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PRESENTATION

Operator

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

During the presentation, all participants will be in a listen-only mode. The presentation will be followed by a question and answer session. (Operator Instructions).

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

Ronald Koehler Covestro AG - Head IR

Good afternoon, and welcome to our full year and Q4 2016 conference call. For your information, we have posted our annual report and the conference call presentation on our website. We assume you have read the Safe Harbor statement.

I would now like to turn the conference over to Patrick.

Patrick Thomas Covestro AG - CEO

Good afternoon, everybody. Welcome, ladies and gentlemen. In 2016, growth in our industries accelerated, which significantly increased our utilization rates. Our new flexibility as an independent company, coupled with our new strategy of sweating our assets, allowed us to more than proportionally participate from the global growth acceleration.

We clearly grew above GDP all year long and delivered a core volume growth of 7.5%. We could translate this growth with a positive volume leverage into a strong bottom line development and increased our EBITDA by 23% to above EUR2 billion.

We achieved a record free operating cash flow of EUR1.367 million [sic - see slide 3 "EUR1,367 million"] and corresponding to a high single free operating cash flow yield of 9%, which is based upon a share price of EUR72, significantly above our peers.
Our shareholders benefited from our strong operational performance. Over the course of the year, our share price progressed by 94%, even 98% including dividend payment, making Covestro one of the top performers. I think number six in the Euro STOXX 600.

For the full year 2016, we will propose at the Annual General Meeting on May 3 a dividend of EUR1.35 per share, thus setting a solid foundation for our long-term progressive dividend policy that we plan for the future.

In 2016 and in quarter 2016, we generated well-balanced growth in all regions and industries. The demand uplift was broad based.

Of our top countries, China showed the best development with a core volume growth of 18% during the year, though on low comps. Growth of 4% in full year 2015. So it seems China is back as a high growth country and again boosting our emerging market sales.

Other positive signs in emerging markets came from Brazil, India and Mexico in 2016.

Germany was relatively weaker this year, with a flat core volume growth in 2016. While the sectors of construction and furniture showed strong, solid growth rates, we observed a slowdown in automotive and in electronics. Certainly, the already flattish development in Germany in the first nine months was additionally impacted by our force majeure in quarter four 2016.

The US delivered a strong growth of 7% last year, demonstrating our ability to outgrow GDP also in mature markets. This provides a good balance between emerging and mature markets for Covestro.

As you've just seen, we delivered on our promises and fully achieved all financial targets we set ourselves, even those upgraded with our new guidance in our Q3 conference call.

Overall, we certainly operated in a favorable market environment, which turned out to be more positive than first anticipated. But foremost we were able to take the opportunities given to us thanks to our excellent employees and good organizational structures that enabled quick reactions to the market.

Thanks to this operational agility, we were also able to limit the negative impacts of the force majeure on polyurethanes, which we had to declare for Europe in the fourth quarter.

I would now like to hand over to Frank for some more financial details. Frank.

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**Frank Lutz - Covestro AG - CFO**

Thank you, Patrick, and also good afternoon from my side. Our sales development in 2016 was slightly negative because the positive volume leverage was eaten up by declining prices and negatively translational currency effects.

Higher volumes had a positive sales effect of 5.0%. 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.

The price decline entirely erased the positive volume effect. It resulted from the pass-through of the raw material price movements to our customers. We should note again that earnings are mainly driven by the supply/demand balance in our industries and not by the development of our raw material costs.

In Q4 2016, reflation kicked in, and we saw a positive pricing impact of 4.6% year on year.

Finally, we had limited negative exchange rate effects, mainly driven by the Chinese renminbi and Mexican peso.

Over the full year 2016, our EBITDA increase was almost equally driven by the volume leverage and a positive price delta.
Both effects were visible in all segments. In Q4 2016, we observed for the first time in the year that the positive pricing delta was more significant than the volume leverage.

On the one hand, our force majeure limited the volume leverage. On the other hand, the pricing delta was pushed both by increasing prices and positive effects from lower raw material costs.

In Q4 2016, as guided, our core volume growth was clearly below the yearly average due to the force majeure impact in PUR. PCS was the main driver for growth in the last quarter.

The adjusted EBITDA margin improved from 13.6% to 16.9% in full year 2016. This is an impressive 330 basis points increase.

The sequential margin decline in Q4 2016 was due to the typical seasonal slowdown. However, we still observed a year-on-year improvement of 380 basis points.

Overall, we were able to increase our adjusted EBITDA each quarter versus the respective prior year periods during 2016, a performance we have now repeated for the second year in a row.

Global industry growth in polyurethanes strongly expanded from just 2% in 2015 to 6% to 7% in 2016, based on preliminary estimates.

We were able to slightly outgrow the industry with a core volume growth of 7.7% despite significant production issues during the fourth quarter in Europe. Given the strong growth, the industry utilization increased significantly, as there were only limited supply additions.

