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CORPORATE PARTICIPANTS

Markus Steilemann *Covestro AG - CEO & Chairman of Management Board*
Ronald Koehler *Covestro AG - Head of IR*
Thomas Toepfer *Covestro AG - CFO, Labor Director & Member of Management Board*

CONFERENCE CALL PARTICIPANTS

Chetan Udeshi *JPMorgan Chase & Co, Research Division - Research Analyst*
Christian Faitz *Kepler Cheuvreux, Research Division - Equity Analyst*
Geoffrey Haire *UBS Investment Bank, Research Division - MD and Equity Research Analyst*
Georgina Fraser *Goldman Sachs Group, Inc., Research Division - Associate*
Markus Mayer *Baader-Helvea Equity Research - Lead Analyst of Chemicals*
Sebastian Bray *Joh. Berenberg, Gossler & Co. KG, Research Division - Analyst*
Thomas Swoboda *Societe Generale Cross Asset Research - Research Analyst*

PRESENTATION

Operator

Ladies and gentlemen, thank you for standing by. Welcome to the Covestro Earnings Call on the Third Quarter 2021 Results. The company is represented by Dr. Markus Steilemann, CEO; Dr. Thomas Toepfer, CFO; and Ronald Koehler, Investor Relations. (Operator Instructions)

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

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

Good afternoon, and good morning to our American investors. Thank you for joining us for the Q3 conference call of 2021. We will have the report and the earnings call presentation at our website, and you can download it. And I assume you have read our safe harbor statement.

And with that, I will directly turn it over to Markus.

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

Good morning, and good day to everyone. Thanks, Ronald, also and a very warm welcome from my side. So we are now on Page #2, which is the financial highlights for the third quarter 2021.

In the third quarter 2021, our earnings performance was well above previous year. In the prior year quarter, as you know, we had already seen a strong volume rebound from the coronavirus pandemic. We also see a continued solid demand in key industries on a global scale. The strong earnings momentum continues to this day and also well into the fourth quarter.

The EBITDA of EUR 862 million came in at the upper end of our Q3 guidance of EUR 760 million to EUR 860 million. At the same time, there is a solid free operating cash flow of EUR 381 million, and this is slightly above prior year, only held back by valuation-driven increase of working capital.

Year-to-date, the earnings per share are at EUR 6.80, up from EUR 0.80 at the first 9 months in 2020.

On July 1, we also implemented our new segment and reporting structure, and we now have 2 segments with Performance Materials and Solutions & Specialties.

Today, we also raised our earnings guidance for the full year 2021.

Let's turn pages to the solid demand recovery that continues on a global basis. Year-to-date, we have seen a solid demand recovery from prior year impacted by the coronavirus pandemic. There has been solid industry demand and that applies globally as well as in our 3 key regions.

The table shows the full year demand estimates for our key industries and respective important sub industries. The expected demand growth in all key industries for the full year 2021 is well above the full year 2020 values. Please compare, for this purpose, the middle column with the left column on the chart. The industry data are largely consistent also with our customer feedback. With that, please turn to the next page.

While the global demand development is positive, the growth potential of our core volumes was limited. Why? The level of unplanned constraints to product availability in 2021 is significantly higher than normal. And the chart lists some key single adverse effects in total, limiting our core volume growth by around 6 percentage points this year.

Let me go through the 4 major points each. First, refilling inventories, especially for polycarbonate products, to improve future availability. That is estimated to contribute a full year impact of approximately 3%.

Second, making up pandemic-related delays of scheduled maintenance shutdowns and that leads to above-average maintenance activities in 2021. This contributes approximately for the full year 1% of volume growth.

Third, a large unplanned shutdown of MDI plant in Brunsbüttel is set to have an impact for the full year of approximately minus 1%. By the way, we have just lifted the force majeure on the MDI production in Brunsbüttel.

And fourth, last but not least, the U.S. Winter Storm Uri that happened this year in February and its consequences on the U.S. supply chains has approximately an impact of 1% for the full year 2021.

To put this into perspective, 4 negative effects eat up 6% positive core volume growth from the acquired RFM business. In 2021, constraints are, at the same time, an opportunity to grow core volumes mid- to high single digit in the next year 2022.

Let's turn to Page #5. As you can see on the chart, core volume growth of only 0.8% in the third quarter 2021 reflects 2 things: that the solid customer demand on the one hand, meets a constrained product availability on the other hand.

