Business Development of the Covestro Group

Results of operations

In the third quarter of 2019, the Group's core volumes were 5.3% higher than in the prior-year quarter. The Polycarbonates and Polyurethanes segments saw volume growth of 9.3% and 5.1%, respectively, whereas volumes in the Coatings, Adhesives, Specialties segment declined by 4.0%.

Group sales amounted to €3,162 million, down 14.6% from the prior-year quarter (previous year: €3,702 million). The main factor here was the decline in selling prices, which had a negative impact of 18.5% on sales. This development was attributable mainly to the Polyurethanes and Polycarbonates segments. Total volumes increased sales by 2.1%. The exchange rate trend also impacted sales, which improved by 1.9%. In contrast, the change in the portfolio reduced sales by 0.1%. The sale of the U.S. polycarbonate sheets business in the third quarter of 2018 had a negative effect on sales, while the gradual acquisition of shares of Japan-based DIC Covestro Polymer Ltd. in the second quarter of 2019 had a positive effect.

All segments saw sales drop in the third quarter of 2019. The Polyurethanes segment's sales were down by 20.1% to €1,478 million (previous year: €1,849 million) and the Polycarbonates segment saw sales decrease by 13.2% to €901 million (previous year: €1,038 million). In the Coatings, Adhesives, Specialties segment, sales declined by 3.0% to €588 million (previous year: €606 million).

The Group's EBITDA declined by 50.5% to €425 million in the third quarter of 2019 (previous year: €859 million), in particular due to significantly lower margins. In contrast, higher volumes, a decrease in provisions for short-term variable compensation, and the effects of applying the new financial reporting standard IFRS 16 (Leases) had a positive effect on EBITDA.

EBITDA in the Polyurethanes segment decreased by 54.6% to €196 million (previous year: €432 million), and in the Polycarbonates segment it was down 58.1% to €132 million (previous year: €315 million). In the Coatings, Adhesives, Specialties segment, EBITDA declined by 11.9% to €111 million (previous year: €126 million).

In the third quarter of 2019, the Covestro Group's EBIT decreased by 68.7% to €221 million (previous year: €707 million).

Financial position

Operating cash flows decreased against the prior-year quarter, reaching €462 million (previous year: €766 million), largely due to the significant drop in EBITDA. Lower income tax payments had a positive effect on cash flow.

Free operating cash flow declined to €243 million in the third quarter of 2019 (previous year: €578 million). This was mainly due to decreased cash inflows from operating activities and the planned increase in cash outflows for additions to property, plant, equipment and intangible assets.

Net Financial Debt

	Dec. 31, 2018[1]	Sep. 30, 2019
	€ million	€ million
Bonds	996	997
Liabilities to banks	24	14
Lease liabilities[2]	193	814
Liabilities from derivatives	12	20
Receivables from derivatives	(12)	(12)
Financial liabilities	**1,213**	**1,833**
Cash and cash equivalents	(865)	(422)
Net financial debt	**348**	**1,411**

[1] Reference information was not restated; see section "Changes in Accounting as a Result of the Initial Application of IFRS 16."
[2] As of September 31, 2019, this also contains the lease liabilities from initial application of IFRS 16.

In comparison with December 31, 2018, the Covestro Group's net financial debt increased by €1,063 million to reach €1,411 million as of September 30, 2019. This rise was mainly attributable to the initial application of the IFRS 16 financial reporting standard and the resulting increase in lease liabilities. The decline in cash and cash equivalents is largely due to a reduction in cash inflows from operating activities and an increase in cash outflows for additions to property, plant, equipment and intangible assets.

Business Development by Segment

Polyurethanes

Polyurethanes Key Data

	3rd quarter 2018[1]	3rd quarter 2019	Change	1st nine months 2018[1]	1st nine months 2019	Change
	€ million	€ million	%	€ million	€ million	%
Core volume growth[2]	**–2.0%**	**+5.1%**		**+0.3%**	**+1.9%**	
Sales	1,849	1,478	–20.1	5,765	4,443	–22.9
Change in sales						
Volume	+0.1%	+2.5%		+0.2%	+2.1%	
Price	–0.5%	–24.4%		+8.6%	–26.9%	
Currency	–0.8%	+1.8%		–4.2%	+1.9%	
Portfolio	0.0%	0.0%		0.0%	0.0%	
Sales by region						
EMLA	773	629	–18.6	2,504	1,941	–22.5
NAFTA	512	431	–15.8	1,473	1,286	–12.7
APAC	564	418	–25.9	1,788	1,216	–32.0
EBITDA	**432**	**196**	**–54.6**	**1,652**	**525**	**–68.2**
EBIT	346	97	–72.0	1,385	226	–83.7
Operating cash flows	453	173	–61.8	993	293	–70.5
Cash outflows for additions to property, plant, equipment and intangible assets	113	135	+19.5	243	375	+54.3
Free operating cash flow	**340**	**38**	**–88.8**	**750**	**(82)**	**.**

