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PRESENTATION

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

Welcome to the Covestro Earnings call on the third quarter results. The company is represented by Markus Steilemann, CEO; and Christian Baier, CFO; (Operator Instructions). I assume you have read the safe harbour statement. With that, I would now like to turn the conference over to Markus.

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

Thank you, Ronald, and hello, and a very warm welcome to our third quarter call. After saying goodbye to Thomas Toepfer in the last earnings call, I have a great pleasure to welcome the new CFO of Covestro, Christian Baier in this round. Christian is an esteemed top manager with a long-standing experience in the capital markets. He had been a member of the Management Board of METRO AG as Chief Financial Officer since 2016.

This had been preceded by various executive positions at the international wholesaler from 2011 before being promoted to the position of CFO. Prior to his career at METRO, Christian had been with Permira, a global investment firm and with Lehman Brothers. The other members of the Board of Management of Covestro and I are delighted that Christian will be actively involved in shaping Covestro's transformation to the circular economy and in the implementation and execution of our sustainable future strategy.

Christian, a very warm welcome to you in this round. We are happy to have you on board. After this encouraging news, let us now come to the highlights of the last quarter. On the next page, you see the overall economic situation has not improved during the last quarter. Low demand and industry-wide price pressure as a result of oversupply across many core products are still ongoing. With that, in the normal pass-through mechanism of lower raw material costs, our sales were significantly down year-on-year to EUR 3.6 billion.

In line with our guidance, we achieved a third quarter EBITDA of EUR 277 million. Free operating cash flow strongly improved in the third quarter 2023 and came out at EUR 308 million. This was supported by our ongoing stringent working capital management. As usually, with our Q3 results, we are narrowing our guidance range for the full year 2023. Before ending on the highlights, let me briefly address the ADNOC situation. On September 8, we announced to enter into open-ended discussions with Abu Dhabi National Oil Company. We are pursuing these discussions in good faith open-minded and in the interest of our shareholders and all other stakeholders. We remain fully compliant in our communication approach and will only comment on the progress of the negotiations, if required by the European market abuse regulation.

As that is currently not the case we will refrain from any additional comments regarding the ADNOC topic. Let's move to the next page. Despite the still economically challenging times, we keep investing into the growth of our business. In the second quarter 2022, we presented to you our investment plans for our solutions and specialties entities, elastomers and coatings and adhesives. A little more than 1 year later and exactly on time and on budget, I have the great pleasure to announce the completion and soon start of operation of both expansions. The first ramp-up was done early Q3 with the new elastomer production line in our integrated site in Shanghai. This plant and its products will especially serve renewable energy markets like wind energy and solar panels and also heavy-duty applications.

In line with our strategy, the business unit Elastomers will continue to regionally enlarge its production footprint.

In our business entity Coatings and Adhesives, the investments in 2 plants for polyester resins and polyurethane dispersions reached the milestone of full mechanical completion. Now further work is ongoing to get the plan to the ramp-up phase in the first quarter 2024. This is the first plant that has been constructed in a modular way in line with our build faster and cheaper program, underlining our cost-leading asset structure. The products coming from these units are supporting the profitable growth of our CA business in a variety of products, catering for the automotive, construction, sports and leisure as well as furniture industry.

These are 2 examples how we are profitably growing our Solutions and Specialty business with regional small investments. We remain committed to our approach to produce products in the region for the region.

Let's now turn to the next page. Coming now to the volume development in the third quarter of 2023. Year-on-year, the global sales volume decreased by 3.8%. This was caused by ongoing demand weakness across all regions and limitations in our internal availability. However, the rate of decline is now smaller compared to the previous quarters. As a reminder, first quarter was down by 17% and second quarter by 8% year-on-year. We still expect a positive low single-digit year-on-year growth in the fourth quarter.

Historically, a volume turnaround has always been followed by an improvement in margins, at least with a certain time lag. Auto remains on a growth path, still benefiting from a healthy order book. After 5 quarters of declining volumes in furniture, the sector turned around in the third quarter with mid-single-digit growth. Also, electronics developed flattish after 4 quarters of decline. The weakest sector remains construction. Looking into the different regions, EMLA showed a return to growth path with increases in 3 of 4 industries important to Covestro after we partially solved the limitation on our internal chlorine supply.

As a result of the low comparison base furniture stands out with significant increase, whereas construction and auto showed a slight increase. Electro was still slightly declining. Sales volumes in North America also increased slightly across the 2 industries, electro and auto. Furniture showed a flattish development, but construction witnessed an ongoing significant decline. After the positive volume development in Asia Pacific in the second quarter, based on a low comparison basis from the COVID lockdowns last year, growth rates have normalized. Furniture and auto now exhibited slight growth and Electro showed a flattish development. Construction was still affected by a significant decline.

With this summary of the demand development, I'm now handing over to Christian, who will guide you through the financials.

Christian Baier ***Covestro AG - CFO & Member of Management Board***

Yes, a warm welcome to all of you on the call also from my side. It is a pleasure to engage with you for the first time in my function as CFO of Covestro, and I'm looking forward to frequent exchanges with the investor community. But before coming to the topics of today's call, let me also thank you, Markus and the entire Board of Management for the warm welcome and the great support during my first weeks with Covestro. I'm really delighted to be part of the Covestro team.

