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Q1 2023 Covestro AG Earnings Call

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PRESENTATION

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

Welcome to Covestro's earnings call on Q1 2023 results. The company is represented by Markus Steilemann, CEO; and Thomas Toepfer, CFO. (Operator Instructions) You will find the quarterly statement and earnings call presentation on our IR website. I assume you have read the safe harbor statement. With that, I would now like to turn the conference over to Markus.

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

Thanks, Ronald, and hello and warm welcome also from my side to the results of our first quarter. Today, we published our Q1 details after we had pre-released the headline figures 2 weeks ago. Sales were down by 20% compared to last year to EUR 3.7 billion, clearly indicating the global demand crisis we are currently facing.

Against this trend, we achieved the first quarter EBITDA of EUR 286 million, clearly beating the guidance of EUR 100 million to EUR 150 million given in early March. Free operating cash flow was also better than expected by us despite the usual seasonal working capital build up.

After the positive trend in EBITDA during the first quarter and improved visibility going forward, we are now returning to a quantitative guidance force for full year 2023, with a defined range for our financial KPIs.

Finally, as you recall, in the first quarter 2022, we initiated a EUR 500 million share buyback program. The program was paused mid 2022 due to the recessionary environment.

With more clarity on the outlook, we are now restarting the program in May. Let's turn to Page #3. In line with our vision to become fully circular and to achieve climate neutrality, we successfully completed two milestones and initiated a new project towards simplified recycling.

A major circularity milestone has been achieved with Baytown, our U.S. side, receiving its ISCC Plus certification. We are the first manufacturer of polyurethane and polycarbonate raw materials in the United States achieving this.

Now the Covestro network of ISCC Plus certified plants reaches across 9 major sites spanning across all regions. This network allows us to regionally produce and offer a broad variety of our circular intelligence materials to our customers.

These products contain a minimum of 25% sustainable content and are marketed under the CQ brand. The second breakthrough is related to the EU funded PUReSmart project, for chemical recycling of polyurethane mattresses.

This project has been completed successfully with closing the loop from polyurethane foam to a chemical recovery of raw materials in a high level of quality and purity.

Now, for the first time, a flexible foam sample has been produced from the fully recycled polyol and TDI. Both raw materials were obtained in Covestro's pilot plant in Leverkusen, which we inaugurated in 2021.

A new governmentally funded project has been initiated by a consortium of industry and science to design future automotive headlamps from a polycarbonate mono material. The project's target is to design lighting systems in such a way that they can be recycled at the highest possible value-added level.

Covestro is the partner of choice for this project as we do not only have extensive expertise in this area, but we also already showcased a visionary headlamp concept a few years ago.

During the 3-year project, the transfer of the results to other applications, like the appliance industry, will be also examined. We will keep you posted on the outcome of this exciting new endeavor.

Let's turn the page to Page #4. Despite a reduced CapEx plan for 2023, we, nevertheless, plan to spend almost EUR 400 million for growth projects with a focus on Solutions and Specialties.

During the first quarter, we announced two important projects: Firstly, our business entity, Thermoplastic Polyurethane will be built its largest site in Zhuhai, China, with an overall capacity of 120,000 tons. It will be constructed in three phases until 2032.

The mechanical completion of the first phase with a capacity of 30,000 tons is estimated for the end of 2025. The total investment lies in the low 3-digit million euro range. This will also be the company's largest investment in the TPU business.

The site will furthermore utilize the most advanced production technologies and will be run on 100% green power. We expect the EBITDA contribution to be in the range of a low to mid double-digit million euro.

TPUs are a highly versatile plastic material, offering a broad range of properties for a diverse set of applications. Most prominent applications are the IT, consumer electronics, footwear and automotive industry.

The second example comes from our business entity Specialty Films. The high double-digit million euro investment into new extrusion lines at the Map Ta Phut site in Thailand will be completed by 2025.

The added polycarbonate films production is an answer to the increasing demand and supporting our expansion of future technologies and industries.

Our Makrofol and Bayfol product range is used primarily in the identity documents, medical and electronic industries. The EBITDA contribution we are expecting lies in the low to mid-double-digit million euro range. Both investments have in common that we are also expanding our sustainable CQ product range with at least 25% alternative nonfossil raw materials.

Now let's turn to Slide #5. We are now coming to the volume development in the first quarter 2023. Year-on-year, the global sales volume decreased by 17%, caused by significantly weaker demand across all regions and limitations in our internal availability.

The region, Europe, Middle East, Latin America has seen significant decreases in almost all industries important to Covestro and was again clearly the weakest region. Part of the volume weakness was caused by our production limitations in Germany.

We plan a gradual ramp-up of the production during the second quarter and third quarter and then return to a normal output in the fourth quarter of this year. Asia Pacific, is also showing a clearly negative volume development across all industries with a modest pickup after Chinese New Year.

Electro, automotive and construction declined significantly and Furniture slightly. Sales volumes in North America were also declining, but with a more mixed picture.

Construction is showing a considerable decline. Electro is still with a slight decline, but we observed an end of destocking in furniture/wood with slight increases and also a slight increase in auto and transport. That concludes the overview on the demand development, and I'm now handing over to Thomas, who will guide you through the financials.

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

Yes. Thank you very much, Markus, and also from my side, a very warm welcome to everybody on the call. I'm on Page 6 of the presentation. So let's start with the sales bridge.

