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PRESENTATION

Ronald Koehler ***Covestro AG - Head of IR***

[Welcome to the Covestro Earnings Call on the FY and Q4 2023 results. The company is represented by Markus Steilemann, CEO and Christian Baier, CFO.

During the presentation, all participants will be in a listen-only mode. The presentation will be followed by a questions and answers session. If you have a question, please use the "raise your hand" function for or post your question into the Q&A tab] (added by company after the call). You will find the quarterly statement and earnings call presentation at our Investor Relations website, and I assume you have read the safe harbor statement.

With that, I would now like to turn the conference over to Markus.

Markus Steilemann ***Covestro AG - CEO & Chairman of Management Board***

Thank you, Ronald, and good afternoon and warm welcome also from my side. Looking back to another challenging year. While the effects of the coronavirus were easing significantly during 2023, the ongoing Russian war in the Ukraine is still impacting the economic development of Europe. The weak demand in most of the core industries that Covestro is involved in had a strong impact on our financial performance.

Let me give you an overview of the key financials. In 2023, Covestro achieved sales of EUR 14.4 billion, clearly down versus 2022. This decline was driven by lower prices and lower volumes. The EBITDA also decreased to EUR 1.1 billion, showing the severe demand crisis we are facing. Despite the lower EBITDA, we could secure a positive free operating cash flow slightly exceeding our guidance. We ended our share buyback in the third quarter 2023 and executed around EUR 200 million. 4.2 million purchase shares have been withdrawn and the share capital was reduced to now 189 million shares.

Before coming to the nonfinancial highlights, let me comment on the ADNOC status. We are pursuing the ongoing discussions with Abu Dhabi National Oil Company in accordance with our fiduciary duties in good faith, open minded and in the interest of our shareholders and all other stakeholders. As always, the progress and the final outcome of such discussions depends on the ability of both parties to agree on topics where the parties are of different views. We will further communicate when there is an outcome and, of course, in line with our duties under the European Market Abuse Regulation.

Turning over to the nonfinancial highlights. The greenhouse gas emissions went down by 8.4% compared to 2020. They have slightly increased versus 2022 despite lower production volumes, mainly caused by 2 external effects. A major contribution was coming from the increased share of coal and electricity mix in Germany and also from increases in energy-related emissions in North America due to the technical problems at an external supplier. We added the first PPA for renewable electricity in North America to the existing power purchase agreements in Europe and Asia Pacific. The virtual PPA with Ørsted supplies us with 90-megawatt or 12% of our Baytown electricity demand. The new PPA and other additions will increase our renewable share of electricity from 16% in 2023 to around 18% in 2024.

We are also using digitalization to accelerate our progress in sustainability. Digitalization is allowing us to automatically generate sustainability data and create life cycle assessments as well as artificial intelligence supported production planning. Covestro's strategic goal is to become fully circular. On our way towards that target, we now developed chemical recycling for all our core products and are progressing into scale up for an industrial process.

Let us remain on the topic of sustainability as we also announced our Scope 3 targets for our greenhouse gas emissions today, which I will explain on the next slide. We are clearly committed to the goal of fully aligning ourselves with the circular economy. As a globally active company contributing to the reduction of greenhouse gases is a clear priority.

In 2022, we announced our ambitious climate target for Covestro's own greenhouse gas emissions: climate neutrality by 2035. This includes our Scope 1 for own production and Scope 2 for emissions from purchased energy. Scope 3 emissions account for around 80% of Covestro's emissions. So, this is the major lever. Scope 3 includes indirect emissions that arise in the upstream and downstream value chains. Today, we are going one step further by completing our target road map for climate neutrality with ambitious targets for these emissions.

By 2035, we target a Scope 3 greenhouse gas reduction of 30% based on reference year 2021, comprising the growth that we anticipate between 2021 to 2035. This represents a reduction of 10 million tons. We target to achieve complete climate neutrality by 2050. This long-term goal aligns Covestro with the science-based target initiative and the 1.5-degree target. How we are going to do that? We identified 4 major levers for implementing the climate neutrality targets, and I will explain them on the next slide.

As mentioned, 4 levers play a decisive role on the path to climate neutrality for Scope 3. Let me guide you through them and give you examples how we are going to pursue these levers. Lever #1, reduction of Scope 1 and Scope 2 emissions from suppliers: Many of Covestro's raw material suppliers have already set Scope 1 and Scope 2 targets themselves. For Covestro, this means a tailwind in the reduction of Scope 3 emissions. We are further enforcing the path to reductions at our supplies by intensively cooperating with existing and new suppliers.

