

## Q2 2016 Earnings Call

### Company Participants

- Pedro Teixeira, IR, Controller & Project Finance Director
- Unidentified Speaker, Unknown

### Other Participants

- Adam Rodriguez, Analyst
- Hassan Ahmed, Analyst
- Lilyanna Yang, Analyst
- Unidentified Participant, Analyst

### Presentation

#### Operator

Good afternoon, ladies and gentlemen. At this time, we would like to welcome everyone to Braskem's Second Quarter 2016 earnings conference call. Today with us we have Fernando Musa, CEO; Pedro Freitas, CFO; and Pedro Teixeira, IR, Controller and Project Finance Director.

We would like to inform you that this event is being recorded. (Operator Instructions)

We have simultaneous webcast that may be accessed through Braskem's IR website, <http://www.braskem-ri.com.br/>. The slide presentation may be downloaded from this website. Please feel free to flip through the slides during the conference call.

There will be a replay facility for this call on the website.

(Operator Instructions)

Before proceeding, let me mention that forward-looking statements are being made under the safe harbor of the Securities Litigation Reform Act of 1996. Forward-looking statements are based on the beliefs and assumptions of Braskem management and on information currently available to the Company. They involve risks, uncertainties. And assumptions because they relate to future events and therefore depend on circumstances that may or may not occur in the future. Investors should understand that general economic conditions, industry conditions. And other operating factors could also affect the future results of Braskem and could cause results to differ materially from those expressed in such forward-looking statements.

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Now, I'll turn the conference over to Pedro Teixeira, IR, Controller. And Project Finance Director. Mr. Teixeira, you may begin your conference.

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

Good afternoon, ladies and gentlemen. Thank you for participating in another Braskem's earnings conference call. Today, we'll be presenting our results for the Second Quarter 2016.

We would like to remind you that, pursuant to the Brazilian federal law, the results presented in today's presentation reflect the adoption of International Financial Reporting Standards. The financial information in today's presentation was reviewed by the independent external auditor.

Let's go, please, to the next slide, which we will present the highlights in the period. In Brazil, the highlight was the resin market, which came to 1.2 million tons, expanding by 3% on the First Quarter. Braskem's sales grew by 8%, to 846,000 tons, with a market share raising three percentage points.

Resin exports also grew in the period, by 21% compared to the Second Quarter of last year and 9% compared to the First Quarter of 2016, amounting to 454,000 tons. Exports of key basic petrochemicals came to 379,000 tons, growing by 6% on the prior-year period.

The crackers in Brazil operated at a capacity utilization rate of 94%, one percentage point higher than in the same period last year and five percentage points higher than in the First Quarter of 2016. This good performance was influenced by production from the gas-based cracker in Rio de Janeiro, given the higher supply of feedstock in the period.

EBITDA for the operations in Brazil, including exports, amounted to BRL2.3 billion, representing 75% of the Company's consolidated EBITDA.

Meanwhile, in our PP operations in US and Europe, the highlights were the average capacity utilization rate of 103%, reflecting the excellent operational performance and strong demand for PP, especially in the US. Sales volume in the quarter came to 504,000 tons. And advancing by 2% on the Second Quarter of last year.

EBITDA in US and Europe was \$212 million, or BRL745 million, amounting for 25% of the consolidated EBITDA. In the Second Quarter of last year, the segment accounted for only 8% of the consolidated EBITDA.

With higher production volume, inventory building. And launch of sales, the petrochemical complex in Mexico begins to be considered a reportable segment, generating EBITDA in the quarter of BRL7 million.

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Brazil consolidated EBITDA was approximately BRL3 billion, representing growth of 15% year over year. And is stable compared to the First Quarter. In US dollars, EBITDA came to \$858 million, 10% higher than in the First Quarter.

In April, Braskem paid dividends of BRL1 billion, which is the highest amount it has ever distributed and corresponds to 32% of 2015's net income.

Even with the dividend payment, the Company's corporate leverage ratio measured in US dollars ended the quarter relatively stable, at 1.79-times.

On slide number 4, we comment on the performance of the segments in Brazilian market. Brazil today's [ph] resin market reached 1.2 million tons, expanding by 3% from the First Quarter. Compared to the Second Quarter of last year, the market remained relatively stable.

Braskem's resin sales in Brazil grew by 8% compared to the prior quarter, to 846,000 tons. Braskem resins exports also grew in the quarter, by 9% compared to the First Quarter.

