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CORPORATE PARTICIPANTS

Markus Steilemann *Covestro AG - CEO & Chairman of Management Board*
Ronald Koehler *Covestro AG - Head of IR*
Thomas Toepfer *Covestro AG - CFO, Labor Director & Member of Management Board*

CONFERENCE CALL PARTICIPANTS

Christian Faitz *Kepler Cheuvreux, Research Division - Equity Analyst*
Geoffrey Haire *UBS Investment Bank, Research Division - MD and Equity Research Analyst*
Isha Sharma *Stifel Europe, Research Division - Analyst*
Jaideep Mukesh Pandya *On-Field Investment Research LLP - Analyst*
Markus Mayer *Baader-Helvea Equity Research - Head of Research & Analyst*
Matthew Yates *BofA Securities, Research Division - Director in Equity Research, Head of European Chemicals Research & Research Analyst*
Sebastian Bray *Joh. Berenberg, Gossler & Co. KG, Research Division - Analyst*
Thomas Swoboda *Societe Generale Cross Asset Research - Equity Analyst*

PRESENTATION

Operator

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

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

Hello, and a warm welcome also from my side to our second quarter call. We are still operating in a challenging environment characterized by weak demand, destocking and industry-wide price pressure. Consequently, our sales were significantly down year-on-year to EUR 3.7 billion. In line with our guidance, we achieved a second quarter EBITDA of EUR 385 million. Free operating cash flow strongly improved year-on-year and was minus EUR 10 million, only slightly negative in a seasonal weak quarter. This was supported by our rigorous working capital management.

For full year 2023, we confirm our guidance for all KPIs. However, we now expect to be rather at the lower half of the guidance ranges. Finally, we continued our EUR 500 million share buyback program and bought back 1.2 million shares during the quarter.

Please follow me on the next page. With the end of the first half of 2023, Covestro's Chief Technology Officer, Klaus Schafer, went into his well-deserved retirement after more than 20 years of valuable service for Bayer and Covestro. As Klaus successor, the Supervisory Board appointed Dr. Thorsten Dreier. Some of you already met Thorsten in his former function as head of the business entity, Coatings & Adhesives.

So Thorsten has already had first contact with the investor community and will continue to do so in his new role. With the background in chemistry, Thorsten started this R&D chemist and has now been with the company for more than 20 years, having worked in production and technology for about half of that time. As the head of various business units, he also gained broad business experience which will be also very beneficial for his new role.

In his role as CTO, Thorsten has assumed responsibility for the corporate functions, Process Technology; Engineering; Group Health, Safety & Environment; as well as Group Procurement. He will also represent Covestro in several industry associations. Thorsten already set his goals very straight. Safe, sustainable and reliable, a strong commitment to our customers and employees. I'm sure that Thorsten will significantly contribute to the success of Covestro and share our transition towards the circular economy. Welcome, Thorsten.

Let's go to the next page. Coming to a topic that, for me personally has a high priority: digitalization. It opens new opportunities for companies worldwide. Covestro recognized the potential of digitalization early on and took advantage of it. The company has now made a major step forward to generate sustainability data and to create life cycle assessments automatically for our more than 50,000 products.

This enables us to meet the requirements of our customers to provide data for all our products and to identify opportunities to reduce emissions of chemical products. These data cover the entire value chain for the products from cradle-to-gate. This efficient automatic calculation will be in line with current certifications and replace the former lengthy and resource-intense manual process.

In future, we can retrieve recalculations at the push of a button using scalable cloud-based computing capacity. In 2024, we plan to roll out the new software making digitalization our core component for generating sustainability data. In the context of digitalization, the use of artificial intelligence, or AI, is being implemented in Covestro and in the chemical industry as well.

Under the moto, "shaping industrial change with AI", Covestro has initiated the exchange with industry peers like Bayer, Evonik, Shell and Lanxess. The focus of the exchange was to discuss about the awareness, capabilities and field of use for AI. The chemical industry employs a lot of complex processes that cannot be described by fixed rules. And here, AI offers great opportunities with self-learning systems.

The new systems help to create a common platform for cross-divisional production planning. Additionally, the AI-assisted generation and dissemination of ESG data is currently the biggest driver for using external data sources. The exchange with peers is helping in the upcoming transformation because overall challenges become clearer and Covestro is already engaging in several pilot projects across different divisions to leverage from the efficiency gains.

Let's move to the next page. As you know, Covestro is committed to reduce its Scope 1 and 2 emissions by 60% until 2030 and to be net zero by 2035. In order to achieve this unique target in the chemical industry, we successfully signed our first renewable energy agreement already in 2019. For Antwerp, we achieved a 45% renewable energy coverage in 2022. The contract with Oersted supplies 10% of our needs in Germany by 2025.

Our large integrated site in Shanghai, China, is already being supplied with 45% of renewable energy since beginning of this year. End of 2022, a second power purchase agreement for solar and wind power was added to the existing contract of solar energy already in place. In the second quarter, we now signed the first agreement in the U.S. for our production site in Baytown, Texas.

From early 2025 onwards, the virtual power purchase agreement with Oersted will supply Baytown with 12% of its energy demand from solar power. Therefore, we successfully established a global coverage of 12% already in 2022. Based on already signed contracts, this will expand to around 18% in 2023 and to around 27% in 2025. With that, we are fully on track towards our goal of 60% reduction by 2030.