Now let's talk business. We are on Page 6 of the presentation. Sales in Q3, 2023 are down by 22.7% year-on-year to EUR 3.6 billion and as such, are the lowest sales within 2023 so far. What contributed to the fairly low number are 3 factors, each of them with negative impact. The by far biggest impact of EUR 660 million was coming from 14.3% lower prices.

Here, the business entity Performance Materials was strongly suffering with a year-on-year decline of almost 20%, whereas Solutions & Specialties was only affected by around 9% from lower prices. A negative FX effect of minus 4.6% or EUR 213 million was mostly driven by weaker Chinese renminbi, U.S. dollar, Indian rupee and Japanese yen. The continuing negative volume development of 3.8% contributed also to the declining sales. Performance Materials volumes declined by 2.4% and Solutions & Specialties by 3.7%.

Let us now look at the EBITDA bridge on the following page. The sequential negative volume effect was still impacting EBITDA, but the pricing delta has turned positive to EUR 69 million. The savings in raw materials and energy costs exceeded the price reductions. Please keep in mind, the raw material price effect is based on the extremely high prices for petrochemicals and energy in Q3 2022. Negative EBITDA effects were coming from FX and other items. Other items were mainly driven by higher provisions for short- and long-term variable compensation. We had reduced the provisions for short-term incentives during Q3, 2022 whereas we continue to build provisions for FY 2023. The provisions for our long-term incentive, LTI, have also increased due to the strong relative share price performance. Other items are impacted by lower operational costs and reductions in stock levels.

Summing it all up, the EBITDA was coming out at EUR 277 million slightly below midpoint of the guidance range of EUR 240 million to EUR 340 million.

On Slide 8, we are breaking down the details for the different segments and are starting with Performance Materials. Year-over-year, the price decline with almost 20% is the main contributor to the sales decline of 26.7%. FX and volume only contributed to minor parts to the drop in sales. Quarter-over-quarter, sales declined significantly in EMLA slightly in North America, -- while it increased in APAC.

However, the overall development is still negative. Q3 '23, EBITDA of EUR 85 million is 60% above previous year, and the year-over-year increase is mainly driven by a positive pricing delta and burdened by FX and negative volumes. Sequentially, the EBITDA in Q3 '23 has been declining mainly due to a negative pricing delta, the one-off insurance effect in Q2 2023 for the chlorine incidents and lower inventories. Volume increases could partially compensate the decline.

After Performance Materials, we are now looking at the segment, Solutions & Specialties. Also in S&S, the year-over-year price decline and demand weakness were a major factor for the sales decline of 17.6%. Similar to Performance Materials, FX also had a negative impact. Sequentially, sales growth was recorded in APAC on the back of higher demand for our Engineering Plastics resins in auto and electro.

Declining sales were observed in EMLA and North America, resulting in an overall negative trend. The EBITDA in Q3 2023 was lower year-over-year due to lower volumes and FX. However, quarter-over-quarter, the positive trend of an increasing EBITDA is continuing. The sequential increase is founded on a positive pricing delta and lower fixed costs. Declining volumes and higher idle costs - due to our strategy to reduce inventories -- had a negative impact. Finally, the EBITDA margin improved to 13.6% continuing the upward trend since Q4 2022.

The next topic is the free operating cash flow development after 9 months of 2023. As you can see from the graph, the free operating cash flow after 9 months was at positive EUR 159 million, of which EUR 308 million came from the third quarter. The free operating cash flow strongly improved year-over-year due to continuous working capital management, lower income tax payments and 0 bonus payout for fiscal year 2022.

Changes in working capital of minus EUR 85 million after 9 months of 2023 were driven by lower accounts payable due to reduced raw material pricing, higher receivables and inventory decreases. The 9M '23 CapEx of EUR 461 million is in line with budget and our full year guidance of EUR 800 million. Income taxes were around EUR 200 million less than in the same period of last year and amounted to EUR 247 million, mainly due to lower earnings.

All in all, the 9 months free operating cash flow has been seeing a strong development, and we are well on track to achieve our full year positive free operating cash flow guidance. Let's now turn to the P&L items below EBITDA. I would like to highlight the impairments after 9M in 2023 at minus EUR 38 million. This is mostly coming from our decision in Q1 to discontinue the loss-making Maezio product line and the closure of the related site. There were no relevant impairments in Q2 and Q3.

Last year, we already adjusted our deferred tax assets in Germany. As a consequence, based on IFRS rules, we must no longer recognize our DTA on tax loss carried forward in Germany. As our accounting projections expect further losses in Germany in fiscal '23, the tax rate will continue to be affected by the regional profit mix. Currently, we assume a P&L income tax of between EUR 150 million and EUR 250 million for fiscal '23. Also important to note is that in contrast to the IFRS rules based on German tax rules, the tax loss carry-forwards can be used indefinitely. So we can use the loss carry-forwards to lower our tax rate in the future. Income taxes after 9M in '23 are significantly lower compared to 9M of '22 due to the reduced earnings situation this year.

