

Q3 2016 Earnings Call

Company Participants

- Pedro Freitas, Chief Financial Officer
- Pedro Teixeira, Investor Relations Controller and Project Finance Director

Other Participants

- Hassan Ahmed, Analyst
- Pedro Medeiros, Analyst
- Unidentified Participant

Presentation

Operator

Good afternoon, ladies and gentlemen. At this time, we would like to welcome everyone to Braskem's Third 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 and all participants will be in listen-only mode during the company's presentation. After Braskem remarks are completed, there will be a question-and-answer section. At that time, further instructions will be given. (Operator Instructions)

We have simultaneous webcast that may be accessed through Braskem's IR website, www.braskem-ir.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. We remind you that questions, which will be answered during the Q&A session, may be posted in advance on the website.

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

Now, I'll turn the conference over to 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 earnings conference call. Today, we will present our results for the third quarter of 2016. We remind you that pursuant to the Brazilian federal law from 2007, 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.

So, let's go to the next slide, which we will present the highlights in this period. In Brazil, the highlight was the resin market, which came to 1.3 million tons growing 6% against the same quarter last year and 8% over the previous quarter. Resin sales grew by 5% to 846,000 tons or 69% of market share.

Braskem's crackers in Brazil set a new record for capacity utilization, an average of 94% (sic) [96%] which is 4 percentage points higher than in the same quarter last year and 2 percentage points higher than the second quarter. To meet the growth in demand, Braskem reduced its resin exports and they were 7% lower compared to both the same quarter last year and the prior quarter.

Exports of basic petrochemicals came to 333,000 tons (sic) [338,000 tons] growing by 11% on the second quarter. EBITDA from the operations in Brazil including exports amounted to BRL2.2 billion, representing 75% of the company's consolidated EBITDA. In our PP operations in U.S. and Europe, the highlight is towards the average capacity utilization rate of 101%, reflecting the continued good level of operating efficiency. Sales volume in the quarter came to 516,000 tons, advancing 3% on the third quarter of last year. EBITDA in the United States and Europe was \$161 million or BRL524 million, accounting for 18% of the consolidated EBITDA.

In Mexico, still in the ramp-up phase, the PE plants operated at an average capacity utilization rate of 63%, which is 31 percentage points higher than in the second quarter. Sales volume was 153,000 tons of which 39% was sold in the Mexican market and 61% was exported. EBITDA reached \$66 million or equivalent to BRL214 million, accounting for 7% of the consolidated EBITDA of Braskem.

In the consolidated results, Braskem reported an EBITDA of BRL3 billion, in line with both the same quarter last year and the previous quarter. In U.S. dollars, the EBITDA reached \$924 million, growing 6% year-over-year and 8% on the prior quarter. The corporate leverage ratio in U.S. dollars ended the quarter at 1.63 times, which is the lowest level of the last 12 years. In September, the Board of Directors approved the distribution of the interim dividends for the 2015 fiscal year of BRL1 billion, which were paid in October.

On slide number four, we comment on the segment performance in the Brazilian market. The total of the Brazilian market was 1.3 million tons, growing by 8% from the second

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quarter and 6% from the same quarter last year. Braskem's resin sales in Brazil follow the overall market and grew by 3% compared to the prior quarter to 890,000 tons. Given the higher demands of the Brazilian market, resin exports declined by 7% compared to the prior quarter. An important highlight was the crackers in Brazil setting a new record for an average capacity utilization rate of 96% or 2 percentage points higher than in the second quarter, due to continued good performance of all crackers, led by the Sao Paulo cracker.

The international resins spread weighted by the Braskem production in Brazil which stood at \$743 per ton in the quarter, an increase of 10% on the prior quarter. For the main basic petrochemicals, the spread reached \$399 per ton, increasing by 16% from the previous quarter. As a result, EBITDA in Brazil, including exports was BRL2.2 billion, down 4% on the second quarter, reflecting the Brazilian real appreciation. This EBITDA represented 75% of the consolidated EBITDA of Braskem.

