Ladies and gentlemen, thank you for standing by. Welcome to the Covestro Investor Conference Call on the Q1 2019 Results. The company is represented by Markus Steilemann, CEO; Thomas Toepfer, CFO; and Ronald Koehler, Investor Relations. (Operator Instructions) I’d now like to turn the conference over to Ronald Kohler. Please go ahead, sir.

Ronald Koehler Covestro AG - Head of IR

Good afternoon and welcome to our Q1 2019 conference call. For your information, we have posted our interim statement and the conference call presentation on our website, and we assume you have read our safe harbor statement.

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

Markus Steilemann Covestro AG - CEO, Chief Commercial Officer & Chairman of Management Board

Thanks, Ronald, and good afternoon, and good morning to our listeners from the United States. The first quarter was challenging, but developed in line with our expectations. The year-on-year comparison looks weak. However, compared to the fourth quarter of 2018, results have improved. We were able to limit our year-on-year volume decline to 1.8% despite a high comparison basis, a very weak automotive market and internal production limitations.

Our EBITDA decreased significantly in a year-on-year comparison but improved nicely quarter-on-quarter. The free operating cash flow was, as expected, slightly negative in the first quarter, reflecting the usual seasonality and the higher CapEx for our growth initiatives. Based on this set of results and despite continuously challenging economic conditions, we confirm our full year 2019 guidance.

Let me provide you, on Slide #3, with some more details on the global core volumes that declined by 1.8% year-on-year, primarily driven by the lower demand in automotive. We estimate that global auto production declined by minus 5%, destocking, especially in polycarbonates and limited availability of polyols. We were able to achieve positive volume growth in TDI and MDI, which demonstrates our ability to grow even in a difficult macroeconomic environment.

Asia Pacific remained our best growth region. We achieved a solid core volume growth of 3.3% despite declining auto production in Asia Pacific by minus 5% and in China by minus 12%. Growth in electronics, wood and furniture and several smaller customer industries was able to more than compensate the weak development in automotive and construction.

Core volume growth in Europe, Middle East and Latin America suffered from the planned maintenance shutdown of polyols. Based on our estimates, car production in EMLA declined by 6% year-on-year. This burdened all 3 segments. Destocking in the polycarbonates
industry was an additional factor that diminished volumes.

Auto production in North America declined by 5% in the first quarter. This impacted our volume development in this region. Another driver was the high imports of mattresses from Asia due to fears of future tariffs, leading to a weak demand for TDI.

Globally, we achieved solid growth rates in electronics, driven by Asia Pacific and North America. Positive growth was achieved in construction in Europe, Middle East, Latin America and North America. Another global growth driver for the first quarter was the wood and furniture industry, although with arbitrage effects between Asia Pacific and North America, as just explained.

I now hand over to Thomas for a full set of financials.

Thomas Toepfer

Well, thank you, Markus, and also warm welcome from my side to everybody on the call. As you can see on Page 4, where you have the net sales bridge, our net sales came in at EUR 3.2 billion and that's clearly below last year's level. The main driver, as you can see, was the sharp decline of prices in MDI, TDI and PCS, reducing our sales by a total EUR 690 million. And what you also see in the bridge is that despite the declining volumes in kilotons, we were able to achieve a positive volume growth contribution of EUR 33 million due to the product mix effect that we achieved. You also see FX effects added EUR 90 million, stemming mainly from the U.S. dollar and Chinese Yuan and portfolio effects come from the divestment of our polycarbonates sheets business, which we completed last year.

If you turn the page, you see the bridge for our EBITDA development. And as you can see, for the first quarter, we achieved an EBITDA of EUR 442 million, absolutely in line with our guidance. And also, as forecasted, the higher competitive pressure in polyurethanes and polycarbonates led to a severe decline in contribution margin, so that the negative pricing delta amounted to a total of EUR 659 million. The volume leverage was positive and amounted to EUR 33 million and all the other bridge item have a rather limited effect.

Overall, it's fair to say that the macroeconomic environment has not improved compared to the fourth quarter of 2018 and sequentially, we experienced an even stronger price and margin pressure. However, the volumes improved slightly driven by the usual seasonality and the sequential EBITDA improvement from EUR 293 million in Q4 to EUR 442 million in this quarter. It's positive and it's mainly driven by a significant cost reduction.

So with that look -- let's look at the sequential development for the group on Page 6. And as already stated, we faced a decline both in core volumes and also in sales during the first quarter. And on the lower side of the page, you see our group EBITDA margin decline from 28.1% in Q1 2018 to 13.9% for the first quarter of 2019, triggered by the pronounced negative pricing delta in PUR and PCS that I already mentioned.

But if you look at it from a quarter-on-quarter perspective, you can see a solid rebound in EBITDA and the margin coming from 9% in Q4 to almost 14% for Q1 2019.

So let's look at the same set of numbers for our 3 business units. I'm on Page 7, where you see polyurethanes. So in Q1, we achieved core volumes which were roughly on par with our previous year level, as solid core volume growth rates for MDI and TDI were compensated by a weaker polyols performance. So as expected, industry utilization decreased driven by the additional capacities that were added during the markets through our competitors last year. And compared to previous year's levels, the net sales decreased in all regions because higher MDI and TDI volumes could not compensate for significant decrease in prices.

So let me talk a little bit more specific about our key products. For MDI, we saw some stabilization in demand and in pricing in the last weeks. Increasing demand in construction helped to reach the usual mid-single-digit percentage demand growth that we usually predict. However, due to the current volatility in the industry, we stay somewhat cautious about the further development during the course of the year. However, to say we're still in midterm, we continue to expect that the current overcapacities will be absorbed by the growing market demand over time.

