

Q4 2017 Earnings Call

Company Participants

- Fernando Musa, Chief Executive Officer
- Pedro Teixeira, Investor Relations, Controller & Project Finance Director
- Pedro Van Langendonck Teixeira de Freitas, Chief Financial Officer & Investor Relations Officer

Other Participants

- Fernanda Perez da Cunha, Analyst
- Gustavo Allevato, Analyst
- Hassan I. Ahmed, Analyst
- Luiz Felipe Carvalho, Analyst
- Pedro Medeiros, Analyst
- Sarah Leshner, Analyst
- Vicente Falanga Neto, Analyst

MANAGEMENT DISCUSSION SECTION

Operator

Good morning, ladies and gentlemen. At this time, we would like to welcome everyone to Braskem's Fourth Quarter and Full-Year 2017 Earnings Conference Call. Today, with us we have Fernando Musa, CEO; Pedro Freitas, CFO; and Pedro Teixeira, IR and Controller 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 session. At that time, further instructions will be given.

We have simultaneous webcast that may be accessed through Braskem's IR website at www.braskem-ir.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 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 and Controller Director. Mr. Teixeira, you may begin your conference.

Pedro Teixeira {BIO 19489140 <GO>}

Hello, good morning everyone. Welcome to the Braskem conference call for the year-end 2017. At this time, we decided to prepare a shorter presentation. We'd intend to deliver just the key highlights for the performance of 2017, what the company expects for the year-end of 2018. So I ask you to move to slide number 3 where we began our presentation.

So slide number 3, it is the summary about what we initially expected for the year of 2017 and what actually happened. So, in Brazil, in terms of regional sales, the company is geographically diversified. We have operations in Brazil, U.S., Europe and Mexico. In general, all the regions, the sales in those regions were positive. There was a growth by 4% in Brazil, 5% in U.S. and Europe, and a huge growth in Mexico, especially because in 2016 during the first semester, the project was pretty much pre-operational. So this is the reason why the increase was so relevant in Mexico.

In terms of spreads, in the beginning of 2017, we expected some volatility. We expected positive spreads for basic petrochemical in fact for 2017, the spreads were very much robust, I would say extraordinary, especially in the beginning of 2017. The growth against 2016 was 28%. We were a little bit more negative in the beginning of the year with respect to the spreads of resins in Brazil. But in the end, the spreads remain a little bit flat as compared to 2016. For U.S. and Europe, we were stable, but in the end, the spreads turned out to be a little bit worse than we expect in the beginning.

And in Mexico, we expected a positive spread in the beginning of the year and the spreads were in fact positive, especially in the end of the year where we see an appreciation of the PE prices and ethane prices remain as stable.

In terms of EBITDA, in the beginning of the year, we expected a smaller EBITDA for Brazilian operations, but in the end, the EBITDA turned out to be positive. There was a growth by 2% as compared to 2016. The EBITDA was relatively stable for U.S. and Europe. In fact, there was a decrease by 7%, but the absolute value remained very much robust and there was as expected a relevant increase in the EBITDA for Mexico by 282% compared to year-over-year; and on a consolidated basis, there was an increase by 17%. The company posted its record EBITDA of \$3.8 billion equivalent to BRL 12.3 billion.

In terms of free cash flow, there was also an increase by 9% comparing year-over-year, and the earnings per share were also positive. In 2016, we had a negative net income. In 2017, the net income was positive of around BRL 4 billion, and these - (00:06:08) a very positive earnings per share in 2017.

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So moving to slide number 4, these with – we highlighted five key highlights that the company performed in 2017. So, in terms of operational performance, 2017 was a year of record of production. So we posted record of production of ethylene, butadiene, gasoline, polyethylene, polypropylene in Brazil, PP in the U.S. and Europe. There were also record of sales in the main chemicals that are produced in Brazil, PE in the Brazilian market, it was a record as well, exports of butadiene and ethylene and PP in U.S. and Europe.

So the consolidated EBITDA, it was a record of US\$3.8 billion, 17% higher than in 2016. In terms of value creation, 2017 was a year where we stabilized, and actually where we started up in the beginning of 2017 and we stabilized our UTEC production in U.S.

