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PRESENTATION

Operator

Ladies and gentlemen, thank you for standing by. Welcome to the Covestro earnings call on the first quarter of 2022. The company is represented by Markus Steilemann, CEO; Thomas Toepfer, CFO; and Ronald Koehler, Investor Relations. (Operator Instructions)

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

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

Good afternoon, and thank you for joining our first quarter earnings call. The quarterly report and the earnings call presentation is available on our IR website, and I assume you have read our safe harbor statement.

And with that, I'll turn the mic to Markus.

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

Thanks a lot, Ronald, and hello and a warm welcome also from my side to the results of our first quarter. Actually, the first quarter with the war in the Ukraine. When we spoke last time on March 1, all of us were under the shock of the Russian invasion the week before. What has happened in Ukraine since then fills us with deep sadness. All of us keep the people in Ukraine in our thoughts, and we hope for a soon ending of the war.

For the global economy, this means another increase of the inherent uncertainties of the economic development. However, despite the challenging times, Covestro had a strong start into the year. In the first quarter, we achieved sales of EUR 4.7 billion. These are the highest quarterly sales in Covestro history. And with the first quarter EBITDA of EUR 806 million, we came out 8.5% above first quarter 2021 and in the middle of our quarterly guidance of EUR 750 million to EUR 850 million. The cash conversion was impacted this quarter by working capital valuation so that we came out with a free operating cash flow of EUR 17 million.

Finally, as you recall, last time we announced a EUR 500 million share buyback, and we started the execution of the program in March. This is now ongoing. After reconsidering the current uncertainties, we took the decision to adjust our guidance downwards for [2022] (corrected by company after the call).

So if you follow me on the next page and now looking into our first quarter volumes, we again achieved a solid growth of our sales volume with organic growth of 3.6%. We remain in that context technically sold out, and that means our volumes were not limited by demand but by our product availability.

While you can see here our regions, Europe, Middle East, Latin America and Asia Pacific, both growing at the same level, you see also strong growth in our North America region. As you might remember, our business in North America was impacted by the winter storm Uri in Southern U.S. in the first quarter 2021, and we had to shut down our plant in Texas. So the growth you see for North America includes

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the rebound effect, and this rebound particularly was driven by the construction industry.

For the other industries, you can see the opposite effect in furniture/wood, where our volumes declined versus the high reference quarter, first quarter 2021, when during the times of COVID lockdown, there was a very strong demand for mattresses and home equipment. Auto and transport, as expected before, remained impacted by the low level of automotive production, which suffered under lack of pre-product availability. We have seen these automotive limitations in our books since mid-2021. So you see here the volume decline still versus the quarter before the limitations.

With this overview of our market environment, I'm handing over to Thomas, who will guide you to the future and further details of the financials.

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

Well, thank you very much, Markus, and also a very warm welcome from my side to everybody on the call. I'm on Page 4 of the presentation. And as you can see and as Markus said in the beginning, our quarterly sales rose to EUR 4.7 billion, which is actually the highest quarterly sales number in the Covestro history. That's an uplift of 42%. And you see the biggest impact came from 23% higher prices. That is the EUR 757 million that you see in the bridge, and the increases actually came from both segments. And they were, of course, enabled by the continuously strong demand that we saw for our products.

With that, I would also say that we were technically sold out and the volume growth that we saw in Q1 was actually only limited by our product availability. The volume increase came particularly from our Performance Materials business. But as Markus said, the business and the segment also benefited from a somewhat lower reference quarter because in Q1 of last year, we had the winter storm Uri that affected our sales at the time.

And you can also see in the bridge the EUR 314 million, which we labeled as portfolio effect. This is obviously the effect from the acquisition and first-time consolidation of our RFM business. At this point, I just would like to mention and reiterate that the integration really runs very successfully, and we're very pleased also with the progress that we're making in terms of the synergies that we realize.

So with that, let's turn to Page 5, the EBITDA bridge. As you can see, we achieved an EBITDA of EUR 806 million this quarter coming from EUR 743 million a year ago. And you see the big factor, of course, in the development is the pricing delta in the middle. As you can see, raw material prices increased by EUR 820 million. And I would say it's a very good achievement that we were able to pass on more than 90% of that to our customers. That is the EUR 757 million so that we came out with an only slightly negative pricing delta of EUR 63 million. So that means the raw material price increases were mostly and largely compensated by sales price increases.

You can see also the volume effect, EUR 39 million. That is a volume leverage of 32% relative to the EUR 121 million additional sales that you saw on the previous page. So the 32% is slightly below the usual level of around 50%, and there are some product mix effects behind that.

FX is positive. And in the other items of EUR 36 million, that includes a EUR 38 million positive effect from lower provisions for variable compensation.

So with that, let's go to the next page, Page 6, which shows you the sequential development of our sales and also EBITDA, first of all, for the group. As you can see on the upper half of the page, there's a continuous sales growth during the quarters. And the higher prices in Q1 2022 versus Q4 of last year, as I said, led to the highest quarterly sales in the Covestro history.

