

Q1 2018 Earnings Call

Company Participants

- Fernando Musa, CEO
- Pedro Teixeira, IR and Controller Director

Other Participants

- Analyst
- Andre Hachem, Analyst
- Frank McGann, Analyst
- Gustavo Allevato, Analyst
- Hassan Ahmed, Analyst
- Leonardo Marcondes, Analyst

Presentation

Operator

Good afternoon, ladies and gentlemen. At this time, we would like to welcome everyone to Braskem's First Quarter of 2018 Earnings Conference Call. Today with us, we have Fernando Musa, CEO, Pedro Freitas, CFO, and Pedro Teixeira, IR and Controller Director.

We would like to inform you that this event is being recorded, and all participants will be in listen-only mode during the company's presentation. After Braskem remarks are completed, there will be a question-and-answer session. At that time, further instructions will be given.

(Operator Instructions)

We have a simultaneous webcast that may be accessed through Braskem's 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 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 currently available to the company. They involve risks, uncertainties and assumptions because they relate to future events and therefore depend on 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'll turn the conference call over to Mr. Pedro Teixeira, IR and Controller Director. Mr. Teixeira, the floor is yours, sir.

Pedro Teixeira {BIO 20753906 <GO>}

Hello. Good morning. Good afternoon, everyone. Thanks for participating in the Braskem conference call for the first quarter 2018.

Let's begin our presentation with slide number 3, where we discuss the scenarios highlights. In terms of demand, in Brazil compared with the fourth quarter, demand was up by 3%, mainly for the MPP demand but for PVC is still lagging behind. So the main impact in this growth in demand is relatively for MPP. Still on the demand side. In the US, demand for PP was down by 4%. There was a movement of this talking in the chain in the US. In Europe, demand remains very robust. There was some movement in terms of restocking in Europe. In Mexico, also demand were up by 8% in this quarter as compared to the prior quarter. There was some restocking in the chain and also some growth in the services sector and recuperation of the industrial sector. In terms of the spreads. In general, the spreads were better in this quarter as compared with the fourth quarter 2017 as the new capacities of the US were still ramping up in the first quarter 2018. And also, there was some unscheduled stoppages in US due to the low temperatures during this quarter. Just one point to highlight. The spreads as compared to the first quarter were lower mainly in terms of chemicals. You have to remember that butadiene price in the first quarter of 2017 skyrocketed. So that was an extraordinary event that happened in that quarter that we haven't seen in this quarter happening again.

So let's move to slide number 4. Let's begin with utilization rate. Utilization rates in Brazil were -- Brazilian crackers posted utilization rate of 90%, were 5% down compared with the other quarters, mainly as a result of the shortage of energy in several regions of Brazil affecting Braskem operation and also, our client's operation. The stoppage for maintenance in the south of Brazil that lasted for 35 days and resumed in April 24. And also, we had an accident in our soda/chlorine facility in Alagoas, impacting the production of soda/chlorine and also, PVC. This accident impacted our results in approximately \$50 million.

Still talking about utilization rates. In US, they were a little bit lower as a result of unscheduled stoppages that we had there and in Germany as well. And in Mexico, even though the utilization rates were in line with the fourth quarter of 2017, they're still below the contractual amount as a result of the lack of butane that we had in that region.

In terms of sales. Braskem sales were in line with the first quarter of 2017, and then we see here a movement of prioritization of our exports of our sales in the Brazilian market rather than to the export market. And the majority of the exports are directed to Marcus Hook, where we were able to obtain better margins than overseas exports.

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In terms of US and Europe, sales were relatively stable during this quarter. And in Mexico, they were up on the domestic market and the Mexican market, and down in terms of exports. Also, there is a movement of prioritizing the Mexican market rather than exports. In terms of EBITDA. In Brazil, EBITDA was lower by 20% as a consequence of the operational issue as compared to the fourth quarter 2017 and minus 40% as compared with the first quarter 2017 as a consequence of the operational issues plus the smaller or lower crisis for chemicals, especially butadiene. EBITDA was a little bit stable for US and Europe, and Mexico was down by 5% as compared to the first quarter 2017. Overall, the company total EBITDA of \$800 million, 10% down what was posted in the fourth quarter 2017 but the net profit of the company was up by 173% on the fourth quarter 2017, as a result of better financial -- or lower financial expenses this quarter as compared to last quarter. Last quarter, we had some extraordinary events as a result of the refinance of certain debt that occurred in that quarter.

