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PRESENTATION

Operator

Ladies and gentlemen, thank you for standing by. Welcome to the Covestro investor conference call on the Q4 and full-year 2015 results. The Company is presented by Patrick Thomas, CEO; Frank Lutz, CFO; and Ronald Koehler, Investor Relations. During the presentation, all participants will be in a listen-only mode. The presentation will be followed by a question-and-answer session. (Operator Instructions) I would now like to turn the conference over to Ronald Koehler. Please go ahead, sir.

Ronald Koehler - Covestro AG - IR

Thank you, Sara. Good afternoon and welcome to our conference call also on behalf of my colleagues. For your information, we have posted our full-year report and the conference call presentation on our website. We assume you have read our Safe Harbor statement and I would now like to turn the conference over to Patrick.

Patrick Thomas - Covestro AG - CEO

Thank you very much Ronald and welcome everybody to our premier full-year conference call. On the chart you can see in front of you, I've tried to gather together the key highlights and I think the theme here is delivering on the promise and continuing to deliver. We posted solid core volume growth of 2.7% year-on-year and adjusted EBITDA up by 41% year-on-year, the adjusted return on capital employed of 9.5% clearly above cost of capital of 7.2%, and recorded a record free operating cash flow of EUR964 million equivalent free cash flow yield of 16%. The dividend proposal to our shareholders meeting will be at EUR0.70, which as of the closing price at February 19, we have a represented dividend yield of 2.7%.

We achieved all financial targets even in a challenging macroeconomic environment. Our dividend proposal of EUR0.70 is at the upper-end of our guided range and reflects the strong development of our free operating cash flow in 2015 as well as our confidence for the future. As we aim for a sustainable dividend in absolute terms, today's dividend proposal should set the floor for future payments. We generate around 40% of our sales



and even a higher share in earnings and cash flows with our Coatings, Adhesives, Specialties business, and with Polyols. Both businesses are very resilient and have shown very little volatility in the past. Our combined cyclical businesses of Polycarbonates, PCS, MDI, and TDI generated below mid-cycle margins in 2015.

TDI margins declined during the year. There are significant overcapacities around the world especially in China. However, we see first positive signs of the market starts to rebound from a low-level and for example, public sources now say that one Chinese producer has closed its 50,000 ton a year TDI plant during 2015. MDI margins developed relatively stable, but slightly below mid-cycle during the year. Cash margin improved slightly during the beginning of 2016. After peaking in quarter three of 2015, PCS cash margins remained unchanged at a high level. As you remember, our core volume growth declined by 0.7% year-on-year in quarter three. At that time, we assumed that this was primarily driven by destocking.

In quarter four, volume growth improved to 3.3% and in our view this was driven by an underlying demand growth without major changes in inventory levels. In 2015 and in quarter four 2015, we generated a rather well balanced growth in all regions. Interestingly, our growth in mature markets is now at or even slightly above our growth in emerging markets. The solid growth of 4% in Germany in quarter four demonstrates our ability to outgrow GDP in mature markets. Let me now hand over to Frank.

Frank Lutz - Covestro AG - CFO

Thanks, Patrick. Our sales development in 2015 was strongly influenced by the development of our raw material prices and foreign exchange movements, both factors are obviously beyond our control. Foreign exchange is mainly however a translational factor and therefore hardly affecting our margins. The price decline results from the usual pass-through of the raw material movements to our customers. Earnings are mainly driven by the supply demand balances of each industry and not by the development of our raw material costs. The only measurements that we can significantly influence are volume movements, higher volume provides us with stronger earnings leverage as we still have underutilized capacity.

As a consequence, management decided to focus on core volume growth as a major KPI and not on nominal sales growth. The earnings increase in 2015 was significantly driven by our ability to gain margin above any raw material price movements. This so-called pricing power contributed almost EUR300 million to our bottom line. The turnaround in polycarbonates was the main driver as the industry reached the tipping point. The negotiation power clearly moved from buyers to sellers in 2015. The strong US dollar also helped with an EBITDA contribution of EUR229 million mainly driven as I said by the translational effects. In 2015, we were able to increase core volumes by 2.7% year-on-year. In Q4 2015, our growth was even above financial full-year average with plus 3.3% year-on-year.

The adjusted EBITDA margin improved from 9.9% in 2014 to 13.6% for 2015. The sequential margin decline in Q4 was due to the typical seasonal slowdown. Overall we were able to increase our adjusted EBITDA each quarter versus the respective prior year period during the whole of 2015. As we have stated before, cost control is key for being successful in a commodity business. Nominal cost inflation looks high in the reported P&L. Nevertheless in order to understand the underlying development the functional cost lines, it makes sense to adjust the nominal figures by foreign exchange, special items, and the short-term incentive program. On a comparable basis then, fixed cost stayed almost flat in 2015 year-on-year.

This demonstrates our ability to keep absolute cost flat while business continues to grow. As we had promised before, we were able to generate a record free operating cash flow of almost EUR1 billion in full-year 2015. We are also quite sure that we will continue to generate a high free operating cash flow also in the coming years and particularly this year. During the IPO, we also told you that we will end the full-year 2015 with a total net debt of around EUR4 billion. In addition, we guided for total net debt to adjusted EBITDA ratio in the range between 2.5 and 3 times. Already with our Q3 2015 results, we outlined that this ratio should be rather at 2.5 times i.e. at the lower end of our initial guidance and now we delivered a total net debt to adjusted EBITDA ratio of only 2.2 times.

