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Q2 2021 Covestro AG Earnings Call

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PRESENTATION

Operator

Ladies and gentlemen, thank you for standing by. Welcome to the Covestro earnings call on the Q2 2021 results. The company is represented by Dr. Markus Steilemann, CEO; Dr. Thomas Toepfer, CFO; and Ronald Koehler, Investor Relations. (Operator Instructions)

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

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

Good afternoon from my side, and thank you for joining our second quarter earnings call. As usually, we have posted all the financial reports, the earnings call presentation on our Investor Relations website. And I want to make you aware of the safe harbor statement, which is inside of that.

With that, I directly turn over to Markus.

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

Thank you, Ronald, and a very warm welcome to everyone on the phone from my side. Good day, and good morning.

The second quarter 2021 performance was well above previous year. Like in the first quarter, the prior year impacted by the coronavirus pandemic, hence, we have a low basis for comparison. The trend of a dynamic demand recovery and increasing product margins that started in 2020 in the second half is, however, continuing. We see strong earnings momentum to this day and well into the third quarter.

In total, the second quarter core volumes were 35% above previous year. The EBITDA of EUR 817 million is in line with the second quarter guidance of EUR 730 million to EUR 870 million and as we announced on July 12. We also have seen a very strong free operating cash flow of EUR 374 million. After closing of the RFM acquisition on April 1, this business is now fully consolidated for the first time in Covestro numbers. We also further raised our earnings guidance for full year 2021, as announced on July 12.

With that, we turn to the next page. The core volumes increased strongly against an exceptionally weak prior year with peak of pandemic's impact in Europe, North America and parts of Asia. While demand rebound continued dynamically, the current quarter's growth potential was limited by constrained product availability.

Let's take a look by the volume development by regions. Low comparable figures, strong volume rebound of 48% year-on-year in Europe. The actual volume growth was limited by constrained polyols availability. We see a similar picture in North America. Strong underlying demand growth of almost 38% year-on-year. The actual volume growth was also here limited by the constrained feedstock supply.

The volume rebound in Asia Pacific came in at 22% year-on-year. In China, as you might remember, the first quarter 2020 had been a pandemic-related trough and the second quarter 2020 had already seen a demand recovery.

Now let's take a view on the volumes by an industry perspective. The ranking is by kilotons sold to specific industries. So we start with furniture, which was up 20% year-on-year, driven by demand in Europe and North America. Construction was up 13% year-on-year globally, driven by good demand in Europe as well as Asia Pacific, while North America growth was limited by supply constraints of MDI and polyols. In the automotive and transportation sector, we saw strong demand growth in all regions, plus 88% year-on-year. Diverse industries, here, we also saw a strong increase of 55% year-on-year as the total RFM volumes have been allocated for first consolidation. Underlying volumes here grew at 14% year-on-year.

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

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

Thank you, Markus, and also from my side, a very warm welcome to everybody on the call. I'm on Page 4 of the presentation, which shows you the sales bridge for the quarter. So as you can see, the sales increased 83.5% year-over-year driven by higher prices and also higher volumes in all 3 segments. And obviously, that is comparing the numbers to an admittedly weak quarter 2 in 2020.

Now the volume effect contributed 29%. That is the EUR 626 million that you see in the bridge, and that is excluding the effect from the RFM consolidation. Now remember the core volume growth, excluding RFM of approximately 25% that Markus was just mentioning. That is the core volumes. And the difference to the sales number is explained by a favorable regional product mix compared to prior year.

Higher selling prices drove our sales by 45.9%. That is the EUR 989 million that you see in the bridge and the price effect mainly came from PUR and PCS. FX is negative 5.4% year-over-year, and that reflects the weakness of the U.S. dollar, but also the Japanese yen, the Chinese renminbi and the Indian rupee against the euro. And then last but not least, you see the portfolio effect. So by consolidating the acquired RFM business, our portfolio increased our sales by 14% and this number is equivalent to the EUR 301 million sales from RFM.

So with that, let's turn the page to Page #5, which shows you the EBITDA bridge. Our EBITDA grew by a factor of more than 6x compared to prior year to EUR 817 million, and that number is fully in line with our quarterly guidance. As you can also see, the volume growth contributed strongly with an attractive volume leverage of 49%, and the pricing delta is also strongly positive with plus EUR 588 million and the large majority of that number is contributed by PUR, again.