On the next page, we're coming now to the business and the volume development in the second quarter of 2023. Year-on-year, the global sales volumes decreased by 8%. This was caused by ongoing demand weakness across all regions and limitations in our internal availability. Looking across the industries, we see quite a mixed development with auto and electro on a growth path, but furniture and construction with declining volumes.

Europe is continuing to be the weakest region with significant decreases in almost all industries important to Covestro, except automotive, where we had a slight increase. Part of the volume weakness was still caused by the known production limitations in chlorine in Germany. The gradual ramp-up of the production during the second quarter has been on schedule, and we expect this to continue throughout the third quarter, resulting in a return to full output in the fourth quarter of 2023.

Sales volumes in North America also declined across most industries. Construction witnessed a significant decline, whereas electro and furniture were only slightly down and in line with the global trend, auto transportation improved slightly. Against the overall declining trend in the other regions, Asia Pacific showed a positive volume development. This was driven by a low comparison basis as we suffered from the COVID lockdowns last year.

Compared to a low basis, electro, automotive and furniture achieved significant growth. However, despite the weak basis, construction still slightly declined. With that summary of the demand development, I'm now handing over to Thomas, who will guide you through the financials.

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

Yes. Thank you very much, Markus, and also a very warm welcome from my side to our Q2 update call. So, I'm on Page 7 of the presentation where you have the sales bridge. And as you can see, our sales declined 20.9% year-on-year to EUR 3.7 billion, which is, by the way, flat versus the first quarter of 2023.

As Markus already mentioned the negative volume growth was 8%, and you find that reflected in the minus EUR 374 million in the graph. And to that point, our Performance Materials actually declined with 10.3%, more than double the decline of our Solutions & Specialty segment, which only declined 4.7%. Now our sales were also affected by 11% lower prices, that is the EUR 518 million in the bridge, again, mainly coming from Performance Materials with minus 15.3% and only minus 6.6% decline from our Solutions & Specialties.

And finally, the FX effects of almost minus 2% year-on-year were mainly driven by a slightly stronger U.S. dollar and slightly stronger Chinese RMB. So with that, let's turn to Page #8, and we already talked about the volumes being significantly below previous year, which indicates the ongoing demand crisis.

And the effect of that on the EBITDA is the EUR 123 million that you see in the bridge. You also see that we had a negative pricing delta with price decreases as an effect of the low demand and continuous destocking; however, partly compensated by lower raw material and energy prices. However, I would like to highlight that the pricing delta is significantly less negative than in the first quarter of this year on the back of lower raw material costs that we saw. You also see in the bridge, there is positive development from other items, mainly driven by significantly lower operating expenses.

And please note one last thing, because of the strong share price increase at the end of the second quarter, we had to increase our long-term incentive provision by EUR 27 million and that is the main driver for the higher provisions for variable compensation of EUR 34 million, which you'll find in the last bullet on the right-hand side of the page. So overall, EBITDA came in at EUR 385 million, slightly above the midpoint of the guidance that we had specified to be between EUR 330 million and EUR 430 million.

So, let's now look into the segments and as always, start with Performance Materials. You can see on the upper part of the page that year-over-year price decline, the demand weakness and also the ongoing destocking were the major factors for the sales decline of 27.3%. If you look at it sequentially, our sales declined in Europe and also North America, but they actually increased in Asia Pacific after the Chinese New Year and also the COVID wave in Q1 leading to an overall flat development, as you can see in the graph.

If you look at the lower part of the page, you see our Q2 EBITDA of EUR 302 million, which is actually 18% below previous year and the year-on-year decline is driven by the volume decline, negative pricing delta which was then again partly counterbalanced by continued positive fixed cost development and also insurance reimbursement of some EUR 75 million for the chlorine incident in our Dormagen site. However, please note that this is a neutral effect on a group level because we booked a corresponding negative effect in "others/consolidation". So as I said, on a group level, the effect of that reimbursement is 0. Sequentially, if you look at our EBITDA, it is also improving as a mix of factors, which is the positive pricing delta, the positive others and also the insurance payment that I just mentioned.

Now let's go to Page 10 where you have our Solutions & Specialties segment. Again, if you look at the upper part of the page, you see that the year-over-year price decline, the demand weakness were also the major factors for our Solutions & Specialities sales decline of 13.5%. And if you look at it sequentially, I can tell you that we had against positive sales growth in APAC, a somewhat flat development in North America, and Europe was still declining sequentially. If you look at the lower part of the page, you see our EBITDA in the second quarter increase both year-over-year and also quarter-on-quarter.

And we had a neutral pricing delta year-over-year, but it was slightly negative if you look at it from a quarter-over-quarter perspective. Nevertheless, our EBITDA margin improved to 11.8%, but it was still burdened by destocking and the low demand that we saw. Let's now turn to our free operating cash flow for the first half of the year. As you can see in the graph, free operating cash flow came in at a negative EUR 149 million, of which however, EUR 139 million came from the first quarter of this year.

So that means our free operating cash flow in Q2 came in at minus EUR 10 million which I think is a quite reasonably good achievement for a seasonally weak quarter and our free operating cash flow improved year-over-year due to the continuous working capital management, the lower income tax payments which we had to make, and also the zero bonus payout for the full year 2022.

If you look at the little table below the graph, you see that in the first half, the changes in working capital were negative EUR 417 million. That was mainly driven by lower accounts payable due to the reduced raw material pricing, higher [accounts] (added by company after the call) receivables and a seasonal inventory increase, but I can assure you that inventory buildup is fully under control as we monitor this very closely. You can also see in the table that CapEx was EUR 279 million. This is fully in line with our budget and our full year guidance, and we paid income taxes of EUR 117 million, mainly driven by payments in China.

