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1COV.DE - Q3 2015 Covestro AG Earnings Call

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**Patrick Thomas** *Covestro - CEO*

**Frank H. Lutz** *Covestro - CFO*

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**Jaideep Pandya** *Goldman Sachs - Analyst*

**Paul Walsh** *Morgan Stanley - Analyst*

**Thomas Gilbert** *UBS - Analyst*

**Andrew Benson** *Citigroup - Analyst*

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**Peter Mackey** *Exane BNP Paribas - Analyst*

## PRESENTATION

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### Operator

Ladies and gentlemen thank you for standing by. Welcome to the Covestro investor conference call on the Q3 2015 results. The company is represented by Patrick Thomas, CEO; Frank Lutz, CFO; and Ronald Koehler, investor relations. During the presentation all participants will be in a listen only mode.

(Operator Instructions).

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

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### Ronald Koehler - Covestro - IR

Good afternoon and welcome to our first and ever Covestro conference call for - regarding our Q3 results and also welcome on behalf of my colleagues. For your information we have posted our interim report and the conference call presentation on our website, which will be available for you.

And we also assume that you have read our Safe Harbor statement. With that, I would like to pass on to our CEO Patrick.

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### Patrick Thomas - Covestro - CEO

Thank you very much Ronald and good afternoon everybody and welcome to our first investor conference call. We, I believe, have successfully established our stock market listing.

Share price has increased by 18%, which makes it the best performing German large capital IPO this year to date. And we're also ready to tap the bond market with a solid investment grade rating. Our strong operational performance should be the basis for further share price appreciation.

If I turn to the nine month sales and earnings, despite a slow growth - despite a slowdown in quarter three, we were able to generate a solid core volume growth of 2.5% year-on-year, year-to-date, which is clearly ahead of our peer group.



Earnings have jumped to a new level with an adjusted EBITDA margin of 14.9%. In quarter three we achieved the highest margin of 15.6% despite weak volumes. This confirms that our year to date earnings increase is rather structural and not driven by short term volatility. Let me just pass on to Frank now to talk to some of the financial details. Frank.

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**Frank H. Lutz - Covestro - CFO**

Thanks Patrick and also good afternoon from my side. In Q3 2015 our sales were almost unchanged year-on-year. However below the line there was quite some volatility as you can see.

As it is typical for our business we however focus on core volume growth which is an important value driver for our long term profitability and in that respect our core volume reflects year on year in Q3 2015.

We demonstrated once again a strong pricing power in Q3 of 2015. We were able to reduce prices less than costs giving a favorable supply and demand balance in some of our industries. The majority of our operational market increase was generated in the segments polycarbonates.

The picture in our polyurethanes segment was mixed. It could increase our markets in polyols with the help of our byproduct styrene. On the other side, our pricing power was weak in TDI driven by overcapacities in the global industry.

If you turn your focus on China we would like to provide you with some more detail on this country. Only 15% of our global sales is generated in China. We achieved still solid core volume growth of 5% year-on-year in the first nine months of 2015 despite a significant weakness in Q3 of this year.

In our view the weakness was driven by destocking as many customers adjusted the full year 2015 growth assumptions downwards. The weakness was most pronounced in July, potentially also driven by the stock market crash. August improved versus July. In September, we even sold the highest monthly volumes year-to-date.

Overall we believe that China will remain a high growth country in line with our budget of about 5% long term growth per annum. Interestingly our core volume growth in the US and Germany even accelerated in Q3 of 2015 compared to the first half of this year.

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**Patrick Thomas - Covestro - CEO**

Thank you very much, Frank. If I just turn to the next chart, what I've done here is I frequently get confronted with the question where are you in the cycle. So in an attempt to answer that I've portrayed our portfolio in a sub segmentation of resilient and cyclical businesses which I hope you'll find helpful.

Polycarbonates is above mid cycle margins but still below the last peak margin of 27%. On the other hand TDI is clearly approaching the bottom of the cycle and we assume that high cost producers are currently burning cash.

Also MDI is operating slightly below mid cycle margins in our view. In addition people tend to overlook polyols. Polyols have a structurally low volatility as the transportation of propylene oxide is difficult and expensive.

This leads to local markets with relatively stable margins and a consequence we believe that CAS, the coating, adhesives and specialty business together with polyols which represent around 40% of sales and a higher proportion of earnings, should develop in a very resilient way.

If I now turn to the overall group results, in quarter three it's clear that we were able to defend our higher margin levels despite the weaker volume development. If I go into the individual business segments in polyurethanes, the adjusted EBITDA was slightly up year-on-year but down quarter-on-quarter.

In MDI, the new plant from BASF in China is currently in ramp up phase and it has yet to be seen what impact that it may have in the Chinese market. Margins in TDI deteriorated sequentially every quarter in 2015 and we believe the industry margins are now so low that it is difficult to imagine that it could drop further. However we've not seen any signs of a rebound.

It may take some years to absorb the current overcapacity and an unknown factor is that related to plant closures. Polyol earnings are steady as usual, however, our byproduct styrene benefited from very tight margin markets in quarter three and this seems to have reduced slightly in quarter four as the styrene margins return to a normal level.



