Q2 2005 Earnings Call

Company Participants

- Jose Carlos Grubisich, CEO
- Jose Marcos Treiger, IRO
- Paul Altit, CFO

Other Participants

- Aaron Holsberg, Analyst
- Daniela Guanabara, Analyst
- Denis Parisien, Analyst
- Eric Ollom, Analyst
- Teresa Mellors, Analyst

Presentation

Operator

Good morning, ladies and gentlemen. At this time, we would like to welcome everyone to Braskem's 2Q '05 and 1H '05 earnings conference call. Today with us we have Jose Carlos Grubisich, CEO; Paul Altit, CFO; and Jose Marcos Treiger, IRO from Braskem. 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's remarks are completed, there will be a question-and-answer section. At that time, further instructions will be given. (Operator Instructions)

We have simultaneous webcasts that may be accessed through Braskem's website, www.Braskem.com.br. The slide presentation may be downloaded from this website. Please feel free to flip through the slide 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 in 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's 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 will turn the conference over to Mr. Jose Marcos Treiger, the IRO from Braskem. Mr. Treiger, you may begin your conference.

Jose Marcos Treiger

Ladies and gentlemen. good morning. On behalf of Braskem, I would like to welcome you to Braskem's quarterly conference call. And I would like to thank you all for attending it. Having said that, we will start the brief slide presentation, followed by a Q&A session, during which our CEO, Jose Carlos Grubisich. And our CFO, Paul Altit, both here by my side, will answer your questions.

Let us go forward, then. Let us start now on this slide number three, where we are showing the first half of 2005 highlights. As you can see, the Second Quarter of 2005 was again quite a challenging period for both the petrochemical industry and for Braskem as well, mostly in the Brazilian domestic market. Our Company, though, has a high level of commercial flexibility, being able to direct high sales volumes to the export markets whenever the domestic market's demand may show signs of slowing down. And therefore, in these first events of 2005, Braskem was able to maintain its high-capacity utilization rate and to increase its production output by 14%, while the average production growth registered by the petrochemical industry as a whole in Brazil was only 6%. Therefore, our exports grew by approximately 70%.

This is a substantially high index, especially, don't forget, the Brazil petrochemical industry average growth for the same period, which registered exports growing by 25%. At the same time, it is worth noticing or mentioning that our Second Quarter domestic sales decreased by 5.5%, while the Brazil market as a whole posted a drop of 8%. Additionally, total sales of our main resins grew. And grew by 7% when compared to the first six months of last year.

During the Second Quarter of 2005, declining prices in international markets, combined with the strong appreciation of the Brazilian real against the U.S. dollar, which reached 12%, have momentarily contributed to the increase in imported volumes of resins into our market. For the Third Quarter of 2005, though, we expect a better scenario, based upon the possibility of a more stable and less appreciated real, coupled with a recovery in the international prices.

Focusing on our first-half 2005 results, it is important to notice that we totally met revenue growth of 22%. Our costs were pushed up by the increase in naphtha price in the international markets, which reached $521 per ton in April. And despite this excess of pressure [ph], though, Braskem's EBITDA, when measured in U.S. dollars, grew by 27% compared to EBITDA I prefer to mention [ph] of 2004. We believe that this is again a strong evidence of Braskem's operational excellence, as well as of the competitive business of the Company's integrated model, which is unique in our region. Following these solid results, net income increased 926 million real, reaching 634 million in the first half of this year.

Moving ahead, let us go now to slide number four. Here on slide number four, as I said, we see the maintenance of high-capacity utilization rates in the production lines of our main products and the consequent increases in production outputs as compared to the Second Quarter of 2004.

Ethylene production grew by 4% and the production of resins by 11% over the Second Quarter of last year. Polypropylene production posted a significant growth of 28%, reflecting secured operating motility [ph]. Also concerning operational efficiency and reliability, a new record in the production of polypropylene market achieved with 48,300 tons of this resin being produced just in May 2005 alone.