A highlight was the average cracker capacity utilization rate of 94% in the quarter, which was five percentage points higher than in the First Quarter, given that the higher feedstock supply and the gas-based cracker in Rio de Janeiro.

The international resin spreads, weighted by the Braskem production in Brazil, stood at \$646 per ton in the quarter, an increase of 5% on the prior quarter. Our basic petrochemical spreads were at \$343 per ton, 1% up from the First Quarter of the year.

As a result, EBITDA in Brazil including exports amounted to BRL2.3 billion, growing by 6% sequentially. This EBITDA represents 75% of the consolidated EBITDA.

Moving on, slide five comments on the US and Europe business unit. The operation in US and Europe delivered important results in the Second Quarter. PP sales volume in the quarter came to 504,000 tons, growing by 2% on the year-ago period, with strong demand from the US automotive industry and healthy demand in countries such as Italy, Germany. And the United Kingdom.

PP spreads in the US stood at \$742 per ton, down 14% on the prior quarter, reflecting the higher volume of PP imports into the country. And 55% higher compared to the Second Quarter of last year. The average price of US propylene, the main feedstock used in the units in the US and Europe, was \$720 per ton, up 5% on the prior quarter.

In this context, the units posted EBITDA of \$212 million, down 3% sequentially and 195% higher year over year. In Brazilian reais, EBITDA was BRL745 million, accounting for 25% of the consolidated EBITDA. In the same quarter last year, the unit accounted just for 8% of the total EBITDA.

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Moving on, let's turn to slide number 6, please. The petrochemical complex in Mexico was gradually commissioned throughout the first half of the year, with the startup of the cracker and specification of the ethylene in March, the startup of the two high-density polyethylene facilities in April. And the startup of the low-density polyethylene plant in June. In this scenario, in May Mexico ceased to be recognized as a project and became a reportable operating segment.

The capacity utilization rate of the PE plant in the quarter stood at 32%, with the building of 74,000 tons of resins inventory. The complex's total resin production was 83,000 [ph] tons, of which 54,200 [ph] tons was sold both in the Mexican and international markets, which includes (inaudible) sales for the period.

The sales price of Mexican PE is defined based on the import priority [ph] in Mexico, based on the price of resin in the US Gulf coast. The average price in the region in the quarter was \$1,156 per ton, 10% higher than in the First Quarter. In this context. And though still in the operational ramp-up phase, Braskem IDESA posted positive EBITDA of BRL7 million in the quarter.

Slide seven shows EBITDA in the Second Quarter compared to the First Quarter. EBITDA in the period was BRL3 billion, 2% lower than in the First Quarter. The higher sales volumes and exports in Brazil and the higher contribution market helped to offset 10% appreciation in the Brazilian real in the period, which affected negatively the EBITDA.

In US dollars, EBITDA was \$858 million, increasing by 10% sequentially.

Moving on, slide eight shows the EBITDA in the first half of the year, up BRL6.1 billion, which was 48% higher than in the first half of the last year. Growth between periods is explained by better spreads for basic petrochemicals and PP in US and Europe; higher resin exports, which mitigated the lower volumes in the Brazilian market; the performance of operations in US and Europe; and the Brazilian real depreciation of 25%.

In US dollars, EBITDA in the first half increased by 21% year over year, to \$1,638 million.

Slide nine shows Braskem's corporate debt excluding the project finance debt in Mexico. On June 30, Braskem's gross debt stood at \$7.6 billion, increasing 3% from end of March. In Brazilian reais, gross debt declined by 7%, influenced by the 10% appreciation in the Brazilian currency.

A total of 78% of the gross debt was denominated in dollars.

Cash and equivalents stood at \$2.1 billion, or BRL6.7 billion.

Net debt stood at \$5.6 billion, 4% higher than in the First Quarter, reflecting the distribution of BRL1 billion in dividends. In Brazilian reais, net debt fell by 6%. 84% of the net debt was denominated in US dollars.

The net debt-EBITDA ratio ended the quarter at 1.79-times when measured in US dollars. In reais, the leverage ratio stood at 1.66-times, down 9% from the First Quarter, influenced by the currency appreciation in the period.

The Company's average debt term is around 15 years. In the quarter, Fitch reaffirmed its risk rating for Braskem of BBB-. This means that Braskem remained above Brazilian sovereign rate at the three main risk rating agencies and investment grade by Standard & Poor's and Fitch.

