

## Q2 2018 Earnings Call

### Company Participants

- Fernando Musa, CEO
- Pedro Teixeira, Corporate Finance and Investor Relations Director

### Other Participants

- Gustavo Allevato, Analyst
- Hassan Ahmed, Analyst
- Luiz Carvalho, Analyst

### Presentation

#### Operator

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

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

We have simultaneous webcast that may be accessed through Braskem's IR website at [www.braskem-ri.com.br](http://www.braskem-ri.com.br) and the MZiQ platform, where the slide presentation is available for download. Please feel free to flip through the slides during the conference call. There will be a replay facility for this call on the website. We remind you that questions, which will be answered during the Q&A session, may be posted in the advance on the website.

Before proceeding, let me mention that forward-looking statements are being made under the Safe Harbor of Securities Litigation Reform Act of 1996. Forward-looking statements are based on 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.

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

## **Pedro Teixeira** {BIO 19489140 <GO>}

Good afternoon, everyone. Thanks for joining Braskem earnings conference call. We'll talk today about the results of the second quarter 2018. So let's begin our presentation, turning to slide number three. This slide will provide some highlights about demand, international spreads. So on the demand side, let's talk about the demand impact in Brazil and in the U.S.

So in Brazil, the demand fell by 4% this quarter as compared to the first quarter 2018 as a consequence of the drivers' truck strike in Brazil. However, if we consider the accumulated demand in the first semester of 2018 and we compare with the accumulated demand in the first semester of 2017, there was an increase by 4%. So there was a fell in this quarter. However, on accumulated basis, we have an increase by 4%. In U.S., the demand rose by 7%. The economy in the U.S. is growing very well. The expected growth rate for the year is around 3%. There are some good results on the segment of tax cut and (inaudible).

Let's move to talk about international spread. International spread in Brazil for PE and PP, this is international spreads for the projects that we sell in Brazil. For PE and PP, there was a drop by 11%. This was expected and due to the consequence of the ramp-up of the new PE capacity gas base that is ramping up in the U.S. Spreads for vinyls remain at stable and the same for chemicals.

In the U.S., the spreads were up by 8%. The demand on the PP side is quite strong. And also, there is a ramp-up of the propylene -- new propylene capacity in the U.S., generating more propylene available in the market. So the spread went up by 8%. In Europe, where the company had a total capacity of 0.5 million tons of polypropylene, the spreads fell by 18%. There was an increase in propylene price, and the weaker -- and there was a weaker demand for the PP in the region.

In Mexico, the spreads fell by 5%. The higher same price and lower PE prices, this was expected with the ramp-up of the new capacity in the U.S., both putting some pressure on the ethane price and also putting some pressure down on the PE price.

So let's move to slide number four, where we provide some highlights about utilization rates, sales and EBITDA per region. So in Brazil, utilization rates remain very, very stable as compared to the second quarter. We consider this as a very good achievement, especially considering the drivers' truck strike. We have to remember that in the first quarter of 2017 -- '18, I'm sorry, the utilization rate was impacted by the blackout that we have in the Northeast of Brazil and some stoppage for maintenance that we had in the cracker in the south of Brazil. And in this quarter, the utilization rate was very much impacted by the drivers' truck strike. However, they remain -- the utilization rate remained stable as compared with the first quarter of 2018. Sales fell by the same reason. Sales fell by 7% this quarter. The teams here in Braskem did as much as possible to keep our cracker operating. However, we were not able to move all the products that we produced this

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period, so the sales went down and the levels of inventories during this quarter went up. However, such levels should return to more reasonable regular levels in the coming quarters.