[1] Reference information was not restated; see section "Changes in Accounting as a Result of the Initial Application of IFRS 16."
[2] Reference values calculated on the basis of the definition of the core business effective March 31, 2019

In the third quarter of 2019, core volumes in the Polyurethanes segment were 5.1% higher than in the prior-year quarter. The upswing in volumes in the furniture and electrical/electronics industries, especially in household appliances, and in the construction sector more than offset weaker demand from the automotive industry.

Sales in the Polyurethanes segment were down 20.1% to €1,478 million in the third quarter of 2019 (previous year: €1,849 million). The trend in average selling prices had a negative impact on sales of 24.4%, chiefly due to more intense competitive pressure. Total volumes had a positive effect of 2.5% on sales. Moreover, exchange rate movements increased sales by 1.8%.

In the EMLA region, sales were down 18.6% from the prior-year quarter to €629 million (previous year: €773 million) on account of a significant decline in selling prices. In contrast, total volumes saw a slight increase. Changes in exchange rates had no notable overall effect on sales. Sales in the NAFTA region decreased by 15.8% to €431 million (previous year: €512 million). Much lower selling prices and a slight downturn in total volumes combined to impact sales, which declined. Conversely, exchange rate fluctuations had a slightly positive effect on sales. In the APAC region, sales decreased by 25.9% to €418 million (previous year: €564 million) due to a considerable drop in selling prices. Higher total volumes had a significant positive effect and changes in exchange rates had a mildly positive impact on sales.

In the third quarter of 2019, EBITDA in the Polyurethanes segment declined by 54.6% compared with the prior-year quarter, decreasing to €196 million (previous year: €432 million). Despite a decline in raw material prices, lower selling prices led to a significant drop in margins. In contrast, volumes had a positive effect on EBITDA.

EBIT was down by 72.0% in the reporting period, dropping to €97 million (previous year: €346 million).

In the third quarter of 2019, free operating cash flow decreased by 88.8% to €38 million (previous year: €340 million). This is mainly due to the decline in EBITDA and an overall build-up of funds tied up in working capital, especially in liabilities, as well as higher cash outflows for additions to property, plant, equipment and intangible assets.

Polycarbonates

Polycarbonates Key Data

	3rd quarter 2018[1]	3rd quarter 2019	Change	1st nine months 2018[1]	1st nine months 2019	Change
	€ million	€ million	%	€ million	€ million	%
Core volume growth[2]	**+2.6%**	**+9.3%**		**+3.5%**	**+2.4%**	
Sales	1,038	901	–13.2	3,127	2,659	–15.0
Change in sales						
Volume	+5.1%	+6.8%		+3.6%	+3.1%	
Price	+9.6%	–20.7%		+13.7%	–17.4%	
Currency	–0.6%	+2.0%		–4.6%	+2.1%	
Portfolio	–2.8%	–1.3%		–0.9%	–2.8%	
Sales by region						
EMLA	331	281	–15.1	1,046	876	–16.3
NAFTA	205	196	–4.4	617	574	–7.0
APAC	502	424	–15.5	1,464	1,209	–17.4
EBITDA	**315**	**132**	**–58.1**	**903**	**441**	**–51.2**
EBIT	272	57	–79.0	773	261	–66.2
Operating cash flows	185	178	–3.8	419	409	–2.4
Cash outflows for additions to property, plant, equipment and intangible assets	49	44	–10.2	116	125	+7.8
Free operating cash flow	**136**	**134**	**–1.5**	**303**	**284**	**–6.3**

[1] Reference information was not restated; see section "Changes in Accounting as a Result of the Initial Application of IFRS 16."
[2] Reference values calculated on the basis of the definition of the core business effective March 31, 2019

In the third quarter of 2019, core volumes in the Polycarbonates segment were 9.3% higher than in the prior-year quarter. The electrical and electronics industry and the construction sector were the main contributors to this growth.

