

Significant Events

Coronavirus pandemic

The coronavirus pandemic continued to adversely influence the global economy. After the drop in demand in our main customer industries reached its peak in the second quarter of 2020, we saw a significant rebound in demand in the third quarter of 2020. The steps taken by Covestro in previous quarters to protect the health of all employees, guarantee our delivery capability, and safeguard Covestro's strong liquidity position are still in place. These include a wide range of health, safety and hygiene measures in effect at our sites. Depending on the local situation in each case, some staff, particularly employees in administrative departments, work from home. Production at our sites was unaffected by the coronavirus pandemic in the third quarter of 2020.

Covestro's Board of Management continues to monitor the worldwide development of the coronavirus pandemic. Existing measures are modified or expanded as required in line with recommendations and instructions issued by the relevant governments and committees of experts.

Other events

Following a resolution by Covestro AG's Supervisory Board, in July 2020 the contract of Board of Management member Dr. Thomas Toepfer was extended prior to its expiration for a five-year term running from April 1, 2021, to March 31, 2026. Dr. Toepfer has been CFO of the company since April 1, 2018, and additionally holds the position of Labor Director.

Covestro's Annual General Meeting (AGM) took place virtually for the first time on July 30, 2020. A fiscal 2019 dividend of €1.20 per share carrying dividend rights was approved at the AGM. The total amount of €219 million was paid out on August 4, 2020.

On August 31, 2020, the Higher Administrative Court in Münster ruled against the complaints brought by several individual plaintiffs against the planning permission decision by Düsseldorf's district government approving the construction and operation of a carbon monoxide pipeline from Dormagen to Krefeld-Uerdingen. The Higher Administrative Court determined that the complaints were entirely unfounded, and the planning permission decision was unconditionally lawful. In addition, the Higher Administrative Court rejected an appeal against its ruling. The plaintiffs can now file an appeal against denial of leave to appeal with the Federal Administrative Court.

On September 30, 2020, Covestro signed an agreement to acquire the Resins & Functional Materials business (RFM) of DSM for a preliminary purchase price of €1.6 billion. The deal aims to grow Covestro's sustainable and innovative business activities in support of the long-term corporate strategy. Integrating RFM into the Coatings, Adhesives, Specialties segment significantly expands the company's portfolio in the high-growth sustainable coating resins market. In connection with the announced acquisition Covestro successfully completed on October 13, 2020, a capital increase comprising 10,200,000 no-par bearer shares that were placed through partial utilization of Authorized Capital 2020. The gross proceeds amount to €447 million before commission and costs and will be used to finance part of the purchase price.

See "Acquisitions and divestitures"

Results of Operations and Financial Position of the Covestro Group

Results of operations

The results of operations continued to be impacted by the consequences of the coronavirus pandemic in the third quarter of 2020. In the course of the quarter, we saw demand for our products recover, albeit to different degrees in various regions and industries.

The Group's core volumes sold increased by 3.0% in the third quarter of 2020 compared with the prior-year quarter. After a substantial decline in volumes in the second quarter of 2020, the third quarter saw a strong recovery driven by volume growth in the APAC region and especially in China. The Polyurethanes and Polycarbonates segments reported increases in core volumes sold of 4.3% and 3.6%, respectively. In the Coatings, Adhesives, Specialties segment, core volumes sold dropped 6.9% from the prior-year quarter.

Group sales amounted to €2,760 million, down 12.7% from the prior-year quarter (previous year: €3,162 million). The main factor here was a decline in selling prices, which had a negative impact of 9.0% on sales. This development was chiefly due to the increased competitive pressure in the Polyurethanes and Polycarbonates segments. Total volumes sold lifted sales slightly, by 1.0%. Exchange rate movements had a negative impact of 3.3% on sales, primarily because of the development of the U.S. dollar and the Chinese renminbi. In addition, the change in the portfolio resulted in an overall reduction in sales of 1.4%: The sale of the European polyurethane systems house business in the fourth quarter of 2019 as well as the European polycarbonate sheets business in the first quarter of 2020 adversely affected third quarter sales in 2020.