The EBITDA generated by the Brazilian operations of Braskem were 10% higher than the EBITDA generation in the first quarter. So the spreads were relatively good. And also, there was an impact of the depreciation of the Brazilian currency, which helped to dilute feedstock cost in reals. In the U.S., utilization rates fell by 13%. We had some nonrecurring events. There was a stoppage from a -- one of our facilities in the U.S. that took a bit longer than expected and some other operational issues in other PP facilities. So that's why the PP -- the utilization rates in the U.S. fell by 13%. As a consequence of that, sales in the U.S. fell by 4%. However, due to very good spreads that we are facing, especially in U.S., the EBITDA in the U.S. in the region -- U.S. and Europe regions remained relatively stable. Talking about Mexico. Utilization rate dropped by 13%. There was a lower supply of ethane. But also, we had a scheduled shutdown to improve some -- to improve the performance of a certain equipment. So that these were the two reasons why the utilization rate in Mexico fell by 13%. As a consequence of that, sales in Mexico dropped by 8%. However, the EBITDA in Mexico remained relatively stable, just minus 2% amounted -- accounted to \$151 million in this quarter. So let's move to slide five. Just highlight -- just to highlight here that overall, the EBITDA of Braskem in this second quarter 2018 was 7% higher in -- when measured in U.S. dollar. When measured in reals, it was 20% higher when compared with the first quarter 2018. Net profit of Braskem was affected. It was down by 48% as compared to the first quarter 2018. It was positive by BRL 547 million. However, they were -- it was affected by the depreciation of the Brazilian currency. This generated a higher financial expense as compared to the first quarter. However, it is important to remember that we have -- the majority of our debt is in the long term, so this is not a cash effect. Moving to slide number six. And here we talk about the petrochemical outlook for the year of 2018. We expect lower PE spreads for the remainder of the year due to the ramp-up of the new capacity in the U.S. and higher oil prices. This is pretty much what we've been talking in our conference calls. For PP, although there are some new capacities in China, the demand is expected to grow more and the spread should remain quite healthy. And for vinyls, PVC and caustic soda prices are forecast to increase this year versus 2017 due to some recent capacity closures, especially in Asia, and as a consequence of environmental concerns. For PP spreads in U.S. and Europe, the spreads for 2018 should be higher spreads due to tight PP markets, especially in the U.S. The demand is very positive in the U.S. so the spread should be very healthy and the additional -- in addition to new propylene capacity ramping up in the region. And in Europe, the spreads are expected to decrease slightly. In Mexico, lower spreads are expected for -- in this quarter as a result of the new capacities of polyethylene that are ramping up in the U.S. So moving to the last slide here. We provide -- we talk about the outlook for 2018. We make a comparison about what was our -- what is our current estimate for 2018 and how this differ from the -- from our previous estimate for 2018. So utilization rate for 2018 versus 2017 is lower. And now we are less optimistic about that, especially because of the truckers' strike and the unexpected issues that we faced in the U.S. during this quarter. So the utilization rates for the year should be lower than we were expecting last quarter. The same effects for demand. Even though the demand should be better as compared to 2017, it should not be as bad as we were expecting mainly because of truckers' -- truck drivers' strike. For spreads, spreads of chemicals, we are more positive about that. We are seeing more higher butadiene prices. For PE and PP,

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they are relatively stable. And for PVC, they are higher than 2017, but a bit smaller than we thought it will be. We have some decrease in the soda -- caustic soda prices. There was -- one impact is the REINTEGRA. End of May, the tax incentive on Brazilian exports under the REINTEGRA tax regime was reduced from 2% to 0.1%. And in the same period, the Special Regime for Chemical Industry, REIQ, was revoked by a provision of the Presidential Decree, which will become effective in September 1, 2018. So if the decree is passed into law, the COFINS on feedstock purchased in Brazil will revert to the general rule. So EBITDA for the year 2018 should be lower than what we posted in 2017. So we remain -- this is our expectation for the year. However, working capital -- actually, free cash flow for the year 2018 should be higher. So we had some negative impact of working capital last year. We should not see the same impacts for -- we are expecting to see the same impacts for this year. We have -- we should have lower interest rates for this year, lower payments of tax, especially because of the U.S. tax reform. CapEx should be a bit higher. And overall, the free cash flow of the company should be high, though a lower EBITDA. So let's move to the Q&A session. Thank you very much.

