

Q2 2019 Earnings Call

Company Participants

- Fernando Musa, CEO
- Pedro Teixeira de Carvalho, IR and Corporate Finance Director
- Pedro van Langendonck Teixeira de Freitas, VP Executive Officer, CFO & Director of IR

Other Participants

- Bruno Montanari, Equity Analyst
- Fernanda Perez Da Cunha, Senior Associate
- Gustavo Allevato, Research Analyst
- Hassan Ijaz Ahmed, Partner & Head of Research
- Luiz Carvalho, Director and Analyst
- Petr Grishchenko, Fixed Income Analyst
- Unidentified Participant, Analyst

Presentation

Operator

Good afternoon, ladies and gentlemen. At this time, we would like to welcome everyone to Braskem's Second Quarter of 2019 Earnings Conference Call. Today with us, we have Fernando Musa, CEO; Pedro Freitas, CFO; and Pedro Teixeira, Corporate Finance and Investor Relations Director.

We would like to inform you that this event is being recorded. (Operator Instructions) We have simultaneous webcast that may be accessed through the Braskem IR website at www.braskem-ri.com.br/ and the MZIQ platform where the slide presentation is available for download. Please feel free to flip through the slides during the conference call. There will be a replay facility for this call on the website. We remind you that the questions, which will be answered during the Q&A session, may be posted in advance on the website.

Before proceeding, let me mention that forward-looking statements are being made under the safe harbor of the Securities Litigation Reform Act of 1996. Forward-looking statements are based on the beliefs and assumptions of Braskem management and on information that's currently available for the company. They involve risks, uncertainties and assumptions because they relate to the future events. And therefore depend on the circumstances that may or may not occur in the future.

Investors should understand that general economic conditions, industry conditions and other operating factors could also affect the future results of Braskem and could cause

results to differ materially from those expressed in such forward-looking statements.

Now I will turn the conference over to Pedro Teixeira, Corporate Finance and Investor Relations Director. Mr. Teixeira, you may begin your conference.

Pedro Teixeira de Carvalho {BIO 19489140 <GO>}

Hello. Good afternoon, everyone. Thanks for joining Braskem's conference call for the Second Quarter 2019. Let's jump straight on Slide #3, where we talk about our operations in Brazil.

First of all, it's important to highlight that the demand in Brazil is -- has fallen by 7% in the Second Quarter as compared to the First Quarter 2019. Braskem sales in the same period has fallen just 4%. So it means that for the Second Quarter, the market share has recuperated from 64% to 67%. Even though that the market has fallen by 7%, on a year-to-date, the market has grown in Brazil by 3%. What happened is that in the First Quarter, the First Quarter was affected by a movement of (review) inventories in the chain. And that's why the market has fallen by 7% on a quarterly basis. But however, on a year-to-date basis, the market is up by 3%.

It is important to highlight that the utilization rate in this quarter was 89% off the crackers in Brazil. We ran our cracker in Bahia at lower utilization rates as a result of the shutdown of our operations in Alagoas. However, we ran our cracker in Rio de Janeiro with a high utilization rate. That's why we kept the utilization rates in Brazil on a stable level quarter-over-quarter.

On the EBITDA, the EBITDA has fallen by 47% from \$293 million on the First Quarter to \$154 million in the Second Quarter as the consequence of lower spreads of polymers, as a consequence of the new PE capacity in the U.S. and the lower growth pace of Chinese economy.

Moving towards Slide #4. Here, we highlight our operations in the U.S. and in Europe. In the U.S., we had a very good market. The market has grown by 9%. And our sales have risen by 7% driven by lower resin prices that encouraged converters to refuse inventories. In Europe, the movement was the opposite. The demand has fallen by 9%. And our sales has decreased by 20%. The demand in Europe was lower because of the slowdown in the economy in the region. And by the summer that usually, the demand is weaker during this time -- during this quarter. Braskem sales have fallen by 20% as a consequence of lower supply of propylene in one of our facilities in Germany. As a consequence, operational issues in one of our suppliers. And we decided to anticipate (inaudible) from maintenance that would happen in the following quarters. We anticipate it to Second Quarter 2019.

All in all, the EBITDA in U.S. and Europe went up by 50%. We'll talk a little bit later. But spreads in U.S. are high. We run with our utilization rates much better in the Second Quarter as compared to the First Quarter. So we were able to improve and to increase our EBITDA by 49%.

Moving on to Slide #5. Here, we talk about our operations in Mexico. The PE demand on a quarter-over-quarter was stable as well as likewise, like our sales, it was stable as well. We ran our facility in Mexico with a capacity utilization rate of 72%. It was 7percentage points down in comparison with the First Quarter 2019, reflecting a lower supply of ethane. As a consequence of that, we have lower availability of products to export. In the First Quarter, we export 90,000 tons. In the Second Quarter, we decreased this number to 81,000 tons.

The EBITDA of this quarter was 13% lower from \$100 million that we posted in the First Quarter of 2019 to \$88 million in the Second Quarter 2019 as a consequence of lower supply of ethane and also lower spreads that we faced in Second Quarter as compared to the First Quarter.

Moving to Slide #6. Here, we talk about our CapEx. We invested in the first half of the year BRL 1.1 billion (sic) (BRL 1.1 billion). This represented 36% of the BRL 3.3 billion that we announced at our investment budget in the beginning of the year. From this BRL 1.1 billion that we already invested, an important portion of that for around BRL 400 million is related to our new PP plant that we are constructing in the U.S. that reached 65.5% of physical completion and should become operational in 2020. And will add 450,000 tons of additional PP in the U.S. market.