Now for TDI, the industry environment remains very much under pressure. The margins steadily deteriorated during Q1. And this also
implies a lower starting point for April, which most likely will then lead to a sequentially lower EBITDA contribution in Q2 for TDI. Overall, we assume that the additional capacities in the industry will keep prices at quite unhealthy low levels for the time being. But if you want to look at it from a positive side, we would say that there is limited further downside risk because we believe that the high-cost producers are now really operating at a level where they are at best cash-cost breakeven.

So finally on polyether polyols, the product continues to be slightly below the long-term average in terms of margins. So overall, if you look at the lower side of the page, you see that the EBITDA margin came out at 10.6% in Q1, which was clearly below the last year’s level primarily driven by the significantly lower MDI and TDI margins. But again, if you take a quarter-on-quarter perspective, we see an improvement by almost 4 percentage points triggered and driven by lower costs.

So let’s turn to polycarbonates on Page 8. Here, we recorded a negative core volume growth of 6.3% in Q1. And that was due to continued destocking and the demand drop in the automotive industry, which represents roughly 1/3 of our sales in polycarbonates and those 2 things, destocking, automotive, were the main reason, as I said, for negative growth in terms of core volume. The prices were clearly below the level of previous year after continuous price drops in APAC as well as in Europe in the commodity space, and you have seen those price drops since the second half of last year. So consequently, the net sales decreased by 16.7% year-over-year.

Due to the numerous capacity additions that are currently being announced, we stay cautious on predictions for the overall industry supply and demand outlook. Nevertheless, things like electric mobility, 5G and several other new applications could potentially accelerate the demand growth above our base case of 4% and for the entire industry. And the industry outlook for polycarbonates, therefore, from our perspective, remains attractive, especially for the high-end applications.

Again, if you look at the lower side of the page, you see the EBITDA margin came in at 18%, significantly below previous year’s level, impacted by both the lower volumes and also the negative pricing delta. Again, the quarter-on-quarter view shows you that we were able to improve the EBITDA margin by 4 percentage points to 18% due to the reductions in cost.

So last but certainly not least, let’s look at our Coatings, Adhesives and Specialties segment. Here we saw an overall positive picture in Q1. The core volumes were on previous year’s level and despite weak demand from the coatings industry. Overall, average prices were slightly above the level of Q1 2018. And additionally, we received some support by FX, and therefore, the net sales in total progressed 6.1% year-on-year.

Again, if you look at EBITDA, the number increased by 7.4% versus Q1 2018 mainly driven by higher selling prices and cost reductions. And again, the sequential development, as you can see, from Q4 to Q1, is very positive.

So with that, let’s look at our cash flow development on Page 10. Obviously, the lower EBITDA level and the increasing CapEx significantly reduced our free operating cash flow in Q1. And in addition, we faced the phasing effect from taxes, and you can see the numbers in the table below the bar chart. So we realize a typical seasonal increase of working capital, as you can see, and the working capital sales ratio temporarily reached 19%, which is a similar level as in Q1 of last year. Now for the year-end working capital position, we assume that we can significantly reduce our working capital, which should then have a beneficial and positive effect on our free operating cash flow.

So talking about the full year, most factors that I just described will continue to drive our cash flow development until year-end, that means a lower EBITDA in the year-on-year comparison, higher CapEx and also negative effects from phasing of tax payments will prevail over the year. On top, let me remind you, we will face the cash out of around EUR 350 million for bonuses for the fiscal year 2018 in the second quarter of 2019 and therefore, we assume that our free operating cash flow will even be worse in Q2 relative to Q1. However, if you look at the full year, we will have then digested these cash phasing effects, and we should be able to generate a solid free operating cash flow in the second half of the year 2019, so that, overall, we continue to assume a free operating cash flow between EUR 300 million and EUR 700 million for the full year 2019.

With that, let’s have a look at the balance sheet, and specifically at our net debt development. As you can see, at the end of Q1, our net financial debt level increased to EUR 1.059 billion. That is the pink colored part of the bar chart on Page 11. And the main reason for the
increase came from the adoption of the IFRS 16 accounting standards and the corresponding increase of our lease liabilities and that represented alone a EUR 642 million increase, as you can see in the bridge.

At the same time and that we first saw our pension provisions, as those increased by EUR 222 million and that’s due to the discount rates in Germany, which again fell to a lower level. So if you take those things together and combine it with our lower EBITDA, this leads to an increased ratio of total net debt-to-EBITDA of 1.1x at the end of Q1 compared to 0.6x at the end of 2018. And if you calculate the ratio with the midpoint of our guidance for 2019, the number will come out at 1.6x. However, since the main deviations or the main increases in debt are caused by accounting changes, we still consider that our balance sheet is very, very solid.

So with that, let’s turn to Page 12, where you have the full year guidance items. As expected, our core volume growth came in negative for the start of the year. But still, we assume an acceleration and therefore a catch up in the next quarters that will lead us to a low- to mid-single-digit percentage core volume growth in 2019 overall and that is the statement that we’re making in the first line of the table that you see here. And also, we’re keeping the guidance for free operating cash flow and return on capital employed unchanged for the full year 2019 and confirm it.