For example, we have been inviting our key supplier base for raw materials, logistics and packaging to virtual supplier events in the coming week. We want to engage with them to share our targets, discuss cooperations on the way to climate neutrality and develop a Covestro proprietary sourcing strategy to reduce emissions. The feedback is very encouraging and the registration rate is by far exceeding our expectations.

Lever #2: driving forward the "MAKE" investment projects: This involves the production of alternative raw materials for our core products with a lower carbon footprint. In the recent months, we have made significant progress on several MAKE projects. Just to name a few, we inaugurated the pilot plant for the production of bio-based aniline in Leverkusen on February 13. But it also includes the production of plant-based variant of the chemical raw material HMDA, which we are driving forward with Geno.

On the recycling side, Covestro developed with partners an innovative technology for the chemolysis of flexible polyurethane forms from used mattresses, in which both main components- the polyol and the precursor to the isocyanate TDI- can be recovered. In this way, discarded mattress foams are converted directly back into renewed polyurethane building blocks. Similar processes have been developed for MDI-based foams and polycarbonates and are further being pursued going into upscaling phases.

Lever 3: profitable sale of products made from alternative raw materials: Our successfully launched CQ label with minimum 25% renewable content will be a key pillar in this. We will focus on first mover customers and jointly promote products with the CQ label. Our network of 16 ISCC Plus certified plants enables us to supply these products globally and satisfy our customers' demand. The first milestone has been achieved by signing an agreement with the Polish Selena Group on using Desmodur CQ with 60% reduced carbon footprint in construction products.

Lever 4: further supporting measures: This is a bracket around several smaller measures. The one with the greatest impact is the change in logistics towards greener alternatives. We also expect the regulators to impose higher recycling quotas and thus, to improve the availability of recycling loss. As you can see, this is a sophisticated undertaking, and we are excited to embark on this journey with the great team of Covestro, our suppliers and customers believing in our vision.

Let's turn to the next page. After this more visionary topic, we are now coming to the business performance of 2023 and to the volume development of the last year. Year-on-year, the global sales volume decreased by 6.8%. This was caused by ongoing demand weakness across all regions and the already known limitations in our internal availability. However, rate of decline has decreased from quarter-to-quarter throughout 2023 and has turned positive in the fourth quarter 2023. In the first quarter, sales volume year-on-year was down by 17%, second quarter down by 8% and third quarter down by only 4% and Q4 sales volume finally turned positive by 3.2%. This was supported by the weak comparison base in 2022 and the improved product availability after our internal constraints were resolved.

How did the different industries develop? Auto was the only constantly growing industry globally during the full year 2023, benefiting from a healthy order book. After 5 consecutive quarters of contraction in furniture, the negative trend turned around by mid-2023, leading to an overall flattish development year-on-year. Electronics encountered this turnaround only by the third quarter and as such, still exhibits a year-on-year slightly negative development. Despite a positive trend in the fourth quarter, the decline in construction industry is still the most prominent with a high single-digit negative development.

Looking into the different regions, EMLA continued to be the weakest region with declines in 3 of 4 industries important to Covestro. There was a slight decline in construction and furniture and significant decline in electro. A part of the weakness was also caused by the limitations in internal availability. Auto was the only positive industry with a slight increase. Sales volumes in North America also increased slightly in auto, electro showed a flattish development and furniture and construction witnessed an ongoing significant decline. Year-on-year, Asia Pacific witnessed a slight growth in furniture and auto, while electro showed a flattish development. The decline in construction was particularly pronounced.

With the summary of the full year 2023 demand development, I am now handing over to Christian, who will guide you through the financials.

Christian Baier ***Covestro AG - CFO & Member of Management Board***

Thank you, Markus, and a warm welcome also from my side. We are on Page 6 of the presentation. Sales for fiscal year 2023 are down by 20% year-on-year to EUR 14.4 billion. All 3 input factors price, volume and FX were negative. The by far biggest impact of almost EUR 2 billion was coming from 11% lower prices. Here, the business entity Performance Materials declined significantly with minus 15.7% and Solutions & Specialties dropped by 6.4%. The continuing negative volume development of EUR 1.2 billion or 6.8% also contributed strongly to the declining sales.

Here, both segments were almost equally affected. PM with 6.7% decline and Solutions & Specialties with a drop of 6.2%. The negative FX effect of minus 2.2% or EUR 395 million was mainly driven by weaker Chinese renminbi, U.S. dollar, Indian rupee and Japanese yen.