In terms of sales. And comparing, again, the Second Quarter of the current year with the Second Quarter of last year, performances we have -- the ethylene sales increased by 4%, while the total sales volume of resins grew by 2%. Additionally, by making use of our commercial and strategic flexibility between local and international markets, Braskem posted in the Second Quarter of 2005 a record performance in the export markets, registering a 12% dollar-denominated growth in revenues over the same period of 2004.

Let us move now to the slide number five. And here we are presenting the financial respects observed in the Second Quarter of 2005, resulting exactly from the operational performance we have just analyzed. As we can see, for the Second Quarter of 2005, revenues increased by 8%, focused on exports, which grew by 12%, reaching almost a quarter of $1 billion in just three months.

On the other hand, EBITDA presented a 7% reduction due to the reflection in the domestic market, combined to record naphtha prices, which reached to $521 per ton last April. In July, naphtha prices have declined 12%. And currently, as we know, they are below the $500 per ton level.

At the same time, continued efforts made by Braskem to reduce its investments and to lengthen its debt profile enabled a reduction of the net debt over EBITDA ratio of 16% in the quarter alone. As a result, our net income, resin, in the Second Quarter was of 428 million reals, representing a remarkable improvement of 730 million reals when compared to Braskem's bottom line in the Second Quarter of 2004.

Now, moving on to slide number six, we see Braskem's accumulated performance during the first half of 2005. In this period, gross revenue grew by 24%. And what's more, exports played an important role, registering a 44% increase and reaching an impressive level of revenues of $0.5 billion. EBITDA for the 2005 first semester increased by 10%, in comparison to the EBITDA rates after the first six months of 2004. This increase is primarily due to better prices practice in 2005 since international express [ph] presented a significant increase when compared to the same period last year.

As expected, the net debt over EBITDA rating as of June 30, 2005, is having an impressive reduction when compared to the Company's indebtedness level as of December 2004. The reduction from 1.52 in December 2004 to 1.08 in June 2005 is even more significant than the degrees registered in the Second Quarter alone, which represented a drop of 29%. As a result, net income on June 30, 2005, reached 638 million reals, which is just 54 million reals lower than the 2004 total net income level. We forecasted the first half of 2004 performance, net income was 900 million reals higher than the current year.

Let us move now to slide number 7, please. Here, on slide seven, we are presenting Braskem's main economic and financial indicators. As we can see, Braskem had net revenue of 2.9 billion in the Second Quarter of 2005, 5% higher than the 2.7 billion revenue update in the same period last year and in line with the 8% increase in gross revenue.

The corporate EBITDA margin declined by approximately 200 basis points due to naphtha price increases registered both in the Second Quarter and in the first half of 2005. And due to temporary reduction in the international prices for resins, as previously mentioned. Nevertheless, our margins were kept around 20%, amongst the highest margins worldwide and the highest one in Latin America, according to our own research.

As a result of Braskem's continued efforts to reduce its investments, coupled with the 12% appreciation of the Brazilian real against the dollar during the Second Quarter of 2005, our financial result was positive in 137 million reals, representing an improvement of approximately 750 million reals when compared to the same period of 2004.

In the first half of the current year, Braskem's financial result was a net expense of 107 million reals or almost 1 billion reals higher than the financial result for the first half of 2004. The equity result was also positively impacted by the appreciation of the real. This reflects the results of Braskem's overseas subsidiaries. In terms of free cash flow, we highlight the 522 million reals generated in the Second Quarter of 2005, reaching 1.1 billion reals in the first half, a 731% increase year-over-year.

Let us move now to slide number eight. Here, we are showing Braskem's debt profile. We have also our very highly liquidity levels. As we can observe, Braskem entered the Second Quarter of 2005 with net debt of 2.9 billion reals and an average maturity of 9.2 years. In July, we have refinanced a significant previous bond which would be due in 2007. Therefore, average pro forma debt maturity as of July 31, 2005, should be a little longer one or 10 years. We also maintained a%age of U.S. dollar-denominated debt equal to 68%. The current weighted-dollar cost of our financing is up 7% per annum.

