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# EDITED TRANSCRIPT

Q1 2020 Covestro AG Earnings Call

EVENT DATE/TIME: APRIL 29, 2020 / 1:00PM GMT



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## PRESENTATION

### Operator

Ladies and gentlemen, thank you for standing by. Welcome to the Covestro Earnings Q1 2020 Results. The company is represented by Markus Steilemann, CEO; Thomas Toepfer, CFO; and Ronald Köhler, Investor Relations. (Operator Instructions)

I'd now like to turn the conference over to Ron Köhler. Please go ahead, sir.

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### Ronald Köhler Covestro AG - Head of IR

Good afternoon, and welcome to our first quarter conference call. I just have to apologize a bit for the 5-minute delay, but there are so many participants waiting still to enter. Therefore, we were waiting for you, and I hope this doesn't break it, so to say. For your information, we have posted our interim statement and our conference call presentation on our website where you can find it and follow it. And we also assume you have read our safe harbor statement.

And with that, I would like to turn it over to Markus.

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

Thanks, Ronald. Good afternoon, and good morning to our listeners from the United States. Current times are extremely challenging for all of us, both on an individual as well as on a professional level due to the coronavirus pandemic and its consequences in all areas of our life. The focus of quarter 1 2020 was certainly to, first, take care about the safety of our employees and then to find ways to secure our business in the best possible way.

Let me start with the financial highlights of the first quarter. As expected, we faced a core volume decline of 4.1%. However, we reached our EBITDA target of EUR 254 million, within the guided range of EUR 200 million to EUR 280 million. In the first quarter, the free operating cash flow was, as expected, negative. This reflected the usual seasonality. As you know, it was not possible to stick to our initially planned AGM date. We now found a new date and format. It will be held virtually on July 30, 2020. Finally, our initial outlook for the year could not be upheld. Therefore, we adjusted the group financial guidance for 2020 already with an ad-hoc publication on April 15.

The chart on Page #3 shows you Covestro's core volume change year-on-year, including the latest available data from April. In the first quarter of 2020, volumes sold in the core business fell by 4.1% at group level compared with the same quarter of the previous year. This was due to coronavirus-related weaker demand in China in February and March. We estimate the global impact on volumes at minus 8% year-on-year. Under regular conditions, the underlying growth in core volumes would have been around 4% positive in the first quarter. The impact by regions gives a better understanding on the global dynamics. Our figures show that mainly China was affected in the first quarter. As it was hit first, the impact on our business was highest in February.

In Europe, volume impacts varied by country. Italy and Spain were impacted first. Automotive production stops were decided late in the



quarter. In April, we faced a major year-on-year decline with a recent stabilization. In the United States, we witnessed the latest but hardest hit. The pandemic arrived late and the political actions affecting the economy were implemented 1 month later than in Europe. In a nutshell, we conclude that quarter 2 will be affected by many more countries, while quarter 1 was mainly affected by China. Consequently, we expect the impact on core volumes to be significantly more severe in quarter 2 than in quarter 1.

After the regional analysis, let me show you on the next slide our main customer industries, how they are affected. The chart focuses on automotive, wood and furniture, construction and electronics, altogether accounting for around 65% of group sales. The data represents our current internal assumptions for different industries. For automotive, we observe that 100% of the production plants reopened in China. On the other hand, all plants are currently closed in NAFTA and some plants reopened in Europe, Middle East, Latin America at reduced capacity. The current lockdown, coupled with the low consumer confidence, is expected to severely hit this industry. Therefore, we assume an industry decline between minus 15% and minus 27% for 2020.

For the wood and furniture industry, we expect also that global markets will decline between minus 12% and minus 17% in 2020. Construction seems to be not as bad as automotive or furniture. However, also here, we see that the lockdown dampens activities meaningfully. It seems that the impact on this industry will be the highest in NAFTA. Our assumption for the global yearly development is a decline between minus 2% and minus 8%. For electronics, major impact is assessed for the region Asia Pacific. Since we faced a severe decline in this region in quarter 1, we might have seen the worst already. We estimate that EE&A will decline by minus 4% to minus 12% this year.

Let me now wrap up this picture on the next slide. In response to the global spread of the coronavirus pandemic, the Board of Management has taken early and decisive actions to adapt the company to the current conditions. In mid-March, we made home office mandatory for employees, wherever possible. As of today, we have thankfully recorded no casualties among our workforce. The second priority was to secure the utilization of our assets and to ensure the ability to deliver to customers. China was first hit by interruptions in February and reduced production rates. We returned to full production rates in the middle of March. However, as the pandemic spread into other Asian countries, our export business from China into Asia Pacific suffered. Therefore, we had to again lower rates in April.