Let me guide you through the volume development by our key industries, ranking by kilotons sold. In furniture and wood, we have seen a decline of minus 17%. The solid demand was there yet constrained by TDI and polyols supply and availability. Secondly, on construction, we have seen minus 11%. Again, a solid demand situation but constrained MDI and polycarbonate ability. And then auto and transportation, minus 6% that still outperformed the global auto production decline of minus 16%, and that was driven by structural factors like, for example, the strong electric vehicle growth.

And last but not least, electro flat with 0% with a small growth opportunity here in Asia Pacific. The volume development by the 3 regions and the key countries is comparable to the global picture that I have just provided.

One positive exception though the higher core volume growth of plus 22.4% in Germany due to relatively low prior year base and highest relative contribution from the acquired RFM businesses compared to the United States as well as China.

With that, I would like to hand over to Thomas, and we'll talk later.

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

Well, thank you, Markus, and also a very warm welcome from my side to everybody on the call. I'm on Page 6 of the presentation where you have the Q3 sales bridge. And as you can see, the sales increased 55.9% year-over-year, obviously pushed by significantly higher prices, while the net volume effect in sales, and that is excluding RFM was essentially 0 because the growth in Solutions & Specialties was leveled out by a decline in Performance Materials. And the reason behind this, just to remind you is that the volume growth was limited by constrained product availability and not by the demand. I think this is very important.

As you can see in the bridge, the selling prices had a positive effect of 43.8% year-over-year, and that is the EUR 1.2 billion that you see in the bridge with the price effect mainly in Performance Materials. FX was positive EUR 45 million or 1.6%, mainly reflecting the weakness of the euro against the Chinese renminbi and the portfolio effect was a positive 10.5% or the EUR 289 million in the bridge. And that is the effect of the consolidation of the acquired RFM business. So the EUR 289 million is equivalent to the sales number of RFM.

So with that, let's turn the page to Page #7, where you have the EBITDA bridge. As you can see, EBITDA is up 89% compared to prior year, and that is largely due to the highly positive pricing delta. You can see the pricing delta is EUR 576 million, mainly from Performance Materials.

Actually, the volume effect in EBITDA is slightly positive because while the net volume effect in sales is 0, the contribution margin of the volume growth in Solutions & Specialties exceeded the contribution margin of the volume declines in Performance Materials. So if you want, we have a positive mix effect between our 2 segments that has a positive impact on our EBITDA.

FX contribution is, like in sales, slightly positive. And like in the previous quarters, the other items include 3 main effects, which I would like to highlight here. So first of all, in the negative EUR 210 million, there is a negative EUR 145 million effect from the higher provisions for variable compensation.

Secondly, there is a negative EUR 8 million onetime effect, which is related to the acquired RFM business and the integration of the business; and number three, there is a negative EUR 5 million onetime effect from our LEAP transformation program and some onetime costs that are associated with it.

So I think with that, I would directly hand it back over to Markus for some details on the group and the segments.

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

Yes. Thanks a lot, Thomas. And let's go for the group first. On Page 8, you see that in Q3 2021, we had the highest quarterly sales in Covestro history. Sequentially, the sales increase was driven by higher volume as well as price and the EBITDA continues to be on a high level.

It was the fourth consecutive quarter with an EBITDA margin around 20%, still well below historic peak of 28.1% in the first quarter of the year 2018. Sequentially, the EBITDA increased due to higher volume, while pricing delta was slightly negative.

Now let's turn to the Performance Materials segment. The Performance Materials core volume growth, as you can see on Slide #9, was at minus 11.6% year-on-year. However, it is not reflective of demand as Thomas also pointed out numerous times. The underlying global demand is solid in our key industries and core volumes of standard products were constrained by product availability and shortages of feedstock.

Most prominently, MDI in Europe was on force majeure during the third quarter after shutdown of our Brunsbüttel plant in Germany. Also, more internal allocation of available material to solutions and specialties was happening instead of external sales by Performance Materials.

Compared to prior year, the EBITDA increased mainly due to a strong positive pricing delta compensating higher provisions for variable compensation. Sequentially, the EBITDA increased due to higher volume and positive pricing delta.

If intersegment sales added to reported external sales, the adjusted EBITDA margin of 25.6% would be there instead of reported 34.5%.

So let's turn to Page #10 and take a look at Solutions & Specialties. The Solutions & Specialties core volume growth was at 22.7% year-on-year and included about 20 percentage points from the acquired RFM business. While volume effect on sales was negative in Performance Materials, this volume effect was with 6.9% positive on sales in Solutions & Specialties. Both, year-on-year and quarter-on-quarter EBITDA, however, declined.