Overall, our net income is negative at minus EUR 11 million. We are now coming to our balance sheet, which continues to be very solid. Versus end of '22, our net financial debt increased slightly by EUR 66 million. The positive free operating cash flow of EUR 159 million limited the increase to now EUR 2.5 billion. The decrease in the net pension liability of EUR 189 million was driven by an increase in the pension discount rates in the U.S. and Germany, resulting in a EUR 241 million net pension liability.

This comprises a pension provision of EUR 340 million and benefit assets of EUR 99 million. Yesterday, we decided to cancel the remaining part of the share buyback program due to the current situation and the limited time remaining until the end of the program on February 28, 2024. As such, we have executed close to EUR 200 million of the intended EUR 500 million program but we will seek for a renewal of the authorization during the AGM in 2024 to be able to continue share buybacks in the future. Summarizing our net debt position and situation, the total net debt-to-EBITDA ratio is at 3.0x based on a 4-quarter rolling EBITDA of EUR 0.9 billion.

However, based on our mid-cycle EBITDA, the ratio would only be around 1x. Covestro remains committed to a solid investment-grade rating, which was also confirmed by Moody's as Baa2 with stable outlook end of Q2 2023. That finalized the financial review of Q3 2023.

And now over to you, Markus, for the industry outlook.

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

Yes. Thanks, Christian. And we are now coming on the next page to the outlook for Covestro's core industries, and we're now on Page #13 of the presentation. The global GDP expectation has been almost flat since our last review and is estimated to be 2.5%. Sadly, this flattish development does not hold true for most of the industries important to Covestro. Only automotive is experiencing a positive volume growth, and this trend is continuing with an improved outlook of 7.9% now. The subcategory of EV or battery electric vehicles is against this trend experiencing a slight downgrade of 7.2 percentage points in growth, expecting now 35.3%.

This is still above any other growth rate we currently see in our core industries. The outlook for the construction industry has deteriorated further to minus 2.2% and residential construction has lost more than 4 percentage points in growth down to minus 4.3%. The reasons for this trend are well known. High interest rates and high cost of building materials. Also, the furniture industry is seeing a recently accelerated negative trend with an expected second year of declining markets between 4% and 5%.

Only the demand outlook for Electro is seeing a flattish development as 0.4% can hardly be counted as growth. Here, the appliance sector is against the trend seeing an upgrade in its growth projections and is expected to show an increase of almost 8%. Summarizing the data, we can see that the development of most of our industries has significant room for improvement. This underlines our own evaluation of the current market conditions that a turn to a positive development is currently still not foreseeable near term. With this, let us now turn to the Covestro outlook for the full year 2023.

As explained in the outlook for our core industries, there is no substantial indication of a short-term improvement of the economic environment. We expect the ongoing demand weakness to continue at least for the remainder of the year. Taking this into consideration, we now expect our EBITDA to come out around EUR 1.1 billion for the full year 2023 and as such, around the lower end of our guidance range of EUR 1.1 billion to EUR 1.6 billion.

Looking at 2024, a theoretical EBITDA mark-to-market estimation based on September 2023 margins flat forward in our current preliminary budget assumptions for 2024 would be around EUR 1.4 billion. However, we remain convinced of our mid-cycle EBITDA concept with a mid-cycle level of EUR 2.8 billion in 2024. We are confident that we can achieve such an EBITDA level under normal economic conditions. One major bridging element would be a high utilization rate of our plants.

Within existing capacities and no further investments, we could grow our volumes by more than 20%, and we already started in this direction. Even on today's squeeze product margins, this would translate into additional EBITDA contribution of more than EUR 1 billion.

With this, hand over again to Christian for a review on the guidance for the full set of KPIs.

Christian Baier ***Covestro AG - CFO & Member of Management Board***

Let us now look at the full set of KPIs. With the ongoing deterioration of the overall price and demand situation, we are now narrowing our guidance for fiscal 2023 around the lower end of the range for all our financial KPIs. As mentioned, we are now expecting the EBITDA to be around EUR 1.1 billion. In line with the EBITDA, the free operating cash flow is expected to come out between EUR 0 million and EUR 200 million. The ROCE above WACC outlook is around minus 7 percentage points -- minus 6 percentage points. For our greenhouse gas emissions, we confirm the guidance range of EUR 4.2 million to 4.8 million tons given in April.

With respect to additional financial expectations, we anticipate our sales to come out between EUR 14 billion and EUR 14.5 billion. D&A remains as guided around EUR 900 million, and as such, slightly above our CapEx budget of around EUR 800 million. We are continuing our strict CapEx regime and are well on track as indicated previously. The expected financial result has slightly improved to minus EUR 120 million to minus EUR 150 million.

P&L tax is estimated to be stable at EUR 150 million to EUR 250 million. However, we are raising the cash tax expectations of EUR 300 million to EUR 400 million for fiscal 2023 due to a tax settlement payment for a German tax audit for the fiscal years 2016 to 2018. This included a EUR 55 million payment in Q3, 2023 and a further EUR 35 million in Q4, 2023.

With a completed summary of the KPIs, I hand back over to Markus.

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

Yes. Thanks again, Christian. So please allow me on Page #16 now to quickly summarize. Our sales decreased to EUR 3.6 billion, and that was caused by lower prices, unfavorable currency and lower volumes. Our EBITDA came in at EUR 277 million, in line with the guidance with positive pricing delta but burdened by currency and lower volumes. Our free operating cash flow has strongly improved to EUR 308 million, supported by the ongoing strict working capital measures. Our full year 2023 guidance narrowed with an expected EBITDA of now around EUR 1.1 billion. And last but not least, Covestro continues to invest in profitable growth despite the challenging environment.