All segments saw sales decline in the third quarter of 2020. In the Polyurethanes segment, sales sank 11.0% to €1,315 million (previous year: €1,478 million), while the Polycarbonates segment's sales decreased 11.1% to €801 million (previous year: €901 million). Sales in the Coatings, Adhesives, Specialties segment declined by 15.8% to €495 million (previous year: €588 million).

The Group's EBITDA improved by 7.3% to €456 million in the third quarter of 2020 (previous year: €425 million), primarily due to a lower level of costs attributable mainly to cost-cutting measures. In addition, the decline in selling prices compared with the previous year was largely balanced out by lower raw material prices. The effect of total volumes sold reduced earnings, however, chiefly on account of a decrease in non-core volumes sold.

In contrast to the decline in sales, EBITDA rose by 12.2% in the Polyurethanes segment to €220 million (previous year: €196 million) and by 12.1% in the Polycarbonates segment to €148 million (previous year: €132 million). EBITDA in the Coatings, Adhesives, Specialties segment was down by 10.8% to €99 million (previous year: €111 million).

The Covestro Group's EBIT was up by 19.9% to €265 million in the third quarter of 2020 (previous year: €221 million).

Financial position

Operating cash flows increased compared with the prior-year quarter, rising 16.5% to €538 million (previous year: €462 million). The key driver here was the improvement in EBITDA. Whereas effects from changes in working capital remained almost neutral, lower income tax payments had a positive effect.

Free operating cash flow rose by 48.6% in the third quarter of 2020 to €361 million (previous year: €243 million). This development resulted from an increase in operating cash flows and reduced cash outflows for additions to property, plant and equipment, as planned.

Net financial debt

	Dec. 31, 2019	Sep. 30, 2020
	€ million	€ million
Bonds	997	1,989
Liabilities to banks	10	232
Lease liabilities	735	698
Liabilities from derivatives	10	7
Other financial liabilities	–	1
Receivables from derivatives	(15)	(7)
Financial debt	1,737	2,920
Cash and cash equivalents	(748)	(1,157)
Current financial assets	–	(593)
Net financial debt	989	1,170

In comparison with December 31, 2019, the Covestro Group's financial debt increased by €1,183 million to €2,920 million as of September 30, 2020. The increase was due to the assumption of a loan from the European Investment Bank (EIB) in the first quarter of 2020 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. On June 5, 2020, Covestro also successfully placed a total of €1.0 billion in euro bonds on the capital market. Short-term loans assumed in the first quarter of 2020 totaling €500 million were repaid in full by the end of the third quarter of 2020.

In contrast, current financial assets increased to €593 million. These were held in the form of money market funds totaling €428 million and short-term bank deposits amounting to €165 million.

Development of the Segments

Polyurethanes

Key data Polyurethanes

	3rd quarter 2019	3rd quarter 2020	Change	1st nine months 2019	1st nine months 2020	Change
	€ million	€ million	%	€ million	€ million	%
Core volume growth¹	+5.1%	+4.3%		+1.9%	-8.4%	
Sales	1,478	1,315	-11.0	4,443	3,502	-21.2
Change in sales						
Volume	+2.5%	+5.3%		+2.1%	-7.4%	
Price	-24.4%	-11.5%		-26.9%	-11.5%	
Currency	+1.8%	-3.8%		+1.9%	-1.2%	
Portfolio	0.0%	-1.0%		0.0%	-1.1%	
Sales by region						
EMLA	629	558	-11.3	1,941	1,506	-22.4
NAFTA	431	363	-15.8	1,286	1,024	-20.4
APAC	418	394	-5.7	1,216	972	-20.1
EBITDA	196	220	+12.2	525	246	-53.1
EBIT	97	114	+17.5	226	(67)	.
Operating cash flows	173	217	+25.4	293	138	-52.9
Cash outflows for additions to property, plant, equipment and intangible assets	135	103	-23.7	375	271	-27.7
Free operating cash flow	38	114	>100	(82)	(133)	+62.2

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

In the third quarter of 2020, core volumes sold in Polyurethanes rose by 4.3% over the prior-year quarter. Volumes sold were up primarily in the furniture and wood processing industry, driven by increased demand in the NAFTA and APAC regions. This was also true in the electrical, electronics and household appliances industry thanks to stronger demand in the EMLA and NAFTA regions.