So with that let's turn to Page 7 of the presentation, where we are showing the EBITDA bridge. As you can see, in the full year 2023, EBITDA dropped by 1/3 compared to the prior year. Selling prices declined stronger than raw material costs due to an unfavorable industry supply and demand ratio. As a consequence, EBITDA got a hit of EUR 415 million from a negative pricing delta. Looking at the bridge, it is quite evident that the volume effect in EBITDA contributed almost equally to the decline in EBITDA as the pricing delta.

However, the volume leverage was clearly below the long-term average due to the current trough margins per ton. FX also contributed to the negative development. Only "other items" showed a very positive development. This was driven by the success of our savings initiative with significant reductions of operating costs. These savings were achieved despite additional expenses for variable compensation.

With that, we move on to the sales and EBITDA development of the group per quarter. On the upper half of the page, you see sales continuously declining as an effect of lower volumes and price pressure due to the long market environment for all products. This is hitting especially our Performance Materials segment. That is a strong indication of the economic trough situation that we are currently in. And in the lower part of the page, you see that the EBITDA slightly recovered in a year-on-year comparison. As a reminder, in 2022, we incurred significant idle costs in order to drive down our inventories as we optimized our working capital. In 2023, our production was running on a seasonally normal utilization rate, but our margins per ton in the segment Performance Materials were at historically low levels.

In Solutions and Specialties, sales decreased by 15.1% to EUR 7.3 billion, showing the impact of the demand weakness and the effect of the downward trend in prices. However, these effects are less pronounced than in the commodity segment Performance Materials. The volume decline of 6.2% was significant, but also slightly lower than in Performance Materials. But the positive highlight here is that despite the decline in sales, the EBITDA came out stable at EUR 817 million. This underlines the resilience of our S&S business, even in trough times. As a result of lower sales and stable EBITDA, the EBITDA margin increased to 11.2%. Looking at 2024, the segment S&S will remain a strong pillar of Covestro's success with a guided EBITDA increase significantly above 2023 levels.

Let's now turn to Page 10 and discuss Performance Materials. Performance Materials is the segment with a stronger commodity character. We clearly suffered from the significant erosion in prices and declining volumes, leading to a negative sales development of 24%, down to EUR 6.9 billion for fiscal 2023. Performance Materials was significantly burdened by a negative pricing delta given the low industry utilization rate. So overall, the EBITDA in the PM segment declined year-on-year by 39% to EUR 576 million. And consequently, also the EBITDA margin declined to 8.4%.

The positive news is that quarter-on-quarter, the volume picture improved and even turned positive in Q4 2023. This was mainly driven by the improved internal availability after we resolved our chlorine production issues. Now if we look ahead into the year 2024, we are expecting that our sales volumes will increase year-on-year. As said, we resolved our chlorine production issues. And with that, we expect a significant increase of our utilization rate. Given our cost leadership, we pursue a sell-out strategy to regain market share. Margin wise, the first half of 2024 will be still challenging, but we expect some margin recovery within the second half of 2024. Based on these assumptions, we guide for an EBITDA range of between EUR 400 million and EUR 800 million.

The next topic is the free operating cash flow development for fiscal 2023. As you can see from the graph, the free operating cash flow in fiscal '23 was plus EUR 232 million, slightly exceeding the given guidance of EUR 0 to EUR 200 million. EUR 73 million came from Q4 2023. And as such, we had a strong second half of 2023. The free operating cash flow strongly improved year-on-year despite the lower EBITDA due to continuous working capital management, lower income tax payments and 0 bonus payout in fiscal '23 for fiscal '22.

Changes in working capital of EUR 250 million in '23 were mainly driven by the lower valuation of inventories at year-end. The fiscal '23 CapEx of EUR 765 million was slightly below our guidance of EUR 800 million. Income tax payments were around EUR 150 million less than for 2022 and amounted to EUR 383 million, mainly due to lower earnings. All in all, the fiscal 2023 free operating cash flow has been seeing a strong development, and we are quite proud of this achievement in this weak economic environment. Covestro has always managed to achieve, in any given year regardless of the economic development, a positive free operating cash flow.

Let's now turn to the P&L items below EBITDA. We have been doing our housekeeping already in 2022. So no further relevant impairments were recorded in 2023 or are to be expected in the near future. I would like to highlight the P&L income tax expenses of EUR 275 million: The main reason for this is that we currently incur losses in Germany and Switzerland. Once our business in Germany becomes profitable again, these deferred tax assets are accessible to reduce our tax payments.