## Questions And Answers

### Operator

Thank you. The floor is now open for questions. (Operator Instructions) Mr. Gustavo Allevato from Santander would like to make a question.

#### Q - Gustavo Allevato {BIO 18933135 <GO>}

Hi guys. I have two questions here at my side. The first one, regarding the domestic production in Brazil. So is the company prepared to export the production from Brazil since the outlook for the domestic market is not as good as the company initially expected? The second question is regarding the utilization at RioPol. If you could provide some color on what was in the second quarter and what's the outlook for the rest of the year. And third and the last question is regarding the operational issue at the Marcus Hook site. Is it bad or should we estimate a lower utilization rate for U.S. operations in the second half due to the issue?

#### A - Fernando Musa {BIO 17592170 <GO>}

Hello, Gustavo. This is Fernando Musa. Good afternoon to all. Gustavo, thanks for your questions. As far as the domestic production in Brazil versus the sales profile and exports, as Pedro mentioned in the presentation, the truck driver impacted our production, had a direct impact on sales in the first quarter because many of the value chains we serve had suffered even higher impact than we did from the truck driver strike. So as we progress during the year, we will probably revert to a more sustainable growth from different value chains. We started the year with an expectation of demand growth in Brazil for resins in -- anywhere between 4% and 5%. Right now we're more in the 3% to 4% range. A lot will depend on how the different value chains behave in this August-September time frame. We did see good recovery in the back end of June when everybody came back. July, also several value chains had good production and good sales. So we'll need to see how this will play out. We tend to fluctuate more when we have operational challenges from a production point of view. We tend to fluctuate more on the exports, which is natural. So the

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reduction in exports, both in Brazil and in Mexico, is a consequence of that. So we'll use the exports as a buffer. Especially the marginal exports are the buffer for that instability in operations when it happens. So as we recover production and we expect healthy back end of the year demand, we should see higher sales in Brazil. But also -- and with improved production, eventually, higher exports volume coming out of Brazil. As far as the RioPol utilization rate is concerned, the second quarter was a very positive second quarter. We actually ran above 100%, 102%, 103% and 104%, utilization rate in the combination of higher supplies from Petrobras and a small volume of imports by ourselves. And for the back end of the year, we continue with the expectation to have good supplies from Petrobras with the occasional import of ethane complementing. So we do expect to run the plant pretty high toward the back end. And as far as Marcus Hook is concerned, it was a mechanical issue at one of the compressors. That has been solved. The plant is back. So we do expect that the second half of the year will go back to the typical utilization rates that we've seen in the U.S., but they're much higher than what we saw in the second quarter.

**Q - Gustavo Allevato** {BIO 18933135 <GO>}

Okay. Thank you. Very clear. Just one follow-up. During the negotiation among the controlling shareholders, does this affect the company's capital allocation in -- for second half -- I mean, more related to your payment of the dividends or your total independence?

**A - Fernando Musa** {BIO 17592170 <GO>}

The negotiation between LyondellBasell and Odebrecht does not impact our day-to-day and our strategic drivers. It is a shareholder decision that could lead to a transaction between the two of them. As far as the plan that we are pursuing, we continue to pursue and deliver on our strategy. There is no dialogue as of now as far as dividends are concerned, especially since we paid dividends 2, 2.5 months ago. So our normal payment would be sometime end of first quarter, beginning of second quarter next year. We just issued a Board policy on dividends that explains how we think and run the process of analysis for dividends, which is a forward-looking current year plus two years of the business plan, expected investment, expected volatility of the industry. And with all that, we will consider dividend. We have an expectation of hitting a net debt over EBITDA below 2.5 times. 2.5 is a ceiling. It's not a target. We're not increasing that to get to 2.5. It's the threshold we look at where the plan, the expected investments and expected potential volatility would keep the debt over EBITDA profile. So if and when it makes sense, in the future, we'll go to the board and discuss dividends by the back end of the year, beginning of next year.

