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Transcript Q&A
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1 BASF Group

1.1 Current demand environment and outlook

Christian Faitz (Kepler Cheuvreux): How do you currently and also perhaps with a view into 2024 see the underlying demand/production volumes for the global automotive market?

Dr. Dirk Elvermann: On automotive, we continue to be positive. Automotive and Ag are the two businesses that have really remained strong in 2023. With around 88.5 million units to be produced, this is a strong sector, and we are benefiting from that, particularly in our Coatings division. Coatings was again very strong in terms of prices and volumes and had the strongest quarter in its history in Q3. The other divisions that also benefit from the auto industry were a little bit weaker than Coatings, but overall, the picture for automotive is very positive.

Andreas Heine (Stifel): On the volume, sequential decline, is that what you think is a normal seasonal pattern or is that in some areas more pronounced? Maybe you can highlight where you see still a downward trend in demand.

Dr. Dirk Elvermann: Here, I think it is important to understand that without Ag, which is by its nature a seasonal business, we did not see a volume decline between the second quarter and the third quarter. So without Ag, we have a flat volume development. As Martin already indicated in the Q2 call, we are seeing a bottoming out in terms of the volume trend.

Chetan Udeshi (J.P. Morgan): I see you are sort of implying Q4 to be sequentially down versus Q3, which is normal seasonality. But can you give us some feel of how you see the earnings development by different segments – as we think about Q4 versus Q3, I think it will be useful, especially given the number of moving parts on energy costs; clearly, now the naphtha price is also going up, what it means for your upstream business?

Dr. Martin Brudermüller: If you look at what is now missing, let me first of all say that the average EBIT before special items in Q4 since 2004 was around €900 million. Since 2004, there were actually two years where it was below €500 million in the fourth quarter, so that was the low end. And this is the order of magnitude that we need to close the gap to the lower part of the guidance.

We are confident that we can reach this. This is why we keep the guidance. One element is certainly everything you can do in-house, self-help measures, cost containment. We have a very high cost discipline. You also see the discipline with the inventory. So the team is really aligned and is doing the utmost to avoid any surprises.

If we look at the market side, we clearly see that order entry is stabilizing. We see a surprising uptick in China, I have to say. India certainly was a little bit more resistant, but there was not too much of an effect because of the market size. But China makes a significant contribution. Some of the plants there are pretty much loaded again, and we will close the gap to volumes from last year or most probably for the whole year quite nicely. The problem is that the margins are not too high because of the supply/demand situation.

I think automotive is an industry that will also help us. We don't expect that this will now soften by the end of the year. And we certainly hope that we maybe also get a little bit of tailwind from the overall stabilization.

So, these are the elements that I think will help us in Q4 to close the gap to the lower end of the earnings guidance.

Charlie Webb (Morgan Stanley): Around the oversupply situation you see more holistically across upstream chemicals and how you see that playing out through 2024. You obviously talk about demand returning. But when you look at historical contexts of where supply and demand sit today versus the past and the likelihood of your expectations around a demand recovery, is it the case that it's just demand that's going to get us there? Over what timeframe do you expect that to play out? Or do you think now actually we need supply to come out of the market? And if so, are we seeing any signs of that? It feels like, holistically, Europe's now on top of the cost curve; maybe it wasn't in the past, and therefore perhaps should be the one taking capacity out. I am just trying to get a sense on how that oversupply situation resolves itself and your view on that, looking through into 2024, into 2025.

Dr. Martin Brudermüller: You talked about oversupply – not a totally new situation. You know that it's very difficult to make statements here for the whole portfolio of chemicals. You have to look into this by product lines. But in the past we also had situations where we thought there would be overcapacities for a decade. And then there was a strong increase in demand, and that was gone after two or three years.

I would confirm what you said: The major topic currently is really an extremely low global demand. In my 17 years of Board membership at BASF I have never seen demand be so incredibly low as it is across all regions, also including China.

If you look into the product lines, I would say there are very few where there are more doubts about whether things will get back into line again. For most of the chemicals we have, we see some capacities coming up, but nothing that would worry me now to fundamentally change our timeline in investments, etc.

Once global demand comes back, I think that will drive margins, that will drive the whole business and will bring the supply/demand situation closer together again, at least for the portfolio overall.