In terms of EBITDA, after hitting our guidance on EBITDA in the first quarter, we also confirm the EBITDA expectation of EUR 1.5 billion to EUR 2.0 billion for 2019. And if you look at the mark-to-market assessment, that number also stays broadly unchanged at EUR 1.8 billion for the entire year 2019 if you base it on the margins that we achieved in the single month of March.

So unchanged to our statements that we made earlier this year. And we think that the expected deterioration of the TDI margin was compensated by an improved margin in MDI.

Now if you look at our EBITDA guidance for Q2, you see in the table that we assume an EBITDA which is around the level of Q1 2019. We expect sequentially growing volumes. However, we also assume a slight sequential cost increase, which should counterbalance the positive volume leverage. And the market develop, in general, remains volatile with a lower-than-usual visibility, and therefore, please be reminded that around in our nomenclature means a single-digit percentage deviation to both sides, obviously.

I should also say that the basic underlying assumptions of our guidance, as announced in our full year conference call, remain unchanged. And our guidance for 2019 continues to include the changes driven by the adoption of IFRS 16. We have now, after Q1, more visibility on the numbers. And for the full year, we assume a benefit of around EUR 120 million for EBITDA in free operating cash flow. And given the decreasing D&A, the effect on EBIT is expected to be rather limited. Interest expenses will be burdened by a low double-digit euro amount. And for convenience, all of this is also stated in a backup slide that is contained as an appendix to this presentation, where you have all the details for the first quarter and you can derive the full year numbers mostly by simply multiplying it with 4.

So with that, I would like to hand it back to Markus for the summary.

Markus Steilemann Covestro AG - CEO, Chief Commercial Officer & Chairman of Management Board

Yes. Thanks, Thomas. The first quarter developed in line with our expectations. Highlights in a year-on-year comparison were limited, but let me still name a few: first, the achievement of stable volumes in Polyurethanes and CAS segments was a positive, considering the multiple headwinds that we faced; second, our EBITDA improved nicely quarter-on-quarter, mainly based on lower costs; third, CAS demonstrated in Q1 how resilient and highly profitable the business remains, even in more turbulent times. Core volumes remained stable and pricing delta was positive; fourth, our CapEx program is on track. Despite the short-term impact this has on our free operating cash flow, it fuels our growth initiatives and thus lays the foundation for our long-term success. Finally, we expect to deliver earnings below midcycle levels on the back of a more challenging economic environment as well as less favorable industry balances this year. Despite that, we are able to confirm our full year 2019 guidance thanks to our strict cost discipline and stabilizing margins.

With that, we would like to thank you for your attention and are glad to take your questions.

QUESTIONS AND ANSWERS
Operator
(Operator Instructions) The first question comes from Mr. Charlie Webb from Morgan Stanley.

Charles Webb Morgan Stanley, Research Division - Equity Analyst
Just a few for me. First up on volumes, just as we think about that sequentially at the Q2, there’s no Chinese New Year, you could understand the outage you currently have in Dormagen versus the polyols outage you had in Q1. What should we expect sequentially, basically Q2 on Q1. That’s the first question on the volumes. Second question just on raw materials. We didn't see a huge amount of raw material release in Q1. Is there a lag effect to that? Should we start to see that come through more in Q2? Was that driven by the polyols outage? Was that having an effect on that? Or should we expect some more unwinding of the raw materials in second quarter? And then finally, just a comment around the EUR 1.8 billion currently mark-to-market or mark to March margins for the full year, is it fair to say that MDI spreads have improved since the end of March? And then TDI now is starting to slight improvement off the bottom in March, at least in Asia. Just to tell that comments was related to margins as of March, not as of April -- end of April?

Markus Steilemann Covestro AG - CEO, Chief Commercial Officer & Chairman of Management Board
Charlie, this is Markus. I would like, at least, to take the first 2 questions. If you compare volumes sequentially for second quarter, what should we expect without outages? Well, we would expect that we see slightly higher volumes, however, those volumes would be more towards the low single digit. And yes, that’s the simple answer. On raw materials, while we would expect for the second quarter a slight relief, however, we expect them little bit higher to be in Q3. That is simply due to the fact that we would have, most likely, 2 to 3 months lag, let’s say, from purchase to production cycle and also with regard to the inventories. But that would not affect any major effects from the 2 mentioned topics. And with regards to the third question, I would like to hand over quickly to Thomas.

Thomas Toepfer Covestro AG - CFO, Labor Director & Member of Management Board
Well, Charlie, it’s a general comment. I mean what we saw over the course of the entire Q1 is that TDI further decreased, while MDI was stabilizing, especially over the course, let’s say, since the middle of the quarter. That essentially has in terms of directionally, continued into April and the 2 effects are balancing off each other. And this is why, yes, MDI was directionally getting a little bit better, TDI directionally a little bit worse. The total effect, therefore, in terms of the mark-to-market remains unchanged. But yes, it is fair to assume that we think -- and you can -- I mean, there’s also some press comments out there, we think TDI is probably approaching unhealthy levels. So as I said also in my speech if you want to take a positive thing out of it, we don’t expect it to decline much further from the current standpoint.

Charles Webb Morgan Stanley, Research Division - Equity Analyst
And just following up, what is the issue at Dormagen, the force majeure? Have you got any -- I guess, you haven't got any signs to when that will be essentially back on line?

Thomas Toepfer Covestro AG - CFO, Labor Director & Member of Management Board
Well, we had a technical incident or you could also call it an accident, where a third-party company had an accident with a claim and that will have a low double-digit EBITDA impact negative in Q2, but it will be resolved shortly. So I wouldn’t call it a major incident, but it was an accident that we had and some repair work going on. But it was fixed shortly, and as I said, low double-digit negative effect in terms of EBITDA to be expected.