**Q - Gustavo Allevato** {BIO 18933135 <GO>}

Very clear. Thank you, guys. Good afternoon (ph).

**Operator**

Mr. Luiz Carvalho from UBS would like to make a question.

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## Q - Luiz Carvalho {BIO 18040760 <GO>}

(inaudible) Thank you. I have a couple of questions here. The first one, regarding the due diligence, Musa, that was required for you to -- or the management to perform in order to actually to comply with the deal. The question is, Bob Patel, the CEO of LyondellBasell within Brazil -- and he had a couple meetings, including the mines and energy ministry. And is there any update regarding conversations that potentially you had with him? And on top of that, is there any update regarding the tag-along of Petrobras? Do you have any clarification if Odebrecht exercised or completed the negotiation with Lyondell? If Petrobras remain in the contributing shareholders, that would trigger the tag-along rights for the minorities. So that's the first one. The second one is regarding the naphtha acquisition from Petrobras. We saw over the past couple, I mean, this quarter that you revisit -- I don't mean significantly, but to pretty much low level in terms of acquisitions from Petrobras. I just would like to understand if this is something -- the new normal or this is something momentary in order to be less dependent from the company. And the third one, you already signed the leniency agreement with some Brazilian, I'm going to say, entities. However, I would just like to follow up if there's something new over the past couple of weeks. We saw some news that potentially there's some additional value regarding the class action or the agreements that you'll be signing. So if there's some update regarding the potential additional cash that you would have to disperse, that would be great.

## A - Fernando Musa {BIO 17592170 <GO>}

So Luiz, as far as the due diligence process is concerned, as we informed to the market, the dialogue about the transaction happens at the shareholder level. We've been asked to support with information to support the dialogue. The process is going well. We're going to provide some information and do expect additional questions from the shareholders so that they can have the dialogue with LyondellBasell. So there's not much more I can say about this as of today.

As far as the tag-along option for Petrobras, I have no information. This is a question you should ask to the Petrobras management. We understand that there is a desire by Petrobras expressed by several interviews by Eva Montero to assess whatever deal Odebrecht might agree upon with LyondellBasell and based on that assessment, make a decision on the right they have today under the shareholder agreement. So I have no other information beyond the fact that Petrobras does have the right for tag-along that is clearly defined in the shareholder agreement. As far as the minority shareholders, there is a provision in the bylaws that in any change of control, minorities will have a tag-along. So this provision would be triggered in the case there is a transaction between Petrobras -- between Odebrecht and LyondellBasell that transfers the control of Braskem. This provision guarantees for the minority shareholders the same conditions that Petrobras would get -- that Odebrecht would get in any transaction. As far as the naphtha purchases that we do from Petrobras, this is a continuous process of managing the different suppliers and contracts that we have. As we discussed in previous calls, we have not only Petrobras has a supplier, but a relevant roster of other supplies from different regions around the world. And this is managed on a month-by-month, week-by-week and in some cases, day-by-day basis. There is no intent to be less dependent of Petrobras. This is a more operational and financial decision based on quality of the naphtha. There are different types of naphtha that would yield different volumes of coal products, so we

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analyze the expectation of pricing for the different coal products and therefore, select the displays of feedstock for different crackers. But also different contracts have different pricing, terms, conditions that we analyze when we're making the decisions. In the recent past, this has led to us buying less than the top volume that we could buy from Petrobras under the contract, but this has no intent to be less dependent. It's a consequence of operational and financial analysis. As far as any other amount related to class action or other potential agreements, there is -- we settled the class-action agreement. And therefore, we have no expectation of others. There is no other class-action going on, so I'm not sure where you got this as far as class-action is concerned. As far as the authorities, we did communicate to the market that the dialogue with the (inaudible), which are part of the Brazilian authorities here, the dialogue with them about a potential agreement is underway. The company's expectation is that any agreement with (inaudible) from a financial point of view would be covered with the agreement that we already signed with DOJ, the Swiss authorities and then (inaudible) Republiku here in Brazil. So we do not have an expectation as of today of any additional mining with or without this agreement that is being discussed with (inaudible) and it's being discussed under confidentiality. Therefore, I cannot enter into more details than what I just shared.