Let's move to slide number 5. In here, we demonstrate the free cash flow generation of the company. We begin with \$818 million of EBITDA. This translates into BRL2.6 billion of EBITDA. We had a small working capital variation this quarter. There was some BRL453 million of interest paid on this quarter, which is lower than what was posted in the previous quarter as a result of the consolidation that we had in our cost of debt. The amount of income tax disbursed this quarter was 182 million and we disbursed BRL403 million in terms of investments. This is splitted between the Delta project, our PP plant in US and also there were some operational maintenance investments. So this led us to our free cash flow of BRL1.7 billion, and this translated into US dollars equivalent to \$500 million in just one quarter. This amount is much higher than what was posted in all of the other previous quarters. So in the first quarter 2017, the free cash flow generation was around \$100 million, and it was negative on the fourth quarter 2017.

Moving to slide number 6. Let's talk a little bit about the outlook that we see in terms of another -- for the next quarter. In general, we expect the spreads, and actually we're using IHS numbers, spreads should be lower in the second quarter as compared to the first quarter. And for PE, as a result of the ramp up of the new capacities, five companies have already started up the PE units, totaling more than 4 million tons of capacity in North America. So that should have some pressures on the PE spreads in US. And for PP, we expect a decrease by 7.7% for the following quarter. It's mainly as a result of higher feedstock price as a consequence of higher oil price.

So moving to the last slide, slide number 7, here is a summary how we see the 2018. In terms of EBITDA, it should be low. We maintain our view that EBITDA should be low, mainly as a consequence of lower prices for chemicals and resins. And for the cash flow, we expect the cash flow for this year should be higher than what was posted last year. Remember that we posted a free cash flow generation in this quarter of \$500 million, mainly since this year, we do not expect to have any relevant working capital consumption that we had last year. Interest payments should be lower this year. There was some benefit as a consequence of the US tax reform. And these three impacts will be -- there were some negative impact as a result of higher CapEx digits.

So the key message is that Braskem remains expecting a higher cash flow generation for 2018 as compared to 2017, though a lower EBITDA. So thanks, everyone. I'll pass to the

Q&A session.

Questions And Answers

Operator

(Operator Instructions) The first question we'll take will come from Gustavo Allevato of Banco Santander. Please go ahead.

Q - Gustavo Allevato {BIO 18933135 <GO>}

So I have three questions. First one regarding the demand. I talk with many companies in different sectors. They mention that demand has been lower than initially expected. So if Braskem can provide some color, how has been your domestic demand in April? Has it decelerated compare to the first quarter? We know there is some seasonality but if the company could provide some information in this topic.

The second question is regarding the ability to increase prices in domestic markets. We saw like increasing resin prices as well as depreciation of the Brazilian real. How are Braskem's clients are handling with this higher price environment? So is the company being able to increase prices?

And the third and last question is regarding the extension of raw material supply agreements. So a lot of people talk about naphtha supply agreements but there is also the propane supply agreement that expires in 2021. So if the company has started discussions with Petrobras to extend this contract as well. Thank you.

A - Fernando Musa {BIO 17592170 <GO>}

Gustavo, this is Fernando Musa. I'll start answering your questions. By demand one, I would say we had a very strong beginning of the year in January/February, followed by slightly softer March and April. In our case, it's important to remember that the price volatility was driven both by international prices, and in the case of Brazil, by the exchange rate, create an inventory effect in the chain that is relevant. So this deceleration compared to January and February that we see is probably linked to those two movements that is leading clients to consume their currently owned inventory in expectation that those trends will reverse. And therefore, pricing for the product might be cheaper in the near future.