In the rest of the world, the positive results are taxed with the national tax rate in the respective countries. Overall, our net income is negative at minus EUR 198 million. And with that, earnings per share amount to minus EUR 1.05. According to our dividend payout policy of 35% to 55% of net income, the dividend will be, as also reflected in the consensus, consequently 0.

Let's now look at our balance sheet on Page 13. Here, we are presenting a solid picture despite the earnings weakness. Our net financial debt is stable with a neglectable increase of EUR 53 million versus end of 2022. The positive free operating cash flow of EUR 232 million has been a cornerstone of this limited increase to now EUR 2.49 billion. The decrease in the net pension liability of EUR 32 million was driven by an increase in the pension discount rates in the U.S. and Germany, especially in the first half of 2023. This comprises pension provisions of EUR 398 million and net [defined] (added by company after the call) benefit asset of EUR 66 million.

Just as a reminder, we executed a third tranche of our share buyback program in 2023 and acquired shares for EUR 49 million. As such, we have spent altogether close to EUR 200 million on the share buyback program. We will be seeking for a renewal of the authorization during the AGM in 2024 to be able to continue anticyclical share buybacks in the future.

Summarizing our net debt situation, the total net debt-to-EBITDA ratio is at 2.7x based on a 4-quarter rolling EBITDA of EUR 1.1 billion. However, based on our mid-cycle EBITDA, the ratio would be only 1.0x. As stated in the past, Covestro remains committed to a solid investment-grade rating, and Moody's confirmed our Baa2 rating with stable outlook in June of 2023.

This finalizes the financial review for fiscal year 2023.

And now over to you, Markus, for the industry outlook.

Markus Steilemann ***Covestro AG - CEO & Chairman of Management Board***

Thanks, Christian. We are now coming to the outlook for Covestro's core industries on Page 14 of the presentation. The global GDP expectation for 2024 is estimated to be 2.4%. Sadly, this slight growth does not apply for most of the key industries for Covestro. Automotive was the positive exception during the past 2 years. However, after the industry worked through its order book, it is now showing significantly lower growth with only 0.8%.

Against this trend, the subcategory of electric vehicles / battery electric vehicles is still rapidly expanding with a predicted growth of almost 29%. This impressive number again outperforms all other growth rates we currently see in our core industries. And especially our engineering plastics entity will benefit from this still ongoing trend towards BEVs. The outlook for the construction industry remains on a low level. It is expected to shrink again by 2.5%. Residential construction also sees a downgrade and is expected to decline by 5.8%. The reason for these trends have not changed: Still elevated interest rates and high cost of building materials.

The furniture industry is set for a stabilization after 2 consecutive years of strong decline. We assume a flattish development in '24. The electro industry has also seen a contraction in the past 2 years with declines of 0.9%. The projection for 2024 indicates a growth of 1.5%. The appliance sector is down versus last year's growth, but overall in line with the forecast development in electro and is expected to increase by 1.4%.

Summarizing this outlook, we see some limited green shoots with the development in electro and furniture, but observe the development in automotive with concern. During the past 2 years, we experienced longer than normal durations of negative growth in furniture and electro. With this experience made, we expect the ongoing construction crisis to continue for some quarters before seeing recovery, maybe towards second half of 2024.

On the next page, we are now coming to the outlook for Covestro 2024. The previously indicated rather slow development of the economy is also reflected in our EBITDA outlook. We are expecting the EBITDA for full year 2024 to come out between EUR 1.0 billion and EUR 1.6 billion. The mark-to-market EBITDA is calculated at around EUR 1.1 billion based on January 2024 margins flat forward and our current budget assumptions for 2024.

Please keep in mind that in the winter season and with Chinese New Year in early February, the margins are usually seasonally low in January. You might wonder about the missing mid-cycle numbers. It does not mean that we have abandoned our mid-cycle concept, we just eliminated the EUR 2.8 billion for 2024 to avoid misunderstandings with the guidance. However, we remain committed to our mid-cycle EBITDA concept with a mid-cycle level as indicated by the blue line. The line is also supposed to increase based on new capacity additions and the shift of commodities to our downstream businesses in Solutions and Specialties. We are confident that we can achieve such an EBITDA level under normal economic conditions.

With this, I quickly hand it over to Christian for the full guidance.

Christian Baier ***Covestro AG - CFO & Member of Management Board***

Yes. As Marcus mentioned, the economic uncertainties are still impacting Covestro's business performance and predictability of our results. The expectation is for EBITDA, as shown on the previous slide, to come out at EUR 1.0 billion to EUR 1.6 billion. The free operating cash flow is forecasted to come out at EUR 0 to EUR 300 million. The range is smaller compared to the EBITDA range as we expect that working capital will breathe related to the economic development. In the case that economic growth accelerates during the year, this would lead to a buildup of working capital and vice versa.