Operator
The next question comes from Mr. Markus Mayer calling from Baader Bank.

Markus Mayer Baader-Helvea Equity Research - Lead Analyst of Chemicals
Three question from my side. First one is on polycarbonates. Can you update us on the phasing of the announced polycarbonate capacity additions of the competitors that you see, in particular, on potential delays? Second question is on this positive product mix effect, you have seen on the top line as well as on the margin side. Maybe some more words on this would be helpful. And then lastly, how you see demand now going in Q2. You said volume should be somewhat better than in Q1. Is there any kind of specific area where we see improvement, for example, automotive or is this more on the broad-based picture?
APRIL 29, 2019 / 1:00PM GMT, Q1 2019 Covestro AG Earnings Call

Markus Steilemann Covestro AG - CEO, Chief Commercial Officer & Chairman of Management Board

Markus, thanks for the questions. Markus speaking. On polycarbonate, what we have seen from the annual report from Wanhua particularly is, that they've now publicly stated, that they will actually delay their line number 2 and 3 additions. And if you put this into the context for 2019 capacity additions for the entire polycarbonate market, that would bring down the number from currently expected 11% capacity addition this year down to 8% capacity addition, assuming that, that would come up at end of the year. And yes, that's what we currently know. As you know, there's other players currently trying to build polycarbonate capacity. And as we have always stated, also in the past, there's always some likelihood and therefore, possibility that there will be further delays with other players. That always has to be taken into consideration. However, has not yet been factored in into the 8% after the Wanhua announcement. With regard to your product mix effect, I would like to hand over to Thomas.

Thomas Toepfer Covestro AG - CFO, Labor Director & Member of Management Board

Well, Markus, quite thank you. There's not so much more to say. It is as simple as that. It's a mix effect, while in kilograms, we declined slightly, by minus 1.8%.

The more profitable products declined less or even increased. Plus I mean, one is just core volumes plus we also have some noncore volumes that flow into our P&L. And sometimes, especially if you have in absolute terms, a relatively small numbers, those things can fall apart in terms of the positive negative. Therefore, there is nothing really special to it. In terms of the expectation for Q2, I would say -- I mean you've seen a negative pricing delta of this EUR 659 million in Q1, it will be slightly less negative in Q2. So expect the number between EUR 500 million and EUR 600 million and all the other bridge items on a year-to-year comparison, so FX, others, et cetera, should be relatively minor. So the big driver is the pricing delta that will determine the Q2 EBITDA.

Markus Steilemann Covestro AG - CEO, Chief Commercial Officer & Chairman of Management Board

Yes. And if I may add then, Markus, on the last topic that you raised on the demands, let's say, in terms of Q2 volumes, we maybe have 2 effects here. Number one is, as we stated earlier, we have better availability from our own assets and that drives also the volume growth opportunities that we have. And we also see, simply due to seasonal changes in particular on the construction industry, some opportunities to drive our volume growth in the order of magnitude that I just mentioned earlier, which means on a low single digit area. And yes, you refer, if I don't recall it wrongly on the automotive, I would say we do not see extremely positive side. The opposite side is true that we compare in second quarter to an extremely strong quarter of 2018. That means it will be a challenge in terms of, let's say, seeing here a really significant improvement, in particular, compared to the last strong quarter that we have here, particularly, not only a demand issue this year, but also baseline topic as they continue from last year.

Operator

The next question comes from Neil Tyler who's calling from Redburn.

Neil Tyler Redburn (Europe) Limited, Research Division - Research Analyst

A couple for me please, perhaps, starting with a follow-up to the question on mix. I wonder if you are able to help us understand, in which divisions that positive mix was most apparent? And second question, you mentioned Asia volumes and clearly the -- your comments on the automotive end market are no great surprise. But could you discuss in a little bit more detail the bright spots that will offset that weakness in automotive production? And then the third question. When we think about the comments you've made at the full year around your resilient business and the EBITDA contribution from that -- those resilient businesses, can you give us some sense of how, in the first quarter, the year-on-year profit of that proportion has changed?

Markus Steilemann Covestro AG - CEO, Chief Commercial Officer & Chairman of Management Board

Neil, let me start with your second question referring to Asia Pacific volumes topic. Again just to put things into perspective, we have seen in Asia Pacific minus 5% decline in automotive production passenger vehicles. In China, we have seen minus 12% alone on the passenger vehicle output, not dealer sales and units, but really production output. So putting this into perspective, that was a situation we faced in automotive. So how do we still manage to get a 3.3% plus on core volumes in Asia Pacific and 5% plus in China? Basic reason for that was that we could overcompensate this by the wood and furniture sales. Referring to one of the topics we discussed in the context of the weakened aftersales on mattresses because there was a lot of exports going out. Secondly, electro, electronic sector was positively really nicely and positively developing. And in some parts, also the construction industry provided some positive growth momentum. So that
was how we were, as you refer to, able to leverage some of the brighter spots against the strong backdrop in automotive. I hope that helps a little bit.

**Neil Tyler Redburn (Europe) Limited, Research Division - Research Analyst**

Yes, that's helpful.

**Markus Steilemann Covestro AG - CEO, Chief Commercial Officer & Chairman of Management Board**

With that, I would like to hand over to Thomas.