On the lower part of the page, you can see the quarterly EBITDA is on a relatively steady level. As I said, the pricing delta in Q1 this year versus Q4 is slightly negative. So sales prices almost, but not fully, could compensate a big part of the strong raw material price increases. And we also benefited from a volume increase quarter-over-quarter.

So sequentially, despite the unprecedented raw material price inflation, as you can see, we still managed to increase our EBITDA margin from 15.3% to 17.2% then in Q1 of this year.

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So let's turn the page and look at our Performance Materials segment and look at the same set of numbers of the sequential development. As you can see again in the upper half of the page, there is a steady increase of quarterly sales, and the increase in Q1 '22 versus Q4 stems particularly from the price increases quarter-over-quarter. The lower part of the page shows you also a relatively stable development of our quarterly EBITDA.

In Q1, EBITDA came in at EUR 620 million. So that was EUR 10 million below Q1 of 2021. And again, considering the strong raw material price increases, that shows you we were able to pass on the majority of that to our customers. Plus, we had a positive FX effect and higher volumes year-over-year.

The Q1 2022 EBITDA margin declined year-over-year. I would say that is a technical effect, again, driven by the higher raw material prices and then also higher sales numbers. I would say it's more interesting to see that sequentially, the EBITDA in Q1 of this year is EUR 30 million above Q4 of last year. And slightly lower pricing delta from raw materials was more than compensated by the volume and the FX effect.

Let's look at the Solutions and Specialties segment on Page #8. And again, you see sequential sales growth driven by a favorable pricing and volume development on the upper half of the page. Of course, the sales in Q1 of this year, if you compare them with Q1 of last year, contained the effect from the RFM portfolio contribution.

If you look at EBITDA, lower part of the page, the EBITDA in Q1 of this year exceeds both the Q4 number and also the Q1 number of 2021. And the strong increase versus Q4 last year comes from higher volumes, positive pricing delta and also lower provisions for variable compensation. And therefore, with that, our EBITDA margin increased Q-over-Q to 10% in Q1 of this year.

So at this point, I would briefly also like to speak about the 17% margin target that we have for Solutions and Specialties. I think I can clearly say we do have a number of initiatives in the pipeline that will help us to increase the margin. And therefore, we stick to the 17% margin target. However, I would like to reiterate that we came out with this target under the condition of mid-cycle pricing conditions and no extraordinarily high raw material price and energy prices that then technically inflate our sales number.

So with that, let us turn to Page 9 of the presentation where you see the cash flow development. As you can see in the graph on the upper left-hand side, free operating cash flow came in at EUR 17 million, which is some EUR 300 million below previous year. And in the table below that, you see the key drivers. And obviously, it is working capital that drives the development. It's very much a valuation-driven development from increased raw material and also increased sales prices, which both increased then our inventories and our receivables valuation.

And just to underscore that, if you look at, for example, our inventories measured in kilotons, it is such that the increase is below 3% in March relative to the December number. And I think that just underscores the fact that the big swing in working capital here is purely valuation-driven. And that is also the reason why our working capital to sales ratio stands at 21% and more than our target number, again, a technical effect because you have the high working capital as of March relative to a 12-month sales number that increased very much over the last year.

So the other component in the table that you see is the CapEx of EUR 140 million. This is fully in line with our budget and also our full year guidance. You see that the paid income tax is higher. That reflects the higher net income of 2021. And the positive number under other effects simply reflects that we revert bonus provisions, which only become cash effective in 2023.

So with that, let's go to Page 10, which shows you the balance sheet, and more specifically, our net debt development. So as you can see, the total net debt reduced by EUR 301 million to EUR 2.3 billion. And the key driver is EUR 364 million lower pension provisions as a result of higher discount rates, while the net financial debt slightly increased by EUR 63 million. The biggest driver here is actually our share buyback program. You know that it's a EUR 500 million program.

The first tranche is EUR 75 million, EUR 48 million of this was already spent in Q1. The rest was spent in the first week of April. The lower

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free operating cash flow number was EUR 17 million, I think we discussed on the previous page. Overall, our total net debt-to-EBITDA ratio stands at 0.7x with those numbers.

So in light of these figures, I would clearly say that our balance sheet and liquidity remains very strong. We, of course, continue to have our commitment to a solid investment-grade rating. And we spent a record payout on the dividend last week, which totaled EUR 651 million.

And I would also like to emphasize that we are prepared for the further execution of our EUR 500 million share buyback. We found the share price attractive for the first tranche, which was EUR 75 million, as I said. We find it even more attractive as we speak today. And therefore, we clearly look at a second tranche and will then potentially not only continue, but also potentially accelerate our program, as I said, with a second tranche.

Let's go to Page 11, which highlights certainly another unprecedented challenge, which is the global energy costs, which almost tripled for us over the last 2 years. So after a strong increase already in 2021, the global energy costs increased significantly, accelerated again in Q1 of 2022, mainly, of course, driven by the European energy prices caused by the Russian invasion into Ukraine.