As you can see, our sales declined 20.1% to EUR 3.7 billion, and Markus already mentioned the negative volume growth of 16.8% that is almost equally spread across both segments, PM and also Solutions and Specialties.

You can also see that our sales were affected by 3.9% lower prices. That, however, was mainly coming from Performance Materials with a negative 7.1% and only negative 0.5% decline from Solutions and Specialties. And you also see there's a small FX effect of 0.6% year-on-year, driven by the stronger U.S. dollar and stronger Chinese RMB.

So let's go to Page 7, and you have the EBITDA bridge. Also here, of course, volumes in Q1 significantly affected our EBITDA, and that shows that we are still in a very weak demand environment.

You could also see the negative pricing delta with price decreases as an effect of the low demand and the ongoing destocking. And in Q1, raw material energy price increases contributed to the negative pricing delta.

However, as of Q2, we do assume a year-on-year tailwind from lower variable costs. You see also a positive development from other items and behind us a significant cost savings, which we realized, especially in the Performance Materials segment.

So that overall, EBITDA came in at EUR 286 million, clearly above the guidance of EUR 100 million to EUR 150 million, which we had given and the better-than-expected results are driven by, as I said, strict control of fixed costs and the lower-than-expected burden from the pricing delta.

So let's look at the sequential development on Page 8. As you can see on the upper side of the page, sequentially, we see a slightly negative sales development, which is due to minor reductions in price and also currency, but I would like to highlight that we are looking at stable volumes sequentially.

And if you look at the lower part of the page, you can see that our EBITDA is coming back into positive territory from the historical low point, which we had in Q4 last year.

And also with that, of course, we have finished the negative trend in terms of our EBITDA margin, and we're returning to a positive 7.6%. And therefore, I think with this, we do see that Q4 actually represents the trough of the cycle.

So let's look into the segments and go to Page 9, where you have Performance Materials. Overall, sales declined sequentially. This is driven by a strong sales decline in APAC because of the Chinese New Year, followed by a slight decline of sales in North America.

However, we've seen slight sales increases quarter-over-quarter in Europe, Middle East and America. And in Q1 2023, if you look at the lower part of the page, EBITDA of EUR 173 million is significantly below last year, but however, it is significantly better than expected and also increasing sequentially.

So the year-over-year decline is driven by the volume decline, the negative pricing delta, which was counterbalanced partly by positive fixed cost development.

If you look at the EBITDA sequentially, we are returning to positive numbers, driven by the fixed cost savings, the positive pricing delta quarter-over-quarter and additionally, of course, the usual seasonal inventory buildup.

So let's now go to our segment, Solutions and Specialties on Page 10. The year-over-year demand weakness also here is a major factor for the sales decline.

If you look at the upper side of the page, you see sequential sales growth in EMEA, benefiting from positive volumes, but slightly negative pricing. And the regions, APAC and also North America are still declining.

If you look at the lower part of the page, you see that our EBITDA for Q1 '23 is below our Q1 2022. And we have a positive pricing delta, which I would like to emphasize both year-over-year and also quarter-over-quarter.

And the EBITDA margin of 8.8% is still depressed by destocking. So we do continue to see significant margin upside going forward. Let's go to the next Page 11 and talk about the free operating cash flow.

So first of all, if you look at the graph, you see we came in at EUR 139 million negative, which is below previous year, and, of course, mainly attributable to the lower EBITDA year-over-year.

What I would like to emphasize is there was, of course, a negative cash contribution from trade working capital buildup of EUR 257 million. But as you can see in the highlighted line item in the table, this is a purely seasonal effect.

So I can reassure you that we run a very stringent working capital management, and we will limit this clearly to the seasonal rebound so that, overall, and you've seen our guidance, we're targeting a positive free operating cash flow for the full year.

Also, if you look at the table, our CapEx is absolutely in line with our budget and the full year guidance. And you do see a negative income tax payment of EUR 22 million, mainly driven by payments in China.

So I would like to remind you that for the full year, we're expecting cash tax payments of between EUR 200 million to EUR 300 million for the full year. On Page 12, I would just like to explain two onetime effects, which are affecting our P&L, and therefore, also our net income.

So first of all, and you see it highlighted, we had D&A impairments in Q1 2023 at minus EUR 33 million, EUR 30 million of this relate to the discontinuation of our nonstrategic and loss-making Maezio product line and the closure of the site in Markt Bibart. It's a noncash item, but as I said, of course, it affects our P&L. And secondly, I would like to talk about the DTA adjustments.

So last year, we adjusted our deferred tax assets in Germany. And as a consequence, based on the IFRS rules, we are no longer allowed to activate our tax loss carryforward in Germany as the accounting projections expect further losses in Germany in the full year 2023.

So the tax rate will continue to be affected by the regional profit mix. And currently, we assume a P&L income tax of EUR 150 million and EUR 250 million for the full year.

What I would like to emphasize, though, is that in contrast to the IFRS rules based on German tax rules, the tax loss carryforward can be used indefinitely. So this means we are confident that in the future, we're able to use the tax loss carryforward in order to lower our tax rate and we're economically not making any losses by the IFRS rules.

And as you can see, the impairments and the income tax together then caused the net income to be negative, which came in at minus EUR 26 million.

So let's go to Page 13 and look at our balance sheet. And let me start by saying our balance sheet remains very solid. The total net debt increased by EUR 215 million versus the end of 2022. You see a decrease in net pension liabilities of EUR 26 million, driven by the increase of the pension discount rate in Germany and in the United States, resulting in a EUR 404 million net pension liability and that consists of pension provisions of EUR 462 million, which, to a smaller extent, are offset by a net benefit from pension assets of EUR 58 million.