Also we concluded the investment for flexibilization of feedstock in the Bahia cracker and now we can run half of the cracker using ethane instead of Naphtha in Bahia. And this investment was completed by the end of 2017, so it was an achievement for the company in 2017. And also the board of Braskem, the board of director approved the investment for new PP plant in U.S., an investment of up to \$675 million for our new PP plant and the total capacity of 450,000 tons that are expected to become operational in the first half of 2020.

Also 2017 was a year of liability management. The company issued two bonds in the total amount of \$1.7 billion. This enabled the company to refinance its short-term debt and extend the tenure of the total debt of the company.

The demand for this offer exceeds by eight times and represented the largest funding transaction of the company and with the lowest cost ever made. With respect to credit rating, Braskem maintained its investment grade by rating by S&P and Fitch; so, the company's BBB plus by these two rating agencies. More recently the outlook that was negative from S&P was stabilizing, and Braskem now was eligible by S&P to become three notches above the Brazilian sovereign. So, considering the diversification in terms of geography, the diversification in terms of feedstock, the company is more detached from the Brazilian sovereign risk.

And last, let's talk about dividend; we had an early distribution of BRL 1 billion in the end of the year, and more precisely in December. This represented around 25% of the net property of the company. So the minimum dividend was paid in the end of last year. And the company is suggesting additional distribution of BRL 1.5 billion to be approved in the next Annual Shareholder Meeting. For the company, the good performance, good results of the company is being shared also with investors.

So, let's move to slide number 5. Let's talk a little bit about the CapEx for the company, what we focused for 2017 and what we expect for the year of 2018. In 2017, we report on a CapEx of BRL 2.3 billion. BRL 1.5 billion is related to operational CapEx and BRL 823 million were related to those strategic efforts that I have already mentioned. And this was a decrease of 31% as compared to 2016, especially because in 2016, we still had some contributions to the Mexican project that was concluded, and no additional investments or cash was required by the project in 2017.

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For 2018, we do expect an increase in the amount of investments. In the operational side, there would be a scheduled maintenance shutdown for the cracker in Triunfo in the south of Brazil that will demand more investment for the year of 2018. And also the new plant, the new PP plant 2018 would account for around 40% of expected investment for this project in U.S. it's 40% of \$675 million that are expected to be invested in 2018. So, the total investment would increase from BRL 2.3 billion to BRL 2.9 billion.

So, let's move to slide number 6 and we are sharing with all of you how the market, in terms of spreads what is expected for the year of 2018 as compared with 2017. It is the source of the spreadsheet IHS. So, for 2017, the PE spreads, so the difference between PE prices and naphtha prices were around \$720 per ton. It is expected an increase by 3.6%. So the average increase expected by IHS for the year of 2018 will be around \$740 per ton. So, better spreads are expected by IHS, even considering the new capacity that are becoming operational.

In fact, five new PE plants have started up until now in U.S. with a total capacity of 4.4 million tons and two more expected to begin its operation in the second half of 2018. And also five new ethylene plants have started up until now in U.S. in the amount of - in the total capacity of 5.5 million tons of ethylene. So, even though the capacity will start up and are starting up, the spreads, the IHS remains very positive in terms of the PE spread.

The same happens for PP, the spreads should increase by 12%, that's the perception of IHS. So 2017 the average spread was \$590 per ton that's a difference of PP against naphtha ARA and the spreads should roll up to \$665 per ton. Some projects were mainly China work were postponed throughout the 2020 and the demand growth for these projects for PE and PP remain very much robust.

So, let's move to our last slide, slide number 7, and here is how we see the outlook for 2018 versus 2017. Utilization rate, the company expect the utilization rate should remain stable. There is no much reason to believe that utilization rates will become much lower than 2017, even though 2017 was a year of record of our production.