**Thomas Toepfer Covestro AG - CFO, Labor Director & Member of Management Board**

Well, I mean, again, I don't want to overemphasize this mix effect. But if you look at the deviation between core volume growth and sales volume growth, it mainly comes from PUR and PCS. And the percentage deviation, according to my memory, is approximately the same. And therefore, it's those 2 segments. They make, obviously, over 75% of our total business, so it's not a specific effect in any one segment, but the 2 big segments are both affected by this effect.

**Laurence Alexander Jefferies LLC, Research Division - VP & Equity Research Analyst**

Could you give a little more detail on the trends in the CAS segment? The strength of results compared with what you saw in the downstream markets? And are you concerned is all about inventory destocking by your customers in Q2?

**Markus Steilemann Covestro AG - CEO, Chief Commercial Officer & Chairman of Management Board**

Okay. So the main driver, I mean, long story short without going into too many details is that we have seen, definitely, industry volumes going down at most of the very large players in this industry. Yet we simply gain market share.

**Laurence Alexander Jefferies LLC, Research Division - VP & Equity Research Analyst**

Can you give some sense on what drove that? I mean what -- in terms of is it a lag in pricing that -- on perhaps the competitors? Or can you give some detail on exactly how sustainable that should be?

**Markus Steilemann Covestro AG - CEO, Chief Commercial Officer & Chairman of Management Board**

One of the key drivers was definitely the limited availability of one of the key raw materials. Not to bore with you with that, but HMDA availability was a challenge. And I think here, we really could outperform in one or the other sense. If you really look at the overall development by industry, you could say that overall stable demand was unequally distributed. So we saw some negative growth in automotive, transportation, wood and furniture as well as construction. And then there was a very broad range in terms of diversified applications, which would let's say, standalone, not even worth to be mentioned. But in the sum of the parts, there was plus 3% in this very broad and diverse range of applications, be it Specialty Films, for example. And there were also some quite innovative products that we brought into the market, for example, in terms of renewable hardeners for automotive coatings and things like that. So that also definitely helped. And that's -- then I would say, partially at least those gains in market share should be sustainable. In the double meaning of the word sustainable, by the way.

**Georgina Iwamoto Goldman Sachs Group Inc., Research Division - Associate**

Markus, I've got a bit of a longer-term focused question. Now that you've been in official capacity infield for a year, I think today, you've given the market some assurance that is limited downside risk to the guidance that you've given. But also seems unclear that there's much upside outside of large-scale outage, and therefore, any earnings upside seemed somewhat out of your control. So as you head out onto the road to the investors after results, what is the kind of 3- to 5-year equity story that you will be presenting? How do you plan to deliver value for shareholders from here? Which businesses are you excited about, and especially, in light of your ongoing balance sheet?
Well, if you look into this, the upside for 2019 might be mainly the market prices, so if you look at this short term within the year. Midterm for sure, you see that we're driving at full steam in many different areas. One of the areas is definitely that we continue to believe in the strength of the high market demand for our core products that we already have in our portfolio. Let me give you a few examples. One of the examples is that, and you see that each and every day everywhere, the concerns of climate change. That means the world needs to move toward sustainable energy. The world needs to move towards less energy consumption, despite the fact that there's a lot of conversations about full electrification of a lot of the value chains that we're going to transform. That means highly effective insulation materials will be in high demand. Just on Friday, the Mayor of New York announced that he would like to start a strong initiative on more energy-effective or zero emission buildings and that he wants to get rid of all the things like steel and glass palaces, as he called it. So if you take this just as a small sign, as an anecdote, but indicative sign about more energy-effective buildings now really taking ground in the market, that is one of the key drivers, I think, for our MDI business. If you look into our polycarbonates business, we are going through a significant transformation in the transportation and also mobility sector away from combustion engine to hybrid vehicles and fully electrified vehicles. That drives the demand for our polycarbonate sector. If you look into safety issues, if you look into temperature management for batteries, if you look into loading stations and so on and so forth. Just to name mobility in a broader sense, that means 5G technologies. That means you need every 100 meters, at least, one of those transmitting stations. And that would also again, and we have successful examples for that already, housing materials made out of polycarbonate due to different effects and so on and so forth. So if you look at the real needs that are currently crystallizing from societal changes and also for deeply needed changes in the overall growth and how we understand, how a sustainable economy should look like, that is exactly, I think, where Covestro with its current portfolio is already very well positioned. And for sure that fuels the creativity also in terms of M&A and let's not forget about our innovation pipeline. There's a lot of small contributions, but they're all summing up to, I think, quite nice future growth opportunities. I hope that gives you some flavor about what we've seen in the next couple of years to come within the given portfolio, but also a little bit of fantasy on the potential inorganic growth opportunities.

I think we have always communicated that we see core volume growth in the next 5 years around 4% per year. And that is already significantly above the expected GDP growth and that is already reflecting how the portfolio is outgrowing the overall economy. And for the time being, I would like to leave it with that.

So if you look at the real needs that are currently crystallizing from societal changes and also for deeply needed changes in the overall growth and how we understand, how a sustainable economy should look like, that is exactly, I think, where Covestro with its current portfolio is already very well positioned. And for sure that fuels the creativity also in terms of M&A and let's not forget about our innovation pipeline. There's a lot of small contributions, but they're all summing up to, I think, quite nice future growth opportunities. I hope that gives you some flavor about what we've seen in the next couple of years to come within the given portfolio, but also a little bit of fantasy on the potential inorganic growth opportunities.

So if you think about the next 3 to 5 years volume outlook, would you say that that might even be more attractive than the previous 3 to 5 years? Or continuing on the same level?