And now Christian and myself are happy to answer your questions that remained open. And with that, I hand it over to Carsten, who will guide us through the Q&A session. Carsten.

QUESTIONS AND ANSWERS

Operator

Thank you, Markus. (Operator Instructions) And the first question comes from Christian Faitz from Kepler Cheuvreux.

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

Yes. Good afternoon, everyone. I hope you can hear me. Also good afternoon, Markus, Christian and Ronald and team. And Christian, welcome to Covestro. Three questions, if I may. First of all, on page 51 of your extended Q3 presentation, you promote the use of polycarbonates in battery electric vehicles. I understand the polycarbonate needs and composite needs are around the battery. Yet I believe one's hopes were rather high for other uses, including glass replacement, for example, in sunroof systems. Where are we on this?

Second question would be on Electro electronics end-markets. Logitech recently made a bit more favorable comments on demand. But do you also see this in your electronic end-markets. And then third question, I believe you have a bit more than EUR 1.1 billion of debt maturing over the next 2 years. Can you walk us through your thought process of how this will be refinanced?

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

Yes, Christian, this is Markus speaking. First and foremost, we could hear you loud and clear. I hope the same holds true for you as well. Good to hear you again. And please allow me to elaborate on the first 2 questions that you have. You are absolutely right with the assessment that polycarbonate in battery propulsed electric vehicles is the material of choice. And that will also, from our perspective, remain so in the future, given the unbeaten combination of product properties that polycarbonate simply has to offer. As I always say, the decathlete of the polymer sector. And the high hopes that we had for users in sunroofs, wind screens, et cetera, have not materialized.

There were still a few niche applications and still a few car models who use sunroofs/who use this for other smaller applications. But that markets remain in total by volume rather small. And for windscreens, the unresolved problem still is the scratch resistivity, but particularly if you have wipers, so to say, operating.

And from that perspective, currently, there is no technical solution that would allow to replace glass-made windshields by polycarbonate-based windshield. That is different, as you know, for headlamps because here you don't have, let's say, the wipers. And that's why scratch resistivity is not such an issue. But once again, maybe there's an ingenious let's say, talent still to come, who once will solve that. For now, sunroofs, windscreens, et cetera, automotive glazing has not materialized to the extent that we once were hoping for.

What do we see on the polycarbonate demand for Electro & Electronics? I think we stated it that we have seen a slight increase on Electro & Electronics in the third quarter in terms of demand, and that trend seems to continue in the fourth quarter as well. So from that perspective, it is not directly related to what Logitech maybe has announced. But at least we see a general trend. But can I now tell you exactly is that in the product range that Logitech is offering only or is it on a broader range, I would rather say it is on a broader range that we see an increase in that segment.

And one of examples we brought, which is not directly related to electronics, was in the electro sector, so home appliances. And here, you have clearly seen that the refrigerator segment is obviously seeing a very nice growth rate. So long story short, I cannot directly link it back to Logitech. But I can confirm in Electro electronics sector, we've seen since a couple of quarters, the first time that we see a slightly increased sales on our side.

And for the third question, I would hand over to Christian.

Christian Baier ***Covestro AG - CFO & Member of Management Board***

Yes. Thank you, Markus, and Christian, thank you for the welcome. Looking forward to our future interactions. With respect to the topic of debt refinancing, we are obviously looking at various products that we're having. At the moment, there is very significant cash that we have out, especially when we look at the bond maturing in the next year, we are talking about interest rates of below 2%. In the current market where we are a couple of percentage points higher, we will certainly be very flexible to use available funds but also tap other sources of financing. As just recently, we have tapped the European Investment Bank for a very strong loan facility that we got there.

So we remain active in the capital markets in order to really look at what is the best solution at the time at hand with having a very broad spectrum of tools that are always available to us also in the current markets without the significant increases in the interest rates.

Operator

(Operator Instructions) The next question then comes from Jaideep Pandya from On Field Research.

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

Yes. I hope you can hear me. My first question really is around -- my first question is around the EUR 3 billion investment on the MDI project. I know, Markus, you've mentioned about ADNOC. I won't make you very uncomfortable. But obviously, this is a topic which is very strategic for Covestro. So could you just give us some sort of information about how are you tackling this in the light of your discussions with ADNOC in the sense? Is this on the table and being reviewed in totality? Or is this actually off the table because you have taken the project off the table. That's my first question.

The second question goes back to -- it's sort of tied to the first question. It goes back to your point about EUR 1 billion EBITDA growth even at current margins, 20% volume growth -- so how do we get that to the EUR 2.8 billion? Would the EUR 800 million really have to come from improvement in spreads?

And what sort of spreads improvement that sort of quantifies. If you could just give us some color with regards to that? And then the final question really is around the competitive landscape. I assume that your availability improves next year and you would like to take back some share presumably in TDI and in MDI from the chlorine issue that you had. Your key competitor in China is increasing capacity quite aggressively. So could you tell us like in a backdrop of low volume growth next year how do you see the competitive behavior? I mean are you willing to go a bit aggressive on pricing to get back to share? Or are you going to defend pricing as well?