Now the total net debt-to-EBITDA ratio stands at 2.8x based on a 4-quarter rolling EBITDA of EUR 1.1 million. And quite obviously, based on our mid-cycle EBITDA, the ratio would look totally different, rather in the region of 1.1x. So let me just close this chart by reiterating the key statement that Covestro remains committed to a solid investment-grade rating.

With that, I would like to turn to Page 14 and talk about our measures to improve the financial performance. Compared to our initial financial planning for 2023, we have identified several levers for cost savings and improvement of our financial performance during the course of this year.

So already in 2022, a differentiated hiring approach was initiated, and that means we're only rehiring positions that are absolutely crucial for the company's performance or indispensable for the reliability and safety of the operations.

And therefore, since the start of the program, the number of FTEs has been reduced by around 250. And we've also, on top of that, implemented a freeze for the contracting of temporary workforce.

Now if you look at the other items on the chart in terms of operational savings, they are essentially based on lower maintenance cost, that means our FAM costs. So savings from our Leap transformation program and the additional long-term savings are supporting our cost ambition in this category.

And then under the headline portfolio streamlining, we are eliminating nonstrategic and loss-making businesses like, for example, the Maezio product line and its production site in Germany.

But I would also mention here the successful sale of our 3D printing business, which was also actually loss-making. And in addition to that, we reduced various negative onetime items.

In addition, that is the last bucket, we strongly reduced our underutilization costs and various small-scale contingencies are, of course, also contributing to further savings over the course of the year.

So with that, let me come to the outlook for Covestro's core industries on Page 15. Compared to our last assumption, the outlook for the global GDP has slightly improved from 1.5% to now 1.9%, which is, of course, a step into the right direction. But far from normal growth rates that we have observed in the past. This positive development, however, does not hold true if we look at our core customer industries, the automotive growth expectation has been corrected downwards to 4.2%.

However, within this the Electric Vehicle outlook remains unchanged and strong with positive 43%, and this gives us confidence because our Engineering Plastics business and the polycarbonates exhibit a much stronger [exposure] (corrected by company after the call) to EVs compared to classical combustion engine-driven cars.

A very similar picture can be drawn for the construction industry. The further reduction to only 0.5% growth for 2023 is strongly influenced by the globally increasing interest rates, the higher construction costs and ongoing destocking and the outlook for the furniture industry remains also on a low level for the year 2023.

If you look at electro industry, the demand expectations have been also corrected downwards to 1.7%. And against this negative development in electro within this, the appliance industry is seeing stronger signs of recovery and is actually expected to grow at 4.4% after being negative throughout the year 2022.

So with this rather mixed picture from our customer industries, let's now come to our own outlook for 2023 on Page 16. What I can say is that as the year progresses, our visibility clearly has improved, and therefore, we decided to reinstate our quantitative guidance ranges for our core KPIs.

And we're now expecting an EBITDA of between EUR 1.1 billion and EUR 1.6 billion for the full year 2023. And compared to our initial guidance, the increase is driven by successful internal cost measures and a positive development of the pricing delta.

We expect unchanged, flat volumes year-on-year for the full year 2023. And sequentially, we expect a slight volume increase in the second quarter driven by seasonal effects and also better product availability in Germany.

Now the seasonal effects are very much driven by Asia as the second quarter will not be impacted by the Chinese New Year, and also the usual improvement in the construction industry after the end of the winter period in the Northern Hemisphere.

And in the second half of 2023, we assume further sequential improvement in the volumes, mainly driven by resolving our own production limitations. So this should allow us to return to a year-on-year growth in the second half of 2023, given the low comparison basis.

As you can also see in the chart, the current mark-to-market calculation comes out at about EUR 1.4 billion based on the margins flat forward. And this is slightly above the midpoint of our new quantified guidance range.

Our assumptions for the revised mark-to-market were lower fixed cost and the improved margins as of March with unchanged flat volumes for the full year. And on this chart, you can also see that we confirm our mid-cycle EBITDA level of EUR 2.8 billion in 2024, driven by underlying capacity growth and of course, the realization of the RFM synergies.

So that leads us to Page 17 for the overview of the remaining KPIs. As I said, the quantified EBITDA guidance, as I explained in the previous slide, is now EUR 1.1 billion to EUR 1.6 billion. We keep the EBITDA guidance range for our Solutions and Specialties segment to be around previous year.

As you can see in the second line item, the free operating cash flow is also upgraded, and we're now expecting a positive number within a range of EUR 0 million to EUR 500 million in 2023. This is mainly driven by the improved outlook for the EBITDA and the Solutions and Specialties segment delivering a positive free operating cash flow significantly above previous year.

Now in line with the EBITDA adjustment, we guide for a ROCE above WACC between minus 6 and minus 2 percentage points. And the ESG KPI relates to our net-zero target comprises our greenhouse gas emissions, which we now guide to be between 4.2 million and 4.8 million tons.

For the second quarter, we expect a sequential improvement in volumes and flattish margins, which should then lead to an EBITDA of between EUR 330 million and EUR 430 million.

For the other KPIs, I can tell you, the financial result was slightly adjusted to be between minus EUR 130 million, minus EUR 170 million, and the closure of the nonstrategic, and as I said, loss-making Maezio product line and the related production site in Germany led to an impairment of EUR 30 million.