Compared to prior year, the EBITDA decline mainly was due to negative pricing data and higher provisions for variable compensation.

Sequentially, the EBITDA decrease was driven by negative pricing delta while volume growth contributed positively.

We have seen a significant increase of feedstock prices in a relatively short period of time, and that could not be fully passed on.

So now I would like to hand back to Thomas.

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

Yes. And I'm on Page 11 of the presentation where we have the cash flow for you. So as you can see in the chart, we generated a free operating cash flow of EUR 1.1 billion for the first 9 months of the year and also EUR 381 million in Q3. Obviously, the EUR 1.1 billion is significantly above previous year.

So the cash generation, both in Q3 and for the 9 months of the year, was boosted by significantly higher earnings, but it was held back by negative cash contribution from higher working capital. And you can see this easily in the table. So let me say that the working capital sales ratio stood at 21.3%, that is virtually unchanged versus the year end of the second quarter of this year.

And there's 2 factors leading to this. First of all, higher feedstock prices and also product prices push up the euro value of our working capital. And secondly, there is still a mathematical effect from comparing a quarter-end working capital based on [relatively] (added by company after the call) high prices with a 12-month sales run rate which includes a relatively weaker second half of 2020.

If you go further down in the table, you see our 9-month CapEx spending was EUR 472 million, that is absolutely on budget and is also in line with our full year guidance. And you can see that the income tax paid for the first 9 months of the year amounted to EUR 309 million. Now the income tax paid in relation to the pretax income reflects the fact that there is a lower level of income in the previous year's quarters and some tax authorities use those prior quarters to determine tax prepayments. And therefore, there is a certain time lag between the cash tax and our P&L tax rate. But overall, for the full year of 2021, our expected cash tax is therefore somewhat below the P&L tax rate, which we have guided to be between 24% and 26%.

I would make a last comment on the last line item, other effects. So that reflects higher provisions for variable compensation. And again, to remind everybody, the way it works is that we are building provisions every quarter for the bonus achievement in 2021, but the cash out for this bonus is only in the second quarter of 2022 and the total amount that we're expecting to build in terms of provisions for this year will amount to roughly EUR 0.5 billion.

With that, let's turn the page and go to Page 12, where you have the balance sheet. Quite obviously, our balance sheet remains strong, and you can see this in the ratio. So the ratio of total net debt-to-EBITDA stands at 1.0x versus 2.9x a year ago. You can also see that the pension provisions decreased versus the year-end of 2020. We have EUR 417 million less, and that is mainly due to the higher discount rates in Germany.

And a last point that I would like to mention, but you cannot obviously see it in the net debt numbers is that we repaid early a EUR 500 million bond in July of this year, which we had placed into the market in 2016 and which would have matured in October of 2021, again, obviously, with no effect on the net debt numbers.

So with that, let's turn to Page 13. Markus has mentioned that we have raised our EBITDA guidance for the full year to a corridor of EUR 3.0 billion to EUR 3.2 billion. And the key reason for the upgrade is the relatively stable industry margin development compared to previously expected margin declines that we had baked in into our guidance.

What you can also see in the chart is that the mark-to-market estimate stands at about EUR 3.2 billion, if you base it on the September data, and that is on par with the upper end of our EBITDA guidance corridor. So therefore, obviously, the EBITDA guidance midpoint assumes a margin decline to happen during Q4 of this year.

What you can also see in the chart is that we expect the EBITDA mid-cycle level to increase to EUR 2.8 billion by 2024 as we communicated it in our virtual investor conference in September. Based on the industry supply and demand forecast for the next years, the EBITDA should remain above mid-cycle.

So the full year 2021 guidance, just to be very clear, includes the following items, include the provisions for the variable compensation. And I said this is expected to be around EUR 0.5 billion, as I mentioned before. It also includes RFM, which has a positive net earnings contribution of EUR 60 million to EUR 70 million, including EUR 40 million integration costs and roughly EUR 25 million negative effect from an inventory step-up as well as EUR 20 million positive cost synergies which we realized and the guidance for the year also includes the effects of LEAP. And here we're talking about the negative onetime effects where year-to-date, we have posted a number of EUR 31 million, and we do assume another low to mid-double-digit euro million amount to be built in Q4.

