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PRESENTATION

Operator

Ladies and gentlemen, thank you for standing by. Welcome to the Covestro investor conference call on the Q3 2016 results. The Company is presented by Patrick Thomas, CEO; Frank Lutz, CFO; and Ronald Koehler, Investor Relations.

(Operator Instructions)

I would now like to turn the conference over to Ronald Koehler. Please go ahead, sir.

Ronald Koehler - Covestro AG - Head of IR

Thank you. Good afternoon and welcome to our Q3 2016 conference call. For your information we have posted our interim report and the conference call presentation on our website and we assume you have read our Safe Harbor statement.

And I now would like to turn directly to Patrick.

Patrick Thomas - Covestro AG - Chairman & CEO

Thank you very much, Ronald, and good afternoon everybody. We clearly had another strong quarter delivering on our promises. We continue to grow above GDP and are able to translate this growth with a positive volume leverage into a strong bottom-line development.

After nine successful months we are once again able to slightly upgrade our guidance. Our shareholders continue to benefit from our strong operational performance.



In the third quarter we are amongst the top picks in the German MDAX with a share price increase of over 32%. Our share price more than doubled compared to issuance price of EUR24 exactly one year ago.

In quarter-three 2016 we achieved another strong quarter with a core volume growth of 9.1% year on year. As promised during the IPO filing our underutilized assets translated into significant earnings improvement. As a consequence, adjusted EBITDA increased by 22% year on year, net income by 62% year on year and free operating cash flow even by 157% year on year. A free operating cash flow of EUR646 million in just one quarter clearly sets a new record.

In the first nine months we continued to grow structurally above GDP by replacing other materials like metals, glass and leather. Growth has also been driven by our new innovations.

Currently we exhibit numerous examples of the K Fair which takes place in parallel as we speak. The K Fair is the largest plastics fair in the world and it just takes place around the corner in Dusseldorf in Germany.

Another pillar of our equity story is our ability to generate a substantial free cash flow. Year to date we have already achieved a free operating cash flow of almost EUR1 billion, hitting the level of the financial year 2015 already after only nine months.

Once again the dynamic demand uplift was broad-based and driven by all regions and industries, although our top country, China, showed the best development with a core volume growth of 25% this quarter though on low comps. You might remember that one year ago the quarter-three figure for China was impacted by severe destocking as many customers adjusted their full-year 2015 growth assumptions in a downward direction. Still we commented in our conference call at that time that we believe China will remain a high-growth country. Indeed we can confirm this trend because we achieved a growth of 18% during the first nine months of 2016.

The United States continues to be well on track this year with a growth of 7% year to date, almost 3 times the GDP growth. Germany stays a relatively weaker spot this year with a core volume growth of 0.4% this quarter. While the sectors of construction and furniture continued to show solid growth rates we observed a slowdown in automotive and electronics.

With a 23% increase in core volume growth Brazil continues its positive trend seen for the first time in quarter two this year. In total the region, Europe, Middle East and Latin America, shows a solid growth of 5% in volume for the nine months, also nicely outgrowing GDP.

We believe that our industry should continue to benefit from a structural upward trend at least until the end of the current decade. The MDI and TDI markets are still suffering from investment decisions even made before the financial crisis. However, we still assume that demand growth will outstrip supply additions until 2020.

Therefore, the current overcapacities will be gradually absorbed. The expected long-term improvement might be accompanied by a volatile short-term development. The current strong price increases in TDI are clearly driven by an accumulation of unplanned outages.

As a consequence, we prepare ourselves for a correction in the market. Nevertheless, the long-term trend is clearly intact and we are even today still far below historical peak margin levels.

For Polycarbonates we should continue to benefit from a balanced supply and demand for the next years. In addition, we also observe a structural improvement in our product mix as we see strong demand growth in higher margin applications such as LEDs, medical devices and automotive interior and exterior applications.

Finally, we generate almost half of our earnings and cash flows from the highly resilient CAS and polyols businesses. This gives us an additional long-term stability.

Now I'd like to hand over to Frank for some more financial details. Frank?



Frank Lutz - Covestro AG - CFO

Thank you, Patrick, and good afternoon also from my side. Our sales development in the third quarter was flat since the positive volume leverage was counterbalanced by declining prices and negative translational foreign exchange effects.

Higher volumes had a positive sales effect of 6.3%. Again, the difference between core volume growth and sales volume growth was driven by declining sales in our non-core businesses and product mix effects.

As forecasted we see again the 3 percentage point gap shown already in Q2. The price decline results from the pass-through of the raw material price movements to our customers. Finally, we had limited negative effect from exchange rates mainly driven by the Chinese renminbi, Mexican peso and US dollar.

