Significant Events

Coronavirus Pandemic

The coronavirus pandemic continues to leave its mark on the global economy, although the impact is considerably less severe than in the previous year. Improvements in the overall situation are chiefly attributable to high vaccination rates and updated measures to combat the pandemic. Compared with the prior-year quarter, we have also observed a further upturn in demand, although this could not be met fully due to bottlenecks in global supply chains. The health, safety, and hygiene measures implemented by Covestro at an early stage last year remain in place. Covestro supports employee access to vaccinations against the coronavirus, including through cooperation with company health facilities. Depending on the local situation in each case, some staff, particularly employees in administrative departments, continue to work from home. Production at our sites was not affected by the pandemic in the first nine months of 2021.

Covestro is monitoring the development of the coronavirus pandemic worldwide on an ongoing basis. Existing measures are modified as required in line with recommendations and instructions issued by the relevant governments and committees of experts.

Other Events

In keeping with the first chapter of the strategy – "Become the best of who we are" – the Group restructured its organizational and reporting structure as of July 1, 2021. The Group's three reportable segments to date (Polyurethanes, Polycarbonates and Coatings, Adhesives, Specialties) have been replaced with two new reportable segments: Performance Materials and Solutions & Specialties. The Performance Materials segment concentrates on reliably delivering standard products at competitive market prices. The focus of the Solutions & Specialties segment is on complex products with a high pace of innovation, which Covestro combines with application technology services. Other business activities that cannot be allocated to any of the aforementioned segments are reported under "Other/Consolidation." Intersegment transactions are conducted at arm's length and reported separately as net sales between segments. This Quarterly Statement marks the first time our reporting reflects the new segment structure; reference information for fiscal 2020 was restated accordingly.

On July 7, 2021, the euro bond placed in 2016 with a total volume of €500 million and maturing in October 2021 was fully repaid at par value ahead of schedule.

On July 26, 2021, Covestro completed the sale of its 51% interest in subsidiary Pearl Covestro Polyurethane Systems FZCO to co-shareholder Pearl Industries Overseas Ltd. The former subsidiary operates a system house business in Dubai (United Arab Emirates). The sale is part of an ongoing effort to optimize the portfolio and represents another step toward refocusing the Polyurethanes segment.
See "Divestitures."

Results of Operations and Financial Position of the Covestro Group

Results of Operations

The business situation in the third quarter of 2021 improved further over the prior-year quarter, a development reflected above all in sales and earnings.

Core volumes sold by the Group saw year-over-year growth of 0.8%, mainly due to additional volumes from the the Resins & Functional Materials (RFM) business acquired from Koninklijke DSM N.V., Heerlen (Netherlands). However, our growth opportunities in the current quarter were curtailed by reduced product availability. Core volumes sold in the Performance Materials segment dropped by 11.6%, although core volumes sold were up 22.7% in the Solutions & Specialties segment.

In the third quarter of 2021, Group sales grew by 55.9% to €4,302 million (previous year: €2,760 million). The main factors here were higher average selling prices, which had a positive impact on sales amounting to 43.8%. Moreover, the portfolio change arising from the acquisition of the RFM business in the second quarter of 2021 and exchange rate movements had positive effects on sales of 10.5% and 1.6%, respectively. Changes in total volumes sold had no notable effect on sales.

In the third quarter of 2021, sales rose by 52.2% to €2,186 million (previous year: €1,436 million) in the Performance Materials segment and 60.6% to €2,069 million (previous year: €1,288 million) in the Solutions & Specialties segment.

The Group’s EBITDA in the third quarter of 2021 improved by 89.0% to €862 million (previous year: €456 million), largely on account of significantly higher margins in the Performance Materials segment. This was mainly due to an advantageous competitive situation and a higher selling price level, which more than offset the rise in raw material prices. However, higher provisions for variable compensation reduced earnings.

EBITDA in the Performance Materials segment increased to €755 million (previous year: €288 million). In the Solutions & Specialties segment, EBITDA was down to €173 million (previous year: €207 million).