Moving on to slide five, we will comment on the U.S. and Europe business units. The focus remained on operating performance to take an advantage of the continued solid demand of PP, especially in the United States. PP sales volume in the quarter was stable in relation to the prior quarter at 503,000 tons. PP spreads in the U.S. market stood at \$617 per ton, down 17% from the previous quarter, due to the 16% increase in the average US Gulf price for propylene as a result of scheduled and unscheduled shutdowns in the United States. In this context, the unit posted EBITDA of \$161 million, down 24% over the second quarter and 114% higher year-over-year. In Brazilian real, EBITDA was BRL524 million, accounting for 18% of the consolidated EBITDA of Braskem. In the same quarter last year, the unit accounted for 9% of the total EBITDA of Braskem.

Moving on, let's turn to slide number six please. In Mexico, the focus remained on the ramp-up process, especially at the polyethylene plant. The polyethylene plant operated at an average capacity utilization rate of 63%, up 31 percentage points from the prior quarter. The total polyethylene production was 166,000 tons while sales came to 153,000 tons, of which 39% was sold in the domestic market and 61% was exported.

The team also worked to develop sales channels in the local and international market and to improve logistics in both markets. Sales volume growth supported by higher dilution of fixed costs and then Braskem posted an EBITDA of BRL214 million or over BRL200 million more than in the previous quarter. In US dollars, EBITDA was 66 million, representing 7% of the consolidated EBITDA of Braskem.

Slide number seven shows EBITDA in the third quarter compared to the second quarter. EBITDA was \$924 million, advancing 8% on the second quarter, which is explained by higher sales volumes in Brazil, higher contribution margins, mainly due to the higher resin spreads in the international market and the contribution from the Idesa project. In Brazilian real, EBITDA was 3 billion, in line with the previous quarter, due to Brazilian real appreciation in the period.

On Slide number eight, you can see EBITDA in the year-to-date of \$2.6 billion, an increase of 15% on the same nine-months [ph] period last year, which has expanded by better PP spreads in United States and Europe, higher total sales volume, the performance of

operation in US and Europe, and the Mexican unit beginning to generate results. These factors offset the higher fixed costs and SG&A expenses due to increase in wages and benefits, logistics expenses, legal and advertising expenses. In Brazilian real, EBITDA grew by 27% to BRL9.1 billion.

The slide number nine shows the Braskem corporate debt, excluding the project finance debt in Mexico. In this context, on September 30, Braskem's gross debt stood at \$7.4 billion, decreasing by 2% from the balance on June 30. In Brazilian real, consolidated gross debt fell by 1%. A total of 78% of the gross debt was denominated in U.S. dollars. The balance of cash and equivalents stood at \$2.4 billion or BRL7.8 billion.

Net debt stood at \$5 billion, down 9% from the end of the previous quarter. In Brazilian real, net debt fell by 8%. 99% of the net debt was denominated in U.S. dollars. The net debt to EBITDA ratio ended the quarter at 1.63 times when measured in U.S. dollars. In Brazilian real, the leverage ratio stood at 1.47 times, down 6% from the end of the second quarter, influenced by the company's strong cash generation. The company's average debt term is around 15 years.

In the quarter, Fitch reaffirmed its risk rating for Braskem of BBB minus and revised its outlook from negative to stable. This means that Braskem's credit rating remained above the Brazilian sovereign rating at the three main risk rating agencies and with investment grade ratings at S&P and Fitch.

Going now to slide number 10. In the nine-month period of 2016, Braskem invested BRL2.2 billion, of which BRL1.1 billion or \$330 million was allocated to Braskem's contribution to the Mexican project, BRL830 million was allocated to maintenance and operating reliability of plants and BRL194 million was allocated to other strategic investments. Of the total amount in the year-to-date, approximately 60% were invested in U.S. dollars buy in the international business and Braskem's capital contribution in the Mexican project.

Slide 11 covers the scenario for ethylene petrochemical industry. The new ethylene capacity coming online in 2017 and 2018, which could cause volatility in the petrochemical supply-demand balance should be smoother due to the cancellation and postponement of certain greenfield projects and by the reduced addition of new capacities in this period from 2016 to 2020, based on newly revised data from the consulting firm IHS.

In the United States, certain new capacity are suffering delays while in the China and the Asia region, coal-based projects have lost some attractiveness due to the lower naphtha price. Moreover, projects are facing highly investment costs and infrastructure problems.

On the next slide, we comment on the petrochemical scenario for resins.