Moving on to the slide number 10, in the first half of 2016, Braskem invested BRL1.6 billion, of which BRL942 million -- corresponding to \$250 million -- was allocated to Braskem's capital contribution to the Mexican project; BRL490 million was allocated to maintenance and the operational reliability of the plants; BRL121 million was allocated to strategic investments. Of the total amount in the first half of the year, approximately 69% involved investments in US dollars by international business and capital contribution in the Mexican project.

Slide 11 covers the scenario for ethylene petrochemical industry. The newest planned [ph] capacity coming on line in 2017 and 2018, which could cause volatility in the petrochemical supply/demand balance, will be added at a smooth pace, due to cancellation and postponement of certain greenfield projects.

Based on recently revised data from the consulting firm IHS, certain new capacity originally slated to start production between 2016 and 2018 are expected to be postponed and potentially canceled. In the US, certain new capacity are suffering delays, while in China and the Asia region coal-based projects have lost some of their attractiveness due to the lower naphtha price. Moreover, projects are facing high investment costs and infrastructure problems.

On the next slide, we comment on the petrochemical scenario for resins. In the US, despite some potential volatility in the near term, PP propylene spreads should remain healthy. Propylene in the feedstock used for producing PP is suffering from oversupply due to the higher production of propylene by refineries, the startup of new propane dehydrogenation plants. And the cracking of propane.

The new PP capacity are not expected to come on line before 2018. Therefore, spreads should remain at high levels until that year.

Although a final investment decision has yet to be made on the construction of a new PP plant, IHS already considers this new capacity of Braskem starting up in 2019.

With regards to the new PE capacity in North America, I should mention here the startup of the Mexican project, which was the first greenfield project to be commissioned. The startup of the new PE capacities announced in the US can temporarily pressure the resins spreads in the region, with this situation expected to be reversed by the end of the decade.

Braskem's main priorities in Brazil are the following: (inaudible) operating efficiency gains in plants to serve the Brazilian market; exporting any volumes not sold in Brazil; conducting maintenance shutdown on one of the lines at the Bahia cracker in the Fourth Quarter; and completing feedstock flexibility project in Bahia.

In the US and Europe, the focus will be on seizing opportunities presented by healthy spreads and markets and seeking new opportunities for growth in PP based on competitive polypropylene feedstock in US.

In Mexico, the focus will be on ensuring the operation and stability of the complex; sales in the domestic Mexican market; and strengthening relationships with local clients; and conducting exporting synergies with various other Braskem operations in US, Europe. And South America.

And in terms of liquidity and financial health, the focus will be on cash generation and the ongoing implementation of the program to cut fixed costs, with potential annual recurring savings of BRL400 million.

That concludes the presentation. Let's go to the Q&A session.

## Questions And Answers

### Operator

(Operator Instructions) Adam Rodriguez, GBM.

### Q - Adam Rodriguez

Congratulations on the results. There has been a lot of uncertainty regarding the supply of ethane from Pemex. Can you explain what would happen in a scenario in which Pemex wasn't able to deliver their contractual ethane amount? Specifically, what are the liabilities to Braskem and Pemex in this scenario?

### A - Unidentified Speaker

On the supply contract in Mexico, we have a very strong contract with a list of rights for the project, which includes a very strong (inaudible) mechanism. But we also have a series of other protections from an operational and flexible point of view.

This contract was reviewed extensively under the project finance and restructuring and led to a situation where the fact that it's a non-recourse project finance required a very tight, very perfected guarantee around the availability of ethane.

So it has been approved by 17 different lenders. And we're very comfortable that the contract is very strong and that in the eventuality that Pemex does not provide us with the ethane that the penalties that they would pay would compensate for that lack of supply.

## Q - Adam Rodriguez

Okay. Thank you for your comments.

## Operator

Hassan Ahmed, Alembic Global.

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

I think obviously Q2 was a bit of an interesting quarter from a demand perspective, not just you guys domestically within Brazil. But it just seems, be it Asia polyethylene demand, be it North American polyethylene demand, seemed to be quite strong.

So the question I have is around inventory. Again, complicating things further in Q2 was the fact that, obviously, it was a very heavy turnaround quarter, right? So my question is that on one side you have turnarounds. On the other side, obviously oil prices were going up, which, between demand looking good and oil prices going up, obviously polyethylene prices went up, as well.

So how much do you think this -- how much of this positive demand growth that we saw in Q2 stems from an inventory build on the back of rising prices, turnarounds. And the like? And how much was just true sort of organic demand growth?

