

**We invest in winners.** That means we invest in strong companies that create value for their shareholders with sustainable business models, solid balance sheets and high margins. We keep the risks low and invest when our position is fuelled by a positive event. We refer to that as the combination of value and event.

### **BASF Convertible Bond 2017 (23)**

“Heads I win, tails I don’t lose much.” These words of well-known investor Mohnish Pabrai sum up his strategy of selecting investments that carry low risk whilst at the same time promising high returns. What sounds to market efficiency theorists like squaring the circle is actually the best of all worlds for us value investors. Although it is becoming increasingly difficult to find such ideas in the current low interest rate environment, we never tire of looking for them in equities and bonds.

We found something close to what we are seeking in the form of a BASF convertible bond. We regard it as an extended money market substitute with a free option. Convertible bonds as a rule combine the regular coupon payments of an ordinary corporate bond with participation in the price performance of the issuer’s shares once it reaches a certain level. The right to this participation is reflected in the price of the convertible bond, sometimes more and sometimes less strongly, depending on the value the stock market attributes to the option. If the share price is higher than the conversion price when the bond matures, the investor has the right to profitably exchange the bond for shares in a predefined ratio. If it is lower, the investor gets back at least the nominal value of the bond. Due to the sharp fall in the price of BASF shares in 2018, the conversion price

(EUR 112) is so far ‘out of the money’ that the option is considered worthless. Along the yield curve, the convertible bond is therefore quoted at the same level as a normal corporate bond. This sparked our interest. The convertible bond was issued in March 2017 with a volume of USD 600 million, subsequently increased to USD 850 million. It bears interest at an annual rate of 0.925%.

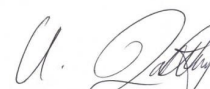
Interest is payable semi-annually in arrears on 9 March and 9 September. A reduction of the nominal value or a default of the coupon is excluded by the prospectus if BASF should experience a one-year loss. The Standard & Poor’s rating is A with a stable outlook. The price is 95% of the nominal value. The current interest rate corresponds to an annual yield of 2.5% until maturity on 9 March 2023. BASF bonds denominated in euros with maturities up to seven years are in negative territory.

We bought the bond at the current price level. Apart from the good credit rating, short maturity and positive yield, we also have the chance of a significant increase in the price if the share recovers in the next three to four years and the capital market assigns a value to the conversion option once more. This is certainly possible, given the historically low valuation and good medium-term prospects for the broad-based chemicals group BASF.

Sincerely yours



J. Henrik Muhle



Dr. Uwe Rathausky

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