

Q1 2020 Earnings Call

Company Participants

- Pedro van Langendonck Teixeira de Freitas, Finance, Investor Relations, Procurement and Institutional Relations
- Rosana Avolio, Investor Relations

Other Participants

- Christian Audi, Analyst
- Fernanda Cunha, Analyst
- Gabriel Barra, Analyst
- Guilherme Levy, Analyst
- Jamie Nicholson, Analyst
- Lilyanna Yang, Analyst
- Luiz Carvalho, Analyst
- Unidentified Participant

Presentation

Operator

Good morning, ladies and gentlemen. At this time, we would like to welcome everyone to Braskem's First Quarter of 2020 Earnings Conference Call. Today with us, we have Pedro Freitas, Vice President of Finance, Procurement and Corporate Affairs; and Rosana Avolio, Head of Investor Relations.

We would like to inform you that this event is being recorded and all participants will be in a 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 simultaneous webcast that may be accessed through Braskem IR website at www.braskem-ri.com.br in 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 this 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

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assumptions because they're related to the 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 results of Braskem and could result to differ materially from those expressed in such forward-looking statements.

Now, I would like to turn the conference over to Rosana Avolio, Head of Investor Relations. Please Mr. Avolio, you may begin your conference.

Rosana Avolio {BIO 20386863 <GO>}

Good afternoon, all. We would like to thank you for joining Braskem earnings results conference call. Today, we will present first quarter '20 results.

So please, let's move to the slide number three, in which we will talk about the current global scenario in view of progression of COVID-19 outbreak. Since the end of 2019 and the beginning of 2020, our policymakers in private sector are putting efforts to fight COVID-19 pandemic. Sanitary, health and economic strategies have been designed and implemented among all countries to preserve people's lives. And as a consequence, the current scenario demands global cooperation. Braskem, as one of the largest producer of thermoplastic resins and chemicals around the globe, plays an essential role in the global supply chain, responsible for supplying raw material of important items used in the combat against the pandemic.

Our resins are used to produce hospital materials, such as surgical masks, doctor gowns and plastic gloves, besides disposable and non-disposable items used in patient treatments. The resins are also used to produce packages for liquid and gel alcohol content, as well as for hygiene products and for food packaging. Also, our chemical products are used to produce hygiene materials, such as sanitary water. In this sense, given important role played by Braskem chemicals, Braskem is an essential part in the global cooperation for the fight against the COVID-19. Committed with that, we are already putting efforts in initiatives that provide solutions to this tough moment.

In the next slide, we will present the main initiatives that we have been taking regarding to that. Working together with our clients, we have donated thermoplastic resins and chemical for the production of more than 60 million surgical masks and for more than 1 million doctor gowns. For production of liquid and gel alcohol packages, representing more than 750,000 liters. Also, we have donated raw material for 3D printing of rods for protection masks. We also donated sanitary water for sanitation of hospitals in cities from the regions in Brazil, where we operate.

Regarding the community support, more than 1,200 families involved with recycling business will receive basic food baskets during three months, more than 50,000 families who lives around our plants and facilities will receive donation of hygiene kits and we're also supporting the implementation of temporary hospital in Alagoas state.

Bloomberg Transcript

Our clients are also being supported with an additional credit line of BRL1 billion offered with special financial conditions. The purpose of this credit line is to support mainly small and medium business. In line with our core value of safety, the company start to operate its industrial assets with minimal teams. In some regions, we have adopted a locking regime, in which some team members accepted the challenge to stay for 20 days working in the plants without external contact getting back to their families only after this period. Besides that, we are also providing medical assistance to team members confirmed and suspicion COVID-19 cases.

In the next slide, we will talk about the pandemic impacts in our business. Regarding our operations in Brazil, we have reduced ethylene production to around 65% of its total capacity, which is 3.6 million tons per year. In the United States, the polypropylene production was reduced to around 85% of total capacity, which is 1.6 million tons per year. The utilization rates will be adjusted considering the market demand and the potential opportunities for export to other regions that may arise, especially with the resumption of activities in Asia. We have been reducing by 50% the number of industrial team members and also contractors allowing us to keep teams safe, while maintaining reliability of our operations. Our sales diversification by sectors contributed to mitigate the effects of the downturn, given the COVID-19 scenario. Around 70% of our sales comes from segments that have shown resiliency, even in this period.

In the next slide, we will talk about the company's financial profile. Last year, we did our liability management exercise through bond issuance with longer tenure that ensures a more comfortable amortization schedule for the next years. In this sense, we ended the first quarter of 2020 with a liquidity position sufficient to cover the next 55 months of debt payments without any cash generation. And as a precautionary measure to face COVID-19 challenge, we disbursed our revolving credit facility amount to \$1 billion in April. In this context, we established a goal to reduce 10% of our fixed costs relative to last year and we are also reducing CapEx for 2020 from \$721 million to \$600 million. In this sense, the company has strong liquidity to face this global economy downturn with no financial threats.

Moving to the next slide, we will talk about the highlights for the first quarter of 2020. In Brazil, the utilization rate was 81%, 3 percentage points above fourth quarter 2019 and explained by an increase in Bahia's cracker production, which was impacted by maintenance turnaround in the last quarter. In the United States, the utilization rate was 95%, 11 percentage points above last quarter and explained by the normalization of operations, which were also impacted by maintenance turnaround in last quarter. In Europe, the utilization rate was 88%, 1 percentage point above the fourth quarter of 2019 and explained by the higher supply of propylene in the region. In Mexico, the utilization rate was 86%, 4 percentage points above the fourth quarter of 2019, as a result of the beginning of detaining ports from United States. We also would like to highlight our good performance in the recordable and lost-time injury frequency rate that stood at 0.81 events per 1 million hours.

Regarding our results highlights, we had a 54% fixed cost reduction relative to the last quarter. Our EBITDA presented 22% increase and our sales volume increased by 4% when compared to fourth quarter of 2019. Cash flow highlights are related to the PIS/COFINS

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monetization, in which we monetized BRL344 million in this quarter. The company still has an outstanding balance of BRL2 billion to be monetized, from which BRL1 billion will be monetized in the short-term. It is important to highlight that our new US PP facility reached 98.4% of completion by the end of first quarter.