When we think about the overall growth expectation, we are still maintaining our expectations we had in the back end of the year, which should lead to anywhere between 4% and 5% volume growth for demand for resins in Brazil, and good growth in the other regions at lower rate than that, more in the 1% to 3%, depending if you are talking about US, Mexico or Europe, but healthy growth coming from the demand side.

In Brazil, it's (inaudible) to comment that some sectors are seeing very strong growth. Automotive is the clearest example of that with some months showing 25%, 30%, 40% increase compared to previous months from a production of automobiles point of view.

But others are still facing challenges. The key example here would be the construction segment.

Having said that, in the recent past, in the last few weeks, we are starting to see some positive signs on the construction side as well, both from construction companies' announcements of new projects but also our sales to clients that are exposed to that seem to be picking up in the last couple of months, which could be an early indicator that construction is getting out of their challenging time in Brazil.

As far as the ability to increase prices, our pricing in Brazil follows an import parity logic. So both our products and the imported products are exposed to the international pricing and the exchange rate. Therefore, our ability to increase price is linked to that pricing logic. Of course when there are very fast and significant movements, you might have a lag. For example, we cut prices in half at the beginning of the month. And there is a big jump on exchange rates during the month. It might take a couple of weeks for us to adjust pricing. So there might be a lag on the way up but the same lag would happen on the way down. So on average, those tend to neutralize themselves. But in the short term, you could have a positive or negative impact, depending on how strong the swing is. It's important to remember that pricing for our products in Brazil follows the international prices. And our raw material is bought in international prices, in dollars. So the business is somewhat protected from a spread point of view, to those two movements.

Finally, as far as the raw material agreements are concerned, you're right, the ethane/propane supply for the Rio de Janeiro cracker expires in 2021. It comes after the expiration of the naphtha contracts. As I mentioned earlier today, my expectation is that now that we are reaching midpoint of the naphtha contract, some point in the near future, and please understand near future as 12 to 18 months, we will start a dialogue with Petrobras around the naphtha contract. And given that the ethane/propane contract comes just after, it will probably include this dialogue during the same time for the Rio de Janeiro cracker. So this will come, as I said, in the near future.

In my definition near future in the world of contracts, is 12 to 18 months. Just putting in perspective that the naphtha contract today is five years but we do have feedstock contracts in the 10, 15, 20-year range. So 12 to 18 months for this type of dialogue is pretty near term.

Q - Gustavo Allevato {BIO 18933135 <GO>}

Just a follow-up regarding the first question. So how is the company seeing the inventories (inaudible) are very low given the purchasing less in the recent months? Or they are in a normalized levels?

A - Fernando Musa {BIO 17592170 <GO>}

I would say, depends by client segment and by client. There was a certain de-inventorying happening in many of the regions and segments that we serve. I would say probably in April, some of those segments went back to normal levels of purchases. But with the spike in oil price recently, it might lead to another expectation around how long it's going

to last. Is it going to revert back closer to 70 or below that in the near future. And this might lead to another inventory build or drop in the near future. If we look at the data from the ABIQUIM, which is the Brazilian Chemical Association, the expectation for May/June are positive, driven mainly by good signs from the economy in general. So that's what I could say on the demand side.

Operator

Next, we have Hassan Ahmed with Alembic Global.

Q - Hassan Ahmed {BIO 7430123 <GO>}

Hi, good afternoon. Fernando, some interesting trends we've been seeing on the ethylene/polyethylene side of things, particularly here in the US. Spot ethylene pricing seems to be hitting multiyear lows, while polyethylene pricing on the contract side has held quite firm. And as I talk to companies and I talk to industry participants, the logic seems to be that a lot of the ethylene crackers came on -- the green field ones came online first. The derivative units are taking their time to come online. And the perception is that as the derivative units come online, ethylene pricing may go up while polyethylene pricing may come down. But obviously the counterargument to that is that over the last couple of weeks, we've obviously seen a bit of a rally in oil prices, which should buoy ethylene and the polyethylene pricing further.

So again, coming back to the question, how do you see this dynamic playing out over the next couple of months? And again, throwing in the fact that we are in turnaround season as well. So how do you see all these crosscurrents playing out through the sort of remainder of 2018?