Similar to last quarters, volume leverage represented again the main earnings driver in Q3 2016. In addition, we benefited from a positive price delta as our selling prices dropped less than raw material costs. This was predominantly driven by TDI. As mentioned already, we had a slightly negative burden from foreign exchange mainly driven by translational effects.

In the third quarter we generated an EBITDA margin of 19.0%. Accordingly in nine months 2016 we generated a margin of 18.3%. Our margin improvement was helped by the deflationary environment.

Over the last two years the pass-through of lower raw material costs burdened our turnover by almost 20%. At the same time, our EBITDA per tonne was not affected by the lower sales per tonne. As a consequence our reported margin also improved helped by these mathematical effects.

In Polyurethanes our core volumes significantly increased by 9%. This is now the third consecutive quarter of achieving a high single-digit growth. We believe that this is driven by solid underlying market development as well as market share gains.

In the first nine months our reported EBITDA margin improved by more than 4 percentage points to 16.1%. Despite that our cash margin per tonne was roughly stable compared to last year.

This EBITDA margin improvement was driven roughly half by our positive volume leverage, that means the higher utilization rate decreased our fixed cost per tonne, and half by the deflationary effect on the top line. Overall our margin per tonne is still significantly below historical peaks.

Polycarbonates generated an impressive double-digit volume growth of a 11.6% in Q3 of 2016. The continuously high growth rates increase our confidence in the fact that our replacement technologies are enablers for structural long-term growth, which is broad-based across industries.

The EBITDA margin remained sequentially unchanged on a high level close to 23% despite the startup costs we faced in China. We inaugurated two new world scale production lines at our site in Shanghai two weeks ago, thus doubling the nameplate production capacities from 200 to 400 kilotons per year in total and reestablishing Covestro as the world's largest polycarbonates producer. This expansion is well-timed as more capacities are needed to fulfill the growing customers demands.

In Coatings, Adhesives and Specialties we achieved a solid volume growth of 3.5% year on year, partially supported by low comps. We continue to see the negative effect on core volumes from the phase-out of a trading product. We estimate the impact at around 5 percentage points on core volumes and 3 percentage points on sales in full-year 2016. The underlying business achieved a high single-digit growth, reassuring our assumption that we should be able to generate a mid-single-digit core volume growth in full-year 2016.

In Q3 of this year our margin remained at a high level driven by the positive product mix effects. Please note that we expect the usual seasonal margin reduction in Q4 2016 similar to last year.

Our total debt stayed almost unchanged since the beginning of the year. In fact, we see on the graph that our net financial debt could be significantly reduced but that the benefits of the high free operating cash flow generation were eaten up by higher provisions for pensions.

We currently consider funding parts of our pension provisions. This might lead to a cash outflow in the fourth quarter. Obviously, such a move would reduce our pension provisions but increase our net financial debt at year-end.

As our EBITDA is nicely up our total net debt to 12 months rolling EBITDA was reduced to 1.9 times. Our target remains unchanged to reduce net debt to EBITDA to 1.5 times over the next years.

With this I hand back to Patrick for the outlook.

Patrick Thomas - Covestro AG - Chairman & CEO

Frank, thank you and let me continue with some guidance for 2016. So in the first nine months of the year we saw a very dynamic volume and earnings growth. So far our start to quarter four was encouraging in Polycarbonates and CAS, although we have to keep in mind the normal seasonality which usually leads to a significantly lower margin in the fourth quarter.

We also see a strong underlying demand in Polyurethane. However, here we face a severe production problem in Europe due to a force majeure of our nitric acid supplier.

At the same time prices for TDI and MDI are strongly up. Overall, with all these moving parts it is very difficult to assess the development in quarter-four 2016.

Nevertheless, given our strong year-to-date development, we see upside to our free operating cash flow and ROCE guidance which we both raised slightly. The free operating cash flow is now expected to be above last year's record level and the ROCE should now be significantly above last year's level.

We keep our guidance unchanged for the core volume growth at a mid to high single-digit increase. However, the force majeure is expected to reduce our available volumes in Polyurethanes significantly in the fourth quarter. As a consequence, our full-year volume growth is expected to be in the lower half of the guided range.

We now guide for an EBITDA of around EUR1.9 billion. Once again, we have to consider the force majeure which leads to higher-than-usual volatility.

We slightly lower CapEx guidance for 2016 mainly due to phasing. However, we stick to our CapEx budget of around about EUR1.6 billion for the three years of 2016 to 2018.