**Q - Luiz Carvalho** {BIO 18040760 <GO>}

Thank you very much, Musa. Pretty clear. Thank you.

## Operator

Mr. Hassan Ahmed from Alembic Global would like to make a question.

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

Hi. Good afternoon, Fernando. As I take a look, Fernando, at Q2, particularly here in the U.S., very interesting market dynamics, right? You had spot ethylene price (inaudible) seems to have recovered from there. Then you had ethane pricing skyrocketing. It seems to have come down from there. And as I take a look at all of the expected capacity that was supposed to come online, and this is for the, call it, 2016 through 2019 time period, be it on the ethylene side, be it on the polyethylene side, it seems around 65% of that capacity has come online or hit the market. So my question is that these movements that we saw, were they sort of just like sharp movements and now there's a new equilibrium that has been established with the market having digested this capacity and only a one-third of incremental capacity left to hit the market? Because again, through all of this noise on the spot market side, it seems that contract polyethylene pricing remained very resilient. So in a nutshell, the question I'm asking is, is the capacity or incremental supply-driven shock behind us? And should we expect more steady sort of ethylene-polyethylene pricing going forward over the next couple of quarters?

**A - Fernando Musa** {BIO 17592170 <GO>}

So Hassan, that's a very interesting question. I would maybe -- I don't have the data that right in front of me here, but I would maybe disagree a little bit with your statement that both ethylene and PE already are at 65% hit the market and 35% not in the market yet. Our information and our reading of what's out there is that probably, ethylene is closer to a higher number than that and the PE is a little bit behind. Second, the ethylene seems to

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be running better than -- the new ethylene seems to be running better than the new polyethylene. So I think the C2 coming down is a consequence of this. The crackers coming out running better, then the PE lines are a little bit behind and are having more trouble. This led to the ethane going up. And now that, I mean, you start to -- the PE starts to catch up and ethane production with the higher price continues to increase, then ethane got a little tame by the -- availability of ethane demand continues to be very strong. So I think there's still some impact coming, but we're clearly getting to a new equilibrium. The expectation everyone had that it would be a big disturbance because everything would come online altogether, clearly, is not the case and will not be the case. The projects have spread out over a 24-month period and therefore, impact is less significant. Cannot forget the demand aspect, which has been very strong, surprisingly strong. The recycling availability in China, that has been reduced because of the ban of import of waste, has helped globally. And it came in at a very positive timing for the industry because it was just when the new PE capacity was ramping up. So I think we are reaching a new equilibrium, and there's still some key capacity as the plants get stabilized and the new capacity that should be coming online enters the market. But the combination of spreading out all the projects and demand being very healthy makes it that some -- even though we do expect lower spreads for the PE chain, it still had a pretty healthy level. The contract price in the U.S. and the exports will probably take all the volatility that come from additional volume in the U.S. The market dynamics in the U.S. from a contract for local clients is very different than the export dynamics. So I would expect more stability on the contract price domestically in the U.S. and any volatility with new plants coming online and new products hitting the market coming on the export market. But again, with the healthy demand globally, it's going to be absorbed quickly and should lead to a pretty healthy, if you have an ethane cracker in the U.S. or Mexico, environment for the near future.

#### **Q - Hassan Ahmed** {BIO 7430123 <GO>}

Very fair, Fernando. Very fair. Now moving on. Again, you're sticking to more of the macro side of things. Just trying to get my head wrapped around the whole sort of trade war, tariffs, questions surrounding what's going on between the U.S. and China, particularly on the polyethylene side. Two parts to this. One is as I take a look at the initial list that came out of products included in that to-be-tariffed list, it seems that LDPE, LLDPE were included. HDPE was not. So the first part of the question is, how should we think about that? And the second part, again, part and parcel with this whole trade thing, is that, I mean, now with Q2 earnings season behind us, I spent time with more of the global PE guys, the sort of U.S. guys that have global asset base footprints, and they don't seem too worried about the trade tariffs, right, on the PE side. I mean, it just seems the recurring answer is, look, yes, we have assets here in the U.S., but we also have assets in Asia and in Europe and we can easily redirect product, which, let's say, was going out of the U.S., we can redirect it from other parts of Asia or Europe into the Chinese market. So they don't seem too worried about any negative impact from that. So I would love to hear your views about be it the grade side of things of the PE as it affects trade and then what some of these companies' global footprint, I think.