Therefore, we have increased our full year D&A guidance to EUR 900 million versus the guidance which we have given in March.

Our ambitions for a strict CapEx regime remain fully in place, and we're guiding for EUR 800 million. That has not changed. However, as I have alluded to in the beginning of the presentation, we continue our investments in the profitable growth of the company. So with that, I would like to hand it back to Markus.

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

Thanks a lot, Thomas. And I would now like to come to a specific topic as we are not only quantifying our full year guidance, but we are also resuming our share buyback program. Let me quickly remind you, we started the EUR 500 million share buyback program end of

February 2022. And the reason for the buyback program was that major M&A acquisitions were out of scope. We felt our share to be undervalued and as such, a good investment. In 2 sub tranches of each EUR 75 million, we purchased around 3.5 million shares in the first half year of 2022.

Yet due to the recessionary environment with the start of the second half of 2022, we had then temporarily suspended the share buyback to protect our balance sheet and retain cash within the company until an economic rebound becomes foreseeable.

However, it was always our strategic intention to execute the share buyback in an anticyclical manner. Now our raised EBITDA and free operating cash flow guidance and the improved visibility that the second quarter 2023 will sequentially result in higher volumes and further raised EBITDA. We consider this to be the right point in time to reinitiate the buyback. We are still firm in our opinion that our share is currently undervalued and deemed the investment into our own shares as best investment for our shareholders.

Consequently, the third sub-tranche of up to EUR 75 million will be launched in May. Let's turn pages now to Page #19, a very busy chart, so let me guide you through it.

As you know very well from the past and the current situation, Covestro's business is a cyclical business. In times of an economic downturn, our core products, MDI, TDI and polycarbonate are usually strongly affected.

Our products are an early indicator of a crisis as we are at the very beginning of the value chain and have strong exposure to multiple consumer industries.

There are steps in the value chain between us and the consumer market, but in time of crisis, the stop of stock replenishment is regular and immediate action and progressing very fast throughout the different value chains. So our products are an early indicator to an economic downturn. During a recession, the value chain empties through destocking.

Upon the start of an economic recovery, a fast and efficient replenishment of the value chain is also required again. Rebounds often create a strong demand to quickly refill the supply chain.

These high-growth rates usually lead to supply shortages, allowing Covestro to execute the pricing power to again, realize financially attractive margins. So despite the cyclical behavior, the long-term growth drivers for our products remain intact or even improve.

The current energy crisis will have a positive impact on the growth of MDI and polycarbonate. The trend for effective insulation to save energy can add 1 to 2 percentage points to the growth rate of MDI in the future as MDI is the best insulating material for buildings and appliances.

And MDI is so versatile, it can also be used in the manufacturing of wind turbine blades giving additional benefits of longer lifetimes and reduced maintenance rates.

Our polycarbonates are an essential part of the battery pack in most electric vehicles as well as a contributor to lightweight and technically advanced electrical features.

This results in a 2 to 5x higher use of polycarbonates in modern EVs compared to a regular combustion car. With that, we believe that once the crisis is over, we will see again a strong rebound of demand for our products.

Let's turn pages to Page #20 to another topic of special attention. In the past year, the competitiveness of European TDI production compared to competitor imports from Asia Pacific was always a point of discussion. And yes, there were times like in the third quarter of 2022, when gas prices peaked so that the import of TDI was cost-wise a better solution than local production in Europe.

Consequently, and supported by a temporarily significant gap of toluene prices between Europe and China, the imports were peaking at this point in time, taking into account the shipment delay of about 6 weeks.

Also we were importing TDI from our plant in China. You can clearly see in the above chart that the landed cost advantage of imports from China in the third quarter peaked even considering logistics and import duties of EUR 350 to EUR 600 per ton.

But as soon as the gas prices were coming down, this advantage quickly disappeared. And with the continuous gas prices decline since the January 2023, this advantage has now reversed.

So Europe as a TDI production location is definitely competitive and has its place to cover the market demand. If we take a look at the imports that have been coming in from Asia Pacific in 2022, around 100 kilotons TDI have been imported and market prices have nevertheless peaked during the time of high gas prices.

This clearly indicates that the market needs the European asset base for reliable supply and with the announcement of a 300-kiloton of European production disappearing towards third quarter of 2023, Europe will even require more imports to cover the again, rising demand.

Demand, as of 2024, will exceed the local European production and customers are hesitant to rely on import given the supply chain interruptions seen in the past 2 years.

We believe that we have a clear technological and cost advantage with our gas faced TDI technology and additionally, an advantage of having a production in the heart of Europe being able to supply TDI competitively to our customers.

So now let's turn to the last page of today's presentation. Let me quickly summarize on Page #21. Volume decline is resulting in lower sales or has resulted in lower sales of EUR 3.7 billion in the first quarter, and that was caused by weak demand and ongoing destocking across many industries.

Our EBITDA came in with EUR 286 million above guidance range of EUR 100 million to EUR 150 million, and that was driven by cost efficiency and improved pricing delta across both segments.

This negative free operating cash flow of minus EUR 139 million still came in better than expected, and that was helped by ongoing strict working capital measures.

We also now quantify the guidance for full year 2023, with an expected EBITDA between EUR 1.1 billion to EUR 1.6 billion. And we resumed or will resume our EUR 500 million share buyback program with a third tranche up to EUR 75 million starting in May.

So -- And for questions that remained open, Thomas and myself are now here to answer them. With that, I hand over to Carsten, who will guide us through the Q&A session.