Overall, our investment case remains unchanged. We are committed to deliver strong organic volume growth which should support a strong earnings and cash flow generation. Full-year 2016 is the foundation for our progressive dividend policy.

Delivering on our promise is very important to us. Given the strong earnings development this year to date we consider now a payout ratio in the lower half of the previously envisioned range of 30% to 50% as more appropriate. Despite the continued limited visibility and high uncertainties we remain committed to deliver on our guidance.

Thank you very much for listening. And we are now opening up for your questions.

QUESTIONS AND ANSWERS

Operator

(Operator Instructions) Paul Walsh, Morgan Stanley.



Paul Walsh - Morgan Stanley - Analyst

Yes, good afternoon Patrick, good afternoon Frank. Thanks for taking my questions. I will just ask two, if that's okay.

The first one around the guidance, can you give us a bit more detail on your assumptions for Polyurethanes in the fourth quarter, i.e., what are you assuming in terms of lost volume? And for your calculations are you using average selling prices and margins from the third quarter or are you taking into account the significant increases we've seen over recent weeks? That's my first question.

The second question relates to MDI specifically and just your views on how you see supply increases in MDI panning out next year, obviously excluding the one-offs. I think that's measurable for everybody. But what are you feeling in terms of the timing of supply increases?

Are there any delays and how you see the MDI market's underlying panning out through 2017? Thank you.

Patrick Thomas - Covestro AG - Chairman & CEO

Thank you very much, Paul, thank you being the first out of the hatch there. So the MDI/TDI force majeure, it is quite difficult to provide exact figures for quarter four because there are quite a few moving parts going on here. However, we have seen estimates ranging from EUR20 million to EUR40 million per month or EUR40 million to EUR80 million for the total force majeure impact.

We feel quite comfortable that we can keep the net impact within this sort of range and our net impact calculations net of volume losses but also current market price increases not priced off the back of an average of the last rolling months. Then in terms of MDI supply, this has been a little bit of a moving feast as we've looked at revising our timings in terms of what happens next on MDI, particularly looking at next year.

I think the one thing we have seen is there was some new announcements from Dow suggesting that the MDI facility at Sadara would probably not be onstream earliest mid-2017. So we now have that in our model as half the capacity next year. We think it may be delayed further based upon the fact that the cracker started up somewhere between 12 and 18 months late.

It's certainly significantly later than was expected. And, of course, the startup of this facility was highlighted as one of the big risks in the original prospectus for Sadara. So I think there may be some challenges there around how we see what happens next.

I did do a rerun of the spreadsheet for capacity addition from 2015 through to 2020. And I now get an average CAGR of around 2.6% addition rate. But otherwise I think all the other changes next year are pretty much as we had planned.

We assume that Chongqing will be able to run at full rate. Obviously we will be at the end of life of Tarragona, so by the end of the year we will be closing that facility but we will get a full year's operation.

And there will be a slight pause then in our capacity until 2019 when we will have a full year of operating the converted TDI plant which we have converted into MDI in Brunsbuettel. Elsewhere everything remains pretty much unchanged.

Paul Walsh - Morgan Stanley - Analyst

Okay, brilliant. Thank you very much.

Operator

Lutz Grueten, Commerzbank.



Lutz Grueten - *Commerzbank - Analyst*

Yes, hi, good afternoon. Thanks for taking my two questions.

The first one is regarding your fixed cost base. I read somewhere that this is quite high and typical for the performance for the polymer industry. Could you please remind me what the fixed cost base is within Covestro on a group level? That's the first question.

The second one I missed a comment on your cost-cutting initiatives in 2016, what will be achieved by end of this year and what will be the additional cost-cutting target then for 2017? Thank you.

Frank Lutz - *Covestro AG - CFO*

Hi, Lutz, it's Frank speaking. On your first question when we look at our production cost, roughly one-third is fixed and two-thirds is variable cost.

And the variable part, of course, also includes raw material cost. And then in addition to that if you also take SG&A and especially the G&A part into account then an additional about 3.5% of sales is G&A costs.

Lutz Grueten - *Commerzbank - Analyst*

3.5% of sales --

Frank Lutz - *Covestro AG - CFO*

Exactly. 3.5% of sales is general and administrative expense cost. In terms of our profitability enhancement program, I think we are completely on track. As you know, we have promised during the IPO that we will deliver EUR420 million by the year 2019 on a gross basis.