In terms of demand, we see demand is very positive in U.S. and Europe. And important to highlight that in Mexico, the demand should also be positive especially in Brazil and in Mexico. And there is an elasticity in terms of the resin market which is higher than if compared with the U.S. and Europe regions. So, we expect a growth for the resin demand in U.S., in Mexico and in Brazil of 1.5 times the GDP.

In terms of spreads, in bottom left in Mexico, the spreads we expect to be better. International expected it is aligned with the view of IHS. U.S. and Europe, it is the same, we produced polypropylene. And in Brazil, the spread should be relatively stable, the combination of resins should be relatively stable and the negative 5% that we expect for 2018 relates to chemicals. In fact 2017, we have an extraordinary spreads for chemicals. We posted very extraordinary impact in the result of 2017 of around \$300 million. And we are not expecting at least for now these spreads have been the same for the year of 2018. So, in the end, the consolidated EBITDA for 2018 should be smaller as compared with 2017.

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Even though the EBITDA should be smaller, the consolidated cash flow for 2018, we expect it to be higher. In 2017, we had an important impact in terms of working capital consumption that we do not expect to happen again in 2018 so that will be a pro. In terms of interest as a consequence of the liability management and optimization that the company made in this debt profile, we expect to have lower interest rate and we have debt for the year of 2018, this should be positive. There was U.S. tax reform that would enable the company to reduce its income tax paid in U.S. that will be another positive.

In terms of our CapEx, as I already mentioned, the CapEx will be higher in 2018 as compared to 2016. And it is important to note that in 2017 we paid BRL 1.5 billion around of global settlement. And for this year, we expect to pay around BRL 300 million. So, it's a much lower payment that will be due this year to the authorities with respect to the global settlement that was closed in 2016. So, in the end, the consolidated cash flow of the company for 2018 should be higher than in 2017.

We thank very much. I will turn into the Q&A session, and thanks.

Q&A

Operator

Thank you. The floor is now open for questions. Our first question comes from Mr. Vicente Falanga from Bank of America.

Q - Vicente Falanga Neto {BIO 18277588 <GO>}

Hi. Good morning, Fernando, Pedro (00:19:08), good morning, everyone. I had a couple of questions. First on the outlook for polyethylene. The market seems to be growing more and more optimistic with the PE cycle. Some experts already mentioning the possibility of an extended up-cycle throughout the next five years. On the other hand, I mean, one risk that we do see is the potential effects of a global trade war affecting polyethylene. In other words, Asian producers potentially retaliating tariffs and pull down steel by the U.S. with tariffs on products such as polyethylene. In a scenario that this eventually happens and then U.S. has to redirect its imminent new supply from Asia to smaller regions, like Latin America, for example, how do you see the region responding? Could the countries in the Mercosur articulate to rise import tariffs on PE at least temporarily? How likely would you see this happening?

And then my second question related to the naphtha supply contract agreement with Petrobras. There are expectations, at least from the market side, that Petrobras could revise this NAFTA supply contract with Braskem soon since it expires in a couple of years. To the best of your knowledge and based on what you're able to share, of course, are these conversations currently ongoing? And also do you see Petrobras' intentions to sell some refineries potentially getting in the way of the volumes they want to compromise with Braskem?

And then just a last comment still on that subject, if I may, sorry. Petrobras just announced that they will build a gas treatment facility in Itaboraí, Rio de Janeiro. Would the company

consider adding more flexibility to its crackers on top of the potential ethane supply coming from this plant? Thank you very much.

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

So, Vicente, thank you for your question. I'll start with the polyethylene outlook and the question that you have. I mean, there is in fact this optimistic view from North America or from the market in terms of the demand growth for polyethylene and you can see that on the spreads that IHS is forecasting for 2018 even with the entry of the new capacities, almost 6.5 million tons of new capacity forecasted to come into the market in 2018, of which 3 million tons in the U.S.

The industry, as reflected by IHS, is forecasting an increase in spreads on the PE to naphtha spread, which is, I would say, a realization of the optimistic view that you mentioned. The potential effect of an eventual trade war, you have to look at it region by region. Polyethylene is a highly global commodity and, I mean, we have very high degree of international trade in polyethylene. And Asia, China in particular, are net importers, significant net importer regions. So you have the U.S. and the Middle East exporting polyethylene, and basically Asia as a major importer.