The absolute net debt is now at EUR3.7 billion or roughly EUR300 million below our last guidance. This translates into a value creation of around EUR1.50 per share. The strong cash flow generation is expected to allow us to pay a decent dividend and to reduce our net debt further. Mid-term we now target a net debt to adjusted EBITDA ratio of 1.5 times. Post IPO we now have a solid balance sheet with an equity ratio of roughly 34%. We still plan to pay back to Bayer loans of around EUR2 billion in two steps during the course of 2016. We either will refinance this via our existing back-up credit lines or by tapping the bond market.

Patrick, give us the guidance please.

Patrick Thomas - Covestro AG - CEO

Thank you, Frank. During 2015 the macroeconomic uncertainties increased. However, our solid volume growth in quarter four makes us confident that our market should continue to outgrow GDP in 2016. Therefore we guide for a mid-single digit increase in core volumes for the full year. As Frank already outlined, we should continue to deliver a high free operating cash flow, clearly above the average of the recent years. We also expect that we will continue to earn a premium on our cost of capital. In addition to the full-year 2016 guidance on our major KPIs we provide a quarterly guidance on adjusted EBITDA. We had a solid start into the year, and this makes us confident for the development in quarter one 2016. So despite several headwinds, we expect that our adjusted EBITDA will be on the level of quarter one 2015.

So in summary, our investment case remains unchanged and we can confirm all of our targets. We expect to deliver solid organic growth, strong earnings, and defend our robust financial profile and pay an attractive dividend. We are confident that we can continue our 2015 track record by delivering on our goals for the full-year 2016.

Ronald Koehler - Covestro AG - IR

Good, thank you, Patrick. We are now open for your questions.

QUESTIONS AND ANSWERS

Operator

(Operator Instructions) Lutz Grueten, Commerzbank.

Lutz Grueten - Commerzbank - Analyst

Thanks for taking my two questions and in fact they are both related to your guidance. The mid-single digit increase in core volume growth, let's call it 5%. Could you give us an idea where that's coming from by region and also by industry group of your main customers. That's the first question. And the second question is again on guidance and the KPIs, the three months you have given here, I got the feeling that this guidance is already reflected in the adjusted EBITDA forecast given and reflected in the consensus you're collecting because this bridge might be also quite important for the capital markets? Thank you.

Patrick Thomas - Covestro AG - CEO

Thank you very much for your question. Yes, where does the mid-single digit number come from? Well, it comes from the composite of our portfolio. As you'll expect, we've seen growth expectation going forward in polycarbonates around about 4% to 5% following a 5.2% growth through the year 2015. That would be in line with most industry experts' view and also in line with our own expectations. In polyurethanes, we saw a very strong bounce back on MDI during the last quarter, which gives us some confidence that we're seeing a better return to normal performance in terms of MDI. So to give you some color on that, we had the demand slowing down during quarter three, which was destocking. We saw growth at the around 8% to 9% level in the fourth quarter on MDI, which is above long-term trend.

So we would expect, and experts would expect us to see something closer to 7% as normal long-term trend. On TDI, we are still suffering from the heavy destocking in quarter three, which took the market down about 10%. It went down around 3% in the fourth quarter and we would now see the growth going forward would be positive. We actually saw around about 2% growth on TDI globally during 2015. So with an expectation of a

return slightly more to a normal level, we would expect 3% to 4% to come from that business. Overall, the cash business grows something of the order 4% to 5%. So in terms of core volume growth, that's the sort of rough mix, it's pretty broadly based.

Lutz Grueten - *Commerzbank - Analyst*

And if you break that down by region or customer industries, the most important ones at least?

Frank Lutz - *Covestro AG - CFO*

Let me just see if I can do that a little bit. I think we would see a reasonably strong view on the automotive sector where we are seeing now a kick up on automotive pretty much globally that took place in the last two months of the year. We saw a rate in the global automotive industry of about 95 million units equivalent on a full-year basis, which is a very positive step up compared to the moderate view in the industry during 2015. So that would be roughly a growth doubling from 2% to 4%.

Construction, we would also see running on about 2%, the electrical electronics industry at about 4%, the furniture industry also at about 4%. But you have to remember that when we look at something like the construction industry at 2%, that's the total construction industry, insulation in construction will grow at 4% to 5% and polyurethane insulation will grow at somewhere around about 6%. That would be the expectation if the normal ratios were to stay intact.

Patrick Thomas - *Covestro AG - CEO*

On your question regarding the guidance, while in the future and also today we will only give you yearly guidance on the three KPIs that are important to us to steer our business. We also do not feel uncomfortable with the current consensus on the EBITDA for the full-year of 2016.

Operator

Markus Mayer, Baader Bank.

Markus Mayer - *Baader Bank - Analyst*

Hi, good afternoon, gentlemen, three questions. First of all, on the maintenance shutdowns you had in polycarbonate, can you give us a guidance if there are larger shutdowns planned for 2016 and if so, when? And secondly, again on your guidance, what does recent year mean on this kind of cash flow guidance. On the cash flow improvement, maybe you can give us some flavor where this cash flow improvement comes from as you have guided basically that net working capital will be more or less similar to 2015 and CapEx is also to remain at 2015 levels - that would be very helpful. And lastly, maybe a kind of indication from your side, what kind of EBITDA or ForEx tailwinds you expect in 2016? Thanks.