If you look at the light blue columns in the upper part of the chart, you see the global energy costs in 2021 for Covestro were EUR 0.6 billion and then rose to EUR 1 billion in 2021. And our first estimate for 2022, which we gave you on the 1st of March, was an increase to EUR 1.5 billion. As we speak today, we would rather look into an outcome of EUR 1.5 billion to EUR 2 billion for 2022.

And the lower part of the page simply shows you the very distinct development in the 3 key regions. So you can see that the main increase, of course, comes from Europe with a very, very pronounced increase, but also some normalization over the last, I would say, couple of weeks or so, which then gives us some confidence that energy prices will remain stable rest of the year.

With that, regionally speaking, the breakdown of the energy costs in 2021 is 70% for Europe; Asia is 20%; and U.S., 10%. You've got the numbers in the green box on the right-hand side of the chart.

So with that, I would like to leave it here and hand it back to Markus.

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

Thanks a lot, Thomas. And we continue on Page #12 and talk about the global demand outlook, which has weakened. So looking ahead into the year 2022, we see the effect of the uncertainties we are currently experiencing. The figures on this chart show the full year demand estimates for our key customer industries and respective important subindustries.

As you can see from the first line in the table, the overall economic environment made us revise the expectation of the global GDP from around 4% to slightly above 3%. The anticipated 2022 demand growth in global automotive, which is depicted in the second line, is still above 2021, but the anticipated strong recovery has suffered from a severe dampening. Our external data provider, LMC, reduced its forecast from around 12% to now slightly above 6%. There might be further revisions coming.

Still strong is the outlook for global construction, which remains almost unchanged and above 2021 level.

And finally, on the last 2 lines, for furniture and electro, after 2021 as a strong rebound year, we now see the growth levels again at pre-pandemic levels.

So let's switch to Page #13. If you open the newspaper, or switch on the news, today's headlines are determined by 2 major issues: the war in Ukraine and still the coronavirus pandemic. Both of these risks have affected and will continue to affect our global businesses. We, therefore, carefully considered the risks prevailing in our path forward in 2021.

As explained already in previous slides, we have cut our GDP forecast to slightly above 3%. We would consider a further significant weakening as a risk beyond our current guidance. The risk of a possible EU gas embargo has not been taken into account for our

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guidance for full year 2022, and Covestro has already drawn up plans for different possible scenarios. However, the restrictions for Covestro depend very much on the design of potential cutback valuations to Covestro and its suppliers.

Where as many people consider the coronavirus pandemic no longer threat, the lockdown of major cities in China are, by its sudden and unplanned nature, a risk to regional as well as global businesses. Furthermore, constraints in logistics on global and regional level are a threat to the economic situation of many companies.

Our concept to produce in the region, for the region pays out here and makes us independent of large intercontinental shipments. Regionally, we and our competitors experienced the same resource scarcity when it comes to delivering our products to our customers.

Thomas already shared the insights into the energy price increase. So let's turn to Page #14 because this brings us to the guidance for the full year. Taking the risks explained in detail in the previous slide into account, we are now forecasting an adjusted EBITDA corridor of EUR 2 billion to EUR 2.5 billion. Almost half of the impact leading to the revised guidance is coming from the impact of the China lockdown on the volumes in Asia Pacific, particularly in the Shanghai region where we are operating our biggest site in Asia.

The other contributing factors are a combination of different effects, amongst them, the weakening global economic outlook, the rising energy and raw material costs and the issues with global and regional logistics. Unfavorable supply and demand scenarios on polycarbonates led to the negative pricing delta in Asia Pacific. With that, we are expecting for our year-over-year EBITDA development and lower volume growth and negative pricing delta impact.

The upper point of our guidance still remains in line with our mid-cycle EBITDA margin concept. The current mark-to-market estimate comes out at about EUR 2.8 billion based on April margins flat forward, so currently above the EBITDA guidance corridor.

Our LEAP transformation program is expected to contribute to our EBITDA development until 2023. We confirm our mid-cycle EBITDA level to increase to EUR 2.8 billion until 2024 driven by business growth and realization of the RFM synergies.

So now let's turn to the overview of all guided performance indicators. This is what you see on Page #15. But before diving into numbers, let me remind you that we have changed the KPIs starting this year 2022. Core volume growth has been replaced by EBITDA, reflecting our ongoing shift away from volume towards value. The lower EBITDA guidance between EUR 2 billion to EUR 2.5 billion also lowers our free operating cash flow expectations.

The free operating cash flow is expected to come in between EUR 400 million and EUR 900 million in 2022. This is also driven by the higher price level impact in working capital, as Thomas lined out earlier. In line with EBITDA adjustments, we guide a ROCE above WACC between 1 and 5 percentage points.

The recently added ESG KPI is related to our net zero target and comprises our greenhouse gas emissions. We slightly reduced our guidance for greenhouse gas emissions to between 5.5% and 6 million tons carbon dioxide equivalents.

In the second quarter 2022, we expect an EBITDA of EUR 430 million to EUR 530 million, lower than previous year of EUR 817 million, mainly driven by the coronavirus lockdowns in China, which we anticipate to be lifted by end of the second quarter. The financial result was adjusted to minus EUR 90 million due to a higher interest portion of pension provisions and other provisions.