## A - Unidentified Speaker

Hassan, I think if you look at the timing of the turnarounds, a good chunk of the inventory build was done, actually, in the First Quarter in the US. A part of it was at the beginning of the Second Quarter.

I would say if we look at Brazil from a specific point of view, we see trends in demand. There was some restocking in the value chain by our clients that had very low inventories. So this was a component.

Based on what we see in the US and global markets, I would say that this trend is coming from a turnaround season that reduced the inventories -- as you said, it was a strong turnaround season -- and still pretty good, healthy demand around the world thanks to reasonable economic situation, in general, around the world.

It's not the case in Brazil. But we are starting to see a shift towards a more strong [ph] economic environment in Brazil. So even in Brazil, we saw in the Second Quarter stronger demand. And this contributed to the strength in prices that came from higher cost because of oil price and tighter supply because of the turnaround season.

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

(inaudible). And I appreciate the sort of positive presentation, where you give us sort of your views about ethylene supply/demand fundamentals and sort of slippage in terms of the timing of capacity additions. And the like. I would appreciate your sort of views on the

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other side of the equation; meaning, the feedstock side of the equation, particularly as it pertains to the NGL side.

Obviously, you guys are polypropylene producers. Polypropylene to propylene spreads are quite important to you. And there seems to be a favorite debate going on right now, a [ph], associated with potentially nat gas prices going much higher and then, part and parcel with that, a combination of NGL exports as well as sort of capacity additions within North America resulting in NGL supply/demand fundamentals priced in quite quickly.

So I would love to hear your views on that.

### **A - Unidentified Speaker**

I think if we look at what's happening on the demand side for NGLs, we see a wave of announcements of postponements. So on the demand side, it looks like there's a loosening up of the potential pressure on the pricing coming from the demand side.

The data we shared comes mainly from IHS external sources. But you guys have been following the written announcements by two players in the US last week, talking about postponements or delays in projects.

So in that sense, I think there is a part of this developments from the fixed cost point of view, because --.

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

By the way, it seems reflective in pricing, as well, because pricing, obviously, for ethane went up to \$0.22-\$0.23 a gallon and now seems to have come all the way back down to \$0.16 again.

### **A - Unidentified Speaker**

Yes. So this is one aspect.

And the other aspect is on the availability of NGLs. With oil now in the \$40 to \$50 range and going back and forth, we see many companies in the US announcing the restart of drilling operations, many companies adding rigs, which if you go back six months every single month you would see and hear the news would be even more rigs being cut, more rigs [ph] in mothballs. And in the recent weeks, I believe almost every single week we have a company announcing puts one rig back on, two, three.

So I think now with the \$40 to \$50 and the development in operational costs for shale exploration and those costs going down, you're going to see a healthy stream of investment in the drilling side that will help balance the supply and make it stable to rising.

So if you couple this with slightly lower demand internally in the US, if you couple this with slightly less pressure from the exports market because if oil stays at this price the naphtha



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crackers are reasonably competitive, as we have seen in our operations here in Brazil, you could have a situation where you have stability in NGL pricing.

Even with some increases in NGL exports, the market should balance between the supply decrease and demand locally and the slight decrease in exports demand. We've heard many reports about China is going down, TGH project; therefore, trading more length with propane [ph]. Many of the US-based projects for TGH have been delayed beyond the two that are and the one that is already operational and the second one that starts early next year.

So I'm more optimistic, quote-unquote, on the sense that I see a balanced availability.

And you mentioned a significant increase in natural gas prices. I don't see a significant increase, unless you're talking about \$0.50 per MBTU being significant. Yes. We could see that. But we're not going to see \$2, \$3, \$4 of increase in the natural gas prices in the near future, in my point of view.

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

Very helpful. Thank you. So much.

## Operator

(Operator Instructions) Michael Rucop [ph], Barclays.

## Q - Unidentified Participant

First, I was wondering if you can give us a sense of CapEx outlays for the next few years. And specifically what is the scale of investment that would potentially be involved with building a new polypropylene plant in the US?

Then, second, now that net leverage has come down so substantially, is there a target that you'd like to stay below when looking at potential new projects or M&A?

## A - Unidentified Speaker

As far as CapEx, the Company usually invests in any given year anywhere between BRL1.2 billion and BRL1.8 billion of maintenance CapEx and operational CapEx to support the current operations it has. This is a number, as I said, anywhere between BRL1.2 billion and BRL1.8 billion. It's pretty stable. And it's a pretty good estimate for expectations for the future.