We also said that we see the first year 2016 as the year where one-time cost will basically balance out the first positive effects that we see coming out of this profitability enhancement program. And then as of 2017 we gradually see an increase, roughly speaking a third, a third, a third per year, maybe a bit more in 2017 and then phasing fully in by the year 2019. So that will be what we are expecting to see for the three years to come.

Lutz Grueten - *Commerzbank - Analyst*

That's quite helpful. Thank you very much.

Operator

[Rory Eliket], Appaloosa Management.

Rory Eliket - *Appaloosa Management - Analyst*

Thank you for taking my question. Just as it relates to the Polyurethane side with the spike in TDI, are you seeing customers shifting at all from TDI to MDI where that's possible?



Patrick Thomas - Covestro AG - Chairman & CEO

Okay, I'm going to try and repeat your question because for some reason our audio signal was very low on your question. You are asking a question about the shipping of MDI around the world as a result of --

Rory Eliket - Appaloosa Management - Analyst

TDI prices --

Patrick Thomas - Covestro AG - Chairman & CEO

Movement from MDI to TDI substitution. Or was it a shipping question? Sorry, your voice is very --

Rory Eliket - Appaloosa Management - Analyst

No, more on the substitution side of it.

Patrick Thomas - Covestro AG - Chairman & CEO

Substitution, okay. Thank you very much. Now it's very difficult to hear you, I'm afraid the line was not very good.

So in substitution year on year pretty much 1% of MDI growth is at the expense of TDI. And that is something which has gone on over many years. And a typical example there would be as you move from a low grade mattress, which is 100% TDI based, to a more high-quality mattress which may include viscoelastic foams or the sort of facilities you see in Tempur mattresses, so very high-end orthopedic mattresses, you start to use more MDI.

So within each sector of the TDI industry including automotive seating there is a slow and steady substitution of about 1% per year with MDI. It's very difficult to make that substitution suddenly. It takes quite significant development period to actually make the change.

So when there is a shortage of TDI is very difficult for somebody to switch MDI into the application quickly. The change I'm talking about takes place over long periods of time and really is because of upgrading of the end-use products.

Rory Eliket - Appaloosa Management - Analyst

Okay, thank you very much.

Operator

Andrew Benson, Citibank.

Andrew Benson - Citi - Analyst

Thanks very much. I guess at some time around this time last year when you went into forecasting process and obviously the Chinese, some macroeconomic picture looked a little bit cloudy at that point. You were relatively cautious in your assessment and that carried through to the start of the year and into comments that Bayer made about your likely performance.

With the benefit of hindsight, and it's always easier with the benefit, can you try and disaggregate where you think you were a bit cautious and where you think if you let unforeseeable events happened and just try to help qualitatively in defining what's a sort of one-off and what is underlying the market just happened to be a bit better? And, secondly, the volumes in China are really extraordinary and must be very considerably ahead of the market.

I know Wanhua had some production troubles and BASF hasn't managed to load Chongqing because of chlorine and other shortages. But how do you see that Chinese market unfolding and how do you see the competition reacting to try and take back market share in due course, please?

Patrick Thomas - Covestro AG - Chairman & CEO

Thank you very much for your questions, Andrew. Sorry you didn't make pole position this call round.

Andrew Benson - Citi - Analyst

Yes, I was very disappointed.

Patrick Thomas - Covestro AG - Chairman & CEO

Faster on the button next time. So China, yes, August and September this year were extremely strong. In fact, they are record months for us in terms of China.

And if we look at where that growth is coming from it's driven by sales principally into the appliance industry and also by a very high season for notebooks. Strong automotive sales in China and also don't forget there's been pre-buying for Golden Week which this year fell into October. So that's quite important when you look at the third-quarter numbers.

When you referred earlier to how people were looking at China, I think one year ago we were sitting here rather confused by how negative people were being around China because what it looked like to us was destocking but everybody else seemed to think there was an economic downturn. This very high growth that we've seen in quarter three, so that's partly based upon that low growth last time last year in quarter three in terms of the destocking.

What's happening in October at the moment, we expect some lower volumes because of the pre-buying that's taken place. We also expect the isocyanate pricing to remain fairly volatile.

If I look at individual sectors then it's quite interesting. So in quarter three in Polyurethanes the appliance business, which is polymeric MDI, picked up and we also saw some restocking on TDI. September is always a high month for polymeric MDI and TDI.

The prices surged and encouraged stock building from the customer side, as well. So we've got almost the opposite of last year which was destocking. If anything we've got pre-stocking ahead of price concerns, so that I think has exaggerated the situation.

Year to date if we look over a broader time period both MDI, pure and MDI polymeric are both good in terms of volumes partly because of an expansion of the customer base and also the prices on MDI have developed fairly favorably. Year-to-date volumes on TDI are up as well and prices are continuing to rise.