Moving to slide number eight, we will talk about the main highlight by region. In Brazil in the first quarter of 2020, the recurring EBITDA was \$233 million, which represented an increase of 214% relative to the fourth quarter of 2019, mainly due to sales volume increase and reduction in commercial expenses. EBITDA presented a reduction of 21% when compared to first quarter 2019 due to an increase in the cost of goods sold, which reflected higher feedstock prices from previous months. Sales presented an increase of 4% when comparing to first quarter of '20 to fourth quarter 2019 due to seasonality of the period. Regarding first quarter of 2019, sales were up by 5% because of the lower availability of resins and Brazilian market supply prioritization. Fixed costs represented a drop of 76% related to fourth quarter 2019 explained by the reduction of third party service under the geological event of Alagoas. In regard of the first quarter of 2019, the reduction of 55% is due to the drop in commercial expenses.

Moving to next slide, we will talk about United States and Europe results. The EBITDA for US and Europe present an increase of 33% when compared to the last year, due mainly to an increase in production and also in sales. Comparing to the first quarter of 2019, EBITDA fell 21% due to lower spreads for European polypropylene business. Resin sales in the US and Europe increased when compared to the last quarter and also to first quarter of 2019, given the higher availability of products.

In the next slide, we will talk about Mexico's results. Mexico's EBITDA present an increase of 2% relative to prior quarter, explained by higher sales volume and utilization rate. Regarding first quarter of 2019, EBITDA presented a drop of 22%, given lower polyethylene prices in the international market. Sales volume increased by 3% and 5% compared to fourth quarter 2019 and first quarter of 2019 due to higher availability of products.

Moving to slide number 11, we will talk about consolidated results. The consolidated EBITDA present an increase of 22% when compared to last quarter, due to an increase in sales and lower fixed costs. Comparing to the first quarter of 2019, EBITDA dropped by 34% due to global economy downturn. Sales present an increase of 4% when compared to fourth quarter of 2019 and dropped by 2% when compared to first quarter of 2019. Fixed costs presented a drop of 53% compared to fourth quarter of 2019 and explained by the reduction of third party services expenses.

In the next slide, we'll talk about petrochemical scenario. The petrochemical scenario has been suffering important variation on the projections made by the external consultants in the beginning of the year. Regarding the resins and chemicals spreads referenced that we follow in Brazil, the polyethylene spread increased by 59% over the figures projected in the beginning of the year, mainly because of the drop of oil price. In this context, the chemicals spreads decreased by 16% in relation to the same comparative period. About the spread in the United States and Europe, the highlight is that polypropylene spread in Europe that increased by 22% in relation to the projections of the beginning of the year.

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Moving to next slide. In May of 2020, we received the Certificate of Monitorship Conclusion by MPF, DOJ and SEC. The monitorship began in 2016 and it was evaluated in phases, all of our governance, compliance, internal controls and risk management structures and procedures. After that, the monitors recommended improvements to be implemented by the company. This work's conclusion means that the company implemented 100% of the recommendations proposed by the monitors, which resulted in an effective and robust compliance and governance structure. During this process, more than 11,000 Braskem documents were requested, more than 400 interviews were done, and more than 1,100 transactions were tested. By the end, more than 80 policies and normative documents of the company were revised besides the revision of the Ethics Code of Braskem. And also more than 40 procedures were revised, which includes the enhancement of our Compliance Program and financials controls.

Moving to next slide. Now, we will talk about the priorities for the second quarter of 2020. In relation to productivity and competitiveness, the priority is to maintain the reliability of our industrial units in the context of COVID-19 and to focus on the negotiation of feedstock supply contracts with Petrobras. As for the diversification of raw materials and suppliers, we will continue to ramp up the complementary ethane import solution in Braskem Idesa. With regard to geographical diversification, we will seek to maximize synergy among regions, where Braskem has operations in order to mitigate the impact of the global economy downturn. About people, governance and reputation, our main priority is to ensure health and safety of our industrial team members. Furthermore, we will prioritize expansion of our recycling resin sales also. And the last priority of the company is discipline in capital allocation in order to maintain liquidity of Braskem.

Finally, in the next slide, we would like to thank our team members who live in two of our industrial units to guarantee the essential materials production that we need to get through this critical moment. Thank you for your effort.

So, that concludes today's presentation. Thank you for your attention. So, let us move to the question-and-answer session. Thank you.

Questions And Answers

Operator

Thank you. The floor now is open for questions. (Operator Instructions) Our first question is from Mr. Gabriel Barra from UBS. You may proceed.

Q - Gabriel Barra

Hi. Good morning, Pedro and Rosana. Thanks for the questions. I have two here. Regarding first question, saw a sharp depreciation of real in the second quarter. And at the same time, a heavy drop in oil price that brought naphtha to very low levels, which in our view, has increased the competitiveness of naphtha-based wells. However, the price of spread has now returned to around \$40 per barrel and the Fed has appreciated again. My question is, how are you seeing this competition in Brazil from forged products in the premium in the -- in second quarter and further has for the year?

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And my second question is, as we know the coupons controller is under the Chapter 11 presence in Brazil and there are some discretionary news about a possible migration of Braskem to the Novo Mercado, right. My question is, how long it would take to include the company in the Novo Mercado segment? And if there is -- there are any restriction today to make this kind of movement? And if I may, I have a third one here, it's regarding the leverage level of the company. The coupon liquid, from our point of view, does not seem to be in a very challenged situation as you mentioned in the presentation, but occupancy [ph] leverage has jumped to something close to 5.9 this quarter. What's the company view regarding the level of the indebtedness? And what's the ideal level at this point? And there is any negative covenant in relation to the leverage gap? Thank you.