So with that, let's turn the page to Page 14. As I said, we raised our earnings outlook for 2021 in terms of the EBITDA. In terms of core volume growth, we're expecting 10% to 12%, and that is including 6 percentage points from RFM. We lowered the corridor exclusively because of the constrained product availability and not because of lower demand, as Markus very clearly stated. And I should only flag to you that obviously the U.S. hurricane season still represents another risk on our ability to fully supply the demand which is out in the market.

We did lower the free operating cash flow outlook despite the improved earnings outlook, but that reflects only the higher expected level of funds, which is tight in working capital because the feedstock and selling prices have increased, I think we explained this when we talked about the cash flow and the increased ROCE guidance reflects the higher EBITDA guidance 1:1.

And then just -- for the sake of completeness, please also note that we have slightly adjusted our full year expectations for D&A as well as for the financial results.

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

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

Yes. Thanks a lot, Thomas. And please allow me before I wrap up the Q3, I would like to bring your attention to 1 highlight of sustainability-driven innovation on Page #15. And this is about a circular foam project that closes the material cycle for polyurethane rigid foams.

And you might now ask yourself, why is that relevant? It is relevant because every one of you has a refrigerator at home, and you can assume that in almost every refrigerator, polyurethane rigid foam is the most effective and also very cost-effective solution for insulation purposes to make this device very energy efficient. And on top of that, what works with a refrigerator works with entire houses, be it private homes or commercial buildings.

Also here, millions of tons of rigid PU foam is used. And so far, there is no real recycling solution available. And that's why Covestro has started and is coordinating an EU innovation project with 22 partners from 9 European countries. You see just a simplified overview on Chart #15 about how that project work. And believe it or not, in reality, it's way more complicated, but we're not shying away from this.

The project goals and benefits are establishing a coordinated waste management and suitable recycling processes. In other words, redesign the entire value chain; secondly, developing an innovative chemical recycling process for rigid polyurethane foam; and last but not least, significant savings potential here in terms of waste, incineration cost as well as carbon dioxide emissions for the entire value chain once the circular concept is established.

What is Covestro, in this consortium, focusing on as an innovative recycling solution? First, we enable the reuse of materials at end of a useful life where mechanical recycling is failing and, therefore, not a suitable option. And we also develop new processes in chemolysis and also smart pyrolysis to obtain polyols on the one hand and amines as a circular raw material on the other hand for production of fresh polyurethane rigid foams without loss in quality.

Therefore, for Covestro, this project, circular foam, is another lighthouse project with which we are advancing the realization of a circular economy as part of our vision.

Now let's turn to Page 16 for a quick wrap up. We successfully implemented our new organizational structure as of 1st of July as well as our new segment reporting. The volume growth were limited by product availability, but while on the other hand, helped by full consolidation of the acquired RFM businesses.

The EBITDA increase was driven by positive pricing delta despite significantly higher raw material prices and that also went along with solid cash generation based on high earnings compensating higher working capital. We also raised the 2021 earnings outlook, reflecting relatively stable industry margins, and we are also confident that the transformation program LEAP is well on track and the new organizational setup has been successfully implemented, as already mentioned, on 1st of July 2021.

With that, we are now looking very much forward for your comments and questions, and I would like to hand back to the operator. Thank you very much.

QUESTIONS AND ANSWERS

Operator

(Operator Instructions) The first question comes from Mr. Christian Faitz from Kepler.

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

Two questions, if I may. First of all, any visibility into 2022 in terms of demand trends, particularly in those end customer industries that have supply issues at present? And then second of all, when do you expect margins in Solutions & Specialties to improve? Would this go hand-in-hand with the margin decline in Performance Materials? I mean just trying to get a grip on the new dynamics of the divisional setup.

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

Christian, thanks a lot. Good hearing you again. This is Markus speaking. Looking into 2022, and that is kind of a continuation of a trend that we have seen in the first half that we also have seen in the third quarter and now continuing in the fourth quarter, we actually estimate that demand remain strong. And then we also could see a rebound in the auto market starting in the second half of 2021.

And it's a bit more of a detailed outlook on Page 3 of the handout that we have provided for this call, where you see a little bit more of the numbers actually that we would expect for the year, let's say, 2022, always in a year-to-year comparison, so for those and the benefit that do not have that script or that presentation at hand.

For example, we would see, and I think that's quite also maybe important detail. If you take a look at the automotive industry, we expect, given the challenging situation in 2021 that we could see an even stronger rebound year-on-year in automotive with, for example, plus 10%. But who knows it's maybe even more telling is that the electric vehicles and battery electric vehicles would see a rise of almost 51%.

