

Q2 2015 Earnings Call

Company Participants

- Carlos Fadigas, Chief Executive Officer
- Roberta Varella, Investor Relations, Director

Other Participants

- Christina Ronac, Analyst
- Frank McGann, Analyst
- Pedro Medeiros, Analyst

Presentation

Operator

Good afternoon, ladies and gentlemen. At this time, we would like to welcome everyone to Braskem's Second Quarter 2015 Earnings Conference Call. Today with us we have Carlos Fadigas, CEO, Mario Augusto da Silva, CFO, and Roberta Varella, Investor Relations 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 section. At that time further instructions will be given. (Operator Instructions) We have simultaneous webcast that may be accessed through Braskem's IR website www.braskem.com.br/ir. The slide presentation may be downloaded from this website; 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 over to Roberta Varella, IR Director. Ms. Varella, you may begin your conference.

Roberta Varella {BIO 19105478 <GO>}

Good morning ladies and gentleman, thank you for participating in another Braskem's earnings conference call. Today we will be commenting on our results for the second quarter and first half of 2015. We would like to remind you that, pursuant to federal law 11,638 as of 2007, the results presented in today's presentation reflect the adoption of International Financial Reporting Standards.

The financial information in today's presentation has been reviewed by the independent external auditors.

Now let's go to next slide, where we will begin our comments. On slide three, we present the highlights for the second quarter of 2015. The average cracker capacity utilization rate was 93%. If we exclude the Rio de Janeiro site, whose production is limited by the continuing feedstock supply issue, the capacity utilization rate came to 97%. The 5 percentage point expansion over the previous quarter was due to the increase in operational efficiency as a result of process improvements through the past years.

Also contributed to this performance, the recovery of part of the competitiveness of the naphtha-based crackers worldwide due to its cost production improvement in relation to the gas-based crackers, and the capture of basic petrochemicals sales opportunities in international market.

The deterioration in the Brazilian economic scenario and the chain's inventory rebuilding in the beginning of 2015 impacted the demand for thermoplastic resins in the second quarter, which totaled 1.2 million tons, 8% [ph] down over the same period last year. Braskem's sales followed this trend and amounted 792,000 tons.

On the other hand, the favorable dynamics of the international market and the exchange rate level resulted in an increase in the export sales. Regarding resins, it's export sales totaled 373,000 tons, 53% more than in second quarter of 2014, and 46% up on first quarter of 2015.

Polypropylene sales by the U.S. and Europe business unit reached 493,000 tons, 7% up on first quarter, mainly reflecting the improved performance of the U.S. economy, which positively influenced demand from sectors related to consumer goods. Given this context, Braskem recorded consolidated EBITDA of BRL2.6 billion. This expansion is explained by the better operation performance; the improvement of the contribution margin, due to the recovery of resins and basic petrochemical spreads in the international market, and the depreciation of the Brazilian real.

Thanks to the improvement in cash flow generation capacity, the company's leverage, as measured by the net debt-to-EBITDA ratio in U.S. dollars stood at 2.27 times, 11% down on the previous quarter and 17% down on the same period of 2014. This was the company's lowest leverage since 2007.

FINAL

Bloomberg Transcript

Construction of the Mexico complex continued to move ahead and was 95% complete at the end of the quarter. The first steam generation boiler was also inaugurated, which is essential for the functioning of the large turbines in equipments such as compressors and power generators.

In line with Braskem's commitment to sustainable development, it's worth mentioning the launch this quarter of Braskem Labs. The program encourages companies to come up with innovative solutions for recurring problems in modern society through the use of plastics.

Now, let's go to the next slide, please. On slide four, we will discuss the performance of the Brazilian thermoplastic resin market and Braskem's sales in the second-quarter and first half of 2015. The Brazilian thermoplastic resins market totaled 1.2 million tons, 15% down on first quarter, which had been positively impacted by the rebuilding of plastic processors' inventories and the anticipation of part of sales volume due to the resin price recovery trend in the international market.