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

Hi, Gabriel. Thank you for the questions, and good morning for -- to everyone. It's a pleasure to talk to you again. This is Pedro Freitas. So, I would take a shot at your questions and I'll ask also Rosana to step in if there was any additional point that she thinks is clarifying for the questions. Okay?

So, starting from the top on the oil prices and re-appreciation of the real. What we see is that -- what really impacts our results are the spreads, right, and the spreads have been holding up on a pretty good level, much better than we expected for the year. So, I would say short-term, our expectation is still to have a good run in terms of the spreads, so -- on a per ton basis. However, Gabriel, as we've been talking to you, to -- I mean, to everybody that follows Braskem, we do see that the supply-demand dynamics of the industry have changed -- or I mean, we went into a downturn in the cycle, especially in polyethylene because of the large amount of new builds that came out, especially in the US and the Gulf Coast over the past two or three years, right.

So, I would say that the underlying structural dynamics are still out there. I mean, we do have some, I'd say, short-term adjustments or -- I mean, the way that the industry reacted to COVID led to better spreads and the fall in the oil prices also helped on that. But structurally, I would still say that we still face an oversupplied industry for at least one or two years going forward. So, overall, competitiveness is still going to be on the agenda going forward. And it depends a lot on the oil price.

Oil price at \$40 is still, I mean, manageable from a competitiveness perspective. We don't see a huge increase of imports into Brazil, for example, which could happen. I mean, if the oil price went back to what it was, I would say, seven, eight years ago, 2013, for example, the oil price was close to a \$100. Then, we did have, I would say, a more challenged situation in terms of competitiveness. But at \$40 per barrel, I mean, I think we can manage that.

On the controlling shareholders and the situation there, I mean, we have not had any communication from them regarding what they will do. We know that there is a very public wish on Petrobras for Braskem to go to the Novo Mercado, but -- I mean, it's -- as far as I understand, it's still a discussion or -- I mean, it's an ongoing conversation between Odebrecht who is our controlling shareholder and Petrobras in terms of what they will ultimately do with the company.

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A few years back, we did look at how is the process to move to Novo Mercado, so we know the steps that we would need to take. It's less than six months to execute a move like that, so it's not a long process, it's reasonably easy. We already adopted Braskem. Even though we are not Novo Mercado, we adopted most of the provisions of Novo Mercado in our governance. There are a few that we don't have, but most of them we already have and we know the ones that we don't have, we know what we need to do to implement those if there is -- that is the decision of our shareholders. But so far, we don't have any communication from them telling us to move in that direction or anything like that. So -- I mean, we would be able to do that if they decide that it's what they want for the company.

Finally, going to the third point on leverage, we do have a strong liquidity situation and I would say a lengthened debt profile with good maturity, lengthy maturity -- average maturity with, I would say, more than 40% of our structural debt is 10 years and above maturity. So, really comfortable with the leverage situation. And I think that's part of what the rate unions is also taking to consideration when they are looking at the company.

So, it is a point of concern. We do have some actions that we are moving on. Rosana mentioned the reduction in CapEx. So, it's more than \$100 million. But if you look in percentage term, the 20% reduction in CapEx that the company decided on, we are also working on cost reductions aiming at a 10% cost reduction for the year. We are managing working capital tightly, so we are looking at how we can improve the working capital position as well.

And finally, we are also looking at other alternatives, be it in the capital markets, be it in the M&A arena, divesting some non-core assets, so we are looking at all the alternatives. And whenever we have something that is more concrete, we will come back to the market and tell you what we ultimately are going to do. But we are looking at several different alternatives there to, I would say, keep the leverage number in check.

I think an important point is there -- there is that our net debt number, although it has increased a little bit, it's still very much under control. The point of the metric is really around EBITDA coming down because of the downturn in the cycle and also because of COVID, but we do see that as a temporary situation. One thing that I'd like to point out is that if we were back -- I mean, if we had the same EBITDA that we had in 2017, we would be at a leverage below 2, roughly 1.5. So again, it is really because of the cyclical nature of the business that we are facing this kind of a high metric in the leverage number.

And then you asked specifically about covenants. We don't have in Braskem corporate debt, we don't have any financial covenants, per se. We do have one instrument in the US, which was -- as part of the financing for the new plant that requires Braskem America, the entity in the US to hold -- I mean, to have certain metrics, but they are not challenging for us to keep. And even if those metrics were reached, I mean, we would just need to constitute the cash reserve for the debt service for six months. So again, it's not a huge part in our company, but that's the only financial problem that we have in our financial instruments overall.

Q - Gabriel Barra

Okay, great. Thanks. Thank you, guys.

Operator

Our next question is from Mr. Christian Audi from Santander. You may proceed.

Q - Christian Audi {BIO 1825501 <GO>}

Hi Pedro. Hi, Rosana. I was wondering, if you could talk to us a little bit about on the demand side. Pedro, what have you been seeing in April and May vis-a-vis what you experienced in the first quarter? Obviously, March was the month, where everything got hit with the pandemic. But I was wondering, if you could provide us with a bit of color as to what has happened to demand in April and May by region and what your expectations are for June, please? Thank you.

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

Hi, Chris. Nice talking to you. We -- as you said, we started to see some movement in demand end of March, but it was not significant for the first quarter, so you can see that overall demand in the first quarter grew by roughly 5% -- 4% compared to the last quarter of last year. We did have a small drop compared to the first quarter of last year, but I mean still I'd say healthy demand in the first quarter in Brazil. And I would say, looking at the US and Europe and Mexico, still good demand performance in the first quarter. We saw most of the hit coming on April, so we did see a reduction of around 20% overall in demand. And then in May, the commercial teams were very bearish. I mean, they were really concerned.

They put out a trend or a view that volumes would be worse in April comp -- in May compared to April. And ultimately, what we saw was already some recovery in May, not huge, but -- I mean, the performance in May was better than expected. So -- and for June now, I know the expectation is to again see a recovery moving forward. So, I would say that we, I mean, overall, are dropping 20% in demand for the quarter, for -- I mean, April. But looking at the year, at least for Brazil, our view now is that overall demand for the year will be about 6% -- 5% to 6% lower than last year. So, there is a reduction in demand, for sure. We were expecting -- we went back to the -- at the beginning of the year, we were expecting some demand growth around 2% to 3%. So, with the drop now of 5% to 6%, it's a large difference. And then that's the scenario.