Let's turn to Page #16. With all the challenges ahead, we should not forget that with every challenge also comes an opportunity. Covestro should benefit from these opportunities mid- to long term as our products are well positioned to contribute to solutions for a sustainable future.

The macro trend of auto and transport is clearly driven by the structural growth coming from the shift towards electric vehicles. Our value-enriched polycarbonate compounds find more use in modern battery electric vehicles, and this trend is continuing. We currently expect an increase in demand for polycarbonate in the BEVs from 2021 to 2026 of up to 1 million tons.

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Polyurethane-based insulation is one of the best options to reach high-energy efficiency, and between 30% to 40% more polyurethane is required to achieve these higher energy standards compared to the current standards. On a global scale, with regard to climate protection, this should drive the growth rate of MDI by 1 additional percentage point per year. The recent energy price increases should then be an additional accelerator for implementing higher energy standards for buildings, opening more business opportunities for Covestro.

Wind energy, last but not least, is one of the answers for our future supply with electricity, and Covestro has already secured renewable power through the different PPAs we have signed. Beyond that, we are considering wind energy is more than just a source of electricity, namely also as an attractive field of business. Our unique polyurethane resin for windmill blades is planned to gain a 10% market share of the epoxy-dominated market by 2032, offering an 8% reduction in manufacturing costs. In combination with other Covestro solutions, we can offer a 30% reduction in blade maintenance costs and a 2-year extended lifetime.

Let's continue with this very clear positive news. The current challenges with the coronavirus pandemic, as you can see on Page #17, and the war in Ukraine are also distracting us from the real global problem, and this is for me very clearly the climate change.

In March, Covestro announced ambitious targets to achieve its goal of climate neutrality. This target is another major milestone towards our corporate vision of becoming fully circular. We are progressing in line with this vision and have reached several milestones along the production value chain of Covestro to underline our commitment.

On the basic raw material side, we signed a memorandum of understanding to purchase 100,000 tons per year of green hydrogen and green ammonia to be used for energy generation and as an alternative feedstock for our production. This is an important step in our efforts to offer more sustainable products that also reduce the carbon footprint of our customer industries.

Another step has been achieved by a team from Genomatica and Covestro who have successfully collaborated to develop a commercial process technology for bio-based hexamethylen-diamine, HMDA, which is an important intermediate for aliphatic coatings and adhesives. Together with our partners, we plan to advance the program to full commercial scale.

Regarding the goal of having carbon-neutral variants of our core products, we have enlarged the ISCC certification to 5 of our 16 major sites, enabling us to using certified renewable raw materials and produce climate-neutral polycarbonate and MDI, and as a first step, TDI with a significantly reduced carbon dioxide footprint. These products will enable us to support customers in their own sustainability goals and transition into a circular economy.

So allow me to quickly wrap it up on Page 18. In a nutshell: Overall, we had a strong start in an increasingly volatile environment. First, EBITDA increased in the first quarter 2022 year-over-year and quarter-over-quarter despite higher energy prices. Secondly, a cash return to shareholders of EUR 1.2 billion, through a payout of a record dividend of EUR 3.40 per share. And we initiated, as Thomas already said, a share buyback program of EUR 500 million.

The guidance has been adjusted, reflecting the currently visible challenges. And therefore, the guidance has been changed and reduced from EUR 2.5 billion to EUR 3 billion to EUR 2 billion to EUR 2.5 billion.

Covestro products are and will continue to be an enabler for a fossil-free future, and they will support further increased demand for thermal insulation, battery electric vehicles and renewable energy. And last but not least, we are a driving force behind sustainable change for more sustainable products that are entering into the value chain of Covestro.

With that, I would like to thank you very much and hand back to the operator. Thank you.

QUESTIONS AND ANSWERS

Operator

(Operator Instructions) And the first question for today comes from Christian Faitz, who's calling from Kepler Cheuvreux.

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

Two questions, if I may. First of all, can you please further elucidate the problems you have in China on the back of the lockdowns? Do you see that start at your own sites? I know that one of your peers apparently has people sleeping at their sites since more than 4 weeks. Or is it just "in the value chain" supply issues? Or actually, do you also see that an actual demand from key customers who have lockdown issues?

And then second question, in the first global COVID lockdown, you currently provided sequential demand trends per region at your Q1 2020 reporting level. Would you mind giving us a feel how demand has sequentially evolved during Q1 and into Q2 this year?

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

Thank you. Christian, Maybe I'll take the first one and Thomas, the second question. So good to hear you. Well, on the first topic, you just mentioned it. Basically, how it all started is that it is not a production issue in itself, but the fundamental reason is that due to the situation that one of our largest plants is located in Shanghai because Caojing, the site what we are talking about in China is a part of the city and municipality of Shanghai.