Further downward pressure came from the slowing of Brazil's economic activity and its impact on domestic demand. The exceptions were still those segments related to agribusiness, which is sufficiently structurally productive and competitive to meet growing demand from abroad. In relation to second quarter of 2014, resins consumption was 8% down.

Following the Brazilian market trend, Braskem's sales totaled 792,000 tons in the second quarter of 2015. The company ended the quarter with a market share of 66%. In the first half of the year, the Brazilian thermoplastic resins market totaled 2.6 million tons, in line with demand in the previous year. Braskem's sales were 1.7 million tons.

Moving on to slide five. On slide five, we present the factors that influenced EBITDA in the second quarter of 2015 in comparison with the previous quarter. Consolidated EBITDA totaled BRL2.6 billion. The average U.S. dollar appreciation generated a positive impact of BRL230 million, with a positive net revenue impact of BRL784 million and a negative cost impact of BRL554 million.

In U.S. dollar, EBITDA was 850 million; an increase around 70%, mainly reflecting the better operating performance, and the improvement in the contribution margin, as a result of the recovery of thermoplastic resin and basic petrochemical spreads in the international market.

Now let's go to slide six. On slide six, we present the factors that influenced EBITDA in the second quarter of 2015 in comparison with the same period last year. The BRL1.5 billion EBITDA expansion is explained by the appreciation of the average U.S. dollar, which generated a positive impact of BRL914 million, being a positive effect of BRL3.1 billion on revenue and a negative effect of BRL2.2 billion on costs; the better operation performance; the higher total sales volume; and the recovery of thermoplastic resins spreads in the international market; which offset the lower basic petrochemical spreads.

Moving on to slide seven. This slide shows Braskem's debt. Since the investment made in the Mexico project by the subsidiary Braskem-Idesa is financed under a project finance model, with debt repaid using the project's own cash generation, the analysis presented here excludes this amount.

In this context, on June 30, 2015, the company's gross debt totaled \$7.3 billion, 2% up on March 31, 2015. In Brazilian real, however, debt fell by 2%, reflecting the impact from the 3% U.S. dollar depreciation in the end of the period. 73% of gross

debt was dollar-denominated. Cash and cash equivalents stood at \$1.5 billion. As a result, net debt came to \$5.9 billion, up by 3%. In Brazilian real, net debt remained flat over first quarter 2015. 75% of net debt was denominated in U.S. dollar.

In line with its liquidity strategy, Braskem also maintains two stand-by credit facilities in the amounts of \$750 million and BRL500 million, which do not include any restrictive covenants on withdrawals during times of adverse markets. EBITDA growth of 16% in the last 12 months had a positive impact on leverage measured by the net debt-to-EBITDA ratio, which improved from 2.55 times to 2.27 times when measured in U.S. dollar, 11% down on the previous quarter. This is the lowest leverage since 2007. Leverage in Brazilian real came to 2.59 times, down by 22%.

On June 30, the average debt term stood at 16 years. Considering dollar-denominated debt only, the average term was around 21 years. In July, the credit rating agency Standard & Poor's changed the Brazil risk outlook from, stable, to, negative. As a consequence, the agency also changed the outlook of 21 Brazilian companies, among them Braskem's outlook from, stable, to, negative.

It's worth emphasizing that only 4% of total debt matures in 2015 and that the company's high level of liquidity ensures that it has sufficient cash and cash equivalents to cover the payment of obligations maturing in the next 33 months, including the stand-by credit facilities, this coverage is 46 months.

Moving on now to the next slide. Slide eight shows our CapEx in the first half of 2015. Braskem invested BRL798 million in the period or BRL516 million excluding the Mexican project. Of this total, around 90% or BRL483 million was allocated to industrial operations, including investments relating to improving operational efficiency and productivity. The remainder was allocated to other strategic projects, such as the production of UTEC in La Porte in the United States. Regarding the Mexican project, which is scheduled for operational start-up at the end of 2015, Braskem invested \$105 million or BRL282 million in the first half of the year.