Now on slide number nine, we can see the improvements obtained in the implementation of our Braskem + Program, which has long gains of substantially increasing our productivity levels and operational efficiency. Braskem + is planned to be concluded in 2007, capturing approximately 420 billion reals in productivity gains on an annual and recurring basis.

In fact, the results posted by Braskem -- by Braskem + since its very implementation has exceeded our expectations. The teams involved have reached results that are significantly better than those expected until the first half of 2005. As a matter of fact, off of the 170 million reals in productivity gains anticipated for 2005 for this entire year, 192 million reals have already been captured by this program. This result is already approximately 13%

higher than the total amount expected for the entire year of 2005 and 37% higher than the 140 million reals planned up for the first semester of the current year.

As we can see on slide number 10, Braskem is reinvesting already for two years in de-bottlenecking its production facilities, aiming at becoming one of the most competitive petrochemical companies worldwide. Currently, its annual production capacity including petrochemical and byproducts is a 5.8 million kt [ph] by the end of 2005. The end of 2005, we will have added another 50,000 tons of PVC production capacity, as well as 30,000 tons of polyethylene.

Among the new events and project, we highlight the Paulinia Project, recently approved by the Board of Directors. This project consists of 300,000 to 350,000 tons of polypropylene per annum, in terms of our polypropylene sales, to be built in a joint venture with Petrobras, where a 60% stake will be held by Braskem and the remaining 40% by Petrobras.

The facility will use formula-grade polypropylene supplied by Petrobras. Total investment of this project is of $240 million, while approximately 30% is expected to come from shareholders and the remainder through a specific project finance. Operations are scheduled to start by the end of 2007. Net present value of this investment is approximately $200 million.

And in addition to this project in Brazil, the internationalization process of Braskem is evolving. And recently, we announced an important partnership with Pequiven in Venezuela to build a polypropylene plant in addition to conducting our feasibility study for the construction of a new petrochemical complex using the Bolivian natural gas resource on the corner of Brazil and Bolivia.

Well, we are now on slide number 11. And this is our last slide before we begin the financial section. And so far, I think we have demonstrated Braskem's off-cycle [ph] potential for creating value. On the other hand, we all recognize the importance of truly understanding and closely following the dynamics of the market. We would like to conclude, then, by sharing with you our views of the petrochemical cycle with you. We are clearly aware of the strong correlation between resin spreads, the difference between resin prices and naphtha prices. And the supply and demand barrier in the global petrochemical cycle.

Under this scenario, we are considering -- which is supported by internationally renowned consultants -- the upcoming production capacities are concentrated in the Middle East, mainly in Saudi Arabia and in Iran, as well as in China and in Taiwan. Considering that the new capacity, which will have to be added, that surge prices slowly impact the current scenarios practically from 2008 onwards, we observe that in the meantime, there is a supply gap substantially -- instantly [ph] the Iranian profits continue to be observed.

On the other hand, the Middle East is expected to keep growing, although at a slower pace possibly. Therefore, Braskem estimates for prices and margins to remain positive, even if it gets approval -- or cannot apply at (inaudible).

I'd like to now to open up for questions and answers -- the second part of our meeting over the Internet. And I thank you all for hearing our message.

Questions And Answers

Operator

(Operator Instructions) Daniela Guanabara, Pactual.

Q - Daniela Guanabara

You've mentioned in the Portuguese conference call a price increase of 10% for polyethylene and polypropylene for August. I'd just like to know if those higher prices are already fully implemented?

A - Jose Carlos Grubisich {BIO 2072165 <GO>}

Grubisich speaking. We just announced this price increase, 10% for polyethylene, 12% for polypropylene. It started first of August. But it is still too early to confirm if the prices will be in fact increased as planned, because there is a high concentration of orders in the end of the month. So it is still too early to make the final decision on that. But we think that the positions are there for a significant price increase because prices in Asia have been going up since the middle of June. And we think that the supply and demand balance are unstable for a price increase.

Q - Daniela Guanabara

Okay, thanks. The second question is about CapEx. You gave a guidance of 650 million reals budget for 2005. In this amount, do you include maintenance CapEx?