Sales in the Polyurethanes segment decreased by 11.0% to €1,315 million in the third quarter of 2020 (previous year: €1,478 million). The change in average selling prices impacted sales, which declined by 11.5% largely due to the decline in selling prices in the previous year caused by an increase in competition and lower raw material price levels in effect since the second quarter of 2020. Furthermore, exchange rate movements resulted in a 3.8% decrease in sales, but total volumes gave sales a 5.3% lift. The portfolio effect from the sale of the European systems house business in the fourth quarter of 2019 negatively affected sales by 1.0% in the third quarter of 2020.

Sales in the EMLA region were down by 11.3% from the prior-year quarter to €558 million (previous year: €629 million), mainly on account of a significant drop in selling prices. In addition, the aforementioned portfolio effect and the change in exchange rates both decreased sales slightly. This stood in contrast to a sharp uptick in total volumes sold. In the NAFTA region, sales fell by 15.8% to €363 million (previous year: €431 million). The key drivers here were significantly lower selling prices and sharply negative exchange rate developments. Total volumes also pushed sales down somewhat. The APAC region's sales slid by 5.7% to €394 million (previous year: €418 million), primarily due to a substantial decline in selling prices. In addition, exchange rate movements had a slightly negative effect on sales, but higher total volumes gave sales a modest boost.

EBITDA in the Polyurethanes segment increased by 12.2% from the prior-year quarter to €220 million in the third quarter of 2020 (previous year: €196 million). The positive effect of volumes sold and reduced price levels as a result of cost-cutting measures increased earnings.

EBIT rose by 17.5% to €114 million in the third quarter of 2020 (previous year: €97 million).

In the third quarter of 2020, free operating cash flow tripled to €114 million (previous year: €38 million). This is mainly the result of the reduced cash outflows for additions to property, plant and equipment compared with the prior-year quarter, an increase in EBITDA as well as an overall increase in funds freed up from working capital.

Polycarbonates

Key data Polycarbonates

	3rd quarter 2019	3rd quarter 2020	Change	1st nine months 2019	1st nine months 2020	Change
	€ million	€ million	%	€ million	€ million	%
Core volume growth¹	+9.3%	+3.6%		+2.4%	-5.0%	
Sales	901	801	-11.1	2,659	2,182	-17.9
Change in sales						
Volume	+6.8%	+3.6%		+3.1%	-5.1%	
Price	-20.7%	-8.2%		-17.4%	-8.5%	
Currency	+2.0%	-3.4%		+2.1%	-0.9%	
Portfolio	-1.3%	-3.1%		-2.8%	-3.4%	
Sales by region						
EMLA	281	239	-14.9	876	698	-20.3
NAFTA	196	154	-21.4	574	456	-20.6
APAC	424	408	-3.8	1,209	1,028	-15.0
EBITDA	132	148	+12.1	441	353	-20.0
EBIT	57	94	+64.9	261	189	-27.6
Operating cash flows	178	203	+14.0	409	306	-25.2
Cash outflows for additions to property, plant, equipment and intangible assets	44	33	-25.0	125	96	-23.2
Free operating cash flow	134	170	+26.9	284	210	-26.1

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

In the third quarter of 2020, core volumes sold in the Polycarbonates segment rose by 3.6% over the prior-year quarter. This was due to growth in volumes sold in the construction industry across all regions and in the electrical, electronics and household appliances industry thanks to increased demand in the APAC region. In contrast, lower demand in the automotive and transportation industry, primarily in the EMLA region, led to declines in volumes sold.

Sales in the Polycarbonates segment were down by 11.1% to €801 million in the third quarter of 2020 (previous year: €901 million). Changes in selling prices driven by lower raw material prices and exchange rate movements led to a decrease in sales of 8.2% and 3.4%, whereas higher total volumes sold had a positive effect on sales of 3.6%. Moreover, the portfolio effect from the sale of the European polycarbonate sheets business in the first quarter of 2020 caused sales to decline by 3.1% in the third quarter of 2020.