In Europe, we see rates at around 70% for polyurethane and polycarbonates. CAS has been running at reduced rates as well since April. In the U.S., our Baytown site was not hit in Q1, but has now, for a few weeks, also been forced to reduce its output. In Q1, we recorded a negative impact on EBITDA of around EUR 80 million, slightly higher than the guided EUR 60 million. On the back of this, another key priority for us was to review our cost savings and CapEx plans and to secure a strong liquidity position.

Continuing on Page 6, we further increased the target for short-term cost savings to now more than EUR 300 million in full year 2020. Previously, we planned to achieve EUR 200 million of additional cost savings in 2020. Half of the savings are driven by cost avoidance versus original budget, for example, lower CapEx-related operational expenses. The other half comes from various measures like reduced consultancy costs, travel restrictions and other expense cuts. In response to the coronavirus effects, we identified more than EUR 100 million of additional measures through lower OpEx, in line with the reduced CapEx budget, less travel and lower supply chain costs. This comes in addition to the ongoing "Perspective" restructuring program, which is expected to contribute savings of EUR 100 million this year. The savings program includes around 900 planned headcount reductions and a deep screening across all areas of the group for possible sustainable savings. In total, all measures are planned to yield more than EUR 400 million of savings for the full year 2020.

On Page 7, let me now go through our standard chart, starting with the regional development. Global core volumes declined by 4.1% year-on-year. We observed the ongoing demand weakness in automotive in EMLA and NAFTA. This translated into a low double-digit decline of core volumes in automotive. Volumes in global electronics also declined by a low double-digit rate, entirely driven by Asia Pacific. Positive volume growth in multiple other industries like medical and chemicals could not compensate the sharp declines. Asia Pacific, usually, our best growth region, was severely hit by the coronavirus in the first months of the year and recorded a double-digit volume decline, mainly driven by China, with volumes down by 29%. All customer industries were affected without exception.

Core volume growth in EMLA was still slightly positive with 1.3%. Growth suffered from the pronounced weakness in automotive. However, strong growth in electronics and multiple smaller industries like packaging, textiles and others could compensate for it. Core volume growth in North America was even strongly positive, posting 5.8% growth. Drivers were strong growth rates in construction and

wood and furniture. These industries counterbalanced the ongoing weak automotive demand.

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

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

Thank you, Markus, and also good afternoon and good morning from me as well to everybody on the call. I'm on Page 8 of the presentation. And the sales bridge that you see shows a year-on-year sales decline of 12.3% for the first quarter 2020. And the main drivers were deteriorating prices in MDI, TDI and PCS, which reduced our sales by a total of EUR 290 million, as you can see in the bridge. And on the other hand, lower volumes triggered by the coronavirus pandemic reduced our sales by EUR 89 million. FX was positive and added EUR 27 million, mainly attributable to the U.S. dollar. And finally, our portfolio changes reduced our sales by EUR 40 million in Q1, and you have the details of that effect in the bullets on the right-hand side of the chart.

So let's turn the page. On Page 9, you see that in Q1, we generated an EBITDA of EUR 254 million, which was in line with our guided range of EUR 200 million to EUR 280 million. The higher competitive pressure in polyurethanes and polycarbonates led to a decline in contribution margin. However, due to a relief on prices of raw materials, the negative pricing delta was slightly less pronounced than we had expected and amounted to EUR 150 million. The negative volume development translated into an EBITDA impact of EUR 54 million. And the line item, other items, contributed positively with EUR 12 million, the main contributors being short-term cost savings, which were partly counterbalanced by provisions for the restructuring book program, which we built, and FX had a very small effect as well.

So with that, let me turn into our segments, and I'm on Page 10. If you look at our Polyurethanes segment on this chart, we faced a core volume decline of 3.6% in Q1. Overall, the industry utilization stays at a low level due to additional capacities added during the last 18 months on the supply side and also due to softer demand triggered by the coronavirus crisis. Overall, our EBITDA margin is at 3.9% in Q1, which was clearly below last year's level, driven by lower volumes and significantly lower MDI and TDI margins. However, if you take a quarter-on-quarter perspective, we also see a decline triggered by the missing seasonal volume rebound and by continuing margin pressure.