I think we have always communicated that we see core volume growth in the next 5 years around 4% per year. And that is already significantly above the expected GDP growth and that is already reflecting how the portfolio is outgrowing the overall economy. And for the time being, I would like to leave it with that.

The next question comes from Geoff Haire calling from UBS.

I wanted to ask some shorter-term questions. There's 2 numbers that stand out in terms of this aspect for sustainability in the future quarters for this year. First of all, the 100% drop through in volume because of the mix and also the margins that you managed to get in the polycarbonate business. I wonder if you can just comment on what you expect as they go through the next few quarters. And also we're seeing headlines about water levels again in the Rhine River. Is that something we need to be aware of for the second quarter?
Markus Steilemann, Covestro AG - CEO, Chief Commercial Officer & Chairman of Management Board

On your second question, Geoff, on the Rhine River levels. Well, we haven't seen any impact in first quarter on Rhine River levels that what has majorly effect in the fourth quarter. We haven't seen any effect in first quarter and we do not expect to see any effect in the second quarter. If you are referring to some of the media hype in terms of a drought that we might expect and also, therefore, lower Rhine River levels in Q3 or even Q4 of this year, this is even beyond speculation, I would say, because a weather forecast that goes, let's say, longer than 6 weeks is, from my perspective, simply not a serious analysis. And that is also what all the serious weather forecast institutions tell you. They have no idea how the summer will look like, whether it will be dry, whether it will be rainy or something in between. There's a lot of media hype around this. But there is no further insight into which direction the weather will develop for the summer. For sure, we have taken the experience of last year into consideration to further improve our emergency response in case something like this would happen again. And from that perspective, those mitigation levels effects would definitely include more trucks. It would also include that we book, in advance, more ships. And yes, that would also come with higher costs. And we also have to be clear, we would not be able to fully compensate no matter how good we prepare simply due to the limited available capacity and trucks and ships but also -- if you look at the traffic on the streets and also on the capacity of the railway. So overall, we're preparing. I think we would be much better prepared, but we would not be able to fully compensate it. However, there is currently no indication that something like this would happen.

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

Okay. And so could you just comment on the sustainability of the margins you saw in PCS end of Q1?

Thomas Toepfer, Covestro AG - CFO, Labor Director & Member of Management Board

Do you mean -- I mean generally, the EBITDA margin that we saw of PCS in Q1?

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

Yes, yes.

Thomas Toepfer, Covestro AG - CFO, Labor Director & Member of Management Board

We think that is -- I mean, there will always be some fluctuation, but I think it will be broadly stable going forward.

Operator

The next question comes from Mr. Christian Faitz who is calling from Kepler Cheuvreux.

Christian Faitz, Kepler Cheuvreux, Research Division - Equity Analyst

I have just one remaining small question please, CFO question. Just for modeling purposes, on the rather low SG&A unit cost of below EUR 100 million in the quarter a reflection of successful restructuring? Or is that a one-off low number?

Thomas Toepfer, Covestro AG - CFO, Labor Director & Member of Management Board

I would say it's neither one or the other. Remember that we have our PSP bonus scheme, where we said that this is, kind of, an automatic measurement to improve the results when times are getting more difficult. And we said that the total bonus for 2018 is some EUR 350 million. So it's the bonus achievement that we have to accrue for goes down in 2019. That is obviously reflected off from our SG&A costs, which then, in that sense, benefit from it. So I would say it's not a restructuring effect yet. I remember we have some also headcount cuts in our perspective programs, but those to the majority, are yet to come and are not yet reflected in Q1 nor is it a onetime effect. It is sustainable because it's driven by our bonus scheme that is helping us to cut costs in less good times.

Operator

(Operator Instructions) The next question is from Mr. Chris Counihan who is calling from Crédit Suisse.

Chris Counihan, Crédit Suisse AG, Research Division - Director

I just had a quick question on the working capital development and specifically inventories up 11%. That's despite pricing down 18%. I would've thought we would see some relief throughout this quarter. Could you maybe comment on that specifically?
Thomas Toepfer  
**Covestro AG - CFO, Labor Director & Member of Management Board**

In general, there is a working capital buildup in Q1. That is a seasonal effect. Now the question is, how is that evolving relative to last year? And relative to last year, I would say, our inventory buildup is absolutely in line. And therefore, I would say, it's what you see is [a pure] (corrected by company after the call) seasonal effect. If you look at the working capital buildup in total, it's some EUR 287 million less buildup than what we had in Q1 2018. And therefore, it also reflects a lower pricing level. And sorry, just I should mention one more thing. In terms of inventories, the effect is less positive because we had to prepare some maintenance shutdowns in the first half of the year. Remember that in 2019, the majority of the maintenance shutdowns happens in the first half year, while in 2018, it was just the other way around. So this is another driver why inventories did not decrease or let's say increase less, as you might expect, in terms of what you see from the prices.

Operator

The next question comes from Thomas Swoboda, who is calling from Societe Generale.

Thomas Swoboda  
**Societe Generale Cross Asset Research - Research Analyst**

I have one rather strategic question, and it's about the oil price. It looks like that Mr. Trump has started to heat up the oil price with sanctions on Iran. My question to you is, in the current supply/demand development and assuming that the oil price goes towards the $100 per barrel towards year-end, what would this do to your earnings?