Patrick Thomas - *Covestro AG - CEO*

Okay, thank you very much, Marcus. Let me take your first question on maintenance shutdowns. You're right that in quarter four 2015, we had a major turnaround in our sites in Caojing. That actually affected the business significantly in terms of stock because we saw such strong demand in polycarbonate that we were actually emptying our stock dramatically and we probably could have provided or sold more polycarbonate in the fourth quarter if we have had a higher stock availability. We built as much stock as we could but demand in the polycarbonate sector has been quite significant.



In terms of full-year 2016 and in fact 2017, there are scheduled maintenance shutdowns across all the major sites and product groups, but we currently don't see any major business or earnings impact from these because all of them should be production losses that we can cover from inventory. So that is different from the 2015 where we guided EUR50 million as the bottom line impact on our turnaround.

Frank Lutz - Covestro AG - CFO

And Markus you asked what's our definition of recent? To me recent is rather three years than five years. I think that gives you an indication of what we see as the kind of benchmarks in terms of free operating cash flow for 2016. Now what's going to affect that, you remember that in 2015 we had a couple of special items that not only affected our profitability, but also our cash flow. Of course, all the cost related to the separation and the IPO, but then also a couple of special items like the closure costs for Belford Roxo in Brazil. Those items obviously will not hit our cash flow statement in 2016 and therefore we feel quite confident that cash flow will remain strong also because we do not think that there will be a significant deterioration when we're talking about working capital.

Markus Mayer - Baader Bank - Analyst

Okay. And the last question based on the EBITDA tailwind from currencies, to a certain extent your expectations here?

Frank Lutz - Covestro AG - CFO

The EBITDA effect from currencies in 2016, we are basically planning at the moment with a comparable exchange rate as in 2015. So therefore broadly speaking, there should not be a significant effect coming from currencies. Now having said that, of course that's the best guesstimate that we can make at that point. Over the course of the year, we will see some currency movement and then we will also see some effects. Remember though that most of the effects that we have are translational ones and not transactional effects. So therefore from a margin perspective, they do not have an effect.

Operator

Christian Faitz, Kepler Cheuvreux.

Christian Faitz - Kepler Cheuvreux - Analyst

First of all, can I please ask why polyurethane pricing in Q4 was so weak, it was minus 20%? I had the impression that some key prices relevant for the segments did not nearly go down that much. So maybe you can point to regional weaknesses, et cetera. And then second of all, just a strategic question. In your presentation, you point to Polyols as being a rather resilient segment alongside with CAS. Since in my view the polyols market is very much attached to the drivers of both polyurethanes within your Polyurethane segment, why is that so in your view? Thank you.

Patrick Thomas - Covestro AG - CEO

So, polyurethane prices weakness in quarter four was primarily driven by TDI price. In the mix was dominating the performance in price in Q4. And yes, there was a kind of battle that broke out in China. We then saw one of the plants in China announced as closed, which I see as a positive step. Since then, we've seen a bit of a rebound on price on TDI. So it would be a long way to say that we've reached the bottom and we've reached a turning point, but it's possible that in quarter four we saw the lowest point on TDI pricing. Let's see how it develops during quarter one. The strategic resilience of the Polyol business is not so much in terms of industry drivers because I agree with you, the industry drivers are primarily the same.

The resilience for me comes from the long-term historic relationship between propylene, propylene oxide, and polyol pricing and the nature of the propylene oxide industry. Because of the propylene oxide difficulty in terms of transportation because essentially transporting propylene oxide



is almost impossible or at least extremely expensive, the polyol locations and propylene oxide locations tend to be very regional. And that seems to be the driver that gives this very stable margin of polyol over propylene. So, that is the sense in which I mean it is resilient rather than anything else. So, there's a pretty constant margin over the last decade if I look at the propylene to polyol pricing structure.

Christian Faitz - *Kepler Cheuvreux - Analyst*

Okay, great. Thanks, Patrick.

Operator

Andrew Benson, Citi.

Andrew Benson - *Citi - Analyst*

Cost cutting, can you just define the benefits in 2016 versus 2015 that you're expecting from the restructuring measures that you're taking? Secondly on the dividend, obviously the dividend is a little bit higher than was expected for the year that just ended. Can you just reaffirm your intentions for 2016? Because one would I think expect a fairly significant step-up, but you're perhaps not indicating that, a little bit confused there. On the MDI business, can you just give a little bit more detail on what you think the outlook is? Because obviously the BASF Chongqing in China have really only just come onstream so one would expect that to be perhaps a bit more competitive. And lastly on the styrene part of core product credit as it were, I know it's a difficult one, but if you could just give some sort of indication of what's likely this year versus last. Thanks.

Patrick Thomas - *Covestro AG - CEO*

On cost cutting, I guess the first step in cost cutting process is to announce what you're going to start in terms of asset optimization. And you've probably seen we have now announced the closure in 2017 of our Tarragona MDI plant, which will be a total shutdown of that MDI unit. We've also closed the facility of MDI in Brazil in Belford Roxo. On the Polycarbonates business, we have been rationalizing sheet production in China and we have now further announced the closure in Darmstadt in Germany of our sheet plant and in Korea also very recently the closure of our Korean plant. Frank, do you want to explain a little bit about the timing of benefits and costs?