So if there is trade war - and that can play out in many different ways, so it's hard to forecast what could happen. But let's say that global tariff increase everywhere. So how would that affect us? I would say there are couple of ways of how that could affect us. I mean, first, the Mexico project and the Mexico operation now would be, I'd say, positively affected. Mexico is a huge net importer of polyethylene. We are the largest local producer. So if Mexico imposes tariff, that would actually be positive for us. And we don't export a lot, and we would direct more of the production to the internal market. So our exports from Mexico would not be materially affected, I would assume.

In Brazil, which is the other region where we produce polyethylene. I mean, we follow international price, so we would have to discuss a little bit what happens to international prices, and also the exports of polypropylene from Brazil follow international prices, so I think the more relevant discussion for what would happen to the Brazilian operation is what would happen to international price.

Hard to foresee, but, as I said, Asia is a net importer, huge net importer. So, if Asia imposes tariffs, it could mean an increase in prices in Asia, local prices, but the exporters from the U.S. or from the Middle East would probably be getting roughly the same sort of profitability. So not sure it would affect our exports for Brazil or even the domestic prices in Brazil that follow these prices. But again, it's a hard question to address, because there are lots of moving parts and it's a very complex system.

Sorry, I was going to the next question, but if you have any follow-up on this one?

Q - Vicente Falanga Neto {BIO 18277588 <GO>}

No, no, that's perfect. Thanks.

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

Okay. So, Petrobras naphtha - sorry Fernando, I'm not sure, if you want to make any comments on that.

A - Fernando Musa {BIO 17592170 <GO>}

Yes. Can you hear me?

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

Yeah.

A - Fernando Musa {BIO 17592170 <GO>}

Hello?

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

We can hear you.

A - Fernando Musa {BIO 17592170 <GO>}

Okay. Just to reinforce, I think, the point Pedro just made that at the end of the day, this is a global market and the trade flows will adjust. The different regions have their own production and demand balance. And if there is retaliation towards PE produced in the U.S., the Middle East will need to supply Asia, especially China, and the U.S. will serve the other markets currently served by the Middle East. So at the end of the day, it's all about the global balance between supply and demand, which, as mentioned before in the presentation by Pedro, seems to be going towards a positive territory with strong demand and most of the capacity additions are already starting up and not a lot of new capacity is expected for the next two, three years to come online. So moving on to [Technical Difficulty] (00:27:02).

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

Fernando, you're breaking up. So I'll...

A - Fernando Musa {BIO 17592170 <GO>}

You guys, why don't you take it and I'll find another line here.

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

Okay.

A - Fernando Musa {BIO 17592170 <GO>}

Okay.

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

So the other question was about the Petrobras naphtha. We have a contract that is valid until December 2020. We are operating with it. So, I mean, that's the situation now. Petrobras is rumored to be looking at refinery sales, but we are the only consumer in Brazil, so it's a discussion that we always have with Petrobras around feedstock and what other possibilities are on that. But the contracts are there, the contract is there, it expires in 2020, so it's something that in due time we'll discuss with them.

Q - Vicente Falanga Neto {BIO 18277588 <GO>}

Okay.

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

And the third point is on the investment in the gas treatment facility in Itaboraí, we are always interested in new feedstock opportunities. We already have a gas cracker in Rio de Janeiro close to Itaboraí, so it would make sense, in our view, to take any available liquids from the gas processing and new build liquids to supply our facility, potentially even for an expansion of the facility, depending on the volumes available. But we would need to look at the investment that Petrobras is making and understand what are the volumes there, to then start the discussion of valuation of any project based on that. But we do see it as a positive, I'd say, evolution in terms of having more feedstock available in Brazil. That would be positive for us, positive for the industry. So we have, I think, a good perspective on this investment by Petrobras.

Q - Vicente Falanga Neto {BIO 18277588 <GO>}

Great, very clear. Thank you very much.