Please turn the page to #11. And here, you see that in polycarbonates, the core volume declined by 4.9%. With EMLA and NAFTA still showing increases in core volume development, the negative driver was clearly the double-digit decrease, which we recorded in APAC as a result of the coronavirus pandemic. All key industries showed volume declines, except in the construction activities in NAFTA and EMLA. If you look at the EBITDA development, you see that the EBITDA margin of 14.9% was clearly below last year's level, primarily driven by the pronounced negative pricing delta and lower volumes. And despite the sequential volume decline, we improved the EBITDA margin by 3 percentage points quarter-over-quarter. So this margin improvement was driven by lower costs and a positive pricing delta.

Please go to Page 12. On this chart, you see that the impact from globally weaker demand also affected our CAS segment during the whole year 2019. And in Q1 2020, the seasonal rebound in volumes did not materialize as macroeconomic conditions worsened. So volumes declined in all customer industries, and we recorded a negative core volume growth of minus 5.2%. Nevertheless, we could defend the high-margin level of last year's quarter with 22.7% in Q1 2020.

So with that, let's turn to Page #13, and let's look at the cash flow. As you can see, our free operating cash flow in Q1 came in as expected with a negative value, mainly driven by our lower EBITDA. And we saw a typical seasonal increase in our working capital, so that the working capital to sales ratio stood at 18.7%, which represents a slight reduction year-on-year. And we counterbalanced the lower demand with adequate production cuts. Therefore, the inventories, if you measure them in kilotons, slightly declined year-on-year. You will also notice the high payout for income taxes. [This is a phasing effect] (corrected by company after the call). Please go to Page 14, where you have the balance sheet. And as you can see, we maintained a very strong balance sheet and have significant sources of liquidity. And presently, these include about EUR 1.2 billion in cash or cash equivalents as well as our undrawn revolving credit facility of EUR 2.5 billion. We secured the liquidity at favorable rates in the course of the quarter, and we raised a short-term working capital line of EUR 500 million as well as a loan from the European Investment Bank in the amount of EUR 225 million, which is devoted for research and development activities in Europe. And the focus here is particularly on the topics of sustainability and circular economy within the European Union.

On March 31 of this year, our net financial debt increased to EUR 1.29 billion, and the main reason for that was obviously the negative free operating cash flow. At the same time, our pension provisions decreased by EUR 530 million, mainly due to the higher discount rates in Germany and the discount rates that are used to calculate the pension provisions are based on corporate bond rates, which increased during Q1 2020. So in combination with a lower EBITDA, these developments led to a slightly increased ratio of total net debt-to-EBITDA of 1.9x at the end of Q1 2020 compared to 1.8x a quarter ago, and our equity ratio remained very solid at 47% also as of the end of March 2020.

So with that, let's go to Page 15, and this chart brings us to the updated guidance for the full year. Many companies currently refuse to provide a guidance given the unprecedented circumstances, and we also considered this option. But we felt it would be more useful to provide a new range and in addition to explain how we developed this forecast.

So as you know, our usual EBITDA bridge is built on 4 key pillars, which are the volumes; the pricing delta; FX; and number four, the fixed costs, which are the main driver of the pillar "others". Now unfortunately, as the management team, we currently only have 1 out of those 4 pillars under our firm control, and that is namely costs. Usually, we cope with significant swings in pricing deltas, whereas the volumes most of the time steadily are growing. Today, however, we are facing significant volatilities in selling prices, raw materials, and also in volumes, so making a close prediction very difficult. Nevertheless, we forecast an EBITDA corridor of between EUR 700 million and EUR 1.2 billion for the full year. And we assume a relatively stable cash margin for the remainder of the year compared to the margin level as of March 2020.

Of course, this is an assumption. And given the volatility in raw material costs and selling prices, also this might vary. However, at least over the past 6 months, the cash margins remained relatively stable. So the most difficult part to forecast is the volume development and a wide range appears imaginable as an outcome for the full year 2020. And therefore, we would like to provide you with a volume sensitivity. So please be aware that 1 percentage point change in core volumes affects our EBITDA by around EUR 50 million for the full year. So let me translate this into our guidance range, and you have the bullets on the upper right-hand side of the chart.

Our EBITDA corridor is mainly determined by the assumed volume development, but also includes some margin movements. At the upper end, we assume a mid-single digit volume decline, coupled with a slightly improving margin compared to the March 2020 level. And at the lower end, we assume a low double-digit volume decline, coupled with a slightly deteriorating margin. So our guidance is based on the assumptions of a very weak Q2, but then some sequential improvement in Q3 and a more normal quarter in Q4. And unfortunately, due to the highly volatile current economic environment, we restrained from giving a more detailed quantitative guidance within the usual range for the second quarter. And we hope that these explanations are helpful for your models, which, of course, you will have to build on your own volume and margin assumptions.