Charlie Webb (Morgan Stanley): Obviously, at the start of the year, we were more upbeat – and, I think, yourself – around China's growth prospects for 2023. Obviously, that hasn't really materialized, perhaps at the pace that people had hoped, albeit you're citing some positives now towards the end of the year. Looking into next year, do you think anything has changed versus the past in terms of the growth algorithm for China as it relates to chemical consumption? Or are you still very convinced that the growth and consumption levels you have seen for chemicals in China are unchanged?

Dr. Martin Brudermüller: Yes, we expected a bigger impulse from China in the second half of 2023. That was how we started into the year. I think we have to clearly say: The world had to learn that China cannot walk on water either. It is also a little bit more difficult for them to kick-start their industry.

It has also to do with their growth model. I would expect that in the longer run they will change this in a way that is also more driven by green tech, because currently too many apartments are empty, and certainly the drop in value for people who put their savings into apartments is not really helping.

Then the whole infrastructure part, which was strongly built: You cannot continuously build airports and fast railway tracks and harbors. That also comes to an end. And exports are also going down due to the weakness in the overall situation. So that is not helping China. And it's also not easy to solve this.

Nevertheless, we look into this regularly and at the fundamentals of China. Per-capita consumption is so much lower than in Western countries that there is enough substance to keep China growing at least for the next 10-20 years, even based on conservative estimates. And that is what we are basing our investments on.

I think we are lower on the growth rates over there, more in the 4% range than higher, and that all makes still a lot of sense for our investments over the years. So, with that, long term, fine. But maybe in the short term a bit bumpier than we originally thought.

Charlie Webb (Morgan Stanley): Can you give us any sense where your Verbund utilization rate is going to sit by region, just roughly? You talked about China loadings being pretty high. You're getting to a pretty good level. How does that compare in Europe and how does that compare in North America?

Dr. Martin Brudermüller: I will not give you utilization rates by region. I would say, currently, on a global level, it's between 60s and 70s. In normal times, you are somewhere in or up to the 80s, with regional differences.

When I was in China last week, our team told us that some of our plants are pretty much sold out again in China. This gives you an indication that the plants are running quite nicely. The problem is really margins and prices.

1.2 Working capital management and inventories

Samuel Perry (UBS): On inventories, you are around €1 billion lower than at the end of 2022. How much of that is a function of reducing your own volumes of inventory and how much marking to market for lower prices? How much scope do you have to reduce this further by the year end?

Dr. Dirk Elvermann: We have both: We have a significant reduction in the inventory volume, so the OIVs.

We also have certainly tailwind from FX and prices, but a substantial part of the inventory reduction is coming from lower volumes. We have started an ongoing structural inventory improvement program.

Just to give you an idea: Until 2017, we were running our inventories at a level of €10 billion and were able to generate EBITDA at a level of €10 to €11 billion. Now we're currently at €15.1 billion, so I think this indicates that there is still room for improvement, and we will vigorously continue to do that.

Jaideep Pandya (Onfield Investment Research): If you think that you are still reducing inventories next year, should we then think that you will continue to sacrifice utilization for reducing inventory and, therefore, even if demand does go up, we should not get overly bullish, at least for your upstream business, for Materials and Chemicals?

Dr. Dirk Elvermann: As I said, we vigorously will go forward and trim the inventories further without sacrificing sales volumes because we feel that we are sitting on a too big bag of inventories. So what we are doing is rather structurally optimizing over time. But there is no arbitrage saying: Cash is worth more than the earnings. We really try to balance that out. I see it as bringing inventory levels back to a healthy level rather than sacrificing anything else.

Jaideep Pandya (Onfield Investment Research): So the inventories are more on the finished goods or on raw materials? Or is it everywhere?

Dr. Dirk Elvermann: You have it everywhere. You have it on the raw materials, on the finished goods, on goods in transit. We are looking into all these categories.

Andreas Heine (Stifel): You have shown the various indicators in industries. If I look at one from the chemical industry itself, from Cefic, inventories are seen as much too high, and the chemical industry is an important customer for BASF. How do you see the inventory levels within the chemical industry?

Dr. Dirk Elvermann: We talk about our inventory management. And, of course, we are also seeing inventory efforts going on at our customers. This also explains why we have the current supply/demand balance and the margin pressure that we have.