Operator

Our next question comes from Mr. Gustavo Allevato of Santander.

Q - Gustavo Allevato {BIO 18933135 <GO>}

Hi, guys. Good morning, everyone. So I have three questions here. First one is regarding the local demand year-to-date. So I talk with other companies in different sectors, the companies have mentioned that demand has been slower (00:30:04) than initially expected. So how the companies are seeing the resin demand for local market in the first quarter? Has it been strong or a little bit slower than initial expectations?

The second question is regarding the Mexico project. So there is a deliver-or-pay for Pemex regarding the ethylene supply there. So when - will it impact the operating result, since Pemex supply less than it was foresaw (00:30:35) in the contract?

And the third and last question is regarding the naphtha supply contract. When it was signed in 2015, if I'm not wrong, the naphtha price was around \$500 per ton. Now it's around - above \$600 per ton. So at the time of the contract had a clause mentioned that in case of further increases in raw materials, the reference price could be reviewed. So I would like to know if you could share with us if you are in the level that the 102.1% is the

price that Braskem is still paying, or since naphtha price went up, Braskem is paying a little bit less than this reference? Thank you.

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

So Gustavo, thank you for the question. So starting from demand growth, we are seeing sustained recovering demands. Last year, demand growth, as Pedro mentioned, was around 4%. We are expecting for this year looking at the results already of the first quarter around 4% demand growth again for PE, PP, PVC. I'd say strong demand from consumption. The auto industry is recovering as well, white goods, electronics as well. And then agricultural demand and demand for, I'd say, agricultural applications has been especially good. The sector that is still lagging a little bit is construction in general, which already is showing some aspects of growth. PVC now is already slightly positive growth in the market. But, I mean, it's still in a lower growth level than the other polymers that we have.

In terms of the Mexico DOP, in 2017 we had a revenue of \$19.5 million, so that will be accrued revenue and we did have already - we already received or settled a portion of that. So the cash flow is on the deliver-or-pay is happening in Mexico. So the contract is working as expected in terms of the protection to Braskem/Idesa in terms of the operating results of the JV.

The other, I think, positive aspect is that, even though we are not receiving all the feedstocks that we had expected at first, the operating rate is pretty good at 88% on average and also the EBITDA margins are above 50%, so actually 55% for the average of year and 60% in the fourth quarter. So again, very good results, even though we're not receiving all the volumes that we had expected. Fernando, if you have any comments on either Brazilian demand or Mexico, otherwise I'll take the other question on the contract, the naphtha contract.

A - Fernando Musa {BIO 17592170 <GO>}

No, it was very clear.

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

So just, Gustavo, you asked about also the contract. Naphtha was at, as you said, around \$400 per ton back in 2015. Now it's at \$600 per ton or \$550 is the expected for the current price, I would say. But anyway, it is a higher level. We think the contract is operating well for us and we do have that fixed price. Conceptually we think that a more, I'd say, flexible pricing formula would be better for the industry.

So a pricing formula that had more variation depending on the level of oil or naphtha prices would be better for Braskem. But the current contract is actually working well, so it has generated the results that we've seen. I think the point to look at is less on the naphtha price level and more on the spread level, and the spreads have been pretty good, given the point in the cycle that we are at. And that's what gives us the results that we have.

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A - Fernando Musa {BIO 17592170 <GO>}

Okay, Pedro, just – this is Fernando – just to reinforce this. The relevant indicator is the spreads. As Pedro mentioned, flexibility in the contract would be a welcome, especially given the fact that at high oil prices, there is a tendency for the naphtha to the product the former (00:36:38) spreads to contract. And at low oil prices, there is a tendency for the spread to open up. So the competitiveness of the whole petrochemical chain fluctuates with the – that is naphtha base fluctuates with the oil price, and therefore if there were some flexibility in the contracting as we had in previous contracts, it would make it at these extremes high or low oil prices more competitive. At the current price level \$400 to \$550, \$600 that we've been experiencing, the current formula works, given the volatility in the spreads and the competitiveness between the naphtha base and the light feeds (00:37:30) based is not fluctuating as much.