So with this, let's go to the next page, which gives you the remaining items of our guidance on Chart 16. As explained, we assume core volumes in 2020 to be below 2019. And the lowered EBITDA guidance also lowers our free operating cash flow expectations. CapEx has been further reduced to around EUR 700 million, and the free operating cash flow is expected to come in between minus EUR 200 million and positive EUR 300 million in 2020. Consequently, we guide for a ROCE after tax between minus 1% and plus 4%.

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

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

Thanks, Thomas.

In the first quarter, the spreading coronavirus pandemic drove down our core volumes, mainly in China. However, we achieved our EBITDA target despite a higher-than-expected impact from the lockdowns. In the second quarter, the impact from the pandemic is expected to be even more severe. Given the deteriorating economic environment and the increased uncertainties, we felt obliged to update our initial full year guidance. We have done and are still doing our utmost to manage the crisis in the best possible way. First, we took the necessary measures for the safety of our employees and our business partners. Second, we decided upon a whole set of

measures to counterbalance the financial impacts.

We thank you for listening and are happy to take your questions.

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## QUESTIONS AND ANSWERS

### Operator

(Operator Instructions) And the first question for today comes from Mr. Markus Mayer, who's calling from Baader Bank.

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### Markus Mayer *Baader-Helvec Equity Research - Lead Analyst of Chemicals*

First of all, I have a question on the dividend. The AGM was delayed. Have you any comments on the dividend for 2019? That's my first question. And then second question is on the business development you have seen so far. Polycarbonate was somewhat stronger than I expected. So you said there was basically also positive tail effect from raw materials. Have you also seen some positive effects for polycarbonate sheets for masks or something like this? Any kind of demand update from this side would be also of help.

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

Markus, this is Thomas speaking. Let me start with your question on the dividend. So obviously, there was a proposal for the dividend for our AGM, which was originally planned for April 17, which had to be postponed, and we now have this new date on July 30. So currently, there is no new decision taken on the dividend.

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

Markus, I take the second question. This is Markus speaking. We have, for polycarbonates, a stronger pricing delta than we actually expected. So prices were even up. Not only the raw materials were helping, so to say. And however, the raw materials delayed impact is about, let's say, 2 months. So you can also see, even though you have seen some of the spot prices, for example, for benzene and benzene derivatives coming down, this normally takes about 6 to 8 weeks to really be fully consolidated in our books. And in addition, we're not only buying in the spot market, but also have contract volumes, for sure, with pricing formulas. But in the end of the day, there is a mix of contracts, so to say, that we also have to honor in this contract. So there was a limited impact in the first quarter. And we will most likely see more in the second quarter. Demand in medical, to particularly address this question, is good. However, the medical segment is still in absolute terms too small to compensate, for example, and counterbalance other weak industries, just to name one, the automotive industry. And yes, we have also seen a business with protective equipment. However, that is also in the overall context, I would say, neglectable. Where I can give you some flavor is in niches of the electronic markets, polycarbonates are selling quite well, for example, for home entertainment equipment. And here, particularly, everybody is looking for a second computer screen. Everybody is looking for a video camera equipment. Everybody is looking for any devices that under voice control and that is exactly where polycarbonate is also widely used. So from that perspective, we also had some counterbalancing effects.

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### Markus Mayer *Baader-Helvec Equity Research - Lead Analyst of Chemicals*

Might I still have a third question, so on the free cash flow guidance. Sorry, forgot to ask it in the beginning. This free cash flow range is -- what kind of raw material costs or net new capital inflows or what kind of raw material cost level have you baked in, in this guidance? Is this based, one, cost level of the end of the first quarter? Or is it -- assumption was ahead for the full year for the raw material cost?

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

I would say the raw material cost in terms of the free operating cash flow is not the key driver. As you know, raw material cost is mainly a flow-through item in our big BU segments, so namely in polycarbonate, but also in polyurethanes, a little less so in CAS. I think the the answer that I would give to this is that our assumption, obviously, is that margins stay relatively stable. And that means that the fluctuation of the raw material costs, which we will obviously see because they have come down, will, to a large extent, be passed on to our customers. And therefore, our core assumption is that the margin level that we see at the end of March will largely flow through for the rest of the year. Then I think the easiest way to derive our free operating cash flow is if you take our EBITDA. And then at the lower end of the guidance, you would probably assume our CapEx of EUR 700 million, obviously, plus tax payments of maybe EUR 100 million



and then a negative working capital delta. And at the upper end, I would say, the tax payments are probably a little higher. And on the other hand, the trade working capital should be at least neutral. And this is, I think, the easiest way to derive the free operating cash flow is all the way down from the EBITDA, taking into account CapEx, taxes and trade WoC.