In polycarbonates we achieve once again very good margins driven by the favorable industry supply and demand balance. In quarter two, we were still a little puzzled as to how much of the improvement was short term and how much was structural.

As margins continue to be very high despite no major planned or unplanned outages in the industry, we now believe that we have a structurally higher margin level established and this trend is certainly be confirmed as we see the results in October.

The margins in our segment of coatings, adhesives and specialties approached a highly attractive level and that despite lower volumes in Q3. In our view the volume decline was driven again by destocking in the market and overall we achieved a solid core volume improvement at 3.5% year-on-year to date.

Margins broadly benefited as a result of lower raw material costs as our products are priced based on the value that we are delivering to our customers.

Frank, take us through the free operating cash flow.

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**Frank H. Lutz - Covestro - CFO**

Yes, in terms of free operating cash flow we are on track for a new record. Historically let me remind you about that, we achieved our last record free operating cash flow exactly 10 years ago, with EUR573 million in fiscal year 2005. That of course helps us to be fully on track with our financing targets.

Moody's now rates as a BAA2 with a stable outlook i.e. what we have in investment grade rating. During our IPO we also promised that we will end the year with a net debt to adjusted EBITDA ratio in the range of two and a half to three times. We are now very comfortable that we will target the lower end of this range.

Overall we are also very confident to deliver on all our financial targets which we communicated during the course of the IPO process. We assume a solid core volume growth for the full year 2015 despite the weakness in Q3.

Adjusted EBITDA should be seasonally weaker in quarter-over-quarter in Q4 of 2015. In addition we will also have a major turnaround in China which will burden the Q4 results with about EUR50 million. During our IPO roadshow we also explained that we usually generate about 40% to 45% of our adjusted EBITDA in the second half of the year. We still expect to end up in this range, however a finish at the upper end seems now more likely. Patrick.

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**Patrick Thomas - Covestro - CEO**

Thank you - thank you Frank. Let me just summarize on the last chart - last chart. We are fully on track. The equity story is fully intact. We aim to achieve solid organic growth as the long-term growth rates for our markets are all above GDP. Given our focussed portfolio and the strong growth profile of our products we do not see any need for any large acquisitions.

This implies that the majority of free cash flow can be distributed to our shareholders. We planned to payout a decent dividend of EUR cent 50 to 75 per share already for this our first stub year.

As of full year 2016 we confirm our guidance of a payout ratio of 30% to 50% relative to net income on our IFRS basis. From today's perspective this implies that our dividend yield will be above most of our chemical peers.

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**Ronald Koehler - Covestro - IR**

So that ends the presentation we are now open for the questions from your side.

**QUESTION AND ANSWER**

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**Operator**

Thank you. Ladies and gentlemen at this time we will begin the question-and-answer session.



(Operator Instructions)

The first question comes from Martin Roediger of Kepler Cheuvreux. Please go ahead.

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**Martin Roediger - Kepler Cheuvreux - Analyst**

Thanks, actually three questions. First you mentioned September had good volumes, but can you talk about the momentum into October? Was there ongoing destocking or did that destocking intensify?

Second question is on your pricing power. Thanks for the chart about the pricing power impact of EUR108 million on EBITDA in Q3. To which extent is that sustainable in your view and maybe you can give us a rough split how that distributes to the segments. I guess that polyurethanes did not really benefit from any price power. You mentioned that TDI had weak pricing power so I guess the whole EUR108 million - EUR108 million you have to allocate to polycarbonates and CAS.

And thirdly on your EBITDA guidance you said a significant increase. On one end you're saying net debt to EBITDA will be probably at the low end of the 2.5 to 3.0 range that implies 1.6 billion adjusted EBITDA for this year.

On the other hand you expect EBITDA to increase in Q4 year over year. Last year it was EUR210 million so adding that to the first nine months I get also EUR1.6 billion. So, actually you expect EBITDA to be EUR1.6 billion. Is that correct and why don't you mention that target specifically?

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**Patrick Thomas - Covestro - CEO**

Okay, Martin, thank you very much for your questions. Just in terms of how it feels in October, from our October perspective we feel we're continuing along the lines of September. So I think the destocking has taken place pretty much and we're seeing volumes in September. I think we actually mentioned in terms of China we saw our record month in September. So I think that is positive in October and we're feeling comfortable.

I think in term of pricing power your analysis is spot on. This is pricing power in polycarbonates much less so in TDI and MDI where we're TDI particularly weak with oversupply in the market place and MDI where we're pretty balanced to be honest. So, if there was raw material movement on MDI I believe that would also be passed through.

In terms of your analysis of the mathematics I'm going to pass over to Frank. When 1.6 equals 1.6 I think we need a CFO to explain.

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**Frank H. Lutz - Covestro - CFO**

Martin, first of all of course your math is right. Second let's not argue about decimal points here. As you know 2.46 would also be rounded into a 2.5 so we cannot exactly to the millionth value what the - what the EBITDA for the full year would be, therefore we're not using any exact numbers but rather give you the guidance that we've just done.