#### **A - Fernando Musa** {BIO 17592170 <GO>}

So I think it's a very important topic. I tend to agree with the statement that when you think globally, trade flows will adjust. And there is production of PE regardless if it's the



same company or not. There's production in different regions. It's a product where trade flows should increase because of new capacity coming in regions where there is no demand, be it U.S. or Middle East. So we will have trade flows. So the industry will adjust. It might be just like any -- from my point of view, this is -- I look at this as a logistics constraint, right? Once you have, let's say, a railroad bridge falls, in the short term, it's painful. But I mean, the flows will readjust and go around it. And eventually, the bridge is fixed, right? It might be a little different for it.

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

I think that's a sensible way of thinking about it, you're right, yes.

**A - Fernando Musa** {BIO 17592170 <GO>}

So in the long term, I mean, trade flows will adjust. With the blockage, which is the tariff, it might be a little but more expensive to -- the optimal flows with the tariffs might be different than without the tariff. So there's a little bit more cost in the system. But compared to the volume and the margins that you make, I agree with the statement that this is a smaller impact. If you go company by company, region by region, it might be different. But in general, my perception, my belief is it will readjust. Having said that, it could be thankful in the transition period as people redirect and until the -- a new equilibrium, as trade flows is established. But as you mentioned, most of the large players have plants everywhere, have commercial presence everywhere. So they have the channels. They will be able to adjust. We will be able to adjust. And different than, I mean, the U.S.-based players, we -- this might be an opportunity for us from a trade flow point of view, right? I mean, we're not suffering the tariffs as the U.S. production. So this could be an opportunity for us to optimize, and the other players that face the tariffs might need to go out of their optimal flows and we could improve our optimal flows depending on this. So we'll need to see how it plays out. On the HD versus low density and linear low, I saw an article this morning saying that China is planning --

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

Yes. I think now they're even including HD, yes?

**A - Fernando Musa** {BIO 17592170 <GO>}

Yes. It looks like HD -- they realized they left a loophole. So I didn't -- I saw the tagline. I didn't have time to read the detailed article, but my understanding of the tagline was HD was in. So eventually, it will be fixed. I think the whole trade barrier, I mean, it's not in their U.S. or China interest to keep going and escalating. Eventually, it will reach an equilibrium, my personal belief. But with two very strong-willed leaders, it's hard to predict. So let's see where it goes.

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

Perfect. Makes complete sense. Thanks so much Fernando.

**Operator**

(Operator Instructions). As there are no questions, I would like to turn the floor over to the company for final considerations.

## A - Pedro Teixeira {BIO 19489140 <GO>}

So I would like to thank you all for listening to our second quarter results call as we expect for the challenging quarter and some external aspects, especially the truck drivers' strike in Brazil that created a lot of challenges from an operational point of view. But despite this and some plant turnaround that we had, we managed to have very strong positive cash flow and EBITDA generation, which helped us reduce even more our leverage ratio. So our strategy of investing in productivity and competitive diversification of feedstock, diversification from a geographical point of view proved itself very valuable once more when we faced different challenges in the different products in the different regions. And with all the challenges that we faced, we'll continue to generate good results, leveraging the asset portfolio and the client relationships around the world to generate positive results. And we'll continue to pursue that strategy as it's been delivering very satisfactory and good value-creation results for our shareholders. So thank you all for listening, and I'll talk to you guys in three months' time when we disclose the third quarter results. Bye-bye.

## Operator

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

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