BASF

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Analyst Conference Call Full Year 2023

Transcript Q&A

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1 BASF Group

1.1 Current demand environment

Samuel Perry (UBS): Previously, Chinese imports into Europe have been cited as a big disruptive issue for demand. Have you seen any signs that that's coming off at all, given demand picking up domestically and also, shorter term, the issues in the Red Sea?

Dr. Martin Brudermüller: We see imports from China coming in in an order of magnitude like never before. Very clearly, there is capacity coming up in many product lines in China, overcapacities for the domestic market, and the market there is also sluggish. So, they also take every opportunity for exporting and selling every ton somewhere in the world.

That's particularly true for the other Asian markets, but also South America, but materials are also coming into Europe. They take a certain advantage from the high energy costs here and the competitiveness they have.

You mentioned the Houthi rebels, disturbing the supply chain. Yes, there are effects. I think they are temporary. There are some products where we are now seeing that this inflow of Chinese volumes is interrupted, which then causes customers in Europe to rethink their supply strategies and to return to European suppliers to be more resilient. But I think this is a temporary effect.

Overall, it is a question of the competitiveness of Europe in the long run, compared with China. But there is very broad activity. We see Chinese materials coming into a lot of product lines.

Christian Faitz (Kepler Cheuvreux): I believe BASF considers itself the globally biggest automotive supplier still. Hence, what's your view on general automotive demand globally this year? Any regional differences you are observing?

Dr. Martin Brudermüller: Very clearly, in 2023, the automotive industry helped us globally because it was one of the healthy sectors that had quite a strong increase in production. That is not foreseen for 2024. If you look at the global expectations, then this is thought to be more or less flat, and is basically stagnating at the level of around 90 million units. I would say, January was much stronger than that, with double-digit volume growth, and China increased its production in January by 46%. But I do not think this is an indicator for the overall year. We expect things to get slower.

But as you know, Chinese domestic sales for cars have been flat for many years now. So, you see also here that Chinese cars and the increased production in China is actually being exported. That's a new focus area of the Chinese automotive industry. Let's see how successful they are and what the impacts are on production in other regions. It's very hard to predict, but I would say, from a global perspective, the automotive industries should be rather flat this year.

Jaideep Pandya (On Field Investment): The first question is on your German plants. How much exports are you doing to China these days from Germany?

When your China cracker will be up and running, where will these flows go? Or would you have to reduce capacities, given we are in an overcapacity world for quite a few years?

Dr. Martin Brudermüller: We cannot give you a detailed picture about exports into China, but it's not such a big volume because we have significantly raised our capacities in China. So, China for China, this is also what the whole Verbund site is.

We usually use the global grid to do pre-marketing for upcoming capacities. But that is too early for Zhanjiang now. So, I would say: Yes, some material is exported to China, but it's not a dramatic amount. I don't feel that we have to reduce production here in Ludwigshafen or Europe because of exports to China. I don't think this is something which you should keep on your list of concerns.

Andreas Heine (Stifel): On China: Can you give us an update what you on your own company see? In the Q3 call, you said that your China plants are running at normal load, but with very thin margins.

Dr. Martin Brudermüller: I would say: Not so much news on what we said last time.

We definitely don't see the dynamic China everyone would like to see. Topics like the real estate sector are still difficult.

I would say there is maybe a little bit light at the end of the tunnel in terms of consumer confidence. People seem to be a little bit better in that regard.

We had slight volume growth at a one-digit level in Q4. I would say, that's the way it has continued. But let me say that you can never evaluate China on the basis of January alone because of Chinese New Year. So, you usually have to take January and February together. It's too early to say because there are different patterns, depending on whether Chinese New Year is late or early.

But I would say: Nothing specifically about China that is shooting up or slowing down.

1.2 Cost savings program

Matthew Yates (Bank of America): You showed in the deck that Germany lost €600 million last year. This time you already took the decision to shut down a few product lines, and you're alluding to potentially more restructuring to come in the second half.

You say the situation is serious, but how radical is the BASF Board really willing to be? Because if I look at headcount, German headcount is only down by 300 jobs year on year, or about half a percent. So, are we going to see a much more radical approach to the German footprint in order to restore that competitiveness over the long term?