A - Fernando Musa {BIO 17592170 <GO>}

Hello Hassan. I think as you said, there are some interesting trends. I think it's important to remind ourselves that in relative terms, the spot ethylene markets, the merchant ethylene market in the US, it's not that relevant. Most of the capacity is in the hands of integrated players, even if they are not at the same site. If you do the balances, they produce a lot of ethylene. They produce a lot of derivatives. So I think in the short term, what's happening is exactly what you said. And crackers started, they tend to once they start to go to pre-utilization rates much faster than the PE lines. It's very similar to what we faced in Mexico, as an example.

We start the cracker, it produces ethylene. Once it goes, it goes. You start the PE lines, and you start with a very simple product slate. You take your time, then you start to change the product slate, it leads to more upgrades. You learn more about the plants. So even if they start at the same time, there is a tendency for the ethylene to be performing sooner than the polymer plants. With the delays that some of the polymer plants have faced, it creates an imbalance because the price of PE and some of the other ethylene derivative is so good. People are running the crackers hard and the penalty to running at lower rates is significant. So they run hard.

There is excess ethylene, the prices goes down because they need to get rid of it. As we go to the rest of the year, this should balance out. And the ethylene price should go up because the excess will be much lower, and eventually, more balanced leading to different logic for the ethylene pricing. And the whole point then becomes PE pricing, which is set typically by a marginal producer, naphtha producer somewhere in Asia. So the oil price becomes a key driver for this.

So when we look at what most of the consultants are saying and most of the companies are saying, the expectation is that because of all those movements, the spreads and profitability of this chain, when looked on an integrated basis, should be a little bit better than what was anticipated last year, especially if you are in the ethane to PE chain. So when we translate that to the Braskem reality, given that we are now more balanced in the exposure to ethane and propane versus naphtha, I think we'll continue to work on the competitiveness of our plans, the flexibility like the investment we did in Bahia last year to enable us to take more ethane, whenever it is very competitive.

So our expectation, as Pedro said in the presentation, is for a lower EBITDA for the year but at a very healthy level when compared to historical trends.

Q - Hassan Ahmed {BIO 7430123 <GO>}

Understood, very helpful. Now as a follow-up, a question around sort of trade and tariffs and all the sort of noise that we keep hearing about, particularly sort of since the beginning of April when China came up with a list of call it, 106 different sort of products that potentially could be tariffed. So taking a draconian view, if that were to happen, how would you see that playing out? And how would that impact you guys?

So that's kind of the broad question. But within that, what I'm kind of intrigued by is that as I went down the list of chemical products being included in this list of tariffs, the one exception was polypropylene. But interestingly, propane was included in the list. So in theory, one could make the case that with so much propane being exported from the US to China, all of a sudden, if that is tariffed, there is an oversupply of propane here in the US, which in a way, could create a sort of lid for ethane pricing, so you get cheap feedstock, but then you have polypropylene, which unto itself is going through a decently tight supply/demand environment.

So it could actually be a huge positive side for the polypropylene side of your portfolio. So like I said, two parts. One, if these tariffs in a draconian scenario would go through, how they would impact you guys, and then how this whole propane, polypropylene, ethane thing may play out in your mind?

A - Fernando Musa {BIO 17592170 <GO>}

So this is a very complex question. I'll try to address it in two aspects, the PE and the PP side.

Starting with the PE side, I think the challenge here is to understand how the trade flows will rebalance. A lot of the capacity that is being built in the US had as a destination China.

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And basically, all the PE has been included in the list. So if the list is really enforced, this flow of products that was destined to be sent to China will need to find other destinations. South America is an obvious choice. Our scenario already has quite a lot of product coming from those projects coming to South America. This could put more volume from the Americas flowing south.

Having said that, everybody was expecting this volume to flow to China. If it doesn't come from the US, it will need to come from other places. So it should rebalance probably immediately to send even more to China and serving less Europe, serving less South America, which they are serving. So this rebalancing is tricky to forecast beforehand, but my expectation is the trade flows will balance and it could change the origin of the product coming to South America or to Europe, but probably not change drastically the volumes because the expectation for demand is still a very healthy PE demand and still a short market in China. So they will need more PE.