And that is when the lockdown hit, we had issues bringing goods outside of the plant because there were limitations on truck drivers. And there were also limitations, therefore, on bringing goods via outbound logistics to our customers. And depending on where the goods were supposed to be shipped, therefore, also customers had issues to just receive the goods because their employees maybe were also under locked down.

Over time, we therefore started getting more and more topics with regards to outbound logistics. That has led to the fact that despite our production was still up and running, also with people staying at the site, staying there overnight also and running safely and reliable the plant, that finished goods were built up. And at one point in time, the finished goods storage was full, and we could not further improve the subdued outbound logistics, and that's why we also partially had to slow down production.

That was the situation in Shanghai that still is with some smaller exceptions, the situation in Shanghai. And therefore, the problems are, as I described coming from the lack of potential outbound logistics, then reduction of production and are not necessarily related to significant overall issues only at our customers, but we were directly affected from that. I hope that helps.

And with that, I would like to hand over to Thomas.

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

Just I think there's one important difference to the 2020 situation because 2020 really was a demand shock where our production facilities were theoretically able to produce, but simply there was no demand from the customer side. And therefore, the volumes that we gave you at the time probably were a fair representation of what's going on in terms of the demand in the market. I think that is different for China as we speak today because, as Markus described it, this is really more a conglomerate of factors. And one major factor is the logistics issues. And I think if you look at the Shanghai Harbor, that alone illustrates a lot.

I can nevertheless tell you that purely from the Covestro volumes that we currently are able to ship and sell in China, this moves around the minus 50% line relative to previous year for the month of April and also as we move into May with now some good signs of recovery. That is the driver for the financial impact that we see in Q2.

And I would say that clearly, the COVID lockdown is the biggest financial impact that we see in Q2 and that also then led to the revision of our guidance. However, it is, in my view, not a representation of the demand situation. It's the representation of the logistics and production situation in China. And therefore, as I said in the beginning, slightly different relative to the situation in 2020.

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***

I just had two questions on the outlook. First of all, on the energy and raw materials portion, I'm intrigued to understand why you've moved that up given that certainly, energy prices have come down since we had the Q4 numbers, at least on a spot basis. I was wondering if you could talk maybe more to do with the raw materials than there's energy in terms of the change in the last sort of 8 weeks.

And also, could you just help us understand how long you think the lockdown and the problems around supply will continue in China? And what have you factored into your guidance in terms of the length of that problem remaining?

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

Geoff, this is Markus speaking. So the last presentation on the energy prices has been done beginning of March. And at that time, we expected energy prices to be around EUR 1.5 billion for the entire year. However, it was just after the Ukraine war has started. So we did not have the picture that we have today and also the energy prices that we have today with the respective futures and assumptions. So from today's perspective, we would rather move that number up to EUR 1.8 billion in that context.

With regard to the lockdown in Shanghai, we, from today's perspective, assume that this will be an effect and a situation that will only accompany us for the second quarter and not beyond that. There's numerous scenarios that you could think about. But to give you also some positive anecdotal evidence for that, we see already that in some living areas and even some parts of the city of Shanghai, lockdowns are lifted and there's a clear ease of the situation. And we are very closely monitoring the situation, but we think it is a Q2 effect, and that is also what we have put into the full year updated guidance.

Operator

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

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

Maybe just a few follow-ups on some of the topics one clarification. So just in terms of the lockdown and the supply issues you have in China, first, why haven't we seen a kind of meaningful response in the China prices -- chemical prices to reflect that kind of reduced availability? Is it just the case that, I guess, supply and demand have been somewhat equally hit? So just kind of how do you see that dynamic?

And then maybe digging into that, you talk about being sold out, but obviously, we're reducing kind of our growth expectations for the year. Just what are you seeing in the order books apart from obviously the sentiment that things are going to slow? Are you seeing any end markets in particular, which actually are slowing? Just some kind of maybe more detail on that as to why you've taken the kind of haircut to your growth expectations beyond obviously just being able to produce.

And then just finally on the mark-to-market. Still kind of coming out of EUR 2.8 billion, if I'm right -- if I read the chart right. Does that include the negative lockdown effect that you anticipated in Q2? Or is that excluding that? Just to understand the mark-to-market.

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

Hi Charlie, this is Markus speaking. On your first question, that already included the answer. We see pretty similar that supply and demand short term have been impacted more or less in the same way. And that reflects also that we have seen that we try to ship out goods to our customers and where we were successful to get the respective permits. The challenge was then to meet somebody at the customer side who could receive the goods. So that's why I would say your question/answer is on spot to say that supply and demand short term might have been hit in the similar order of magnitude.

And we also can say that some of our competitors, namely, Wanhua, have not been affected because they're sitting at a different site and a different location in China. And we assume from today's perspective that they have at least short-term gained market share for the respective goods.

And on the last, there's an addition by Thomas. Thomas, would you like to go ahead?

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

I just want to answer, Charlie, the question on the mark-to-market maybe. So to give you some color on the numbers, you've seen mark-to-market came down from EUR 3.3 billion to EUR 2.8 billion. I would say 2/3 of that is a volume effect, and that includes the lockdown in Shanghai. So that is, to your question, very specifically. And 1/3 of that essentially is a slightly negative pricing delta. You've seen that in our Q1 results.