Now what I would like to specifically highlight is the other items bucket because it includes 3 main effects, which I would like you to look at. So first of all, it includes a negative effect of EUR 122 million, which is the impact from higher provisions for variable compensation. Secondly, it includes a negative EUR 35 million effect, onetime effects, which are related to the first-time consolidation of the acquired RFM business and thirdly, it contains a negative EUR 10 million onetime effect related to our LEAP transformation program.

So what I would like to stress is that we continue our high-cost discipline, and you can see that the negative other items are fully explained by onetime effects, and that means that we are maintaining our fixed cost discipline absolutely unchanged.

And so with that, I would like to hand it back to Markus for the individual business unit results.

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

Thank you, Thomas. Before we do so, let's just take a quick look once again at the group results. In the second quarter of 2021, Covestro posted the highest quarterly sales in its history. You can look from a sequential perspective that the increase in this revenue was mainly driven by higher prices of EUR 0.4 billion and the RFM contribution of EUR 0.3 billion. Operationally, we have seen increasing earnings momentum that already started in the second half of 2020 and continues beyond today, well into the third quarter.

Sequentially, the EBITDA margin for the group declined. Main reason is the effect from first-time consolidation of acquired RFM businesses. While RFM contributed to sales, the contribution to EBITDA was net positive, but minor. We achieved an EBITDA margin of 20.7% in Q2 2021 and remained with this on an attractive level and still well below historic peak of 28.1% in the first quarter of 2018.

Let's now turn on the next page and look at the first segment, polyurethanes. The core volume growth of 27.8% year-on-year was driven by dynamic rebound of demand from all key customer industries compared to a weak prior year. Based on preliminary industry data, MDI as well as TDI industry demand grew strongly. Double-digit rates in Q1 and Q2 versus prior year and single-digit rates above pre-pandemic levels of 2019.

Of all Covestro segments, however, PUR was most burdened by constrained product availability, mainly in the United States and Europe. Limited feedstock supply remained a key constraint for us to produce sufficient products to meet very strong underlying customer demand. In the U.S., we meanwhile lifted force majeure for polyols on June 1, for TDI on July 1 as well as for some MDI grades on July 14.

For MDI in Europe, we declared force majeure on July 2 due to an unforeseen production issue beyond our control in Brunsbuttel, Germany. This is expected to last several weeks and to burden group core volume growth by several percentage points in the third quarter.

Compared to prior year, EBITDA increased mainly due to a strong positive pricing delta in all 3 product routes. EBITDA margins of 24.6% are still well below historic peak of 32.7%, which happened in the first quarter of 2018.

Now on the next page, let's turn to polycarbonates. Here, the core volume growth came in at 15.4% year-on-year. Key driver was strong demand recovery from automotive and transportation industry, compared to very weak prior year.

Globally, double-digit volume growth rates in automotive and transportation and electro and electronics led to improving product mix and more sales in specialty high-margin grades. Higher prices and higher volumes equally drove sales growth year-on-year. Positive pricing delta and higher volumes also drove year-on-year EBITDA growth, compensating higher provisions for variable compensation and defending high margins. EBITDA margin of 25.6% in the second quarter 2021 are still well below historic peak of 30.3% in the third quarter of 2018. The industry trading conditions expected to remain very attractive in the third quarter.

Let's turn to Coatings, Adhesives and Specialties. Here on the next page, you see very high volume growth of 133.5% year-on-year, thereof 100 percentage points from first-time consolidation on RFM. Likewise, portfolio effect substantially drove up sales. Similar to PCS, underlying volume growth of CAS, driven by strong demand recovery from automotive and transportation industry comparing to a very weak prior year.

Growth potential was limited, however, as our access to certain feedstock remained constrained. Regionally, most dynamic growth in Europe, driven by automotive transport as well as furniture and wood applications. Compared to prior year, EBITDA more than doubled mainly due to higher volumes and a notable positive pricing delta compensating higher provisions for variable compensation. The EBITDA also includes negative onetime effects of minus EUR 35 million related to RFM. Excluding effects from first-time consolidation of RFM, EBITDA at EUR 169 million and margins at 18.3%.