One thing that I think is interesting to see is that a lot of the sectors that we serve, about 70% of our sales go to sectors that are more resilient. So, we did see more of a drop in construction, in the automotive industry, in some industrial clients and also in infrastructure. But if you look at consumer goods, packaging, cosmetics, in the healthcare sector, I mean those were doing -- I mean, we did see some reduction in demand there in some of those sectors, but much, much less than the first ones that I mentioned.

Going to the other regions outside Brazil just for a moment, Europe is now already improving with the opening of the economy there. So, May was much better than

expected in Europe and we're still, I would say, about 10% below normal sale in Europe, but that's much better than we were at, I would say, in April. In the US, the expectation is for an improvement in June. We are running at around -- today at around 85% in the US, so -- I mean, doing not so bad in the US, I mean -- and then in Mexico, actually we're selling -- we had a very good sales month in April. And then in May, again, a good sales month. So overall, we do see an improvement.

Operator

Our next question comes from Ms. Lilyanna Yang from HSBC. You may proceed.

Q - Lilyanna Yang {BIO 14003234 <GO>}

Thank you. I have one question on Mexico. Can you give us guidance on where do you see the capacity utilization also like April, May? You already kind of indicated April was a good month. No? But I wonder about your ability to place a volumes in the export markets because I see that sales for the Mexico market remains actually still a little bit less than what I had anticipated. Right? So I wonder, if you're being -- going to be able to have high utilization rate actually in the first quarter because you're able to place volumes in exports or at least replace more of the imported products with your arm? So -- and what is the current balance that PEMEX currently own you as of now or as of March? Another thing on Mexico, can you give us color of the cost of imported gas with the site and to the plant? And if I can follow up with what you just mentioned about demand. When you talk about, for instance, in Brazil the 20% demand reduction, is it year-over-year or versus pre-pandemic, pre-lockdowns or is versus your budget? Thank you.

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

Hi, Lilyanna. Thank you. Thank you for the questions. I'm going to answer, I'm not sure, I really caught the point on supply, but then I'll ask Rosana as well to step in if I'm missing anything or then you can follow up.

But in terms of capacity utilization in Mexico, we are at about 80%, a little bit more than 80% in April and May. Some of it's being supplied by the imports of gas. So the -- we have been able to ramp up the imports for ethane -- of ethane in Mexico. And in the best month so far, we've reached 15% of the supply to the site coming from the gas imports, which is, I mean, close to the target or to the maximum that we -- we think we can go up 20%, so already pretty close to that. But when you start to run the operation, you see that, I mean, there is still operational improvements, there are operational improvements to be made. Right?

So one thing that we're seeing is the flow of ships in the harbor and getting one ship lined up to discharge, while the others leaving the harbor. So, getting that operation to be efficient is still something that our team is learning. So you do have kind of a drop in supply whenever you have a new ship coming in. So, that adjustment is still going on. So, the best month was close to 15%, but then we saw a drop. So we are still adjusting how to do that operation. But -- I mean, it's flowing, it's ramping up well and we are not facing other than this issue of how to optimize the flow in the harbor. Everything else is running according to expectations.

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On the ability to export and the markets for Mexico, so compared to the first quarter of last year, we did see a drop in internal market of about a bit less than 10%, which was more than overcome by an increase in the export side. So overall, the sales increased by 2%, first quarter against the first quarter. Right? So that shows that we are being able to export. And -- I mean, you could see in the presentation -- I mean, the main markets Mexico is exporting to, a lot into Europe, some into the US and also selling into the Americas outside of the US and Mexico. So -- I mean, we are not facing any issues in exporting. We already have commercial teams operating in Europe and in Latin America, in the US. So we are leveraging this commercial presence that Braskem has in the other regions to place the Mexican product as well. So, it's working well and we believe that this ability to export is there and will stay there.

And at times, even -- I mean, one thing that I mentioned already at other points in time and calls like this, at times, exporting is even more profitable than selling to domestic market, right, because the price reference in Mexico is linked to the export price from the US, which can be depressed, given the supply dynamics. And sometimes when you sell into Europe, because Mexico has a trade agreement with Europe, the Mexican product does not pay import tariffs into Europe. And that offset the cost of the freight, the shipping from Mexico to Europe. So sometimes, it's even more profitable to sell in Europe than selling in Mexico, for example. So that sort of thing is also part of the optimization of the sales and the results that we tried to do in Mexico. And then on the Brazilian, the 20% drop, it's against the expected production. I mean, it -- you could see it as kind of a 20% drop on a regular quarter, right, on a regular sales quarter.

Q - Lilyanna Yang {BIO 14003234 <GO>}

Perfect. Thank you. And can you also talk about the PEMEX, what's the balance today that they arguably owe you because of the non-delivery of the ethane?

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

Yeah. So, on the liquidated damages, right?

Q - Lilyanna Yang {BIO 14003234 <GO>}

Yes.

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

We have -- I'm just looking it up here. We have \$40 million in liquidated damages that they haven't sent us. They're credit notes for \$40 million. So that's the --

Q - Lilyanna Yang {BIO 14003234 <GO>}

Thanks.

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

Thank you.

Operator

(Operator Instructions) Our next question is from Fernanda Cunha from Citibank. You may proceed.