On top of this, we have the strategic projects. We just ended a phase where the Mexico project was a relevant part of it. So as we talk about the future, it's going to depend a lot on which decisions we'll make around projects.

We have announced a couple of, I would call, smaller projects, like the investment in the cracker in Bahia in the north of Brazil to create flexibility to receive ethane. That is being

implemented this year and next year. And we also shared the news that we have been evaluating a new PP plant in the US.

These are two examples of what I called the strategic that it's very hard to provide kind of a running rate, because it's going to depend on the strategic moves and the strategic decisions that will be approved by the Board. And as soon as they are approved, they will be communicated. And you guys will be able to incorporate that in your forecasts.

### **Q - Unidentified Participant**

Okay. Thank you. And on leverage? I don't know if you had any comment there?

### **A - Unidentified Speaker**

On leverage, we have been for many quarters now reducing our leverage when measured in dollars. The way we measure it is we exclude the Mexico -- both Mexico results and Mexico's debt, since it's a project finance with non-recourse.

So when we look at that measure, we ended the First Quarter of this year at 1.72-times of net debt to EBITDA; and now, we are at 1.79. There are two reasons for that increase. One is we paid BRL1 billion of dividends in April. So that represents roughly 0.1 in our leverage.

And the other one is we've made a commitment to a reserve account in the Mexico project. So we moved that from available cash to another line in the balance sheet. And that has increased our leverage by 0.03, or so.

So those are the two larger impacts on our leverage.

And our expectation is to continue to generate relevant cash to enable the de-leverage of the Company so that we are ready for strategic opportunities that might come, like the ones I described. For example, the new PP plant in the US would be a relevant investment, because it would be a world-class plant, therefore a relevant investment.

So the strategy from a financial point of view is to manage the leverage to a healthy point to enable us to act on the strategic opportunities that might come.

Just an additional note. We aim this year to remain below 2. So that when the downturn in the cycle comes we don't go over 2.5 net debt to EBITDA.

### **Q - Unidentified Participant**

Okay. Thank you. That's very helpful.

### **Operator**

(Operator Instructions) Lilyanna Yang, HSBC.

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### **Q - Lilyanna Yang {BIO 14003234 <GO>}**

The number one question is on if you could provide clarity on why the maintenance CapEx has a wide range? If I understood correctly, you mentioned between BRL1.2 billion to BRL1.8 billion per year. So I wonder why it would be closer to BRL1.2 billion or to BRL1.8 billion depending on the years?

And on a second question, it's also regarding your leverage targets. Looking at the level that you feel comfortable for the coming years and thinking that the spreads will be probably denied [ph] in the short term, it feels like you might have room for an even higher payout, right? So what are your considerations for increasing your payout? Or, if you think that there are small M&A opportunities in the short run?

### **A - Unidentified Speaker**

On the wide range -- the BRL1.2 billion to BRL1.8 billion -- it's very dependent on a year-to-year base on the turnaround at the cracker sites. So in a year where you have a large cracker turnaround, you're going to get closer to the BRL1.8 billion. In a year where you have no large cracker turnaround, you're going to be closer to the BRL1.2 billion. So that's the reason for the range.

As far as the leverage and the higher payout, as I explained before, our strategy is to maintain a healthy leverage point so that we can act upon strategic opportunities. So it's going to be -- any decision on higher payout is going to be a tradeoff made by the Board and the shareholders between the availability of strategic opportunities and their interest to receive more dividends.

### **Q - Lilyanna Yang {BIO 14003234 <GO>}**

Okay. Thank you.

### **Operator**

(Operator Instructions) I'll turn it over to the Company for closing remarks.

### **A - Unidentified Speaker**

I would like to thank all of you for your attention. This was another strong quarter for the Company. Despite the challenges in the Brazilian economy, we have been able to run our operations really hard in Brazil and outside of Brazil and shift some of the excess volumes that we had in Brazil, given the low demand situation here, to the external markets, leveraging our presence in the US and in Europe and the rest of South America where we've been present for quite a while.

So this was a very good continuation to a very strong year last year, a very good First Quarter.

And the expectations as we go forward are pretty positive from a spread point of view. We see a lot of stability. If the oil price stays in the \$40 to \$50 range, we see a lot of

stability in the spreads. And the economic environment in Brazil seems to be hitting a point of inflection. And most of the indicators that we are seeing now indicate a positive trajectory for the future, which is very good for our financial results.

So once again, thank you very much for your time and attention. And any further questions you might have, the Investor Relations team will be at your disposal.

Thank you very much.

## Operator

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

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