It's important to factor in all the other changes that China is doing that still are playing out in the PE side, which has to do with first, the prohibition of import of waste, which is reducing the availability of recycled materials and that needs to be substituted by virgin material, either produced locally or imported. And second, all the environmental tightening that is leading to shutdown of smaller, more or less environmentally friendly plants in China, and putting pressure on the coal-to-olefins plants.

So when you factor all this, it creates a challenge from flow and who will be the competitors in the different regions. But it's a global market. This is a traded commodity. It will find its place. And my expectation is that it creates a lot of challenge in the short term as people redirect and rethink their logistics and their shift channels to market, but eventually, it will balance.

On the PP side, the story might be a little bit different, as you indicated, because of the unbalance between PP and propane. And PP not being included and being tight in the US and propane being very long and not flowing to China, means that probably the propane will stay in the US. Our own plant that has been built will probably be very competitive to exports. The other plants announced will probably be accelerated. Some that have not been decided might have their fund investment decisions accelerated. Because we could see a world where producing PP in the US for export becomes a very good business, as was the case 10, 15 years ago. And US could become a market where raw materials for PP is very competitive coming from the PDHs. And the market is good in the US, but the market globally is very good because the PDHs in China can't be supplied only by propane from the Middle East, and the propane from the US will be needed.

So it could be a positive for PP if all this is implemented. But again, we need to see how the trade flow for propane is going to balance out, and how much of an operating rate reduction the PDHs and therefore the PPE plants attached to them in China will take from the challenge from PP. Worst case scenario, the pricing of PP goes up, because propane in China will be more expensive because of the tariff. And therefore for margins with the propylene in the US being priced from a PDH that has very cheap propane compared to a PP plant buying propane priced from an expensive propane in China. It could be good news for the PP market, as you described.

Operator

Next we have Frank McGann, Bank of America Merrill Lynch.

Please go ahead.

Q - Frank McGann {BIO 1499014 <GO>}

Just to follow up on your comments on Mexico and utilization, and the ethane situation. I was wondering if you could just perhaps expand on what you're seeing right now and how you see utilization over the next couple of years there.

A - Fernando Musa {BIO 17592170 <GO>}

Okay, Frank. As far as supply in Mexico, what we can say is that in the last two weeks, it has been very strong, better than what we saw in the first quarter. Mexico is facing challenges in ethane availability, but that explains the decision to start importing ethane. And this is happening at the good frequency now, which is helping the supply of ethane into the market. So our expectation is to run the plant this year anywhere between 85% and 90% in Mexico, benefiting from the strong margins that we're seeing, the strong spreads. And if oil stays where it is, this should continue. And we do expect to continue to generate very positive results out of the Mexico plant.

It's important to remember that we have a very strong contract, which has strong penalties from deliver or pay. Those penalties have kicked in already from last year. There is six months catch-up period. We are booking the penalties after the six months period. And we have already collected payment from the first ones from last year. So the contract is working, the plant is working well, the market is working well. We're benefiting from the significant spreads. And from especially in the first quarter, as Pedro mentioned, there was the strong winter, very severe winter on the Gulf Coast, created problems for our PP plant, but also created problems for some of the PE plants. So we had very good local sales since the beginning of the year.

Q - Frank McGann {BIO 1499014 <GO>}

And at what level of utilization -- or I'm not sure what the contract, how it defines it. But at what level do the penalties kick in? Or what kind of essentially equivalent utilization would be included in, with those penalties in mind?

A - Fernando Musa {BIO 17592170 <GO>}

The contract is for 100% of the contracted volume. If they don't deliver 100%, the deliver or pay kicks in. If we don't take, the take or pay kicks in. There is a two months period for managing -- two quarters, for catch-up for both sides. So there is no threshold for the deliver or pay to kick in. It's 100%. If they don't deliver, deliver or pay. If we don't take, it's take or pay. But there's six months catch-up.