Q - Fernanda Cunha {BIO 20784520 <GO>}

Hi. Good morning, everyone. I have three questions. The first one is in relation to your market share in Brazil. It seems that this quarter, you have seen sales flat, while demand in Brazil grew 3%. So I just wanted to know, if there has been any changes in commercial strategy there? The second one is in regards to the FX devaluation pass-through. When we look at your historic markup over the products sold in Brazil, it seems that you have reduced your markup this quarter, not only in nominal terms, but also in the percentage terms. So I'm just wondering, if there has been any lags or any delays in the pass-through of FX, which should be reverted in upcoming quarters? And then on the last one, has there been any change in the -- in supply strategy? I know you've mentioned previously that you have increased your purchases from domestic refineries versus imports, but if you could give us more color on that. And also, if you could say if you have been able to purchase any feedstock with large discounts over the auctions that Petrobras has been doing? Thank you.

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

Hi, Fernanda. Thank you for your questions. I'm not sure where you're looking at the market share. I mean, my -- the reference that I have is that market share has been stable or very similar to the past quarters. So, if I look at the -- I mean, the markup increased against the fourth quarter, it dropped against the first quarter of last year. So -- I mean -- but looking at those references, I mean, our market share has been pretty stable, I would say. When I look at the -- what you call, the markup of sales, I mean, Braskem as I think everybody knows, sells and import parity in Brazil and that is part of our strategy. Right? I mean, we will -- we -- and time and again we do that, we adjust this -- these prices to accommodate or to reflect changes in international prices and also in the exchange rates. There are two -- I would say, two main factors that could affect that dynamic. One is just our commercial strategy. So, looking at segments, then looking at demand and the client relationships, we will adjust that as part of our commercial strategy, but the overall, I would say, concept of import parity is still there. Right?

The other aspect, which may explain -- or which does explain some of this difference that you saw is the volatility in -- and especially in FX in the first quarter. So when the real was devaluating, becoming more devalued, we need to adjust our prices, increase prices to reflect that. Right? But there is a lag in the price adjustments. So, when you look at -- whenever the real was devaluating or the prices in the international market are going up, we tend to lag in this difference or this -- I mean, if you look at import parity against the actual price that we sell, it tends to lag. Right? So whenever prices are going up or the exchange rate is going up, we will have a lower markup. Whenever they are coming down, then we usually show more -- a bit higher of a markup because it's the time lag to adjust our commercial -- I mean, the price table, right, to the market. So I think that explains this difference. But structurally, I mean, it's still import parity.

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On the supply strategy, up here we imported roughly two-thirds of the naphtha that we consumed in Brazil and this year actually it was reversed, we consumed roughly, in the first quarter, 70% of national feedstock and 30% was imported. So -- I mean, we are constantly revising that strategy and looking at price differentials the way that the cargoes and the supply was being priced in international market against what we have in the contract here in Brazil. The decisions in the first quarter were geared, more geared towards national production, natural feedstock. Part of that is because the freights to bring -- the tankers that bring naphtha are the same types of ships that are used for oil. Right? And with the drop of oil prices, you may remember that a lot of the tanker capacity in the world was being -- and it still is being used to store oil. So, the three ships that we can use to bring naphtha had a higher freight. And then -- so that's kind of the structural piece, right, the shift from imported to domestic impacted by the drop in oil prices, but also the increase in specific freight prices for tankers.

And then when we go to kind of the other point that you asked about the auctions, Petrobras in April, we did have an additional volume contracted with Petrobras that had a discount, a more substantial discount because of the situation. So, Petrobras had an incentive for us to consume roughly 220,000 tons of naphtha that we purchased and with discounts that range between \$15 to \$30 per ton. So, that was our spot trade, a spot purchase, but we did do that. And whenever Petrobras comes back to us with similar conditions, I mean, we will look at those as part of just regular strategy.

Just an additional point on the naphtha supply strategy. I mean, we do have the divestment of the refineries that Petrobras is conducting. And -- I mean, we anticipate that there will be different owners in the two refineries that are closer to our plants in the South and in the North of Brazil. So, when we look at -- everybody knows that the naphtha contract that we have expires by the end of the year. So what -- that contract now is being negotiated and the structure of that -- I mean, it's not -- we don't have a final deal done, but the structure of that will be to split that -- the naphtha contract into more than one contract, so that we have a contract in the South, another in the North. So that whenever Petrobras sells the refineries, we already have the contract structure arranged for the new configuration in the future.

Q - Fernanda Cunha {BIO 20784520 <GO>}

Okay, thank you very much. Just on the first question. What I mentioned was that I'm not related to say that demand in Brazil increased by 3% year-over-year and your sales volumes remained flat. So, I would suggest to me that you have large market share here. So, I was just wondering, if there has been any things in terms of selling dramatically and exporting or there -- you haven't changed your commercial strategy?

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

Yeah. I think we can -- no -- well, at least in -- we will prioritize domestic market. Right? What I think that maybe -- may explain that and then I think we -- I mean, you can get in touch with Rosana later to go over the numbers, but we did have a change in the chemical exports. Right? So we reduced exports of chemicals. So -- maybe it's a matter of the figures, right, looking at what our resin sales and what our overall sales in Brazil is, that

may be -- that may explain this kind of divergence in the numbers. But probably the explanation there is in the chemical sales, not on the polymer sales.

Q - Fernanda Cunha {BIO 20784520 <GO>}

Okay. Well, thank you very much.

Operator

Our next question is from Luiz Carvalho from UBS. You may proceed.

Q - Luiz Carvalho {BIO 18040760 <GO>}

Hi. Pedro, Hi Rosana. Thanks for taking the questions. Again, I know that Barra already did, but I had two basically follow-ups. The first is about Mexico. How are you seeing the situation with PEMEX in terms of the contracts and the supply, any potential fines? And second, we had a quite sequential discussions with some investors talking about the relevance of the basic petrochemicals in your results. Looking back to 2016 and '17, basic petrochemicals, I mean, used to represent something close to 40% of the results. But now, when you rerun, let's say, this number despite that you don't give this breakdown anymore, we read something closer to 20% to 25% of the total reserves. So I just would like to see if you can give us a bit more color on the relevance of the petrochemical, the basic petrochemicals, on your overall results? Thank you.