And please note that we expect a cash tax payment of between EUR 200 million to EUR 300 million for the full year. So overall, my assessment is that with this development in the first half, we are fully on track to achieve a positive free operating cash flow for the full year.

Now on Page 12, there's a couple of items that I would like to explain to you because I do think they're essential. So first of all, you see highlighted in the graph that we had impairments in the first half of this year of some negative EUR 37 million. The increase was quite low in the second quarter with only EUR 4 million additional after the first quarter where we had negative EUR 33 million, of which, again, EUR 30 million was related to the discontinuation of our nonstrategic and loss-making Maezio product line and the subsequent closure of the site in Markt Bibart in Germany.

The second item is the DTA adjustments. So last year, we adjusted our deferred tax assets in Germany. As a consequence, based on IFRS rules, we are now not any longer allowed to activate our tax loss carryforwards in Germany because the accounting projections expect further losses in Germany in the full year 2023.

So therefore, the tax rate will continue to be affected by the regional profit mix and currently, we assume a P&L income tax of between EUR 150 million and EUR 250 million for the full year. Now, please note that in contrast to the IFRS rules based on German tax rules, the tax loss carryforward can be used indefinitely. And this said, we are confident that in the future, we are able to use the tax loss carryforward in order to lower our future tax rates. However, for Switzerland, those tax loss carryforwards expire after 7 years, and we have no plan to use those due to the closure of our Swiss legal entity.

Overall, we had lower income taxes compared to the first half of 2022 due to the reduced earnings level in the first half of this year. And therefore, as a result of all of this, we only had a slightly positive net income of EUR 20 million, as you can see also in the table.

Now let's go to the next page and look at our net debt situation. First of all, let me say very clearly, we continue to have a strong balance sheet. And as you can see in the title, Moody's also confirmed our BAA2 rating with a stable outlook. What you also see in the graph is that our total net debt increased by EUR 328 million versus the end of 2022, mainly driven by the negative free operating cash flow in the first half of this year and also by the share buyback which we had resumed.

Now as we had announced during our Q1 call, we have continued our EUR 500 million share buyback program with a third sub-tranche of up to EUR 75 million based on the share price of EUR 37 at the time, and we executed the third tranche from May to June with a strong increase of the share price that tranche came in at EUR 49 million total volume.

What you also see in the graph is that there is a decrease in our net pension liability by EUR 47 million which is driven by the increase in the pension discount rate in Germany and also in the United States, resulting in a EUR 383 million net pension liability, and that again, consists of EUR 445 million of pension provisions, which are partly offset by a net benefit asset of EUR 62 million.

So therefore, overall, we currently have a total net debt-to-EBITDA ratio of roughly 3x based on a 4-quarter rolling EBITDA of EUR 0.9 billion. However, I mean, this is certainly a trough number and based on our mid-cycle EBITDA, the ratio would only be 1.1x. So let me just reiterate, at this point, Covestro remains fully committed to a solid investment-grade rating. And I think the strength of our balance sheet also underscores that. So, with that, let me turn it back to Markus.

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

Thank you, Thomas. Now we're coming on the next page to the outlook for Covestro's core industries. Since beginning of the year, the outlook of the global GDP has slightly improved from 1.5% to now 2.4%. Although the message sent from this is positive, our core industries are not the beneficiary of this development. After the end of the COVID pandemic, the service sector is more than proportionately benefiting from the regained freedom of travel and socializing, thus driving this GDP growth. Most of the producing sector remains stuck in the ongoing demand weakness and destocking trend. Looking into the industries important to Covestro, we see that only automotive is expecting a further improved demand raised to 6% now.

The expectation for the construction industry has deteriorated and even turned negative. The reasons for these trends are the high interest rates, higher cost for building materials and ongoing destocking. The furniture industry is seeing a very similar trend with now an expected second year of declining markets. The demand expectations for electro were also adjusted downwards to almost no growth.

With this disappointing development of our core industries, let us now turn to the Covestro outlook for the third quarter and the full year 2023. On Page 15, you see, as explained in the outlook for our core industries, that we currently see the potential risk of a further deteriorating economic environment and ongoing demand weakness for the remainder of the year. Therefore, we currently expect our EBITDA to come out at the lower half of our guidance of EUR 1.1 billion to EUR 1.6 billion for the full year 2023. We expect now volumes to decrease mid-single-digit percent year-on-year for the full year 2023. However, the second half of 2023 will result in higher available capacities from resolving our production limitations towards the fourth quarter 2023. This should allow us to continue a slight quarter-over-quarter volume growth in 2023. The current mark-to-market calculation comes out at about EUR 1.2 billion based on July margins flat forward. This is in line with the midpoint of the lower half of our EBITDA guidance. We are confirming the mid-cycle EBITDA level of EUR 2.8 billion in 2024.

We are confident that we can achieve such an EBITDA level in a normal economic environment. The most important element of bridging the gap would be a high utilization rate of our plants. Without further investments, we could grow our volumes by more than 20%. Even on today's depressed product margins, this would translate into an additional EBITDA contribution of more than EUR 1 billion. I now hand back to Thomas again.

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

Thank you very much. And I'm on Page 16 of the presentation, just to give you some more details on the guidance topic. So first of all, if you look at the upper part of the page, we are confirming the guidance for all our key KPIs. However, given the continuing weak demand and the deteriorating outlook for most of our core industries in the second half of 2023, we are, as of today, expecting a target achievement for all KPIs rather in the lower half of all the ranges that we've given you.

