

Business Development of the Covestro Group

Results of operations

The Group's core volumes in the first quarter of 2020 were down 4.1% compared with the prior-year quarter, mainly due to considerably weaker demand in China. This is attributable mainly to coronavirus-related production stoppages at our customers there in February and March 2020. The Coatings, Adhesives, Specialties and Polycarbonates segments saw core volumes decrease by 5.2% and 4.9%, respectively. In the Polyurethanes segment, core volumes fell by 3.6% from their level in the prior-year quarter.

Group sales amounted to €2,783 million, down by 12.3% from the prior-year quarter (previous year: €3,175 million). The main factor here was the decline in selling prices, which had a negative impact of 9.1% on sales. This development was mainly driven by the increased competitive pressure in the Polyurethanes and Polycarbonates segments. Total volumes sold impacted sales, which declined by 2.7%. Exchange rate movements had a positive effect on sales amounting to 0.8%. In contrast, the change in the portfolio reduced sales by 1.3% overall. The sale of the European polyurethane systems house business in the fourth quarter of 2019 and the sale of the European polycarbonate sheets business in the first quarter of 2020 had a negative effect, whereas the step acquisition of shares and subsequent full consolidation of Japan-based DIC Covestro Polymer Ltd. in the second quarter of 2019 had a positive effect.

All segments saw sales decline in the first quarter of 2020. Sales in the Polyurethanes segment were down 13.7% to €1,274 million (previous year: €1,476 million), while sales in the Polycarbonates segment fell 14.8% to €733 million (previous year: €860 million). In the Coatings, Adhesives, Specialties segment, sales decreased by 8.8% to €572 million (previous year: €627 million).

The Group's EBITDA declined by 42.5% to €254 million in the first quarter of 2020 (previous year: €442 million), in particular due to significantly lower margins. This was chiefly due to selling prices that fell on account of a year-over-year change in the supply/demand situation and volumes that decreased in connection with the coronavirus pandemic. The impact of the coronavirus pandemic reduced EBITDA by around €80 million in the first quarter of 2020, based on an internal calculation.

EBITDA in the Polyurethanes segment dropped by 68.2% to €50 million (previous year: €157 million), and in the Polycarbonates segment it was down by 29.7% to €109 million (previous year: €155 million). In the Coatings, Adhesives, Specialties segment, EBITDA fell by 11.0% to €130 million (previous year: €146 million).

In the first quarter of 2020, the Covestro Group's EBIT was down by 74.6% to €67 million (previous year: €264 million).

Financial position

Operating cash flows decreased to minus €110 million from the prior-year quarter (previous year: €120 million), largely due to the significant drop in EBITDA.

Free operating cash flow amounted to minus €249 million in the first quarter of 2020 (previous year: minus €45 million). This was mainly attributable to the decrease in cash flows from operating activities. Cash outflows for additions to property, plant, equipment and intangible assets were down to €139 million (previous year: €165 million).

Net financial debt

	Dec. 31, 2019	Mar. 31, 2020
	€ million	€ million
Bonds	997	997
Liabilities to banks	10	766
Lease liabilities	735	728
Liabilities from derivatives	10	25
Other financial liabilities	-	1
Receivables from derivatives	(15)	(26)
Financial debt	1,737	2,491
Cash and cash equivalents	(748)	(1,200)
Net financial debt	989	1,291

In comparison with December 31, 2019, the Covestro Group's financial debt increased by €754 million to €2,491 million as of March 31, 2020. The increase was due to the assumption of short-term loans totaling €500 million and a loan from the European Investment Bank (EIB) in the amount of €225 million for research and development. The focus here is, in particular, on sustainability and the circular economy in the European Union. Cash and cash equivalents were higher, mainly on account of the aforementioned net cash provided by financing activities, although negative free operating cash flow caused this figure to decline.

Material business events

On January 2, 2020, Covestro successfully concluded the sale of its European polycarbonate sheets business to the Serafin Group. This included central management and distribution functions in Europe and production sites in Belgium and Italy. Serafin has pledged to continue operations at all sites. Covestro will continue to act as a key supplier of raw materials for the foreseeable future.