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

Hi, Luiz. So on PEMEX, I mean -- I think everybody knows that the underlying issue is the lack of availability of sufficient ethane in Mexico, right, because I mean the country -- the oil production is falling and then the associated gas production is falling. And then together with all that, the availability of ethane is falling. We -- so, PEMEX is supplying the contracts within the minimum volumes that are there. So they are supplying between 70% and 75% of the contract. We keep looking for a constructive solution with PEMEX. I mean, there is this delay in the credit notes related to the liquidated damages, so Braskem Idesa, the JP in Mexico is looking at all alternatives.

We did communicate with PEMEX and sent them letter to preserve the rights of Braskem Idesa under the contract. And there are also -- I mean, all alternatives are being looked at, right, including legal measures are also being evaluated. But we do want to have a constructive solution with PEMEX. I mean, it's really important for us to have very good relationships with our suppliers. Right? And the same applies to Braskem Idesa. So, we aim to have something that is good for all parties involved. So far, we don't have any resolution to that, so it's still an open issue that I think over the next month we hope to have a positive resolution to that. But so far, I mean, it's still open and we're still looking for something that is constructive and positive for everyone. Okay.

On your second question around the relevance of basic chemicals, I would say the following, right, the 40% that base chemicals used to represent, it's -- I mean, I don't remember if the 40% back then was related to the overall Braskem results or just related to the Brazilian results. The basic chemicals is about 40% of the Brazilian operation, which

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is roughly 20% of the overall Braskem results. Another part of that could be the way that you look at the internal transfers. So, depending on how you look at the price of ethylene and propylene for the internal transfers to -- for us to make PVC, PE and PP, I mean, the ethylene price dropped a lot. Right?

So, if you're accounting for an internal transfer, where the price of ethylene -- the internal price of ethylene is performing -- ethylene prices, depending on how you account for those, you could be transferring results from, internally from chemicals to polymers. But if you look at -- if you exclude those internal transfers, you're right, the chemicals business is about 20% to 25% of the results. Still -- I mean, it's still a very important piece of the business. I mean, 20%, 25% is from gas, it's really important. It's, I would say -- to give an example, right. Butadiene, we are one of the top five producers in the world.

So -- I don't know Rosana if you have any other points to add there, but -- I mean --

A - Rosana Avolio {BIO 20386863 <GO>}

Yeah. Hi, Luiz. Probably the 40% that you're taking is from -- remember that we used to disclosure Brazil in segments, which was polymer, chemicals and so on. So, the chemicals results in the past, it was included this whole kind of internal transfers that Pedro mentioned. Now, not anymore because it's more minimal. I mean, selling channel (inaudible) channel price. So now, we are communicating through regions, right, which is Brazil. And when we take a look at specific about Brazil, chemicals represent 40% of Brazil, which is 20% of the total, as Pedro mentioned.

Q - Luiz Carvalho {BIO 18040760 <GO>}

Okay, very clear. Pretty clear. And just one last question from my end, if I may. With the current results, I mean, we had -- I mean, you delivered three -- \$294 million on EBITDA this year -- this quarter, sorry. How the potential change in the short-term in terms of oil price coming back to \$40 and the FX rate coming back now to, I don't know, close to BRL5 would change the competitiveness of your -- of the company in the remainder of the year? I mean, you're seeing that, I don't know, if we -- this is analyzed, let's say, the EBITDA, I mean, between, I don't know -- I know that you don't provide any guidance, but between \$1.6 billion, \$1.8 billion will be something that would be feasible under the current conditions?

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

So, Luiz, as I said earlier, I mean, it's still that \$40 per ton, still, I mean, manageable for us. There is a dynamic, which is kind of tricky to model, even for us it's tricky to model, which is what we call the inventory effect. So -- I mean, if you look at the cost of goods sold that we have now in Braskem, especially in Brazil in the naphtha crackers because of the lead times and the operational cycle of the business, we are probably carrying now in May, we are carrying costs of January, maybe February, but -- I mean, we do moving average cost accounting, so we do carry costs that go back to when oil was at \$60 or \$65 per barrel. The expectation in the beginning of the year for the year was oil at \$62 per barrel.

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So now, with the current oil prices, I mean, we still think that it's still positive, right. In the first quarter, for example, we were carrying an inventory cost and the cost of goods sold related to the last quarter of last year. So that effect hurt first quarter results, I would say, specifically. In the second quarter, I think the issue is more around volumes and less on costs. We also had -- I mean, this is not going to be huge, but on the margin, we decided to carry a little bit more invent -- naphtha inventory and buy a little bit more feedstock than we needed when the oil price was below \$30. So right now, I think we are carrying, I would say, a much more cost advantaged inventory, which would translate into results over the third quarter. So again, it's a bit of a complex calculation and modeling to be done. But the -- overall, I think that we will cash some value out of this more opportunistic position that we took when the oil price was much lower.

The other point is that polymer prices and some of the chemical prices are sustained at good spread. I mean, if you look at the spread polyethylene to naphtha, for example, at the end of the year -- at the turn of the year, it was around \$250 to \$300 per ton. It went up to \$600 per ton. Now, it's at about \$400, so -- \$450. So, still a very good spread compared to the end of the year or to the expectation we had for the year. So overall, the discussion that I'm having with my team looking at this year, it's going to be difficult to -- or not difficult, but complex to explain because every quarter we'll have a different dynamic. First quarter, still good volumes, a squeeze on margins because of the higher inventory cost.

I would say, a good cost -- fixed cost performance, be it because of our own internal efforts, but also helped by exchange rate. Second quarter, we're probably looking at better spreads, but lower volume and still a good cost performance. Right? And then going into the third quarter, we probably will carry the spread, the positive spread impact. We do hope to have a bit of a volume recovery. So the third quarter could be very good. But then going to the fourth quarter, again, that will depend on where the spreads end up, but the spreads could go back to the, I would say, \$250 per ton, that would be more expected in the downturn. Right? So -- I mean, I think it's going to be very volatile in terms of the explanations for each quarter. But looking at the second and third quarter, I would expect to have a benefit in the cost of goods sold because of that.

