innovation. In addition, we will partner with customers in developing effective and reliable formulations, also with increasing use of digital solutions.

[Slide 14: Agricultural Solutions]

I will now turn to the Agricultural Solutions segment, which recorded a strong second quarter. Significantly higher prices in all regions, paired with favorable currency effects and higher volumes, led to a positive sales development. This reflects overall strong demand in the northern hemisphere in 2022. EBIT before special items increased considerably, mainly driven by higher sales offsetting higher costs.

Global agricultural markets continue to be healthy with robust commodity prices, while challenges from global raw material and transportation capacity shortages and inflationary cost increases remain. We look optimistically into the second half and expect a good start into the season in South America.

[Slide 15: BASF Group Q2 2022 and H1 2022: Financial figures]

In the following, I will briefly look in more detail at the financial figures for BASF Group in the second quarter of 2022 compared with the prior-year quarter:

- I will start with **EBITDA before special items,** which increased by 76 million euros and amounted to 3.3 billion euros. **EBITDA** reached 3.4 billion euros, an increase of 6 percent.
- At 2.3 billion euros, **EBIT before special items** reached the high level of the prior-year quarter.
- **Special items** in EBIT amounted to plus 11 million euros compared with minus 39 million euros in the second quarter of 2021.
- **EBIT** increased by 1.5 percent to 2.4 billion euros in Q2 2022.
- **Net income from shareholdings** increased by 477 million euros to 433 million euros. The considerable increase compared with the prior-year quarter primarily resulted from the higher income from our shareholding in Wintershall Dea, which amounted to 446 million euros.
- **Net income** amounted to 2.1 billion euros, compared with 1.7 billion euros in the prior-year quarter. The increase was mainly driven by higher net income from shareholdings.

[Slide 16: Cash flow development in Q2 2022 and H1 2022]

Let’s now look at the details of our cash flow development in Q2 2022 compared with the prior-year quarter.

Cash flows from operating activities amounted to 1.2 billion euros, a decrease of 1.3 billion euros compared with the prior-year quarter. The decline was mainly driven by higher bonus payments, which were almost 1 billion euros higher than in the prior-year quarter. Overall, changes in net working capital led to a cash outflow of 1.7 billion euros compared with a cash inflow of 9 million euros in Q2 2021.

Cash flows from investing activities amounted to minus 639 million euros in the second quarter of 2022 compared with plus 323 million euros in the prior-year quarter. In Q2 2021, proceeds from divestitures, particularly from the divestment of BASF's pigments business, led to the positive development.

Payments made for property, plant and equipment and intangible assets rose by 16 percent to 892 million euros. **Free cash flow** thus decreased by 1.4 billion euros to 336 million euros in Q2 2022. The decline was mainly caused by the lower cash flows from operating activities.

[Slide 17: Strong balance sheet]

Turning to our balance sheet at the end of June 2022 compared with year-end 2021:

- Total assets increased by 9.6 billion euros to 97 billion euros.
- Noncurrent assets amounted to 53.6 billion euros, an increase of 1.3 billion euros. The increase was mainly driven by translation effects due to the depreciation of the euro.
- Current assets increased by 8.3 billion euros to 43.4 billion euros, mainly due to higher trade accounts receivable. In addition, higher inventories, other receivables and miscellaneous assets and cash and cash equivalents contributed to the increase.
- Noncurrent liabilities decreased by 1.3 billion euros to 24 billion euros, mainly due to lower provisions for pensions and similar obligations. These provisions decreased by 50 percent to 3.1 billion euros due to higher interest rates.
- Net debt increased by 5.2 billion euros to 19.5 billion euros at the end of June 2022.
- The equity ratio was 47.8 percent compared with 48.2 percent at the end of 2021.

And now I will hand back to Martin.

Martin Brudermüller

[Slide 18: Main construction phases of the new Verbund site in Zhanjiang, China – stepwise approach]

Ladies and gentlemen,

I would now like to give you an update on the progress of construction at our new Verbund site in Zhanjiang, China.

In December 2019, we kicked off the investment project with the decision for an initial phase ahead of the main Verbund to respond to the high demand from our customer industries. As planned, and despite all COVID-19 challenges, the first plant for the production of engineering plastics is currently starting up. The second plant for thermoplastic polyurethanes will come on stream in mid-2023.

Following the final approval for the construction of the planned Verbund site in Zhanjiang, we are now starting construction of phase 1. This is the implementation of the main part of the project – what we call the heart of the Verbund. This phase comprises a world-class mixed-feed steam cracker, several value chains for petrochemicals, intermediates and chemicals for consumer products as well as related infrastructure. It is planned to start up this core complex in a sequence as of the end of 2025.

Further expansion and diversification of the value chains with additional product lines is already in preparation and is planned to be implemented in a second phase that is scheduled to go on stream from 2028 onwards.

BASF will implement the most advanced process technologies and will power the entire Zhanjiang Verbund site with 100 percent renewable electricity. By utilizing the latest digital technologies and applying the highest safety standards, the site is intended to be developed as a role model for smart manufacturing and sustainable production.

The new Verbund site in Zhanjiang will be a key platform for long-term profitable and sustainable growth, not only in Greater China but for the BASF Group as a whole.

[Slide 19: Outlook 2022 for BASF Group]

To conclude, I will present you our adjusted outlook for 2022.

We now expect global economic growth and chemical production to grow by 2.5 percent each. Global industrial production is expected to grow by 3.0 percent. We anticipate an average oil price of 110 U.S. dollars per barrel of Brent crude and an exchange rate of 1.07 U.S. dollars per euro.

For the second half of the year, BASF anticipates a gradual cooling of economic development globally, but much more pronounced in Europe. This assumes that there are no severe restrictions resulting from new lockdowns in China and that natural gas shortages do not lead to production shutdowns in Europe.

Due to the very positive business development in the first half of 2022, we are adjusting the forecast for the BASF Group for the 2022 business year. Based on the above-mentioned assumptions, we are now forecasting higher sales of between 86 billion euros and 89 billion euros for 2022. The lower end of the range for BASF Group's EBIT before special items was increased to 6.8 billion euros from 6.6 billion euros; the upper end remains unchanged at 7.2 billion euros. We are confident that we can achieve the upper end of this range.

ROCE is likely to be lower at 10.5 percent to 11.0 percent because of the higher capital base driven by price and currency effects.

We expect lower CO_2 emissions of between 18.4 million metric tons and 19.4 million metric tons in 2022.

As additional information, I would like to add that we expect capex to amount to less than 4.0 billion euros in 2022 – lower than our original planning of 4.6 billion euros.

Current developments, mainly driven by the war in Ukraine and its impact on energy and raw materials prices and the availability of raw materials, especially in Europe, may lead to additional headwinds, deviating from the assumptions I just presented. In particular, risks could arise from production stoppages at major European sites as a result of further restrictions to European gas supplies from Russia. In this case, the loss of European capacities could be partially compensated for by higher plant capacity utilization at sites outside of Europe. Further risks could arise from the future course of the coronavirus pandemic and new measures to contain the number of infections. Opportunities could arise from continued high margins, even in the case of an economic slowdown. We are responding to the economic slowdown with cost reduction measures.

We are now glad to take your questions.