The ROCE above WACC is expected at minus 2- to minus 7-percentage points. The greenhouse gas emissions in scope 1 and 2 are estimated to be between 4.4 million to 5.0 million tonnes. Two [counteracting] (corrected by company after the call) effects are influencing this development. The expected high single-digit percentage increase in volumes will lead to higher emissions. This should be offset by EEG exit in Germany, the increasing renewable electricity share and further efficiencies in our production.

Sales is expected to come in between EUR 14 billion and EUR 15 billion. In Q1 2024, we expect EBITDA of between EUR 180 million and EUR 280 million. This would be above Q4 2023 but below the EUR 286 million in Q1 2023, mainly due to lower margins per ton. We will continue with a reduced CapEx budget of around EUR 800 million. Out of that, we assume an expansion CapEx of around EUR 300 million, mainly for strategic expansion projects.

Our single largest project is the aniline plant in Antwerp, which should support our MDI business in Europe with low-cost raw materials. Expected start-up is in 2026. We assume a high double-digit EUR million EBITDA contribution from this plant. Besides this, we invest mainly in the S&S segment.

And with that, back over to you, Markus.

Markus Steilemann ***Covestro AG - CEO & Chairman of Management Board***

Once again thank you, Christian. So allow me to quickly summarize. Sales decreased to EUR 14.4 billion, and that was mainly caused by lower prices, lower volumes and also an unfavorable currency exchange rate. EBITDA for the fiscal year 2023 was in line with the guidance at EUR 1.1 billion. It was, as we have already explained, burdened by negative pricing delta, lower volumes as well as the currency effects that we have seen. I'm very happy about that we once again demonstrated to deliver a solid free operating cash flow in the full year 2023 of EUR 232 million, which was supported by successful working capital management.

The full year 2024 guidance has just been announced with an expected EBITDA between EUR 1.0 billion and EUR 1.6 billion. And Covestro continues its climate neutrality pathway and we just today announced our Scope 3 greenhouse gas emission targets and aiming for climate neutrality until 2050.

And now Christian and myself are happy to answer any questions that remained open. And with that, I hand it over to Carsten, who will guide us through the Q&A session custom. Carsten?

QUESTIONS AND ANSWERS

Carsten Intveen ***Covestro AG - IR***

Thank you, Markus. (Operator Instructions). And the first question comes from Christian Faitz from Kepler Chevreux.

Christian Faitz ***Kepler Cheuvreux, Research Division - Equity Analyst***

Two questions, if I may. First of all, any early view on how China demand came back out of the New Year celebrations? And the second question would be on, Markus, you mentioned the robust growth in electric vehicle demand -- battery electric vehicle demand almost plus 30% seen this year. Do you not see a certain slowdown, because demand seems to be slowing down also for electric vehicles as we speak? And is that -- could that potentially affect your polycarbonate applications or composite material? And I guess I'll leave the "elephant in the room" question to others.

Markus Steilemann ***Covestro AG - CEO & Chairman of Management Board***

Thank you, Christian. Good to hear you. The economic situation in China on a, let's say, more general view: the service sector currently remains the key driver of growth and China manufacturing rate continues to slightly increase month-over-month, also benefiting from so-called recent stimulus packages. For example, and we come to that later on BEVs and electro particularly, we saw consumption goods growing, while investment level remains weak and real estate market remains really depressed. So China export range turned positive year-on-year already in November, plus 0.5%. That trend also continued in December, driven by double-digit percentage growth in auto, appliances and furniture.

However, and we all know that, unfortunately geopolitics as well as the Red Sea crisis, raise uncertainties. What did we see in our own numbers to give you a quick trading update, we did not believe that China numbers would grow into the sky. But we, from our perspective, would have expected that we will see some growth in China after Chinese New Year: First signs, and we're just 4 days in the week, that means we have only 3 days after Chinese New Year, if you want to say so, in our books!

And therefore, I would see the demand from our perspective, once again in an overall weak scenario, demand as good. And we are also currently pushing in a, I would say, rather encouraging start after Chinese New Year, even though it is based on just a few days, also for some price increases. So that maybe gives you an idea that there is some dynamic currently to be seen.