Q - Gustavo Allevato {BIO 18933135 <GO>}

Okay, very clear. Thank you, guys.

Operator

Our next question comes from Mr. Luiz Carvalho from UBS.

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

Hey, guys. Thanks. I have three questions as well. Fernando, maybe if I can touch on the naphtha contract on a different angle. Is this negotiation happening from the management level, I mean Braskem with Petrobras, or it's happening more in the (00:38:06) Shareholders Agreement between Odebrecht and Petrobras, just to understand where we are in terms of negotiations so far. And that's the first question.

The second question, it's regarding also the Pemex supply. Is there any update regarding the diversification there in terms of the potential pipeline bringing – I don't know, bringing gas from U.S. or something that you can share with us in order to look at a bit more longer-term supply if Pemex is not able to – how can I say – to fulfill the full contract.

And third question, it's related to dividends and in this year we saw, if I'm not wrong, 60% payout according to your presentation you expect in 2018 low EBITDA level, but a higher free cash flow. So I just would like to understand, how do you see or what's the management – how can I say – way of thinking regarding the dividend payment for 2018? Thank you.

A - Fernando Musa {BIO 17592170 <GO>}

Okay. On naphtha contract, all (00:39:16) contracts are negotiated, managed, dealt with by management with suppliers, all suppliers including Petrobras. So, this is management responsibility, not shareholder responsibility, to guarantee the adequate supply of feedstock for our operations and our teams around the world deal with different suppliers. There has been a lot of talk about the naphtha contract because of the announcements of potential changes in governance that were made by Petrobras

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confirmed by Odebrecht. But dealing with feedstock suppliers is a management responsibility and not a shareholders' responsibility.

On Pemex supply, Pemex is already working around the alternative to guarantee the supply that they committed under the contract. They have started to import ethane from the U.S. into Mexico to help increase the flow for the petrochemical industry in Mexico. We see it as a good initiative by Pemex, many companies around the world are doing that activity of moving ethane around the world, including Braskem, which we started late November. So this is something that we see a very positive as a way to – in combination with the efforts that Pemex is doing at the production side and fractionation side of its systems in Mexico, it creates a risk mitigator for the supply which is – it's good from our point of view.

As far as the dividends that could be paid out early 2019 from the 2018 results, this is a decision that will be made at the end of the year. But as we mentioned in the presentation, our expectation is of a strong cash flow generation. We have an increasing in CapEx, further reduction in the payouts coming from the global settlements that the company signed in December 2016. So this should lead to a discussion that we'll have at the end of the year once we have more clarity on expectation for 2019 and 2020 that as of today seems to be improving. This would lead to a decision that if you look at the past few years, our payout ratio has been in this 50% to 60% of net income ratio. So we'll make the decision by the end of the year, but the underlying expectation of results leads to a strong cash flow and therefore, a decent payout for next year as well.

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

Okay.

A - Fernando Musa {BIO 17592170 <GO>}

Pedro, do you want to add...

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

Yeah, go ahead, sorry.

A - Fernando Musa {BIO 17592170 <GO>}

I was going to ask if Pedro wants to add anything on the dividend question.

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

No. I think that's it.

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

So just a quick follow-up on this one, and taking the opportunity that you're both on the call, really to the capital allocation. And then this high payout with high – how can I say – cash flow, then how do you see potential acquisitions or for the projects on the way? You already made a significant large project, which is the Ethylene XXI. You are now with a

project of PP in U.S. But how can we think looking forward in terms of, let's say, the capital allocation when you look to this cycle, right? Thank you.

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

Yeah. Thanks for the question. This is something that now that the Mexico investment is behind us as far as cash needs, and we're in full steam ahead with the new PP plant in the U.S., we do anticipate that new opportunities will come to the company, be it new projects, new construction, or acquisitions. We have always looked at those opportunities; nothing interesting came up besides the PP plant that was approved last year. But this is consistently being analyzed. We have a very disciplined process to look through our strategy and the positioning we have in the different regions and businesses where we are operating. We'll continue to look for that.