The integration of the acquired RFM business is running smoothly since the closing date on April 1. The realization of synergies is developing ahead of plan. And now back to Thomas.

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

Yes, let's have a look at the cash flow, which you can see on Page 10 of the presentation. We generated EUR 374 million free operating cash flow in Q2. And as you can see in the graph, EUR 692 million in the first half of the year, and obviously, both values are well above the prior year. So the cash generation in the first half is driven by significantly higher earnings, which then more than compensated negative cash effects from higher working capital, which you find in the table below the graph. So talking about the working capital, our working capital-to-sales ratio stood at 20.9%, that is virtually unchanged versus the end of Q1 2021. And there's 2 important factors which led to this relatively high numbers.

So first, higher feedstock and product prices, which, obviously, push up the euro values. And secondly, it's simply a mathematical effect if you compare a quarter end working capital, which is based on high prices with a 12-month sales run rate, which includes a relatively weaker second half of 2020. If you look further down in the table, you find our CapEx of EUR 289 million for the first half of the year, which is on budget and also in line with our full year 2021 guidance. And you can see that we paid income taxes of EUR 176 million.

Now obviously, there is some time lag because the tax authorities usually use the prior quarter's earnings to determine the income taxes to be paid. And so for 2021 for the full year, we expect our cash tax rate to be somewhat below the P&L tax rate, which, again, we guided to be between 24% and 26%.

Last item in the table, the other effect that reflects higher provisions for variable compensation. So on this one, remember, we are building provisions every quarter in our P&L, and therefore, you see them in the EBITDA, but the cash-out will only occur in the second quarter of 2022 for the full year 2021. Now the impact of that mechanism on EBITDA this year will be around EUR 0.5 billion negative. And that, of course, also includes the RFM business.

So with that, let's turn to the next page, that's Page 11, and you have the balance sheet details. I think my comment would be very simple. Our balance sheet remains strong also after the closing of the RFM acquisition. We transferred the purchasing price of EUR 1.5 billion as planned to DSM on closing day, which was April 1. Nevertheless, despite the payment, our balance sheet ratios remain strong. You can see that the ratio of total net debt to EBITDA, and that is including our pension liabilities stands at 1.2x at the end of this quarter compared to 2.9x a year ago. And you also note from the graph that our pension provisions decreased versus the year end of 2020 by EUR 431 million, and that is mainly due to higher discount rates in Germany.

So with that, let's go to Page 12, where you have the EBITDA history, so to speak. We raised our EBITDA guidance to a corridor of EUR 2.7 billion to EUR 3.1 billion on July 12, and obviously, we fully confirm that number today. Now the key reason for the upgrade is the better-than-previously-expected margin outlook for the second half of the year. And with that, our EBITDA guidance now is well above the mid-cycle earnings level, which we have indicated here with the dotted line.

What we've also indicated with one little dot is the mark-to-market estimate, which remains at about EUR 3.1 billion, if you base it on June market data. And obviously, also now the upper end of the corridor is now on par with that mark-to-market estimate. So that also means that our midpoint, which is then EUR 2.9 billion, assumes that margin will come down to some extent during the second half of the year. And what I would also like to mention here is that our guidance includes a net earnings contribution from RFM that is expected to be slightly positive this year, including the integration costs and also the inventory step-ups. And our current planning also assumes some shifts of integration costs from 2021 into 2022.

But what I would like to say at this point is that this does not mean that we are delaying the synergy realization. As Markus already said, we are on plan, if not slightly ahead of plan, with the synergy realization, but the occurrence of the cost in our P&L will simply happen a little later.

And last comment on that page would be that the full year outlook, so the corridor of 2.7 to 3.1 now also includes the expected negative onetime effects in connection with the LEAP transformation program. So the first half of the year includes EUR 26 million negative in the EBITDA. And for the second half of this year, we also assume another double-digit euro million amount. And as I said, this total negative LEAP effect is now included in our increased earnings guidance.