Operator

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Next we have Andre Hachem from Itau.

Q - Andre Hachem {BIO 20209966 <GO>}

I have two questions. My first question is related to the vinyl cycle. If I understand correctly, the up-cycle in vinyl was caused by the ban on mercury in the manufacturing process. How long do you think this cycle will last? And what is currently happening to (inaudible)?

My second question is related to Mexico. What is being done to address the lack of ethane supply to the projects? Is there any long-term solution in mind?

A - Fernando Musa {BIO 17592170 <GO>}

Hello Andre, when we think about the vinyls business, I would say there are several trends that are leading to increase in spreads and profitability, both on the PVC side and in the caustic soda chlorine part of the business. There is a series of capacity that has been shut down and will be shut down, in Europe especially in the chlor-alkali side, which is reducing availability. Part of it is for old technology mercury-based, but also asbestos-based technology that has been shut down. There is quite a lot of capacity also in China that is the carbide technology that starts from coal, that also is being shut down by the environmental tightening that I mentioned in Hassan's question.

So on the chlor-alkali side, it's clearly I would say, a reduction of production capacity around the world, not a lot of significant investments being made, and positive demand on the caustic soda. When we look at the PVC side, we see a market where very, very little new capacity has been built over the last five to 10 years. Most of it was built in China. And this capacity, a lot of it was on this carbide route, which is not very competitive base. And some of it is being shut down by the government for environmental reasons.

So we have a market that has very low utilization rate over the years, as low as 75% globally, which is benefiting from some marginal capacity shutdowns, but a strong global growth from a demand side. Given that there are no relevant new PVC additions from a capacity point of view announced, our expectation is that this reasonable growth that we're seeing in the markets will lead to an increase in utilization rates over the next years, which should lead to improved margins in that chain. So when you combine those two, we're seeing positive trends, both for the chlor-alkali side of business and to the PVC side of the business.

Having said that, we might see investment announcements coming in the near future, because everybody's seeing those trends. The challenge here is that those projects might take four, five, six years, given the complexity, especially if you're thinking integrated complex. And so we'll probably enjoy three to five years of positive increase in operating rates for PVC and healthy margins in the caustic soda as this market unfolds.

In Mexico from a supply point of view, as I said, we have a very strong contract. We have been having very good months in the past, and the last few weeks have been very positive. There is a challenge from availability in the markets that in the short term, Pemex

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is solving it by imports. And in the mid-long term, the energy reform should lead to investments that could and should put the production back at a pretty healthy base.

As we progress over time, we will continue the dialogue with our suppliers to make sure that they comply with their obligations under the contract, which they are doing, either increasing the supply as I mentioned, in recent past, or whenever they can't pay their deliver or pay penalties. And it is clear that the supplier has the intention to fulfill the contract and maintain a healthy flow of feedstock for our plants.

Operator

Next we have (inaudible) of Citigroup.

Q - Analyst

I have two questions, a little bit more detailed ones. So the first one is regarding your purchases of naphtha. So reconciling also with the numbers that Petrobras provided, I see you purchased around 50% to 55% of naphtha from Petrobras, while historically this ratio used to be 70%. So I was wondering if there is more space to import more naphtha? And also if you could provide some color in terms of how much this change in strategy, how much does that impact your results. That would be my first question.

And then my second one would be in terms of the Mexico plant. I'm trying to reconcile here the results that you booked from the third quarter of 2017 around \$14 million. I'm just trying to understand whether this \$14 million is exactly the difference between the utilization rate and what is stipulated in your contract, so between 87% and 100%? Or is there still sort of more impact related to the third quarter?

A - Fernando Musa {BIO 17592170 <GO>}

Okay. So I'll start with naphtha. Our consumption based on capacity is around 10 million tons of naphtha per year. Our contract with Petrobras is for 7 million tons per year. It includes a series of flexibilities around volume that are typical in this type of contract. And over the years, especially after the new contract was signed in December 2015 with the pricing going to 102.1% of the reference price from European markets, the feedstock team has increased our imports, direct imports. We historically imported the 3 million tons that are not supplied through -- cannot be supplied through the Petrobras contract.