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**Martin Roediger - Kepler Cheuvreux - Analyst**

Thank you.

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**Operator**

Our next question comes from Jaideep Pandya of Goldman Sachs. Please go ahead.

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**Jaideep Pandya - Goldman Sachs - Analyst**

Thanks and good luck guys. First question really is on polycarbonates. If you just look at the margin trajectory for this year through the three quarters you obviously have sequentially increased margins. So, just sort of - I'm just trying to understand this business fundamentally going into next year.



Do you think that you'll be able to sort of keep prices stable i.e. if, you know, we get the year on year benefit from lower raw material as we go into next year? I know it's difficult to know next year but just want to understand the sequential trajectory of this business. That's the first question.

And then the second question is really well also related really to polycarbonates. If you can tell us when does your supply come in next year and if you expect the demand supply balance in polycarbonates to sort of remain roughly the same as this year or do you expect any material change? Thank you.

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**Patrick Thomas - Covestro - CEO**

Okay, thank you very much for this good question. So the polycarbonates sequential trajectory is going to find its natural point at some level in supply and demand balance and it really relates very heavily to your second question which is how we see supply developing.

So on the supply side I think it's fair to say that we don't see any net growth in capacity in 2016 at all in the market globally. So that would say that with some growth in demand the market would be slightly tightening next year. That's driven by a number of issues which are fairly well known.

Teijin in Singapore have half closed their assets already and will finish closing it at the end of this year. That is between 3% and 4% of global capacity. Saudi Kayan have actually publically stated that they will have a turnaround next year roughly the same time as they had this year over a similar duration. That would equate to roughly 1% of global capacity.

And you referred to our plants. We did put a risk statement out to the time of the prospectus that as results of the fire in China we did not have our permits to start up those plants. We now have received those permits and we're in the rather nice position of being able to be flexible about when we bring those plants on stream now.

So there's a degree of flexibility that we have which means that if the market demand picks up we're able to respond to that. If the market stays static then we're also able to bring those assets on when they're needed by the market. But I think that's probably the best way of looking at it.

But certainly if you look at the demand balance, supply demand balance going out over the next few years, we've now got a period where the average growth in capacity is somewhat south of 1.9% in our view and we've actually seen a number of delays announced on some of the facilities that were planned for China, as I know were in some of your databases.

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**Jaideep Pandya - Goldman Sachs - Analyst**

Okay, and just a question really on MDI, do you think that given the demand supply balance in this product, I know it's a much concentrated product compared to TDI, we could see margin development similar to TDI and MDI over the next couple of years.

Just trying to understand if you are sort of at a stage where margins stay stable or do you expect material margin pressure in MDI over the next couple of years? Thank you.

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**Patrick Thomas - Covestro - CEO**

I think that it's stability. I think we would expect with the supply and demand balance that we see going forward, we would see fairly stable margin development. There are always going to be movements quarter over quarter over in MDI pricing.

MDI has a vast range of different products that make up the mix. But I think I would not expect to see it following the track of TDI.

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**Jaideep Pandya - Goldman Sachs - Analyst**

Thank you, thank you so much.

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**Patrick Thomas - Covestro - CEO**

Thank you.



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**Operator**

Our next question comes from Paul Walsh of Morgan Stanley. Please go ahead.

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**Paul Walsh - Morgan Stanley - Analyst**

Yes, thanks very much guys. Afternoon Patrick, Frank and Ronald. Two questions if I can. How do you get people to focus on the -- on the CAS segment, Patrick? It's very different to the other businesses in terms of margins at least are sustainable through the cycle from historical evidence.

How do you get people to really think about that business, you know, more widely within the context of the investment case? That's my first question. And my second question relates to the savings program. You said, I think through the process, something along the lines of EUR420 million, which if I remember correctly came at a very low cash cost.

And I'm just wondering how the group is increasingly thinking about how to streamline costs in a world where you are now fully deconsolidated from Bayer.

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**Patrick Thomas - Covestro - CEO**

So, in terms of CAS, I think what we're seeing is a number of analysts now looking at some of the part valuations, which is already, I think, a sensible and positive way of looking at Covestro as a whole.

And I think that is why I put that chart that I have in the pack, with Ronald's help to really say, you know, actually we have a polyos business that is pretty resilient as well and shows very little cyclical supply and demand effects because of the nature of that business.

And we're doing some work on promoting within the chemical trade journals and other places more color around our CAS business. So, we've been putting out quite a bit of materials more recently and we will continue to do that to help people understand this coating adhesives and specialties ingredients business and see the nature of the reason for its stability.

So, hopefully you will start to see more material in the chemical press and around the major publications helping to explain this more independently.

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**Paul Walsh - Morgan Stanley - Analyst**

And is there any reasons to believe that the CAS segment's overearning at the moment? I mean I thought the Q3 margin was particularly high. I know raw materials have gone down, but is it as simple as what if raw materials go back up again then you just lose a bit of margin or, you know, are you pretty comfortable with the way you're trending this year?