So with that, let's go to Page 13, talking about guidance. As I said, we confirm our raised earnings outlook for 2021 as published on July 12. If you look at the table, let's start with core volume growth. Core volume growth is guided to be between 10% and 15%, including 6 percentage points from RFM. However, given the constraints that we have in some of our production sites, it is quite likely that we will end up in the lower half of the core volume growth guidance range. And on that topic, I can say that the force majeure for MDI and Brunsbuttel will cost us again several percentage points of growth in Q3. And therefore, we expect that the volumes, excluding RFM, will decline year-on-year in Q3. However, please note that Q3 2020 represents a relatively strong basis because we achieved in this quarter a positive growth rate compared to 2019. And also, on that topic, unfortunately, also the upcoming hurricane season in the U.S. represents another risk for that guidance.

So let's look at the guidance for our EBITDA in Q3. We have indicated a guidance range of EUR 760 million to EUR 860 million EBITDA for Q3, and the midpoint of that range of EUR 810 million for Q3 assumes a slightly deteriorating pricing delta compared to Q2, which should then be compensated by lower RFM-related one-offs and also a planned quarter-on-quarter volume growth.

Last comment on this page is that the implicit sequential EBITDA decline for Q4 is driven by the usual seasonality and also a further deteriorating margin environment. However, I would like to emphasize that the visibility on the margins is still very limited, and our markets are benefiting from a very strong demand rebound and the effective industry utilization remains high, and therefore, the margins could also hold up for much longer than initially assumed.

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

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

Thanks a lot, Thomas. And let me just put together a few highlights before we then enter into the Q&A session. We have seen strong earnings momentum that started already in the second half of last year, so 2020, and that continues to date and well into the third quarter. Let me highlight a few more details.

The volume growth reflects, on the one hand, a strong rebound and also, on the other hand, first-time consolidation of the acquired RFM business, however, was limited by constraint in product availability. At the same time, you can say that we saw a soaring EBITDA, mainly driven by positive pricing delta and for sure, the just mentioned volume growth, with the continued momentum into the third quarter of 2021. At the same time, that came with a strong cash generation based on the high earnings as well as positive cash phasing effects that Thomas just alluded to a while ago.

The raised 2021 earnings outlook can therefore be confirmed and is now well above mid-cycle levels. And last but not least, the transformation program LEAP, is very well on track with the new organizational setup already being implemented on July 1 as of this year.

With that, thank you very much for your patience. We are now happy to take your questions.

QUESTIONS AND ANSWERS

Operator

(Operator Instructions) And the first question comes from Christian Faitz from Kepler Ceuvreux.

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

Yes. Markus, Thomas, Ronald, congrats on the results. Two questions from my side as a start. First of all, can you please share with us some more details on the Brunsbuttel force majeure? When could you envisage a restart there?

And then second question, assuming that your cash flow generation continues as envisaged for the year and even beyond, can you remind us on your priorities, on your uses of cash? In that context, what is your current thinking around the MDI plant in the U.S.?

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

This is Thomas. Let me start with the second question. So in terms of use of cash, our priorities have not changed. Remember, there's a chart where we indicate the 4 key pillars in terms of priorities from the left to the right. And number one is our CapEx spending, and I'll share some more thoughts on that in just a minute. Number two is an attractive dividend to our shareholders. And you know that we have just quite recently changed our dividend policy to a payout ratio of anything between 35% and 55%, which, obviously, in a good year, could yield to a significantly higher dividend than also in the past. And we do think that it makes a lot of sense that in good years, our investors should participate in our strong cash generation leading to a very attractive cash yield on the shares.

Number three, we do think that portfolio measures could be an option. I think the RFM transaction so far proves to run quite successfully and also smoothly, and we're fully on track to generate the synergies. So if we should find further opportunities to also grow inorganically, that would be definitely an option. But I should also say there's currently nothing concretely in the pipeline or on the plate or on our desk to be decided. But of course, it is something which is part of our strategy.

And last but not least, of course, if there's excess cash, we might also think about things like a share buyback. But currently, quite frankly, this is nothing which we would contemplate because in the future, we would only do this in a very opportunistic and anti-cyclical way. And therefore, currently, I would say, this is not in the cards.

Now on your question on MDI, also nothing new to report. We will take a decision on that. As we always said, in the second half of the year, we're currently in the second half. So you should expect the decision to be taken rather towards the end of this year. And we will then decide if and when to continue the MDI-500 investment. So I think that would be my comments on the use of cash, Christian.