Ultimately, this has now been going on for quite a while, and we see and believe from talking to many of our 82,000 customers that the destocking and tight inventory management is coming to an end. So we see that bottoming out and will eventually then also see demand coming up again.

The magic question is: When exactly is the tipping point? But for the time being, this prudence in inventory management, also in the sectors that we are serving, of course plays a role.

1.3 Capital expenditures and dividend policy

Gunther Zechmann (Bernstein): On your revised capex budgets and the cuts, especially on the 2023 to 2027 one, a 14% reduction from original budget. Do you assume a lower chemical production now? Do you still hold on to your ambition to outgrow global chemical production? Or would you be comfortable being diluted in volume terms if profitability is as low as it currently is in the upstream segments?

Dr. Martin Brudermüller: Let me start with the China project because that's a big chunk of capex. Let me clearly say that we are in budget here because the environment is currently pretty good for investments. First of all, inflation is very low in China: It was 1.9% in 2022 and it's expected to be only 0.7% in 2023. So, there are no cost-driving elements there. Beyond that, contractors are rather willing to make favourable contracts for us to employ their people. And we also do not have material price increases there. That's why our team was able to make very good contracts in China. We might even come in below budget at the end of the whole project. That's one contribution.

The second element is certainly that the global utilization rate is now rather low due to the demand crisis, and that means we have to first fill our plants again. I don't think that this will happen overnight. That gives us some time to consider and to think: When do we do expansions and what is the right staggering? Which projects might we hold back a bit longer? That's kind of a postponement part.

But we will also look at the number of projects, and we want to reduce the number of projects. Normally engineers always offer steel and iron solutions. But you can also solve some of the topics using measures that need less capex, by organizing things differently and finding alternatives. These are two elements that very clearly contribute to this.

We will not reduce our growth targets. That is very clear. So, we don't want dilution, and will simply keep our discipline. I think this is the right thing to do in this environment. I would expect that this will really give a good development for BASF to be a little bit more tight on capital in the years going forward.

Laurent Favre (Exane BNP Paribas): I'm a bit confused on the Zhanjiang site and the €4 billion cut in capex. Martin, you've mentioned that you may come under budget on that. So it doesn't seem to be the area where you've got the capex cut. Is it all about cutting everything else, or are you also implying there's a change in the startup for phase 1 and phase 2 of 2025 and 2028? So, is some of the cut in capex just falling after 2027?

Dr. Martin Brudermüller: First of all, we are very happy that we made great contracts at the right moment for Zhanjiang. As basically most contracts are signed, there's not a huge risk anymore that things could get out of control. The only thing you have is the RMB/euro exchange rate because we account for everything in euros.

From that perspective, we feel really good about this project. I think I mentioned that we might even come out a little bit lower than we actually expected at the very end of the project.

We also talked about supply/demand and everything. With such a big project, you can never really plan the best time to enter the market. For phase 2, which is then going to come, we will work on this when we really know what are the right products. Are there some products that go into phase 3? Others might go from phase 3 to phase 2. We have not defined that final part. And we might make adaptions depending on the market situation. But that's too early to say.

What we really want to do is that we take capex out through the whole portfolio, through all the businesses. I think you know that we normally have more projects than capital. This is good because all the investment projects are in a natural competition, also internally. We will look then at the different market perspectives and how we stagger and prioritize the projects.

I think one element is also clear: We now have to fill our capacities again. How fast Europe will come back, which is certainly the most challenged region in terms of competitiveness, is the question. And this is why we have the clear intention to take out €3 billion in the next years. Because these are also the years that are still challenging with regard to finalizing the Zhanjiang site. So I don't talk about the end of the period, but really about one that contributes to BASF's performance in 2024 and 2025.

Peter A. Clark (SG Corporate and Investment Banking): I know you're giving us a profile again next February, but am I right in thinking, obviously, with the China plant, even if it's coming in a bit light against the regional expectations, next year is the big year for capex spend in terms of this profile. So 2024 is still the bigger year of capex spend when we look at the 2023-2028 timeframe?

Dr. Martin Brudermüller: Yes that is absolutely the case, as you said.