Considering the more challenging-than-expected petrochemical scenario impacted by the slower global economy growth, the company will reduce its 2019 budget for investment by approximately \$100 million. We are still analyzing where the cuts will happen. However, because of the cycle, because of the petrochemical scenario and the economic growth, we are revisiting what products would be prioritized.

Moving to Slide #7. Here we talk about our free cash flow for the first half of the year. On a consolidated basis, we posted in this quarter an EBITDA of BRL 1.6 billion, adding up to an EBITDA that we posted in the First Quarter of BRL 3.3 billion, resulting to an EBITDA of BRL 4.9 billion during 6 -- the first six months of the year.

From this BRL 4.9 billion, BRL 2.2 billion was related to nonrecurring events. And the vast majority of such nonrecurring events happened in the First Quarter of 2019. We discussed this in such events in the previous calls. Most of them is related to the recognition of PIS/COFINS tax revenue. So the recurrent EBITDA for the first half of the year, deducting this such nonrecurring event was BRL 2.7 billion. We had a positive impact of working capital variation in this quarter in around BRL 2 billion. As a consequence, a volume of sales that were down. And this reduced the accounts receivable and the increase of volume of imported naphtha at competitive prices and longer payment terms.

The maintenance CapEx, we have already discussed, at BRL 687 million. Interest paid accumulated BRL 1 billion since the beginning of the year. And we paid BRL 200 million -- around BRL 200 million of income tax. Strategic investments and the vast majority of debt is the delta product in the PP plant in the U.S., amounted BRL 473 million. So adding all of these numbers, we had a positive free cash flow before debt of BRL 2.4 billion (sic) (BRL 2.4 billion), a strong free cash flow that would represent a 15% return for investors.

Moving to Slide #8. Here, we talk about our debt leverage and credit rating. We had a -- we ended the quarter with a total cash position of \$2.4 billion. If we add the revolving credit facility of \$1 billion, we will reach \$3.4 billion of liquidity available for the company. Such amount of \$3.4 billion is sufficient to cover the debt service of the company, the amortization schedule of the company during 46 months without considering any cash generation of the company.

Without considering the BRL 3.8 billion that we have in cash (bracket) as a result of the issue that we have in Alagoas that we will talk a little bit later in this presentation, the amount of liquidity of the company is sufficient to cover the amortization schedule of the company throughout 38 months. So we have a sufficient amount of liquidity available to serve our debt.

Moving to Slide #10. Here, we bring a slide where we talk a little bit about the situation that we have in Alagoas, the impact, the status. So first, it's important to discuss and explore the -- what is the business model that we currently have in Alagoas. Before we stopped our operations in Alagoas, we had an integrated model that came -- that was integrated from the salt into the PVC. So we explored salt in Alagoas, plus cleaned and treated it. We produced caustic soda and chlorine. Caustic soda, we sold -- we needed to sell to clients in the market. And chlorine was used for the production of EDC, VCM and PVC. And therefore, we used to sell PVC to the clients.

The company rapidly changed its business model in Alagoas into a nonintegrated business model. So as of now, the company is importing caustic soda. So we are not -- no longer producing caustic soda in Alagoas. We do produce caustic soda in Bahia. And the caustic soda that we are importing, we are serving the clients. So the clients are being attended from the caustic soda that the company is being imported. We are also importing EDC so that we are able to produce VCM. And therefore, produce PVC and be able to serve our clients here in Brazil.

The nonintegrated model, it's, of course, less competitive than the integrated one. And we bring in the middle of the graph the difference of spreads between an integrated and a nonintegrated business to give a perspective on the impact. We ran our models. And we -- a nonintegrated business should have an impact around \$30 million to \$40 million per quarter lower as compared to an integrated model. We are working some optimization in order to reduce this impact.

On the right side of the slide, we bring some status about the situation that we have in Alagoas. So on the operational front, we are temporarily operating to a nonintegrated business model. We are optimizing it to reduce the impact. And we are also evaluating salt mining alternatives. On the technical front, we are running -- we are testing the sonars. We have already tested 15 out of 35 sonars in our mines. And we hired foreign and national experts. And we are conducting additional studies to really understand the situation there in Alagoas.

On the legal front, we have BRL 3.7 billion -- actually BRL 3.8 billion of cash flow (blocked). BRL 3.7 billion, we are waiting for a decision from STJ on the decision to unfreeze. And we

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are also -- such amount of cash. And we are also waiting on the decision on our appeal by the Alagoas court. There was BRL 2.5 billion of new request to freeze our cash by the ministry -- by the public ministry of work. The judicial decision is still pending on that front. And the justification of hearing is scheduled for August 19.

Moving towards Slide #11. Here, we talk about the outlook for the spreads. And here, specifically, the spreads that would affect our operations in Brazil. Spreads for chemicals, we expect for 2019 to be 29% lower as compared to 2018. This is mainly as a consequence of new refineries that started up in Asia, generating or making available more product in the market and putting the pressure on the prices of chemicals. On the polyolefins, the spread should be 28% lower this year. And this is mainly as a result of the new PE capacity that entered in the market and also as a result of the slowdown in -- on demand as a result of the trade war.

Let's move to Slide #12. And here, we bring the forecast for spreads in the U.S. And as you can see, the spreads in U.S. are stable, slightly higher than we expected spreads to be in 2019 as compared to 2018. The PP market is tight in U.S. The economy in U.S. is hot. And there is a higher supply of propylene sustaining the price of propylene in a lower level.

We brought, in this presentation, a new graph showing the level of imports in the U.S. As you can see in the first half of the year, we already -- we have in the market in U.S., we have 16,000 tons of PP. So it's an important sign that the market's capable to absorb the new capacity, 450,000 tons capacity that the company will start up in 2020.