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**Patrick Thomas - Covestro - CEO**

No, I think, Paul, it's exactly the way that you've described and of course you have to remember that there's a bit of a ForEx effect in there as well on CAS.

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**Paul Walsh - Morgan Stanley - Analyst**

Yes.

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**Patrick Thomas - Covestro - CEO**

And I think if you look at the overall ForEx effect and proportioned it in roughly the sales values of the three segments, you'd probably get a quantification of how much that's affected the CAS business. But you're right, I mean we have to eat or enjoy the raw material variation.



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**Paul Walsh - Morgan Stanley - Analyst**

Understood, and is that pretty live I - you know of course it's a quarter, it's not like there's a three or four quarter delay between deflation fitting into your business. It's a relatively quick process.

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**Patrick Thomas - Covestro - CEO**

It's pretty instant, yes.

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**Paul Walsh - Morgan Stanley - Analyst**

Yes, okay.

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**Frank H. Lutz - Covestro - CFO**

On the savings or profitability enhancement program, Paul, I'm not sure I understood your question correctly, but I answer it in two ways and I think one of the others will hit the question.

In terms of the net effect that you will see in 2016, we guided you in the road show that there would be a zero net effect because the savings that will materialize in 2016 will be eaten up by one time effects and then only over '17, '18, and '19 you will see the full effect of somewhere between EUR100 million and EUR150 million on a net basis.

From a cost savings perspective and that accounts for about EUR150 million out of the EUR420 million on a gross basis, we have now, given that we are independent from Bayer, of course looked at some processes already, i.e. the process of redefining some of our business processes.

We have as we indicated during the road show a changed the business model slightly for 26 of our countries that we are doing business in because all the sales functions are being supported centrally by a sales support entity in Switzerland. Of course that not only helps to bring down the amount of legal entities, but also helps to save costs.

So there's a couple of measures already underway. We are also in the process of defining more line items and there will be more to come over the next, I would say six to 12 months to get to the full potential.

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**Paul Walsh - Morgan Stanley - Analyst**

Okay, I hear you. So you'll just communicate on the additions to that as in when you've got something to say.

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**Patrick Thomas - Covestro - CEO**

Exactly.

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**Paul Walsh - Morgan Stanley - Analyst**

Okay, understood. Thank you.

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**Operator**

Your next question comes from Thomas Gilbert of UBS. Please go ahead.



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**Thomas Gilbert - UBS - Analyst**

Thank you, gentleman. Good afternoon. Three questions from my end. Can you quantify or remind of us of the peak to trough profit volatility that the byproduct styrene sales in polyols produce or can make up just to dimensionalize that?

The second question, in the balance sheet fully realize that pension provisions increase, fully understandable, but what I'm trying to understand is the other provisions increase as well by EUR100 million and the current portion without, non-current portion going down, what kind of other provisions have gone up and why?

And then the third question is on -- on the polycarbonates business. We've seen some auto data out of China in October that were very strong, but skewed towards smaller cost in Chinese produce. Can you elaborate on the polycarbonates grades whether you are agnostic to number one, small versus big cars and number two, whether you are stronger with Western or with the relatively up and coming car manufacturers, thank you.

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**Patrick Thomas - Covestro - CEO**

Okay, thank you very much for your questions, Thomas. So, on the styrene, first we need to be clear for everybody's benefit with the sales and profits of the styrene business are fully accounted for within our polyols division within the polyurethane PUR numbers.

We expect for full year this year a positive earnings contribution of approximately EUR70 million and that's based upon the favorable stock prices that we got in quarter two and quarter three, having now returned to normality. So, I guess the full spread of impacts of styrene could be a sort of minus 20 plus 70 range, peak to trough.

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**Frank H. Lutz - Covestro - CFO**

Pension, on your question regarding provisions here, of course pension provisions went up because of the lower interest rates and the other provisions, these are two effects. One is because we are doing better, also the bonuses that we will pay out at the end of this year will go up and therefore we have built provisions for the short term incentive program.

And the second effect is the closure of our Belford Roxo site in Brazil and we had to build some provisions for the closing costs that will come up during the next couple of months.

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**Patrick Thomas - Covestro - CEO**

Then going on to automotive, Thomas, I think agnostic is probably the right word. If you look at our sales distribution in China, we supply all of the Chinese domestic producers.

The size of the car doesn't have a huge impact on the overall capacity or consumption. It's more the trim labels and the sophistication. Interestingly in China you're seeing less hybrids and more real electric vehicles. On fully electric vehicles, we tend to even better than non-hybrids or others because we produce the polycarbonate crash shield that's used around the battery to avoid lithium fires in an accident. So, actually some of these small vehicles have quite high levels of polycarbonates in them.

In fact, I'll draw your attention to one electric vehicle which is the i3 which probably has one of the highest levels of polycarbonates consumption of any mobile in the marketplace, from BMW. Even the rear light clusters are not using acrylic, they're using the polycarbonates, so there's quite a lot of small car adoption.