Effective March 17, 2020, Covestro obtained a new syndicated revolving credit facility totaling €2.5 billion with a term of five years, including two options for extending the term by one year in each case. An important new feature of the credit line is its link to an ESG (environment, social, governance) rating: The lower (higher) the externally calculated ESG score is, the lower (higher) the interest component of the credit facility. The new facility replaces the existing revolving credit line of €1.5 billion and, like it, functions as a backup liquidity reserve.

Business performance in the first quarter of 2020 was heavily influenced by the dynamic evolution of the coronavirus pandemic. In China in particular, our customers experienced production stoppages in February and March 2020. As a reaction to the worldwide spread of the coronavirus, Covestro actively implemented crisis management plans and adapted workflows to local conditions. The Board of Management took steps early on to adjust the company's activities to current conditions, protect the health of all Covestro employees, guarantee our capability to continue deliveries to customers, and safeguard Covestro's strong liquidity position. Moreover, the Annual General Meeting originally planned for April 17, 2020, will now take place as a virtual meeting on July 30, 2020.

Business Development by Segment

Polyurethanes

Key data Polyurethanes

	1st quarter 2019	1st quarter 2020	Change
	€ million	€ million	%
Core volume growth¹	-0.2%	-3.6%	
Sales	1,476	1,274	-13.7
Change in sales			
Volume	+3.0%	-2.5%	
Price	-29.4%	-10.8%	
Currency	+2.1%	+0.7%	
Portfolio	0.0%	-1.1%	
Sales by region			
EMLA	669	589	-12.0
NAFTA	411	395	-3.9
APAC	396	290	-26.8
EBITDA	157	50	-68.2
EBIT	57	(51)	.
Operating cash flows	4	(86)	.
Cash outflows for additions to property, plant, equipment and intangible assets	102	84	-17.6
Free operating cash flow	(98)	(170)	+73.5

¹ Reference values calculated on the basis of the definition of the core business effective March 31, 2020

In the first quarter of 2020, core volumes in Polyurethanes declined by 3.6% from the prior-year quarter. The major contributing factors here were a downturn in volumes in the electrical, electronics and household appliances sector and the automotive industry.

Sales in the Polyurethanes segment were down by 13.7% to €1,274 million in the first quarter of 2020 (previous year: €1,476 million). Changes in average selling prices resulted in sales falling 10.8%, while total volumes sold were responsible for a 2.5% dip in sales. The drop in prices was primarily attributable to increased competitive pressure worldwide compared with the previous year. Exchange rate fluctuations gave sales a 0.7% boost. Moreover, the portfolio effect from the sale of the European systems house business in the fourth quarter of 2019 negatively affected sales by 1.1%.

In the EMLA region, sales fell 12.0% from the prior-year quarter to €589 million (previous year: €669 million), mainly due to a significant decline in average selling prices. Total volumes saw a modest increase, although the previously mentioned portfolio effect depressed sales slightly. Exchange rate fluctuations had no notable overall impact on sales. The NAFTA region's sales were down 3.9% to €395 million (previous year: €411 million) on account of significantly lower selling prices. In contrast, higher total volumes and exchange rate movements increased sales slightly. In the APAC region, sales slid by 26.8% to €290 million (previous year: €396 million) chiefly due to the effects of the coronavirus pandemic. A significant drop in both total volumes and average selling prices affected sales adversely. In contrast, exchange rate changes improved sales slightly.

EBITDA in the Polyurethanes segment decreased 68.2% from the prior-year quarter, falling to €50 million in the first quarter of 2020 (previous year: €157 million). Lower selling prices cut deeply into margins despite a decline in raw material prices. A downturn in volumes also had a negative effect on EBITDA.

EBIT was down to minus €51 million in the first quarter of 2020 (previous year: €57 million).

In the first quarter of 2020, free operating cash flow fell by 73.5% to minus €170 million (previous year: minus €98 million), mainly due to the decline in EBITDA.