Frank Lutz - *Covestro AG - CFO*

As we indicated during our IPO, we think that 2016 will be a year where costs cutting or improvement measures on the one hand and the costs related to those improvement measures will create kind of a wash. And then we will see positive effects coming in 2017, 2018, 2019 with the full effect really showing up in our P&L by 2019, which should be somewhere around EUR150 million. I'll continue with the dividends. Thanks for the question because it gives me opportunity to explain a couple of things. We said during the IPO that we will pay a dividend between EUR100 million to EUR150 million for 2015, which we consider first of all to be a steadier year where our dividend policy does not kick in yet. It only kicks in for fiscal 2016. So the EUR0.70 is not related to any kind of measure that we will apply in the future with one exception; it sets the floor for future dividends because we said that we put a high value on dividend continuity which means at worst, so to speak, dividends stay flat and preferably it goes up. And then, the second metric that we measure our dividend policy by is that we want to pay out 30% to 50% of our net result or our EPS. So do not apply that metric, as I said, to the 2015 numbers yet, but you can measure us by that in 2016.

Patrick Thomas - *Covestro AG - CEO*

On your third question, Andrew, on MDI, I think probably the best way of looking at this is if we look at our supply and demand dynamics and the major capacity changes we can see. There are a couple of changes that we've identified. I listened carefully to the Dow call and I couldn't really get a fix on the MDI unit, but what we believe will happen is that unit will not come onstream until early 2017. That's the first change in our data series.



We also have looked at the demand growth on the supply side over the next five years and there are a number of effects that are factored into this. But overall, demand looks like it's growing at about 5.8% on average over the period from the beginning of this year to 2020 and the supply side is now down to 3.7% based upon our industry analysis. So that's suggesting that the industry utilization will tighten. Industry utilization at the moment is running at about 85% and so that is why we are sitting at this level of margin that we see at the moment. Just to give you one spot point, we looked at quarter four growth on MDI and we've seen history of slowdowns, destocking, and then recovery on MDI because MDI is relatively difficult to trade and it's relatively difficult to hold large inventories. So there's normally quite a sharp response if the market is still growing and sure enough, we saw globally a growth of between 8% and 9% in quarter four in the industry, which would suggest that we're returning to a slightly stronger growth perspective which I've factored into my five-year forecast. Is that helpful?

Andrew Benson - *Citi - Analyst*

Yes, that's very helpful, thanks for that.

Ronald Koehler - *Covestro AG - IR*

On Styrene, Styrene obviously was a very positive surprise in 2015 because it contributed about EUR72 million to our EBITDA, which we did not have in the cards when we're doing the planning for 2015 and all of which obviously was accounted for within PUR. We are more cautious for 2016 and only expect about a third of that to hit the P&L in 2016. Now margins or prices at the moment are quite stable. So we might see a positive surprise here, but it's really too early to say.

Operator

Peter Mackey, Exane BNP Paribas.

Peter Mackey - *Exane BNP Paribas - Analyst*

A few questions if I can, a couple on the cash flow side. CapEx was a little bit lighter than you'd originally indicated for 2015 and you were expecting CapEx to decline in 2016. What do you think now? I know you've given us the 500 to 550 range, but has there been a bit of shift from 2015 to 2016 or how should we think about that please?

On working capital, I think you've indicated at the time of the IPO, there was some hope to reduce working capital to sales by perhaps 1 percentage point, you've obviously done this year partly because of Caojing and particularly polycarbonate. Do you think it's sustainable at these sorts of levels? Should we expect some rebound in the working capital ratio or actually do you anticipate some further opportunities to reduce that, please? And third question, I wonder if you could give us a few qualitative comments about the divisional split or your divisional outlook for the first quarter simply because I would have thought you'd be expecting to see quite a significant improvement in polycarbonate year-on-year in Q1, polyurethane's probably a bit weaker although your commentary sounds a little bit more optimistic again. And cash, I would've thought should be benefiting from some lower input costs again. So I wonder if you could just put a little bit more color on that and if I can put one last question, going back to Andrew's question about the dividend.

The 30% to 50% payout ratio combined with your view that you think mid-cycle margins around 15% to 16%, should we expect a dividend payout towards the top-end of your ratio if your margins are below what you think are mid-cycle? Is that how we should think about 2016 dividend payment or could you put a bit more color on that please? Sorry for so many questions. I hope that's okay.



Patrick Thomas - Covestro AG - CEO

No, its fine Peter. Thank you very much for your good questions. So let's start with the easy ones on CapEx. CapEx, we would expect to be in the range around about 500 to 550. There is no dramatic shift between years or anything. It just is the numbers that we have. So, there's nothing that's been delayed by way of project or anything else. Working capital, Frank?

Frank Lutz - Covestro AG - CFO

I think Peter, it's always the same. You see the year-end effects when inventories go down and receivables go down and that obviously also had a positive effect for us in 2015. However, you see the same effect every year. So in 2014, working capital towards year-end also went down. I do expect that during the course of the year, because this is also normal business, working capital will be slightly higher, but by the end of 2016, I expect working capital to be again on the same level as we saw at the end of 2015.

I do think that there is some possibility to further improve working capital. If we are really in need of cash, we could push that little bit harder. Also, once we reduce the number of production sites for MDI in Europe, of course, that will have an effect on working capital at some point. So I think there's a couple of levers that we could pull if need be.

Patrick Thomas - Covestro AG - CEO

Okay. Thank you, Frank. In terms of a qualitative picture, I guess, it's important to talk a little bit about polyurethanes to start with. Polycarbonates I think you got pretty much right. We should expect to see good results flowing through on polycarbonates through the year. Everything is still in our favor in terms of supply and demand dynamics and if I look at the growth level that we delivered during the year 2015, we delivered about 5.2% growth in terms of PCS. I think there's a couple things happening, which is going to help us in PCS, the Saudi Kayan shut down is happening slightly earlier. It's kicking in March. That's about 1% of world output. The Singapore unit is down and closed from Teijin. The SABIC Sinopec capacity seems to be delayed 2018-2019 and there's another plant in Japan which surprised us is closing the Idemitsu plant in Chiba, which is 50,000 tons unit closed end of 2015.