Q - Luiz Carvalho {BIO 18040760 <GO>}

Okay, thank you very much. And again, thanks for taking the -- these additional questions.

Operator

Our next question is from the Guilherme Levy from Morgan Stanley. You may proceed.

Q - Guilherme Levy {BIO 20821639 <GO>}

Hi, good morning. Thanks for taking my question. My first question, can you give us an update on the ramp up of the new US plant? I'd like to know if the expectation remains to start the plant through July. And second question is actually a follow-up question. You mentioned that the overall demand in Brazil is down 20%. Can you provide more color on how is the demand behavior by product -- I mean, for PP, for basic chemicals, PVC, et cetera? That would be very helpful. Thanks.

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

Okay, Guilherme. So I'll take the first question and then I'll ask Rosana to take the second one.

On the US plants in -- the expectation is to start up in the next quarter, in the third quarter. Hard to say if it's going to be in July or not, we did have an expectation to start up in the first half of the year around May or June and then there was this delay because of the commissioning of the plant. We are at -- I mean, if you look at the construction percentage or the percentage of completion, we are close to 100%, right, so it's basically done. There is no more construction risk out there. It's more about have the -- having the certification by the system providers, so that we can ensure that the guarantee that they provide are in place and then the commissioning of a few systems in the plant. Right? So, if you go back a couple of months, our expectation was for that to be done by July. There is still some uncertainty out there because of COVID and the ability of a few people that need to travel to get to the plant to do -- to perform some of the tests. So, we cannot be certain that it will start up in July, but it's basically done. It's more about getting people there to do the tests and then start up. That's why we kept saying, we assume that by the third quarter, we should be able to start it up. But -- I mean, as far as construction risk and getting things done, it's pretty much done.

A - Rosana Avolio {BIO 20386863 <GO>}

Yes. About your second question -- hi, Guilherme, about demand, just to give a statement about what we are expecting right now, year-over-year in terms of polyethylene, we are expecting a drop by 5% compared to last year. For polypropylene, a drop about 8% and polypropylene being more affected because we are talking here about durable goods, right. And PVC, we are expecting a 6% drop from 2020 to 2019. Of course, there is still a lot of uncertainty in this scenario, right. This is the best projection that we have at this point and let's see what happen in the coming months. Right? But it's what the numbers that we are seeing by now. But on the other hand, just to give a comment, we are seeing a recovery in Asia. So, we are exporting a lot to Asia since, I would say, two weeks from now. So not only polymers from US, from Brazil, but also chemicals. So probably these export that we are seeing -- and remember that being an after producing -- producer at this point creates advantage, right, considering the oil price as Pedro explained before. So, we are exporting not only chemicals, but also polymers with a good margin to Asia. So, this is offsetting this weaker demand in Brazil.

Q - Guilherme Levy {BIO 20821639 <GO>}

Okay. Thank you very much.

Operator

Our next question is from Jamie Nicholson from Credit Suisse. You may proceed.

Q - Jamie Nicholson {BIO 1540918 <GO>}

Hi, thanks so much for the call and for taking my question. I just have a quick follow-up about the comments you made on the rating agencies. And I'm wondering, if Fitch and

S&P have your BBB minus rating on negative outlook, I'm wondering if they've given you any timeframe for when they would like to see your leverage come down before they may take potential negative rating actions? Thanks.

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

Okay. Thank you. Thank you, Jamie. Thank you for the question. The indication that we had from the rating agencies is that they would give us roughly 12 months to take any action. Of course, I mean, it's not written in stone, but they said that they would expect at least 12 months before they would take any actions. So, that is, of course, compared to the moment where they give us the negative outlook, right, back in end of November. We have been reinforcing with them the actions that we're taking in terms of CapEx reductions and costs -- fixed cost discipline that we already mentioned earlier. We -- the other thing that I already think I mentioned here, but the other thing that they look at is our debt coverage of 55 months that we have looking at the cash position.

So, there is a lot that goes into that type of assessments. And I mean, we do expect to show a deleveraging of the company by the end of the year. That would then -- especially with this recovery in the second quarter, third quarter, we do expect to see deleveraging, which we expect to be a positive -- have a positive view from them. Right? They know that on the low end of the cycle, leverage goes up. So -- I mean, I wouldn't say it's a run of the new day to day discussion, where we are -- I mean, the numbers, the metrics are not good. Right? We recognize that. So, what we are doing is taking all the measures necessary to get those metrics back under more, I would say, acceptable numbers or more expected numbers, but I think there is a lot going on and we're doing a lot of -- making a lot of effort to get it back under more normal metrics.

Q - Jamie Nicholson {BIO 1540918 <GO>}

Thanks. Thanks for that color. Do you have any leverage target for the end of the year that you're trying to achieve?

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

Not specifically by the end of the year. I mean, we do have, I would say, two numbers that we --

A - Rosana Avolio {BIO 20386863 <GO>}

Hi. So, just to continue here, this is Rosana. Pedro will be connecting in a few minutes. But about the target that Pedro mentioned, we do not have a specific target. We have a -- I mean, a specific target for dividend distribution because we have a business policy in the company that says that any distribution on top of the minimum, which is -- in Brazil is 25% of the previous year net income, we are not allowed to pay additional dividends. But internally, what we follow, if I can call like that, is kind of 2.5 times US dollar without project signings of next quarter. This is a reference that we follow internally, but in terms of specific targets just for dividend distribution.

And just one comment, we see the whole picture, right, so it's leverage plus debt profile, not only that leverage and debt profile, we see the whole picture together. Yes, we are

presenting a more -- leverage higher than in the past quarters. But again, as Pedro mentioned, when we take a look in our debt profile, we are pretty much comfortable. We end the quarter with \$2 billion, an additional \$1 billion as standby credit facility and no pressure in the short-term. So, once the cycle gets better in terms of spreads, we will have a better EBITDA and then we will deleverage the company. So this is how we see the whole picture, leverage plus debt profile.

I think Pedro is back on right.