The acquisition route is one where the very strong results has been leading to high valuations in our point of view for a cyclical industry. And I think the new expectations around positive cycle going forward might lead to tougher negotiations around any potential acquisition. Having said that, if the right asset or company comes up for sale, we'll certainly look at those, given a very strong track record of making the acquisitions in a very successful way for Braskem shareholders generating a lot of value from the acquisitions made over the years. So it is part of our plan and we'll certainly be, as I mentioned, part of the decision-making in the backend of the year, early 2019 around dividends is going to be this potential new projects will come into the equation when we make any decisions about dividends for the upcoming years.

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

Okay. Perfect. Thank you very much.

A - Fernando Musa {BIO 17592170 <GO>}

Just a complement there. Fernando. The discussion around dividend payout and also on investments always goes also through the discussion about leverage. So we always consider the company's ability to leverage and limit the leverage so that we don't over-extend ourselves. So that's also part of the considerations that we always have whenever we're discussing this balance between new investments and dividend payout.

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

Clear. Thank you. Thank you, Pedro. Thank you, Fernando.

Operator

Our next question comes from Mr. Hassan Ahmed from Alembic Global.

Q - Hassan I. Ahmed {BIO 7430123 <GO>}

Good morning, gents. A two-part question, one about the near-term, and one about the longer-term. On the nearer term side of the things, you talked about compressing EBITDA year-on-year in 2018. Just a bit confused about that, because as I take a look at

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the fundamentals, clearly Brent crude is up \$15 a barrel relative to 2017 averages. So at least in my mind that should equate to a \$0.07 to \$0.08 a pound tailwind in the price of ethylene, polyethylene, and we are obviously seeing that, particularly in the U.S. market, where contract pricing has gone up. So on the ethylene, polyethylene side, and you also obviously alluded to sort of expanding spreads year-on-year, then we're obviously in the near term entering a pretty heavy turnaround season, particularly in Europe, I think April alone there are five ethylene crackers that are going to be turned around.

Then I take a look at the polypropylene dynamics near term, supply/demand continues to get tighter, so I'd imagine polypropylene margins will be up year-on-year as well. And finally you have chlorovinyls, where the fundamentals look extremely attractive. So the near term question really is, why do you feel that you will see compressing EBITDA in 2018 relative to 2017? So that's the near-term side.

On the longer-term side, I mean, obviously, post 2018 we're entering a capacity addition vacuum period. So the handful of companies that had already announced some incremental capacity, it seems even they now are backing off, meaning the other day Chevron came out with an announcement that they were reconsidering the next-gen cracker on the back of higher capital costs, obviously, higher steel prices, higher energy prices, and the like. So longer term I'd like to hear your view, I mean, are we basically going to see a tight - what was going to be a pretty tight environment even get tighter. So that's kind of my two-part thing about the near and long-term.

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

Hello, Hassan. Thanks for the questions. On the short-term, I think there is a couple of factors that need to be put it here in the discussion. First, Braskem is much larger than PE. So, if you look at the crackers profitability, especially the naphtha crackers in Brazil, in the first half of the year in 2017, the co-products had very, very strong price increases that led to significant profitability in our operations, thanks to that. The expectation is that those co-product price increases will not happen this year. We didn't see it last year, it happened in the first quarter. We didn't see it happening this year. And this should put more pressure on the overall basic chemical spreads.

Second, even though the scenario for PE is one where the spread should be held, it's important to remind ourselves that there is a lot of new production coming aligned in the U.S. Some of it will target South America. So, we do expect increased competition in the region, which should lead to a tempering of this spread increase translating into concrete margin increase for us. So, we probably will see more competition from the U.S. based production in South America, which will be counterbalanced by the better spreads in general as mentioned before. And the net-net combined with chemicals in our point of view right now is that this should lead to a decrease.

Two other extraordinary factors that are important to factor in is, we did have a positive EBITDA contribution from the acquisition of quantiQ last year, it will not repeat itself and...