And we have, over the years, developed a portfolio of other suppliers, either through contracts or spot purchases, that create the ability for us to do this type of swing. So depending on the market conditions, depending on product quality from different naphtha that are available from the production planning based on what products we want to produce because some naphthas will yield more ethylene, others will yield more aromatics, we'll make decisions based on, as I said, production planning, logistics, the pricing and the payment terms of those different sources. This management is done on a daily, weekly, monthly basis, and leads to the decision that is best to Braskem, which in the recent past, has been towards more of a balance, as you said, 50%, 55% from Petrobras under the contract, and the balance being imported directly by Braskem.

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Our ability to import is significant, as you can see. We import consistently close to 50%. We could import a little bit more. It would be, as of today, a big challenge to go to 100% imported not from Petrobras, given the challenges that we face in the cracker in Sao Paulo, where the logistics access is a little bit more challenging. We have good logistics in Bahia and in (inaudible) but Sao Paulo, being landlocked is a bit more challenging not to use the Petrobras infrastructure and the Petrobras contract.

So the decision to go towards that is, as I said, an economic decision based on logistics planning from the different crackers, the expected product portfolio that we want to maximize, the pricing of the different contracts and the payment terms of the different contracts.

In Mexico, as I said in the previous question, the logic of the contract is if Pemex does not deliver 100% or if we do not take 100% of the contracted volume of feedstock, we will receive deliver or pay, or take or pay penalties. So the number that was booked relative to the first quarter is this calculation. So Pemex did not deliver enough ethane, they would have two quarters to catch up, because they did not catch up, because they undersupplied as well given the utilization rates that we shared in the fourth quarter and in the third quarter. We know that they can't catch up now. Therefore, this was booked in the first quarter.

We should get the cash payments in the second quarter. There are some delays between the booking, the recognition of this and the payment. It's important to notice that this is on the feedstock utilization rate is on the capabilities of the plants. We have inventory of ethane, we have inventory of ethylene. The PE plants have different utilization rates. So it is very close, but it's not a direct translation from the utilization rate to the feedstock.

Q - Analyst

Okay, I see. It's just that you booked in the third quarter around 270 million of revenue. And now you just received 14 million for a utilization rate difference of 13%. So it seems to be quite low compared to what you booked in the third quarter. If you can comment a little bit more on that, if I'm doing the right math.

And then just a follow-up question on the first one, are you able to say how much of your cost improvement in terms of this 15%, 20% more that you're now importing, how much that has actually hit on your results of importing naphtha?

And in addition to that, given that the oil price is now around \$75 per barrel, can you mention if there is any -- if that has triggered any revision in your current naphtha contracts?

A - Fernando Musa {BIO 17592170 <GO>}

So on the Mexico side, just to be clear, the deliver or pay, or take or pay has a connection to the price of the feedstock, not to the revenues. So you mentioned the revenues, I'm not sure why. It's a direct proportion to the feedstock. So the ethane prices have nothing to do with the revenue. So as I said, if there is less ethane supplied to us, there is a

penalty for each ton of ethane. And that's how the logic works for the deliver or pay, or take or pay.

As far as for the naphtha purchases, if I understood your question, we make the decisions in how much we take from the Petrobras contract versus other suppliers based on the best economic decision for Braskem. So all the impact has hit either the balance sheet or the P&L because some of the decisions taken, for example during the month of March, might still be in inventory cost and will hit the cost of goods sold during April, or eventually in some cases, might even hit in May. So the decisions were made based on best economic alternative for Braskem, and all the impact has been accounted for. It's either in the results or it's in inventory, either because we still have the naphtha, has not been processed, or we have intermediary products in inventory or finished goods in inventory. The decision is made in March, and most of them will lead to results in April.

Operator

Next we have Leonardo Marcondes of UBS.

Q - Leonardo Marcondes {BIO 20870206 <GO>}

My first question is related to the naphtha contract. Mr. Musa mentioned it earlier that 2019 would be a more adequate moment to negotiate the extension of the contract. My question is why 2019? Don't you think that the earlier Braskem negotiated the contract, the better for investors to have more visibility on the case?