So I think if you take all that lot together, you've got a pretty strong picture growth of 5.2% in 2015. We expect the 4% to 5% growth that everybody understands background for the full-year 2016. That means demand continuing at about 4.5% to 4.6%, supply only at 2.3%. So I think that's a nice situation for the PCS business.

On polyurethanes, we had a weak quarter four in terms of earnings. However, core volumes actually grew close to 5% year-on-year and this carried over into a very strong start into 2016. So don't take quarter four 2015 results as your starting point in the model. There should be the usual seasonal improvement from quarter four to quarter one. From today's perspective, we are confident that earnings will be at a similar level in quarter one compared to quarter one 2015.

Peter Mackey - Exane BNP Paribas - Analyst

And just on CAS in Q1?

Patrick Thomas - Covestro AG - CEO

In CAS yes. There's a couple things in CAS that are important. I don't think there is a huge benefit in terms of raw material input costs. That effect has kind of tailed off now. There seems to be point at which oil price drops and then our feedstocks don't drop any further because of the margins of the supply steps between oil and our feedstocks. What I think is important is we will see an effect as some of our trading business on chlorinated rubber disappears out of the portfolio and Frank do you want to say a little bit about the effect that it has on our volume and earnings.



Frank Lutz - Covestro AG - CFO

Yes, I think from a volumes perspective, it's about 3.5% of our volume. So on an adjusted basis, we also expect volume growth in 2016 within the CAS business. What I would like to add though is that the business used to be a pure agency business with relatively low margins i.e. the overall CAS margins were rather diluted by this business and now that this business is going away, we should see the positive effect on the overall margin.

Patrick Thomas - Covestro AG - CEO

And just to add one thing to that, Peter. You remember when we talked before about the CAS business, we have this continuous process of lifecycle management where we have historically also exited powder coatings, we've exited polyester coatings as well, and we sold that business. This is along the same track enriching the portfolio so though it has a volume impact, it improves the overall margin of the business longer term.

Frank Lutz - Covestro AG - CFO

In our list of priorities when we're looking at dividend, the number one priority is never pay a lower dividend than the year before and that is what we get measured by. The 30% to 50% payout ratio of course helps us to adjust our dividend relating to the year that we're having. In weaker years, the percentage theoretically will be higher; in stronger years, the percentage will be lower. Now in your logic you're saying lower margin translates into a weaker year, theoretically that's right. Now you and I know that a lot of things happen between the margin and the bottom line so let's see how 2016 develops and then we'll see where we'll end up. But as I said, priority number one stands.

Peter Mackey - Exane BNP Paribas - Analyst

Sorry to follow up there. But given your guidance and how you're viewing 2016, can you say whether you would expect to be towards the top end of that ratio or the bottom end of that ratio basically? Is this something that you think is going to build up over time?

Frank Lutz - Covestro AG - CFO

Peter, I'd love to answer that question, but I really don't know. We are at February 23 today, it's just too early to see how things develop. At the moment, I think if you look at the consensus, the consensus says that we are going to pay out about 40% as our dividend. As I said before, we're not uncomfortable with consensus at all.

Operator

Andreas Heine, Mainfirst.

Andreas Heine - Mainfirst - Analyst

Basically most questions have been answered already, I have only two smaller ones. One, is on the hedges. Have you hedged the currency ratios you are predicting for this year already for most of the year? That's one. And just one for clarification, the core volume that includes all the volume of so-called product so it's including the volume you have with swaps with other players in your space. Is that the right view on the core volume? Thanks.

Frank Lutz - Covestro AG - CFO

Second question first, Andreas. No, it does not include the swaps. Otherwise your definition is right, but it does not include the swaps with other players. On your first question, we do not hedge anticipated exposure. So therefore what you're saying, we are not fully hedged for the full year. However, we hedge ourselves as soon as we book exposure, which also explains why the currency effect on the transactional side is rather minimal



and most of the currency effects that we are seeing are translational and that again also explains why we not hedging for the full year because we do not believe that we should hedge translational exposure, but rather transactional one.

Andreas Heine - *Mainfirst - Analyst*

That means also that you don't have a lot of hedge expenses in 2015 which are not any more in place. It was basically a rather small event, the hedges.

Frank Lutz - *Covestro AG - CFO*

Yes, absolutely and you should not expect that to change during the course of 2016.

Operator

Patrick Lambert, Raymond James.

Patrick Lambert - *Raymond James - Analyst*

Congrats for good Q4. Just one single question actually regarding China. If you could comment a little bit more on the 3% growth you saw in Q4. How broad-based it was and also how big it would have been if Caojing was not shut down for maintenance? Anything you could point out on behalf of a Chinese Q4 rebound will be good. Thanks.

Patrick Thomas - *Covestro AG - CEO*

This is a very important question. So China, just to give you some background, represented around 15.5% of the Group sales last year. The sales in quarter four were about 11% down year-on-year and about 3% quarter-on-quarter. Core volumes were actually up 3% year-on-year and stable sequentially so 209,000 tons in both quarter three and quarter four. So full-year net sales were still up 5% above full-year 2014 primarily because of the very strong first half and core volumes are still positive at 4.5% year-on-year because of the very strong first half growth of 12%. So, I think what we've seen is a loss of consumer confidence and procurement destocking events that took place during quarter three and some recovery in quarter four. When we look to full-year 2016, I expect to see clear volume growth year-on-year in Asia Pacific primarily driven by polyurethanes and polycarbonates.