QUESTIONS AND ANSWERS

Operator

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

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

Two questions, please. First one, very straight one. What is your order book visibility at present?

And the second one, I mean, I don't need to be nagging, but any particular reason why your R&D expenses in Q1 are up quite considerably in relation to the past and should we count on a 3-digit quarterly figure going forward. Thank you very much.

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

This is Markus speaking. Looking at the order book, for sure, for April, we are, almost 100% because it's basically the last day of the month. For May, we see currently about 40% of the usual order intake, and that's not unusual. And for June, 20% roughly.

And that, is not an unusual pattern, so to say, which gives us, quite some good insights about the months to come. So from that order of order intakes and order book view we definitely see that what we have baked into our full year guidance and also Q2 guidance is obviously coming in.

Positive news is maybe if you look into some more specifics. There is, as you know, some talks about the general situation in North America in terms of, some economic macro indicators.

What we see, we have seen a slight dip in April, but it looks as if in May, things are not only back to normal but even slightly positive, a bit more positive than we expected. So, on the research development cost, I hand over to Thomas.

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

Yes, Christian, on R&D, they are up EUR 11 million from EUR 94 million to EUR 105 million. Within this, there is the effect from the impairments that I talked about in Markt Bibart. Not to the full extent, but about 1/3 of the EUR 30 million impairment that we had to incur finds its way into the R&D cost because it's intangible assets which we had to impair. So essentially, the full effect can be explained by this noncash impairment of Markt Bibart.

Operator

And the next question comes from Chetan Udeshi from JPMorgan. Chetan, so far, we've not been able to hear. Could you please unmute?

(Operator Instructions) Okay. If there are issues, Chetan, you are not forgotten. Otherwise, we'll continue on the line and try again to get you into the call afterwards. Then the next question comes from Matthew Yates from Bank of America.

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

I'd like to just dwell on the Q1 result for a minute, if that's okay. Because obviously, you came in double what you guided or I guess, EUR 150 million in absolute numbers.

Can you just help me understand and on that Slide 7 bridge, where exactly did the upside come from? Because it didn't seem to be volumes. So if it was cost, why didn't you already know about this fixed cost saving when you guided in early March?

Or is it more about market conditions rather than the proactive things that you were doing? And maybe if I can tie that into Slide 14, I think you had around some of the new initiatives that you've identified. Is there any aspect the results from that were coming through faster than expected?

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

Matthew, this is Thomas. So first of all, you're right, the positive development in Q1 was not driven by market conditions. As we highlighted, we would say the demand is still pretty much depressed, specifically in Europe.

So the out-performance really came from a better pricing delta and from cost savings. I would say they were equal in size, maybe the cost savings were even bigger than the pricing delta. The pricing delta improvement came very much in March and therefore, at the end of the quarter and the cost savings were driven by many small items, which then altogether summed up.

So the visibility during the quarter is not always so big, but I think we also expressed already during the quarter that our guidance seemed somewhat conservative. Therefore, it did not come as a total surprise to us.

And what we're indicating with Page 14, is that those savings were not short-term measures, but they're really the result of also structural things, which we have implemented in the course of our Leap program. And therefore, we do think that they are also sustainable over the course of the year.

Operator

And the next question comes from Markus Mayer from Baader Bank.

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

Three questions, if I may. Coming back to these cost savings, which were higher than expected of this guidance or implicit guidance range, how much came from these cost savings and how much came basically from a better pricing delta. That would be my first question.

Then a second question is on this outlook overview from your end customer industries and also GDP. Three out of 4 most important end market saw at least according to the assumptions you have versus the ones you had in this full year (inaudible) saw a decline in the outlook, whereas GDP improves.

Now I am puzzled, what is basically more important for you is basically at the end, the (inaudible) change was your original volume assumption for the group. That's my second question.

And then the last question is on TDI. You said last year, roughly 100,000 tons have been imported into Europe. Is this [fuel] also the maximum of imports, which can be imported to Europe, given its chemical reactivity or what would be theoretically a maximum number, which could be imported to Europe. That's all from my side.

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

So Markus, let me start with the first question. The way I understood it is that your question is our mark-to-market came up from this EUR 1 billion to the EUR 1.4 billion. If you plug in the margins as of end of March and apply to flat volumes for the full year.

And this EUR 400 million uplift relative to the EUR 1 billion that we had given earlier in this year essentially comes from 50% of that is better pricing delta and 50% of that is better cost positions that will find their way into the 2023 results. So EUR 200 million from the one and EUR 200 million from the other. Maybe on the other questions, Markus, you want to talk about TDI?

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

Yes, absolutely. So Markus, if you look at the TDI import capacity, what we're basically talking about is not only shipping capacity, but what we need, we need storage capacity and unloading capacity in respect of harbor, which is a key challenge as we're talking here about hazardous and very reactive chemicals.

So having said that, it is not easy to build those capacity up. But even if it is built up, let me quickly recap on what I tried to explain a little bit earlier in one of the slides.

It is absolutely necessary that we get this additional capacity imported into Europe as one of the largest sites in Europe, which represents roughly 40% of European-based capacity, is about to be shut down by third quarter of 2023. That means we have nameplate out 300,000 tons, how much real available capacity is represented by this? The jury is out.

Nonetheless, we and our customers strongly believe in the growth opportunities and their demand for TDI. And therefore, we need import capacities. Otherwise, we will have, at least for some time, temporarily maybe, a shortage of TDI in Europe. So we need this capacity.