The capital markets seemed to have an intense discussion on the additional capacities coming from a large Middle East project. Let me just clarify one point. This project is expected to add 400kt, or 5%, of new capacities to the global MDI supply. Based on current industry growth, this capacity is needed and should get absorbed in just 10 months.

The additional TDI production of 200kt represents 8% of the world capacities but is also needed, as the industry is currently tight. As a consequence, there might be a short-term increase in pricing volatility. However, this is not changing our long-term view that the overall industry utilization rate is gradually increasing.

We also recognized a debate regarding production outages in 2016. In general, production outages are quite common in our industry. As you know, we had to declare force majeure in Q4. However, despite that, we were able to outgrow the industry on a full-year basis.

Based on our knowledge, none of our leading peers declared force majeure in 2016. This means they were all fully honoring their supply contracts despite a few production issues. Overall, we believe that outages had, if at all, only a limited effect on the polyurethanes industry in 2016.

The adjusted EBITDA margin in PUR increased to 15%. A significant part of this improvement was driven by the increase in utilization rates which is just a catch up to the margin levels of our peers. Positive price movements mainly added to the earnings in Q4, which provides a strong starting point into 2017.

Apart from the legacy projects in TDI in Middle East and in Yantai, China, there is currently no world-scale plant under construction. This means even if someone announced a new plant today, everyone would need at least two to three years before the additional supply came on-stream.

Polycarbonates generated an impressive double-digit core volume growth of 10.3% in 2016. The growth even accelerated in Q4, pushing the utilization rate quite high on our two new lines in China.

Based on year-end nameplate capacity, we re-established Covestro as the world's largest producer with a capacity share of 29%, followed by the next player with a share of 27%. 
The EBITDA margin increased from 17.7% in 2015 to 21.3% in 2016. The margin increase was mainly driven by a positive volume leverage and a product mix improvement.

On the negative side, we faced some startup costs in China for doubling our polycarbonates production capacity in Shanghai.

In CAS, our core volume growth adjusted for the phase out of a trading product, increased by 4.5%. This is a growth above the industry.

In 2016, our EBITDA margin slightly increased by 100 basis points to 24.5% year on year, although we saw the usual seasonal margin reduction in Q4 2016.

As you might have seen, we recently announced price increases. These should allow us to keep our innovation efforts on a high level while still keeping our current margins.

Our income statement was heavily influenced by the carve out in 2015. However, we have not booked any special items in 2016. This makes a year-on-year comparison difficult. As in 2016, we will continue to focus on IFRS-based numbers.

This does not mean that we intend to hide any special factors. We will continue to disclose any material extraordinary items. However, we leave the decision up to you if such effects represent truly adjustable items or are just a part of normal business.

The gross margin improved by almost 6 percentage points, mainly reflecting the strong volume leverage and the positive pricing delta. Higher bonus provisions led to an almost similar effect compared to last year’s special items.

As we overachieved on all our three KPIs, the bonus payout reached its maximum level in 2016. This increased costs for all P&L lines.

In 2016, we had two large extraordinary items. First, as announced, we received an insurance payment of EUR30 million in PUR. Secondly, our “Other financial results” were burdened by EUR30 million due to a currency hedging loss. Both items were booked in Q1 2016.

Overall, we were able to increase our IFRS-based EPS by an impressive 132% year on year. The proposed dividend per share of EUR1.35 for financial year 2016 represents a payout ratio of 34%, in line with our previous guidance.

As promised, we were able to generate a record free operating cash flow of almost EUR1.4 billion in 2016. Overall, besides some positives and negatives, the free operating cash flow mainly followed the EBITDA development.

As the free operating cash flow is one of our three key KPIs, I would like to give you some more color for 2017. In Q4 2016, reflation kicked in. We would expect this trend to continue in 2017 driven by higher raw material prices. I would like to provide you with a sensitivity scenario.

Based on an unchanged working capital to sales ratio, a 10% top line inflation would cause a EUR185 million cash need for working capital.

We assume a CapEx of around EUR550 million in 2017.

In 2015, we built EUR60 million provisions for the closure of the MDI plant in Tarragona, Spain. As previously announced, this cash out should happen in 2017.

And finally, in 2017, we expect a cash tax rate in line with the effective tax rate of slightly below 30%.

Our total debt level has been reduced by almost EUR1 billion in 2016 thanks to the benefits of the high free operating cash flow. The ratio of total net debt to EBITDA decreased to 1.3 times end of 2016. This is already below our target of 1.5 times. Given our solid investment grade of Baa2 from Moody’s, we do not see any need to further reduce this ratio in the future.
In Q4 2016, we transferred bonds with a value of EUR450 million to fund parts of our pension provisions. This was obviously neutral to our total net debt and simply represented a swap between net financial debt and pension provisions.