Sales in the Polycarbonates segment were down 13.2% to €901 million in the third quarter of 2019 (previous year: €1,038 million). A decline in selling prices reduced sales by 20.7%, primarily because of greater competitive pressure. In contrast, total volumes and exchange rate movements accounted for 6.8% and 2.0% of sales growth, respectively. Moreover, the portfolio effect from the sale of the U.S. polycarbonate sheets business in the third quarter of 2018 had a negative effect of 1.3% on sales in the third quarter of 2019.

Sales in the EMLA region decreased by 15.1% to €281 million as a result of a considerable drop in selling prices (previous year: €331 million). In addition, total volumes had a mildly negative effect on sales. Exchange rate changes had no significant overall impact on sales figures. In the NAFTA region, sales were down 4.4% to €196 million (previous year: €205 million), due to a significant decline in average selling prices and the aforementioned portfolio effect, which had a substantially negative impact on sales. In contrast, total volumes had a significant positive effect, and exchange rate movements increased sales slightly. Sales in the APAC region declined by 15.5% to €424 million (previous year: €502 million). A lower selling price level considerably pushed down sales, whereas total volumes provided a strong boost. Changes in exchange rates had a somewhat positive effect on sales figures.

In the third quarter of 2019, EBITDA in the Polycarbonates segment decreased by 58.1% compared with the prior-year quarter, dropping to €132 million (previous year: €315 million), mostly on account of lower selling prices. The decrease in raw material prices and increase in sales volumes had a positive effect on EBITDA, however. Moreover, earnings in the previous year had been affected by non-recurring income of €36 million from the sale of the U.S. polycarbonate sheets business.

EBIT was down 79.0% to €57 million in the third quarter of 2019 (previous year: €272 million). Write-downs of assets amounting to €26 million in connection with the sale of the European polycarbonate sheets business had a negative effect on EBIT, with €21 million of those impairment charges attributable to noncurrent assets.

Free operating cash flow fell by 1.5% to €134 million in the third quarter of 2019 (previous year: €136 million). The decline in EBITDA stood in contrast to a greater release of funds in working capital, especially in inventories.

Coatings, Adhesives, Specialties

Coatings, Adhesives, Specialties Key Data

	3rd quarter 2018[1]	3rd quarter 2019	Change	1st nine months 2018[1]	1st nine months 2019	Change
	€ million	€ million	%	€ million	€ million	%
Core volume growth[2]	**+7.2%**	**–4.0%**		**+3.7%**	**–3.0%**	
Sales	606	588	–3.0	1,827	1,836	+0.5
Change in sales						
Volume	+9.7%	–4.7%		+4.3%	–2.7%	
Price	–0.5%	–2.1%		+0.8%	–0.3%	
Currency	–0.4%	+2.2%		–3.5%	+2.5%	
Portfolio	0.0%	+1.6%		0.0%	+1.0%	
Sales by region						
EMLA	280	257	–8.2	877	828	–5.6
NAFTA	131	145	+10.7	390	433	+11.0
APAC	195	186	–4.6	560	575	+2.7
EBITDA	**126**	**111**	**–11.9**	**401**	**407**	**+1.5**
EBIT	103	82	–20.4	332	320	–3.6
Operating cash flows	119	129	+8.4	202	179	–11.4
Cash outflows for additions to property, plant, equipment and intangible assets	26	39	+50.0	70	103	+47.1
Free operating cash flow	**93**	**90**	**–3.2**	**132**	**76**	**–42.4**

[1] Reference information was not restated; see section "Changes in Accounting as a Result of the Initial Application of IFRS 16."
[2] Reference values calculated on the basis of the definition of the core business effective March 31, 2019

In the third quarter of 2019, core volumes in the Coatings, Adhesives, Specialties segment were 4.0% lower than in the prior-year quarter. This development was mainly attributable to weaker demand for coating precursors from all key customer industries, particularly the automotive sector.

The Coatings, Adhesives, Specialties segment's sales decreased 3.0% to €588 million (previous year: €606 million) in the third quarter of 2019. A negative effect on sales by 4.7% and 2.1% was due, respectively, to total volumes and the decrease in selling prices on average. In contrast, exchange rate movements had a positive effect on sales, which rose by 2.2%. The gradual acquisition of shares in Japan-based DIC Covestro Polymer Ltd. also bumped up sales by 1.6%.