The Covestro Group's EBIT increased to €654 million in the third quarter of 2021 (previous year: €265 million).

Financial Position

Cash flows from operating activities increased compared with the prior-year quarter, rising to €564 million (previous year: €538 million). A higher EBITDA was the main factor here. Funds were tied up in working capital in contrast to funds freed up in the prior-year quarter. This, along with higher income tax payments, had a negative effect.

Free operating cash flow was up, amounting to €381 million in the third quarter of 2021 (previous year: €361 million), largely due to higher cash flows from operating activities.

Net financial debt

	Dec. 31, 2020	Sep. 30, 2021
	€ million	€ million
Bonds	1,990	1,491
Liabilities to banks	227	225
Lease liabilities	672	756
Liabilities from derivatives	9	21
Other financial liabilities	1	1
Receivables from derivatives	(13)	(22)
Financial debt	**2,886**	**2,472**
Cash and cash equivalents	(1,404)	(496)
Current financial assets	(1,126)	(720)
Net financial debt	**356**	**1,256**

The Covestro Group's financial debt decreased by €414 million as of December 31, 2020, to €2,472 million as of September 30, 2021. This was mainly due to the early repayment of the €500 million euro bond maturing in October 2021.

Cash and cash equivalents declined in comparison with the figure on December 31, 2020, by €908 million to €496 million. This development was driven primarily by the net purchase price payments for the acquisition of the Resins & Functional Materials (RFM) business amounting to €1,469 million and the early repayment of the aforementioned bond. Moreover, cash and cash equivalents declined on account of cash outflows for additions to property, plant, equipment, and intangible assets of €472 million and dividend payments of €259 million. In contrast, positive cash flows from operating activities of €1,545 million, the net sale of money market fund units of €270 million, and net proceeds of short-term bank deposits of €136 million increased cash and cash equivalents. The redemption of short-term bank deposits and net sale of money market fund units in particular decreased current financial assets, which were down €406 million to €720 million.

Net financial debt grew by €900 million compared with the figure on December 31, 2020, to €1,256 million as of September 30, 2021.

Performance of the Segments

Performance Materials

Performance Materials key data

	3rd quarter 2020[1]	3rd quarter 2021	Change	1st nine months 2020[1]	1st nine months 2021	Change
	€ million	€ million	%	€ million	€ million	%
Core volume growth[2]		**–11.6%**			**+0.7%**	
Sales (external)	1,436	2,186	+52.2	3,874	5,883	+51.9
Intersegment sales	334	768	>100	882	1,954	>100
Sales (total)	1,770	2,954	+66.9	4,756	7,837	+64.8
Change in sales						
Volume		–6.9%			+2.0%	
Price		+57.6%			+52.5%	
Currency		+1.5%			–2.6%	
Portfolio		0.0%			0.0%	
Sales by region						
EMLA	655	994	+51.8	1,813	2,839	+56.6
NA	344	565	+64.2	1,007	1,344	+33.5
APAC	437	627	+43.5	1,054	1,700	+61.3
EBITDA[3]	**288**	**755**	**>100**	**458**	**2,053**	**>300**
EBIT[3]	145	614	>300	29	1,629	.
Cash flows from operating activities	372	410	+10.2	367	1,263	>200
Cash outflows for additions to property, plant, equipment and intangible assets	126	116	–7.9	329	319	–3.0
Free operating cash flow	**246**	**294**	**+19.5**	**38**	**944**	**.**

1 Reference information based on fiscal 2019 is not presented here due to the new organizational structure.
2 Calculated on the basis of the definition of the core business effective March 31, 2021.
3 EBITDA and EBIT include the effect on earnings of intersegment sales.

In the third quarter of 2021, core volumes sold in the Performance Materials segment were 11.6% lower than in the prior-year quarter. This was chiefly the result of a drop in core volumes sold in the furniture and wood processing industry as well as the construction industry, especially in the EMLA and APAC regions. Global demand was solid, but limited product availability due to the effects of unplanned production stoppages affected our ability to meet it. This restricted the potential for growth.