So having said that, the niches where we are very well positioned and where even more specific material consumption of our portfolio is happening are the ones that are growing the fastest within the given industry. Look at the construction plus 3% '21 to '22. Furniture also expected at about 3.5% to 4%, and electrical electronics as well as household appliances, talking about fridges again, at plus 5%.

So if we look in the total year, I would say, 2022, -- there is from our perspective still solid demand growth to be expected, in particular for the product portfolio and sustainable solutions that we have.

Coming back to the Q3 Solutions & Specialties margins, that was down as the internal transfer pricing caused the negative pricing delta. In the fourth quarter, the margin is expected to be even lower, given the normal seasonality that we are now entering into the fourth quarter.

In 2022, based on slightly, and I have to be very particular here, slightly lower Performance Materials prices the margins should start to improve. Long term, there is more upside, given a value pricing approach, volume leverage as well as our transformational program LEAP. I hope that answers your questions.

Operator

The next question comes from Mr. Geoff Haire from UBS.

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

I've got 2 questions. I was wondering if you could just go through your business and explain which parts of the business have seen or most seen in terms of your capacity constraints? And then also just on the Specialty & Solutions business, is there a big difference between the timing of you having to take higher raw material prices and the ability for you to pass those on to your customers? So if you could just talk a little bit about that, that would help.

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

Geoff, good to hear you again. So I maybe hand over here to Thomas for the first part of the question and then take the second one. So Thomas?

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

I was not sure whether I got the first part right. Let me start with the second one. So I think you asked about the timing of the -- and then let's check whether we all got the question correct on the first one. So the timing on Solutions & Specialties, yes, there is a time lag. And as Markus described, of course, prices were rising in Q3 that had a negative effect on Solutions & Specialties because they were not able to raise their prices as quickly. And in Q4, we're even expecting that margins might become further under pressure simply because of the normal seasonality. That might ease that in 2022.

What is important is that for the first time, we have this full transparency about what is really the additional margin that this segment is generating, and that in addition to the fact that, yes, we have to be more agile in terms of customer contracts and adjusting. It gives us really the opportunity to start a value-based pricing discussion with our customers and really sell the products to those customers where we have the biggest impact and where we get the biggest return for the value that we deliver.

And that transparency, I think, is now greatly improved with the fact that we do see the margins for our Solutions & Specialties on top of what the input factors are. So I would expect, as I said, in Q4, maybe even a slight further decline, some improvement over the course of 2022. And then, as Markus said, with the measures that we will focus on in terms of value-based pricing and focus on the right customer segments, there should be further upside in the years to come. And as you know, we set ourselves a target of 17%, which we think is clearly achievable for Solutions & Specialties.

So now maybe to the first question. Geoff, could you repeat the question?

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

Sure. It was a very straightforward question. Within your business, what parts are most sold out? So where have you got the biggest capacity constraints?

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

Okay. Geoff, this is Markus speaking. And I take it. You see we're still, let's say, so excited that we are still struggling who should go first to answer all those questions.

So let me start with MDI. So we believe that the MDI market is overall very strong. And why do we believe that? Well, in 2020, according to the data, we see there has been a downturn of only around 1.5%. The industry is expected to increase, on the other hand, already by 10% in the full year 2021. So that means we will be then, for the full year, well above 2019 levels already.

PCS is also strong, however, but just back on [2019] (corrected by company after the call) global market level. So here, we still need some time to be really well above precrisis levels, and we also increased in this industry our global market share. TDI is still below [2019] (corrected by company after the call) levels as furniture and bedding did not fully recover. And however, we are actually sold out in all our product categories.

If you look now at supply/demand, I think what is important to understand the difference between nameplate capacity, where you normally calculate the overall industry utilization and available capacity. Here, we have seen in our 3 major product group quite different pictures. MDI, I talked about there is not so much of a big difference even though there is still some impact from the Uri Winter Storm that happens back in February in the United States.

However, in TDI, actually, the nameplate capacity would still be this year around 74%, but the available capacity is significantly lower or has been significantly lower. And therefore, based on that perspective, the industrialization on available capacity is much higher.

Since BASF has actually brought back its TDI plant in Ludwigshafen after a major additional turnaround, we have seen that already margins in Europe have actually come down. And that's why I would not expect at current overall margin levels that we will see significant further pressure on the spreads that we are currently seeing in the TDI business. And therefore, there should be limited further downside risks from today's perspective.

Let me now switch to polycarbonates to give you additional flavor. Also here, a major difference between nameplate capacity utilization versus available capacity utilization because a key topic here is still the tight BPA availability, and here, particularly in Chinese market.