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

Yes, Jaideep. Thank you so much for your questions. Let me start with the first one. And that is totally unrelated to ongoing open-ended discussions with ADNOC. It is just a general explanation of the rationale to invest in MDI. And maybe one, if you allow minor correction, we're not talking about a EUR 3 billion investment but the investment costs are rather around EUR 2 billion, depending on where you invest, maybe slightly lower, maybe slightly higher and also depending on how you invest. That means the way how you construct the plant might also have a significant impact about the total cost of the plant.

So long story short, the number is rather around EUR 2 billion and not in the order of magnitude of EUR 3 billion. So having said that, the decision to pause an MDI investment was not driven by financial means. It was driven by the current, let's say, short-term, at least turbulent market dynamics in the MDI market and also the worries that we already could foresee in the current construction market. We know that mid- to long-term MDI is still in high demand, and it is still the best raw material for insulation panels for commercial as well, sorry, for commercial and residential buildings.

But we also have to very carefully assess when that growth is, let's say, kicking in. And as we currently see the construction market is under big pressure. The construction market worries us a little bit at current times. And from that perspective, I think it was a wise decision not to go for the respective MDI construction at the time when we had it on the table because it would have just further increased the price pressure on MDI and in the MDI markets. So from that perspective, I would say we are currently once again assessing when is the right moment in time to invest. And we will let you know as soon as possible when we have taken the decision. If you look at the supply-demand balance, last sentence to this, we see that there is actually towards the end of the '20s, beginning of 30s, no additional supply capacity coming.

And from that perspective, we think that the right moment in time to once again go back to that investment decision is coming soon. Was that in terms of the EUR 1 billion related or, let's say, with the way to the EUR 2.8 billion, I would actually hand over to Christian. Christian?

Christian Baier ***Covestro AG - CFO & Member of Management Board***

Yes. Thank you, Jaideep for the question. With respect to the EUR 2.8 billion for the mid-cycle, basically, we are talking EUR 1.1 billion this year we are talking exactly about those roughly above 20% that we were stating. And with the currently depressed margins, this is roughly above EUR 50 million basically per additional percentage point. And then your rough calculation at flattish fixed costs of those additional volumes you basically come to a setup of the spread between EUR 0.7 billion or around that number. So your calculation is right in that direction.

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

And Jaideep, to your next question about -- yes, you called it market share, you droped words like price war. I think what is important is that this 20% is an average number, an average global number. And that is important. Why? Because it is not only MDI and TDI, where we try to gain market share back, it is also other products where we see significant room in increased asset utilization also in the Solutions and Specialty area, although not to that same extent. But to, I would say, still reasonably high extent that would also contribute and help us to get back to higher volumes out of existing assets.

Secondly, at least from our perspective, Wanhua has always been a return-driven competitor who behaved very logical. Thirdly, we believe that there are first signs of growth opportunities, at least from the second half of next year. And we must also not underestimate that, let's say, if I may say so, the leading dogs on the place are not directly getting into an infight but there's still smaller dogs, let's say, in the backyard, which also produce at much higher cost than we do. So there's also an opportunity for us to gain market share, whilst at the same time, not getting heads on with one of the largest players in this market.

Fourthly, Wanhua has currently its largest asset bases in China. And we know that many customers are looking at us, particularly in Europe and would love to have more material from us. And we have in Europe cost competitive assets compared to imports from Asia

Pacific, so versus landed costs. And so from that perspective, overall, we believe there is sufficient room to sell out our fully running assets, particularly but not limited to Europe. Particularly, in the -- but not limited to the MDI as well as TDI space without entering to a price war. I hope that gives you some flavor.

Operator

And the next question comes from Sebastian Bray (inaudible) from Berenberg. (Operator Instructions).

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

Hello, everybody. Good afternoon. Can you hear me?

Operator

Very well. I'm sorry, it's Sebastian Bray, please apologize.

Sebastian Christian Bray

There's no problem at all. I just have 2 questions, please. The first is on the decision announced yesterday evening to terminate the buyback. I'd just like to understand better the thinking behind this, in particular, what the other options would have been. Is it just simply the case that effectively an extension of the time period over which stocks could have been bought back past April of next year wouldn't have been possible and effectively to extend this, the buyback first needs to be cancelled and then a new one authorized at the AGM or would it have been possible to extend ad-hoc? That's my first one.

And the second is when thinking about the current valuation of the stock, and potential for cyclical recovery. How are you thinking about CapEx next year? Because I think in the past, Covestro has indicated that we could go lower than we are now at around EUR 800 million. And I imagine that, depending on what happens to the stock price, it could be quite interesting to buy back stock again more aggressively as opposed to investing CapEx now, given group utilization is quite low. But could CapEx next year be EUR 600 million or so? Or that's too pessimistic hence it would be higher?

Christian Baier ***Covestro AG - CFO & Member of Management Board***

Yes. Thank you for your questions. I'll take the first one and Markus will take the second one. With respect to the buyback decision, exactly your point is the correct one. It is the AGM that is allowing those share repurchases. And that permission is basically running out. And therefore, that window is closing now at a point of time where there is only a very, very short window to really execute this. And from our perspective, that was not the proper timing with respect to the rush into that at this very special moment. But as stated also yesterday, we are focused on asking the AGM next year for the permission on another share buyback and therefore, so be able to have that instrument in our toolbox.