Moving toward Slide #13. Here we bring the margins in Europe. Unfortunately, the margins should be lower in 2019 as compared to 2018 as a consequence of the slowdown in the Eurozone, especially to a weaker performance of the auto segment. The spread should, of course, be lower as well in Mexico because of the new capacities that are still coming online in the region.

We are getting to the final -- to the last slide of our presentation. And here, we bring a comparison about what we previously estimated for our EBITDA in the First Quarter of the year and what is our current estimate for 2019. We haven't changed much our view in terms of international spread. So from May until August, May was the time where we had this conference call. Last time, the spread hasn't changed much. So we are not expecting any huge impact in terms of spread. Utilization rate, it's also -- we are not changing our perspective on that. However, demand should be a little bit lower, the growth of demand. The GDP in Brazil has reduced from 1.5% to 0.8%. And in -- we haven't changed our expectation of growth in Europe, the GDP. In the U.S., in fact, it increased by -- from 2.3% to 2.6%. And in Mexico, the GDP that was estimated to grow by 1.6% was reduced to 0.2%. So we are not expecting any important change in our EBITDA, in our current view as compared to the view that we had in May.

So thank you very much. Let's move now to the Q&A session.

Questions And Answers

Bloomberg Transcript

Operator

(Operator Instructions) Our first question, it is from Gustavo Allevato from Santander.

Q - Gustavo Allevato {BIO 18933135 <GO>}

So I have a couple of questions. The first one is regarding the cash flow generation. So we noticed that there was a revenue anticipation of BRL 500 million. I would like to understand what's that? And also the supply account, we know (that will impact) significant improvement. Can you explain...

A - Fernando Musa {BIO 17592170 <GO>}

Gustavo, sorry to interrupt. Can you speak up a little bit to...

Q - Gustavo Allevato {BIO 18933135 <GO>}

Okay. Can you hear me now?

A - Fernando Musa {BIO 17592170 <GO>}

Yes. Please go ahead. Sorry.

Q - Gustavo Allevato {BIO 18933135 <GO>}

Okay. And the cash flow generation, I would like to understand the BRL 500 million regarding revenue anticipation for our clients. And also what drove the improvement in the supply account in the Second Quarter, the first question. The second question, when can you expect the dates for the 20-F? It seems we had two months before the trial in New York. And third. And the last point. And also regarding the Alagoas issue. You mentioned that there is a trial on August 9. So with regarding like a potential resume of the operations and potential liabilities, what's the status of the negotiations of the local authority?

A - Fernando Musa {BIO 17592170 <GO>}

Gustavo, thanks for your question. I'll start with the last one. And then I'll ask Pedro Freitas to address to others.

On Alagoas, I would separate there is a series of legal discussions that will take its necessary course. On the operational side, we have been working on a series of alternatives to move salt, which is the feedstock necessary for the chlor-alkali plant into the Alagoas -- in the MaceiÃ³ site.

So today, we are operating under a nonintegrated model importing EDC for the PVC plant, importing caustic soda to serve our clients in Brazil, while we investigate and assess the alternatives to bring salt. So the expectation for full return of the chlor-alkali plant are being assessed. It is something that will take several months to be decided/implemented given that we basically have 2 alternatives. One is bring salt from another region. And the challenge for that option is developing the logistics, i.e. receiving and moving the salt into

the site; and second, doing some investments to mix the salt with water to create the brine that is -- goes into the industrial process.

The second alternative is find another region close by in the Alagoas state where there is no population or close to area where we could resume the mining operation. This would require licensing for the extraction process and the construction of a brine pipeline to move the brine from the salt extraction site into the industrial plant. This have the licensing time line plus the building the brine pipeline time line.

Both of those alternatives are being evaluated. And we don't have a definitive time line yet. But this is something that will take several months to finalize the studies and start implementation.

Pedro, do you want to address the...

A - Pedro van Langendonck Teixeira de Freitas {BIO 19740578 <GO>}

Yes. So on the 20-F, it's -- we have been working very hard to adjust and analyze the (inaudible) as we have been communicating for the past 2 quarters. We are getting closer to wrapping up the issue. So I think we are working well. And we should be -- the current expectations -- of course, there are things outside of our control in this process. But we should be ready to file the 20-F before the hearing that we have at the NYSE, which is set for October 17.

On the cash advance or the revenue advance, we have sold the rights that we have in a commercial contract on a nonrecourse sale of those rights. We have an obligation to supply the product. It's a regular commercial contract of the company. And we basically sold the revenue rights under that contract upfront. So that's the point that you raised on the cash advancement.

A - Fernando Musa {BIO 17592170 <GO>}

And on the supply side, we've been managing the choices around supply of naphtha to manage not only profitability. But also working capital impact. And typically, these decisions have different outcomes, depending on price point and cash flow generation.

In the Second Quarter, we ended up with 35% of the naphtha being bought from Petrobras, which has a shorter -- we pay at sites. So there is no working capital financing. And 65% from imports, which going back several years, we would see the exactly opposite, 2/3 being acquired locally from Petrobras and 1/3 being acquired from imported suppliers, from foreign suppliers. So this set of decisions...

A - Pedro van Langendonck Teixeira de Freitas {BIO 19740578 <GO>}

Just on the supply side also, what we also see an increase because the compound impact of the price of naphtha, the international market, which increased by roughly 10%. Then also currency translations. So we also see those impacting there. But the main one is that

Fernando said, the increase in naphtha imports, which have a longer term -- payment terms, we are able to secure those from our suppliers.

Q - Gustavo Allevato {BIO 18933135 <GO>}

Okay. Clear. Maybe a follow-up. I just want to understand, how much more does the company pay as far as the imported naphtha compared to Petrobras naphtha? I know that's a decision not looking for just profitability. But also looking at the working capital. If you could give us some color just to have an idea for our forecast.