If you look at the lower part of the page with respect to additional financial KPIs, we expect for the third quarter 2023, an EBITDA between EUR 240 million and EUR 340 million. Our D&A will remain as guided around EUR 900 million. The financial results is confirmed at minus EUR 130 million to minus EUR 170 million, and we are strictly managing our CapEx. So, we're expecting our total CapEx spend to be roughly EUR 800 million. And as I said before, we're well on track to achieve that number. And with those details, I would like to hand it back to Markus.

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

Thank you, Thomas. And now let me please quickly summarize on Slide #17. Sequentially, we have witnessed continuously low sales of EUR 3.7 billion with the price declines being compensated by volume increases. Our EBITDA of EUR 385 million came in slightly above midpoint of the guidance and was driven by sequentially positive volume and pricing delta.

Despite the seasonally higher working capital, we are still on track for full year positive free operating cash flow, and that is helped by ongoing strict working capital measures and cost saving programs. The full year 2023 guidance is confirmed, but rather at the lower half for all key performance indicators due to the expected or anticipated weaker development of our core industries.

And last but not least, the third sub-tranche of share buyback was accomplished with EUR 49 million. And speed of continuation in this regard depends on share price development and cash generation. Before we are now coming to the Q&A part of this call, I would like to touch another very important topic.

This is the last time Thomas will be with us on the earnings call of Covestro. So let me take this opportunity today to thank Thomas personally and in the name of all Covestro employees for his outstanding contribution as the CFO of this company. His contribution to the transformation of the company in the last 5 years and the excellent reputation he created for Covestro in the financial markets are tremendous success factor for Covestro today and in the future. Thomas, we are all sad to see you leave and wish you the best of luck in your new position as the CFO of Airbus.

Now coming back to our normal agenda. Thomas and myself are now here to answer any questions that remained open. With that, I hand it over to Carsten who will guide us through the Q&A session.

QUESTIONS AND ANSWERS

Operator

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

Christian, so far, we've not been able to hear you. Would you mind to check if you are unmuted?

(technical difficulty)

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

Hello?

Operator

Now we could hear you, Christian. So the next question comes from Christian Faitz from Kepler Cheuvreux.

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

Yes. And Thomas also from my side, thank you very much for the great interctions I had with you over the past several years. All the best for your future. So, 2 questions perhaps. First of all, on the end customer side, I mean, you said several times in your presentation that automotive was your main positive driver in Q2. Looking at currently underlying new orders, this customer segment #1 for Covestro seems now be done with working down order backlogs that have been building up into late 2022. Hence, what kind of demand trends are you seeing at present? And what do you expect into year-end, plus -- what was it plus 6% or so, it looks a bit ambitious? And then second, also on the demand side, China, what kind of demand trends in key industries are you seeing in China at present, any improvement in the acceleration of demand?

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

On your first question. From our perspective, those 6% are driven on, first and foremost, better availability of some of the components actually that also have driven down the demand in recent years. And here, we have to mention once again microchips and microprocessors, that has eased a little bit, the crises is far from it, but has eased a little bit. And that's why the overall automotive industry is now working on some of the backlog orders. I think what, from our perspective, also what drives to plus 6% is that we have, , an unproportionately higher exposure to the, car segments of higher-class cars, which are the ones who are driving part of the recovery.

And in addition, we have somewhat higher exposure to systems that are driven with electrical propulsion systems. And both of, those factors which are more Covestro-specific from our perspective, justify this plus 6% growth from our opportunity also towards the year-end. But we also have to be very clear, we are with regard to global car sales, not back to the volumes that we had seen pre-crisis. So even though we see now a recovery and a very positive recovery and much appreciated recovery, we are not yet back to the levels that we have seen pre-crisis and that also should also provide further growth opportunities in the years to come.

With regards to the second question on China. I had the chance, and some of our colleagues also had the chance, to visit China recently. And one thing is for sure, that has been now discussed quite widely, the quick recovery in China in the second half of this year is not to be expected. We will, however, see that China in the third quarter will enter into the seasonally and traditionally highest quarter because there's still a pre-Christmas production now happening and starting.

There is also, at least here and there, confirmed information that stimulus packages seem to be in the making, although it seems to be qualitatively different from the stimulus package we have seen in the past. What I'm referring to is it seems to be that China uses these stimulus packages not to short-term boost market demand, but to first and foremost, rather distribute them broadly amongst different sectors, for example also the travel and entertainment sector. Secondly, it is supposed to drive particularly local demand and not necessarily only drive export-driven businesses.

And that means, in turn, that there is a recovery to be expected, but that recovery might come slower; however, will then last longer and have structurally more impact. And that would translate into, I would not expect the second half to be particularly strong with regard to recovery in China. But given all I have said, Q3 should be slightly up versus Q2 and Q4. We simply have to see, based on the stimulus package, whether we see first positive results already in the fourth quarter of this year. Therefore, last sentence, in 2024, we can expect that the situation in China will continue to gradually improve.

Operator

And the next question comes from Thomas Swoboda from Societe Generale.

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

I will ask two questions, please. Firstly, on your guidance for Q3, it seems that you were pointing to a more negative pricing delta in Q3. Could you discuss where you see pricing pressure in particular on product and regional level, if possible? My second question is and I will risk asking on the current situation, but I will ask it indirectly. In terms of your mid- to long-term growth ambitions, do you currently face any limitations in terms of backward integration, financing capabilities or how can I put it, being very exposed to the capital market that are limiting your growth vice versa if you would have unlimited resources and would be shaded from the public a little bit more, would you be able to grow much, much faster than you would be -- then you are able to grow currently in the mid-to-long term?