But of course, the mark-to-market number already includes April. So that has continued directionally into April. And then from the EUR 2.8 million to the midpoint of our guidance for the full year, that is essentially a pricing delta effect that is baked in here, which reflects the lower projections for GDP, which I think everybody has in mind that they have changed since the beginning of the year. So I think this is how it would decompose what has happened to the mark-to-market.

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

That's really helpful. And just in terms of the demand trends, any particular markets -- you talk about being sold out, but any kind of sense from any customer end markets where things are slowing? Obviously, automotive is still constrained, but kind of perhaps...

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

If I can pick some industries, I would say there is a certain weakness in appliances. You can see that also in the Chart 12 that we presented with a somewhat negative growth rate projected for the year. Automotive, I would completely agree with you that this is more a supply constraint that we have. And there are some other specific markets like, for example, mattresses and soft furniture in the U.S. that is suffering. But I would say it's not a broad-based weakness. It is specific industries and specific regions where we see some softening. But of course, in light of the revised GDP forecast for the year, we've taken that into account for our full year guidance.

Operator

Next up, we have Matthew Yates who's calling from Bank of America.

Matthew Yates ***BofA Securities, Research Division - Director in Equity Research, Head of European Chemicals Research & Research Analyst***

Actually, I'd like to follow up on Charlie's question there, is around the -- how you're thinking about the Shanghai impact. It sounds like you're not assuming that you recover all of the lost production given Wanhua or others may have stepped in to take share. But in terms of the order book visibility you have, is there an expectation that there would be some catch-up in order to work down your finished goods and you've got line of sight on the customers who would take those? Or have we effectively just lost those sales for good?

The second question I have is around the specialty business. I think, Thomas, you mentioned in your introductory remarks that we have to view the percentage margin target in the context of whatever the top line is going to be given distortions from price movements. Can we, therefore, change the debate to talking more about an absolute EBITDA number that you think is deliverable for that business over the midterm?

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

Matthew, this is Markus. I'll take the first question. If I look the Shanghai situation, first, we want to reiterate that we deem this to be a short-term effect that mostly will happening in the second quarter or totally will happen in the second quarter. We had the plan originally, as you might imagine, to run our leading cost plans fully flat out, and the production reduction is a clear loss with a catch-up possible.

Nonetheless, we have to say Wanhua, as I said earlier, has kind of stepped in and gained maybe short term some market share. So that business for the second quarter, which was there, is most likely gone. But as depicted in a different question, we also assume that supply and demand somewhat were hit to the same order of magnitude. And we believe, and we also have some insights in that context, that demand will recover after the lockdown has been stopped rather quickly and also go back, I would say, to normal levels. For sure, that

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business has been lost in the second quarter. Therefore, it will affect the total annual numbers. But if you just look in the third and the fourth quarter, we would expect demand to normalize back to the levels that we would have seen in a normal year. So we are not yet concerned about any structural demand shortage or demand decline particularly in China. Thomas?

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

And maybe, Matthew, on the Solutions and Specialties question, I would not switch our target here and go to an absolute one. But of course, I would like to give you some indications so that you don't have a feeling we have a very soft target, and you cannot follow up what we really mean. So I would say, directionally, the current situation is in the order of magnitude of 1 to 2 percentage points in terms of the margin that it costs us because it is not a mid-cycle environment, and the situation is somewhat inflated in terms of raw material, and therefore, also sales prices.

So I think that at least gives you then an indication what our feeling is where we're currently standing in terms of the pricing cycle. And if you want, you can also backward calculate it in absolute EBITDA, but I would not change the official target for the segment here.

Operator

Next up, we have Jaideep Pandya who's calling from On Field Research.

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

I have a few questions on raw materials, really. Could you talk a little bit about availability on ammonia, on chlorine? And then also in light of what is happening in European refining, are you concerned about benzene availability if we have a sharp preference for mid-distillates? That's really my first question.

And then the second question is, when you look at your global landscape right now, are you making very high profitability in North America compared to the rest of the world? And therefore, if North America market loosens because of demand or because of more supply structurally into North America, then we will have some level of convergence?

And then just final follow-up is, could you just update on your MDI plant plans and progress in North America?

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

Jaideep, I take the first and maybe also third question, and Thomas, maybe the second one. So on the raw materials, ammonia as well as chlorine topic that you addressed and benzene availability, we currently do not foresee any shortages of any of those materials. Part of the reason is that we are either having long-term agreements with respective suppliers where we have had no indications that, that supply would actually be shortened.

Secondly, at some sites, we are producing chlorine ourself and/or ammonia ourselves and/or with partners. And also here, we have no indication that we would actually have a challenge to get access to ammonia. And from that perspective, switching now to benzene. Also here, next to all you hear, we do not foresee any shortage, particularly in benzene or even toluene with regard to the output of the respective refineries.