And therefore, you can assume that there might be an upscaling within this year of another 50,000 tons of import capacity on top of the 100,000 tons that we have seen being imported last year.

So yes, once again, it's difficult to judge talking about, , the chemistry we are handling here. We need that import capacity. And we feel in that overall situation as the, 1 of the last 2 standing TDI suppliers with an IP-protected leading cost position, very well positioned in that market. Then back to Thomas.

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

Yes. So maybe just on your second question, if I understood correctly, you said, well, the outlook is slightly less positive for the Covestro industries. How does that get along with our assumption of flat volumes?

So I would say two things. One is, the change in growth rate, of course, is very, very small. So we're talking 0.3, 0.5 percentage points per industry, which I would say is within the normal volatility range.

And secondly, I mean we're still talking about growth in all our customer industries and our assumption for 2023 is flat volumes relative to 2022. And therefore, I would say those numbers for us were not significant enough as to change our assumption. We do think it's well based.

Operator

And the next question comes from [Georgina Fraser from Goldman Sachs] (corrected by company after the call).

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

Thomas, I actually just wanted to follow up on your volume assumptions. So exactly the point you made, you are actually talking about growth, and you even revised up your GDP growth assumption.

So why are you forecasting to undergrow the end markets? And then into a little bit more detail, I did notice that you had revised up the appliances outlook. Could you maybe talk a little bit about what's driving that? And if it's something that you're already seeing today or just a change in assumption that's coming later in the year?

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

Yes. Georgina, why are we undergrowing the industry? And again, we're talking about relatively small numbers. This is because we, as you know, have some production issues in Germany specifically in Uerdingen and Dormagen site so that we have limited output and had to declare force majeure.

Now turn it positively, the repair work is going on as planned, and we're making good progress here so that we're working on it over the course of the second and the third quarter, and we should be then in full swing back again at the end of Q3, beginning Q4.

In addition, of course, to the demand environment, which is still a little somewhat slow, we also have some output issues. We do think that flat volumes year-over-year is a fair assumption. Now on the appliances, I'm not sure, Markus, whether you have deeper insights? What's behind this?

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

Well, from my perspective, it's a simple reason, but under appliances is not only, refrigerators under appliance, but other white goods, so to say, which means there is other things like dishwashers. So my most beloved device at home.

And the issue here is, it's a very tiny one, availability of chips. So there is an increased production rate simply because the supply chain is getting back to a more normal level with availability of, low-class microchips and semiconductors.

And that's one of the reasons why this overall, provided external outlook has increased, but it is not that substantial for us, as Thomas mentioned, because that is not particularly driven by the refrigerator market, which is the most important, submarket in appliances.

Operator

And the next question comes from [Charlie Webb from Morgan Stanley] (corrected by company after the call).

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

Maybe just two questions from me. So first, just thinking about the spreads, maybe you can just walk us around a little bit, obviously, you kind of alluded to a slightly better kind of volume indication seasonally and sequentially looking through the year.

So just, how do you see spreads shaping up in terms of that balance of supply demand across some of your key commodities? Just a sense on that regionally and by those kind of key commodities, MDI, TDI, polycarbonates would be really useful.

And then just second question on TDI itself, obviously some talk around some of the limitations MOFCOM has put on TDI crisis for one of your competitors to close the deal that they are currently undertaking.

How do you think about that in terms of what it has or what implications that has for the China TDI market? And how would you calibrate that into your kind of mid-cycle thinking in its current form? Does it reduce kind of your mid-cycle as it relates to TDI earnings in China? Does that have a small impact or not? Just trying to understand that, would be great.

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

Yes, Charlie, let me maybe start with the spread question. So I think from an overall picture, you've seen that our mark-to-market stands at EUR 1.4 billion. Our midpoint of EBITDA guidance is at EUR 1.35 billion. So essentially, what we've done, take the number and maybe reduce it slightly. I'm not going to call it a haircut, but it's a slight reduction that we've made.

If you look into the immediate future, that's also true for the second quarter. So we're essentially assuming that the uplift that we're expecting for Q2 in terms of EBITDA is purely coming from better sales volumes, which are seasonally driven.

And as I said, the fact that China has no Chinese New Year and that the construction season is kicking in, but we're essentially assuming that the margins stay flat also in the second quarter of the year. The upper end of the guidance, EUR 1.6 billion, would require some meaningful upside of the margin to happen in the second half of the year.

I think this is in the cards, if demand picks up, but of course, we're not planning with it. As I said, our base assumption is still flat volumes and also margins essentially flat forward. So yes, so I think that would be it from my side on the spread. Maybe Markus, you want to talk about TDI?

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

Thanks, Charlie, for your question. And thanks also for once again hinting on TDI. So what's the situation? Wanhua, the largest, local producer of TDI in China has bought a smaller competitor.

And one of the first measures is that they will shut down a smaller capacity in the order of magnitude, I think, it is 30,000 or 40,000 tons of TDI capacity. So a kind of a small consolidation is going on there.

However, given the size of those players, that has called the antitrust authorities on stage, and they have gone through a rather, sophisticated paper that kind of limits the opportunity of setting the price for TDI in China. However, that goes back, I think, looking 3 to 4 years backwards on the pricing, and we must not forget that, for example, one of those years was 2021, where we have seen rather high prices.