Now, let's go to the last slide. On slide nine we will talk about the global scenario and Braskem's priorities. Reduced growth of the U.S. economy in the first quarter of 2015 led international monetary fund to revise its annual global growth estimate down from 3.5% to 3.3%. However, it believes that the gradual recovery of economic activity in the developed markets, which constitute one of the main global GDP growth drivers today remains intact.

Regarding China, the GDP outlook expansion remained the same, close to 7%, given the policies adopted by the government to ensure more sustainable growth.

The main risk factors associated with the global economy are related to greater financial market volatility, especially in Asia, and an impasse in the Greek debt negotiations and its potential impact on the Eurozone and the world economy.

The Brazilian outlook remains challenging. Given the deterioration in the economic scenario, annual GDP is expected to shrink by 1.8%.

As for the petrochemical industry, the scenario remains positive. However, with the end of the scheduled and unscheduled maintenance shutdowns, particularly in Europe and Asia, and the consequent normalization of production, petrochemical spreads in the international market are expected to be narrower than in the second quarter.

The points of attention are still related to oscillations in Chinese demand, geopolitical issues in the Middle East and North Africa and the recent negotiations to end the trade embargo on Iran, which may put further pressure on oil prices. In this context, Braskem's strategy remains based on the development of the petrochemical and plastics chain and investments in projects designed to diversify the feedstock mix and improve global cost competitiveness, through the renewal, on a competitive basis, of the naphtha supply agreement with Petrobras; conclusion of the renewal of the energy contract with Chesf; and completion of the construction of the integrated project in Mexico and its operational start-up at the end of 2015.

In line with its commitment to financial health and cost discipline, it intends to temporarily reduce investment levels; implement a program to reduce fixed costs, which on a nominal basis should generate annual savings of between BRL300 and BRL400 million for Braskem.

That brings us to the end of our presentation, and we will now go to the question-and-answer session.

Questions And Answers

Operator

Thank you. The floor is now open for questions. (Operator Instructions) Mr. Frank McGann from Bank of America would like to make a question.

Q - Frank McGann {BIO 1499014 <GO>}

Good afternoon. There is actually perhaps two things. One is, as you are looking forward, and you are looking at the economy obviously is quite weak. And I was wondering how you are seeing overall demand trends, as you have come through the second quarter and the beginning of the third quarter, how that compares to perhaps where your original expectations were.

And secondly, with the weaker economy, more of your products potentially can be sold into the export market. I was wondering how you were viewing that as -- the potential effect that could have on margins on those products sold as exports versus sold in the domestic market?

A - Carlos Fadigas

Hi Frank. This is Carlos Fadigas speaking. When we're talking about demand, when you compare the first half of this with last year, we are down 1%. But the economic situation in Brazil has, I would say, deteriorated over time. We started the year with a forecast for GDP that was close to zero, and at this point the average, the consensus or the average opinion in Brazil is that GDP is going to go down about 2%, so that is for GDP. For Brazil, as I mentioned to you, we are down 1%, when you compare the first half to the last year.

Our best projection at this point is that demand in Brazil will end the year roughly 2% lower than it was last year. Having said that, over the last weeks, eventually two months, but especially the last week, the political situation in Brazil has further deteriorated, so I wouldn't say that we have a different number, I just would say that the level of uncertainty has increased. We have more uncertainty at this point.

What our customers are saying is that they are the final customers. Right now are also buying, I would say, just the amount needed to keep the business running. So they also see this uncertainty. They are avoiding any type of inventory. And the final demand is also in -- varies, domestic consumables to consumer goods, it's negative throughout most of the spectrum. The agriculture sector in Brazil and its demand for plastic is still a positive one, but apart from that most of the segments are either in negative or, eventually, neutral.