Polycarbonate saw very good third-quarter performance, which is traditional. Quarter three is always the high season for notebooks as well as strong automotive sales. In the gaming and toys industry we see high growth and head of Christmas.



Year to date the growth has been 19% and part of that has been share taking because of the number of competitors who experience planned and unplanned supply limitations on the PCS side. In CAS in China we've seen the sales up year on year and sequentially at a similar level to quarter two. The volumes in quarter three were slightly below previous year.

Overall year-to-date volumes up 11% and that is this continued trend of replacing solvent-based coatings and adhesives with waterbornes, particularly in the furniture industry but also now in the automotive interior segments. So this has moved beyond synthetic leather textiles and footwear into the furniture and auto interior segment area.

So I think bottom line for China for us has been we have always assumed that China runs at about a 6% GDP. We plan on the basis of 5% to 6% GDP. I think we are in that zone depending upon whose numbers you look at.

The important thing for us is we are seeing a multiple of that GDP level, which we would expect to see in China. And this quarter is artificially higher than the artificially lower quarter of last year, and I think that's probably the best way of explaining it. Does that make sense, Andrew?

Andrew Benson - *Citi - Analyst*

It does. But you wouldn't, 25% growth in the third, you wouldn't say, you surely must think you are taking a bit of market share and that might unwind.

Patrick Thomas - *Covestro AG - Chairman & CEO*

That has to be true. And part of that is because one of the things that we've just done as we reported on it started up our Polycarbonates extra two lines. And if you remember about a year ago, we were talking about starting up the first 100,000 tonnes by the end of this year and the second 100,000 tonnes by the end of next year.

We really had to bring that forward because the sales levels were developing to the point where we needed the second line up and running quite quickly. It didn't incur any extra cost to speed that up. If anything, it actually saves us money to speed it up.

And so we decided to do that and we currently have both the new 100,000 tonne lines running. So we now have a total of 400,000 tonnes capacity in Polycarbonates in China. And that is pretty much occupied at the moment.

We are building up the running rate on the new second line and it's looking extremely good. So that is based basically on lack of other supply and market growth.

Andrew Benson - *Citi - Analyst*

Okay, brilliant. Thanks very much.

Operator

Martin Roediger, Kepler Cheuvreux.

Martin Roediger - *Kepler Cheuvreux - Analyst*

Yes, thanks. First on the supply issue from Ineos, when do you expect the raw material supply to normalize? And did you already run out of raw materials at your European Polyurethane plants?

In regards to that, you showed this 86 million volume effect, your volume leverage for your EBITDA in your EBITDA bridge. I try to understand which you said that is sustainable in the fourth quarter having in mind eventually problems in volumes in MDI and TDI at least at your European plants in Q4. Maybe you can help me here to get a better understanding about that let's say volume leverage effect in Q4.

Finally, on tax rate the guidance is around 30% for this year while you had 28.3% the first nine months. Would 28% tax rate also fit to your definition of around 30%? Thanks.

Patrick Thomas - Covestro AG - Chairman & CEO

Thank you very much, Martin, for these of good questions. So let me start off with our nitric acid supply. Our nitric acid supply has a mechanical problem with one of the big pieces of rotating equipment that sits in the plant.

As a result of that, they've had to remove that from the plant, send it to another country in Europe to get it fixed and we believe it will be back and fully fixed by December 11, somewhere during that week. That's when we expect to receive supply from that plant, from our original plant that we normally get supplied from. In between times, of course, every day we are finding other supplies of nitric acid where we can from all around our region and from around the world.

The difficulty there is, obviously, logistics and we have a few challenges with logistics at the moment in between locations, particularly on the Rhine because the water level of the Rhine is extremely low at the moment. And we're able to operate with relatively small cargoes on the Rhine at the moment, much smaller than usual. Normally we would be able to replace this capacity much, much faster but unfortunately things have conspired against us in that case.

So we believe we will be up at full rates shortly after December 11, week of December 11 when the nitric acid unit should be back on stream. In the meantime, we are mitigating that impact as much as possible as you can imagine.

The second question is on the EBITDA bridge. Frank, do you want to --

Frank Lutz - Covestro AG - CFO

Sure. Martin, I think on the volume leverage question for Q4 I think it's hard to answer that at the moment given that as Patrick just explained we don't really know what the volumes will be and what the impact on our volumes of the force majeure exactly will be. I think the best guidance that I can give you is we gave the guidance for the full year of EUR1.9 billion, and we said that everything is factored in there and I think this gives you some sort of indication of what kind of volume effect and volume leverage effect we see in there.