Polycarbonates

Key data Polycarbonates

	1st quarter 2019	1st quarter 2020	Change
	€ million	€ million	%
Core volume growth¹	-6.3%	-4.9%	
Sales	860	733	-14.8
Change in sales			
Volume	-2.9%	-2.6%	
Price	-12.8%	-9.6%	
Currency	+2.6%	+1.0%	
Portfolio	-3.6%	-3.6%	
Sales by region			
EMLA	289	262	-9.3
NAFTA	188	181	-3.7
APAC	383	290	-24.3
EBITDA	155	109	-29.7
EBIT	105	54	-48.6
Operating cash flows	138	35	-74.6
Cash outflows for additions to property, plant, equipment and intangible assets	39	29	-25.6
Free operating cash flow	99	6	-93.9

¹ Reference values calculated on the basis of the definition of the core business effective March 31, 2020

In the first quarter of 2020, core volumes in the Polycarbonates segment fell by 4.9% from the prior-year quarter. Volumes in the electrical, electronics and household appliances sector and the automotive industry in particular were down substantially. In contrast, volumes in the construction sector grew significantly, but were only sufficient to partly offset the aforementioned declines.

Sales in the Polycarbonates segment decreased by 14.8% to €733 million in the first quarter of 2020 (previous year: €860 million). A lower level of selling prices and drop in total volumes reduced sales by 9.6% and 2.6%, respectively. However, exchange rate movements led to sales growth of 1.0%. Moreover, the portfolio effect from the sale of the European polycarbonate sheets business in the first quarter of 2020 adversely affected sales, which decreased by 3.6%.

In the EMLA region, sales were down by 9.3% to €262 million (previous year: €289 million). Changes in selling prices and the aforementioned portfolio effect caused a substantial reduction in sales. In comparison, a sharp increase in total volumes had a positive impact on sales. Exchange rate fluctuations had no notable overall effect. The NAFTA region's sales declined by 3.7% to €181 million (previous year: €188 million) as the result of significantly lower average selling prices. In contrast, the changes in total volumes and exchange rates increased sales modestly. Sales in the APAC region saw a sharp downturn due to the effects of the coronavirus pandemic, falling by 24.3% to €290 million (previous year: €383 million). This was evident in a significant decline in total volumes and considerably lower selling prices. Exchange rate changes improved sales slightly.

In the first quarter of 2020, EBITDA in the Polycarbonates segment decreased by 29.7% from the prior-year quarter, falling to €109 million (previous year: €155 million). The driver of this development was a lower selling price level, which led to reduced margins despite a decline in raw material prices.

EBIT was down by 48.6% to €54 million in the first quarter of 2020 (previous year: €105 million).

Free operating cash flow fell to €6 million in the first quarter of 2020, a reduction of 93.9% (previous year: €99 million). This was attributable to a downturn in EBITDA and an increase in cash tied up in working capital.

Coatings, Adhesives, Specialties

Key data Coatings, Adhesives, Specialties

	1st quarter 2019	1st quarter 2020	Change
	€ million	€ million	%
Core volume growth¹	-0.1%	-5.2%	
Sales	627	572	-8.8
Change in sales			
Volume	+1.1%	-7.1%	
Price	+1.7%	-3.9%	
Currency	+3.1%	+1.1%	
Portfolio	0.0%	+1.1%	
Sales by region			
EMLA	294	279	-5.1
NAFTA	144	139	-3.5
APAC	189	154	-18.5
EBITDA	146	130	-11.0
EBIT	118	100	-15.3
Operating cash flows	12	40	>200
Cash outflows for additions to property, plant, equipment and intangible assets	24	25	+4.2
Free operating cash flow	(12)	15	.

¹ Reference values calculated on the basis of the definition of the core business effective March 31, 2020

In the first quarter of 2020, core volumes in the Coatings, Adhesives, Specialties segment were 5.2% lower than in the prior-year quarter. This development was driven by weaker demand for coating precursors in all key customer industries, particularly the automotive industry.

The Coatings, Adhesives, Specialties segment's sales were down 8.8% to €572 million in the first quarter of 2020 (previous year: €627 million). A decrease in total volumes sold and lower average selling prices due to changes in the competitive landscape negatively affected sales by 7.1% and 3.9%, respectively. However, exchange rate movements had a positive impact on sales amounting to 1.1%. In addition, the step acquisition of shares and subsequent full consolidation of Japan-based DIC Covestro Polymer Ltd. in the second quarter of 2019 also gave sales a 1.1% boost in the first quarter of 2020.