So, maybe as a wrap up I would say a higher level of uncertainty, a negative scenario, at this point, a loss of demand for resin up roughly 2%. But we have to keep an eye on that to understand how the political situation will evolve and as a consequence of that, how the economic situation will evolve.

Naturally, we -- the top priorities, now addressing your second question about exports, our top priority is to allocate the products to the domestic market, where we have better results, I would say. The secondary market would be Latin America, and then exports to overseas. The growth in exports reflects the willingness to keep the plants running full. What I am trying to say is that with the exports to make, we do not make that good a margin growth in Brazil. But it's still a positive margin, it will help us run the plant to close to full capacity as possible.

Having said that, if you think about minus 2, even if you go further, to minus 3, minus 4. But if you think about minus 2, it is not a dramatic change based on what we had last year. So the dynamic around its spread, the dynamic around the U.S., the weakening of the Brazilian real, is much more important to the results of Braskem than allocating 2% of what was going to be sold in Brazil to be exported. I hope I have answered your question.

Q - Frank McGann {BIO 1499014 <GO>}

Very clear. Thank you.

Operator

It's going to Christina Ronac from HSBC would like to make a question?

Q - Christina Ronac {BIO 6623815 <GO>}

Hi. Thank you for the call. Congrats on a great quarter. There has been some quotes on newspapers talking about the naphtha contract with Petrobras. There was something about 50-50 chance you can get it done by the end of this month or not. Can you provide us any color on how that is progressing and any more detail on what Petrobras is asking for versus what you are willing to do? So we can get kind of a some idea of how far apart you and Petrobras are on (inaudible) new long-term contract? Thank you.

A - Carlos Fadigas

Well, Christina, thank you for your question. The 50-50, I think, came out through the press to give it some color on my comments yesterday during the press conference. I actually said we would like to avoid giving specific chance of signing a long term contract. So what I said was that I would like to avoid, say, putting a chance on that, so just go with 50-50. So that's what I said.

To give more color on where we are right now, first of all, the confidence level of two teams, Braskem team and Petrobras team they are full in support and myself will be at Petrobras next Monday to have a meeting there, exactly to address the naphtha contract. So, we are engaged, we are meeting, we are discussing. I see the efforts on both sides, not only

Braskem with its motivated folks on finding a solution, but Petrobras is doing the same. We put what we believe should be a creative alternative on the table. It is a formula that varies, that could go from -- the initial suggestion was 90% of ARA price, Amsterdam-Rotterdam-Antwerp, European reference price. It jumped to 110% of that, and that would vary with the price of the naphtha.

The higher the price goes, the better for the oil producers, and the naphtha producers, the worse, the tougher for the buyer. Therefore, there would be a discount. The lower it goes, it's tougher for the naphtha producers and better for the petrochemical companies, who will be a premium on top of that. So, that was our proposal.

Petrobras is in the same, I would say, position they had before. I do not know how familiar you are with that, but over time, Petrobras claimed that they have used roughly half of the naphtha, they used to supply us to add to the gasoline pool. And therefore they claim that to supply the petrochemical sector, they had to import naphtha.

FINAL

Because of that, their position is that we should compensate them for the cost of buying naphtha in Europe and bringing that to Brazil. That's a position that we disagree with. We have always been supplied by the naphtha produced locally. We have nothing to do with the growth in demand for gasoline in Brazil it actually grew 70% over the last five years. It's a rare case of huge demand growth for gasoline. And that has to do with the price of gasoline being low for, actually subsidized in some circumstances, for a very long period of time.

But I'm just giving you some of the background. So, our position is we put some alternatives on the table that we feel is creative and could accommodate the change in this market over time. So, if we are to sign a long-term contract, it should be a formula that could accommodate for different scenarios going forward.

Petrobras' position remains one that we should compensate them for the cost of importing naphtha. We have until the end of this month, of August. The current extension of the contract will finish by the end of this month. And we have until the end of the month to come up with a solution.