A - Jose Carlos Grubisich {BIO 2072165 <GO>}

We have a total 600 million reals spent for 2005. We invested already 230 million reals in the first half. And we estimate that we're going to have the full 600 million reals because the investments in Paulinia will start in the Third Quarter -- this quarter '05. And we're also implementing the investment of PVC in Alagoas and we are expecting to start up the operations in the Fourth Quarter of '05. So we're going to speed up the investments in the service in Fourth Quarter. And we have part of the maintenance, which is not the maintenance costs, which is CapEx. But what is current maintenance cost is in the cost of products sold.

Q - Daniela Guanabara

Okay. And can you give me a guidance for CapEx for '06?

A - Jose Carlos Grubisich {BIO 2072165 <GO>}

We do not have yet the CapEx for '06, Daniela. We think it's going to be in the same ballpark -- 600, 700 million reals. But we have not put together yet the final CapEx program for next year. We're going to have a big impact of Paulinia because we're going to start the investment this quarter. And we do expect to have the investment in operation by the end of '07. We do intend to decide yes or no, this investment in this new $400,000 for the polypropylene price in Venezuela, which would start definitely in 2006. But we're going to invest at least the same amount we are investing in 2006 of 600 to 700 million reals. We could eventually go beyond that if we have a new investment with very attractive and high internal rates of return.

Q - Daniela Guanabara

Okay, thanks. Just the next question -- out of this 600 million for this year, how much is Paulinia?

A - Jose Carlos Grubisich {BIO 2072165 <GO>}

Just a moment. Hello?

Q - Daniela Guanabara

Hi. I'm here.

A - Paul Altit

Our plan is to invest between 30 to US$40 million until the end of this year.

Q - Daniela Guanabara

30 to $40 million?

A - Paul Altit

Yes. That's for 100% of the investment, okay? So as we have 6% equity position in terms of cash, we're going to invest less that.

Q - Daniela Guanabara

Okay. Thanks.

Operator

Aaron Holsberg, ABN AMRO.

Q - Aaron Holsberg {BIO 6234516 <GO>}

Given the fact that you've just increased prices, are you expecting an increase in domestic demand and domestic volume relative to the Second Quarter?

A - Jose Carlos Grubisich {BIO 2072165 <GO>}

Yes, Aaron, we do expect the recovery in volumes in the Brazilian market. In fact, we had already an increase in sales and therefore products in July. We think that during the Second Quarter, there was a reduction in inventories along the production chain. And we got better sales in July. And we think this might be the track for the second half of the year.

So we are expecting in recovery in volumes in the domestic markets in the second and third and Fourth Quarter, we see a very consistent volume recovery in Argentina. And this is going to be combined with a recovery in selling prices in the global market. So we are expecting even that the spreads go up in the Second Quarter period.

Q - Aaron Holsberg {BIO 6234516 <GO>}

Okay. And I guess my other question is you ended the quarter with 1.2 billion in cash on your balance sheet. Admittedly, you're prefunding the call of the Trikem bond. But how much cash do expect to have when you end the Third Quarter? Like, how much do you plan to use to pay down or prepay that?

A - Paul Altit

This is Paul. Thanks for the question. Yes, you are absolutely correct in the sense that we had a higher cash because of the call we did at the end of July. We have the financial performance here, which probably demands us to maintain in cash at least one month of payments, which is more or less something around $500 million. We have a monthly payment of debt. So we're bringing down 100% of everything in front of us between the next couple of months until December. So we're not providing the market with a specific number. But we should end the Third Quarter with still a very important amount of cash. And from December also, we'll have a very important amount of cash as compared to 2006 payments. So Braskem will maintain a very liquid and solid position.

Q - Aaron Holsberg {BIO 6234516 <GO>}

Okay. And I guess my final question is the kind of the rationale for the Venezuela project -- I mean, this would be your first production capacity outside of Brazil.