On the battery electric vehicles, growth rates are slowing down, you're absolutely right. However, that exact number of 29%, for me, I think we could hit that target by year-end. Simply because the situation we see in Europe, the situation we see in Germany, is not necessarily reflecting the aggressiveness, the willingness to go and also the adoption rates in other countries when it comes to BEVs. So from that perspective, I would say that that number is still realistic and also such growth numbers are currently also supported by the numbers that we see in our order books.

On the third question that you indicated, I'm not sure what you're talking about. So... no, just kidding.

Operator

The next question comes from Chetan Udeshi from JPMorgan.

Chetan Udeshi ***JPMorgan Chase & Co, Research Division - Research Analyst***

Just to address the elephant in the room question, just to make it easier. Are you able to confirm whether you are actually in a formal discussion at all, because some of the press reports are saying that you haven't necessarily encouraged any formal discussions? Are you able to confirm whether you are at least in formal discussion?

And then just a second question is on the polycarbonate business, what are the trends you see on your margin in polycarbonate business? Because we've seen just recently, SABIC started up a JV in China after a long delay. It seems still a sort of an inflow of capacity in that part of the chain. And have you seen any improvement in polycarbonate margins? Or is that still very depressed?

Markus Steilemann ***Covestro AG - CEO & Chairman of Management Board***

Yes, Chetan, happy to hear you. This is Markus speaking. It depends always how you define formal. But as we have announced last year in September that we are in discussions, you could call that formal. So in that sense we are discussing. And that's what we have confirmed numerous times already, on numerous times also today. So in that sense, if you define formal that we see each other, that we meet each other that we are discussing topics, yes, we are formally in discussions. I'm not sure whether this meets your requirements in terms of how you define formal, but that's what I can confirm once again.

On your polycarbonate question what we always try to distinguish is that we have standard polycarbonates and that we have blends of polycarbonate where we mix other materials into, which is part of the EP business, engineering plastics business, in our Solutions and Specialty segment, whereas the commodity part is part of the Performance Materials. Why do I emphasize that? The recent capacity additions that we have seen over the last 2 years only came on stream in China, and that has led in China to a massive, let's say, overload of capacity and also globally has put the market into a severe overcapacity situation.

But what we are doing is, and we have started it about 15 years ago already, a strategy to push more and more for high value-added downstream business. And that's why we are talking: we're in the mid-70s to high 70s of business that is already in that high value-added downstream business. So while we are talking, we're getting less and less dependent of that commodity market because we use more and more of our produced standard polycarbonates as a feedstock internally to put then high value-added materials into it.

And then there's typical supply-demand pattern in terms of finding the right prices that do no longer apply. But here really value pricing applies. And that's why still there is the fact that we have a totally oversupplied standard polycarbonate market, but our exposure is now meanwhile in our portfolio, less than 20%. Or 20% plus-ish. But 75% to 78% is in this high-value segment. That is part of our Solution and Specialty segment.

So the margins are rather stable at Solution and Specialty business. And at the same time, while SABIC has finally started its joint venture in China, they also announced publicly that they have shut down a PC line, I think, in Cartagena in Spain. And that plant was actually basically exporting to China. So you see that there's also some cleanup/consolidation with older plants against newer plants happening in the market. I hope that's helpful. I mean both answers hopefully are helpful.

Operator

Now the next question comes from Sebastian Bray from Berenberg.

Sebastian Bray ***Joh. Berenberg, Gossler & Co. KG, Research Division - Analyst***

I would have two, please. The first is on the gas price environment, implicit in the guidance. Spot gas prices in Europe are pretty comparable to early parts of 2021 and even the back end of 2020, these are years in which Covestro have materially high EBITDA on average than what is guiding to now. What is the assumption sitting in the gas price for Covestro at the moment when setting the guidance range be low and high end? And if gas prices were to prevail at current rates, would this be a tailwind to guidance as it has been said.

My second question is again on what happens if gas prices normalize in Germany and other parts of Europe? Is Covestro for a period of having an effective tax rate of about 15%, because it's paying a lot of tax relative to the profitability of the company at the moment? And if it can start to utilize its deferred tax loss carryforwards, does that effectively mean that we're in for a period of 15%, 20% effective tax rates?

Christian Baier ***Covestro AG - CFO & Member of Management Board***

Thank you, Sebastian for your questions. With respect to the gas price development, given that our industry is mostly driven and the margin is driven by the real demand-and-supply utilization situation we are looking especially at this topic. And when we are talking about energy prices, we are taking that as an overall broad box. When we look at the overall energy costs in 2023, we have roughly incurred EUR 1.1 billion of energy cost. We would expect that number to be broadly the same over the year 2024.