Sales in the Performance Materials segment were up 52.2% to €2,186 million in the third quarter of 2021 (previous year: €1,436 million). Driven by higher prices for raw materials and energy and a still advantageous competitive situation, average selling prices increased sales by 57.6%. The change in exchange rates had a positive effect on sales of 1.5%. Total volumes sold, however, had a negative effect of 6.9%.

In the EMLA region, sales grew by 51.8% over the prior-year quarter to €994 million (previous year: €655 million) on account of a strong increase in average selling prices. Exchange rate movements were neutral overall in terms of sales. In contrast, a decline in total volumes sold reduced sales considerably. In the NA region, sales were up 64.2% to €565 million (previous year: €344 million). This was mainly attributable to higher average selling prices, which resulted in a strong increase in sales. Exchange rate changes again remained neutral overall with respect to sales, but lower total volumes sold had a slightly negative effect on sales. Sales in the APAC region climbed by 43.5% to €627 million (previous year: €437 million), primarily due to an increase in selling price level, which gave sales a strong boost. Exchange rate changes had a slightly positive effect on sales. However, a decline in total volumes sold reduced sales considerably.

EBITDA in the Performance Materials segment grew over the prior-year quarter to €755 million in the third quarter of 2021 (previous year: €288 million). This was mainly due to a significant increase in margins, which resulted in part from intersegment business. Higher selling prices more than compensated for the countereffect of higher raw material prices. However, higher provisions for variable compensation had a negative effect on earnings.

In the third quarter of 2021, EBIT increased to €614 million (previous year: €145 million).

Free operating cash flow was up 19.5% to €294 million in the third quarter of 2021 (previous year: €246 million), chiefly as a result of the increase in EBITDA. Cash was tied up in working capital, whereas in the prior-year quarter funds had been freed up from working capital, which had a negative effect in the quarter under review.

Solutions & Specialties

Solutions & Specialties key data

	3rd quarter 2020[1]	3rd quarter 2021	Change	1st nine months 2020[1]	1st nine months 2021	Change
	€ million	€ million	%	€ million	€ million	%
Core volume growth[2]		**+22.7%**			**+31.0%**	
Sales (external)	1,288	2,069	+60.6	3,689	5,549	+50.4
Intersegment sales	7	8	+14.3	18	19	+5.6
Sales (total)	1,295	2,077	+60.4	3,707	5,568	+50.2
Change in sales						
Volume		+6.9%			+17.5%	
Price		+29.5%			+19.7%	
Currency		+1.8%			−2.8%	
Portfolio		+22.4%			+16.0%	
Sales by region						
EMLA	457	758	+65.9	1,395	2,113	+51.5
NA	297	437	+47.1	870	1,137	+30.7
APAC	534	874	+63.7	1,424	2,299	+61.4
EBITDA[3]	**207**	**173**	**−16.4**	**522**	**568**	**+8.8**
EBIT[3]	161	106	−34.2	385	391	+1.6
Cash flows from operating activities	136	82	−39.7	345	189	−45.2
Cash outflows for additions to property, plant, equipment and intangible assets	51	66	+29.4	133	151	+13.5
Free operating cash flow	**85**	**16**	**−81.2**	**212**	**38**	**−82.1**

[1] Reference information based on fiscal 2019 is not presented here due to the new organizational structure.
[2] Calculated on the basis of the definition of the core business effective March 31, 2021.
[3] EBITDA and EBIT include the effect on earnings of intersegment sales.

In the third quarter of 2021, core volumes sold in the Solutions & Specialties segment rose by 22.7% over the prior-year quarter. This development was mainly due to additional volumes from the acquisition of the Resins & Functional Materials (RFM) business. At the same time, reduced product availability, for instance due to raw material bottlenecks, had a negative impact on core volumes sold and therefore limited our growth opportunities.

In the third quarter of 2021, sales in the Solutions & Specialties segment grew by 60.6% to €2,069 million (previous year: €1,288 million). An increase in average selling prices caused by higher raw material and energy prices and an advantageous competitive situation increased sales by 29.5%. At the same time, the portfolio effect stemming from the RFM acquisition gave sales a 22.4% boost. Growth in total volumes sold also had a positive effect on sales of 6.9%. Exchange rate changes increased sales by 1.8%.