Our balance sheet at year-end looks even more solid than one year ago. We increased the equity ratio from 34% to 41% over the course of the year. As promised, we repaid the Bayer loans in March and June during 2016, partly thanks to the placement of three bonds with a volume of EUR1.5 billion in the first quarter 2016. So we have no further financial liabilities to Bayer apart from some normal business-related payments.

Additionally, we shifted part of our liabilities from short to long term.

With that, I would now like to turn back to Patrick.

Patrick Thomas - Covestro AG - CEO

Thank you very much, Frank. 2017 has clearly started well for us. Nevertheless, we will not forget there are still many macroeconomic uncertainties, and we may face increased political turmoil around the world.

Despite this, we are confident that in our segments of the industries that we serve, we will continue to outgrow global GDP.

Core volume growth remains a focus for us as we continue to expect ongoing positive volume leverage. In 2017, we assume growth in-line with our industries, which should allow us to achieve a low- to mid-single-digit core volume growth.

In 2017, we assume a free operating cash flow slightly above the average of the last three years, or to be more precise, slightly above the EUR881 million. This takes into account planned higher CapEx and downside risks from higher working capital needs, as outlined just now by Frank.

We also expect a further improving ROCE.

In addition to the guidance on our major KPIs, we provide an early outlook on the EBITDA. We had an encouraging start to the year. As a consequence, we expect our EBITDA will significantly increase compared to quarter 1 2016.

Let me help you with an interpretation of the word significantly. If you check out chart 22 in the backup, you will see that in absolute terms, we are seeing a similar volume leverage and a similar pricing delta but fully compensated by pricing. Raw materials will be up, of course, in that period.

For the full year 2017, we assume an EBITDA at or above the 2016 level. In our view, this adequately takes into account the risk of increased competitive pressure which may arise from the ramp-up of new capacities.

Overall, our investment case remains unchanged. We are committed to delivering strong organic volume growth, which should support a solid earnings and cash flow generation.

Full year 2016 was the foundation for our progressive dividend policy, and based on our robust financial profile, we're confident of paying an attractive and higher dividend for 2017, as well.

Delivering on our promises is very important to us. Consequently, we will do everything we can to control -- to continue our track record of the last two years by delivering on the guidance again for 2017 as well.

Thank you very much for listening to us, and we are now open for your questions.
QUESTIONS AND ANSWERS

Operator

(Operator Instructions). The first question comes from Mr. Stephen Benson from Goldman Sachs. Please go ahead, sir.

Stephen Benson - Goldman Sachs - Analyst

Hi there. I just had a question regarding the margin outlook. So I believe at your IPO you gave a range of EBITDA high to low of 5% on the low side and 18% on the high. Given that you've just done 17%, I wondered whether that range still stands, and if perhaps you've got a view on what the mid-cycle margin might be for Covestro.

And secondly, just on the CapEx versus depreciation, it still looks like it's running at a low level going forward. So how far out into the future do you envisage that this begins to converge? Thank you.

Patrick Thomas - Covestro AG - CEO

Thank you very much, Stephen. Let me just kick off by saying that the guidance we gave at the time of the IPO was based upon a historic oil price at $120, and of course we've seen deflation of the sales line since then. And we estimate that moves our margin corridor by about 4%. So I would say today's number is something of the order of 3% to 4% higher than you would have expected based upon $120 oil.

So that's a mathematical effect, principally, and I think that probably stands. Therefore, I don't see us at peak margins right now. So I think if we look at where we are in the cycle, we are seeing absolute levels of EBITDA per ton which are not representing historical peaks.

Does that help, Stephen?

Stephen Benson - Goldman Sachs - Analyst

Yes. That's useful, thanks. And just on the CapEx?

Patrick Thomas - Covestro AG - CEO

On CapEx, we are running at below depreciation at the moment. This year was slightly lower due to timing of payments, but next year, we would expect to spend at EUR550 million. We expect to still follow our guidance of EUR1.6 billion through from 2016 to 2018 that we gave originally, and we think we'll be spot on that number.

Stephen Benson - Goldman Sachs - Analyst

Okay. So a much bigger year in 2018 then. Okay. Okay, thank you very much.

Operator

The next question comes from Mr. Patrick Lambert from Raymond James.
Hi. Good afternoon, and congratulations for the Q4 numbers. A few questions regarding your needed inflation for 2017. Could you give us first your oil price scenario for 2017, what you based on your views on the oil price, and what does that impact imply for the needed inflation for especially PUR and PCS, if you could comment a bit on how much you need to raise prices? I have my assumptions, but I'd like to see your views on that.

And linked to that, what would be the impact on margins, mathematical impact of margins, on those movements of raw materials and pass-through mechanism? Thank you.