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**Operator**

The next question comes from Charlie Webb, who's calling from Morgan Stanley.

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**Charles L. Webb Morgan Stanley, Research Division - Equity Analyst**

Just a couple for me. So first, just kind of following up on that working capital. Just trying to understand why we didn't see a better working capital performance year-on-year. I'm surprised, given the raw material deflation, that working capital outflows were higher year-on-year, especially given the volume environment. So perhaps just first off on that one. And then, secondly, just around utilization rates. Can you help us understand across products, what the current industry utilization rates are? And currently, what [rates] (added by company after the call) you're operating at? I just want to try and understand how you're faring relative to your peers.

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

Yes. Let me maybe take the working capital question first. So first of all, the raw material impact, first of all, is probably less pronounced because our working capital is mainly driven by finished goods. And what you saw is the normal seasonal impact after we had admittedly driven down our inventory levels quite low at the end of December. So the pickup was a little bit more pronounced in Q1 2020 maybe than in 2019, simply because the starting point was more ambitious this year than it was last year. That's the first one. Secondly, it's mainly determined by finished goods, not so much by our raw materials. And thirdly, the price decline for raw materials that you have seen really only kicks in for us with a delay of at least 2 months. And therefore, it had, from that perspective, no impact on our working capital performance in Q1.

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

Charlie, let me take the second question, which is a bit difficult because we have, as you know, extremely extraordinary times here and that is totally unprecedented. And that's why talking about industry utilization is, in this context, also quite difficult as we get very, very mixed messages on, let's say, how overall the industry is doing or how individual players might be doing. So if you look at the full year and just we're starting with MDI, we assume that as of last year, the industry utilization was around 87%. And we did actually not significantly deviated on a normalized level for the entire year. For the full year 2020, we are currently calculating again, and that is an estimate, on a normalized basis, with 80%. However, that could significantly vary quarter-on-quarter simply due to the fact that some competitors might have shut down entirely, given the cost curves that some of them have, and you know that the MDI cost curve is also steep for the entire industry. But also there were preannouncements of turnarounds that were planned maybe later in the year, which we also might have seen. So from that perspective, it is very difficult to say.

And that is also a picture that we see in our overall setup of assets. We have had assets, and Thomas commented on that a little bit earlier, in China that we're running at reduced rates and very low rates, for example, in February and March and now have revamped and then had been slowed down in China. But we also have seen similar patterns now in Europe, where we have actually brought down production to a much lower level than in previous years in Europe. And now we're seeing actually similar effects in the United States, whereas we see positive signs for potential development of capacity in MDI ramping up again in Europe. So it is a very, very mixed picture. On TDI, it is actually a similar picture last year. The industry, based on our insights and market intelligence, was around 80%, 81%. And this year, we expect the overall normalized industry utilization to be at around 69% to 71%, just to give you a flavor. But also here, we will see asset by asset, competitor by competitor, an entirely different pattern on a quarterly level. So from that perspective, it is very difficult to judge, frankly speaking, also for us where the overall industry utilization might be at current market demand, which is highly volatile, and it is -- excuse my French, very wobbly here in this context. And therefore, it is for me, frankly speaking, almost impossible to give you a clear number that would be meaningful, to be very honest.

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**Charles L. Webb Morgan Stanley, Research Division - Equity Analyst**

Okay. Just one other, if I could sneak it in, on your volumes activity. Thank you for providing that. I just did a quick calculation. It looks like it's a 40% drop-through based on that sensitivity. And I see in Q1 the drop-through is something more like a 50%. So just any sense on what the difference is, the Q1 drop-through in volumes versus the guide, the kind of sensitivity of 40%?

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

I mean, Charlie, I would say it is simply the effect of smaller numbers in Q1. I mean, first of all, you're absolutely right with the drop-through rates. But there is some fluctuations simply because of mix effects and a relatively small volume base in Q1. I think, directionally, the 40%, as you said, are the one that we always had and which we think will hold true for the full year. But well observed, in Q1, there were some deviations, which are not representative for the rest of the year.

**Charles L. Webb Morgan Stanley, Research Division - Equity Analyst**

Okay. And if we assume that Q2 is going to be weaker from a volume perspective than perhaps Q1, given the U.S. and Europe situation, would we expect a higher drop-through than the 50% we had in Q1?

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

No. We have given you the volume sensitivity for the full year, which is this -- the fact that the plus/minus EUR 50 million, plus 1 percentage point of change in volume, I would, for the sake of simplicity, simply divide this by 4 and take this as an assumption for Q2.