A - Fernando Musa {BIO 17592170 <GO>}

The imported naphtha is not necessarily more expensive. We have multiple suppliers. The quality of the naphtha is a relevant factor. Some cargoes might have quality that could benefit the production of propylene. Others have -- will have a lower yield on propylene as an example. So the choice of whom we buy from and the value of it is also -- is impacted by the quality of the naphtha, the intrinsic specs of the naphtha. So your statement that imported naphtha is more expensive than local naphtha is not necessarily true every single time. It will depend on where we're buying from. We have some shorter contracts, not as long as the naphtha Petrobras contract. But 1, 2-year agreements where it has more logic. Sometimes we'll buy on the spot. So you have opportunities when the market is very long. So it's a very diversified portfolio. And as I said, we look at both the cost and the flow to assess the decision from a financial point of view. But a big component of the choice is the quality, the source, the cargoes to help us optimize logistics and optimize the production at the crackers here in Brazil.

Operator

Our next question is coming from Luiz Carvalho.

Q - Luiz Carvalho {BIO 18040760 <GO>}

Basically 2 questions here. I mean last year, we discussed about the -- a little bit the (inaudible) levels for the company. And now we are seeing, as you probably -- as you just mentioned in the presentation, lower demand in China, Mexico and Europe, higher capacity still coming from U.S., potentially maybe lower import tariffs and the rate and in Brazil, FX rate is below 4. Then also we are seeing lower domestic margins, which going to discuss a bit in the second question. So we are pointing -- I mean every single point that we look to (inaudible) to the environment today points to a new level of EBITDA for at least 2019 and '20, right? I mean we were discussing between \$3 billion and \$3.5 billion last year. And now potentially, we had pointing to something on a recurring basis close to, I don't know, \$1.8 billion to \$1.9 billion, right?

So I saw that you announced the CapEx. But I would like to know what are the other measures that the company might take to address or to face this challenging environment that we see ahead? The second question is a bit more on the domestic tranche and also in Mexico. We saw the EBITDA margin dropping from 18% to 6% year-over-year, while at the same time, you kept the market share stable and also you increased the exports by 10%.

In Mexico, the margin dropped from 57% to 32%, potentially on a lower utilization. So I just would like to understand, what is basically driving this lower EBITDA margin? Is it just the lower spreads? Or higher competition? Or you basically have to lower the prices to keep the market share in Brazil? So just try to, I don't know, get a bit more color on the strategy of the company to face this higher competition as well.

A - Fernando Musa {BIO 17592170 <GO>}

Thank you. So on the first question, clearly, we're facing a more challenging external environment from a petrochemical spreads point of view. But also a lot of uncertainty from an economic growth point of view, especially driven by the China-U. S. dispute that is having repercussions in multiple other regions as well.

So as you mentioned, we are, of course, analyzing this and reflecting this into our planning. One first impact is the revision of the portfolio of projects and the assessment of projects that had been thought of in a scenario where we would see recovery of the spread cycle sooner compared to what we see today, they probably don't make that much sense. So we've been flipping from capacity growth/improving reliability of supply projects to more cost savings and productivity type products -- projects. So part of the reduction is this conceptual change, which put some projects on hold. And I mean it takes a while for us to reprioritize and start working on the other projects that have a different type of impact.

So the first answer is not only we're cutting down the CapEx expected for this year. And probably for next year, we'll adjust the level towards our expectations for next year. But the intrinsic portfolio, the portfolio should have a different type of impact with more project focused on cost savings, be it fixed cost, variable cost at the plants, et cetera.

On top of that, we have been looking at a series of other initiatives towards process improvements, efficiency and effectiveness in the business processes that we have been looking at it for quite a while in the quest of improved performance. The current scenario is accelerating due to those processes and decisions. We should see these impacts coming to hit the bottom line in the next few months.

Several examples that I could mention for -- including investment in new digital tools that are leading to improved operation at the plants through modeling and use of these models into how we do quality control, reducing the number of people in the labs and the number of samples that we need to take out from the process, use of robotic process automation in shared services areas that has led to the reduction of the number of people necessary for transactional operations are 2 examples that we've been working on and now are accelerating to have those impact.

On top of that, we have a new project coming online on 2020, which should help us -- the new PP plant in U.S. So we'll have additional capacity. So it's going to provide us for -- with improved profitability once it starts. And one of the key challenge from an operational point of view that we have been facing is development of ethane in Mexico. And we'll be looking at ways to improve that supply, both working with PEMEX to improving its ability to serve us. But also working on alternatives for us to reimport directly, which would help us.

But also if we make a new infrastructure for imports viable, it will help PEMEX as well in its management of its production and supply of ethane in the country.

So a series of activities, trying to incorporate the cycle perspective into the decision-making of the company, in capital programs, in process improvements, structure, number of people, et cetera.

As far as the margins are concerned, I would say that it is mainly the spread -- the global spreads. We do have series of small relative to Braskem size smaller internal operational issues. And supply issue in Germany is one example. The Alagoas plant being shut down is another example. But I mean every year, we have a series of internal or external factors. Like last year, we had the truck driver strike in Brazil that created some challenges. We had, in the summer, the low brine creating challenges for production in Germany.

So a key driver of the change in margins, I would say, is the global spread scenario for our industry.

Operator

Our next question is from Petr from Barclays.

Q - Petr Grishchenko {BIO 19084897 <GO>}

This is Petr Grishchenko with Barclays. I have some questions on the asset freeze and the judicial deposits. Can you maybe provide an update on the last piece you mentioned earlier on the call about BRL 2.5 billion potential freeze? And how do you expect liquidity to be impacted if this goes through? Also just wanted to confirm the USD 2.5 billion liquidity that you mentioned, that still includes USD 1 billion of frozen assets. And I mean any color on that end would be helpful.