And my second question is regarding Odebrecht. Odebrecht entering the grace period, which is non-payment of bonds. I'd like to know how do you guys see this impacting Braskem?

A - Fernando Musa {BIO 17592170 <GO>}

Okay, Leonardo, first on the naphtha contract. I see your logic for having more certainty. The sooner the better for the investors. But from a commercial point of view, we need to negotiate at the time that is close enough to the expiration of the contract. It's important to remind ourselves that these are long contracts, extremely relevant. So if we started negotiation too soon, the market conditions when this volume kicks in could be very different.

Anyway, this contract if we start the renegotiation, it would kick in as of 2021 anyway. So the challenge here is we don't want to do it last minute because of the complexity, but we're not even at the midpoint of the contract yet. So in the conference call with the press in the morning, I mentioned 2019 because I don't want to leave it for 2020 when we are kind of 12 months out. And right now, we're just hitting the midpoint. So anywhere between the next 12 to 18 months, we should be having a dialogue around this contract with Petrobras for a renewal that will kick in early 2021.

As far as the Odebrecht situation that you mentioned, there is no direct relationship between Odebrecht and Braskem, except the fact that Odebrecht owns 38% of our

shares. This is a topic for Odebrecht to evaluate. We don't have any, as I said, direct contact. And I suggest you address your questions to Odebrecht, because I don't have much to say on that topic.

Operator

(Operator Instructions)

At this time, we're showing no further questions. We'll go ahead and conclude today's question-and-answer session. At this time, I'd like to hand the conference back over to management for any closing remarks.

A - Fernando Musa {BIO 17592170 <GO>}

So I would like to thank all of you for participating in the call and for the questions.

A couple of final messages here. I want to reinforce the strength of our strategy and the results that are coming out of it. It was a strong quarter from a cash flow generation, a strong month from a EBITDA generation. A bit challenged when we compare to last year's first quarter, given the exceptional results we had in the first quarter last year, but some very good results from earnings, from EBITDA, from cash flow generation, which confirms that our strategy of focusing on productivity and competitiveness, diversification of feedstock and flexibility of feedstock, and the diversification from a geographic point of view is paying off.

One topic that was not mentioned during the Q&A that we'd like to reinforce is also the fact that Braskem's portfolio today is pretty hedged against the specifics of the Brazilian economy. First because a relevant part of our revenues and operations are outside of Brazil. Second because as demonstrated during the recession years in Brazil in 2014, 2015, 2016 with significant decline in local demand, we were able to use our global presence to continue to generate increasing results every single one of those years, despite the challenges that Brazil was facing. And finally, given our business model in Brazil being basically dollar-driven, both on the feedstock side and on the pricing of our products, any relevant depreciation of the real, as we're facing in the last few days is actually a positive for us. It makes the small base of fixed costs and other costs that we have in real denominated. It makes us more competitive when measuring in dollars, which is the key driver given that we sell linked to a dollar-denominated indicator and buy the feedstock linked to a dollar-denominated indicator.

So as Pedro mentioned in his presentation, our expectation for this year is a solid result, lower EBITDA compared to last year, but still very, very positive and strong results, better cash flow generation from last year. This was one of the key drivers for the decision and recommendation that was approved at the general assembly for the payment of BRL2.5 billion, i.e., an additional BRL1.5 billion that is paid to date on top of the BRL1 billion that was paid in December. We are increasing our CapEx program compared to last year, not only because of the new PP plants in the US, but also a series of other improvements in capacity and debottlenecks, and improvements, small ones around the world.

So we'll continue to invest in our plants, invest in our people, invest in our process to serve our clients, and continue delivering on our strategy that has been very successful up to now.

Thank you very much and looking forward to the dialogue in three months' time with the second quarter results.

Operator

Sir, we thank you and the rest of the management team also for your time today. Again we thank you all for attending today's Braskem's earnings conference call. At this time, you may disconnect your lines. Thank you again, everyone. Take care and have a wonderful day.

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