On your tax question though, on the tax side I would say 28% is not around 30%. But we would stick to our 30% guidance for the time being. It is in the end really a question of composition of our profits.

The more we generate in lower tax countries, and especially Asia I would certify into this category, the better, of course, our effective tax rate will be. And we will see how that continues for the remainder of the fourth quarter.

Martin Roediger - Kepler Cheuvreux - Analyst

Thanks.

Operator

Patrick Lambert, Raymond James.



Patrick Lambert - *Raymond James - Analyst*

Hi, good morning everybody. Thanks for taking my questions. Again, regarding the force majeure, just to make sure that I understood correctly, you estimated the EBITDA impact in Q4 in PUR between, what, EUR20 million up to EUR80 million.

Is that correct? That's the first question.

The second question is the same impact on cash flows, if I remember correctly when we were discussing at Q2 level in terms of working capital in the second part of your year you were hesitating on actually trying to get a bit more inventories by the end of the year. I think it's going to be very difficult with the force majeure.

Could we see actually a pretty nice free cash flow development there? And you raise your free cash flow development for the full year. Can you quantify that a bit with your EBITDA guidance linked to that and inventories management? Thanks.

Patrick Thomas - *Covestro AG - Chairman & CEO*

Thank you very much, Patrick, for your questions. So let me just clarify my position on the numbers relating to the force majeure. The EUR20 million to EUR40 million was an effect per month on EBITDA and the EUR40 million to EUR80 million was the total force majeure impact.

Patrick Lambert - *Raymond James - Analyst*

So assuming two months down.

Patrick Thomas - *Covestro AG - Chairman & CEO*

Exactly. That's it. That was how I was getting at it.

Patrick Lambert - *Raymond James - Analyst*

Sure. The free cash flow?

Frank Lutz - *Covestro AG - CFO*

On the free cash flow well, Patrick, you are right. It might get a bit more difficult to build up inventory given the force majeure that we see currently. We have not estimated a significant additional impact on working capital so far.

Let's see how the fourth quarter continues. At the moment, if you look at our inventories or at our let's say the total working capital, that's about EUR200 million higher than at year-end 2015, and that's the normal effect that we always see that at year-end our working capital tends to go down and then in Q1 of the following year working capital goes up. But that's already factored into our guidance of free operating cash flow for the full-year 2016.

Patrick Lambert - *Raymond James - Analyst*

May I ask a quick one? Has Wanhua restarted its MDI plant in China?

Patrick Thomas - Covestro AG - Chairman & CEO

We expect them to restart, I think it's published as mid-November. And I don't think they have had any significant loss of position in the market because when they went into the turnaround they published that they had adequate stocks to take them through to the end of the turnaround. And I'm not sure that the tragic explosion that they had has changed that.

Patrick Lambert - Raymond James - Analyst

There was no investigation post that?

Patrick Thomas - Covestro AG - Chairman & CEO

That's right. Sorry, there is an investigation but we do not believe that it will affect their restart up.

Patrick Lambert - Raymond James - Analyst

Thanks, Patrick.

Patrick Thomas - Covestro AG - Chairman & CEO

Based upon what they are saying to the market, you are asking the wrong expert here. You should be asking Wanhua these questions.

From what we understand of what Wanhua is saying, they were pre-stocked ahead of the turnaround. The turnaround is still the same length of time and we don't think from what they have said in the market that their investigation into their tragic explosion will cause any delay in the startup.

Time alone will tell but that's what they are saying. And we know (multiple speakers)

Patrick Lambert - Raymond James - Analyst

So mid-November is the time to look?

Patrick Thomas - Covestro AG - Chairman & CEO

That's what they are saying.

Patrick Lambert - Raymond James - Analyst

Thank you.

Operator

(Operator Instructions) Geoff Haire, UBS.

Geoff Haire - UBS - Analyst

Good afternoon. Just two very quick questions. First of all, just your comment on the payout ratio.

I just want to check. I am assuming you're happy with where the consensus of the dividend is at the moment. You are not suggesting that the dividend could be cut below where consensus is? If you could just comment to that.

And then the other question is I just a point of clarification. I think you very happily described what the makeup was of the increase in margin for the PUR business. I was just wondering if you could repeat that, I didn't quite catch the numbers.

Frank Lutz - Covestro AG - CFO

Thank you. Let me answer your question on the consensus on dividend.