So long story short, I would not expect that this overall regulation, including, this potential price cap, if I may call it that way, will have any significant impact on our ability with regard to earn money with TDI and secondly, also on our ability with regards to our mid-cycle earnings not only because of that very specifics that I just described, but it is just one country and it's just one product, which is not representing the major share of our entire product portfolio.

Let's not forget about the wonderful products like MDI, polycarbonate and the Solutions and Specialties segment. I hope that answers your question.

Operator

In the meantime, Chetan Udeshi from JPMorgan e-mailed me his question. Let me read out for him and thanks Chetan for doing so.

First, he's surprised as you're guiding to flat net pricing in second quarter versus first quarter as we have seen prices come down for MDI, TDI, polycarbonates in China and Europe.

Do you think external pricing data don't fully reflect what you are seeing? Second, it seems second quarter volumes need to be up 5% plus quarter-over-quarter for you to deliver the midpoint of the EBITDA guidance.

Can you please clarify how much of this is better availability versus underlying demand? And related to question two, what are you assuming for second quarter year-over-year volume growth?

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

Yes, Chetan. So we're not guiding net pricing to be flat quarter-over-quarter we are guiding net margins to be flat. So yes, you're seeing that prices are coming down for MDI, TDI, PCS, et cetera. But as I also said in my speech, we do see some tailwind from raw materials kicking in.

Remember, there's always a not insignificant time lag of some months in our data. So therefore, yes, I know it's always a little difficult to build the bridge between the prices that you're observing and the margins that we are guiding for because we, of course, have some more visibility on how raw materials are coming in into our P&L.

And therefore, yes, let me say we do think it's realistic that margin-wise, we're talking about a flat development quarter sequentially. And secondly, you said volumes have to be up 5% sequentially to deliver the midpoint of the EBITDA guidance. I can follow this logic and the numbers, so it does not seem to be totally off.

How much of this is better availability. That is the smaller part. The bigger part is underlying demand. But again, this is not so much fundamental lift up, but there's no Chinese New Year in the second quarter and the construction season is kicking in. So we're not saying that things are getting fundamentally better, it's just seasonality that, of course, will play a role here.

Operator

And the next question comes from Jaideep Pandya from On Field Research.

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

The first question is on free cash flow. If I take like EUR 1.6 billion at your upper end and EUR 500 million as your upper end for free cash, could you just tie those two numbers?

Because you hardly paid any cash tax. So if you're going to pay between EUR 200 million and EUR 250 million of cash tax, are you actually assuming a net working capital inflow despite volume pickup? Because otherwise, I can't seem to square how you get to EUR 500 million free cash from EUR 1.6 billion EBITDA.

The second question is around your energy costs. So in the improvement of spreads in March and assumption of some spread improvement through the year, how much is the energy cost component playing as a role. So could you just give us some quantification of what you would expect for energy cost this year versus last year?

And then the third question really is on MDI. If I just use furniture as a reference industry, do you expect growth to rebound to the sort of 5-year historical average for all this MDI capacity that is coming?

Or do you think that even if we undergrow maybe for the next 12 months, because it's coming from essentially one player and this player is expected to be disciplined, we won't have an overcapacity issue in MDI. Thanks a lot.

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

I hope I got all the questions. Let me start with the cash flow. Let me first explain the midpoint of the guidance. So if you start with the midpoint in terms of EBITDA and then you deduct the EUR 800 million of CapEx and you deduct EUR 200 million to EUR 300 million of cash tax payments and a little bit of other items, then that brings you to the midpoint of the EBITDA range.

Now if you are assuming that we are achieving the upper end of the EBITDA, the thing is that this means there will be a significant uptick in demand, and that would then lead to higher working capital needs. So therefore, to your question, we're not per se planning with a big uptick in working capital if we talk about the midpoint of our guidance because then we would probably be at the same level end of 2023 as we were in 2022.

However, of course, if there is an economic recovery, which will then also lead to higher demand in 2024, that would have a somewhat counter effect in our working capital because we would have to increase our inventories in order to be able to build up or to supply the demand in 2024.

And therefore, I think a key to my message is if we increase our EBITDA, that does not flow through to 100% into our free operating cash flow and that explains the upper end of the guidance for the free operating cash flow.

I mean just on energy, we had energy cost of EUR 1.8 billion last year. You know that is almost double the amount that what we had 2 years before.

Our energy cost in the first quarter of this year were roughly EUR 300 million, driven by two things: One is the energy prices came slightly down, but our consumption went up because, first of all, Q4 is seasonally lower, plus we have started our chlorine facility in Tarragona, which is quite energy-intensive.

So EUR 300 million is the number based on, as I said, somewhat lower prices, but higher consumption. And our assumption for Q2 is that it will stay roughly on the same level. It's difficult to predict it for the second half of the year.

But again, energy cost is only one part of the equation. Our assumption is flat margins. And probably if you multiply EUR 300 million times 4, you're not totally off or at least we don't have a better expectation for 2023.

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

Yes. Jaideep, on the last topic with regards to MDI. So we believe that structurally MDI growth is fully intact. But we also believe that -- and you said, well, just let's take the furniture example as one example, but to really look into the MDI growth, there's two things that need to be considered.

#1 is, we're not only talking about newly constructed private and commercial buildings, but also about a significant market for refurbishment of buildings, not to forget that about 25% to 40% of global energy demand is driven by cooling and heating of buildings.

So there's a huge need for more, energy-efficient buildings. And that is the key driver for retrofitting of homes and new built homes for insulation materials where MDI plays a major role.