The EMLA region's sales dropped 8.2% to €257 million (previous year: €280 million) due to a considerable decline in total volumes. Average selling prices remained mostly stable, however. Exchange rate changes had no significant net effect on sales. In the NAFTA region, sales rose by 10.7% to €145 million (previous year: €131 million). The increase in total volumes, higher selling prices, and the effect of exchange rate movements were each responsible for the slight growth in sales. The APAC region's sales were down 4.6% to €186 million (previous year: €195 million). Changes in total volumes and average selling prices had a significant negative impact on sales. Conversely, the effect of exchange rate movements and the portfolio effect from the gradual acquisition of shares in Japan-based DIC Covestro Polymer Ltd. gave sales a modest boost.

In the third quarter of 2019, EBITDA in the Coatings, Adhesives, Specialties segment decreased 11.9% from the prior-year quarter to €111 million (previous year: €126 million). This was primarily due to negative volume effects and lower margins.

EBIT was down by 20.4% in the same period, dropping to €82 million (previous year: €103 million).

Free operating cash flow decreased by 3.2% to €90 million in the third quarter of 2019 (previous year: €93 million).The decline in EBITDA and increase in cash outflows for additions to property, plant, equipment and intangible assets were not offset by the overall greater release of funds in working capital.

Forecast

Economic Outlook

Economic Growth

	Growth[1] 2018	Growth[1] forecast 2019 (2018 Annual Report)	Growth[1] forecast 2019
	%	%	%
World	**+3.1**	**+2.8**	**+2.5**
European Union	+2.0	+1.3	+1.3
of which Germany	+1.5	+1.0	+0.4
NAFTA	+2.8	+2.4	+2.1
of which United States	+2.9	+2.5	+2.3
Asia-Pacific	+4.8	+4.7	+4.4
of which China	+6.6	+6.3	+6.2

[1] Real growth of gross domestic product; source: IHS (Global Insight), Growth 2018 and Growth forecast 2019 as of October 2019

We expect global economic growth of 2.5% for 2019, slightly less positive than our outlook in the 2018 Annual Report. We likewise anticipate a slightly slower growth in the Asia-Pacific and NAFTA regions. The forecast for Germany has been downgraded considerably, while the expectations for the European Union as a whole remained largely unchanged. Overall, we expect to see ongoing difficult economic conditions due to such issues as political uncertainties in Europe and increasing global trade barriers.

Main customer industries

Compared with the expectations we expressed in the 2018 Annual Report, we so far see only minor changes, or none at all, for the performance of the construction sector and the electrical, electronics and household appliance industry, assuming no further trade barriers arise. Growth in the furniture industry is anticipated to be somewhat weaker than presented in the 2018 Annual Report. In contrast to our statements in the 2018 Annual Report, we now anticipate a significant downturn in the automotive industry.

Forecast for Key Data

On the basis of the business performance described in this quarterly statement, we confirm the Group forecast and, in consideration of the potential associated risks and opportunities, provide more specific bandwidths for the forecast for the rest of the 2019 fiscal year than those forecast to date in the 2018 Annual Report.

We now expect core volume growth for the Covestro Group in the low-single-digit-percentage range. This also applies to the Polyurethanes and Polycarbonates segments. For the Coatings, Adhesives, Specialties segment, we currently anticipate a drop in core volumes in the low-single-digit-percentage range (2018 Annual Report forecast: core volume growth in the low-to-mid-single-digit-percentage range for the Covestro Group as well as for the Polyurethanes, Polycarbonates and Coatings, Adhesives, Specialties segments).

For fiscal 2019, we anticipate free operating cash flow (FOCF) for the Group of between €300 million and €500 million (2018 Annual Report forecast: FOCF between €300 million and €700 million). For the Polyurethanes segment, we continue to assume an increase in cash outflows for additions to property, plant, equipment and intangible assets that will exceed the expected net cash provided by operations. FOCF is expected to decline in the Polycarbonates segment as well, although the trend here will likely be much more positive than for the Group as a whole. In the Coatings, Adhesives, Specialties segment, FOCF is now projected to be slightly below the prior-year level (2018 Annual Report forecast: FOCF around the prior-year level).

For fiscal 2019, we expect ROCE[1] between 8% and 10% (2018 Annual Report forecast: ROCE between 8% and 13%).

[1] ROCE: 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 non-interest-bearing liabilities such as trade accounts payable.