Yes, we are happy where the current consensus stands. Let me remind you, though, we said 30% to 50%, our current earnings per share stands at EUR3.31. So you can do the math and we will definitely be within the range.

Geoff Haire - UBS - Analyst

Okay.

Patrick Thomas - Covestro AG - Chairman & CEO

Maybe, Geoff, I can give the view on Polyurethane margin in a slightly different way. Because I had a number of questions about are we already above mid-cycle margin or not? In the first nine months we've seen on average an unchanged cash margin per tonne for Polyurethanes compared to last year.

We calculate cash margin by deducting raw material costs from revenue per tonne. So just to be clear where we are. Our EBITDA margin improvement was driven principally by positive volume leverage and the top-line deflation as I explained earlier.

In our view the average cash margin per tonne was below mid-cycle levels during the first nine months. Admittedly, the cash margin improved during quarter three, but is still around mid-cycle levels. So overall we believe the cash margin should improve during the next years driven by the improved industrial capacity and utilization rates.

So it might not be a completely linear relationship and we can't exclude any further short-term disruptions caused by plant outages. But directionally it should be clearly up there after. Does that make sense?

Geoff Haire - UBS - Analyst

Yes, that makes sense. Thank you.

Patrick Thomas - Covestro AG - Chairman & CEO

Thanks, Geoff. It was a good question. Thank you.

Operator

Peter Mackey, Exane BNP Paribas.



Peter Mackey - *Exane BNP Paribas - Analyst*

Good afternoon, everyone. A few questions from me, please. Firstly, going back to the good old force majeure again, it seems as if you won't be drawn on your operating rates at the moment, though it would be very helpful if we could.

But are you able to and perhaps choosing to produce TDI rather than MDI at the moment given what's going on in the TDI markets? And are you actually able to crystallize some of the TDI spread that we're seeing?

Secondly, are you seeing any sign at all of input prices beginning to reflate in CAS at all? Thirdly, just on working capital, there was this line which appears to have been restated relating to other non-cash items in working capital, which swung quite significantly from a negative to a positive year on year. I wonder if you could just run through those or the factors there.

Just a final question, perhaps a slightly more conceptual one, but, obviously, TDI has been very buoyant over the last four or five months even prior to your force majeure. It, obviously, the BASF situation last week created some further sentiment issues in the TDI market.

What would you look for -- what should we be looking for a normalization of TDI? Everything that you are looking at and that we are looking at suggests below, comfortably below mid-cycle utilization rates.

What is it do you think that will be the trigger for things to get back to normal in TDI? That's it. Thank you.

Patrick Thomas - *Covestro AG - Chairman & CEO*

Thank you, Peter. Thank you for a good set of challenging questions.

Whenever you preface something by I just have a number of short questions I know what to expect. Okay.

Peter Mackey - *Exane BNP Paribas - Analyst*

Sorry, they became a bit longer.

Patrick Thomas - *Covestro AG - Chairman & CEO*

It's fine, Peter. So operating rates, no, we never talk about our own operating rates. Correct.

On TDI versus MDI switching and optimizing margin we do a little bit of that. We can do a certain amount of that. It's really quite difficult.

You have to remember that at the current TDI margins the MDI specialties are just as attractive. So it's not actually as obvious as you might think looking at the MDI pricing in ICIS because that's the kind of more the commodity end of the market where you see pricing there.

Of course, what we are trying to do at the moment given limited feedstock is optimize the whole equation. And so it's a day-to-day product management task that we go through.

And also we have to look at all our customers and treat them in a fair and honest way because we've declared force majeure. So there are certain legal constraints to what we can do in terms of fixing that mix.

So I think it's fair to say we are doing our best to optimize to avoid customer damage first and financial damage second. We are trying to do both those things in the optimal way.

If we look at raw materials let me just check my chart on raw materials. I've got it just here. I was looking at some of the feedstock comparisons.

In the CAS side there's been some very, very slight inflation on the raw material side but nothing that is too dramatic or has caused any concern in that space. Your question on TDI, what causes, to think we've gone back to normality.

Some people who would be cynical would say we are in a normal state of TDI because TDI plant reliability has always been an issue. TDI plants are extremely difficult.

And I think the key, and I think physically there is no connection as far as I can tell between the awful explosion that BASF had which was very tragic which was principally affecting polyolefins and olefins and their ability to start up their TDI plant. I don't think there's any issue there.

For me, when you see the TDI plant in Ludwigshafen running normally and then the trigger point for that in my mind, this is just my opinion, you have to ask BASF whether they think my logic is right, but what I'm looking for is when they closed Schwarzheide. When Schwarzheide shuts down as the old TDI plant then you know that they've got confidence in the new TDI plant, then you have reached a normal level of stability.