So from that perspective, for sure, if a complete curtailment, for example, of Russian gas would come -- so an embargo, no matter from which side it will be induced, that will have significant impact on the respective value chains. But to be clear, that scenario is not built in into our updated guidance, simply because it is too complex to assess what it really would mean, what a gas curtailment would mean for us and for the entire industry, in particular, factoring in where our sites are located because particularly gas curtailment that would have a significant impact on ammonia supply and production in Europe could lead to 2 effects.

Number one is it could lead to the fact that in some areas of Europe, and particularly Germany, there would be hardly any gas available, whilst at the same time, gas supply would be normal in other parts of Germany, simply due to the physical nature of the pipeline network and the respective supply sources. That's why it is very difficult to judge on those impacts before it actually happens.

Secondly, for sure, we're also looking at a global scale where are potential alternative sources for ammonia because ammonia is a good

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that is globally traded, that is globally shipped. And even though if there would be potential shortages on ammonia production in Europe, there is still alternative sources and also existing infrastructure for ammonia in or to Europe available. So that I hope gives you a little bit of a flavor about the current view on raw materials.

With that, I would like to hand over to Thomas on the second question, North America.

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

Jaideep, I hope I got your question correctly. So North America is a profitable market, but I think some of the consultants and some of the margins that are published are simply grossly overstating the profitability. So just to put that into perspective, actually, before the COVID lockdown in China, our China business was even slightly more profitable than our U.S. business. And therefore, it is not that we have a huge gap in terms of profitability between the regions.

And then back to your question, that would then also mean that swings in demand and also swings in volumes across the region do not overproportionately mean that there is profitability variability in our results.

And then the last one, the MDI plant, I would say unchanged. We are looking into the options, and we're planning to take a decision after the summer break.

Operator

(Operator Instructions) Next up, we have Chetan Udeshi who's calling from JPMorgan.

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

I think the first question is the EUR 250 million EBITDA hit from Chinese lockdowns, can you help us understand how have you come to that number? Because I think, Thomas, you talked about 50% lower volume in April and recovery in Q2. But I'm just thinking, just to have on a group level, EUR 250 million of EBITDA hit, you probably need the Chinese business to be down 50% for all of Q2. So what is the underlying assumption for that business for all of Q2? And the second question is, can I kind of check the changed gas cost guidance or energy cost guidance, does that factor in the recent spike that we've seen in the U.S. energy prices as well or rather U.S. gas prices?

Sorry, and third question, can you talk about how are you finding the higher energy cost pass-through so far in Europe for April? And maybe if you have any visibility on May contracts, that would be useful.

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

Chetan, let me take the first one. Just to be precise, I didn't say it was only April. I said it was a significant volume decrease around the 50% level in April moving into May with some recovery. And I think to be fair, we will not be back to full normal, and again, look at the situation in the Shanghai harbor before the end of Q2.

So we do see an uplift, but this topic we'll have to deal with it over the course of the entire quarter. And therefore, with a 50% drop-through rate, which is normal, we're talking about a EUR 500 million sales loss, which then translates into the EUR 200 million to EUR 250 million EBITDA that we are foregoing in China. So that is the assumption behind it.

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

Chetan, also on the second one, the gas cost spike that you have referred to, in the United States, is actually included in our mark-to-market energy costs for the full year of around EUR 8.1 billion. Sorry, EUR 1.8 billion, not EUR 8.1 million. Sorry for that. So EUR 1.8 billion to be absolutely clear includes the recent spikes in U.S. natural gas prices.

And on the pass-through opportunities, the pass-through opportunities on energy prices mainly rely on the overall situation and supply and demand situation in the market. And here, we have also factored in for the remainder of the year that the environment will get more difficult. That has been factored into the guidance. And if you would like to have a little bit more flavor on that one, we assume from today's perspective that even though it has lasted longer than we originally expected that now, most likely, that impact will come a little bit stronger.

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It comes later, but stronger then. That means it faster decline, and that will, to a larger extent, affect the polycarbonate business and here, particularly the standard polycarbonates business, followed by our PET business and then TDI business. And we assume that MDI, given the supply/demand, to be rather balanced also for the remainder of the year to be almost not affected at all. I hope that gives you a flavor about what we currently see.

Operator

(Operator Instructions) And we have one more question on the line from Georgina Fraser who's calling from Goldman Sachs.

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

Just a couple of questions left. Am I right in thinking that you would normally kind of check your planning assumptions through the year ahead, about a month ahead of results day? I'm just wondering if you kind of decided to wait and see, just kind of understanding the timing around the ad hoc announcement that we got just yesterday.

And then my second question is -- I think that you said in the presentation part that you assume energy price headwinds will kind of remain at the current level, this EUR 1.8 billion, for the rest of the year and that you've got a bit more confidence of that being the case. Would really help if you could just elaborate a bit more on what gives you that confidence. I think energy prices are one of the hardest things to have confidence in forecast for in general.

And then third question, could you maybe give us an overview of how you, the management team, are spending your time at the moment and how that might be different from last year? Are there any structural projects that are taking a backseat due to near-term challenges?