In Brazil, with the recovery in oil price and consequently the increase in naphtha price, the resins price should narrow, also influenced by the lower price for PP in Asia and PE in the United States, due to the new capacity to come online in the respective regions in 2017. Despite the narrowing, resin spreads in Brazilian market should remain above historical level.

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In the U.S. and Europe, expectation is for a healthy PP-propylene spread despite volatility due to high volumes of PP imported, debottlenecking of some units in the United States and lower propylene supply in Europe due to the use by crackers of the imported gas as a feedstock. For the spreads between PE and ethane, the gas-based feedstock used by the Mexican complex, producers should maintain their competitiveness despite the expected narrowing of spreads due to lower PE price, due to new capacity coming online and higher ethane price influenced by the strong demand.

Moving on to the last slide, Braskem priorities in Brazil were capturing operating performance gains in the plants to serve in domestic markets; exporting any volumes not sold in Brazil, conducting maintenance shutdown on one of the lines at the Bahia cracker in the fourth quarter; completing the feedstock flexibility project in Bahia.

In the U.S. and Europe, the focus will be on showing commercial and operational efficiency, seeking new opportunity for growth in PP-based on competitive propylene feedstock in the United States and commissioning the new UTEC's plant in Texas. In Mexico, the priority will be ensuring the operational stability of the complex, to participate within the Mexican market and strengthening relationship with local clients and conducting exporting synergies with various other Braskem operations in the U.S., Europe and South America.

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.

Finally, on the international investigation process, the focus will be in advancing the dialog with the authorities to find a solution.

That concludes today's presentation. Let's go now to the question-and-answer session.

Questions And Answers

Operator

Thank you. The floor is now open for questions. (Operator Instructions) Mr. Felipe [ph] from Bradesco would like to make a question.

Q - Unidentified Participant

Hi. Good afternoon, everyone. Thank you for the questions. So, I just had one simple question here. So Braskem is generating a lot of cash today, so I think our investors are happy to see how much the company is able to trade in terms of cash. So, I think a big question for us is to understand what to do with this cash.

So, I think the most obvious answers are first, increase dividends or second, go after new strategic projects such as PP paraffin in US or any other color that company may consider strategic. So what I would like to hear from you is, in terms of priorities, what is the priority of the company right now, it's either to increase dividend as happened this year once or

go after the PP paraffin in US, and if you are going after the PP projects, what'll be the state of the projects under the study to-date? That's it. Thank you.

A - Pedro Teixeira {BIO 19489140 <GO>}

Hello, Felipe. Thank you for your question. As you said in the first quarter, demonstrated the continuous strong cash generation that the company has generated.

As for the use of cash, we see at least three levers; first on, dividend as we just announced in October, BRL1 billion additional payment that was executed. Second, as you mentioned, it creates the opportunity for us to continue to invest in projects that are either capacity expansion like the potential PP project in US that would be built in Texas or investments like the one we're making right now in our Bahia cracker to create flexibility. So, project portfolio would include capacity additions, but also improvement in competitiveness to support future cash flow generation.

And the third is to continue our process of reducing the leverage. We are now at 1.63 debt over EBITDA. We want to continue to manage the use of cash along those three dimensions and the concept here is to prepare ourselves for a potential down-cycle in the PE ethylene value chain that might be coming depending on the PE implementation of the project going on in U.S. And therefore, we will manage those leverages making sure that we can maintain debt to EBITDA under 2.5, which is our desired leverage point.

Q - Unidentified Participant

Okay, great. Thank you very much.

Operator

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

Q - Hassan Ahmed {BIO 7430123 <GO>}

Good afternoon folks. One of the sort of recent trends that we have seen over the last couple of months is sort of production scaling back of coal out in China, right? And there are obviously a variety of products you guys produce, be it on the polyolefin side of things or the PVC side of things that are currently being produced using different sort of production percentages, coal as a feedstock.

So, do you believe that -- some of this sort of resilience or strength in, be it, PVC pricing or ethylene, polyethylene pricing, we are seeing on the back of the entire coal prices, A. And B, what's your perception going forward in terms of the impact this may have in the market?