And here, that has a particular large effect because all major capacity, if not all capacity that came on stream in the last 1.5 years, 2 years was actually coming from China in China. And therefore, the currently equivalent of around 400,000 tons of nameplate capacity is currently mothballed. And therefore, if you now take BPA capacities that have been announced into consideration, the BPA market is partially to be expected to normalize in '22.

So long story short, there might be some margin pressure on the polycarbonate market. However, that market is still very nicely growing with only 6% capacity addition increase in '21 and 11% increase in '22, but let's see how that figures out. It's a long answer. It's a quite complicated picture, honestly speaking. But currently, and we have, I think, indicated that we see still good opportunities in those markets also with reasonable margins going forward.

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

Can I just follow up with a question on the first topic about the value-based pricing. Why did it take splitting the divisions like this to enable you to do that? Could you not have done under the old divisional structure?

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

Well, I had the chance actually to work in 2 of those larger former business units, and the key question was always exactly that mixture between fully integrated margins for what we call today Solutions & Specialties versus the pure commodity products.

So long story short, following a textbook approach, these are really different businesses in terms of how market dynamics work, what is important to customers. But if you have the same people selling that stuff, if you have the same people doing research and development in 1 business unit, if you have the same people going out there to the respective markets and trying to, on the one hand, increase prices, mainly driven by supply/demand with very, very quick reaction times but also then being in a situation where you have to go for a respective highly an innovative product, which should be sold by value and not by a cost-based approach that really pushes most of the people to their limits, and they always have to change hats within 1 talk towards the customer, honestly speaking.

So separating those businesses by the entire nature of how they are run, on the one hand, big commodities, quick reaction time, supply-demand driven and then reliability is key versus high complexity management, high innovation pressure but also entirely different pricing approaches, that actually has pushed the organization and individual simply to their limits. And that's why we believe this is the right setup to reflect those these entirely different business characteristics. And that is exactly what you currently also see.

So what we see in terms of the segment profitability and growth patterns is textbook like. That is exactly what we would have expected. If you split the businesses, and now we have the opportunity to really individually in those segments address all the challenges that we have.

Operator

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

Markus Mayer ***Baader-Helvea Equity Research - Lead Analyst of Chemicals***

Two questions from my side. The first one is on the EBITDA and Foreign Exchange rate sensitivity, including RFM. Could you give us here some hints for 2022? And also in this regard, what are potential parts of potential 2022 EBITDA and free operating cash flow bridge as far as you know?

Or in other words, what are potential plus and minuses for 2022, really liberated on TDI and MDI and potential polycarbonate margins but what are other parts for free operating cash flow and EBITDA?

And then the last question would be on this BASF, TDI ramp-up of the Ludwigshafen plant, is this reduced marginally part of your September mark-to-market indication? Or is this basically not included in this mark-to-market indication?

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

Let me maybe start with the sensitivity and the outlook, Markus. So I mean, first of all, you've got the sensitivities indicated on Page 13 of the presentation. I would say this is essentially unchanged or it will not change in 2022 when RFM is with us for 12 months and not just for 9 months. So where the sensitivity is roughly 1 percentage point change is plus/minus EUR 8 million for the Chinese RMB-euro relationship and 1 percentage point in the relationship to the dollar is roughly EUR 4 million. So I would say that this is essentially unchanged also going forward with RFMbeing with us for 12 months.

On the outlook, I would say the most important item, of course, is the core volume growth. We have indicated that for every percentage point of core volume growth, we would expect an EBITDA impact of roughly EUR 60 million. So if we assume that we get over the constraints that we've seen in 2021, I do think there's an opportunity for a mid- to even high single-digit growth number in 2022. And again, that you can multiply it out with EUR 60 million per percentage point.

I think the second item that I would give you is the others bucket. So first of all, if you strip out the bonus, we would expect it to be mid- to high double-digit negative. Remember, we said there will be a cost rebound in 2021. That I do expect it will be smaller than what we had originally expected because some of the rebound will only occur in 2022, and that is then reflected in this mid- to high double-digit number that I expected.

On the positive side, you should have the fact that the bonus accrual will be lower. So remember, this year, we have roughly EUR 0.5 billion, but that is for to 250% bonus achievement. If you assume a 100% bonus achievement for next year, that gives you definitely some positive effect of roughly some EUR 250 million on this one.