Dr. Martin Brudermüller: I said it's serious because you can really see that Europe lost competitiveness compared to other regions. But within Europe, Germany particularly lost competitiveness. And in our industry this certainly has to do with the product slate because we have a lot of base chemicals, more base chemicals than the other European countries. That's why the volumes have come down further in Germany compared with the average in Europe. And that's also why, our headache in terms of competitiveness is really in Ludwigshafen.

Let me also mention that, in a difficult year BASF actually had really good earnings all over the world but not in Germany. So, we are resilient and, I would say, also competitive. But we have to do something here.

When it comes to measures, I said "serious" because although some people and politicians think that the market will come back and that everything will then be fine, some issues in Europe and in Germany are becoming structural. That means these are the framework conditions that BASF will have in the long run. And that's also why Ludwigshafen has to adapt itself to these new market realities.

When it comes to jobs and employment: Letting people go, in Germany particularly, is a difficult task because you have very intensive protection by labor laws. And this is also why

this goes rather slowly, unless you put a lot of money on the table and incur one-time costs to pay people to leave.

So, to a certain extent we also use fluctuation and the demographic situation, since we have a lot of retirements going forward. I think that's the cheaper solution than paying out a lot of money.

When I say structural changes, then I think we have to look into more of the production facilities. Most probably, some are no longer competitive for exporting ex Europe. So, you have to look at the European market realities. You have to look at the decarbonization cost of these assets. It is also a fact in Ludwigshafen that the assets are older on average than at other sites. You have to see whether it really makes sense to maintain and to invest further to keep them. That's an exercise that the new Board will do.

But believe me, we are very, very determined to bring costs down by €1 billion on top of what we had already announced. We have good ideas about how to do this. But let me also say: It's not only about releasing people, it is also about excellence in everything we do, like purchasing, etc. We will reduce the amount of stuff we have to buy; we will also change how we buy. I think it's important to say that it's not only personnel costs. But I would predict, that in coming years the number of people working in Ludwigshafen will continuously go down quite significantly.

We are confident that we will continue to have a Ludwigshafen site. You will hear our plans from Markus and the new Board team in the second half of this year. But it will be a smaller site that is focused on the European markets and the opportunities there.

Chetan Udeshi (JP Morgan): I'm just reading, Martin, your comment in the Annual Report, which says: "BASF remains an integrated company with a broad portfolio. Particularly in a year such as 2023, this structure proved its value once again." I'm just looking at your numbers in 2023, and it's hard to see the value of the integrated approach.

In fact, if I'm a bit more critical, your capital employed from 2007 to 2023 has doubled, but your EBIT is still down in that period. So, as also the new Board looks at the strategic alternatives: Why is the structure of BASF not up for debate? Because clearly, to your comment, it feels, to us at least, the integrated approach is not delivering the value, just from an external point of view.

Dr. Martin Brudermüller: First of all, we have explained to you our Differentiated Steering approach. This aims to give those units that are less integrated in the Verbund – Coatings, Battery Materials and Agricultural Solutions – more space to act as pure plays. I think that will bring the performance up.

On the other hand, I think where you really have an economies-of-scale effect is all the services that are provided, also from finance to R&D and to digitalization and whatever. So, we keep them in the Verbund because we think we will have lower service costs than if businesses are allowed to build up their own structures.

This is why I said: integrated company. I'm very honest here: Some people, particularly on the labor relations side, think BASF is now going to be a holding, and that is not the intention of the Differentiated Steering approach, at least not at this moment of time.

When you say you don't see Verbund delivering, I have to clearly say: If you don't have volumes and you have huge plants for chemicals and materials, then you don't see the Verbund advantage. You see the advantages when these plants are loaded. And this is always when you praise us. In the times when commodities are great, then BASF is super-super strong and much stronger than the competitors because that's then where the materials and the volumes flow and where the full Verbund advantage comes in.

With low utilization, you don't really see it. And this is also why I cannot say and give you big arguments why you would have seen Verbund advantages in 2023.