And that's why looking at that demand pattern, first and foremost, coming out of the crisis, there is a high chance that the market would show a very strong rebound pattern, which would then very fast lead into balanced markets and looking a little bit further out, there is from today's perspective as announcements, limited capacity built up to '25 and '26 and following years.

In '26 and following years, there is currently even no announcement about additional capacity being built or added. So, the market might even get short or very short in the midterm. And you cannot just turn on the tap and say, okay, let's produce some more MDI.

No matter how you do it, it takes a couple of years from the first planning/announcement to really get quality MDI out of the pipes. And that's why, from today's perspective, you might come to a gloomy outlook. I would say with a quick rebound, limited announcements and also the structural need for MDI given, the sustainable development in energy reduction targets, the MDI market is still intact.

Operator

And the next question comes from Sebastian Bray from Berenberg.

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

I would have two, please. The first is, if I go back to the last time Covestro was doing well in excess of EUR 2.5 billion of EBITDA back in 2018. I recall stock bought back in that year was a little in excess of EUR 1 billion, if memory serves.

I appreciate the capital allocation technicalities have changed in the meantime. But if EBITDA does go back to that level, is that a number that you feel comfortable with?

And then just related to that on the buyback, this EUR 75 million, is there a time period over which these shares are due to be repurchased? Or it's just open ended, it will take a few months and then you'll see how it goes?

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

No. I mean let me start with the last one. So the up to EUR 75 million is the normal tranche that we have. So usually, this runs for 6 weeks until the end of June. Remember, this is consistent with the two earlier tranches that we did in 2022.

I'm not exactly sure whether I fully understood your first question on the buybacks. So yes, we had an EBITDA in excess of EUR 300 million. Yes, there was a buyback in excess of EUR 1 billion with an average price north of EUR 70.

I think we have, since then, as you correctly said, adjusted our capital allocation policy with the topic of buyback being a purely opportunistic and anticyclical measure that we would take. But we would also say that at the current share price, we do think it's an attractive investment.

We do think that the share is undervalued and therefore, this is the key argument for us to restart our buyback with a tranche of EUR 75 million. But our view as to what should the order of magnitude for buyback be, and what also should be the way be it is executed, I would say, has fundamentally changed since 2017, '18.

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

So Sebastian, we were a little bit unclear about, your first part of the question: was it related to CapEx if we would return back to mid-cycle earnings level. Can you just please repeat it? Maybe we didn't get the question clear here.

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

Yes. So no, the answer was the one I was looking for, which is if you feel comfortable -- , if you go back to mid-cycle or what you call mid-cycle for EUR 2.8 billion, is a buyback equivalent to what happened when you last did an EBITDA around that level where the number was in excess of EUR 1 billion potentially on the cards? And the answer seems to be no, we fundamentally reassessed being opportunistic as regards to buying back shares. Is that right?

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

Absolutely correct. You said it nicer than I could say it.

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

Okay. That's helpful. And if I may just push for one more polycarbonate market. I don't think you've mentioned any of the comments related to that. We focused on polyurethane. How is that trading at the moment?

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

Well, as you know, we have intensively changed our exposure in terms of what polycarbonate market we're talking about. And that's why also in modeling, the results of Covestro, it's getting maybe a little bit more difficult as we have significantly outgrown in the Solutions and Specialty Polycarbonate markets and shifted significantly our portfolio to that market. So what does that mean?

We have, meanwhile, about 70%-plus sales in the Solutions and Specialties Polycarbonates segment. That means, our exposure is 30% minus in the commodities area, and that commodities area is very depressed. And at the same time, we have leading assets in all regions. That means, on the one hand, that provides us with very low and cheap feedstock.

And on the other hand, also helps us even in, highly priced competitive markets to still be positive on margins for the commodities. And it also leads to a second effect that even though commodities are very depressed our specialty is still okay.

The overall earnings for us is less volatile than they have historically been due to that shift in product mix in the polycarbonate exposure.

And we're pushing hard to further increase the specialty share in the portfolio. You could guess that every year between 4 and 5 [percentage points] (added by company after the call) is shifted towards Solutions and Specialties segments. So that at one point in time soon, 3, 4 years, maybe we only have an opportunistic exposure to the PC commodity markets.

Operator

And we have a follow-up question from Jaideep Pandya from On Field Research.

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

Sorry to ask you this again, Thomas. But you had a working capital burn of EUR 257 million in Q1. So what I was actually trying to ask you is, what do you expect for working capital for the rest of the year?

Because otherwise, honestly, I'm a bit struggling to square the math because, again, you had a CapEx of EUR 120 million, and you're guiding for EUR 800 million. So a lot of these numbers are bit under what you're guiding for on a full year basis.

So that's why I'm struggling a bit more bridging the EBITDA to cash. So could you give us some color on what do you expect for working capital?

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

Yes. Sorry that I was not clear. So essentially, we're expecting that working capital should be neutral for the full year 2023. So the EUR 250 million that you see negative in Q1 is a seasonal buildup, which should then be neutralized over the course of the year. That is the usual swing that we have.

And therefore, if you take the midpoint of our guidance, the number that I would plug in for working capital is essentially 0.

Operator

Thank you, ladies and gentlemen, for all your questions. There are no further questions at this time. So handing back to Ronald.

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

Yes. Thank you all for all your interesting questions. If you have more questions, don't hesitate to come back to the IR team. And with that, I wish you all a good afternoon or going on for the next conference call, I guess. So yes, goodbye from my side. Thanks. Bye.

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