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

So Thomas, let me maybe take the first question with respect to the guidance in Q3 and also what that means with respect to the pricing delta. So first of all, I would confirm that for Q3, we're expecting a negative pricing delta if you look at it from a quarter-over-quarter perspective. So that could be somewhere in the region between EUR 150 million to EUR 200 million negative. If you look at it from a year-over-year perspective it's almost neutral. So, what is it that we're seeing quarter-over-quarter, it is mainly a weakness in TDI, mainly in Europe, but also to some extent in other regions.

The polyol weakness will continue. There might be a little bit more downside in PCS commodities, while MDI, we rather would assume that it is flattish. So, it's a mix mainly coming from our commodity businesses where, as I said, sequentially, we would see that there is a negative pricing delta as you correctly said. However, again, year-over-year, it's almost neutral.

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

Thomas, this is Markus speaking. Thanks for your question and coming to the second question that you have asked. Covestro has a very clear strategy. It's well positioned in the key regions. That means North America, Europe as well as Asia Pacific. And we have access to very competitive and sufficient and reliable raw materials, be it on smaller raw materials or strategic raw materials for our business. And in that context, with regard to the limitations that you indicated also on growth, we do not see neither by the way how we are financed nor by the respective resources limitations on our growth opportunities.

Operator

Next question comes from Markus Mayer from Baader Bank.

Markus Mayer ***Baader-Helvea Equity Research - Head of Research & Analyst***

Two questions from my side. The first one is this discussion in Germany on the subsidized industrial power price. And maybe you can elaborate what do you think this would help the chemical industry as such and in particular Covestro. That would be my first question. And also the environment for the chemical industry. And the second question would be on the dividend. Are there any exceptions why you would violate your positive net income requirement to pay out a dividend, as I guess, given your guidance and the current assumptions, this would mean that there would be no positive net income or only limited positive net income and as such, no dividend payment?

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

Thanks for the questions. This is Markus speaking. On the first question, so the statements I make, I make predominantly in the role as President of the German Chemical Industry Associations, in particular, here for the high energy-intensive industries. And the energy price subsidy is a Band 8, if you want to say so. The real issue is that in Germany, due to the lack of abundance of electrical energy, the prices are much higher with regard to other regions, but also with regards to other countries in [Europe] (corrected by company after the call).

Just to give you a number, power prices in the Netherlands or Belgium are up to 40% lower than we currently have them in Germany. So, and that's why in my role as a President of the Industry Association, I strongly lobby to build a bridge until all that green energy is abundantly available, so that prices are lower, in particular, on electricity in Germany, again. That's the context for the energy price subsidy as you called it. Covestro would, for sure, welcome such price break but does not need it given that we have the cost-leading assets in Europe based on today's energy prices. And that's why I'm also not particularly lobbying for this in my role as Covestro CEO. And for the second question, I would like to hand over to Thomas.

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

Yes Markus, I think I hear your question, I would say, it's August 1, and it's just a little bit too early to talk and speculate about the dividend for the full year. We do have a dividend policy, which is very clear, 35% to 55% payout. And again, it would be too early to speculate about exemptions from that. Currently, we do feel very comfortable with that policy. And then let's just see how the year evolves. So therefore, I would currently not like to speculate and give any indications about exemptions from the topic which is too early to decide on.

Markus Mayer ***Baader-Helvea Equity Research - Head of Research & Analyst***

Okay. Maybe I can ask another question on the first one for Markus. Given the discussions you have currently with potential subsidies for industries, which has high energy, do you think that is understood by the politicians or that there's a higher chance that you would have expected maybe a few months ago? Or basically, there is no change from the sentiment among politicians and what you are shouting is not heard by politicians?

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

I hope that I'm not shouting, Markus, but at least make my voice being clearly heard. That would be, I think, more effective and efficient. What I see is at least that it is in a public political realm being intensively discussed and that's the good news. That means it is heard by politicians because otherwise, they would not discuss it. That intensively and particularly, it is between 2, , secretarial states. It's between the German Ministry for Climate Protection and Economy and on the other hand, the Finance Secretary of Germany because the one said, the other one has to pay for it, and that's currently where to sum it up, in very broad terms, the political debate is.

On a likelihood, I would not like to position myself here because it is a rather complex matter, but it is only one of many matters that the current government in Germany has to solve. And as you know, politics is always about finding compromises. And I don't know what else will be on the scene and might be traded in or traded out for that subsidy. So please excuse me that I'm not giving you a likelihood of success.

Operator

The next question comes from Jaideep Pandya from On Field Research.

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

Yes. Can you hear me?

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

We can hear you, Jaideep. Yes, very well. Thank you. Yes, we can hear you.

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

I have three questions. First is on the Solutions & Specialties actually. Your mid-term margin target is 17%, but you're running around 10% right now, so significantly below. So, what is really the plan to get back to in the zip code of 17 or should we just forget the 17 because it was given in a different economic demand context? So, if you can just run us through short-term and medium-term drivers of what you're doing to improve profitability here?

The second question is just, unfortunately, actually should be for your Board rather than you, Markus. But I am going to ask you, what is really the process of succession planning in Covestro because you just appointed a CTO after extending your current CTO's tenure, and you've replaced him with an internal candidate. Now obviously, Thomas is leaving, but you as far as at least I know, you don't have a new CFO. So, I just want to understand what is the process of succession planning in Covestro at a management level?