Sales in the EMLA region were down by 14.9% to €239 million (previous year: €281 million). Lower selling prices and the aforementioned portfolio effect had a significant negative impact on sales. In contrast, an increase in total volumes sold boosted sales slightly. Exchange rate movements had no notable effect on sales. In the NAFTA region, sales fell by 21.4% to €154 million (previous year: €196 million). The key drivers here were lower total volumes and exchange rate changes, which each drove sales down substantially. Lower average selling prices had an additional slightly negative effect on sales. The APAC region's sales dropped 3.8% to €408 million (previous year: €424 million), primarily due to a substantial decline in selling prices. Furthermore, exchange rate movements resulted in a modest decrease in sales, but the change in total volumes pushed sales up sharply.

In the third quarter of 2020, EBITDA in the Polycarbonates segment rose by 12.1% from the prior-year quarter, increasing to €148 million (previous year: €132 million). Improved cost levels as a result of cost-cutting measures had a positive effect on earnings. Higher margins had a positive effect. These resulted from lower raw material prices, which were able to more than offset lower selling prices.

EBIT was up by 64.9% to €94 million in the third quarter of 2020 (previous year: €57 million).

Free operating cash flow grew to €170 million in the third quarter of 2020, an increase of 26.9% (previous year: €134 million). This was attributable to an upturn in EBITDA, an overall increase in funds freed up from working capital and a decrease in cash outflows for additions to property, plant, and equipment compared to the prior-year quarter.

Coatings, Adhesives, Specialties

Key data Coatings, Adhesives, Specialties

	3rd quarter 2019	3rd quarter 2020	Change	1st nine months 2019	1st nine months 2020	Change
	€ million	€ million	%	€ million	€ million	%
Core volume growth¹	-4.0%	-6.9%		-3.0%	-12.5%	
Sales	588	495	-15.8	1,836	1,510	-17.8
Change in sales						
Volume	-4.7%	-8.3%		-2.7%	-13.9%	
Price	-2.1%	-5.0%		-0.3%	-4.0%	
Currency	+2.2%	-2.5%		+2.5%	-0.3%	
Portfolio	+1.6%	0.0%		+1.0%	+0.4%	
Sales by region						
EMLA	257	214	-16.7	828	681	-17.8
NAFTA	145	113	-22.1	433	353	-18.5
APAC	186	168	-9.7	575	476	-17.2
EBITDA	111	99	-10.8	407	289	-29.0
EBIT	82	68	-17.1	320	196	-38.8
Operating cash flows	129	80	-38.0	179	214	+19.6
Cash outflows for additions to property, plant, equipment and intangible assets	39	41	+5.1	103	95	-7.8
Free operating cash flow	90	39	-56.7	76	119	+56.6

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

Core volumes sold in the Coatings, Adhesives, Specialties segment fell in the third quarter of 2020 by 6.9% compared with the prior-year quarter. This development was mainly due to a decline in volumes sold in the automotive and transportation industry as well as the construction industry caused by drops in demand in the EMLA and NAFTA regions.

In the Coatings, Adhesives, Specialties segment third quarter sales in 2020 were down 15.8% to €495 million (previous year: €588 million). A reduction in total volumes sold and lower average selling prices resulted in 8.3% and 5.0% declines in sales. In addition, exchange rate movements had a negative effect on sales of 2.5%.

In the EMLA region, sales decreased by 16.7% to €214 million (previous year: €257 million), principally on account of a sharp drop in total volumes sold. Furthermore, average selling prices decreased sales minimally, while exchange rate changes were neutral overall with respect to sales. Sales in the NAFTA region declined by 22.1% to €113 million (previous year: €145 million), chiefly due to a significant decrease in total volumes sold. Moreover, exchange rate developments and average selling price changes both caused sales to decline slightly. In the APAC region, sales were down 9.7% to €168 million (previous year: €186 million), mainly on account of a considerable drop in selling price level. Exchange rate movements also had a modest negative impact on sales, while an increase in total volumes sold improved sales substantially.