**Operator**

The next question comes from Christian Faitz, who's calling from Kepler Cheuvreux.

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

Two questions, please. First of all, can you please comment on the demand situation in China? Obviously, the severe lockdown is over. Yet there are varying reports about the sustainability of the recovery, given the large export dependence of many of your Chinese customers. You alluded to that a bit, but how does the situation look at present would be quite interesting. And then second question, can you please elucidate your other financial results in your P&L, which was rather high? And what is your expected run rate for the remainder of this year?

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

So Christian, this is Markus speaking. It might be of help to look at one of the charts that we have presented a little bit earlier. And I'm referring to Page #3, that gives you a flavor about how the volume developments were over recent months, and we also have put in here the 7 days average. And there you see that there is definitely recovery in China happening and has happened since end of March. And we also have seen that Europe, in this context in about, let's say, the last 1, 1.5 weeks has also started to stabilize. However, this is still a very weak stabilization according to what we see. And whereas the U.S. is still approaching the trough or just in the middle of the trough, I would say, and also recent data, which are not shown in the chart, for the last 7 days, which we just get freshly in this morning, indicate that this is also the trend that we have seen for the last week of April. So globally, you still can see that the curve is somehow showing a relief. But it is still, for us, absolutely not foreseeable how stable, in particular, the development in China is. Currently, we can truly say there is real demand behind each and every order that we have. So we see a ramp-up in the automotive industry. We see, as I said, some relief in particular electronics demand, which is where the majority of goods is produced in Asia Pacific. And we also see in the medical sector still a high demand of our products. Nonetheless, it is, for us, currently impossible to really judge how sustainable this will be because, as you know, many of the demand in China is depending on export into Asia Pacific, but also depending on export to the United States and Europe. And here, the big, big question mark is how much is this driven really by local demand versus how much is driven by export effects and how those effects in the next couple of days and week will really impact our sales in China. For now, the trend that we have shown here on Chart #3 for all respective regions is confirmed by the last week data that we just freshly got in this morning.

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

Now to your question with the other financial results, I think you're probably referring to the minus EUR 24 million that we recorded relative to the minus EUR 5 million that we had a year ago. And the main driver of that is actually a valuation effect. Because the fair value of planned assets for funded long-term employee plans had to be adjusted, and that plays into this number and is the main driver for the more negative result this year. So that shouldn't repeat itself. And I think we will uphold our guidance for the full year financial results, which should be just slightly above EUR 100 million. So pure accounting valuation effect in connection with pensions.

**Operator**

The next question for today comes from Isha Sharma calling from MainFirst.

**Isha Sharma MainFirst Bank AG, Research Division - Analyst**

In polycarbonate, you mentioned that the prices were up. Is that due to the mix? Or do you see delays in previously announced capacity additions? And in that respect, it would be nice to understand why was there so much pressure on polyurethanes? Were there further downward pressure on prices quarter-over-quarter? And my second question would be, could you please help us just to understand how you -- I know you've probably touched on this a little bit, but do you see any change in customer behavior in your end markets that you might see as a development because of COVID? So anything that you hear from your sales team on the ground that would be super helpful to understand how this might develop.

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

Okay. Isha, this is Markus speaking. And to give you some flavor about what we have seen in polycarbonates, I would not actually associate this with product mix effect. The major effect is really that prices have slightly improved. And there is numerous explanations for that. One explanation or an explanation that I would not consider is that capacity came on stream late or that some projects have been delayed because this would be too short term from my perspective. However, what we could see is that some competitors, and that's what we assume, maybe have sold stocks and inventories last year, so last quarter 4 in 2019, at very low prices just to get rid of it and manage also their liquidities. And an additional effect could be that in the commodity segment of the polycarbonate's area now some competitors might be even reaching negative cash margins and contribution margins. And from that perspective, they maybe have stopped producing. That is 1 topic.

Second topic is regional exposure. So many, many customers asking us on very short notice to deliver. And then it is very difficult for producers who have global supply chains and only kind of supply from one region to organize this on very short notice or organize it at all. So also here, a clear hedging, so to say, that we have always pronounced also in other IR calls that this global presence in each and every important region is a competitive advantage, and I think that also plays a role. And we also have seen that we sold significantly more in high margin, let's say, segments, for example, in electronics, but also in medical. So from that perspective, that might give you a flavor why the pricing development is as it is and why we also have seen margins improving from Q4 to Q1 in 2020. If you look at the downward pressure on prices, we have always made it very clear that for polycarbonates as well as for MDI in the commodity area, we might not yet have seen trough levels. So whereas for TDI, we have approached trough levels, and that is also what our current data indicating that there was continued price pressure on MDI and partially, but only partially also for polycarbonates and less so for TDI. That gives you maybe a flavor why the polyurethane results have further declined.