A - Fernando Musa {BIO 17592170 <GO>}

Okay. So on the asset freeze, just to recap where we are, to date we have BRL 3.8 billion of our accounts frozen by the courts here in Brazil. The BRL 2.5 billion is another lawsuit or process in the courts that was started more recently on the same facts by a different part of the judicial system in Brazil. This one has -- follows a separate different process. We do not expect this to happen.

It is a representation of the current status, which is an ask by the prosecutor of those freeze. But the underlying fact is the same one that led to the current freeze, which we are disputing in court. And we will do the same with that one. We do not see this happening.

So we'll see how this is played out. Our legal actions have been always to discuss in the courts the underlying facts to start with and then provide the necessary guarantees to the courts (inaudible). If in the future, there is any culpability approved against Braskem proven in courts, that we have the ability to face it from a financial point of view. There is no need for those additional freeze -- account freeze, especially given that we have

provided certainty bonds to the courts that could provide that "insurance" to the legal system.

So yes, it is out there, the lawsuits. We do not expect it to be granted this additional freeze given that it's the same underlying factor. And there would be no need for guaranteeing it twice. On the liquidity issue, I would let Pedro to address.

A - Pedro van Langendonck Teixeira de Freitas {BIO 19740578 <GO>}

Yes. So on the liquidity, we today with the cash freeze, we still are still able to operate normally. We've made some adjustments in our cash management so that the cash is at the right places in our system. But we are able to keep operating normally. And the cash freeze does not create any limitation on our ability to fulfill our obligation.

We also have a revolver credit facility -- revolving credit facility of \$1 billion, which is undrawn and which we can use at any time. It's a revolving credit facility that is extending until 2023. The one that we have right now was contracted with a pool of banks last year.

I think it's important to say as well that even considering the cash blockage that we have right now, we have 38 months of debt coverage in our cash. So again, we have -- just the average term of our cash is close to nine years. And we have, I would say, a very conservative liquidity policy. And that shows in -- I mean even with close to \$1 billion locked, we still have 38 months of debt coverage.

Q - Petr Grishchenko {BIO 19084897 <GO>}

Okay. Also maybe following up on that Alagoas issue that been already discussed. Has there been any update in terms of the timing for the studies? And when do you think you expect reviews to conclude?

A - Fernando Musa {BIO 17592170 <GO>}

We are focusing the studies towards providing more information to address the issue of what needs to be done so that the people who had to be removed from their homes can go back home safely.

There are 2 types of studies. Some of them try to understand what's happening with soil. And therefore, with the structure's surface. The other type of studies is interpreting this and looking for the solutions to understand the risk and to address the risk for that. So this is something that, I mean, happens in phases. And as we get new information, we process those and adjust the course of action.

So we do expect that by -- over the next few months until the end of the year, we'll have way more clarity on both topics so that we can discuss with the relevant authorities our point of view so that the actions that might be necessary for the population to be comfortable with what's happening -- understand what's happening and to be -- for them to be able to go back to their homes are addressed correct.

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So there's no definitive time line because some of those studies will lead to potentially, for example, engineering studies in how to implement a certain engineering solution for a part of a neighborhood. Since we do not have clarity on all those potential "solutions," it's hard to give a total time line for when these will be designed and implemented.

We're working on. And my expectation is that by the end of the year, we'll have way more clarity than we have today, which will be good for the population. But also for us given the impact that this clarity will have for the operational -- for the operations of Braskem but also for the whole legal process that is going on in parallel.

Q - Petr Grishchenko {BIO 19084897 <GO>}

Got it. That's very helpful. And maybe switching gears. Can you perhaps provide an update on the status of the controlling stake? Do you have any idea on the timing when the final ruling can come out, whether Odebrecht's allowed to keep shares and whether you think this could impact your deliberations on dividends?

A - Fernando Musa {BIO 17592170 <GO>}

So I'll give you my current understanding of the situation on Odebrecht. We do not have direct actions to it. And we do not participate in this process. So our current understanding is that Odebrecht filed for (foreign language), which is something similar to a Chapter 11. It's not exactly the same. But similar to Chapter 11 in the U.S. Under that process, they have 60 days to present a plan to the -- their debtholders on what they plan to do and for the restructuring of the company.

The Braskem shares have been given and guaranteed to debt. That is not included in the Chapter 11 procedure and -- formally. The filing done by Odebrecht asked the court to consider it as a relevant instrument for the restructuring of the overall holding company. The judge granted something towards that line in the standstill -- (coordinating) the standstill on the bank's ability to exercise their guarantee. The banks have went to court and disputed that.

So my understanding today is that if the banks that have that guarantee would exercise their guarantee, they could do it. They have not done it. So I assume that when the banks and Odebrecht have been discussing this process and are trying to find a solution that is - it will address the needs and constraints of the 2 processes.

So in a concrete term, today, Odebrecht owns the shares. They are not part of the Chapter 11 formal restructuring. The banks that have that debt have not exercised any guarantee. And therefore, the political rights, the economic rights have not changed compared to previous discussion.

The dividend discussion has another logic and has nothing to do with that given the situation that we faced that created an unexpected situation that was not seen before in the country under our judicial system. Here, we were not able to discuss in the general assembly the dividends. And now the Board and management, we have been discussing given the petrochemical scenario and the legal situation around the Alagoas geological

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issue, we've been discussing what to do with the dividends. And we should have a decision in the future -- the near future on what to do with dividends. This has no link to what's happening with Odebrecht.