I do hope we find a solution that can allow us to sign a long-term contract. If we don't, I think that at certain point, both sides will have to face, at least discuss, the possibility of going after another extension. But having said that, we are remain focused on trying to find a long-term solution. I hope I have given you some more color about the discussion.

Q - Christina Ronac {BIO 6623815 <GO>}

Thank you. And if you don't mind, can you also clarify the assumptions out there on the contract Petrobras has denied, that 6 billion number the prosecutor has come up with? But Petrobras, and I'm sorry, I do not want you to speak on their behalf, but they wrote a vague letter saying there was something odd about the contract and they were investigating it.

Do you know what they were referring to, when they say there was something odd about the contract? I think something about a wrong signature. I don't know if you have more explanation of what may be going on there?

A - Carlos Fadigas

Yes. The comment I can make, Christina, because, as you know, it's a delicate topic and, on top of that, as you said, I wouldn't like to speak on behalf of Petrobras. I will tell you what I read through the press and what is I'd see kind of common knowledge in Brazil. Petrobras, especially the current officers, the new Board, the new officers, they are revisiting most of the things that were decided, signed and done in the past. So, they are going through the very extensive internal audits about everything that has been done in the past.

And this has been very public in all the so called wrongdoing, and things that shouldn't have happened and so on. So, that's what we read. My understanding is that one of the analysis they made about the several decisions in second quarter was around this naphtha

FINAL

contract. And the information we have is that, among all the internal compliances and governance procedures, there was some of them that weren't properly addressed. That's all I know.

Having said that, the same documents they mention, this lack of full compliance with governance's rules, they also mention the same document. They also mention -- they were not able to find any loss to Petrobras. And on this topic, there is extensive material supporting the conditions at the time of the negotiation, and how this contract did not bring a loss to Petrobras. That's also part of the document we had access to, but the several decisions made in the past, they are being revisited, reanalyzed, scrutinized and checked against all the compliances and governance procedure of Petrobras, this contract is one of them.

Q - Christina Ronac {BIO 6623815 <GO>}

Okay. Thank you very much

A - Carlos Fadigas

That's all I had to add. Thank you too.

Operator

(Operator Instructions) Next is Pedro Medeiros from Citigroup would like to make a question.

Q - Pedro Medeiros {BIO 16187063 <GO>}

Good afternoon. Thanks for taking the question. Fadigas, this is actually a follow up to the Portuguese version of the call. We talked a bit about the outlook for demand from China and how the outlook for demand from a number of polymers is working and how you guys seeing this market? But I was wondering if you can talk a bit about what kind of impacts the startup of a

number of our CTO and MTO facilities in China that you previewed to start for this year and early 2016 may have on the market. Can the increased capacity be easily absorbed by the outlook of demand?

A - Carlos Fadigas

Okay, Pedro. China is actually one the regions in the world where capacity is being added, right, I mean, it's mainly if we talk about polymers, more specifically about -- especially about polyethylene, it's U.S., Middle East and China, right. For several years, now we've been tracking the ethylene capacity addition in China, and other chemicals, not only ethylene addition in China, is coal, through olefins in China and a huge debate about whether they are going to be in all these projects, whether they have enough water, the water at the right place and so on.

Bloomberg Transcript

FINAL

So, I will confess to you, I am not an expert in China, but what I have learned overtime, especially over the last five years in that these huge offers, especially in polymers, never happened the way the people forecasted. It has happened previously in the past, 10 years ago, back in '06 with the carbide route to PVC; it has dampened the operating rates of PVC worldwide. But never happened in the material way with polyethylene and polypropylene.

So if we are to think about the additions of capacity of ethylene, the forecast for the next several years, starting with '16, going all the way to '18. What we see actually is a kind of a balance, and actually it starts to change, specifically with polyethylene, more dramatically in '18, with because of the U.S., not because of China. But for instance the number we have, to give an idea, for this year, is an addition of capacity that is lower than it was before -- it is 4.9 million tons of ethylene, when before we had 6 million tons of ethylene.