And then maybe over to Markus for the Brunsbuttel question.

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

Yes, Christian, this is Markus. So on Brunsbuttel, the restart actually has just happened. However, we have to realize that volumes will stay constrained simply due to the low inventory levels and also additionally planned and required maintenance shutdowns in August. Therefore, the loss of volumes will continue for some time compared to normal operations and will burden our Q3 in terms of volume growth compared to previous year's level, again, a very strong comparison basis by several percentage points on a group level. However, all in all, let's say, all these developments have been somewhat baked in into the full year guidance.

Operator

The next question comes from Georgina Iwamoto from Goldman Sachs.

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

I have got so many questions. I'm trying to figure out which 2 to ask you. Okay. So the first one is there have been a lot of force majeures this year. I was just wondering how much volume do you think you've missed out on? Or put another way, how much should volumes go next year if you think you've got better capacity availability? And on the back of that, have you been able to carry out as much maintenance as you plan this year? Or is that something that we should be thinking about for 2022 as well?

And then my second question is on pricing in CAS, a huge ramp up, 13% in the second quarter. Is that a positive surprise to you? Are you aggressively pursuing pricing actions? And is it sustainable?

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

Georgina, this is Thomas. So maybe on your first question in terms of what is the impact of the force majeures. Yes, admittedly, we had to cope with some more technical challenges than we had anticipated, some of which were really externally driven like the winter storm, Yuri, also like technical issues at our suppliers, et cetera, et cetera.

So yes, I think, it's fair to say that in terms of the core volume growth, we had originally planned with a higher number. And if I should quantify that, I think, this leads you back to the core volume growth range, which I had just given you. So the 10% to 15% is still valid, deduct the 6 percentage points from RFM, which we think will fully come through. And then the rest is organic and our indication would be that we would rather end up in the lower half, if not at the lower end of that range. And that just gives you the indication that we lost several percentage points due to those unplanned outages. As I said, some of which happened at our site, some of which happened at other sites.

What I can reconfirm is there's no shift. But I should also say, and you're right, this is, of course, a potential for next year in terms of growth because it should not happen to the same extent. And secondly, we have not shifted any maintenance plans and 2021 was a normal year in terms of maintenance shutdowns. So this is year-over-year, not a special effect that I would expect.

And with that, maybe over to Markus for the CAS question.

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

Thanks a lot, Georgina, for the question. Also, a very warm welcome from my side. If you look at CAS, this is the result of hard work and that hard work has already started end of last year with the clear targeting and also aiming for higher prices and starting very tough negotiations also here with our customers. They have then over time led to new contracts and have then also led to the results that you see with prices being, I would say, significantly up and customers now paying higher prices for our products. And that's why I would say, will that last. I'm quite confident that it will last until the next negotiations. But then we have to, for sure, also look how the overall market condition is developing in that context.

For now, those prices have been fixed. Those prices have been agreed by the respective contractual situation and obligation. And we were in that context, not only able to say pass on in some of the more commoditized product groups increasing raw material prices, but also overcompensate those respective prices. So that's why I'm also, overall, quite confident that we will see those prices to last a little bit longer.

Operator

And now we're coming to the next questioner. It is Daniel Chung from Redburn.

Daniel Chung ***Redburn (Europe) Limited, Research Division - Research Analyst***

Markus, Thomas, Ronald. Just a couple from my end. So the first is, it'd be great to get your views on what you're seeing and your customers in terms of their inventory levels. And maybe you can touch on your assumptions on whether we're expecting potentially a big phase of customer restocking to the end of the year or maybe this might roll into the next.

And then secondly, could you comment or even quantify the type of lead times your customers are experiencing and how that's developed? Maybe you can translate that to your order books going into this coming quarter.

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

Well, Daniel, thanks for the question. I would like to take the first one and maybe then Thomas takes the second one. So overall, we see since mid of last year, actually, this growing momentum of customer demand and was also with that, all the developments that we have just outlined to you a couple of minutes ago. That means, yes, we see that there is customers who try to maybe order more, some customers even panicking and try to stock material. However, they simply do not get their hands on the material.