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

Yes. Thanks, Sebastian. I'll take your second question. So on CapEx, if you put things into perspective, let's say, the old number that we originally planned to spend for 2024 was around EUR 900 million to EUR 1 billion. The current planning is around EUR 800 million. And with regards to the comments you made, that's now going for CapEx for growth as we are anyhow in underutilization maybe a bit flavor what it means. If we would now invest into growth even for the Solution and Specialty area, those assets would come on stream only in the next 2 to 3 years which means if we would not invest next year, we would run out of opportunities to grow our Solutions and Specialties.

So from that perspective, I currently sit clearly on the position that EUR 800 million is the right balance between short-term needs and on the one hand -- on the other hand also mid- to long-term growth opportunities. Another topic is we could further trim down the CapEx, but then we would cut into many already in execution projects, and that is normally the worst because you have then a lot of sunk costs if we short-term cancel those projects or at least significantly increase overall investment costs which is not in line with our philosophy to spend our CapEx, as we stated also in our previous speeches here, more wisely and more efficient and effective. So that's why the number most likely from today's perspective will be around EUR 800 million for next year 2024.

Operator

And the next question comes from Geoff Haire from UBS.

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

This is Geoff Haire. Thanks for the presentation. I just had a quick question about the auto sector. Clearly, you've alluded, Markus to some slowdown, particularly in the EV side, but we are aware that inventories are obviously building particularly in Europe. I was just wondering, would you be willing to comment about what your thoughts are for the auto sector as we move into 2024?

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

Yes, Geoff. Thanks and very helpful that you asked that question because it's a little bit of a complex picture I have to admit. Even though we see, let's say, increased growth rates -for the automotive industry. It is always worthwhile to look a little bit what is behind it. It is admittedly a high uncertainty. The order backlog is still healthy in the industry. Just talking about the recent microprocessor crisis that we had in '21, '22 and extending partially into '23. So there's still a healthy backlog in the system. On the other hand, there's also replacement need high, given that there are 4 years now with below 2019 levels in terms of absolute car sales. That means we have lost basically 5, 6 years of growth.

And that's why we believe 2% to 3% growth in '24 for the automotive industry is a conservative approach in that context. That what we could see and foresee for the underlying demand. There might be higher growth rates possible. Once again, talking about the backlog and there might be also a little bit more higher growth rates possible, talking about the replacement needs. But once again, the economy currently is in a big turmoil. And that's why it is still with high uncertainty. But I believe 2% to 3% growth should be definitely in for next year. If you put -- if you want to have a number, then I'm sitting on that conservative number.

Operator

And the next question came in writing from Martin Evans from HSBC.

Martin Evans

Why do you continue with this theoretical "mid-cycle" target of EUR 2.8 billion for 2024, especially given your own mark-to-market forecast for 2024 is half of that. Given these trading conditions are the new reality and likely by your own admission to be difficult in 2024, why do you not abandon as it is confusing as it is purely academic?

Christian Baier ***Covestro AG - CFO & Member of Management Board***

Yes. Thank you for your question. And let me just elaborate a little bit on the mid-cycle. From our perspective, this gives a very strong and good indication of the potential that we do have with the existing and installed capacity at any given point of time when we return to a market normality. And given in our industry, this comeback can be very fast from our perspective, it's very important to bringing this across. And just to remind on how the mid-cycle is being calculated, this is really under normalized market conditions and with our respective capacity utilization and with our respective fixed cost and then the EUR 2.8 billion also recently updated since the RFM acquisition for the RFM synergies. So for us, it's an important yardstick to be used, and we keep it as pragmatic as possible. Obviously, the environment needs to be there in order to achieve that EUR 2.8 billion, then as mid-cycle.

Operator

And the next question comes from Charlie Webb from Morgan Stanley. (Operator Instructions).

Charlie, we so far have not been able to hear you. Would you mind to unmute using star 6 on your telephone.

Okay. I think we just lost Charlie. So Charlie, if your question is still well would you mind to use to raise -- to raise your hand function again.

We then continue with the next question from an unknown British telephone number, (Operator Instructions). Could you please state your name, company name followed by your question and please unmute your microphone with star 6.

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

Hello. Can you hear me? Chetan here from JPMorgan. I had a couple of questions. I think at the beginning of the presentation, you mentioned about volumes improving year-on-year. And I'm just curious, is that just a function of comps? Or do you actually see real demand improvement? This goes across all of your markets that you mentioned, which were improving, like furniture or electronics. Because really I think we started to see the volumes come under pressure from second half of last year. So I just wanted to understand whether this is real improvement or it's just a base effect which is coming into play here.

The second question, and apologies, I don't know if it was actually answered earlier, but you keep referring to this EUR 2.8 billion mid-cycle EBITDA, which is fine. My question to you is as you discuss potential scenarios with ADNOC. Is that your base case that you will use in arriving at some sort of a sensible valuation? Or is that just not related to what you might be talking to at ADNOC at the moment? And the last question I had was just on your bonus provisions. The last year, your EBITDA was much higher, but you had, I think, from memory 0 bonus provisions or may be much lower. Why are you having or have already recognized EUR 160 million bonus provisions this year given your profitability is much lower?