But it is really in the core. And that is also an approach that we are strengthening with Differentiated Steering because we will then have one ERP system, one S4/HANA core that really caters only for the Verbund businesses. Issues will be much simpler and, with that, also much cheaper.

I'm still convinced: In this true value chain approach, if the plants are under full steam, I say there is a clear advantage for the Verbund, but not with low loads.

Oliver Schwarz (Warburg): The new efficiency program at Ludwigshafen: Are the related costs part of the guidance or are they more likely to drop in in 2025?

Dr. Dirk Elvermann: This is a special items topic, and we are always considering both the benefits and also the cost and then take the net perspective.

Oliver Schwarz (Warburg): Also on the free cash flow?

Dr. Dirk Elvermann: Also on the free cash flow.

Alex Stewart (Barclays): The €1.8 billion of one-time cost to deliver the savings: Could you clarify for us how much of that is cash versus non-cash?

Dr. Dirk Elvermann: I think it's too early to break that down. A big part of the one-time costs are obviously severance payments, which eventually turn into cash; that is very clear. But how this will be staggered over the next couple of years, we will have to see. There will be certainly some rollovers from one year to the other.

I would also say that €1.8 billion as cumulative number is on the conservative side of things.

1.3 Outlook 2024

Chetan Udeshi (JP Morgan): You ended the year with a very, very low number in terms of EBIT or EBITDA, and you are guiding full-year EBITDA to be in line with consensus. What I'm trying to get to is: Are you happy with Q1 consensus as it stands today? Any sense of how Q1 earnings should be?

Because even last year, you as we thought about recovery in the second half, which didn't play out. And I'm just curious how much of that is still the case in this year's guidance, that it's still very back-end loaded in terms of recovery. And what if it doesn't come through?

So, I am just curious: How would you guide us on Q1, whether related to consensus or some sort of a number, so we get a bit more conviction that this guidance is not like the one last year where it was very backend-loaded and hence subject to risk of clearly things not materializing in terms of improvement?

Dr. Dirk Elvermann: I think, first of all, it is great that the analyst consensus is matching our guidance. In terms of EBITDA, it's in line with the consensus, yes.

Our guidance indeed builds on recovery of the economy in the course of the year. We will see volume growth throughout the businesses, but we are also banking on a margin recovery. The first effect is likely to kick in earlier, the margin recovery a little bit later, and then also supported by a strong and strict cost discipline, as explained in our speech. You noticed that we are not only saving costs on the go, but that we are also taking another step of structural measures and that will also contribute overall. So, we stand by that guidance for sure.

Martin Evans (HSBC): If I turn to page 174 of your own report and accounts, the risk section, the potential short-term risks to your EBITDA, a key metric, is quite a negative table you present with the risks to your margins of up to a billion euros and a risk to your business from competition of another billion.

I appreciate this is the risk committee, and they have to be cautious. But you've discussed margin risk from weaker prices, and you've discussed competition risk from China. So, what is the chance that you come back to this later in the year, particularly with the new Board etc. and say that, in fact, you've taken on board your risk committee's issues with the business, and we get a fairly substantial cut to that €8 billion plus guidance?

Because the risk committee's concerns, on margins in particular, look quite scary. Can you discuss?

Dr. Martin Brudermüller: We have certainly put a lot of thought into this, and I think it is a very true and honest risk pattern which we show you.

But let me also very clearly say: I think our guidance this time is not to sell a hockey stick – in other words that everything will get great at the end of the year. As I said in my speech, we rather think it will basically be at a similar level and only slowly crawl up. Everything else then is upside and positive; we take it as we get it.

I think, if you look at the situation – maybe others are getting nervous – the highest risk is from a push on prices and a loss of margins and volumes.

But let me also say: We have a volume target which is higher than the market. This also has to do with the fact that we lost some volumes with outages of plants, etc. And it is also very different by product line.

But I have to say, most of the power that is coming is coming from inside, from structures. This is the cost reduction and all the points that you mentioned. This is why it is not a very intensive, let's say, market-driven, loaded guidance we give. This is why I think it is an ambitious guidance, no question about that. But it's not an unrealistic one if the environment stays like this – and by that I mean that we don't have additional wars and interruptions, etc. If things come back up and we get a hockey stick, then we will deliver more. But in that respect, we feel comfortably ambitious with our guidance.