A - Jose Carlos Grubisich {BIO 2072165 <GO>}

Yes. In fact, we have two projects which we could consider outside Brazil. The first one is the (multiple speakers) petrochemical complex in the corner of Brazil and Bolivia. And we keep working on that as planned. So we are working very much on technology selection, distribution of the product mix, high-density, low-density, medium-low-density. We need to make a final decision on the best portfolio published in investments and we are working very much also to decide what is now worldscale because we do want to have this Bolivian project to be, which is very competitive. We do want to have the most competitive projects for polyethylene in the Americas.

And we think that on a different basis, it's going to be as competitive as any project in the categories. Everything that at the present volatility in Bolivia is not in the quick compares for our decision. We do expect to have all the information put together to make a decision in the second half of 2006. And we do expect to have this project in operation by the end of the period [ph].

And as for the project in Venezuela, the concept behind this is to go to places where we can find reliable and very competitive fixed stock. Bolivia is very competitive natural gas. And in Venezuela, we have good indication that we can build a very competitive project base for low-cost propylene from the refinery. And the Venezuelan project would be in a position to supply the domestic market in Venezuela, which is presently 100,000 tons. It's marked with the potential growth.

Out of Venezuela, we would supply the markets in the Pacific with -- and in South America and eventually have product available to export to the U.S. market and to the European market.

Operator

(Operator Instructions) Denis Parisien, Standard New York Securities.

Q - Denis Parisien {BIO 20333702 <GO>}

I'm wondering, in the previous couple of conference calls, you gave us some guidance that you -- well, you told us that you expected naphtha prices to decline in the second half of the year. I mean, obviously, the recent trends in energy prices suggest that that might have been a little optimistic. Have you altered your view of how your cash generation and your EBITDA and free cash flow might be by the end of the year. And how that might have an impact on your net debt to EBITDA ratio?

A - Paul Altit

Dennis, in fact, we use it as guidance for oil and naphtha -- the market guidance. So we in the beginning of the year, we have the expectation that oil would maintain itself at a very high level. But probably coming down slowly throughout the year, which unfortunately did not happen. What did happen in the last couple of few months is that the correlation between naphtha and oil did decrease slightly in the sense that eventually naphtha could be at a higher price than it is now if it maintained the same correlation it had six to eight months ago. So this went in our benefit.

Looking forward, we still believe that oil should maintain a high value for this year, certainly between 50 and $60 per barrel. We don't believe it should be different by the end of the year. We still believe that naphtha should maintain a high price. But we still also believe in principle that the commercial practice should recover and it should move up slightly in the second half, with a sense that we believe that there are chances of increasing margin in the second semester, in principle, this is our thought.

When we look at the disposition also, take into consideration that we believe that the local domestic economy should also increase in the second half and that also potentially be producing slightly more resins and starting the new production of 50,000 extra tons of PVC and 30,000 extra tons of polyethylene in the last quarter. We believe that this should be enough to push us ahead a better performance in the second half. This is our expectation in principle.

Regarding cash flow, we have been having a very strong cash flow. We had 1.1 billion reals of net cash in the first half. In principle, we believe in the second half we should have net cash pretty much in line with the first cash. So we have quite stable working capital demands. And in this sense, comparing '05 with '04, we believe our cash should be increasing at a very important substantial increase of EBITDA, specifically in dollars, not related currency.

Net debt to EBITDA -- we're on 1.1. And by the end of the year, we should be pretty more on the leverage. So this in one sense is a kind of a concern in the sense that we don't want to push work up. So our rate of cost of capital has to be at a competitive level. And it starts becoming to other leverage [ph]. So we can be flexible in the sense that we can manage financing with suppliers, we can manage eventual possibilities of integration of the petrochemical sector in Brazil within the next couple of months. So we have flexibility of maintaining net debt to EBITDA between 1 and 1.5, which we believe would be enough to maintain a good level of rating and a good profitable capital.

Q - Denis Parisien {BIO 20333702 <GO>}

Thank you for that very thorough answer. If I may follow up a little bit, in the Second Quarter, did you guys discount domestic prices in line with the decline in international prices?