Patrick Thomas - Covestro AG - CEO

Thank you very much, Patrick. Yes, so for 2017 oil, we're running at Q1 now and we would expect to see that flat through quarter two to the end of the year. That's our basic assumption, and I think the way to think about this is we're in a mode at the moment where our margins are driven more now by supply and demand balance and the tightness that we're seeing than compared to raw materials.

So I think from the point of view of our margin per ton of product, we see a fairly constant flow as the raw material prices move. So there is obviously a delay in that process, but it's not massive or significant if you look at our history. So that might give you a reflationary effect on the top line, and in fact in quarter 4, we already saw some pricing effect.

Patrick Lambert - Raymond James - Analyst

But when I look at aromatics in general, they are pretty significantly in January, Feb, and that's going to go through your inventories and manufacturing work in progress over the next few months. And the current price for all the PUR and PCS products, are you happy with those?

Does that mean that at those levels, you actually are already absorbing some of this raw material inflation?

Patrick Thomas - Covestro AG - CEO

Yes, at the moment, we're already absorbing the inflation, and price increases are taking place at the moment across all the main segments. If you look at the PUR daily information, or if you look at the ISIS data, you'll see that the pricing is moving up with aromatics.

I think aromatics beyond quarter 1 are likely to be relatively flat.

Patrick Lambert - Raymond James - Analyst

Okay.

Patrick Thomas - Covestro AG - CEO

And we'll see how that develops. But that's our assumption at the moment. Okay, thank you, Patrick.

Patrick Lambert - Raymond James - Analyst

Thank you.
Patrick Thomas - Covestro AG - CEO

Yes, thank you.

Operator

The next question comes from Mr. Thomas Swoboda from Societe Generale.

Thomas Swoboda - Societe Generale - Analyst

Yes, hello, gentlemen. I will try three questions, please. Firstly, CapEx for 2018, you just said before it’s supposed to be much, much higher versus 2017. If you could give us any indication of what number are you thinking of, that would be very helpful. Eventually, a new run rate as a percentage of sales that would be very helpful.

Secondly, on TDI, you mentioned the Sadara project in MDI. I think this is well understood. My question on TDI is: do you expect any meaningful global supply growth in TDI in 2017? We, I think, don’t need to mention the obvious project. Just wondering what do you think how globally the supply could develop? What your best guess is?

And the third one on your guidance. If I understand your guidance correctly, you’re talking about some EUR200 million of EBITDA growth in Q1. But at the same time, you try to be cautious, so for the year you somehow are saying in the worst case EBITDA could be flat. That would mean that in the second half, latest, your EBITDA should be shrinking. Could you just outline the assumptions you have for your worst-case scenario? What would need to happen for this worst-case scenario to kick in? Thank you.

Patrick Thomas - Covestro AG - CEO

Okay, thank you very much, Thomas. Frank, do you want to talk about CapEx first, and then I’ll take TDI?

Frank Lutz - Covestro AG - CFO

Sure. Thomas, in the IPO, we said that during the years 2016 to 2018 we expect to spend EUR1.6 billion on CapEx. We have spent EUR400 million roughly speaking in 2016, which leaves us with EUR1.2 billion over the next two years, of which about EUR550 million will be spent in 2017 and EUR650 million will be spent in 2018.

Patrick Thomas - Covestro AG - CEO

Okay, and on your TDI question, Thomas, I think just take you to the macro level first of all and then specifically 2017. At a macro level, I think the trend we’re seeing through to 2021 shows demand growth between 3% and 4%, which is historically close to the average.

Supply growth is about 6% based upon our estimates. If we actually look at what’s happening in 2017, we foresee 2.8% growth in supply. That plays against minus 6.4% in 2016, so there’s a partial catch up but not a full catch up, and that’s for the reasons you’ve suggested.

A number of people in their numbers have forgotten that Schwarzheide did not close down. It’s still running. It got relicensed to partly compensate the situation I think in Germany. And of course Vencorex is now closed, or actually closed last year, so that should be pulling out. So 2016, minus 6.4%, plus 2.8% supply side growth on 2017.

In terms of guidance, I like your math on guidance on Q1. Let me explain where we are on the full year. We intend to give quarterly guidance as we go through the year, but let me try and help a little bit on the full year.
We have included an assumption that the plants in the Middle East actually do start up in the middle of the year, so that's why you see a first-half, second-half impact. That may or may not happen, but we have assumed that they do start up in the middle of the year successfully.

We've also factored in some economic and political risk. We've included the situation in Sweden, as we are advised to by the Americans, and we will update you each quarter thereafter on each call. The key for us is always delivering on our promise. That above all else is what you can expect from Covestro. So hopefully that answers your question, Thomas.

Thomas Swoboda - Societe Generale - Analyst
It does indeed. Thank you very much.

Operator
The next question comes from Mr. Peter Mackey from Exane BNP Paribas.