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

Chetan, thank you very much. So I take the first question, where you say Q4 volumes year-on-year that is mainly comps. So because Q4, 2022 was minus 13% compared to Q4, 2021. So we're really comparing ourselves to a very low basis. So that is the main explanation. And we have alluded to where we see the individual industries going and what our own sales, let's say, is saying for the respective segments that we are exposed to. And part of the volume growth that we are seeing in our own business is not directly related to market growth but rather related to increased availability of our own plants. By the way, maybe giving you some evidence of what we are planning to do next year in terms of selling our assets fully out once the capacity is available again. So that is maybe the explanation to your first question, and then I would hand over to Christian for the next. Thank you.

Christian Baier *Covestro AG - CFO & Member of Management Board*

With respect to your question regarding the valuation perspective and here very specifically without any reference to the ADNOC situation very theoretically, just from a mid-cycle perspective, this is in normalized market conditions, the infrastructure that we have already existed. And in any M&A situation, for sure, there would also be a discounted cash flow perspective taken into account, including basically growth perspectives that would happen. And again, no reference to any conversations on the ADNOC side. With respect to the bonus position, let me just state with respect to the financial KPIs, you're absolutely right with the statement compared to the prior year development.

There is a fourth important component in our short-term incentive program PSP around the greenhouse gas emissions. And there is a certain discretion with respect to the decision-making on the payout of that we are there on solid track to achieve the targets that have been given in the long term or in the incentive program and the long term set targets on that. So discretion on that point of time, and there has been provisions made so far during the year, which will be decided upon concluding the year.

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

Sorry, what was that KPI, you mentioned fourth KPI, what is that fourth KPI?

Christian Baier *Covestro AG - CFO & Member of Management Board*

It is the greenhouse gas emissions target, the CO2 reduction that we do have as the fourth KPI where we are on solid track to achieve the targets at the upper end, given our very strong focus on sustainability and CO2 reduction, and that is basically a KPI that when the other financial KPIs are not fulfilled, is at the decision and discretion of the management team to decide on it, which we will do at the conclusion of the year and with respect to where we are coming out with the results.

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

Can I push a little bit further on that topic. Isn't your carbon emissions down today just because demand is bad and you can't produce at full capacity given your own production in cuts? Or are you saying you are actually doing much more better even on adjusting for -- even adjusting for that production issues?

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

Well, let me just jump in here as, let's say, I have witnessed and also developed that KPI system. And the absolute carbon dioxide reduction, it is an absolute emission reduction that was requested by many shareholders to be included in our short-term incentive scheme. That's why we, in the first place, also put it in. It also perfectly fits our carbon emission reduction targets. Secondly, a slight portion, a slight portion is due to the fact that we have lower production output, but not to the order of magnitude that the production output is going down simply because of the fact the lower the output is, the less efficient our plants are getting, which means if you have, let's say, 20% lower production output, your carbon dioxide footprint and output of the plants is by far not going down by 20%. And then that is, I think, very important to know. Thirdly, it is worth to mention that we have significantly also decreased our carbon dioxide footprint by, for example, efficiency and effectiveness measures that we invested into, which are also going into that bonus. So even though you might make the assumption, hey, you are just lowering your production number that you are achieving your carbon dioxide targets, no.

The carbon dioxide emission reduction targets are achieved by actively investing, by actively improving the energy efficiency and with that lowering the carbon dioxide footprint of our assets. And it is also not, let's say, pro rata driven down by lower output - the opposite is true. The lower the output is, the less effective the plants are. So that might give you some ideas how this works.

Operator

The next question comes from the person with the U.S. telephone number (Operator Instructions).

The person disappeared. So let's go to the next one.

Paul Gleize ***TIG Advisors, LLC - MD***

It's Paul Gleize from TIG funds. Christian, nice to meet you, and Markus just had a question for you. I was curious if you could provide a little bit of details around the utilization rate. So last quarter, you mentioned that there was 20% of excess capacity and 10% could be easily contracted. It seems like we're still running with 20% excess capacity. So what has been done in the last quarter to contract that excess capacity?

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

Well, I love the interpretation that you bring forward about "could be easily contracted". I'm not aware that I exactly said that. What I said is that we're aiming to gradually sell out those assets and that we will do that quarter by quarter. And to give you some flavor, those 20% -- roughly 20% are distributed amongst our assets in the commodity segment as well as in the specialty segment. In the commodity segment, larger share of the unsold capacity is simply because it was technically not available, and that is particularly true for our European commodity assets. That was due to an unforeseen technical failure that already happened last year in our central chlorine productions. We are still repairing those unforeseen technical glitches.

And we assume that by end of the year, we'll have the largest share of those technical issues solved and then be able to gradually continue to sell out our assets in the commodity segment. And once again, particularly from our European assets because assets in China, assets in Asia Pacific, and then also to a larger extent, assets in the United States are already sold out in the commodity sector.

Secondly, for the Specialty segment, it's a bit more tricky as here it is about compensating existing applications, very special applications by newly developed -- by newly developed applications. That takes a little bit longer. So what have we done in the last quarter? First topic is we have actually continued to work on the technical issues with our commodity segments and whatever was available has then been actively promoted in the market, and we have seen, let's say, first gradual improvement against the usual seasonal downtrend from the third quarter to the second -- versus the second quarter.