Jaideep Pandya (On Field Investment): On your Q1 guide or not guide, but on your Q1: Should we think Q1 will be flattish year on year, and you will make up for the 10% midpoint growth that you're alluding to for the year? Or do you think that your start will be a bit soft, given it's such a big ag-dominated quarter?

Dr. Dirk Elvermann: Q1 had a, I would say, solid start. Will this be possibly lower than Q1 2023, which was quite a strong quarter in the overall scheme? Yes, this could be the case, and this would be on the back of the Agricultural Solutions business, as you rightly note.

So, yes, I think it's spot on. A decent start, a solid start. But due to Ag it could be that we come in a little bit lower. But we will have to see what the rest of February and March will bring.

Oliver Schwarz (Warburg): On your free cash flow guidance: The $1.6 billion you expect as a one-off gain from the Wintershall deal in Q4, is that included in the free cash flow guidance?

Dr. Dirk Elvermann: What we get from Wintershall Dea is not part of the free cash flow guidance. So, this is out. This is not accounted for in free cash flow budget. So, you have to see that separately in the cash flows from investing activities. So, it's not in.

Sebastian Bray (Berenberg): What is the guidance assuming in terms of gas price? Is the company reasonably hedged? How much did BASF spend on gas in 2023 versus 2024? We've been very focused on volume recovery, but even if that doesn't materialize, I have the feeling that if gas prices keep dropping, that could be quite supportive for guidance.

Dr. Dirk Elvermann: You note that we are not giving a guidance for gas prices. You see where the gas prices are currently standing. I think many people have been a little bit surprised that prices have stayed so stable over the winter. It was certainly a mild winter. But I think what we have to take into consideration is that in Europe industrial productivity was also very low. So, this offers an explanation.

Is there an upside risk for gas prices compared to what we see today? There certainly is. But I think it remains rather unclear. We are not providing a guidance on gas.

1.4 Wintershall Dea

Samuel Perry (UBS): Do you expect to receive the full cash proceeds at closing, so the $1.56 billion, or is there a delay to the receipt of any of the cash based on the business performance?

Related to this, do you expect to receive a dividend from Wintershall this year while the process is ongoing?

Dr. Dirk Elvermann: We are currently expecting the full cash proceeds of $1.56 billion to be received upon closing. We expect closing, as said, in the fourth quarter.

Wintershall Dea will not pay its shareholders a common dividend this year. Last year, we received a dividend of €290 million. This will not be the case this year.

So, full cash proceeds: Yes. Dividend: No.

Andreas Heine (Stifel): Can you give an update on where you see the discussions about the state guarantees for the lost Russian assets?

Dr. Dirk Elvermann: On the federal investment guarantees: Wintershall Dea is pursuing these claims diligently; this is ongoing.

I have to ask for understanding that we can't disclose any details. But this is developing positively, I would say.

What is always worth mentioning is that these claims are not accounted for. So, whatever is gotten back from the federal investment guarantees is a clear value upside compared to what you see in the financial statements of Wintershall Dea and also BASF.

2 Segments

2.1 Chemicals

Matthew Yates (Bank of America): There was a story on ICIS recently about restarting the smaller cracker at Ludwigshafen. Is that just an automatic return post maintenance, or was there any discretion in that to respond to demand patterns that you may be seeing so far this year? Maybe that related to Sam's question about the impact of the Red Sea on trade flows.

Dr. Dirk Elvermann: Indeed the crackers in Ludwigshafen, as also our other crackers in the worldwide grid, are now running. They run according to demand. At the same time we are being as flexible as we can in adjusting to the demand that we are seeing. But currently, indeed, the crackers are up and running.

2.2 Materials

– No specific questions –

2.3 Industrial Solutions

– No specific questions –

2.4 Surface Technologies

Peter Clark (Société Générale): You talked about tightening belts on the capex for the growth projects. Certainly, on my calculation, it looks like the growth allocation for the capex 2024 to 2027 has come down substantially, over €10 billion to under €7 billion. I know you've already trimmed something. You are getting benefits of inflation being low.