The other thing about small cars is they want to pretend to be big cars and when you have a small sunroof on one of the small vehicles, they make it look like a large panoramic roof by adding a polycarbonate black super shiny surround, which actually increases the content significantly without increasing the weight of the glass on the small vehicles.

So, small to large cars, the uses are just slightly different. Chinese to local foreign producers to international producers, we're present in all of them. I would say that October is looking like it's probably going to be quite a strong month in terms of automotive and in the USA we're expecting to be - let's see, the third month this year with double digit growth. So, full year '15 in America will probably be an all-time record for our sales into automotive.

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**Thomas Gilbert - UBS - Analyst**



Thank you Patrick. Can I just follow up on the second question on provisions generally, from provision releases, for example restructuring cash outs or environmental litigation, whatever, can you remind us, is there a guidance for cash out from other - or the cash flow impact of provisional releases for 2016 already?

Is it going to be sort of in the low double digit as previously sort of hinted? Can you -- can you talk around that?

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**Frank H. Lutz - Covestro - CFO**

We have not given guidance, but you're right. It should be in the low double digit range. I don't expect significant cash out from the provisions that we have built so far, other than of course what we are paying out in terms of short term incentives...

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**Frank H. Lutz - Covestro - CFO**

... that will of course will have cash effect, but that's of course part of the general personnel cost.

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**Thomas Gilbert - UBS - Analyst**

Thank you, thank you very much.

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**Operator**

Your next question comes from Andrew Benson of Citi. Please go ahead.

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**Andrew Benson - Citigroup - Analyst**

Yes, thanks very much. Firstly, if I can ask on from Paul Walsh's question. You've announced a EUR420 million restructuring program. When you were talking about announcing measures, an additional - what - were you talking about fulfilling EUR420 ambition or are you now planning on further measures now that you're independent and you perhaps have more flexibility to make those decisions?

The second on TDI, is there much that you can do to address your costs to improve profitability? Thirdly, can you just go through the cash ins and cash outs associated with the Bayer separation and any pension things, just so that we can get a good idea on that - the issues in the fourth quarter? Thanks very much.

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**Frank Lutz - Covestro - CFO**

Let me start with the profitability enhancement program and we are a bit picky on semantics I know, but it's not a restructuring program because we don't need to restructure our company. I think the numbers show that there is no restructuring need, but there is certainly the potential to increase profitability.

And what we have showed you in the road show and we are not deviating from that number at the moment is that we see additional potential of EUR420 million, EUR270 of which coming, broadly speaking, out of growth and better asset utilization and EUR150 about coming out of redefining business processes.

And that's what we are working on at the moment and this is the program that we want to have fully implemented by 2019.

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**Patrick Thomas - Covestro - CEO**

Andrew, maybe I can pick up on TDI profitability and then I'm going to hand it back to Frank on the Bayer separation cash flow question.



On TDI profitability I just bring you up to speed as to what we've included in our guidance at the moment. The first is that we've started up our new low cost Dormagen facility. It was fully on stream at the end of last year and we've had a very good year now of running that facility. We've now got to the point where we're confident enough that in September we actually closed 125,000 ton TDI unit, which is in Brunsbüttel.

So, that facility is now shut down and earlier we shut down the 55,000 ton unit in Dormagen. So, we're now in the situation where globally we have one gas-phase facility in Ciaojing, which is we believe the lowest cost and certainly the most energy efficient plant anywhere in the world in a zone where energy is relatively expensive.

We have copied that technology into Europe and we're now running that low cost unit in Europe where energy, again, is expensive. In America, we could never justify replacing the TDI unit there because the TDI unit there is enjoying the low energy price and the gas-phase process wouldn't actually significantly be justified, so that's where we are in terms of the asset profitability.

We are looking at other ways in improving the profitability clearly. So, but structurally we have done everything we can in terms of closures and implementing our process technology in the right places.

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**Andrew Benson - Citigroup - Analyst**

Can I just -- before we go to the last question, can you just give a sense of the -- of the quarterly step down in profitability, because obviously you must have been double running parts for some time and if - once Dormagen and Brunsbüttel completely shut and you've got, you know, the ongoing configuration, what the level of cost reduction is?

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**Patrick Thomas - Covestro - CEO**

Yes, it's roughly of the order of EUR50 million. That would be a good indicator. Five, zero.

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**Andrew Benson - Citigroup - Analyst**

Okay.

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**Frank Lutz - Covestro - CFO**

Yes. Now in terms of cash in and cash out, what exactly do you mean, Andrew...?

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**Frank Lutz - Covestro - CFO**

... related the cash out, what's not already in the nine month figures, or what are you after?

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**Andrew Benson - Citigroup - Analyst**

Yes, what -- the residual measures associated with independence? I think there are some pension payments or pension transfers. What the cash - comparatively on the debt, debt equivalent of those changes?

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**Frank Lutz - Covestro - CFO**

Yes, no I understood. Okay, so, basically after the 30th of September there will be broadly another cash payment, one off cash payment in the amount of roughly speaking EUR200 million all together during Q4. Now, keep in mind of course that you also got a cash contribution from Bayer right after the 30th of September in the amount of EUR1 billion.