In January we saw core volume growth up year-on-year and our planning assumptions are assuming a GDP growth of around about 6% compared to the 7% which came from IHS data in 2015. So, that's really how we're looking at China. In terms of individual sectors, we saw some strong growth in the automotive sector in China driven by the government's 5% tax reduction on small vehicles, particularly small engine vehicles, and that boosted the world's automotive production level up to an equivalent of 95 million units a year during the last two months of last year and that seems to be continuing this year. And as you know, we supply just about every automotive player anywhere in the world so we see that as positive.

Construction is still a weaker zone although I saw some data this morning that suggested that whilst domestic construction is weak, we're not that active in domestic construction in China, industrial construction materials are more our business, so non-residential, and that is still growing. So, I think a lot of the news flow you see relates to empty apartment blocks. We're more interested in factory units, which use double metal face panel construction and board stock and that goes for America as well. I think we've seen some fairly good sales in the construction arena. The only sector in China that is suffering at the moment and that affects the TDI business primarily is the furniture industry because with a lot of apartments empty, people are not filling up hotel buildings or apartment blocks with furniture and soft furnishing which is 80% of the TDI businesses. So, that's a bit more color about China. Hopefully that's helpful, Patrick.



Patrick Lambert - *Raymond James - Analyst*

In the CAS business in China, do you see any specific development in 2016 apart from your capacity coming back onstream?

Patrick Thomas - *Covestro AG - CEO*

No, the CAS business is driven by a number of sectors which seem to be less affected. So the synthetic leather segment, textile coatings, wood coating would be perhaps one that is being more affected alongside furniture. But things like automotive refinish, footwear glazes, footwear adhesives are all tracking along fairly strong because they're driven very strongly by export.

Operator

Jaydeep Pandya, Goldman Sachs.

Jaydeep Pandya - *Goldman Sachs - Analyst*

Thanks. A few questions really. First of all, just conceptually I want to understand, you've obviously made a big step up in polycarbonate profitability in the last sort of 12 to 15 months. It seems like everything's going to remain sort of status quo. So, just wanting to play slightly devil's advocate here from two angles. If this is the case, what is the probability that some of these mothballed capacity does actually come back because these are actually pretty good returns that you guys are making right now.

And secondly, if we do see an oil price rally from whatever we are at \$30 and change to sort of \$50 or somewhere in the region above that, what happens to polycarbonate pricing then? Do you think that prices will go up and i.e., you keep the spread or you think that actually prices remain roughly where they are and actually the spread shrinks then? That's my first question.

Then, my second question is sort of around your working capital by division where I see a massive drop in polyurethanes but an increase in polycarbonate for 2015 versus 2014. Maybe it's just because of the way you split it by division, but if you can just explain what happened there, that would be great for 2015 versus 2014? And then the final question really is around polyurethanes. Just looking at the numbers that we have access to for Covestro, you've done 3.9% growth in core volumes in 2014 and 1.8% in 2015, it's definitely below 5%. Is the story here that MDI is actually growing above 5% but TDI is actually not growing and if that is the case, why is the case like that? Thanks.

Patrick Thomas - *Covestro AG - CEO*

Okay, thank you for your questions. Polycarbonates first of all, yes, you're right, profitability has gone up to what would appear to be a very attractive level, but I think it's fair to say that the capacity that has disappeared has actually been closed not mothballed. For example, the 3% of world capacity owned by Teijin in Singapore has been closed and as far as we know it's being dismantled because the land that it sits on is owned by the Singapore Development Board and will be made available to other investors. So it's already on the block.

So from that point of view, we've looked very carefully at what new capacity can come along in this situation where the market is attractive and I think it's around about 2018, 2019 when the earliest next step comes in and the lead time on the polycarbonate facility is somewhere between four and five years depending upon where you are in the world from the time in which permits are lodged and then asset is operating. So I think from that supply demand point of view, I think we're reasonably well covered. If oil prices went up, then we would see potentially some of the downstream derivatives. In the case of polycarbonates, it would be phenol and acetone could rise in price and then we would really see the test in the marketplace as to how tight the market is because one would expect at that point you could pass those prices back into the market, if the pricing power is there. Your second question, I think related to working capital by division. Frank, can you help here?



Frank Lutz - Covestro AG - CFO

I think you need to look at the overall driving factors of 2015 and then a couple base effects that we saw between 2014 and 2015. Now, first and foremost, of course we saw lower raw material prices, which impact the value of inventories and brought working capital down. We saw in 2014, a production outage in our PUR business predominantly in the US, which brought down inventories quite significantly. In PCS, we had in 2015, of course, the situation that our sales were significantly higher, that usually increases receivables, but at the same time, it reduces inventories. So there is a couple of counterbalancing effects all together that impacted working capital by division, both related to 2015 developments, but also base effects coming from 2014.

Jaydeep Pandya - Goldman Sachs - Analyst

And just to sort of not to harp on this but I'm looking at page 204 right of the annual report and there is a EUR200 million swing in polyurethanes year-on-year and EUR130 million swing in polycarbonates. Polyurethanes going down, Polycarbonates going up. The sort of factors that you described in my mind are sort of general factors. And this swing is relatively large, I mean, we've sort of seen drop in raw material prices pretty much across the board. So is there anything specific which was related to the way you were assigning inventory or whatever or the factors that you described are just magnified?