And then the third question, I'm sorry to ask you this very directly now. But I mean, what is your different strategy given that finally, somebody is knocking on your door a little loudly? So, if this is real, how are you defending this? Or are you just using the famous words, no comment and not talking? So can you please confirm what is official version from Covestro on ADNOC and how are you defending it if it is real?

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

Jaideep, thanks for your questions. And let me start in the order as you have asked the questions. So, the midterm target is for S&S 17%. Inflation makes it more difficult, but the absolute EBITDA is still targeted to be up by several hundreds of millions. And that is based on four pillars, which we also in previous calls have put forward. So, this is nothing that is new but that we are continuously working upon to get reality to deliver those numbers. It's for sure, volume growth. And as we have stated, there are still significant opportunities within the existing assets to grow our volumes. It is value pricing, which we've seen starting to kick in. It's maybe one of the hardest parts because it changed fundamental approaches of our sales people towards the customers.

But under the leadership of Sucheta Govil, our Chief Commercial Officer, we're making here good progress. At the same time, it really takes time to now not only accelerate, but also get it through the entire organization worldwide through all our customers so that we get the real value for our products out of the pockets of our customers. It is continued cost savings, which we luckily enough have started early enough and we are addressing them structurally, not only with short-term savings which normally tend to bounce back at one point in time and there is still the RFM synergies where I can say, we are delivering slightly ahead of plan in terms of time, but also in terms of synergies, but they will only fully kick in by 2025 as we outlined the plan.

So long story short, volume growth, value pricing, cost savings and the RFM synergies will lead us to those 17% or the respective absolute EBITDA level that was appropriate at that point in time when we communicated that target.

On the second part, it's very simply explained. We try to bring with our overall process the best talents from within the organization and the best talents outside of the organization into the Board of Management and make them ready at the right point in time. There's numerous actions we are taking in terms of early identification of talents, a very structured development plan and then at the same time, also making sure that they make the right experience at the right time to really bring them in and that we are ready when we need a succession in the Board of Management.

On questions, particularly the succession in CTO and said, and you are right, we prolonged the contract of the CTO for another 6 months. The reason was not that we didn't have a successor already lined up, but the main reason was that we were in a very particular situation with regard to managing an acute energy crisis. And Klaus Schafer next, to his great, capabilities in general terms as a CTO was a particular expert and extremely well connected to all the relevant players with deep insights into the energy markets.

And that's why we decided in that crisis, so to say situation, to prolong his contract for another 6 months because that gave also Thorsten, who has now taken the helmet since mid of this year, first and foremost, to gain great insights in practical terms about the energy markets accompanying Klaus and at the same time, getting another 6 months for free, so to say, to prepare himself for the role. So even it might look from the outside to be a little bit bumpy, at least I assume that this was somewhat indicative in your question, it was all well planned and then added, by a crisis situation move to keep Klaus for another 6 months in his role to have the safe pay of hands in this very rough waters a few months more on deck.

So that maybe explains a little bit. And with regard to Thomas: Thomas has decided and I think he has also extended reasons, to move on to Airbus as the new CFO there. And he has communicated this in February, and we have started immediately a very thoroughly planned process for, finding the right successor of Thomas. The process is about to be finalized. And from that perspective also here, a very structured process exactly in line with what I said earlier on the overall succession approach that we're normally taking. And in that context, I can also make sure that we will have also here the right person in place. So that's for your second question.

And on the third question, I have to say that Covestro does not comment on rumors and that this is a general policy. And so also, in this case, please bear with me if I say that Covestro does not comment on respective market rumors.

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

Apologies for this, but so you're basically saying you can even say if you've got an offer or not, this is all market rumor. Is that how we should understand this comment?

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

You should understand the comment as it says. Covestro does not comment on rumors.

Operator

And the next question comes from Matthew Yates from Bank of America.

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

There's a couple of small things, please. First for Thomas, the tax guide. Sorry, if it's just me, but if you wouldn't mind just walking me through the P&L mechanics there? I'm struggling with, I guess, an implied EBIT guidance of something like EUR 300 million, EUR 400 million. Then you have your interest expense, how you still end up with EUR 200 million or so of tax on the P&L? That's the first question.

And then secondly, can you just help me understand the buyback. Obviously, you've got this kind of modular approach that gives you flexibility. If I understand correctly, you've now finished the third tranche, but haven't sanctioned a fourth tranche. What are the circumstances under which you take that decision? The fact that you haven't, is that because you're worried about the 3x trading leverage? Or is it something around the share price level, which is now, I guess, close to EUR 50 compared to EUR 37 when you did the third tranche?

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

Yes. Matthew, this is Thomas. Let me try to explain a little tax conundrum that we have here at Covestro. So, the issue is simply that our auditors are telling us that because we had a row of loss-making years in Germany, and also the projection for our German P&L is that it will be loss making this year, IFRS simply does not allow us to post positive tax assets. So, essentially post positive tax loss carryforwards against the losses that we're making and then kind of counterbalance these positive tax assets, which we would generate in Germany with the P&L taxes that, of course, we generate in other countries.