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

Yeah, I'm back. I'm back. Sorry, something happened, I was disconnected. I'm not sure, Rosana, if you answered or --?

A - Rosana Avolio {BIO 20386863 <GO>}

Yeah. I mentioned about the reference that we follow, the 2.5, the dividend to distribution and as we see the whole picture, right, leverage plus debt profile. If you have additional questions, Pedro, please?

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

No, I was going to talk about directly the 2.5, which is kind of the initial target -- or I mean, that's what we want to get under and we feel more comfortable when we are under 2. Right? But -- I mean, the main goal was to get under 2.5.

Q - Jamie Nicholson {BIO 1540918 <GO>}

Okay, thanks. Thanks, Pedro. Thanks, Rosana.

A - Rosana Avolio {BIO 20386863 <GO>}

Thank you.

Operator

Our next question is from (inaudible) from Santander. You may proceed.

Q - Unidentified Participant

Hello. Thank you. Thanks everyone for the call. Just a follow-up on that discussion around net leverage. I presume that that, quote-unquote, lower net leverage by the end of the year is driven more by improving EBITDA because of the kind of FX catch up rather than having any asset sales baked into that. Is that correct?

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

Yes. The way that we work on this decline is to not assume that we're going to be able to sell any assets by December. We are working on that. But when you look at the numbers, what we are -- I mean, our base trend, right, the way that we run the company is looking

at just the operational gains that include FX, but also importantly CapEx reduction. And also, I mean, the other point that I mentioned around reduction of fixed cost and better spread. But we look more at the operational numbers. And then -- I mean, if we are able to do -- to execute any asset sale by the end of the year, then it's a plus.

Q - Unidentified Participant

Okay, thanks. Just a couple other things. I presume that I should look at the credit lines that you're providing to suppliers as something that will run through your working capital calculation. Is that correct?

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

Yeah. They are there. Just to give you -- I mean, so not to overstate the point, we are providing credit lines to our customers and also supporting some of our suppliers, especially the small and mid-sized companies. The numbers involved in the supplier side are not large, we're talking about less than \$60 million. I mean, it's like \$20 million, it doesn't get up to \$30 million even. So it's really -- I mean, because these are small and medium sized suppliers, the amounts that we have outstanding with them and kind of the payment terms we have with them, they are not substantial, right, in total. For each individual company, they are substantial, but not in aggregate for Braskem.

On the client side, we already gave our client credit terms. Right? We already gave them payment terms that range, I mean, up to 30, 45 and sometimes even 60 days. What we are doing is just that the financial costs related to that extension, so the charges, right, the charges that we charge to extend payment terms, we have reduced those. So, it's not like we are extending additional materially, I mean, we're not extending additional credit limits to clients. They are working still within the credit limits that they have. In certain cases, we are creating some exceptions, but those are very much on a case-by-case basis. So it's more of a --

Q - Unidentified Participant

Okay.

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

-- let's say a financial incentive, but it does not impact materially our working capital.

Q - Unidentified Participant

Okay, that's clear. Final thing, just to make sure that I understand the current language versus what was initially in the project finance structure at the Idesa JV. In the event that you receive a downgrade from either of the two agencies that are currently rating you investment grade, there is a contingent equity call that could be up to a \$1 billion to the parents, I guess, 75-25 between yourselves and Idesa. Is that still -- is -- am I understanding that correctly? In the event that you are downgraded, you could be responsible for posting collateral in LC or even cash for up to what BRL750 million. Is that correct?

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

So, at first, you said a \$1 billion and then you said BRL750 million --

Q - Unidentified Participant

Sorry, sorry. It's BRL1 billion, reals, reals.

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

We do have an --

Q - Unidentified Participant

No, no. Hello?

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

Yeah?

Q - Unidentified Participant

Sorry, it's \$200 million, I guess, and that presumably will be split between yourselves and Idesa.

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

Yeah. That is related to the -- I mean, the structure of the contract. If you think about the structure of the contract formally, even though the plant is operating for more than four years now, we're still under construction under the structure of the financing, right, because, I mean, we haven't reached the milestone of physical completion because of the lack of ethylene. So, because of that, we still do have an obligation like that related to the construction, which is done. Right? So -- I mean, we do have that situation.

Q - Unidentified Participant

But the contingent equity is driven by ratings language in the document, though, correct? There's the equity claim -- there's the equity call, which is separate, which is a function of completion. And then there's the Braskem ratings explicitly. Right?

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

Yeah. It's related to the rating that Braskem has. Yeah.

Q - Unidentified Participant

So, these are two separate facilities, so Braskem Idesa could call an additional equity. I mean, their leverage now is in 7 times area and they've got some amortization issues. So, that's potential risk to the parents. And then additionally there's the potential ratings downgrade.

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

No, they are related. They are related. So, it's basically the same. Right? I mean, if there is an issue with -- I mean, remember that, Braskem Idesa has more than \$200 million in cash right now. Right? So --

Q - Unidentified Participant

Right.

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

-- in terms of liquidity to -- in Braskem Idesa, I don't think we have an issue. But if there is an issue with debt service, there is a debt service reserve account in the project, which has -- I mean, which is supported by the parents. It's -- but then the number is likely lower. I mean, it's at around \$150 million. But that would be if they had any issues with debt service. Right? It's limited to that.

Q - Unidentified Participant

But just to clarify, the contingent equity language is still as -- was reflected in the original project finance.

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

Yes, yes.

Q - Unidentified Participant

So that -- got you. Understood. Thank you very much for that. That's all I had.

Operator

As there are no questions, I would like to turn the floor over to Mr. Pedro Freitas for closing remarks.

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

Okay. Thank you. So, I'd like to thank all of you that participated in the call for your questions. I think we covered pretty much all the aspects of the business, all the relevant points and the latest developments. And I do hope to see you back hopefully in August now with the third -- the second quarter results, if not sooner. Okay? So thank you all and stay safe. Bye-bye.

A - Rosana Avolio {BIO 20386863 <GO>}

Bye-bye. Thank you.

Operator

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

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