Frank Lutz - Covestro AG - CFO

Absolutely, there is nothing specific, we are not booking things in a different way. It's just as I said, the special effect that we saw at the end of 2014, which got compensated in 2015 and then also, of course, had its impact on our working capital. Nothing funny.

Patrick Thomas - Covestro AG - CEO

And then on to your question relating to polyurethanes. So one thing which is important to think about in our portfolio and it was I think on page five of the presentation that we made. If you look at polyurethanes for us, it is more than just MDI and TDI. That represents roughly half of the total sales. The other half of sales related to polyols. Now the polyol situation for us is restricted because we have a finite volume of propylene oxide capacity, which is not currently increasing and we are effectively fully utilized on our propylene oxide capacity. So that part of the polyurethanes business does not see the growth that you're talking about.

The growth that you are talking about in terms of the MDI industry is the historical growth rate of around about 7% which is the last five years. If you then look forward to the next five years, we expect to see a demand growth of about 5.8%, which is on average still slightly below the 7% historical norm, but we see a supply side growing at 3.7%, which is lower than the demand growth. So I think what we're talking about on MDI is below mid-cycle margins recovering over the next couple of years to a level of utilization, which makes the industry able to raise prices more strongly.

If you look at industry utilization, you can get a cross-check on that because it's about 85% industry utilization globally. Generally, we would say pricing power is not there for MDI. We typically see that at around about 90% utilization. TDI is slightly different. We have seen the growth in capacity on TDI coming in slightly lower than we expected. We had forecasted I think on the last call about 14% addition in TDI capacity in 2015. That actually turned out to be around about 12% and then we've seen more announcements of rationalization of capacity. So this year 2016, we expect to see about a 4% reduction in the supply side. So that will be a number of facilities closing, which are published. So that's on the supply side.

On the demand side, we have seen as you've rightly said an industry demand level for full-year 2013 that was actually around about 12% on TDI. That then dropped back to about 2.8%, 3% in full-year 2014 and then we've seen some decline in growth during 2015. I think the problem is that this is a notoriously volatile segment. This is the most volatile. Peak-to-trough margins in this business have been the most extreme of any of the sectors we are in and what we have to see now is the consumption of that capacity that's come online and the rationalization of the existing assets that are on the ground. We are confident we are in one of the best positions in the cost curve and logically in TDI there is still a very long cost curve, it's



fairly steep, and there should be more consolidation in assets that we will see over the next two to three years. We actually saw, as I said earlier, a bit of a turnaround in TDI already; but it's probably still too early to call the bottom of the cycle during quarter four.

Jaydeep Pandya - *Goldman Sachs - Analyst*

Just a couple of follow-ups. On polycarbonates, when do you expect your plant to come onstream in 2016? I joined the call late, sorry if you've answered the question. And secondly, is there any substitution effect i.e. is PMMA a substitute for polycarbonate or in your mind in applications that you're dealing with today polycarbonate is the only material? I'm just asking because we are in a relatively tight demand/supply world for the next couple of years so are there any substitutes that people could start using in the polycarbonate area? Thank you so much.

Patrick Thomas - *Covestro AG - CEO*

What a good question. So, our plant will produce roughly 50,000 tons out of the 100,000 ton capacity that comes on this year. The rest of the capacity would come onstream next year, which will be a further 100,000 tons. We have a high degree of control over the timing of that start-up and obviously it will be driven primarily by market demand. Your question about substitution is a very interesting one because what we've seen for the last five years is the substitution of acrylic PMMA by polycarbonate in two areas principally. One in the tail lights of cars, which traditionally front lights are all made out of polycarbonate, but because of the lower risk of stone damage, acrylic is used typically because it's cheaper on the rear lights.

That had started to change partly because of insurance claims and because people are trying to make the rear light clusters more robust and more difficult to break. That is an area that could go back if the price of polycarbonate went too high potentially, but typically once the car industry has switched, they tend to stay switched. In flat screen TVs there's always been some competition between polycarbonates and acrylics. The disadvantage of acrylic MMA is that it expands thermally and above a certain screen size you get quite significant thermal expansion, which gives you popping and banging noises when the screen warms up, which is not the greatest of effects in the middle of a romantic movie.

That can go either way though and it depends upon the price of the TV and the quality of the TV that's made. And then the final area of application is in signage. In signage petrol station signs and gasoline stations, things like that, traditionally acrylic has been used; but with greater risk from vandals and people throwing bricks at the signs, people have switched to polycarbonate and polycarbonate has become a material of choice particularly in certain areas of the world. So, it's a mixed effect really. So, the substitution backwards and forwards between polycarbonates and acrylic has been quite a long story and there are degrees of freedom there and certainly if there was no material available, then people would find a solution for the non high-end optical.

Operator

Markus Mayer, Baader Bank.

Markus Mayer - *Baader Bank - Analyst*

On the last question, on the substitution question. Over the last years have you seen that the polycarbonate content per car that there was any kind of change in the industry (inaudible). But for the overall car, was there more polycarbonate used or less than last year because in this I think there was an interesting article from the American Chemical Association which says that polycarbonate is used less and less in cars since 2009 whereas poly EPDM is up since then. And secondly, on your confidence on the automotive demand, where is this coming from? So is this a particular region or kind of trend projects whatever? Certainly on the Chinese currency the devaluation risk, is this mainly an issue for polycarbonate or is this not an issue at all? And then lastly, do you expect any kind of impact post the SABIC restructuring of its polycarbonate business? Sorry for this long question.