In the third quarter of 2020, EBITDA in the Coatings, Adhesives, Specialties segment decreased by 10.8% from the prior-year quarter, amounting to €99 million (previous year: €111 million). A negative effect exerted by volumes sold and a slight decline in margins caused earnings to decrease somewhat. Reduced costs as a result of cost-cutting measures were unable to compensate for these effects.

EBIT was down by 17.1% to €68 million in the third quarter of 2020 (previous year: €82 million).

Free operating cash flow dropped by 56.7% in the third quarter of 2020 to €39 million (previous year: €90 million). Although cash in working capital was freed up in the prior-year quarter, this quarter saw an increase in cash tied up, which adversely affected free operating cash flow. The decline in EBITDA also had a negative effect.

Forecast

Economic Outlook

Global economy

The grave consequences of the coronavirus pandemic are having 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 drop significantly for a decline in growth of 4.6% for 2020 as a whole. The expectations for all regions were revised sharply downward. According to current estimates, we expect only China to post slightly positive growth. The economies in Europe, North America and Latin America are forecast to report negative growth rates. After two quarters of recession in the first half of 2020, however, the third quarter of 2020 saw the global economy enter a recovery, which is expected to continue in the fourth quarter of 2020.

Economic growth¹

	Growth 2019	Growth forecast 2020 (Annual Report 2019)	Growth forecast 2020
	%	%	%
World	+2.5	+2.5	-4.6
Europe	+1.5	+1.2	-7.7
of which Western Europe	+1.3	+0.9	-8.1
of which Germany	+0.6	+0.4	-5.7
of which Eastern Europe	+2.7	+2.4	-5.9
Middle East	+1.1	+2.0	-7.7
Latin America	-0.3	+0.9	-8.2
Africa	+2.6	+2.9	-4.0
North America²	+2.0	+1.9	-4.0
of which United States	+2.2	+2.1	-3.5
Asia-Pacific	+4.2	+4.2	-2.1
of which China	+6.1	+5.8	+1.9

¹ Real growth of gross domestic product; source: IHS (Global Insight), Growth 2019 and Growth forecast 2020 as of October 16, 2020

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

Main customer industries*

We expect the coronavirus pandemic to also have a significant adverse impact on the performance of our main customer industries in fiscal 2020. In contrast to the significant losses felt in the first half of 2020, all of our main customer industries reported varying degrees of improvement in growth rates in the third quarter of 2020. Unlike our outlook in the 2019 Annual Report, we now believe the automotive industry will see a steep drop amounting to a double-digit percentage. Growth in the furniture industry will also likely be considerably weaker than expected. We project negative growth rates in the low single-digit range, down from our forecast in the 2019 Annual Report, for the electrical, electronics and household appliances industry as well as for the construction industry.

* Covestro's estimate, based on the following sources: LMC Automotive Limited, B+L, CSIL (Centre for Industrial Studies), Oxford Economics. We limited the economic data of our "automotive and transportation" and "furniture and wood processing" main customer industries to the automotive and furniture segments (not the transportation or wood processing segments).

Forecast for key performance indicators

As a consequence of the third quarter 2020 results and early fourth quarter 2020 business performance, which were both better than expected, Covestro adjusted the forecast given in the 2020 Half-Year Financial Report on October 9, 2020. Based on the business performance described in this Quarterly Statement and the aforementioned economic outlook, and taking into consideration our potential risks and opportunities, we confirm the forecast for the rest of the 2020 fiscal year adjusted as compared with the 2020 Half-Year Financial Report. We expect our key performance indicators to develop as follows:

In the course of fiscal 2020, core volume growth is still projected to decline year over year (forecast in the 2020 Half-Year Financial Report: year-over-year decline).

Free operating cash flow (FOCF) is expected to be in the range between €0 million and plus €300 million this year (forecast in the 2020 Half-Year Financial Report: between minus €200 million and plus €300 million). FOCF in the Polycarbonates and Coatings, Adhesives, Specialties segments is anticipated to perform significantly better than FOCF in the Polyurethanes segment.

For fiscal 2020, the return on capital employed* (ROCE) is projected to amount to a mid-single-digit percentage (forecast in the 2020 Half-Year Financial Report: between minus 1% and plus 4%).

* 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.