A - Pedro Teixeira {BIO 19489140 <GO>}

Okay, thank you, Hassan for your question. We've been following what's going on in China with the significant investments that were made over the years and are still being made in multiple plants leveraging different types of feedstock, the main one being coal. What our

analysis has shown is that at the current oil price and the way the Chinese market -- government is managing coal price and the environmental aspects of it, the coal to olefins and therefore polyolefins is not very competitive.

So, our assumption is that the scale back in production from coal is the combination of the environmental restrictions and the economic logic kicking in to moderate their production.

As we look forward, it seems that a little bit similar to what we are seeing in the US, many of the projects that have been announced over the years in China are being delayed and/or canceled. One analysis that we did in a little bit more detail was the whole PDH investment where we see many reports mentioning several million tons of propylene production from PDH. But when you dig a little bit deeper, many of those projects seem to be either very early stage or more on the idea phase. So, we're probably going to see spacing of any future capacity entrance in China, which should contribute to a smoother supply and demand equilibrium going forward.

Having said all that, of course, the relative prices of oil, coal and gas in U.S. is a key contributor to the methanol to olefins in China, value chain are the crucial variables. So, if they stay where they are, we do expect that this capacity will have a mild effect on them.

Q - Hassan Ahmed {BIO 7430123 <GO>}

Very good points.

A - Pedro Teixeira {BIO 19489140 <GO>}

If you look at the expectation for ethylene new capacity in China, in the first quarter of this year, IHS was expecting 2.7 million tons of new capacity in '19. In the third quarter, they're only projecting 0.8 million tons for 2019. So, this is a concrete illustration of the spacing out of the new entrances and/or canceling of new projects.

Q - Hassan Ahmed {BIO 7430123 <GO>}

Very helpful. Now as a follow-up, obviously a lot of discussion on ethane, particularly out here in the U.S., but potentially not enough discussion surrounding propane and why I bring that up is obviously you guys have been producing the polypropylene as well. So, my question really is that as these discussions continue, one of the points that's constantly brought up is that as ethane demand continue rising in the U.S., be it from the influx of new greenfield facilities or more and more sort of exported ethane, propane may provide a relief valve, meaning you could -- propane could provide a ceiling for ethane pricing.

So now, my question to you is that what do you feel, with that as a backdrop over the next couple of years, how do you see propane and propylene pricing shaping out?

A - Pedro Teixeira {BIO 19489140 <GO>}

We would share your point of view. As you said, the ethane consumption going up with the new projects starting in US and we will probably reach a point where propane use at

the crackers will increase and therefore help balance the supply to the new and existing cracker base in US.

So, with that in mind, you probably reach a point where ethane and propane go towards some kind of export parity and linking between ethane and propane price. In that scenario, the propylene question is a little bit trickier, because on the PDH side, you will have the Dow PDH and the enterprise PDH up and running. They will be competitive. They will run 100% of the time. So, you have that production coming. If the crackers start to use a little bit more propane, you have more propylene in the market. So, one very possible scenario is that propylene prices decrease in US given the abundance of supply coming from the PDH as that will be running plus the crackers moving to more propane --

Q - Hassan Ahmed {BIO 7430123 <GO>}

Propane feedstock, (inaudible).

A - Pedro Teixeira {BIO 19489140 <GO>}

So, this should lead to a high availability of propylene and low price of propylene, which is one of the key drivers for our PP project in US which is a combination of strong PP demand in US, but a very good competitive cost position to serve both US and eventually to export PP out of US into other markets around the world, in that scenario where propylene is very competitive globally.

Q - Hassan Ahmed {BIO 7430123 <GO>}

Super helpful. Thank you so much.

Operator

Sarah from Barclays will like to make a question.

Q - Unidentified Participant

Hi. Good afternoon. I had two very specific questions. One is regarding your debt and accessing the capital markets. So, I know that you've been reducing your debt, but I was wondering if you are contemplating any kind of transaction, either new net financing or possibly more likely doing any liability management and perhaps likely targeting the 2018? And then, the other question that I had was about S&P, which still has your rating on negative outlook and what kind of conversations you have been having with them? Thank you.

A - Pedro Teixeira {BIO 19489140 <GO>}

Hello, Sarah. Thank you for the question. This is Pedro Freitas. We are always analyzing the market for -- we've been planning to get in. We right now don't have anything in our hands. We do look at our upcoming bond maturities in '18, '20, '21 and we will -- when the timing is right, we will go to market to really financing [ph] those bonds. But so far, we are still analyzing the market.