But has something fallen out of Battery Materials? Because, obviously, most of the spend on China is still happening.

Dr. Dirk Elvermann: We are trimming the capex and so the main part of the current investment peak is indeed for the China project. For batteries, we are now taking a little bit of a longer view and are also looking into where we can de-risk with partnerships.

So, you are right: The majority of the investment is in China. Batteries: We are fully committed, but we are slowing down here a little bit.

2.5 Nutrition & Care

Chris Counihan (Jefferies): On Nutrition & Care: Could you talk us through the steps to bring this business back to the targeted mid-cycle EBITDA margin and the timing to realize this? I just ask: As the business used to contribute close to high hundreds of millions of EBIT, it's now closer to break even. The strategy has been a low-cost producer waiting for others to drop out of the market, and that's probably going to take even longer as your European peer is cutting costs, divesting its vitamins business and presumably selling to someone who will drive further cost reduction on its own accord.

It also seems opposite to the new cost savings program, where you talk about adapting production for end market demand. So how long do you continue to accept these results and what's the way out?

Dr. Dirk Elvermann: Our nutrition business has three parts: There's an aroma business. There's a vitamins business, and there is a pharma business.

For aroma, we are currently seeing good volume growth momentum. Colleagues are in a hunting mode to get the volumes in because that is very crucial for this business. And we see that happening. Prices are still under pressure, but we anticipate that the prices are bottoming out here. And we see a pricing upside here over time.

The nutrition business is basically vitamin A and vitamin E. What do we see here? For vitamin A, we now have the full vitamin A plant onstream, which should have the full cash cost advantage in the overall landscape. So, here we are leveraging on economies of scale, and now have to fill that plant. But also with what we see elsewhere in the market, we are confident that we are getting a leading position. If you look at vitamin A prices, historically they are really at the bottom. So here we are banking on the pricing upside that should come.

In terms of vitamin E, you currently see longer shutdowns of plants, for example in China. So, overall, it's getting a little bit more difficult here, which we see also as a possibility to gain momentum on price and volumes.

Pharma, the smallest of the businesses but also worth noting here: If you take just biopharma, for instance, there was a long, long destocking after Covid. But now finally we see the recovery here, so some very positive views.

But you are right: You need staying power, and it takes patience to bring that business back into the profitable arena.

2.6 Agricultural Solutions

Christian Faitz (Kepler Cheuvreux): We hear left and right from industry sources and your peers that the channels are full into 2024. I'm missing any of that in your statements. Is that not what you're seeing as a prominent number three player globally?

Dr. Dirk Elvermann: First of all, we expect another good year from our Agricultural Solutions division. Fundamental demand from farmers is seen. The start into the year will be weaker than last year. And indeed, what you said is right: We are also seeing channel inventory. We see pressure on the prices, and we see the destocking at the distributor level.

So, what is happening there? It seems that distributors are not taking a long shot, but are rather waiting a little bit longer and buying according to the season. We have to bear in mind that there are also higher financing costs out there now. So, we see a little bit of a shift from Q1 to Q2. But fundamentally, we see also demand from farmers in 2024, and this is what ultimately counts. So, some clouds, but still a strong business in 2024.

Sebastian Bray (Berenberg): Ag – what is going right versus your competition? Is there a boom in canola seeds? Are you taking market share in fungicides?

Dr. Dirk Elvermann: What is special? As you know, we have quite a chemicals-loaded business, but we also have strong seed businesses like the canola business you mentioned where we have a leading position, in Canada particularly.

What I can say is: There is no specific concern about any of our businesses in the Ag business. It seems that we are in a comfortable position, both in terms of the business mix and also the distributor landscape that we have.

Sebastian Bray (Berenberg): Just to check that: Can you sell Dicamba at the moment following the U.S. ruling or is that not possible?

Dr. Dirk Elvermann: There is an EPA ruling, as you know, which we take very seriously. For Dicamba, selling the Engenia over-the-top application is not possible for us. Of course, we are observing any ruling there.