Patrick Thomas - Covestro AG - CEO

Let me start with the last one first before we forget it, SABIC restructuring. SABIC have published that they are going to treat the business more as a commodity. I'm not quite sure what that means, but they seem to be cutting back on quite a lot of research and development spend is my inference from what I hear in the marketplace. So that I would see as a positive from our point of view because we would then be the only global player with assets in all regions, wet side and dry side assets, and with the commitment to developing new materials and maybe I'd link that to the glazing and interior components of cars. What we found is that there is increasing use of polycarbonate in vehicles and I actually have the study you referred to in front of me.

The absolute amount of polycarbonate that is being consumed is increasing and it's replacing a lot of the metal components that are being traditionally used in trim. So for example, the chrome door handles and things like that are now made out of polycarbonate. There is a reverse substitution as car companies realize that the interiors are probably lasting too long and they're just not wearing at all with polycarbonate and so there is some reduction in polycarbonate or what I'd call more efficient use of polycarbonate in interior trim components. So, the first step in a car is you replace the lump of metal by polycarbonate and that increases of course the polycarbonate. The second step is you optimize the use of that polycarbonate.

So for example for an illuminated light switch in a car, you may have back molded the original polycarbonate foil with a polycarbonate. Now you might back mold it with polycarbonate ABS blend and in the future you might back mold it only with ABS. So, there is a kind of overuse to start with, then it reverses back again. But overall we see adoption in glazing particularly in the roofs of vehicles, sun roofs and panoramic roofs, and we see an increased use of polycarbonate internally. There's very little substitution by acrylic in those applications. The acrylic's being more used on the rear ends of vehicles to provide some of these very stylish designs on light clusters and things that you're seeing as very fashionable. Do we want to say something about renminbi effects?

Frank Lutz - Covestro AG - CFO

It cuts both ways, I think it helps China exports because they become cheaper and a significant part of what gets produced using our product in China is actually sold outside of China. On the other hand of course importing some of the precursor product into China will become more expensive with the currency going down. However I think having said that, it's really too early to say the development of the currency has not been that bad and especially if you look at it from a longer period perspective over 12 months or 24 months, then we are not in the area that we are really worried about.

Patrick Thomas - Covestro AG - CEO

And finally Markus, just on the automotive industry in terms of growth rate, we saw a slow growth in 2015 particularly due to the decline in demand in China. There has been a bit of a re-adjustment in the Chinese automotive industry away from foreign brands, particularly when they're manufactured in China. The high-end foreign brands are still being purchased, but which are mostly imported into China. So the European part of that is still intact in terms of exports to China.

The business being damaged most is the domestic production of foreign branded vehicles in China at the expense of domestic vehicle manufacturer from Chinese majors. And Chinese majors are now getting a subsidy from the government of around about 5% on small vehicles, tax reduction and that has boosted small vehicles. China is also leapfrogging from internal combustion engine to all electric and that seems to be gaining some traction. And the final thing that the Chinese automotive industry is doing is they are experimenting with the export of vehicles from China into Europe and they've chosen the Southern European market particularly and if you drive around in Italy at the moment, you'll see a lot of Great Wall pickup trucks, which look remarkably like Toyota Land Cruisers.

In fact they're exactly modeled on a Toyota Land Cruiser, but they're roughly half the price and Great Wall, which is a very good company and a good customer has been very successful in starting to trial market these vehicles meeting all the European standards and of course choosing the right countries to market them in where the price difference between a real Land Cruiser and a Great Wall is a huge incentive for procuring a new vehicle. So those are really the dynamics.

Paul Walsh, Morgan Stanley.

Paul Walsh - *Morgan Stanley - Analyst*

Yes, thanks very much. Obviously, all the questions are raised. So mine are very short. The 420 restructuring program you announced last year. Where are we with that? Any size of potential contribution this year and any update would be helpful. And second question, you won't be able to answer this I suspect Patrick, but I think one of the issues I've been picking up with people is the residual overhang in the Bayer shareholding, any thoughts around that from your perspective?

Patrick Thomas - *Covestro AG - CEO*

Okay, Paul. So the answer on the Bayer thing, you are exactly right. The good news is you've got a Bayer conference call this week. So you can ask the question there.

Paul Walsh - *Morgan Stanley - Analyst*

I was hoping to get a sneak preview, but I'll ask it.

Patrick Thomas - *Covestro AG - CEO*

Please ask it and I'll listen in.

Frank Lutz - *Covestro AG - CFO*

On the EUR420 million program Paul, as indicated already during the IPO, we expect 2016 to be kind of a wash year where the benefits that we see gets eaten up by the expenses or the other way around and then starting with 2017, there will be a positive net effect that then will grow into 2018 and 2019. And then by 2019, you should see the full effect of EUR150 million net.

Paul Walsh - *Morgan Stanley - Analyst*

Okay. So to be clear, Frank, on the current year, the current outlook being comfortable with consensus, returns, cash flow and so on includes no net benefit from internal actions.

Frank Lutz - *Covestro AG - CFO*

Exactly right, yes.

Ronald Koehler - *Covestro AG - IR*

Good. It seems we have no further questions in the line. So from that perspective, I would like to thank you all for participating, listening in. If you have follow-up questions, obviously don't hesitate to call the IR department. And we have announced actually some days ago that we plan to do an Investor Day, May 12. Obviously, I would really love to have you all here visiting us close to Leverkusen in Dusseldorf and also with a site visit. So for now, thank you for listening in and bye-bye.

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