A - Pedro van Langendonck Teixeira de Freitas {BIO 19740578 <GO>}

And just to complement, if we look at our commercial, if I might say so, relationship with Odebrecht, we don't have any meaningful receivables from them. So there is no exposure there. And also we don't have any cross-default or cross-acceleration clauses that would trigger an acceleration of Braskem debt because of the (situation and intervention).

In a potential change of control, we would only have provisions for debt acceleration if there were a downgrade of Braskem that -- of Braskem rating because of the change of control. But in the current situation, there is no cross-acceleration provision.

Q - Petr Grishchenko {BIO 19084897 <GO>}

Sorry, I didn't catch the last thing you said. You -- can you repeat it, please? You said the only impact you expect is, what's on the debt?

A - Fernando Musa {BIO 17592170 <GO>}

There is no impact.

A - Pedro van Langendonck Teixeira de Freitas {BIO 19740578 <GO>}

There is no impact. What I said is that we don't have any meaningful credit exposure to Odebrecht on the commercial side. And on the debt side, we don't have cross-acceleration or cross-default provisions that would trigger any of Braskem's debt because of the situation of Odebrecht. So our credit exposure is completely segregated. And the only thing that would lead to a potential credit debt acceleration would be down -- a change of control that leads to a rating downgrade of Braskem.

A - Fernando Musa {BIO 17592170 <GO>}

(inaudible) provision.

A - Pedro van Langendonck Teixeira de Freitas {BIO 19740578 <GO>}

Which is not the scenario right now. So...

A - Fernando Musa {BIO 17592170 <GO>}

Exactly.

Q - Petr Grishchenko {BIO 19084897 <GO>}

Yes, of course. Okay, got it. And maybe last question, can you perhaps comment on the Braskem Idesa, any progress on -- any planning on building a ethane importing terminal? There were some reports recently kind of discussing this. Any latest thoughts on that

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would be very helpful. And also can you perhaps mention what were the highest utilization rates at a plant during the Second Quarter and if you expect basically the measures appropriate to pay dividends at some point.

A - Fernando Musa {BIO 17592170 <GO>}

So on the imports, we are working on a couple of alternatives to support the construction of the necessary infrastructure to substantially improve the ability of the Mexico region where we are located and where the Mexico -- the PEMEX crackers are also located.

To increase this region's ability to import, the main bottleneck is the -- would be the construction of a terminal with cryogenic tanks and the associated unloading and pipeline to move the ethane to our plants and PEMEX plants. This is a large project, which we've been discussing with multiple interested parties on building and operating the terminal. We have more than one option for that solution. So we're working very hard ourselves, together with PEMEX, because this infrastructure would be helpful with PEMEX as well and potential investors to make this a concrete project, not only a discussion. So we're working on that.

In parallel, we've been looking at alternatives that could be more short term, maybe less efficient, less sizable. But that we could implement sooner given that building a terminal and a cryogenic tank could take a couple of years. So we've been looking at other alternatives that we're close to make viable. If and when those become a reality, we will of course communicate to the market. But we are working around that.

On the availability, I mean what's the peak utilization rates, the -- one of the challenges we have been facing -- we face 2 challenges: First, the average utilization rates in the quarter was low, it was 72%, if my memory is correct. But the second challenge is it has been very volatile. So some days, we're close to 100%; some days, we go to 30% availability of ethane. So it's been very volatile. We do have some storage of ethane and some storage of ethylene that balances this volatility in the intake of ethane. But we have not seen on average anything lower than 70 was close to the lowest we've seen. And it is close to the lowest we expect going forward. So our view is it's (70 up) that we should be expecting. And the Second Quarter was one where we were close to the lower bounds of the ability of the (inaudible) system to serve us with ethane. With those long-term and short-term solutions for import being implemented, the ability to supply the complex, either from PEMEX or from -- by ourselves, will increase. And we should see increased operating rates with imported ethane in the future.

Operator

Our next question is from Bruno Montanari from Morgan Stanley.

Q - Bruno Montanari {BIO 15389931 <GO>}

Two quick follow-ups. One on the PEMEX and import infrastructure. Are the discussions you alluded to in this conference call in line with what PEMEX included in their business plan? Because if memory serves me right, they're saying they'll double the import

capacity between 2019 and 2020. Or would these discussions mean extra import capacity than what they have on the business plan that they just recently published?

Second question, just to check, on the naphtha imports in Brazil, is this 65% import rate sustainable? Or should we think of it as more of a one-off opportunity you took advantage of in the quarter?

A - Fernando Musa {BIO 17592170 <GO>}

So on the import capabilities in Mexico, we know that PEMEX has its own system. They are already importing. And they have been looking at ways to improve their own ability to import through their current system. I would say I don't have the details of their plan and what's included. And I saw the same data. But I don't know if they are counting on the potential terminal that would -- that is being discussed as part of that or not. Regardless of that, the long-term solution that we've been discussing would certainly create way more import capabilities than doubling the current PEMEX capability. So I would say it is extra.

I don't know if everything that we've been discussing is extra or if PEMEX included part of their improvement is using the new structure, I would not know the answer to that question. But I would say it's fair to say that we should have more import capabilities in the region than doubling the current PEMEX ability to import.

On the naphtha import, the 65%, it is sustainable. But as discussed before, it is the consequence of a series of choices that have many operational and economic drivers. It will be 65% imported as long as those drivers lead to that decision. We have proved over the last several quarters that our ability to import needs to improve and has been improving.

The key bottleneck is logistics. We have been working on our logistics system to improve that ability. And we have been working with other owners of parts of the logistics infrastructure necessary to import, including Petrobras, to improve our ability to import directly not depending on buying from Petrobras.