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

Georgina -- this is Thomas. Let me take the question. So I agree with you. It is not the normal procedure that we look at the numbers in the very last minute, and it's also not our intention to spoil your May holiday. But here, really, we wanted to collect essentially last-minute information from all the BEs. And we got this over the weekend, put it together on Monday and then had a discussion on Monday night in the Board. The key swing factor here was really the COVID situation in China where we wanted to get the latest update from the team where we stand.

So I would say it's not a normal process. It should not be the normal process in the future. But here, in light of the situation, we felt it was appropriate to look at it this way.

In terms of the energy costs, I would agree with you, it's very hard to predict. Why are we coming to this range of EUR 1.5 billion to EUR 2 billion and the EUR 1.8 billion run rate essentially because we've seen energy costs were EUR 450 million in Q1 with some overshooting at the beginning of March and then prices coming down again. So that gave us at least a feeling that we have a fluctuation around that point and not a steady development in one direction.

And we take this maybe as an indication that energy prices might stay at that level. But I would agree with you there is, of course, no guarantee for that, but we currently do see that the energy prices have essentially moved sideways since the end of March. So that would be consistent with our assumption. Management time, back to Markus.

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

Georgina, this is Markus speaking. Management time, I would not say that necessarily management spends the time differently. However, there is a few topics, which, for sure, are more intense and more intense definitely, and Thomas has alluded to that by answering the first question, is really assessing the situation, not necessarily on a daily basis, but almost at a daily basis what is the latest and greatest information we can get to assess how might that impact our business, not only with regard to energy prices but assessing demand patterns, looking at supply chain topics that are changing significantly our overall environment and so on and so forth.

The second topic is we're looking into every opportunity to accelerate projects in the context of energy efficiency on the one hand, but also in the context of alternatives, for example, with regard to gas supply. And here, I'm not meaning replacing one gas supply with

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another gas supply, but looking for short-term replacement with alternative feedstock to also lower our own dependency on natural gas in the short term.

And thirdly, for sure, we're looking into acceleration of alternative raw material sources. That means if not now, everybody has finally understood how important it is to get away from fossil fuel sources as well as fossil raw material sources, then I would wonder when. And that is exactly why we are at full steam driving ahead with our vision to become fully circular and at the same time also with our clear ambition to become climate-neutral now by 2035. So has the time significantly changed, our time allocation? No, not necessarily. However, some topics are even more intensively discussed than before.

Operator

The final question for today is from Jaideep Pandya who's calling from On Field Research.

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

Two questions, if I can. Firstly, on polycarbonate, could you just tell us how is like the pricing dynamics in the specialty grade polycarbonate given that there is a decent amount of oversupply now in the commodity grade, whether you have already seen weakness in prices in specialty grade or whether, essentially, grade prices are still relatively good?

And the second question is little bit of philosophy of the question really, but could you remind us what is the defense strategy at Covestro? And really, do you think being listed on the public market is sometimes the right thing when you guys discuss internally or -- because I just fail to understand how will the value unlocking at Covestro happen because if you beat, your stock goes down because people think it's peak. And if you miss, your stock goes, because you missed it.

So it's not really a question, but it's really wanting to gauge is there a clear defense if there was aggressive approach or you're basically akin to anybody who wants to own Covestro shares, whether it is individual investors or whether it is acquirer.

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

So Jaideep, this is Markus speaking. Allow me on your first question, what we can actually see across the board is that the polycarbonate prices on average for us are increasing in Europe as well as the U.S. And that is particularly because the teams were quite successful in pushing prices through, and by that, covering higher raw material as well as energy costs. However, that has been successfully managed for both, types of polycarbonate to see it very clear black and white a little bit here.

The commodity prices have risen, and we were also able to successfully pass on respective prices for the specialty business. It goes there a little bit slower, yes. That's clear. However, it lasts longer. And that also now leads into Asia Pacific.

The commodity price in Asia have gone down for polycarbonates. And as we alluded to a little bit earlier, this trend of, in principle, downward trending prices in the commodity segment is also baked in into our full year guidance for polycarbonate, and that also is the larger share of the price-driven respective EBITDA guidance impact. But the specialties are flattish. And that also reflects a little bit that there is a clear difference as we expected to be in those businesses. Sometimes it's harder to get prices up, but customers really pay for the inherent value and not necessarily based on the supply-demand balance for those specialty grades.

On the second bit, I think Thomas will allude to that.

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

Yes, Jaideep, just a quick answer. I mean, first of all, we do feel that it's appropriate to be on the public stock market for the company. However, we also think it's our fiduciary duty as a management to listen if somebody comes up with an appropriate proposal that is worth listening to, which currently is not the case. But if it was the case, of course, we would take the time and listen to whatever is proposed. So I think that's our very simple stand to that.

Operator

Mr. Koehler, there are no further questions at this time.

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

Thank you very much. Interesting conclusion in the questions. I'm happy to receive all your follow-up questions if you may have. If not, we will latest talk to you in the Q2 conference call or perhaps we might see each other in between. Thank you for listening in, and goodbye.

Operator

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

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