Peter Mackey - Exane BNP Paribas - Analyst
Afternoon, everybody. I've got three questions as well, if I can, please. First, and I'm sure there's a simple explanation here, if I look at the PUR revenues by region, I understand why Europe declined a percent or so in the fourth quarter. But I'm intrigued that NAFTA sales seem to be down by even more, 2% and a bit or something. Asia Pacific was up 50%, as you'd expect, with pricing doing what it did. So I wonder if you could just talk about what happened in North America, please.

Secondly, I was a little surprised that there wasn't more inventory reduction in the fourth quarter given the outages. And the balance sheet number, I think, actually went up from the third quarter. So I wonder if you can talk about the inventory position. Is it simply a pricing effect and volumes -- the volume decline is hidden in that?

And then, finally, just coming back to Frank's viewpoint about the no other force majeures, and that suggests a negligible impact. That does rather assume that the whole of the industry is done on contract. Do you have a feeling for the amount of the MDI and TDI volumes that are in the global industry that are done spot versus contract, please?

And, just to that, I note the contrast with last year when you were fairly cautious about polycarbonate and the issues with Saudi Kayan and supply interruptions and so on. You're not, obviously, as cautious this time around. Just wondered if you could contrast the two situations, please.

Patrick Thomas - Covestro AG - CEO
Thank you very much for your questions, Peter. As usual, when you say this must be a trivial answer, we've got people running around here trying to find you answers to your first question. That's always the case - we know you well.

So there you are. Have you managed to find the answer on PUR NAFTA?

Frank Lutz - Covestro AG - CFO
It's predominantly related to the development of the US dollar against the euro, which was significantly weaker in 2015 in the fourth quarter. And that's translated into a higher euro number. Other than that, there is no magic explanation to that.
Okay. And on the inventory effect, Peter, can you just repeat the question because I didn't catch the whole of it? I was running around looking for a number on NAFTA.

Peter Mackey - Exane BNP Paribas - Analyst

You drifted off with my long-winded question. The inventories: I was surprised that the inventories' number didn't come down more in the fourth quarter. I realize, obviously, there's a price versus volume effect. I just wonder if you could talk a little bit about the degree of inventory volume reduction in the fourth quarter, please, given the outages.

Patrick Thomas - Covestro AG - CEO

Yes, I think the biggest effect, Peter, on the inventory was in the last two weeks of the year we replenished a lot of what was going on. I mentioned in my opening remarks that we managed to mitigate a significant part of the force majeure as a result of some extremely flexible swapping and sourcing of feedstocks. So, in fact, the impact of the force majeures you've seen was significantly less than we would have otherwise expected.

Therefore, we were able in the last two weeks of the year, when things are slow anyway in terms of demand, able to build stocks back up again. Because, to be honest, we could see the order book for January and, ahead of an early Chinese New Year, there was an opportunity to keep the assets running flat out at the end of the year, which has not normally been the case, I must say. So that's one of the big changes.

In terms of force majeure spot versus contract, in terms of how this market works, it's very different across each segment. So, on your comment about force majeure, it protects suppliers from contractual positions. The percentage of those contractual positions is probably the majority of the business, but certainly more than 50%. I haven't got an exact number for you, Peter, but what we'll do is try and get you a number and come back to you.

Peter Mackey - Exane BNP Paribas - Analyst

Fabulous. Thank you.

Patrick Thomas - Covestro AG - CEO

Okay. Thanks.

Operator

The next question comes from Mr. Paul Walsh from Morgan Stanley.

Paul Walsh - Morgan Stanley - Analyst

Hello?
Operator

Mr. Walsh, you have the floor. Go ahead.

Paul Walsh - Morgan Stanley - Analyst

Yes, sorry, I didn’t hear. It suddenly went quiet my end. Patrick, Frank, good afternoon. Thanks for taking my questions. Apologies for the silence. It’s probably one of the only times I’ve been quiet.

China, that’s been a fantastic recovery story through 2016. If you look at volume growth across your business in Q3, Q4, it’s been great. And, if I ran the math, it’s contributing well over half of your volume growth last year. I’m just wondering at what point the comps get tougher at current volume run rates in China and what that would imply for this year, i.e. in your guidance, what -- have you assumed China just moves sideways from here, or further accelerates?

Second question is I think, Patrick, you made a comment, or maybe it was Frank, around no need to get leverage down from the current levels of 1.3, which sort of begs the question, given CapEx is still running, depreciation, what are you going to spend the money on, please.

Then just a final question around the guidance for Q1, just to clarify. The bridge for the quarter we just had has a benefit from raw materials to the tune, I think, of EUR61 million, and pricing on top. Are you indicating the pricing delta, which is the EUR185 million, is a similar order of magnitude in the first quarter, but that includes raw material costs that will clearly be a headwind in Q1, or is that not the right interpretation? Thank you.