So there is slight improvements clearly to be seen. And from my own assessment, looking at the current trading update, I see that this trend is continuing in the fourth quarter. And on the Specialty segment, we're looking with full steam and full forces for newer applications to then produce materials and load the assets in the specialty segment. So it is a tough cookie. We are chewing it, we're making first progress. So the gradual improvement is clearly observable and that is exactly also what we will continue to do because our aim is to sell out our assets and make sure that we fully load them.

Paul Gleize ***TIG Advisors, LLC - MD***

So I believe you mentioned in the past that -- you believe that you're the lowest cost producer out there. So why can't you just take market prices or am I? Or is it suggesting that market prices are actually under your cost curve?

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

No. We can do that. But once again, the asset needs to be available. And that is exactly what we're saying. It is not just commodities that we are selling. Over 50% of our portfolio is specialty business, and that is exactly not about the price. It is about new applications. So let me give you an example, a very simple one. If you have glues that go into a windscreen of a BMW 5 series and you have glues that go into the packaging of a Mars bar, those are not comparable chemistries.

And if know the sales of the BMW 5 series is down, you cannot just sell that glue somewhere else. What you have to do is you have to look for new applications that then will continue to fill the assets even though the sales of cars is still down. And that is the thing that takes more time. On TDI, it is simply an availability of, let's say, commodity, it's still an availability issue. So when the TDI asset is back on stream and fully back on stream, we will as quickly as possible, let's say, sell into the markets. And I do not want to comment, let's say, on our pricing tactics in that context. But the clear appetite is to sell out the asset as quickly as possible once it is back on stream and available.

Operator

And we have a follow-up question from Geoff Haire from UBS. (Operator Instructions).

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

Markus, I just wanted to get some assurance from you. You obviously said that you look to fully utilize your asset base next year. Can you give us assurance that, that won't result in you just lowering the price to fill the asset base?

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

While I think one thing is important, we're looking to optimize our absolute margin structures. So it's not about filling the assets just for filling the -- for the sake of filling the assets. Secondly, it is important that -- and we had an earlier question around that we're not competing in the markets against the lowest or one of the lowest cost producers, but we're competing against the high cost curve, the producers that are sitting at the high end of the cost curve. And the current situation that we were not in the market due to technical dis-availability of our plants has maybe kept some high-cost producers in the market. And that is exactly where our opportunity is. So we will still enjoy good margins and still be able to sell out. And I'm convinced about that. Having now had the chance to look for more than a decade into those markets, there's opportunities out there.

Operator

And we have a follow-up question from Jaideep Pandya from On Field Research. (Operator Instructions).

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

Yes. It's a question just around - apologies to asking this- but just around the ADNOC situation. I mean what has been the feedback from your customer and your employee base given obviously, on the financial markets, at least I have recognized that quite a few of investors right now are sort of sitting on the sidelines because Covestro is a bit of a difficult one to judge given the uncertainty of the outcome. So what has been the response from the customer base and the employee base?

And is there some kind of a timeframe because obviously, ADNOC is involved in another company in Europe. And there, it's been quite a few months now and there has been nothing that has come out yet. So is there a particular time frame with regards to the Board where you will dedicate, let's say, 6, maybe 9 months through this negotiation. And if it leads to nowhere you will sort of call it a day or is this very hard to comment on?

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

Thanks, Jaideep. You said it in your last sentence, it's very hard to comment on. But let me -- please allow me to give you some flavor. With regards to feedback from customers, I'm actually not aware of any comment by any customers. I have seen a few, but I mean besides the fact that they have read the press and just made comments like, oh, you must have a lot of work on your desk, which I didn't comment on, but there were no, let's say, other comments. With regard to employees, and I think that is totally normal, there is, for sure, some uncertainties here and there, a lot of questions that we get which is very, very normal in such a situation. And therefore, they are focusing, and that's what we always tell them to stay safe, to operate safe, to make sure that they really take care about their business. And from that perspective, I think right now, we have limited nervousness.

And we also do not see other, let's say, indicators going in the wrong direction, let's say, higher fluctuations than usual or something like this. So from that perspective, on the customer front, it is absolutely quiet. And on the employee front, beyond the limited nervousness, which I consider to be normal, there's nothing going on. With regards to the time frame that you addressed, there is no regulatory, let's say, timeframe. So we don't have anything that is may be comparable to the U.K. or so unless specific things are not happening, for example, if there would be, let's say, a real public offer - binding public offer, then yes, there is a few timelines that would then start to tick. But let's say, just pursuing let's say open-ended discussion does not have any limitations on the timeframe.

Operator

So with that, there are no further questions at this time. So handing back to Ronald.

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

Our activities -- and with that, I would like to wish you goodbye. Okay. So I just got a message I wasn't clear on the microphone. So again, thank you for participating. Thank you for all your questions. If you have follow-up questions, don't hesitate to contact the IR department. And yes, with that, I would like to say goodbye, and we might see each other over the next months with our regular IR activities or then perhaps related latest with the next call, in February of next year. Okay. See you then. Bye-bye.