Markus Steilemann  
**Covestro AG - CEO, Chief Commercial Officer & Chairman of Management Board**

Thomas, this is Markus speaking. That's a real glass ball question, a crystal ball question. So in very short terms, we always look at the oil price to be not, and please don't get me wrong, that relevant for our business because we're looking into supply/demand situations for our key products. That means whenever raw materials increase, they increase normally for everyone in the market for as input factors, for example, for benzene, that then goes into aniline, so the entire value chain. And then we're looking more into supply/demand balances for our key product and not into feedstock costs or even cost of a barrel of oil. For sure, there is some short-term effects in terms of lagging. That means if we are in an upwards trend, it might take us some time to push prices through in the market. And that's why sometimes when the prices go up, we have a little bit of lagging before we can push this through. If prices go down, we sometimes benefit a little bit from holding on longer to the respective prices and then we see the spreads for our products, in terms of margins, going up. But generally, this is a pass-through for most of our businesses and there might be some effect on the resilient businesses, where it is more difficult to really than increase prices. So that's how I would -- a little bit lengthy explain what effect that might have.

Operator

We have a follow-up question from Mr. Neil Tyler who is calling from Redburn.

Neil Tyler  
**Redburn (Europe) Limited, Research Division - Research Analyst**

Sorry, I just wanted to come back to a question I asked earlier regarding whether you can give us any perspective on what you describe as your resilient businesses across the various divisions? And how those are shaping up or where they stand in EBITDA terms Q1 versus Q1 last year, i.e, how resilient have they been?

Thomas Toepfer  
**Covestro AG - CFO, Labor Director & Member of Management Board**

Well, I mean, first of all, let's just -- I would like to remind everybody, what do we classify as resilient. We say our CAS business is part of the resilient part, and we say roughly 60% of PCS belongs into that bucket. And we classify our polyols business as being resilient. And a very small portion, let's say, 25% of the MDI business. If you go through those components, we would say that the contribution from CAS is maybe slightly up. We think that PCS is slightly down because the commodity prices are down and the commodity price level has a certain spillover effect also in the more differentiated space of the product. And the polyols business slightly down and MDI relative to midcycle levels also slightly down. But overall, we're still in the normal range. So again, if you look at the components CAS up, the others slightly down, but overall, still in the broad range of what we always see.

Operator

The next question comes from Mr. Sebastian Bray who's calling from Berenberg Bank.
Sebastian Bray  Joh. Berenberg, Gossler & Co. KG, Research Division - Analyst

I would just have one, please. It's a more strategic question. Can I ask, is Covestro a net buyer or beneficiary of carbon credits in Europe? And is this likely to increase as a headwind or as a competitive advantage over the next 2 to 3 years given the prices are up quite substantially? And if you can give an idea of magnitude. Is this something that is not likely to be substantial on the cost line? Or something that could become quite big at current carbon prices?

Markus Steilemann  Covestro AG - CEO, Chief Commercial Officer & Chairman of Management Board

Yes, Sebastian, thanks a lot for picking up German day-to-day politics. And actually, we pre-bought carbon credits for almost 10 years, that's why we feel, kind of, safe for quite a while. And that's the current status because nobody knows when the carbon price will come. To what extent it will be getting to the entire energy incentive and therefore, also carbon-dioxide-heavy industry. And also how high this price, at one point in time, really will be. And we also must not forget that there is already first technologies going on and around also to very limited extent that use carbon dioxide already as a chemical feedstock. It will not save us, however, seeing it sends a very positive single about proactively we address to stopping, not only in terms of, prebuying carbon credits but also making sure that we close the loop towards a circular economy, which is something that we are strategically in for.

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

All right. Perhaps I would ask a follow-up on that. The first would be, if you didn't have carbon credits, what would your annual costs be or -- and what sort of magnitude? And secondly, when do these credits expire as a whole? Is it 2026? Or -- whether expire but until when do you have them?

Markus Steilemann  Covestro AG - CEO, Chief Commercial Officer & Chairman of Management Board

Well, it would be highly speculative because, as I said, we don't know to what extent it will come, at what prices will it come, what would be taken into consideration. So I think I would say, as of today, I would see myself be unable to give you any concrete number that would go beyond speculation.

Operator

The next question comes from Isha Sharma, who is calling from MainFirst Bank.

Isha Sharma  MainFirst Bank AG, Research Division - Analyst

I have one, please. Could you please help us with the segment-wise development in earnings for Q2 and also the second half of the year, especially for polycarbonate as we see very low volumes for Q1. How should we see this for Q2 because the prices are still falling? Polyurethanes is it fair to assume that the situation remains more or less where it was for Q1, so more or less stable EBITDA. Just a little bit of color on that, please.

Thomas Toepfer  Covestro AG - CFO, Labor Director & Member of Management Board

Well, Isha, I would say, I mean, I said, the main driver for the year-on-year bridge for Q2 is the negative pricing delta of what I said between EUR 500 million and EUR 600 million. And I would say, 3 quarters of that pricing delta comes from the polyurethanes segment, while the CAS segment is broadly stable and 1 quarter is negative to the PCS segment. All the other building blocks are not very meaningful in terms of size. So I think that gives you an impression of where the segments should go.

Operator

The next question comes from Charlie Webb calling from Morgan Stanley.