Patrick Thomas - Covestro AG - CEO

So let’s just take your last quarter 1 guidance point first. Yes, your interpretation is exactly right, okay?

Paul Walsh - Morgan Stanley - Analyst

Brilliant. Thank you.

Patrick Thomas - Covestro AG - CEO

Yes, no problem. Let’s answer them all in reverse order. No need to get leverage down. What are we going to use the cash for? So in 2017 and beyond we have a number of opportunities for what I would call smart debottlenecking. So this is increasing capacity, which we need to do in some of the plants that we are operating at the moment at the limit.

And we have a way of doing that at relatively low specific costs in terms of CapEx per ton of capacity, which makes them very attractive projects. They’re not huge, but they are significant. And we would probably share some of this with you during Capital Market Day when we put together some examples across each of the business units and get into the specifics of supply and demand and what we think we can do between now and a significant investment in capacity. All of that is still within the EUR1.6 billion we’ve guided on.

Bolt-on acquisitions certainly would be a possibility. We're looking at several opportunities, but they're all relatively small. And we have no plans to go and fix a fourth leg to our business. So that gives you some idea as to where cash would be going.

China, certainly, the comps are going to get a little bit tougher. As I said during my commentary, it was off a fairly slack growth in China in 2015. I think we’re seeing a very strong growth on automotive, which is not necessarily going to last. So during 2016 we were benefitting from a program the Chinese government put in place during October 2015, which put a tax incentive on any vehicle with an engine size of less than 1.6 liters. Basically, the purchase tax was cut in half.
That ended at the end of 2016 and is replaced by a higher tax rate until the end of 2017 and then from 2018 onwards we're back to the normal tax rate. So that means that we saw the Chinese light vehicle market close the full year 2016 at about 27 million units, which was 14% up year on year, so the incentives clearly worked. I think the growth there will slow down in 2017 and it's too early to see what happens in 2018.

There's a reported car sales number that comes out every month in China and in January it showed sales were down year on year, January to January, by nearly 10%, which is quite a significant drop. That comes from the Chinese Passenger Car Association. Clearly, at the end of the year, everybody rushed to get their benefit into their pocket. And we also had a short Chinese January because of the New Year. So it may be, by the time we get to March, that we would expect to see some feedback on what the effect will be.

The other thing we're seeing countering that, though, is the strong growth in electric vehicles in China. The incentives there are quite large and all the real new-energy vehicles, as they are called, are now, in terms of numbers, up to nearly a third of a million vehicles produced in 2016, growing very, very fast. And those vehicles do not need to pay a registration charge for their number plate, so that gives quite a strong incentive.

It's about RMB100,000 to register your vehicle in China just for one number plate, so that actually counteracts that car effect, and is in our favor, because a normal vehicle in China will contain about 5kg to 10kg of our material. An electric vehicle will contain probably 25kg of our material. So there are some counter-acting effects going on there. I still expect to see China grow double digit in 2017.

So that's a long answer on China. But I think it's quite interesting to see what the dynamics are, particularly in this automotive space, which has become an important part of the global business.

Paul Walsh - Morgan Stanley - Analyst

That's really helpful. Perhaps a sneaky follow-up question which isn't a follow up at all, it's just another question. On EBITDA per ton, because we all have -- we all talk about margins, but I think the truth is EBITDA per ton is what you guys think about. Any chance you can give us what peak EBITDA per ton has been historically in MDI, TDI and polycarbs?

Patrick Thomas - Covestro AG - CEO

Absolutely no. And that's not the cheeky answer to your cheeky question.

Paul Walsh - Morgan Stanley - Analyst

Thank you.

Patrick Thomas - Covestro AG - CEO

Okay. Thanks Paul.

Operator

The next question comes from Mr. Laurent Favre from Evercore ISI.

Laurent Favre - Evercore ISI - Analyst

Yes, good afternoon everyone and thanks for taking three quick questions and they are not cheeky.
On CAS, can you talk about the -- I guess, the margin performance in the fourth quarter? I think it's down for the first time in a while. I'm just wondering how much of that is raw material inflation playing out and how much of the higher raw material cost you've already absorbed in the business.

The second one on CAS is core volume growth. Can we start to assume that the business actually reports volumes in line with your underlying core volume growth in 2017, or do you have more to do on demarketing of lower-margin products?

And the last one is on polycarbonates. Utilization rates, I assume, are at, or slightly above, 90%. At 5% volume growth per year you don't have a lot of time left before you are absolutely at full capacity. At what point in time do you have to think about a new investment, or is it where you were alluding to smart debottleneckings? Thank you.

Patrick Thomas - Covestro AG - CEO
Frank, why don't you answer Laurent’s question about quarter 4 CAS.