And when you are then, as you spoke about our guidance range, I think through that, we are in terms of being at the top or rather at the bottom of the guidance range: This will depend certainly on the margin development, especially towards the later part of the year. And there, it's going to be a matter of a supply-demand balance that should be expected at that point of time and that development to see. So that's what will bring us to the bottom or the high end of the range overall and think about demand and supply in that setup.

With respect to the deferred tax assets and the loss carryforward that we have built over the last 2 years, especially in Germany, which has driven somewhat that slightly distorted, especially when we talk, tax rate perspective. This is something where we will be able to infinitively use those tax loss carried forward at the point of time where, especially in Germany, we are turning again into the profit-making situation.

And yes, then you're absolutely right, at the point of time where we are able to activate those deferred taxes on the balance sheet, there could be years where we have even a tax rate that is below that longer-term perspective that we give between 24% and 26%, but for that, we need to turn also the German business into a good profitability, where we are working on, on the one hand and confident being on the other hand.

Operator

The next question comes from Jaideep Pandya from On Field Research.

Jaideep Pandya ***On Field Investment Research LLP - Analyst***

Yes. First question is on your guidance, actually. When I look at EUR 1 to EUR 1.6 billion range, and I just use your high single-digit volume guide and multiply times 40% leverage, I get to roughly EUR 460 million from just a volume contribution. And given that you're guiding for a flat energy bucket, what sort of margin are you baking in? Because last year was a relatively trough year across the board for a lot of your product portfolio. So are you expecting further pressure in margin in PM and therefore, the midpoint is at sort of EUR 1.3 billion?

The second question, apologies for this now, but it's a little bit controversial around the ADNOC situation. So obviously, there's been a bit of a like delay since you put the open-ended release out there. And as the delay progresses, it seems like life is getting better for Covestro on the volume side and also on the spread side. So if I take your upper end of the guidance and use the so-called magic EUR 60 number, I'm getting to an implied valuation of around 8.6x EBITDA.

So I'm just trying to understand what's the delay from? Is it from the ADNOC side because they want to perform more due diligence? Or is it from the Covestro side, because you're sort of not happy with the EUR 60 price, and obviously, as things progress, you would want a higher price? That's my second question.

And the third question really is around Solutions and Specialties business. What is the visibility you have, especially from a key end market coatings, because a this has been a difficult end market for you for the last couple of years. Have you seen pickup in buying activity from the coatings chain already? Or is this something which you haven't seen yet this year?

Christian Baier ***Covestro AG - CFO & Member of Management Board***

Thank you, Jaideep. It's Christian. And I'm also trying hard. And if we then take the first question with respect to the guidance, your triangulation on the volume is realistic. We are then also assuming costs that are flat baked into that, and that means we are fighting successfully the inflation. While we assume EUR 200 million to EUR 300 million negative pricing delta, which is mainly coming from the low starting point, just to remind us, in December 2023, margin was the lowest during the year of 2023. So we are coming from that level and therefore, expecting a bit of a negative pricing delta also baked into that guidance. And for the other two, I'll hand back over to Markus.

Markus Steilemann ***Covestro AG - CEO & Chairman of Management Board***

Yes, Jaideep, thanks for this question #2 that you said. Honestly speaking, the overall conversations in this context are not, let's say, looking for the current business situation, but they're looking rather - with regard and as part of our fiduciary duties to make sure that we fully understand what's the best solution for our shareholders and all the other stakeholders and what's the best solution for the company - from a long-term perspective. So from that perspective, please also excuse that I will not comment on any assumptions about who is slow, who is fast, who is maybe whatever delaying to gain any benefits from current market environment.

And so because, honestly speaking, this would not be the right approach. The right approach is that we make sure that the 2 parties have their confidential talks with each other. That the 2 parties understand, let's say, what are the topics where we agree and what are the topics, where we don't agree. And that the 2 parties understand what amongst others, let's say, would be the right answers to, for example, move forward. So please understand that I cannot comment, let's say, on any assumptions on short-term developments or any potential assumptions about delay of one or the other side. So I hope that helps you a little bit to understand the situation.

So then with regard to your last question, as with the other industries we are talking about, and I'm leaving construction out for the moment, coatings started well on volume terms, but it's still very early days. We just had Chinese New Year being over, as I alluded earlier, and the coating industry from our view is still far away from normal demand levels. There is here and there very, very small signs, some very small green shoots, but we do not see trees. Yes. Hope that helps, Jaideep.