So given that some customers try to do that, given that they have not made so many positive experiences or were not simply to get their hands around material, we think that current demand patterns are really reflecting the true demand that is out there. Or to put it better, we are still not able to supply all the demand that is out there. And that is also continuing well into the third quarter as we have outlined because that is the main driver for the current momentum. There's very strong demand across all of our industries and also across regions.

So having said that, we do not see that restocking or stock building plays a major role in the current overall trading environment. Whether this will change actually towards year-end, a big question mark because, at least from our perspective, and from today's perspective, as far as we can see through our order books, the demand is still strong, the supply is still subdued. And from that perspective, it is very difficult to judge what will happen towards year-end.

The only region where we see a little bit more normalization in terms of supply and demand is in China. And therefore, we expect that in China this tight situation at one point in time will normalize. So 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***

Yes. Maybe, Daniel, to your second question, if I got it correctly, it was about the lead times of our customers. So the lead times that we're seeing on average across all the products is about 6 to 8 weeks. And that is also the visibility that we have in terms of our sales and EBITDA development. Now that number is pretty much unchanged or has been unchanged over the last quarters. And therefore, nothing really big has changed also in terms of our visibility. The only thing that is maybe worth highlighting is the automotive industry, where I think we can clearly see and say that we are sold out until the end, both for Europe and also for the U.S.

Operator

(Operator Instructions) And with this, we come to the next questioner. It is Charlie Webb from Morgan Stanley.

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

Two for me. So first, just on polycarbonates. Obviously, we were talking about the risk normalization as some backward integrated new plants come on the stream. So just any update in terms of what you see in polycarbonate as you had another fairly robust quarter in Q2. Just help us understand how we should be thinking about the second half and into next year for the margins as that new capacity comes into the market?

And then just secondly, just one on demand in terms of what you're seeing on the ground in China. Obviously, you say the supply and demand across commodities is maybe a bit more balanced than you see elsewhere in the world. But just how is demand in China right now? Are things softening off the highs or are you still seeing very strong activity?

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

Charlie, this is Markus speaking. Very good to hear you. So on the first question on polycarbonates. Three new plants have been announced. However, according to market sources and publicly available information, only one so far did start up, but is experiencing significant quality problems. And the 2 others are still announced and expected but could also be delayed.

It is always -- and we try to reiterate that call by call. One thing is announcing, the other thing is getting it built, and the third thing is operating it successfully, and the fourth thing is then operating it, let's say, under economically viable conditions, which currently is a challenge, simply given the fact that one of the key raw materials, Bisphenol A, is still in short supply, and we produce Bisphenol A on our own and use it almost entirely captively. Whereas most of the -- or at least a large extent of the newly built polycarbonate capacity was not backwards integrated into Bisphenol A, which led to the fact that we had capacity for polycarbonates.

However, there was limited Bisphenol A supply. And that situation seems to continue for a while, even though Bisphenol A plants are not that technically demanding compared to a polycarbonate MDI or TDI plant. It still takes time to build the respective capacity. So long story short, next to the announcement, we have not yet seen all the capacity on paper really showing up in reality. And the one that has shown up is still dealing with technical challenges, means quality problems towards the customer.

On the second bit, on the China demand and supply, it is the region with most excess capacities, that's clear, but also strong long-term demand growth. That means from time to time, short term, we can have respective overcapacities. And today, given all the challenges that I just described and the demand as well as available supply, I would assume that currently, the market in China is roughly balanced. However, we have still tight markets, for example, in polycarbonates and oversupply markets are observable more in the TDI product groups. So that's how I would currently look at the trading situation there.

Operator

The next question comes from Thomas Swoboda from Societe Generale.

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

I will risk 3 questions, please. Firstly, a follow-up on CAS. Could you just update us, if you can, on the average length of the new contracts? That would be very helpful.

Secondly, on LEAP, you target EUR 200 million cost savings over the next 2 years. I can imagine it is getting tougher, get those cost savings in the current environment. So just a question there. Are you still sticking to the EUR 200 million? And if you could give us a hint on phasing, if possible?

And thirdly, can I pick your brain on MDI? I think on one of the previous calls, you said if Baytown should come from Covestro, it would be based on renewable raw materials. I know you don't want to talk about the possible investment yet. It's still the question. Is it feasible over the next 5 years, let's say, to have enough renewable raw materials available in this region to run world-scale plants?