**Operator**

The next question for today comes from Sebastian Bray, who's calling from Berenberg.

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

I would have 2, please. The first is on the reduction in pension liability. I think it's due to the performance of German plan asset or so probably be the change in the discount rate. Could you remind me of how this is calculated? Is it just investment-grade German debt? The second question is on the IFRS 16 cash out for lease payments or interest on leases. What was this in 2019? I remember this was disclosed separately at the end of 2018. But if you are calculating a free cash flow figure, including the lease payments, how much does that justify?

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

So let me take the first question with the EUR 530 million reduction in our pension liabilities. That is, as you correctly said, driven by a decrease in the discount rate, while the asset performance actually was negative. And you find this also in our quarterly report. If I have the numbers correct from the top of my head, the pure discount effect of some EUR 720 million and the counter effect is then the negative asset performance. So that is what is behind it. The discount rate in Germany went up from 1.0% to 1.9%. And yes, investment-grade bonds are the benchmark here. So that's what's behind it. IFRS 16, the effect on cash flow, I don't have the number from the top of my head. Before I give you the wrong one, we'll just look it up and send it to you separately.

**Operator**

The next question for today comes from Thomas Swoboda, who's calling from Societe Generale.



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

I've almost given up, but I still have 2 questions, if I may, and I will try to ask them one by one. Firstly, on inventory levels, some companies are reporting or saying that there was some degree of panic buying in Q1, which they observed. I know you cannot carry much inventory yourself in polyurethanes. But I'm just wondering if you have any insight how the inventory situation looks at your customers? Meaning, are the end product based on your stuff high, low or whatever you might see?

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

Yes. Thomas, this is Markus speaking. We have seen some customers, but really very, very limited amount in the U.S., for example, who thought that in case supply chains might be disrupted, that they maybe pile a little bit more of materials on stock, but that was very selected. Actually, for most of the customers, we have observed that they're in very tight control actually of their raw material inventories, in particular, as they were all expecting very, very sharp focus on liquidity and the liquidity situation of corporations, plus, which I think also gives further evidence to the thesis that inventory levels are rather low. Currently, customers are ordering only what they immediately need, which would also indicate, and that goes, by the way, across the board, not only in the specialty grades, but also in the commodity area. When they order, they want to have delivery on very short notice. And we're also in very close contact with our customers exactly to also make sure that we get access to their cash in terms of that they're paying. And that's why we're also looking very, very closely about how the order pattern looks like, how the demand pattern looks like. So currently, I have to say that we have no indication that there is unusual high stock levels or things like that. So definitely not for the industries/for the applications that we support with all materials.

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

That's interesting. The second question I have is on the short-term cost measures in 2020 is that EUR 200 million to EUR 300 million. And the question is how quickly and to what extent those costs would come back in a scenario where we see economic recovery? Will they come back all in the very short period of time? Or will this be stretched?

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

No, they will not come back. Again, just a short recap. We said in the beginning, it was EUR 200 million. And I said, of those EUR 200 million, EUR 100 million was essentially budget cuts or kind of cutting out planned increases, but they are not year-on-year effective. So that leaves us with EUR 100 million from our original announcement, plus another EUR 100 million that we now announced as of today. So that gives you year-on-year EUR 200 million. And again, this is a broad range of savings driven by maintenance costs but also driven through lower CapEx spending, travel, entertainment, training, et cetera, et cetera. It's difficult to say how quickly they will come back. But definitely not all on the spot on January 1 next year, but they will be stretched out because simply the cost discipline will be maintained up. So again, rule of thumb, I would say, 50%, we will maintain also and also bring into 2021.

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

That's terrific. And if I may sneak in a third question, a small one. How big is the OpEx for Baytown at the current level of investment you have made?

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

So you probably mean what is the kind of the sticky costs that we still have in 2020, despite the fact that we cut the MDI-500 project. Is that your question?

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

Yes, more or less. What would this for the project cost you on a perpetual basis if you would stop investing for the time being?

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

There is no perpetual cost. These projects are executed in stages. The Baytown MDI-500 project was still in the planning phase where the rough engineering was being done. We call this stage-gate 2. Essentially, we mothballed all our plans we had, put them -- we can put them in the draws, so that at a later stage we can essentially take it up and then continue into our front-end loading Phase #3. So

there is no permanent running costs for keeping the option up. There is a certain ramp down costs, which we have, which is a mid-double-digit million amount this year because we had to ramp down our construction sites, deal with the people, repatriate many people, et cetera, et cetera. But there is no permanent cost for keeping the option up.