Q - Unidentified Participant

Great. Thanks. And regarding any conversations with S&P regarding what might be required for them to remove the negative outlook on your rating?

A - Pedro Freitas {BIO 21187627 <GO>}

Yes. So on that, the review that we get from S&P is very much because of the Brazilian sovereign rating. So, the negative is there. From our understanding is that, the negative is there because of the Brazil situation. Brazil is two notches below us. So, if there is any further downgrade in Brazil, our understanding is that negative is there because of that. On the other hand, Fitch has removed the negative from our rating. So, we have now a stable outlook for our investment grade rating with Fitch.

Q - Unidentified Participant

Got it. Thank you.

Operator

(Operator Instructions) Mr. Pedro from Citigroup will like to make a question.

Q - Pedro Medeiros {BIO 16187063 <GO>}

Thank you so much for taking the question. Congratulations for the results. I have two questions, one of them is a follow-up, I think most of my questions were answered in this call and the Portuguese version as well. So, the first one is, when looking forward to 2017, there is a particular event for your propylene assets in the U.S., which is the startup of the PDH facility from enterprise in which you have an uptick or agreement to take a good share of that facility on propylene production. So, I just wanted to understand what is the effect to your polypropylene business margins for 2017 with the startup of that facility in the contract itself. Is there any change on the contract conditions as well given the delays on the project?

And the second question is, how does that contract interact and if it interacts at all with the expected supply for the conversion that is taking place in Camacari expanded for net chain supply which is different, but if you mind to comment on that and how the economics of that conversion should work? I would appreciate. Thank you.

A - Pedro Teixeira {BIO 19489140 <GO>}

Okay. So, talking about the contract purchase of propylene from Enterprise, this is a contract that involves volumes that can be produced both from the PDH or the Enterprise bidders. We do not foresee any change in that contract. This is a long-term contract that was signed back in 2012. Their project is delayed, but it was in the window that existed in the contract before the startup date. So, there is no trigger of any penalty on the Enterprise side because of any delays. So, we do expect to start receiving volumes from the PDH paid contracts during 2017. We're the largest buyer of propylene in the U.S. market and we have multiple contracts. This is one of the contracts that we have that will be a part of the supply for three assets in the Gulf Coast.

As far as impact for the margins, as I said before, during the previous question, the higher availability of propylene in the region should lead to lower propylene price. Therefore, the contracts -- the effect of the PDH at starting should be a positive contributor to the PP business margins in the U.S.

Speaking about the ethane contract or ethane flow from the U.S. into Camacari, even though we have an agreement with Enterprise as well, the two contracts are not connected, those are two independent contracts. So, there is no link whatsoever with except for the fact that it's the same buyer and the same seller.

As far as the concept of this ethane supply into our cracker, the concept is to convert a part of one of the trains in Camacari, so that it can also crack ethane and not only naphtha. We are doing the investment as we speak with an expectation of the end of the process in the second half of next year where we could start flowing ethane from the U.S. into the Camacari cracker.

The concept here is a concept of flexibility, so we will have the flexibility to either crack naphtha or ethane. We do believe that ethane cracking will be competitive, even though it will land in Camacari, we have cost addition because of the logistics compared to U.S. cracking, but given that this is an addition and flexibility into a much larger cracker, the economics are interesting.

The investment necessary to adapt the cracker is in the \$100 million plus \$120 million in total and includes not only some other patience [ph] at the cracker, but most of the investment is in the logistics at the port and the pipeline to move the ethane from the ship into the cracker in Bahia.

Q - Unidentified Participant

Okay. Well, thank you so much. Very clear.

Operator

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

A - Pedro Teixeira {BIO 19489140 <GO>}

I would like to thank all the participants to this dialogue, it was another strong quarter for Braskem with very good operational results, very good commercial results, which reinforces our conviction that our strategy that is built around, increased focus in competitiveness, increased focus on the internationalization of our operations and the desire to diversify our feedstock matrix is the right strategy, we have been generating very solid and positive results over the last few quarters and we do expect to continue to be able to generate some good results. Thank you all for participating. 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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