In the EMLA region, sales were up 65.9% to €758 million (previous year: €457 million). Key drivers here were the aforementioned portfolio effect and an increase in average selling prices, both of which substantially increased sales. Higher total volumes sold likewise triggered significant sales growth. Exchange rate movements had no notable effect on sales. In the NA region, sales were up 47.1% to €437 million (previous year: €297 million), mainly on account of the aforementioned portfolio effect. Increases in selling prices and total volumes sold both caused sales to rise considerably. Exchange rate changes remained neutral overall with respect to sales. In the APAC region, sales were up 63.7% to €874 million (previous year: €534 million). Changes in average selling prices had a strong positive effect on sales. The aforementioned portfolio effect also increased sales considerably. At the same time, exchange rate movements and an increase in total volumes sold each had a slightly positive impact on sales.

In the third quarter of 2021, EBITDA in the Solutions & Specialties segment declined by 16.4% from the prior-year quarter, decreasing to €173 million (previous year: €207 million). Increased raw material prices, for instance from the intersegment business, offset higher selling prices and led to lower margins, which reduced earnings. At the same time, higher provisions for variable compensation had a negative effect on EBITDA. Besides, total volumes sold were up, which increased earnings.

EBIT was down by 34.2% to €106 million in the third quarter of 2021 (previous year: €161 million).

In the third quarter of 2021, free operating cash flow dropped by 81.2% to €16 million (previous year: €85 million). Contributing factors here included the decline in EBITDA and a year-over-year increase in funds tied up in working capital.

Forecast

Economic Outlook

Global Economy

The end of the first half of 2021 saw a new record high in worldwide economic output, although the impact of the coronavirus pandemic is still evident in some segments of the global economy. Thanks to a sharp upturn in vaccination rates and the subsequent launch of controlled measures to fight the coronavirus pandemic, we anticipate very positive economic growth rates in all regions the 2021 fiscal year as a whole. The potential spread of new coronavirus variants raises the possibility of additional waves of the pandemic, which could have a negative impact on supply chains, product availability, and therefore growth. For this reason, economic growth remains dependent on vaccination progress and pandemic-fighting measures taken by various countries going forward. Pandemic-related logistics problems and progress in the transition to sustainable energy are currently pushing up energy prices, which is in turn putting downward pressure on global economic growth. Minimal short-term production growth, inflation, and interest rate hikes also could have a negative effect on the remaining growth in 2021. In contrast to the outlook we published in the Annual Report 2020, we still anticipate robust growth in the global economy and a resulting increase in economic performance of 5.5%.

We revised our estimates for all regions upward, principally due to substantially higher production volumes and consumer spending. In the NA region, we anticipate a more significant increase in expected economic growth compared with our outlook published in the Annual Report 2020. This is due to factors including expansion of the US economic stimulus package, continued expansive monetary policy, and the demand for services in excess of expectations to date. Another overall economic situation significantly better than the assessment we presented in our Annual Report 2020 is taking shape in the EMLA region. This is mostly due to rising vaccination rates, the progressive lifting of pandemic-related restrictions, the strong labor market, and the spending of savings amassed by households during the coronavirus pandemic. In the APAC region, we expect the economic recovery to proceed slightly faster than stated in our outlook in the Annual Report 2020, driven mainly by growth in China coming in stronger than expected.

Economic growth[1]

	Growth 2020	Growth forecast 2021 (Annual Report 2020)	Growth forecast 2021
	%	%	%
World	**–3.6**	**+4.4**	**+5.5**
Europe, Middle East, Latin America[2], Africa (EMLA)	**–5.7**	**+3.4**	**+4.9**
of which Europe	–6.0	+3.2	+5.0
of which Germany	–4.9	+2.8	+2.8
of which Middle East	–3.5	+4.5	+4.4
of which Latin America[2]	–7.5	+3.7	+5.6
of which Africa	–2.5	+2.4	+3.5
North America[3] (NA)	**–3.8**	**+4.0**	**+5.4**
of which United States	–3.4	+4.0	+5.4
Asia-Pacific (APAC)	**–1.1**	**+5.7**	**+6.1**
of which China	+2.3	+7.6	+8.2

1 Real growth of gross domestic product; source: IHS (Global Insight), "Growth 2020" and "Growth forecast 2021" as of October 2021.
2 Latin America (excluding Mexico).
3 North America (Canada, Mexico, United States).