And therefore, the last item, of course, is the pricing delta, which, of course, is the big question mark. And I'm not going to comment on that, but the comment that I would give you and then you can back with engineer our expectations is that the current consensus of EUR 2.7 billion for the EBITDA next year, I think, is quite realistic. And we feel not uncomfortable with it. So obviously, that implies a negative or a conservative development on the pricing side.

So I think that will be my comments on 2022 and then maybe the rest, we will give you when we come out with our full year financials.

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

Maybe, Markus, I'll just jump in on the TDI question. There was this particular question on BASF, TDI ramp-up, whether this is fully included already into the mark to market. What we have seen that since that ramp-up of the BASF plant European spreads have declined already.

But as I said, Asian spreads are already on relative low levels at the same time. And that's what I would say that we see currently a slight rebound in Europe. And that's why I'd say, very generally speaking, that is already included in the mark-to-market numbers.

Operator

The next question comes from Ms. Georgina Fraser from Goldman Sachs.

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

I was just wondering if we could talk a little bit about capital allocation. You've already set out recently the sustainability kind of investor conference your CapEx plans. So I was wondering how you were thinking about the remainder of the balance sheet capacity and how you're thinking about the value creation opportunities between M&A and buybacks? Just wondering which of those you think would be more value-accretive at this point?

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

Yes. Georgina, thank you very much for the question. And yes, let me refer back to -- a little bit to what we said in our virtual investor conference, where we said CapEx is our most important priority because we do think it is the basis for our future profitable growth. And therefore, you've seen and heard that we are again putting on the table our MDI expansion project. We're evaluating what is the right region, whether the United States or China. So definitely, that is our key focus because we do think there is very healthy demand in all the markets, Markus alluded to MDI and TDI, and we feel that we should at least grow in line with the market demand.

Secondly, we want to pay an attractive dividend. We have, therefore, our dividend policy of 35% to 55% payout. I also indicated in the virtual investor conference that 2021 will be a good year, but I would not consider it an absolute peak year. And therefore, I would not assume that we will be at the very, very low end of that range. But even if you're only in the lower half of the range, that would still mean that our dividend for 2021 will at least double relative to the dividend that we paid a year ago. And that just underlines that we want to be very attractive to our investors.

We do think that M&A should be part of our strategy and RFM, I can only say has been very successful so far, both in terms of the operational performance of the business as well as the integration that goes very well and also the synergy achievement where we are ahead of our internal plan with the achievement. And now to your question, share buybacks, I would only characterize that as something that we would do opportunistically because we feel our dividend policy gives us sufficient leeway to manage the balance sheet such that we are not running into an inefficient situation, and we can be very attractive to our shareholders. And therefore, a share buyback, in our view, currently is not really in the cards, and we would only do this in the future if it would make a lot of sense from an opportunistic perspective and also from an anticyclical perspective. I think this is how we would characterize it, Georgina.

Operator

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

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

Yes. I have one question, please. And first, thank you for providing the detail on the challenges you had on your volumes on Page 4. I have a question on the rebuilding of inventory, which you say has taken up around about 3% of your capacity.

So the question is twofold. Firstly, could you comment when this rebuilding of inventory happened, was a particular quarter that allowed you to rebuild inventory? Could you just comment how it developed? And secondly, could you just describe where you see the year-end inventories for your main product groups? That would be very helpful.

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

So Thomas, on the inventory buildup. So first of all, we're doing this for 2 reasons: one is we do think that the supply chains will still be under stress also in the first half of 2022. And we, therefore, we want to be prepared with respect to our customers and be a reliable supplier. But on top of that, what is important to know is that in Q1 next year, we do have a peak maintenance quarter with significantly higher maintenance shutdowns than we would usually have in the first quarter of the year.

And to prepare for that, that is why we're building the inventories. So there's nothing else behind it. We started to do so already over the summer. And therefore, you've seen the effect to a -- minor effect in Q2 and now to a bigger effect in Q3, and that will slightly continue until the end of the year. But the real value, of course, that you will see in our balance sheet then depends on the valuation.

So again, if you weight the 2 factors valuation versus KT then still the valuation has the much bigger effect on our inventories. And in terms of kilotons, we're really only going back to a healthy level plus a little bit of reserve for the higher maintenance shutdown. So we're not doing crazy things here, but really just bringing it back to normal.

Operator

The next question comes from Mr. Chetan Udeshi from JPMorgan.