Frank Lutz - Covestro AG - CFO
First of all, Laurent, on your question about higher costs or margin, yes, we had a slightly lower EBITDA in the fourth quarter in CAS, which was mainly related to higher cost, and that is, of course, raw material prices. This is also the reason why we just recently announced that we are increasing our prices over the next six months by 15% in CAS. So we are quite comfortable that the increase will take care of the higher raw material cost and also will allow us to maintain the margin that you are used to in the CAS business.

On core volume growth for 2017, as indicated, 2016 was impacted by the end of a trading contract. Adjusted for that trading contract, the growth -- the core volume growth would have been around 5% in CAS and that is also the number that we are expecting for 2017.

Laurent Favre - Evercore ISI - Analyst
So that contract was January 1 to December 31 and then January 1 2017 we're back to normal?

Frank Lutz - Covestro AG - CFO
Exactly. The contract ended on December 31, 2016.

Laurent Favre - Evercore ISI - Analyst
Okay.

Patrick Thomas - Covestro AG - CEO
On PCS, debottlenecking, what are the options? So we've just doubled the capacity in China, so we're up to 400,000 tons. We believe that there are debottlenecking options within the existing lines that can take us by a further 200,000 tons spread across the lines, somewhere in the region of 150,000 tons to 200,000 tons. And that comes in at a relatively efficient utilization of capital. So that is always the thing with brand new plants. They're up, they're running, they're doing extremely well and we can now look at the opportunity to stretch them.

Thank you, Laurent.
Patrick Lambert - Raymond James - Analyst
Hi, a quick follow on, again on pricing. If I look at CAS, pricing was still down in Q4 and that's why you, I guess, started to raise prices on the back of raw material. But could you comment why those prices were still down? Is there any particular product line more competitive, or anything that could put some light on the pricing there? Thank you.

Patrick Thomas - Covestro AG - CEO
Yes, some of it is to do with timing of contracts, but there's also a small mix effect in there. We believe that now is the right point in the cycle to start increasing our prices on the core range in CAS and that's why we announced the price increases. So that's where we're going. It's that time of the year for the new contracts and is also the right time in the state of the market.

Patrick Lambert - Raymond James - Analyst
Is there any uptake on industrial coatings? I think you mentioned Q3 being a bit weaker than usual.

Patrick Thomas - Covestro AG - CEO
Industrial generally has not seen a huge amount of growth, and I think if you follow most of the major industrial coating manufacturers, they've all seen fairly static numbers. So, as a segment, certainly, that is one of the weaker parts of the CAS business. But we have so many different segments that they tend to compensate for one another.

I think in the presentation there was a statement which was suggesting that we're below the 4% long-term growth rate in the coatings industry. And certainly if I follow most of the big customers that we supply, they're all commenting on a slowdown, particularly in industrial last year, yes.

Patrick Lambert - Raymond James - Analyst
Could well be also 2017.

Patrick Thomas - Covestro AG - CEO
Well, let's see. It depends on infrastructure investment principally. If oil and gas moves up, then you'll see it rapidly coming back again. The biggest impact in industrial coatings last year was the oil and gas segment. And as rig counts start to increase again and as some of the fracking that's going in America continues to operate, then we would expect to see that grow again.

Patrick Lambert - Raymond James - Analyst
Okay.
Thank you very much.

Patrick Lambert - Raymond James - Analyst
Thank you.

Operator
The next question comes from Mr. Andrew Benson from Citi.

Andrew Benson - Citigroup - Analyst
Thanks very much and afternoon everybody. A couple of questions - funnily enough, most of the questions have been asked - but on the LyondellBasell relationship and your constraints on polyols, can you just give us an idea of what you're thinking there on how to grow supply? And also on the styrene credits that you get?

And also a follow-up to Paul Walsh's question about what you do with the cash. Obviously, a normal thing would be a share buyback, although you've got a parent that may or may not be looking to sell at some time soon. So can you just give us your thoughts around how to manage the share or is that just off the table at the moment, the parent relationship and the potential for share buybacks in due course? Thanks.

Patrick Thomas - Covestro AG - CEO
Thank you, Andrew. So, LyondellBasell, clearly, we have a long-term partnership with LyondellBasell. One of the opportunities we have in terms of expansion is to grow that relationship through debottlenecking and that's something we're currently exploring. That comes into the category of smart debottleneck projects that we're looking at, which are relatively capital-cost efficient, but would give us access to more propylene oxide.

The other thing that we've done is we've just kicked this off and this is the first real point of commercial sales. You'll remember we started to substitute propylene oxide with carbon dioxide in one of our new process technologies, Cardyon, which is an interesting development, because it seems to be gaining market acceptance in flexible foam applications. And the polyol we produce there, obviously, has 20% less propylene oxide in it, so it's a slightly different type of achieving growth.