Charles Webb  Morgan Stanley, Research Division - Equity Analyst

Just one quick follow-up. Just relating to the environmental enforcement in China following the unfortunate explosion we saw earlier, I guess, in the quarter, Q1, as we look at it, do you see any increased scrutiny from the Chinese regulators around chem parks? Do you expect it could have or will have any implication for feedstocks in terms of your businesses? Have you look ahead into the rest of the year?
Markus Steilemann  Covestro AG - CEO, Chief Commercial Officer & Chairman of Management Board

Charlie, thanks for the question. We currently look at it, we definitely see that, and I mean it very positively, the Chinese government and authorities are significantly stepping up, not only the legislation but also the implementation and oversight of execution of improved safety and environmental standards across the board. So we also see that those are no longer, let's say, specifically apply to particular industry players, but they are really applied to all players, be it local or be it multinationals or be it joint ventures. And it also has led to a significant shutdown of chemical operations, of chemical parks, of chemical plants across the country. And it is very clear and obvious that this strategy of concentrating chemical operations within clearly assigned chemical parts is clearly a followed trend in China. So from that perspective, we see that the efforts are being now really implemented, being really stepped up and equally applied to almost all participants in the market. That did affect us. It affects us, in a sense, that also we face sometimes also unannounced inspections in terms of safety and with that, also we face, if you would like to say, higher scrutiny in terms of how we live up to environmental standards. But I would say, if you look into our operations, we always had, globally unified very high safety standards and very high environmental standards that we've always adhered and sometimes even exceeded legally required limits, exceeded in a sense of we were, let's say, for example, emitting less than actually was allowed. So from that perspective, I think we see that. We very much welcome those efforts and it also creates a more playing level field and we feel extremely well prepared already as of today with the current measures we have in place since years.

Charles Webb  Morgan Stanley, Research Division - Equity Analyst

And just to be clear, is that comment kind of based on a continued theme? Or is that -- do you see an acceleration post the unfortunate event earlier in the year?

Markus Steilemann  Covestro AG - CEO, Chief Commercial Officer & Chairman of Management Board

Well, I would say, it's both. I mean, that was a topic that was always on the agenda. If you look into the recent 5 years plan, safety of chemical operations was always somewhere in there and the increase of this, also the increase in environmental standards and a more sustainable economy by all means. And yes, for sure, respective recent incidents have only accelerated this speed. So from that perspective, it is nothing that was unexpected. That's currently what we see. That also applies, for example, 2 permits that you need for chemical operations. Here, we definitely could see that some of the approval processes slow down, they do not currently affect us in terms of execution of investments, but that is also something that we clearly observe, that the procedures for permits has slowed down.

Operator

The last question for today comes from Chetan Udedshi from JP Morgan.

Chetan Udedshi  JP Morgan Chase & Co, Research Division - Research Analyst

Couple of questions, firstly on MDI, we've seen a big increase in China over the last 3 months. Can you, maybe, from your experience so far, can you talk about how do you see the stickiness of those price increases have you seen in China, that's number one. Number two is, also on TDI, it seems, at least, 2 of your competitors have announced increases in TDI prices in the U.S. from end of April or May. Is that something you see as well? And the last question, sorry, is on the other line of the EBITDA bridge. Just from memory, I think you mentioned on, full year results call, that would be, like, low triple-digit million euros positive. It seems like, at least, first half, it is flat to even negative. So is the phasing of that positive number primarily second half?

Markus Steilemann  Covestro AG - CEO, Chief Commercial Officer & Chairman of Management Board

Okay, Chetan, let me take the first 2 questions. On MDI process, I think we have commented already, how we look at the current price development and the MDI prices that was just announced yesterday, if I remember that correctly, by the largest player in China on the MDI prices, an increase by roughly RMB 600 per tonne, which would reflect something like around 3 to 4 percentage point. We still have to wait and see how this develops in the market. The second topic is, let's say, on the seasonal rebound on construction that might support a little bit a stabilization on maybe even very, very slight uptick for MDI prices. We mainly also see that some of the planned maintenance shutdowns, even though inventories have been built, might help a little bit, but then there is also, again, the risk once those capacities come back that those price increases vanish. So I would rather say, on average, we would currently face balance market and that's why I would not see significant opportunities from today's perspective of a real uptick in MDI prices. If we look now into MDI, again one more flavor, U.S. market growth in MDI, we expect it to be around 6% to 8% and that also would mean that we would need more capacities there. And currently, we still have a net import market for the U.S. in terms of MDI demand. So that's the current situation on
MDI. If we just look at TDI in terms of price increases, I think Thomas mentioned that earlier. For TDI, we would currently see that we are hitting levels where some of the incumbent smaller producers and in-competitive producers hit may be exactly there cash cost 0-point and there might even be cash burning already. So from that perspective, that might explain why some try to increase the prices, would that really be something that would go through in the market, we have to wait and see. Currently, that's all I have to say because it's quite sensitive to talk about price development in this context here.

Thomas Toepfer Covestro AG - CFO, Labor Director & Member of Management Board

Well, then Chetan, on your question on the distribution of the others, so yes, I would still confirm the statement that we have made for the full year, which is a low triple-digit amount that we are expecting. And therefore, yes, as we only expect maybe a slight positive effect in Q2, but as said, it will not be a major effect, the distribution is mainly into the second half of the year. And that’s still what we’re expecting also from our perspective program, where some of the measures simply take some time and are back-end loaded before they show their full impact on the P&L. So the answer, in short, is, yes.

Operator

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

Ronald Koehler Covestro AG - Head of IR

Thank you all for participating and the lively discussions. If you have a follow-up, don’t hesitate to call the IR department. Otherwise, we might see you actually next week at the sell-side dinner in Frankfurt. Everyone is can join either from Frankfurt or from London. And also obviously, the buy side, we are happy to see you on various others locations, be it conferences or roadshow. Thank you all for listening, and see you. Bye-bye.

Operator

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