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

Two questions. First, a simple one. Do you see any change in the mark-to-market from September to November? And if so, any color on any material change in any of the product spreads, net margin will be useful? And the second question was, thank you for that slide on Page 4, which shows the impact from different factors and how that has impacted the volumes for Covestro. I was just wondering if you had any sense of how that number might look for the industry as a whole across your divisions in terms of how much volumes might have been lost due to similar factors at your competitors, too?

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

Chetan, let me maybe take the first question. So a mark-to-market number, I would say, some up and downs in some products. But if you take it as a whole for Covestro, as far as we can see, there is almost no change over the course of October. I think November is still a little bit early to tell. But I think the message is it's not an outdated number, but it is still pretty much what we sense is reasonable in the market. Again, with some up and down by product, by region, but broadly speaking, stable over the last 5 weeks since the end of September.

On the other question, what we've seen is the things that we report for the winter storm, of course, that is also affecting other companies. But we have some, I would say, Covestro specifics, one is our unplanned shutdown in Brunsbüttel and the other one is our inventory buildup that I just explained. And therefore, I would say, to some extent, we're a little bit harder hit than others for some Covestro-specific factors, which will then either represent an opportunity even for 2022 or they are very sensible because they help us to also deliver a successful Q1 of next year. So I think there's a positive flip side to the fact that we might be affected a little bit higher than some others.

Operator

The next question comes from Mr. Sebastian Bray from Berenberg.

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

My first one is on the new segment structure. What is the reason for the -- on a historical basis, roughly EUR 110 million to EUR 120 million expansion in the negative line of the other EBITDA. Has there been some reallocation of costs from segments to other? And if so, does this affect more of the Specialty segment or the Performance Materials?

My second question is the bonus -- does a cash out next year guided for about EUR 500 million. If Covestro were to do an identical EBITDA in 2022 to the one they did in 2021, would you pay out a level of EUR 500 million or would it be less?

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

Yes. Sebastian, let me take those 2 questions. So first of all, the other item, we simply took the opportunity to be very strict in allocating all the costs that are not under the control of the segments into this other bucket. To also give some more transparency, what are the potential costs that our management holding has. And that is the only reason before we had a little bit of a mixture. And now this is simply the much more clear-cut picture what is happening in the BEs versus what is happening in central functions that cannot be influenced by the BEs. And we do think this is a better approach than what we have historically done.

To your second question, so if we deliver an EBITDA result in 2022, which is comparable to the one that we're expecting in 2021, the PSP would be lower. So the payout would be lower than the EUR 500 million and the target achievement rate would be lower than the 250% that we have provisioned for this year, simply because this year target achievement is very much driven by the high core volume growth that comes from the rebound relative to the very low year 2020.

And that is the first reason. The second one is you know that we have a 3-year period that the KPIs for our PSP program are defined for and the next 3-year period starts next year, where, obviously, we will set ourselves, again, more ambitious goals, and that is the second factor why I would expect, if you take the same phase number for EBITDA, the bonus achievement relative to that would be lower.

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

Just to follow up, you've guided earlier to a high double-digit euro million underlying figure for the other line in 2022. Does this include the bonus that you would expect to pay out or not pay out but provision for if the consensus of EUR 2.7 billion EBITDA turns out to be right or would the figure be slightly higher?

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

No. Sorry, the number that I gave you, that was excluding the bonus. And that goes back to our statement, we want to,, until 2023, keep fixed costs flat, excluding fluctuations that come from bonus achievement. And therefore, we said that relative to that number, so excluding bonus, we would expect a bounce back of cost of EUR 100 million to EUR 200 million this year. We will be lower than that, but some of that will come in 2022 and that is the number that I was referring to.

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

But if I were to say that everything goes according to plan next year, the other line is negative 150. Does that give you a strong feeling either way?

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

Say that again, if you were...

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

If I were to say that if everything goes according to plan next year and the consensus is right, the underlying negative EUR 150 million at EBITDA, is that right?

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

Excluding bonus, Yes.

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

Excluding bonus, negative EUR 150 million. Okay understood.

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

No, no sorry. If excluding bonus, the other line next year should be a mid- to high double-digit amount. So it would be anything between EUR 50 million and whatever EUR 90 million would be our expectation.

Operator

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

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

Thank you very much. I think that concludes the call exactly on time, and therefore, I think it's a good timing now to do that. And thank you for all of your questions on your interest. We hopefully see each other perhaps live going forward. I mean, right now, we started a bit of activities also going out, still limited, I have to say. But yes, things hopefully will further normalize also with our Investor Relations activities. So as I said, thank you for your interest, and see you hopefully soon. Bye.

Operator

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