So many of those small investments and/or adaptations on how we operate terminals, tanks have been implemented in the last few months. So we can operate importing 65%, maybe even a little bit higher from a logistics point of view, from a sustainable point of view.

If it will be 65% or not, I mean the economic and financial variables and the quality, which is also a big driver of the choice of naphtha and where it comes from given the different coproducts will be produced depending on the type of naphtha, different amount, all of them are produced. But the amounts change and can change significantly from one type of cargo to the other. Those factors will influence that.

So our key strategic move, I would say, in the naphtha supply has been to create the ability to have a more diversified supply base through the development of contracts

and/or commercial relationships to buy the molecule and improving the logistics setup so that we can move it into our complexes. Those 2 aspects have received a lot of attention over the last couple of years. And we're seeing the impact of it in this quarter as a clear illustration of our ability to bring more naphtha from other sources around the world.

Operator

Our next question is from Hassan Ahmed from Alembic Global.

Q - Hassan Ijaz Ahmed {BIO 7430123 <GO>}

Look, as I take a look at the back half of 2019, it just seems that the drumrolls seem to get more and more negative with supply additions imminent, macro concerns, trade war-related uncertainties and the like. But then I start taking a look at spot U.S. markets. And they're very different from the same time last year, meaning spot ethane prices are collapsing. Spot ethylene prices seem to be popping.

So what is it that the spot market's seeing that, I guess, corporate management isn't? I mean it doesn't seem -- through the lens of the spot markets, things don't seem that dire. They actually seem quite good. So what's going on in your view?

A - Fernando Musa {BIO 17592170 <GO>}

Nice talking to you. I think it's a fair question. My reaction would be that you're comparing 2 very different dynamics. One is a short term, which is the spot, which has a lot of -- and you're focused on 2 products, ethane and ethylene, that honestly by themselves are completely useless, right. So it's all about what does the ethylene become and then how is this traded.

So I always tend to look at the integrated chain. And PE being the biggest user of ethylene is a key driver of this dynamic. I would say this volatility in ethane and ethylene creates noise in the U.S. It's driven by availability of ethane that is a direct consequence of oil and associated gas and the need to extract, to respect the specs on the natural gas that goes into the pipelines and LNG.

The ethylene is all about, I mean, a very thin spot market relative to the total production and consumption of ethylene in U.S. And I mean if you look at the PE export prices out of U.S.. So they've been under \$900 per ton for a while. It's been a while since we've seen such a low price. And the low price is driven by the global PE supply-and-demand expectations of the economic cycle, the spread cycle.

So I agree with you that, I mean short term, you have weird phenomena. If you go to the (C3-PP) chain, you'll also have some of those weird phenomenas between propylene and PP in U.S. and propane, propylene pricing and very weird movements happening if you look at day by day, week by week in propylene in price term. And the PPE price and (PPE largely) globally has been pretty stable.

So my view is mid-term, it is a very challenging market because of the macroeconomic environment, the uncertainty that trade wars are creating for many value chains, the challenge that all this is creating for growth in China, the repercussion of that to other regions. Plus we did have a big wave of new projects being built in U.S. and also in China that are hitting the markets when, I mean growth of demand is kind of slowing down a little bit compared to, it's not negative growth, it's just doing -- it's growing less strong, not as strong as anticipated before. So that's my view (inaudible).

Q - Hassan Ijaz Ahmed {BIO 7430123 <GO>}

Understood, understood, understood. No, no. It's fair. I mean it's just one of those quirky markets.

A - Fernando Musa {BIO 17592170 <GO>}

I hope you're right on your last report on an up cycle coming sooner rather than later. (inaudible).

Q - Hassan Ijaz Ahmed {BIO 7430123 <GO>}

It's always darkest before dawn. Now as a follow-up, slightly longer-term question. I mean every second day these days, there's yet another new headline encouraging recycling, talking about cities, states, counties, countries, imposing plastic bans in some way or form. Again, tough to sort of analyze exactly what that'll do to sort of eventual demand growth. But if one were to take a realistic view -- or actually more than a realistic view, err to the side of caution, it seems if some of these single-use plastic bans are implemented, more and more guys sort of start recycling, I mean at most, it may shave maybe 70 basis points off of global demand growth for something like polyethylene.

So my first question around that is what are your views around that? I mean do you think that seriously impedes demand growth going forward? Is it dropping the bucket? I mean - so that's one part.

And the second part is more Braskem specific. Are you guys seeing more and more interest in the legacy product that was green polyethylene?

A - Fernando Musa {BIO 17592170 <GO>}

Okay. This is a very relevant point. And I would frame the issue slightly different than you did. I would say the recycling is creating a new source of plastics that will be added to the plastic that comes from our current plants.

So I think the industry has a challenge that we need to address the recycling or the end-of-life issue, especially for single use. To solve that, the solution seems to be recycling. And this will lead to another source of plastic coming from the feedstock that is used plastic. So demand, given the contributions that plastic has to product performance, food safety, cost, flexibility to use, this plastic will continue to be used. And if we solve the recycling issue, demand should not suffer, might accelerate. Total demand.

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But you have a "new plant" coming from a different type of feedstock. It's not gas. It's not methane but from PPE propane. It's recycled plastic that will lead to a different type of plastics that's most likely, for quite a while, will need to be blended somehow with the virgin that comes from naphtha or from gas to have the quality performances that are necessary to achieve product quality for consumers.

So this is something that is creating a challenge and an impact because the -- things are moving very fast, as you said. It's very easy to ban. But it's not that obvious to substitute with the same quality, with the same cost, with the same environmental impact. Some of the alternatives that are used once it's banned end up having a worse environmental impact. So it's something that we will see as a bigger driver. But it becomes also a big opportunity for us.