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

Thomas, this is Thomas. Let me maybe start with your second question on LEAP. So first of all, the most important thing about LEAP, of course, is the new organizational structure that we have given ourselves, and that is now fully in effect since July 1, and we will then also report in that new structure for the first time with our Q3 results. And the entire purpose of this is really to structure the company such that more commoditized materials that have totally different market and customer dynamics are grouped together while the solutions and specialties that have different success factors and different ways to operate, especially in the supply chain are also grouped together so that those businesses are steered in the most entrepreneurial way and that we gain customer accessibility and proximity through that structure.

But also we said, because we do this, because we're giving ourselves an optimal set up, that should also help us to keep our fixed costs flat relative to the 2020 level all the way until 2023. And just a couple of comments on that, keep fixed costs flat. So first of all, remember, 2020 was a very low level because with our cost saving and contingency program, we saved EUR 360 million. EUR 220 million of that was hard savings against 2019 and the rest was cost avoidance, but the absolute fixed cost in 2020 was significantly lower than in 2019. So that is the starting point.

And what we've guided is that there might be some cost increase this year between EUR 100 million and EUR 200 million simply because of some of the measures, which were short term in nature, would have to be relaxed, and we will then compensate that with, again, savings in the years 2022 and '23, that will again then bring us to the 2020 fixed cost level.

I would say so far, we're tracking pretty successfully in terms of cost development you've seen in the EBITDA bridge that the only other items were one-off costs. And therefore, we might be doing even slightly better than the EUR 100 million to EUR 200 million increase this year. So let's see at the end of this year where we end up. But that is with respect to LEAP, I think, we're well on track. And yes, the target remains unchanged to keep fixed costs flat all the way until 2023.

So with that, maybe over to Markus.

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

Thanks, Thomas, and welcome also from my side. Thanks for your questions. So back to the Coatings and Adhesives, Specialties business. If you look at the contract, you can say that normally, they last for 3 months, most of them for 6 months, but we also have some that go, for example, over a period of 3 years, just to highlight one here in the specialty films unit. And having said that, it is very difficult to say what the real average is in terms of revenue versus individual contract versus volume. But just to give you a flavor, that business is normally the business with the longest contracts in our entire portfolio amongst those 3 segments.

Now switching gears towards your statement around this assumed MDI-500 investment. I don't know where actually you have caught that statement. But it's very important to look at the MDI investment from a very general perspective, what opportunities do we have in very general terms, and that is not only related to the MDI investment.

We have already the opportunity to partially get access to renewable raw materials in the market. It could be used as a complete drop in for -- and when I mean complete, I mean, in terms of specification, a complete drop in for petrochemical-based raw materials. However, the availability of those raw materials is still rather limited. So we're talking about a very, very low, let's say, below 1% range that we would be able to currently actually get access to in the raw materials market.

However, that availability is increasing, at least we're expecting this availability to increase over the next years. And that would be then regardless if we would build a new plant on MDI or we would just use it as a drop-in solution of sustainable raw materials for our existing plants to be clear on that one.

And the second bit is -- the second -- let's say, the different side of the same coin on renewable raw materials is renewable energy. And we need also renewable energy supply to make our overall operations more sustainable. And here, we're looking currently into each and every opportunity in different regions with the different characteristics of the respective energy supply markets. And I have to tell you it is not easy.

It's not necessarily only a matter of supply, but also in terms of risk exposure and so on and so forth. So long story short on renewable raw materials, no, it is not that in case we would invest. And once again, Thomas alluded to that, in MDI, this is not 100% based on renewable materials. And we have still the opportunity to go for new renewable materials in existing plants. However, the availability is still a limiting factor. And the second bit is, we're also looking into renewable energy for our entire operations. But that is also a plan that we're very diligently currently working on, but so far, no large update on that one.

Operator

(Operator Instructions) There are no further questions. And with this, I hand back to Ronald Koehler. Please continue with any other points you wish to raise.

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

Thank you for joining the conference call, and thank you for all the questions. You will have a further opportunity to ask us more questions on our virtual investor conference, which we will undertake at 28th of September, and I'm happy to see you there virtually, obviously, and to continue our discussion. Thank you for today and goodbye.

Operator

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