Jaideep Pandya ***On Field Investment Research LLP - Analyst***

Can I squeeze in one more, if possible. Just on TDI, I think last year, there was a comment that TDI market grew like around 6%. And obviously, you undergrew the market because of European production issues. This year, if the TDI market grows in the same direction, what sort of share expectation you have? And would it be mainly taking share from your European competitors? Or is it also from the Chinese competitors that you plan to gain your share back?

Markus Steilemann ***Covestro AG - CEO & Chairman of Management Board***

That's a bit tricky question talking about, let's say, too many details on individual plans, because the European TDI supply is just now represented by 2 plants, if I just take the European producers, because 1 producer has shut down and ceased operations. And then there's only 2 remaining producers where capacities are very well known. That's why I'm a bit cautious, let's say. We have clearly said that we solved the chlorine supply issues and the last tiny bits will be done until the second beginning of the second quarter. And then we believe that our assets are reliably up and running, safely up and running. And that would provide us with that volume leverage that is part of our guidance.

And based on our data, indeed, last year, the market grew by 6% to 7%. We were flattish exactly because of the availability topics. On the other hand, throughout a large amount of time last year, our Chinese TDI asset was when it was running fully loaded. So there is limited opportunity from a China market perspective to really grow in China out of Chinese assets. So the main contribution for the TDI growth will come from Europe. And that material is, due to the overall relative cost position, supposed to supply the European market.

So 1 competitor dropped out. There is just 1 competitor left. So in the end of the day, yes, it is about gaining market share. So that's why we're also giving the highly energy-efficient plant we have the proprietary technology. We have the gas phase technology. We believe that after we fixed our production issues that we will see strong volume growth in Europe out of these fully safely and completely running assets.

Operator

And the next question comes from Geoff Haire from UBS.

Geoffrey Robert Haire ***UBS Investment Bank, Research Division - MD and Equity Research Analyst***

Just 2 quick questions. Just on ADNOC. This is more a legal question. How long can the discussions keep going? Or could we be in a situation that we could be talking in February 2028 yet, and you could still be in discussions with ADNOC over this? Or is there a legal requirement as to when this would stop?

The second question is just coming back to the energy issue. You're saying that energy cost in 2023 was EUR 1.1 billion. From memory, I think it was about EUR 1.6 billion in 2022. How much of the lower gas cost has had to be passed on to the customer base through lower prices because of the low capacity utilization you've got at the moment in the industry?

Markus Steilemann ***Covestro AG - CEO & Chairman of Management Board***

Geoff, thanks for the question. On your first one, and everything, let's say, the same as it currently is. There is no legal framework in which there would be a legal end to this, as we call it, formal discussions. That would only be triggered, let's say, specifics like, for example, a formal offer would be on the table, because then things would go into a specific direction also from a legal requirement. But under current circumstances, legally, there is no limitations. Another question is, and let me be very clear about it. I do not believe that it is in anyone's interest to drag on, let's say, forever with these discussions.

Christian Baier ***Covestro AG - CFO & Member of Management Board***

And then with respect to your question on the energy cost side, yes, it has been around EUR 1.8 billion in 2022. And basically, when you just look at this supply-demand situation, it is tough to really assess exactly what has been needed to be handed over. When you look at the price delta that we did have in the year 2023, which was negative at around EUR 400 million, I think that's the better one to be looked at. Therefore, you can see we have not benefited in a margin perspective from the lower energy costs driven by the sluggish demand development, which, again, when demand comes back in, there is also a good reason for this to go even then beyond any developments on the raw material cost and that's what we are looking at from a supply-demand perspective.

Operator

Then we have one more question from the chat. The question is, what are the factors behind the higher variable compensation of EUR 166 million in full year 2023, given the results were below full year 2022?

Markus Steilemann ***Covestro AG - CEO & Chairman of Management Board***

Yes. Thanks for the question. The variable bonus is driven by 4 key performance indicators, 3 financials very well familiar to you. And those were all at 0 but the greenhouse gas emission development was positive and triggered, therefore, the provisions of around EUR 100 million to be paid out in 2024. More details you would find in the compensation report of the annual report.

Operator

So with that, there are no further questions at this time. With that, handing back to Ronald.

Ronald Koehler ***Covestro AG - Head of IR***

Thank you all for your interest. And if you have any follow-up questions, don't hesitate to contact the IR department. And besides that obviously now with the full-year results, we're kicking off our normal Investor Relations activities, so there might be the chance on the one or other occasion to meet and to talk further on that. So thanks for your interest and for your questions and see you soon. Bye-bye.