Samuel Perry (UBS): I acknowledge your comments in the opening remarks around dividend pay-out retention at these levels this year. If I think longer term, perhaps once you've managed to exit the Wintershall asset and noting that the dividend from Wintershall has historically not been an insignificant portion of the free cash flow, do you think there would be scope for a discussion around resizing after this?

Dr. Martin Brudermüller: I will not give any further indications for the future policy, but there is no reason to now change anything in our guidance for the dividend policy.

I think what is also clear is that we are in a business that has a certain cyclicality; we all know that. For that reason, it's also important to meet expectations. In 2014, we had a free cash flow that did not support the dividend pay-out, and this was also the case, by the way, in 2020. In 2014, we increased the dividend, in 2020 we kept it flat.

I think, given the fact that we have a very stable and solid balance sheet, that we have a good credit rating, that we have a high equity rate. All of these things support us.

You also know that what comes on top of normal BASF activity is our China development. This will add something on the capex side in 2024 and 2025 but will then return to normal levels. I think we have to be clear that the China investment, which we are convinced is very important, also supports the growth of BASF and is actually one source of the future capability to pay a dividend.

You said something about the Wintershall dividend, which we will no longer have when we exit the business. But we are adding something with the new Verbund site that will also enable us to pay good dividends going forward.

1.4 Credit ratings and interest expenses

Laurent Favre (Exane BNP Paribas): You've highlighted that you've got a stronger rating than peers. I was wondering if you could remind us: Why is it so important for a business such as yours to have a single A rating? And is the rating more or less important than keeping a stable dividend?

Dr. Dirk Elvermann: I can confirm that an A credit rating is important for us. We were also able to maintain the A rating in this challenging year. We are at A– now at Standard & Poor's and equivalent at Moody's. And we are at A flat at Fitch. It is evidence of our strong balance sheet that Martin also talked about and, therefore, also, a sound justification for a strong dividend, because what we try to do is really balance out for the equity and for the debt capital markets. With the strong rating we are demonstrating the strength of our balance sheet and, secondly, the very strong cash performance, which is also taken into account by the rating agencies.

It is important for us. It is not the one leading indicator for us. Of course, we are looking into other things as well. But it is one of the cornerstones of our financial policy and, thus, we are happy that we can preserve a strong A rating, also in difficult times.

Jaideep Pandya (Onfield Investment Research): On your interest cost, you have about €3 billion plus of debt to refinance in 2024 and 2025. Dirk, could you just give us some color: What will be the interest costs or what could be the interest cost increase in 2024 as you refinance some of your debt?

Dr. Dirk Elvermann: Yes, we are in a higher cost environment, but it's a mixed picture because, on the one hand, we are financing in the various regions. China, for instance, is still a low interest cost region. Overall, you also saw that we were able to keep our debt level at the level of last year.

So, therefore, yes, the interest cost is going up. You see that in our financial result also, but the effect is limited. In the short term, for the commercial papers, we are talking roughly 30 basis points. And for the longer-term financing we are talking roughly 25 basis points. And this has an impact on the financial result, I'd say, roughly in the double-digit million-euro range.

2 Segments

2.1 Chemicals

Chetan Udeshi (J.P. Morgan): You mentioned the impact from cracker outages in the US and China. Are these crackers even profitable at these levels? I am just trying to understand whether you actually lost any earnings because of these outages or actually it saved you from having bigger losses in your upstream business.

Dr. Dirk Elvermann: We would have loved to avoid the cracker outages because they are both profitable. In the one in Nanjing, China, which is already on-stream again, the impact was, I'd say, limited, also due to the short time of the outage. So this was a single-digit million-euro amount. The harder hit was the cracker in Port Arthur, which is now, as we speak, being ramped up again. And here we are talking a mid-double-digit million-euro amount.

So, yes, we would have loved to avoid that, but unfortunately, it hit us. But the good news is that one cracker is already on-stream again and the other will be on-stream again very shortly.

2.2 Materials

– No specific questions –

2.3 Industrial Solutions

– No specific questions –

2.4 Surface Technologies

Matthew Yates (Bank of America): I'm a bit confused on the strategy for the auto catalyst business. I mean, typically, when a company carves out an asset as a separate legal entity, it tends to signal the start of the disposal process. But you were pretty vocal in your remarks that that wasn't the case for BASF, at least not at the moment. So, what additional operational strategic flexibility does this carve-out give you in navigating that transition in the combustion engine that you referenced?