In the EMLA region, sales declined by 5.1% to €279 million (previous year: €294 million). Total volumes and average selling prices each put slight downward pressure on sales, while changes in exchange rates were neutral overall with respect to their effect on sales. Sales in the NAFTA region fell by 3.5% to €139 million (previous year: €144 million) on account of a moderate decline in total volumes and slightly lower average selling prices. Sales increased slightly due to the effect of exchange rate changes. The APAC region's sales decreased by 18.5% to €154 million (previous year: €189 million) as a result of the effects of the coronavirus pandemic. The decrease in total volumes and lower selling price level had a significant adverse effect on sales. Conversely, exchange rate changes and the portfolio effect of the step acquisition of shares of Japan-based DIC Covestro Polymer Ltd. improved sales somewhat.

In the first quarter of 2020, EBITDA in the Coatings, Adhesives, Specialties segment decreased by 11.0% from the prior-year quarter, amounting to €130 million (previous year: €146 million). A negative effect of lower volumes and margins put downward pressure on earnings.

EBIT slid by 15.3% in the first quarter of 2020, down to €100 million (previous year: €118 million).

Free operating cash flow increased to €15 million in the first quarter of 2020 (previous year: minus €12 million). A year-over-year decrease in cash tied up in working capital, primarily in trade accounts receivables, more than compensated for the decline in EBITDA.

Forecast

Economic outlook

Economic growth¹

	Growth 2019	Growth forecast 2020 (Annual Report 2019)	Growth forecast 2020
	%	%	%
World	+2.5	+2.5	-3.1
Europe	+1.5	+1.2	-4.3
of which Western Europe	+1.2	+0.9	-4.4
of which Germany	+0.6	+0.4	-4.5
of which Eastern Europe	+2.7	+2.4	-3.7
Middle East	+1.0	+2.0	-4.5
Latin America	-0.3	+0.9	-4.6
Africa	+2.6	+2.9	-1.1
North America²	+2.2	+1.9	-5.5
of which United States	+2.3	+2.1	-5.4
Asia-Pacific	+4.2	+4.2	0.0
of which China	+6.1	+5.8	+2.0

¹ Real growth of gross domestic product; source: IHS (Global Insight), Growth 2019 and Growth forecast 2020 as of April 15, 2020

² North America (not including Central America): Canada, Mexico, United States

The grave consequences of the spread of the coronavirus pandemic will have a substantial negative impact on the global economy. In contrast with our outlook in the 2019 Annual Report, we now project global economic output to decline significantly, with growth at minus 3.1% for 2020 as a whole. The forecasts for all regions were revised sharply downward. According to current estimates, we expect only China to post positive, albeit weaker, growth. The economies in Europe, North America, and Latin America are forecast to perform much less robustly and report negative growth rates.

Main customer industries

We expect the coronavirus pandemic to also have a significant adverse impact on the performance of our main customer industries. Unlike our forecast in the 2019 Annual Report, we now believe the automotive industry will see a steep downturn amounting to a double-digit percentage. Growth in the furniture industry will also likely be considerably weaker than expected. In the electrical, electronics and household appliances sector as well as the construction industry, we project a negative growth rate in the mid-single-digit range, down from our forecast in the 2019 Annual Report.

Forecast for key performance indicators

As a result of the coronavirus pandemic and the resulting increasingly unfavorable business environment, the Board of Management of Covestro AG adjusted the forecasts in the 2019 Annual Report on April 15, 2020. For fiscal 2020, we now expect our key performance indicators to develop as follows.

In the current year, core volume growth is projected to decline (forecast in the 2019 Annual Report: low-single-digit percentage range increase).

Free operating cash flow (FOCF) is expected to be in the range between minus €200 million and plus €300 million this year (forecast in the 2019 Annual Report: between €0 million and €400 million).

For fiscal 2020, return on capital employed* (ROCE) is projected between minus 1% and plus 4% (forecast in the 2019 Annual Report: between 2% and 7%).

*The return on capital employed is calculated as the ratio of EBIT after taxes to capital employed. Capital employed is the capital used by the company. It is the sum of current and noncurrent assets less noninterest-bearing liabilities such as trade accounts payable.