That is on top of a market which is 130 million tons and globally we are growing 3% a year.

Ethylene we grow slightly above that, if we get 4% growth on top of that, we will need exactly 5 million. So that's why I am mentioning, as we look forward, even with China, we

see kind of a balance of capacity. China would account roughly for one-third, 2 million tons per year of capacity. Some more is forecasted for '18. But between now and '18 is never more than 2 million tons, and that is already included in this 5, eventually to 7 million tons per year. So I do not see China with 2 million per year that they would be adding in a total of between 5 and 7 million per year. The forecast we have for next year is 7.3 and then 6.7 million tons in the following year. So we are talking, if not in perfect balance with growth in demand, we are talking about eventually 1 million tons additional, on top of a market with 130 million tons. So I do not see that as immature.

And to be honest with you, after seeing back in the last decade all the threads with additional capacity coming from the Middle East, and that never impacted the market at one single time. It came spread overtime. And all the concerns with China for several years now has been spread overtime. Projects have been cancelled. Projects have been delayed.

It may be wrong, but the one single thing that still kept with most of our attention on the supply side is the United States., because of its discipline, because of its engineering capacity, because of the players that building these plants. So, I think that -- yeah, we can always have, I may be wrong, and always have a surprise coming from China from the supply side, but the one single thing that actually kept our attention is the U.S. I don't see this huge wave of polyethylene or even polypropylene coming.

They have managed to put some other markets in a tougher position. They managed to add a huge capacity of PTA and PVC, for instance, it is not going through a good time, but not the case with the resins we produce, still an important and will remain for some time. So, that's our view on China.

Q - Pedro Medeiros {BIO 16187063 <GO>}

Okay. That was a very good description. Thank you so much, Fadigas. Once again congratulations for the results.

A - Carlos Fadigas

Thanks Pedro.

Operator

(Operator Instructions) I will turn over to the company for closing remarks.

A - Carlos Fadigas

Well, I would like to thank you all for participating. We had a very long call in Portuguese, we ended up having a short call in English. I would like to thank you all for being on in this call in English. I will finish by saying that I am glad we had a good operational performance in the second quarter. It came at the right time, the operational performance, because the margins were there to be captured, the weak in Brazil real, finally is heading -- is bringing back competitiveness to the Brazilian industry, so when these two conditions presented themselves, we were able to act on that and to capture the margins for Braskem and reach a record EBITDA in this quarter.

As we did that, we also kept working on things long-term, so the signing of the contract in the Northeast of Brazil, we are working very hard on that. We do hope to have it finalized soon. So, we are going to have energy contracted until 2037. So, it is going to be up to somebody else to think about it in the future, not to this management. And, as we were working on the margins of the second quarter, we also kept focusing on the plant in Mexico.

So, all in all, despite of the news in Brazil, despite the political environment and economic environment in Brazil, I'm glad to see that the team kept focused and we delivered good result. Thank you all for participating the call, and I wish you all have a good week.

Operator

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

This transcript may not be 100 percent accurate and may contain misspellings and other inaccuracies. This transcript is provided "as is", without express or implied warranties of any kind. Bloomberg retains all rights to this transcript and provides it solely for your personal, non-commercial use. Bloomberg, its suppliers and third-party agents shall have no liability for errors in this transcript or for lost profits, losses, or direct, indirect, incidental, consequential, special or punitive damages in connection with the furnishing, performance or use of such transcript. Neither the information nor any

opinion expressed in this transcript constitutes a solicitation of the purchase or sale of securities or commodities. Any opinion expressed in the transcript does not necessarily reflect the views of Bloomberg LP. © COPYRIGHT 2022, BLOOMBERG LP. All rights reserved. Any reproduction, redistribution or retransmission is expressly prohibited.

FINAL

Bloomberg Transcript