And when our force majeure ends on TDI in Europe then I think we will be back to the normal stability, albeit a fairly volatile stability because it is TDI. I think that's the best way of looking at it.

Frank Lutz - Covestro AG - CFO

And on your question regarding working capital and especially the line item changing other working capital and other non-cash items let me elaborate a little bit on that. First Q3 2015, you might remember that in Q1 of 2015 we announced that we would close our site in Belford Roxo and in order to take care of all the closure-related cost we built some provisions in Q1 of 2015.

In the carveout process it was decided that the site in Belford Roxo would stay with Bayer, which means that in Q3 of 2015 when the carveout happens we could dissolve those provisions that we had built in Q1 of 2015 at the site and, therefore, also the related costs stayed with Bayer. And that is why you see a negative effect in Q3 of 2015.

In Q3 of 2016 you see a higher number, and that is predominantly a root cause for that, we had to build higher provisions for short-term incentive. You did not see such a high number in the first two quarters because in especially Q2 we paid out the short-term incentive for 2015. So provisions that we had built could be dissolved.

Others were built for 2016 so they counterbalance each other to some extent. And now in Q3 you see the full impact of all the provisions that had to be built for the good performance in 2016 that was related to the third quarter. That's the explanation of those two figures.

Peter Mackey - Exane BNP Paribas - Analyst

Wonderful. Thank you very much indeed.

Operator

Thomas Swoboda, Societe Generale.

Thomas Swoboda - *Societe Generale - Analyst*

Thank you for taking my two questions. The first one is on autos. Some of the US automakers are talking about cooling down of selling volumes going into 2017. I'm just wondering in terms of your geographic exposure, is your exposure to the auto sector comparable to your group exposure or should be aware of some shifts to this exposure?

And, secondly, if you could comment if you have any anecdotes about your selling volumes to the auto industry, especially in the US and Europe if you have any? And secondly, a very quick one on the funding of pensions, and sorry if I missed it but did you attach a number to your plans? What is the volume of the funding you have on your mind? Thank you.

Patrick Thomas - *Covestro AG - Chairman & CEO*

Okay, thank you. Let me just give you some brief view of how I see automotive at the moment. So I think in Europe, Middle East what we are seeing is continued growth which is relatively stable.

It's not as strong as it has been in previous years. I think the issue there is possibly about Brexit because the UK, obviously, imports about 90% of light vehicles in Europe.

In NAFTA we have seen very strong demand earlier in the year, which was principally because of these OEM incentive programs which were offering the 0-0-0 deals. So you got a car but with zero maintenance cost for the first five years, zero interest credit, zero insurance charge, dot, dot, dot, dot. There were a lot of these promotional deals.

I think that's slowed down now. I think probably 2016 will end flat pretty much on 2015's level of about 17.5 million vehicles if I remember rightly.

I think in Asia-Pacific you've got a very, very different story. I think you got solid production in China. Right the way through to 2017 there are tax incentives.

You got this strong growth rate and electromobility, which although it's only a small part of the segment at the moment, probably about 1.6% share, it's growing at about 125% per annum. And we are also seeing more use of our CAS-type products for automotive coatings as they start to make more cars for export. So that's been driving our CAS business in Asia-Pacific.

The main drivers that are relevant to us are high-end coatings in our CAS business, Polyurethanes and Polycarbonates for the light weighting. If we look at what happened in quarter three year on year in automotive, volume wise Germany was about negative 7%, the US was about plus 2% and China was plus, 33%. It really is a dramatically different picture from region to region.

So hopefully that insight is helpful on the automotive story. Pensions.

Frank Lutz - *Covestro AG - CFO*

Yes, the funding of the pensions, Thomas, we have not taken a final decision yet. We will do so in November.

We're watching our cash flow generation at the moment. And assuming that the cash flow generation will continue as we currently see it I can imagine that we will spend a number somewhere between EUR400 million to EUR500 million on funding our pension liabilities.

Thomas Swoboda - *Societe Generale - Analyst*

This is helpful indeed. Thank you very much.

Operator

Mr. Koehler, there are no further questions at this time. Please continue with any other points you wish to raise.

Ronald Koehler - Covestro AG - Head of IR

Good. Thank you all for participating and for your interesting questions. I will be looking forward to see you either on the road over the next weeks or months or later with our full-year conference call then next year. Thank you and goodbye.

Operator

Ladies and gentlemen, this concludes the investor conference call of Covestro. Thank you for participating. You may now disconnect.

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