So, in other words, what happens is we're making profits in countries outside of Germany. We're paying the full P&L tax on those. We're making losses in Germany, but we're not able to post a positive tax asset for those losses. And therefore, the overall tax rate is very much distorted relative to the overall earnings that we're making in the company. Now the good news, and I tried to explain that this is only

IFRS. So practically speaking and more importantly economically speaking, the tax loss carryforwards in Germany cannot be posted in IFRS but they survive for German tax purposes. So as soon as we're making profits again in Germany, those taxes carryforwards can be used and therefore, we're not running into an economic damage, it is just a somewhat distorted representation of our IFRS accounts with the positive tax effects in Germany don't show up and only the negative payments.

So, we hope that this explains it a little bit. Otherwise, I think we're very happy with you to do a special tax session with the Investor Relations team.

Now, on the share buyback, our policy was to say, let's do this in an anti-cyclical and somewhat opportunistic way. I mean, currently, we're in the middle of August. So this is not share buyback period anyway, but we will simply take a decision, I would say, by the end of the month, how to proceed. And of course, we will continue with our policy that it should be opportunistic, and it should be driven by the relative share price. And therefore I mean, let's take a decision then.

Currently, I think what is also clear is that there is quite a bit of noise in the share price. And therefore, the question is whether the current situation is ideal to resume the share buyback or whether it wouldn't be better to have some more kind of clean share price development as an action field. This is how I would think about it.

Operator

And the next question comes from, I don't get the full name, from Sebastian which reminds to state your full name and company, please. Sebastian, please go ahead.

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

Yes. This is Sebastian Bray of Berenberg Bank. I just have one, please. It's around the terminology for what Covestro has bought since I believe, September '21 in calling mid-cycle EBITDA guidance, but with the caveat that it's subsequently added 2024 EBITDA guidance. I'd like to tease this open a little earlier. Is Covestro effectively saying that it's comfortable with a number of EUR 2.8 billion EBITDA for 2024? Or could 2024 mean '25, '26 or year thereafter? Because the visibility I imagine the company has is about 1 or 2 months, but the company has quite doggedly stuck to this target now for several quarters. And I'm wondering how have the moving parts for reaching it changed since the target was originally set in September '21?

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

Well, Sebastian, first and foremost, thanks for the question. And Thomas will add on later a few points. The mid-cycle EBITDA guidance is based on average margin over the cycle and normalized utilization rates. So, what do we need [to come there] (added by company after the call)? First and foremost, we need more volumes,and we have stated it also in our introductory statements earlier, even today, if we were able to fill our assets and we have 20% more opportunity on volume growth out of existing assets without changing anything else that would mean even now under a depressed margin scenario, we would have additional EUR 1 billion more EBITDA opportunity compared to today's full year outlook. Then as stated, there would still be a gap of a couple of hundreds of millions. And that would then need better margins and if I talk about better margins, these are so-called mid-cycle margins we are talking about.

And from today's perspective, both might take longer than 2024, let alone the fact that we have seen in the past swings of EUR 1.6 billion and even higher billion Euros in one given year, depending on how the overall environment economically looks like. But that maybe gives you a picture average margin over the cycle, normalized utilization rates and therefore, more volumes from today's perspective and slightly better margins from today's perspective to get there to '24, but it might this time take longer than '24. Thomas, any additions?

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

I think Markus has said it. So just to be very clear, the EUR 2.8 billion, of course, is not a concrete guidance for the year 2024. What it tells you is if you apply mid-cycle conditions in terms of the margin to the situation that we will have in 2024 with respect to the cost position that we have, with respect the synergy realization that we have, with respect to RFM, with respect to the capacities that we have available because of our growth investments and if you then kind of run that through the system, that should, under mid-cycle conditions, give you an EBITDA of EUR 2.8 billion. But of course, I think everybody's assumption is that we will have below mid-cycle conditions in 2024, most likely.

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

All the best, Thomas. But I may just jump in with one last one and as a follow-up. Has nothing changed to Covestro's assessment if it's achievable profitability between September '21 and now? Is the internal thinking that what's lost in Europe has gained elsewhere? Or how do I reconcile the fact that the whole sector's profitability has come under very significant pressure over the last 2 years with the maintenance of an absolute EBITDA target being left unchanged?

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

No, that's a very good question. I should have stated that immediately. So, our assumption is that fundamentally, the European profitability should be unchanged. And our argument for that and I think this is very clear, is that we are the cost leader in Europe. And yes, we did have a situation in Q3, Q4 last year where cost leadership was not helpful because the energy costs were so high that even as a cost leader, you were undercut by imports from Asia and therefore, all of a sudden, the regional market model that has held up for several decades, was turning into a global market model, and therefore, European profitability was, all of a sudden, undercut significantly.

That, in our view, was a unique situation, but that has changed at the current energy level of EUR 30 per megawatt hour. It's definitely back to a regional market model. And therefore, the only thing that determines the profitability in the region is actually the supply demand balance. That, we think, has not changed in Europe. The closure of the BASF TDI site should rather be helpful. And the reason why our profitability in Europe is so depressed, is mostly driven by the very, very sluggish demand in several customer industries. As soon as that normalizes, our view is that fundamentally, we should be in good shape.

Operator

And the next question comes from Geoff Haire from UBS.

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

I apologize in advance for the question. Leaving aside any potential bidder for Covestro and price, what does the Supervisory Board and the Management Board look for when it comes to a potential suitor?

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

Well, let me be very clear on that point. We are at any given time, committed to all stakeholders. So we are at any given point in time looking at all options that make sense. And therefore, let me also rest you assured, the Board of management is fully aware of its fiduciary duties and in this context aligns any of its decisions solely with the interest of its shareholders and other stakeholders. This principle is embedded in and also secured by a regular exchange with the Supervisory Board. I hope that gives you some clarity around your questions.