Main Customer Industries

In all main customer industries, we continue to forecast positive growth for the year 2021. However, we expect the pace of growth to differ in the individual industries. Growth in the automotive industry is projected to be 2.8%, down from outlook presented in the Annual Report 2020. This is chiefly due to bottlenecks in the supply of semiconductors and petrochemical by-products, and the resulting limitations in car manufacturing. At 2.2%, growth in the construction industry will likely exceed our expectations presented in the Annual Report 2020, however. We anticipate the growth rate in the electrical, electronics and household appliances industry to come in at 13.2%, higher than expected in the Annual Report 2020, on account of the growth in consumer expenditure persisting throughout the coronavirus pandemic. The projected growth rate for the furniture industry was raised to 4.8%.

Growth in main customer industries[1]

	Growth 2020	Growth forecast 2021 (Annual Report 2020)	Growth forecast 2021
	%	%	%
Automotive	–15.9	+17.3	+2.8
Construction	–1.8	+0.6	+2.2
Electrical, electronics and household appliances	+4.5	+6.3	+13.2
Furniture	–4.8	+4.6	+4.8

[1] 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). As of: October 2021.

Forecast for the Covestro Group

The analysis of the development of our key management indicators is based on the business performance described in this Quarterly Statement, the economic outlook outlined above, and consideration of our potential risks and opportunities. There has been no fundamental change in the risk situation from the presentation in the Annual Report 2020. At the time this Quarterly Statement was prepared, there were no risks that could endanger the Group's continued existence. The acquisition completed on April 1, 2021, and integration of the Resins & Functional Materials (RFM) business of Koninklijke DSM N.V., Heerlen (Netherlands), has been factored into this forecast.

Covestro adjusted the forecast presented in the Annual Report 2020 on April 13, 2021, as a result of business development that has been better than previously expected. An increasingly positive outlook led to the forecast being raised again on July 12, 2021. Taking into account current business performance, we once again adjusted our forecast on November 8, 2021, and currently expect the following developments in our key management indicators for fiscal 2021:

Forecast key management indicators

	2020	Forecast 2021 (Annual Report 2020)	Previous forecast 2021 (July 12, 2021)	Adjusted forecast 2021 (November 8, 2021)
Core volume growth	–5.6%	Between 10% and 15%	Between 10% and 15%	Between 10% and 12%
Free operating cash flow (FOCF)	€530 million	Between €900 million and €1,400 million	Between €1,600 million and €2,000 million	Between €1,400 million and €1,700 million
Return on capital employed (ROCE)[1]	+7.0%	Between 7% and 12%	Between 16% and 20%	Between 19% and 21%

[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 noncurrent and current assets less noninterest-bearing liabilities such as trade accounts payable.

We currently anticipate that core volume growth for the Covestro Group will be between 10% and 12% (previously: between 10% and 15%), with around 6 percentage points attributable to the acquisition of the RFM business. We assume that core volume growth in the Performance Materials segment will come in between 0% and 2%. However, the Solutions & Specialties segment is anticipated to generate growth well above the range expected for the Group.

FOCF is currently forecast to be in the range between €1,400 million and €1,700 million this year (previously: between €1,600 million and €2,000 million). In contrast with the forecast to date, we anticipate an increase in funds tied up in working capital, which affects FOCF negatively. The Performance Materials segment is expected to produce FOCF well over the prior-year figure, while FOCF in the Solutions & Specialties segment will likely be slightly under the prior-year figure.

For fiscal 2021, we now expect a ROCE of between 19% and 21% (previously: 16% and 20%).