And taking everything together, our guidance for the net indebtedness including pensions at the end of 2015 still holds true. We still target the EUR4 billion, so despite the cash ins and cash outs that are happening still after the cutoff date 30th of September.

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**Andrew Benson - Citigroup - Analyst**

Okay, thanks very much.

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**Operator**

Your next question comes from Martin Dunwoodie of Deutsche Bank. Please go ahead.

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**Martin Dunwoodie - Deutsche Bank - Analyst**

Thanks. Afternoon, everyone. Just coming back to the inventories and destocking and that kind of area, could you remind us how much visibility you have in your order books and how that varies by business?

And then secondly, related to that, you've already mentioned that you've had some destocking TDI, which sounds like it's pretty much over, you've obviously got your shut down in Shanghai in Q4, but what are you expecting? And I guess given where we are in the year already what kinds of things are you seeing already in terms of destocking towards year end whether it's a normal destocking period, or whether you're expecting more pronounced destocking given what we see in terms of macro weakness.

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**Patrick Thomas - Covestro - CEO**

Okay, yes, Martin, thank you. Order book visibility, we have pretty strong visibility one month ahead. Going beyond two months, then it's quite difficult and it's probably about 30% of the order book would be visible two months out. Three months out, clearly, very little visibility.

That doesn't mean we don't have annual contracts which have volumes provided for. All I am talking about is the actual visibility of real orders which is I assume what you are looking for.

In terms of, yes, in terms of quarter four and the destocking process I think what we are seeing and we are being particularly sensitive around China, is what we are seeing is now our return to the normal stock management towards year end in China.

The place which I am seeing more issues actually rather than China, and China to me was a July-August event to a very large extent, but we have now seen the knock on effects of that through the ASEAN countries.

Because of course the ASEAN countries are very often providing components for Chinese manufacturing. And in fact if anything we saw bigger effects in ASEAN during the Chinese loss of confidence than perhaps even in China.

So if you think about who's assembling which bits and whose making which bits in the electronics arena particularly, but also to an extent in automotive, the ASEAN countries have been effected. That certainly effects a lot of people who have business in the ASEAN region. It's not a huge issue for us because we are not supplying a lot of those customers.

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**Martin Dunwoodie - Deutsche Bank - Analyst**

So nothing severe anticipated for year end?

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**Patrick Thomas - Covestro - CEO**

No, really not. I think you'll see a normal seasonality and our working capital track will be pretty much as normal.



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**Martin Dunwoodie - Deutsche Bank - Analyst**

Great. Thank you.

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**Operator**

Your next question comes from Lutz Grüten of Commerzbank. Please go ahead.

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**Lutz Grüten - Commerzbank - Analyst**

Yes, thanks. A few questions left. On the P&L, the other operating income is significantly up. It would be helpful if you could give us some ideas of what is behind. I was quite pleased to see net working capital be down after nine months over H1. I would have expected this slightly up due to the shut downs coming in the final quarter. Any explanation why I was wrong with my assumption here?

And finally on the dividends you confirmed the range, 100 million to 150 million. What are the financial criteria you look at for that decision? The final quarter is almost done, it might be helpful to give us some ideas what are the really most important financial criterias here. Thank you.

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**Patrick Thomas - Covestro - CEO**

Okay Frank, you're going to look into the P&L of the operating income?

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**Frank H. Lutz - Covestro - CFO**

Sure. And the other operating income is predominantly influenced by a onetime payment that we received from Bayer because we were no longer using the Bayer brand name and the Bayer logo, and that was roughly in the area of EUR50 million.

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**Patrick Thomas - Covestro - CEO**

Thank you, Frank. On net working capital, yes, I think we have seen some improvement and some of the issue is that actually the volumes that we've been selling have been higher than expected so there has been some reduction in stock.

There's also been a cash positive contribution from working capital in quarter three mainly because of the lower polyurethanes sales and hence lower receivables. So that is probably the effect you are alluding to.

Overall our inventory level went up from 70 to 76 days which is actually going in the right direction to prepare for the turnaround.

Okay. Financial criteria for dividends, Frank.

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**Frank H. Lutz - Covestro - CFO**

Financial criteria for dividends. I mean, we -- as you know we are given the guidance that regardless of the development we want to pay dividend for the stub year of 2015 in the order of EUR100 million to EUR150 million.

Going forward, so starting with fiscal year 2016 about 30% to 50% of our net income per share should be paid out as dividend. We put a high focus on dividend continuity and dividend stability going forward. But of course this will only start with the first -- if you want real dividend payment which will happen somewhere in the second quarter of 2017.

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**Lutz Grüten - Commerzbank - Analyst**



I understood the 30% to 50% payout ratio, I was just wondering there is still a high range EUR100 million to EUR150 million given the fact that the year is almost done, the final quarter might be not having a huge impact on full year numbers anymore. I was just wondering what the criteria might be to make a judgment then on the EUR100 million or EUR150 million.