Operator

The next question comes from Isha Sharma from Stifel.

Isha Sharma ***Stifel Europe, Research Division - Analyst***

I just have two left, please. What exactly has driven the decline in your mark-to-market EBITDA from EUR 1.4 billion in Q1 to EUR 1.2 billion. Your competitor, Huntsman, has mentioned narrowing spreads in MDI for the low Q3 outlook that they have mentioned. Do you also subscribe to that?

The second question is on Solutions & Specialties. Here, the EBITDA accelerated, but pricing delta has sequentially also declined, if I'm not mistaken, in Q2 versus Q1. Is this because of longer line effect? And should we expect this to then further deteriorate in the second half? And I also want to thank you, Thomas, for being so generous with your time to us.

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

Okay, thank you so much for that last comment. Isha, let me try to answer your questions as good as I can. So on the first one, the reduced mark-to-market, that is essentially driven by a volume decline, and that makes up EUR 200 million to EUR 300 million of that. So essentially, a mid-single-digit percentage decrease. Remember, we were saying that we were expecting 2023 volumes on the same level as 2022. Now we're saying mid-single [%] (added by company after the call) decline. You remember that we [currently] (corrected by company after the call) multiply every percentage point with EUR 60 million of EBITDA. So that gives you the order of magnitude that has changed in the mark-to-market.

On your second question, I would say, yes, I said that quarter-on-quarter, the pricing delta was slightly negative for Solutions & Specialties. But when I say slightly, we are really talking about a single-digit number. So I mean, it's almost lost in statistics. And going forward, I would also see that there's no major effect. So I think for the sake of simplicity, you could also say that pricing delta was flat in the second quarter Q-over-Q and will remain flat also for the rest of the year, at least as far as our expectations go.

Operator

And we have another follow-up question from Jaideep Pandya from OnField.

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

The question really is just around your asset network, specifically in Europe. I mean, Markus, you mentioned about the 20% volume uplift, but it sort of looks like we might be in a cycle where that is a bit far away. So and then if I look at the Chinese plants that are coming up, the nameplate capacity is at par with yours or even higher than yours. So in that context, does Europe need to shut down maybe 15%, 20% of polyurethane capacity to actually balance and have a situation where you just don't get swamped from imports? Or can you actually survive a benign demand environment in Europe and still maintain profitability or breakeven or above breakeven? Just want to understand what is your European profitability today? And if volumes don't improve where do we go?

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

Yes. Jaideep, thanks for your follow-up question because for sure, we are also having all those questions in mind. But let me elaborate a little bit of that. I don't know whether you recall the year 2015. In 2015, we had also quite significantly underutilized European assets, and we made it in about a year those assets were filled. Then if you look at today's situation and the industry cost curves, we are in almost every product, in every plant where we produce the cost leader. And where we haven't been the cost leader, we invested in the plants, for example, Tarragona, Spain into a chlorine production, which now puts this asset from our perspective into the cost-leading position in Europe.

Then it also has been mentioned, I think by Thomas a little bit earlier, the closure of the TDI-BASF plant, as already said. And in that context, the imports that we are currently seeing are mainly coming from high-cost producers, which have assets outside of Europe and try to import from Asia Pacific to supply their customers with their own demand. So in general terms, I see that MDI demand should accelerate because the MDI demand is driven by energy-efficient buildings, as you know.

And we think next to the fact that there is a construction industry decline, refurbishment of existing buildings will get more and more important to get to the carbon dioxide emission reduction targets that the European Union has. And that's why there will be sufficient and additional demand for MDI returning, plus these assets are the ones that are least underutilized. That means the assets that should be first, if I may say so, back into the positives is definitely MDI, then followed by TDI. Once again, BASF closure helps. And then the polycarbonates, but here only the standard polycarbonates, whereas we have more or less now 4/5 of our external sales in the nonstandard polycarbonates, so they're highly blended grades for special applications.

So long story short, it's about cost leadership in Europe. It is about that we see opportunities that demand will come back in industries where it counts and that at current energy price levels with a leading cost position, we also feel comfortable and competitive against attempts to import material from outside Europe. So all in all, you could only look at the negative side. But as an individual company, we feel very well positioned to also master this challenge and also return back to may I call it enjoyable margin levels. Currently, we deliver positive results, but they're definitely not at an enjoyable level. Let me put it that way.

Operator

There are no further questions at this time. So, handing over first to Thomas.

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

Well, thank you very much. I just wanted to steal two minutes of your time for thanking, first of all, Markus, thank you very much for your kind words. I can only say it was always a pleasure and a real privilege to be part of the Covestro team. I think it's an absolutely fascinating and great company, and I really felt privileged to be part of it over the last 5 years. And secondly, I would like to thank everybody on the call for the many discussions that we had over the last 5 years, for following Covestro through some ups and downs and for challenging us with your questions. It was also always a real pleasure to be in touch with you. And I'm really looking forward to at least meet some of you again in the future.

Again, let me conclude by saying, I'm really very attached to Covestro and it's also, to some degree, with a heavy heart that I'm leaving. But of course, it's a little bit of a personal decision because it will bring me back to Hamburg, which is my home city. And therefore, it's kind of a homecoming for the family. So with that, back to Ronald, I think to conclude the call, and I wish everybody a nice summer holiday.

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

Yes. Thank you all for your participating and for all your questions. If you have more questions, don't hesitate to come back to the IR team. And with that, I wish you a nice remaining day and bye-bye.