A - Paul Altit

Dennis, if you look -- if you go back to 12, 18, 34, up to 52 months behind us, you will see that local practice, international practice in Brazil, which means international practice plus logistic cost plus taxes. And I had mentioned, too, the expenses and insurance before. But we have a very strong correlation of our own dealer lines. What happens is that when you have devaluation of the real, we normally have a lag of aligning prices by two up to five months. But in the other way around, when you have appreciation for the real, which is exactly what's happened, we tend to have a slight increase in local margin, which is exactly what's happened in the first half.

So despite the fact that the domestic economy didn't grow or didn't grow as much as we thought it would, we have the advantage of the appreciation of the real in the sense that this gave us the opportunity of mitigating this effect. And therefore maintaining prices for a longer period of time in reals, which meant increasing price in dollar-denominated because of the appreciation of the real. And therefore helping us to maintain a reasonable, fairly good EBITDA margin.

Q - Denis Parisien {BIO 20333702 <GO>}

Perfect. And when you say that you are expecting -- I mean, we see in the price series that are available Bloomberg, there's already been a fairly good recovery in international prices. But do you think that they will get all the way back to where they were toward the beginning of this year?

A - Paul Altit

Well, as you know, this is a forward-looking statement. So we have to be careful. Yes, we believe that China should be purchasing more, importing more. And we're pretty much in line with the international analysts in the sense of (inaudible) international analysts. We believe that in the second half, we should have prices moving to a level higher than this was as an average in the first half. We are expecting -- this is our expectation here.

Q - Denis Parisien {BIO 20333702 <GO>}

Thank you. And I -- if things don't work out that way, I won't hold you to it. Your guess is as good as mine. The last, just a quick one -- I know you said in your press release and you repeated during the conference call that your average cost of debt in the Second Quarter has gone down to 7%. Could you tell me what that was in 2004, please?

A - Paul Altit

Yes, Denis. What's happened, I think it's easy to understand that we are really pushing down debt and maintaining liquidity. So I think what has happened in this Second Quarter for Braskem in the sense that we're funding CapEx with CapEx funding -- we're not funding CapEx with other kinds of funding, which means that, yes, we have been funding CapEx with 5 to 5.5% a year average all-in costs, which means all costs included between 5 and 6%. We have been funding imports, nothing for us for a very competitive around 0 to 5 and 6%. We have been issuing bonds. So a much lower price than we paid two years ago, a revenue funding CapEx with the National Development Bank in Brazil, which is TJLP plus 3.5 to 4% a year, which is more or less 6, 65% of CDI, up to 70% of CPI.

We have been funding CapEx in Brazil with the National Development Bank, which typically would charge us 12% fixed rate, which is cost [ph] anytime. And this is 12% as compared to 19.5% of CDI. It's very competitive for us. We have been launching the fences [ph] in Brazil for 104% of CDI. So yes, the cost of capital is really coming down. So this is the good news and with the good liquidity. So this is helping us to decrease overall financial costs.

So financial costs are coming down due to three main reasons. First of all, reduction of gross debt and net debt, for sure. But secondly, reduction of cost of capital. And the third reason is that we're managing working capital at a much more competitive rate than we were doing probably one year ago. So the working capital also is costing much less than it did a year ago.

Q - Denis Parisien {BIO 20333702 <GO>}

Thank you for that extremely thorough answer. But could you tell me what the comparative figure was for 2004 on average -- the one that we compare to the 7% in the Second Quarter?

A - Paul Altit

I would say our dollar-denominated debt in '04 should be around 8.5%, more or less. And probably it's around 7% by now.

Q - Denis Parisien {BIO 20333702 <GO>}

Thank you, very, very much.

A - Paul Altit

Again, just to give you an idea, cash and property in '02, Denis, we were probably paying up to 125, 130% of CDI. And if you look at our recent transactions, which were totally announced in the markets, we were funding around 104, 105% of CDI, we should be doing some receivables and stuff, funds in Brazil for 103% of CDI. So really the cost of capital isn't really coming down. And because we're using much more debt in the hefty [ph] and Banco more debt [ph], which are two of the local banks, for much lower cost than we did two or three years ago, because our rating is moving up, this is also helping us to decrease cost of capital.