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**Frank H. Lutz - Covestro - CFO**

Well let's see how the year develops. I mean, remember it's been a step year. We went public on the 6th of October. If we only based the dividend payment on what we earned between the 6th of October and the 31st of December we would probably not pay out EUR100 million to EUR150 million.

So let's see how the full year comes out and then we'll take decision together of course with the supervisory board and eventually in the shareholders meeting.

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**Lutz Grüten - Commerzbank - Analyst**

Sure. The shareholders are always greedy but thanks for the answer. Thank you.

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**Frank H. Lutz - Covestro - CFO**

Yes they are.

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**Operator**

Our next question comes from Laurent Favre of Bank of America Merrill Lynch.

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**Laurent Favre - Bank of America Merrill Lynch - Analyst**

Yes, good afternoon and thank you for taking three questions. The first one is on styrene. There was this cool off out there from one of your competitors that there's little reason why next year should be worse overall for the year based on, you know, 1% net supply additions maybe 1.5 % to 2 % demand growth. I was wondering what was your view on this?

The second question is on the impact of shutdowns. Can you remind us if there was any other big shutdown that was part of an adjusted EBITDA for the first nine months and whether we should assume that we get the EUR55 million back next year and whether you have other big shutdowns that will be part of adjusted EBITDA in 2016?

And the third question, just on Q3, you got three business lines, three regions so we get nine lines], you know, lines. There is one that is actually accelerating in Q3 and that's European polycarbonates. I was just wondering why that was the case. Thank you.

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**Patrick Thomas - Covestro - CEO**

Thank you, Lyle. Let me try styrene first of all, and you have to remember we are not world experts in styrene.

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**Laurent Favre - Bank of America Merrill Lynch - Analyst**

Me either.

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**Patrick Thomas - Covestro - CEO**



I've seen - well, I've seen what has been published and I think when I saw the very optimistic data around about half year which said that structurally Europe would have higher styrene margins. I think my answer at half year was watch out because American material will start landing into Europe fairly quickly if the margins stay so high. That is pretty much what has happened. But there actually is a limit to how much that can happen.

So the real question mark, and I don't know what the answer for this is for next year which is why I've given a clear statement for what happens this year. Next year we have to really think about what happens as it develops because in America there have been a number of styrene facility closures as well.

So the supply and demand balance in America is relatively tight. So at some point there's got to be some equaling out of this supply and demand balance in Europe. The other thing is most of the styrene assets are relatively old. There is a lot of old facilities both in Europe and America and there are very few replacement facilities being built.

So there may well be a structural improvement in the overall styrene margins. I always work on the basis that I look at the downsides and try and let you know what those can be. So I've told you about styrene this year and the positive benefits and the assumption that it doesn't continue into quarter four.

If there is an upside on styrene next year I will be very happy if that happens, but I cannot have any influence over it. Please Laurent, yes.

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**Laurent Favre - Bank of America Merrill Lynch - Analyst**

On the shutdown from the 55 million for the next year.

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**Patrick Thomas - Covestro - CEO**

I thought you were going to ask a follow-up there on styrene for a second. No? On shutdowns, our planned shut down on the Caojing site in China is taking place during fourth quarter. It affects all of the business units so it is a complete site shutdown.

It will be out for six weeks between the months of October and November. Everything is on schedule. It has a negative impact of EUR50 million on our earnings. We have already factored that in to our full year and quarter four guidance.

So that is really where we are. And it's after that we hope not to have to shut down Caojing for another five years. This is the synchronization of all the legal inspections into one year. Because obviously we built Caojing over quite a long period and each year we start a plant up there it starts its five years counting.

We've actually chosen now to synchronize all of those into one shutdown. After we've done that, then we will have much higher availability in Caojing and we shouldn't have the next major turnaround for five years.

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**Frank H. Lutz - Covestro - CFO**

Yes in terms of PCS in Europe during the third quarter, we basically -- you saw the significant increase in profitability due to two effects: a, the volumes increased and b, we were able to increase prices.

And that was quite a beneficial situation because in the other regional areas either volumes went down or we could only increase prices. But in Europe basically both came together and that helped us to increase profitability there.

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**Laurent Favre - Bank of America Merrill Lynch - Analyst**

Okay. Thank you. Thanks a lot.

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**Patrick Thomas - Covestro - CEO**

Thank you, Lyle.



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**Operator**

Our next question comes from Peter Mackey of Exane. Please go ahead.

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**Peter Mackey - Exane BNP Paribas - Analyst**

Thanks and afternoon everybody. Just a few sort of mopping up questions I guess. Now just straight follow on from Laurent's question on the accounting maintenance. Was there anything similar in the fourth quarter of last year that has a comp effect that we should be aware of, please?

And then I just wanted to get some guidance on some of the stuff that we don't talk about very often. The industrial operations had a negative EBITDA in the third quarter. Corporate and reconciliation line was, you know, has been quite volatile quarterly.

I wondered if you could give us some guidance on how you think that's going to look like at the full year stage. And then just in the financials line, I recall when we spoke before about the associate's line the Wilmington joint venture was I thought just booking depreciation through the - your P&L.