Dr. Dirk Elvermann: First of all, we are very satisfied with the carve-out. It was completed exactly as we hoped for, and now we have a fully dedicated business. It's an excellent go-to-market organization with a lean back-end structure, service structures and a dedicated ERP system. We think it sits in the right place. It is very industry focused.

It is important to understand that this business is still very cash-generative, fully invested and highly profitable and it has a long tail. It's a sunset business ultimately because everybody is clear that the combustion engines market will not last forever. What we believe is that there is still quite a noteworthy period and we are enjoying this business very much.

Does it also create flexibility if you carve out such a business? This is certainly the case. But let me be very clear: The first and foremost intention was really to profile the business better in the BASF Group and not to divest it.

2.5 Nutrition & Care

Matthew Yates (Bank of America): Martin, when you took over as CEO, one of your priorities was to get better downstream performance. I appreciate it has not been an easy environment at the moment, but to see the Nutrition & Care division loss-making is quite a dramatic outcome for a business with €8 billion of capital employed.

What's the strategy here to improve the profitability of the business? Is it simply just a matter of waiting for the volumes to come back? Or do you actually need to demonstrate some more market leadership in terms of your pricing strategy, especially around vitamins?

Dr. Martin Brudermüller: Downstream is a mixed bag; that is very clear. But if we look at Ag, which is performing very well, I think we clearly improved the performance. Also the Industrial Solutions actually provide a very stable performance through difficult times. We talked about Coatings, which is now having a super run, even in this difficult time. So, I think we have to differentiate a bit when looking at the different downstream pieces.

Nutrition & Health: Very clearly, we are not content with that. But if we compare with the numbers of our major competitors then I would say that we have very much a market topic here, particularly in the vitamins business: capacity topics, overcapacity topics, but also a very weak and soft market development.

In July 2022, we already announced that we are restructuring the nutrition business. We have brought together the human nutrition and animal nutrition business units into one business unit, which is Nutrition Ingredients. So, we've repositioned ourselves as an ingredients provider. You know that our very strong Verbund-integrated vitamins business, which is based on the citral value chain, goes into both human and animal nutrition, and that is also the case with the carotenoids.

We are very confident going forward because with all the investments we have done in vitamin A – both on capacity, but also the formulation side – we have the very clear indication that we have the best cost position in the industry. This was the case in the past and is likely to be even better in the future.

Is that a situation that improves tomorrow? Most probably it will be a battle. But normally the strongest comes off best in a fight. And I think this will be also the case with BASF.

So, it is a repositioning and a partial restructuring. But I think we have a hand of good cards to strengthen the business and contribute to the downstream performance of BASF in future.

2.6 Agricultural Solutions

Christian Faitz (Kepler Cheuvreux): Can you specify and also quantify the insurance payment in Agricultural Solutions?

Dr. Dirk Elvermann: If we deduct the insurance payment from the Q3 results of Agricultural Solutions, we would have been more in line with average analysts' estimates, which are slightly negative.

So, overall, the slightly positive result that we get for Ag is on the back of this insurance payment. The insurance payment was related to damage that was part of a third-party processing plant, which negatively impacted EBIT before special items in 2022, and now we have been compensated for this.

Chetan Udeshi (J.P. Morgan): We've seen a few of your peers seeing significant earnings pressure. I think so far, from a Q3 perspective, you've had very weak volumes, but also much better pricing. Can you talk about what you see in Q4, because I think your peers are talking about weaker demand for the ongoing season in Latin America. How do you see that dynamic in volumes and pricing playing out in Q4?

Dr. Dirk Elvermann: You referred to competitors who are also in the media with not so good forecasts. There are always special situations why the performance is as it is. I think, this year, in terms of portfolio, also in terms of timing, we had quite a favorable situation with strong pricing power overall and with a very strong first half of the year. And now, the second half is, first of all, anyway the weaker half of the year due to the high seasonality in the business.

We now also see that the southern hemisphere is delayed. And it's also coming a bit weaker. But I'd say we are in a comparatively resilient situation compared to what you might have heard elsewhere.