Operator

Eric Ollom, ING.

Q - Eric Ollom {BIO 4374335 <GO>}

Most of the questions have been asked. I guess just two questions. One, you mentioned about the higher degree of imports in the Brazilian market due to the real appreciation. Could you just elaborate a bit on that? What is the current market share of imports and where are your expectations going forward? And then the second question would just be the project finance, I suppose, for the 70% of the Paulinia Project -- could you just give us some details on that? Has that been incurred yet? When will we -- when will that be incurred and who will be the supplier of that?

A - Paul Altit

Okay, just starting by the Paulinia Project, Paulinia is a $240 million investment. If you add working capital, this number could go up to 270, $280 million. We will fund this together with Petrobras. We have 60% of this project. Petrobras has 40% of this project. 30% of this will be funded with equity.

So in principle, most of our CapEx was 30/70 -- 30% equity and 70% debt. And we are funding the 70% with spending these [ph] numbers low, which will cost us around TJLP plus 3.5. The TJLP we pay now is around -- between 9, 9.5%, it's gone up strong, plus 3.5% in local currency. And we are importing between 25 and $30 million, which we should use in net financings key from Japan. We have been doing some transactions with -- the debt is 95% guaranteed for commercial risk. And I believe 90%, if I'm not wrong, don't hold me to that. But I think between 90% for political risk. This means in terms of funded for investment-grade costs. So, the overall cost of this financing should be around 5% a year approximately -- between 5 and 5.5% of us. And so this is how we are funding Paulinia.

Regarding imports, what happens are falling [ph] -- when you have a certain period of time with depreciation of the real, some clients tend to think more opportunistically. But we believe that the industry as it is structured in Brazil cannot support a permanent height of volume of imports because of logistic problems, because of the necessity of having more LC issued by medium-sized companies. So we have -- the real got so strong against the dollar specifically in the Second Quarter that we believe that this should not be a trend in the sense that the imports typically in the first half we believe were higher than average. So Brazil typically, imports are 20% of the market and typically we export around 20%.

But we must also take into consideration that the softened core market really is becoming more and more integrated. So when we account -- most of these imports are still coming from Argentina. And so Argentina and Brazil are becoming more and more integrated in the sense that our prices for exports to Argentina, our polyethylene, polypropylene, for instance, are pretty much in line with our internal prices. So you have to look at logistics, decisions of importers, even the exports. But Brazil should not be importing more than 20%, as I mentioned.

Q - Eric Ollom {BIO 4374335 <GO>}

And in terms of this above-average imports in the first half, is it from the customer or from the producer side?

A - Paul Altit

It's basically coming from customer. Maybe I will ask Carlos to give you a little bit more detail on that for Eric, please.

A - Jose Carlos Grubisich {BIO 2072165 <GO>}

What happened is that we are driving our commercial policies to occupy if not surmise [ph] profitability. So what happened is that we increased our premium to import price right in the second half -- in the Second Quarter. And we replaced the profitability more than market share. So some customers took advantage of the set rate of the decline in prices in the international market and they decided to spend at least 0.1 for [ph] Brazil.

We have, as Paul mentioned, a constant flow of polyethylene that has previously come in from Argentina. But you know that we consider that Brazil and Argentina we are talking about an integrated market. There is a consistent flow of importation from Argentina and exports from Brazil to Argentina. So that is going to continue. But we do not see any major impact from importation from customers outside this episode.

We think that the extent rate expectation is changing. So people are more than -- they're going to have the devaluation of the local currency. The international price will go up. So we think that the importations will fade out in this Third Quarter. We still feel very much focused on margin improvement. And in this we increased our market share because we sold more than our competitors in the Brazilian market Second Quarter.

Operator

(Operator Instructions) Teresa Mellors [ph], Citigroup.