But, you know, that contributed nothing in the first half and minus four in the third quarter. How should we think about associates and interest income for the year or for the fourth quarter please? That's it. Thanks.

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**Patrick Thomas - Covestro - CEO**

Thanks very much for your good questions. Yes there was a similar effect last year towards the end of the year but it wasn't in Caojing, it was in Baytown. We had a major turnaround of similar magnitude, it was slightly smaller.

My recollection was it was around about EUR30 million, but I may be wrong on that so we can check and come back to you on that. But certainly Baytown took the pride of place in turnarounds last time. The question around industrial operations.

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**Frank Lutz - Covestro - CFO**

Yes. In industrial operations profitability went down because HCI prices in North America went down. Honestly speaking basically on the basically central administrative functions you see a lot of volatility because -- due to the carve out and the additional functions that we are doing ourselves basically.

We saw some increases there and we believe that now of course given that we are an independent and stable organization we know our cost base and have our cost base going forward.

But that is the main reason why you saw quite some volatility compared to the time when we were still part of Bayer and got some of the services that we now have to do ourselves provided by Bayer.

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**Peter Mackey - Exane BNP Paribas - Analyst**

So what sort of numbers do you think the - well, certainly the corporate reconciliation line might - what do you think that might be for the full year is your best guess?

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**Frank H. Lutz - Covestro - CFO**

Yes, for the full year. In 2014 you saw an effect of about minus 28 million. I would think it's in the mid30's, minus mid-30's this year

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**Peter Mackey - Exane BNP Paribas - Analyst**

OK. And then on the financial items.



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**Frank H. Lutz - Covestro - CFO**

We have predominantly the effect out of our joint venture with Lyondell as the PO joint venture. Historically we saw a negative effect of about minus 15 million which is predominantly due to depreciation and that is also what we expect this year. Now of course when we also take the interest results in then I think the total number altogether would be somewhere between EUR150 million to EUR200 million.

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**Peter Mackey - Exane BNP Paribas - Analyst**

Okay. Thank you very much.

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**Operator**

We will take a follow-up question from Jaideep Pandya. Please go ahead.

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**Jaideep Pandya - Goldman Sachs - Analyst**

Oh, thanks. Could you tell us what is your utilization in polycarbonates in Q3 and sort of on a nine month basis? And what is your view on market share gain that you've had this year in this product? Thanks.

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**Patrick Thomas - Covestro - CEO**

Very good question which I can't really answer because in an oligopoly like this that would be very sensitive information. My guesstimate would be that the market shares increased slightly, and that's all I'm prepared to say I'm afraid.

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**Jaideep Pandya - Goldman Sachs - Analyst**

Let me ask you the other way. Do you need your new capacities next year to put similar volume growth or you think if you don't bring your plant up next year you can still grow in this region next year?

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**Patrick Thomas - Covestro - CEO**

I think it will be fairly clear that we will need that facility. The exact timing that we'll need it will unfold as we get into next year. And I think the best way of thinking about this is when we come to look at full year guidance for next year, which we will do obviously later in the season.

There is a couple of things to think about. Now, we're not ready to give specific guidance or an outlook for 2016 but I think on the factors is you need to think about of significance, one is that we will be increasing our capacity utilization as the markets grow and that's a positive. The polycarbonates industry has got this structurally improved supply and demand balance and we will monitor that carefully and that will affect the timing of us bringing those assets on stream.

On the downside of course styrene margins, which we've talked a lot about on this call, I believe may be lower next year. And the TDI industry is of course operating as a sort of extended bottom of cycle position and we need to see how that develops next year. The wildcard of course is if there are any plant closures there. So hopefully that's helpful.

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**Jaideep Pandya - Goldman Sachs - Analyst**

Okay. Just one quick follow-up is on CAS. The sequential increase in margins, is it purely because of raw material benefits in Q3?

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**Patrick Thomas - Covestro - CEO**



Yes, most of it is raw material benefit coming through although there are always some seasonal mix effects around the product range. And if you look at the last year's quarter-by-quarter development of the CAS business you'll see that typically because of product mix in the fourth quarter the margin is usually lower than in the preceding three quarters.

And that's also because of course the cost absorption is lower on what is seasonally a lower -- lower volume. So that you can some idea of the seasonality of the CAS business by looking at the 2014 set of data.

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**Jaideep Pandya - Goldman Sachs - Analyst**

Okay. Thank you. Very clear.

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**Patrick Thomas - Covestro - CEO**

Thank you for your questions.

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**Operator**

There are no further questions at this time. Continue with any other points you wish to raise.

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**Ronald Koehler - Covestro - IR**

Okay. I've got no further questions. I thank you all for your interesting questions and I hope we answered them well. We plan to release our full year results actually February 23rd. At that time we are not planning for a staggered process so you should get a full release, that and this -- our second quarterly full year release, our first full year release.

So obviously speaking latest 23rd, but I'm quite hopeful that we will see in between. So I wish you all the best and see you soon. Bye.

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