The other thing that's happening in polyurethanes, particularly in the construction industry, is there's a stronger dependence upon polyesters as the source of the b-side to the isocyanate. And that's because the technology that gains better fire resistance is a polyisocyanurate foam, not a polyurethane foam. And that means that the growth rate in the whole polyol propylene oxide chain is slightly slower than the overall growth rate of the demand for polyols across the whole polyurethane spectrum.

On styrene we saw, year on year, I think pretty much the same earnings contribution in 2016 that we got 2015. And in full-year 2017 we expect roughly the same contribution, at or slightly below 2016.

Cash, Frank?

Frank Lutz - Covestro AG - CFO
Yes, well, it's not that we don't have enough ideas what to do with our cash. One thing that we did, as you know, in the fourth quarter of last year was that we reduced volatility on our balance sheet that's coming from our pension liabilities by funding them.
Just to give you an idea, our pension liabilities moved by EUR1 billion within only three months due to, A, of course, the funding on our side, but also, and most importantly, by the change in interest rates. And of course that is still a big volatility factor on the balance sheet. And with the additional cash that we’re generating at the moment, during the course of 2017 we would also have the ability to further fund our pension liabilities.

When it comes down to a share buyback, first of all, I think you heard me say that before, that I don't think that it's such a great idea for a company that just went public about one and a half years ago to think about a share buyback. But also from a technical perspective it's not as easy as you might think. Under German stock corporation law we would not be allowed to buy back shares from only one single party.

We would have to offer that to all our shareholders, which, of course, also means that the number of shares that we could buy from the one single shareholder who we know is willing to sell, would be probably rather limited, so that, from a technical perspective, is not a good solution.

Andrew Benson - Citigroup - Analyst

Okay. Okay. Just as a follow on, so on the LyondellBasell you cite that as a constraint on your growth in your polyols business, so why are you thinking just about a debottleneck? Why not a bigger leap in capacity?

And then, just very lastly on the financing charges, giving the the contribution to the pension and the reduction in debt, why are your financing charges only falling very modestly?

Patrick Thomas - Covestro AG - CEO

On the Lyondell question, yes, a big leap is also possible, but it requires consenting adults and so, clearly, this would have to be something that's going to take a little bit longer to plan for and would probably fall beyond the next decade. It's not ruled out in any sense, but it would be subject to a discussion that we haven't had fully yet.

The most likely location could well be in Asia, because the polyol market is now developing in Asia and is becoming a little more sophisticated as the whole polyurethane industry becomes more sophisticated in Asia. So that's all work under construction, I think is probably the best way of describing it. There's no firm commitment on either side.

Andrew Benson - Citigroup - Analyst

Okay.

Frank Lutz - Covestro AG - CFO

And on the financing, well, we are still expecting about EUR40 million roughly coming out of the interest that we have to pay on our pensions. And in an environment where interest rates might go up again I think this is a fair, maybe a bit cautious, assumption.

So apart from that we are also, as you know, still providing a significant intra-company loan from Germany to China, where, of course, interest rates are higher and, therefore, also hedging costs are higher. So, therefore, that is also factored into our total financing cost that we are guiding for the full year of 2017.

Andrew Benson - Citigroup - Analyst

Well, thank you very much.
Patrick Thomas - Covestro AG - CEO
Thanks, Andrew.

Operator
The next question is another follow up from Mr. Peter Mackey from Exane BNP Paribas.

Peter Mackey - Exane BNP Paribas - Analyst
Yes, sorry, at the risk of annoying everybody a bit more, but two more questions. Just back to Frank’s point. You commented on the EUR1 billion reduction in the pension liability quarter on quarter. About EUR450 million of that comes from the CTA, and, as far as I can tell, about EUR300 million from higher discount rates, this still leaves about EUR250 million of a quarter-on-quarter shift that I can’t quite quantify. I wonder if you have any insight into that, please?

And the other thing, sorry, boring guidance one. The industrial and corporate lines, have you got any guidance on those? I noticed that the industrial operations made a EUR13 million-odd EBITDA positive in the fourth quarter. Have you got any comment about how we should picture corporate and reconciliation in industrial operations for 2017, please?

Frank Lutz - Covestro AG - CFO
Let me start with the last question first. Total, we expect a negative impact on EBITDA of about EUR70 million. That’s more or less in line with 2016.

And then on the pension liabilities, the interest rate impact was actually slightly higher. It was roughly EUR380 million and then we had EUR120 million broadly coming from the performance of our existing pension assets. And that was especially related to the stock market rally in the month of December.

Peter Mackey - Exane BNP Paribas - Analyst
Very clear. Thank you very much.

Patrick Thomas - Covestro AG - CEO
Thank you, Peter.

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

Ronald Koehler - Covestro AG - Head IR
Good. Thank you very much for all of your questions and we will speak to you, latest, in the Q1 conference call, or we might see you on the one or the other occasions during the quarter. Thank you and bye-bye.
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