It becomes an opportunity in 2 fronts: One is using this recycle and fostering and becoming one of the users of this new feedstock and changing, therefore, our product portfolio with this recycled resin. And it also, going back to your second question, gives a little lift to our green polyethylene because -- and I say a little lift because the renewable base doesn't address this challenge of end of use, end-of-life use. It is another aspect that it addresses its carbon footprint.

So if you combine recycle with virgin and the virgin being green, then you have a pretty interesting combination. So we have an advantage towards that. And we've been working around that. And this could be a differentiator compared to others. That's -- I mean we're ahead of the game in our ability to combine recycling with regular virgin, with the "green virgin" plastics to create solutions that address different problems for different clients.

So I wouldn't say that this is leading to increased demand for green today. But we have good expectations that the combination of those 3 type of plastics will be very compelling. And therefore, we should see an increased lift coming from this.

Operator

Our next question is from Fernanda Cunha from Citi.

Q - Fernanda Perez Da Cunha {BIO 20784520 <GO>}

I just have a quick follow-up on Mexico utilization rate. When we look at PEMEX ethane output for this quarter, for the Second Quarter, it actually, it has dropped very little against the First Quarter. So I'd just like to understand if are there other obstacles right now in Mexico that is leading to less ethane available for your plant? Or was there any one-off impact in this quarter that drove down your utilization rate? If you could give any color on that, I'd appreciate it.

A - Fernando Musa {BIO 17592170 <GO>}

So there are 2 consumers of ethane in Mexico, our plants and the crackers that are owned and operated by PEMEX. So if you look at PEMEX ethane production, it will be used to supply our Braskem Idesa and also to supply its own polyethylene, ethylene oxide plants,

for example. So that's why it's important to create an infrastructure to import to increase resilience of the system so that not only they can serve our contract and respect the limits of the contract. But also to give them the ability to run their plants at a higher utilization rate.

Given the structure of the contracts, if you look at how they've been operating the system, they have privilege serving us versus serving their own plants if necessary. This is not a long-term sustainable solution. That's why we've been discussing with them that jointly making an effort to create a sustainable and large infrastructure that is competitive to import ethane is going to be good for both of us. So that they can serve us better, they can serve their own plants better. And -- while they work on improving their production of natural gas and the extraction of ethane so that they reduce the need to import. But this is going to take a while.

Operator

Our next and last question is from (Jaime Michelson) from Credit Suisse.

Q - Unidentified Participant

I just have a quick question about your -- the comments that you're making about your working capital and generating cash by upfront sales of your commercial contract. I'm wondering if you could give a little bit of background. Was this a move to generate cash given the constraints on your cash? And do you expect to continue to be able to generate cash flow off of your working capital for the rest of the year? What's your outlook for being able to do further transactions along this line? Then also just to clarify, your cash without the judicial deposit is down to \$1.4 billion. Is that correct?

A - Pedro van Langendonck Teixeira de Freitas {BIO 19740578 <GO>}

So (Jaime), thank you for the questions. This is Pedro Freitas. On the second one, it's correct, I mean, \$1.4 billion is our cash already, excluding the judicial part of asset freeze.

Considering the -- about the advanced sales, I mean we do commercial agreements with clients regularly. We have different forms of payment and different forms of different agreements around how clients are going to pay us are negotiated. In this particular case, we've done it this way. I mean we do bids not necessarily the same structure as this one. But we do this type of agreement with clients looking at cost and the commercial interest of the company all the time. So it is a regular tool that the company has available for use at any time that we need.

Q - Unidentified Participant

And do you expect -- regarding working capital, do you expect that to be a further source of cash for the remainder of the year or flat? Can you give us some guidance on what you expect in terms of cash generation for the second half of the year?

A - Pedro van Langendonck Teixeira de Freitas {BIO 19740578 <GO>}

So looking at working capital, as Fernando said earlier, we have moved towards more imported naphtha, which has longer payment terms. We may have some more renewals of contracts for new sources that we're developing. We may have some additional opportunities to generate cash from extending payment terms with suppliers.

So it is a possibility. But it will depend always -- as always, I mean even in terms we have today, we look at the cost of doing that and the convenience -- the commercial convenience of doing that. So it is, I'll say, an analysis that is done and is considered as a whole in looking at the overall interests of the company.

Operator

This does conclude our Q&A session. I will turn over to the company for closing remarks.

A - Fernando Musa {BIO 17592170 <GO>}

I would like to thank all of you for participating in this Second Quarter discussion.

As we discussed, the industry is facing a series of challenges. But Braskem is also facing its own set of particular and private specific challenges. But as in previous situations, we see the strength of the Braskem team, the dedication, the commitment, looking for solutions and working very hard to address the issues and, I mean think about the current but also the long-term perspective of our clients, of our suppliers, the regions where we operate, the communities we operate in, to look for interesting projects and ideas.

So we will continue pursuing our strategy of improving productivity and competitiveness, diversification of feedstock, diversification from a geographic point of view.

As we progress and have more clarity on what's happening in the cycle but also with the shareholder structure, we have now the ability to pursue some ideas, opportunities that were kind of on hold during the whole LyondellBasell discussion. Since that stopped in early June, many of those conversations that were put on hold towards interesting projects have restarted. Some of them make even more sense in the current cycle environment, some of them make less sense. But we're pursuing some very interesting opportunities that could generate interesting value creation. And we'll continue to pursue those in the quest for the right balance between the financial health of the company. But value creation short and long term.

So thank you very much for your attention today and looking forward to another discussion in three months' time with the Third Quarter results. Bye.

Operator

Thank you. This concludes today's Braskem earnings conference call. You may disconnect your lines at this time.

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