Q - Teresa Mellors

A couple of questions on demand. First, on PP and PE [ph], we saw -- you mentioned that we saw a decline in EBITDA at your customers' level during the Second Quarter. But for these two products we saw increase in your inventories. Do you think you are going to have any problem to pass through these products to the customers in the second half of the year, or the pickup in demand that you already start to see in July is really going to be able to have the store for these higher inventory levels?

A - Jose Carlos Grubisich {BIO 2072165 <GO>}

First, we have a very clear position in terms of operational management. We have been very consistent in that policy. We have -- we are running all our production facilities close to capacity because we understand our organization is the leader of the game in petrochemicals. And we are increasing capacity on one hand and increasing our utilization rates of our capacity. So you can see that Braskem is producing every quarter more tons of polyethylene, polypropylene and PVC.

First priority is to sell as much as we can in the Brazilian market, taking into consideration that we do want to maximize profitability. We do not play market share. But we have the best net back, what we sell domestically.

Second priority and second to the Brazilian-driven strategy is to sell in the regional market, mainly Argentina, because that's where we have the second-best net back. And when we have implemented those two priorities, we decide to go for the overseas market in a more aggressive or more conservative way.

What we did at the end of the Third Quarter, at the end of the Second Quarter, was to retain that stock, expecting that prices and spreads will go up. Okay? We could have sold more. We could have decreased our investments more than what we did. But we didn't. We decided to keep volumes in-house, expected margins and prices to be better in the Third Quarter. So if you be very objective in the (inaudible) space, we can't pass through the volumes in the Third Quarter in the combination of domestic market recoveries, Argentina and the export business overseas.

Q - Teresa Mellors

Okay, perfect. On another -- the other resin and PVC, what's the outlook for pricing in the second half of the year? With this new capacity that you're bringing online, more 50,000 tons, what's your outlook for demand on PVC, if you could talk a little bit about that?

A - Jose Marcos Treiger

Yes. You know, the market for PVC has been a disappointment for us, because the infrastructure housing in Brazil has been going in the wrong way. No major investments. We had major expectations for the PPB the private and the public investment, which did not happen. But what we're seeing now is that volumes are recovering. So inventories by the end of the Second Quarter were very low and customers are back in purchasing programs.

What was also in the Second Quarter is that on a cash cost basis, international prices aligned to the old technology in China. They have separate base of PVC production. And when we see the cash cost of that technology, that's where we had the license of PVC prices and we expected the Chinese cash cost to go up in the second half of the year. And we think that volumes will go up in the Brazilian market. So we think recovery in volumes, a recovery in selling prices, which means a recovery in the profitability for Braskem, because we have a very competitive cost for electricity based here on a local currency. So we're going to benefit from low costs and also profit devaluation off the local currency.

Q - Teresa Mellors

Okay. On these new two possible new PVC projects that could increase your capacity by 100,000 tons, are you holding on on that, waiting to see how the market evolves?

A - Jose Carlos Grubisich {BIO 2072165 <GO>}

Yes. We plan to start the new capacity 50,000 tons with our other investment in Alagoas -- to cap on a strength [ph] of October-November. So no major impact in this supply-demand in 2005. But true in part in 2006. And we keep working on the assessment of the two additional opportunities. So they both know that in Camacari and Alagoas again. But we're going to make the decision through the end of this year. And everything is going to be dependent on the profitability per ton going ahead in this market. The decision is not yet taken.

Operator

(Operator Instructions)

A - Jose Carlos Grubisich {BIO 2072165 <GO>}

There are no more?

Operator

At this time, there appear to be no further questions. I would like to turn the floor back over to Mr. Jose Carlos Grubisich for any closing remarks.

A - Jose Carlos Grubisich {BIO 2072165 <GO>}

I would like to thank all of you for attending this new conference call. We are here to answer to any additional questions you might have. And again, we are very confident that the Brazilian market will recover. And that besides, of course, the petrochemicals worldwide, which is positive. And we think that our margins will go up in the second half of the year. So, thank you very much and hope to see you again next time.

Operator

Thank you. That does conclude today's teleconference. You may disconnect your lines at this time and have a wonderful day.