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

Right. So you could freeze it for a longer period of time without extra cost. That is basically the message.

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

Correct.

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**Operator**

The next question comes from Geoff Haire, who's calling from UBS.

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

Most of my questions have been answered. I just wanted to take a focus really into next year and the year after on CapEx. Clearly, you've brought the CapEx down by EUR 200 million in 2020. What would we expect to see happen in '21 and '22? And I appreciate that's dependent on demand levels. But I was wondering if you could just talk a little bit about that. Should we still be looking at EUR 900 million-ish of CapEx in '21 and '22? And then, finally, just a clarification question. The positive price delta that you saw in polycarbonate in Q1, do you expect that to completely reverse in Q2?

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

So first of all, on CapEx, I would expect CapEx for 2021 around our depreciation level. So take a number between the EUR 700 million and the EUR 900 million. And as you correctly said, I think we will adjust flexibly depending on the demand situation. But also keep in mind, we cannot so easily switch on and off projects. So it will be a probably slow ramp-up relative to the number that we see this year. And then for 2022, we don't have any precise guidance out. And I think this is understandable because it depends very much on the project portfolio that we will decide at some point this year, and therefore, this is really an open question. I think your second question was on the polycarbonate pricing delta for Q2. I mean, essentially, what it holds true for PCS will be that, in general, we expect the pricing to be relatively stable. So therefore, I think, for your models, I would not model in a major change Q-on-Q.

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**Operator**

The next question comes from Chetan Udeshi, who's calling from JPMorgan.

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**Chetan Udeshi *JP Morgan Chase & Co, Research Division - Research Analyst***

Just a couple of questions. First one, just follow-up on the previous question on inventory at customers. I was just trying to see if you had any data to collaborate what you might be seeing in, say, auto volumes just now versus, say, the global auto production, which was, say, down 23% in Q1 and probably down 50%. So are you shipping into your auto customers in terms of volumes similar to that or is there probably a better number for you? And if there is, is that because you're winning share? That's the first question. And second question I had was more on just how to think about the different moving parts on Q2 to the extent you can help outside of volumes, if you had some early thoughts into what could be the net pricing impact and the impact on the other line in Q2.

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

Chetan, this is Markus speaking. On the first question for quarter 1, just to put this into perspective, according to our market insights, the global market production of auto was down minus 26% year-on-year. Our volumes into automotive for Covestro are down minus 10%. Is that now an indication that we would gain market share? I would say, not necessarily because there is also here a few moving parts. One of it is definitely the shift in inventories. Other topic is, for sure, also that particularly polycarbonate where we have segment by segment the highest exposure, polycarbonate is also not equally distributed amongst, let's say, the different car models. We normally sell into higher class models. And if mass markets are down or in particular, low price producers are down, for example, in China, that might have not such a big effect as we still continued in first quarter to sell to a lot of premium manufacturers. And as we tried to bring across the major impact on our automotive industry was in China and in the Chinese manufacturers. That means, in particular, the mass production

has been hit quite hard, where our polycarbonate exposure is not that high. So it's not about gaining market share. That could be an effect, but I would rather expect that this is due to the application mix and exposure to different segments in the auto market. So on the second question, Thomas, will jump in.

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

Yes, Chetan. Again, Q2, not very visible for us. And this is why we didn't come out with a specific EBITDA guidance. But just to give you some moving parts that probably you can apply in your model. So let's take as a starting point the EUR 459 million EBITDA of Q2 2019. Then I would say in this quarter, you should apply a negative pricing delta, which is a low triple-digit number. And you should probably apply a high double-digit benefit from others, so cost saving, et cetera, et cetera. So that brings you then to a new starting point or adjusted starting point, which is just slightly above EUR 400 million. And then I think from that, you have to apply your volume assumption. And again, take what we said for the full year, which is 1% equals EUR 50 million for the full year, divide the EUR 50 million by 4 and apply that to [Q2] (corrected by company after the call). I think that is, I would say -- structurally, that would be a sound framework, obviously, with the major uncertainty around what is the volume assumption that you plug in.

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**Operator**

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

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

Thank you. Perfect. And we are on time finishing that call. Thank you all for your interest and for your interesting questions. If you have more, don't hesitate and come back to us for additional questions and then speak to you soon, potentially virtual. We have obviously a big scheduled plan for a lot of virtual conferences, roadshows, whatever. So I'm pretty sure we will speak soon. See you then. Bye.

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**Operator**

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

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