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...the divestment of quantiQ. And in Brazil, there is a tax incentive, the FECCEI (00:51:55), which has lower rates in 2018 compared to 2017. So the impact of it to our profitability will be reduced as well. So, when you put all this into the equation, it leads to our expectation of a declining EBITDA for the short-term.

Having said that, if the optimism that we're seeing in the industry around PE and PP really goes to a very positive scenario, this could, I mean, lead us to being closer to last year results if those spreads really stay strong or get even stronger than currently anticipated for the back end of the year.

On the mid-term, I think at the end of the day when demand is perceived to be very strong over the next few years, this will lead to investment. If CapEx becomes even more expensive in the U.S. as it had become over the last four to six years, I think the fact that people have mastered the ability to move the ethane around the world could create the ability of investments being made in other regions with ethane flowing from the U.S. towards that. So, we already start to hear news of ethane crackers being built in China with imported ethane, and the capital intensity in China is significantly lower than what you see in the U.S. Gulf Coast.

So, either the CapEx cost in the U.S. will go back to a more reasonable level and the projects will be built in the U.S. or when projects will be built in China, India or other places where capital intensity is lower and the feedstock will flow as the industry master the ability to move ethane around the world. So, my expectation is, we might have an extended positive cycle, but eventually product will be needed and then projects will be built to deal with it.

Q - Hassan I. Ahmed {BIO 7430123 <GO>}

Very helpful. Very helpful. Now a boring follow-up if I may.

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

Yeah.

Q - Hassan I. Ahmed {BIO 7430123 <GO>}

I was taking a look at your consolidated EBITDA, and there seems to be a BRL 182 million drag to EBITDA in the quarter. And it seems that it was under the eliminations and reclassifications line, and it seems for the last couple of quarters, there has been a negative drag as that line item. And that drag prior to, call it, two to three quarters was not there. So, just trying to understand what that drag is.

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

Pedro, do you want to take this? This is more of a...

A - Pedro Teixeira {BIO 19489140 <GO>}

Yeah. So, Hassan, what we've been doing is, we have on the segment because we export from Brazil to Europe and to the U.S. a little bit, but more to Europe. We are adding the profitability of those exports or the margin of those exports to both businesses, to the Brazil segment and to the Europe segment. And then we eliminate that on the consolidation so that we don't have a double count on the consolidated results. So, that's the main reason for that.

Q - Hassan I. Ahmed {BIO 7430123 <GO>}

Got it. Got it. Got it. Okay. Very helpful. Thanks so much, guys.

Operator

Our next question comes from Mrs. Fernanda Cunha from Citibank.

Q - Fernanda Perez da Cunha {BIO 20784520 <GO>}

Hi. Good morning, everyone. I have two follow-up questions. And my first one is regarding Mexico project. Given that Pemex ethane production is dropping and I understand they're imported from U.S., but can you give us a guidance of what would be a reasonable utilization rate of that project for this year?

And also, I understand that this quarter you were reimbursed for the difference in the utilization rate for the second quarter 2017 given that Pemex did not deliver the 100% supply of ethane. I'm just trying to do a back-of-the-envelope math here and I'm trying to understand whether you're going to be reimbursed for only the ethane cost or are you actually going to be reimbursed from the margin from not producing the PE? So those are my two questions regarding the Mexico project.

And my last one is on dividends. What is the reasonable leverage ratio? What is your target leverage ratio going forward? I'm just trying to understand if it's reasonable to think that your dividend payout going forward could be close to free cash flow for there was (00:57:23) this quarter, as far as, as there was this year. Thank you.

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

Okay. Good morning, Fernanda. On Mexico, our expectation is to be running anywhere between 85% to 90% depending on availability of supply from Pemex. As far as the penalties, the delivery of paid penalties they partially offset the margin, they do not compensate for the full margin and the structure of the contract is not linked to a margin compensation.

And as far as leverage, the dialog with the board is to have 2.5 times as a top number for leverage. We could eventually go a little bit above that in the case of a relevant acquisition if it makes sense, but this would happen if we had very strong synergies expectations that would quickly bring us back below 2.5 times.

Pedro, I don't know if you want to add anything on the three topics.

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A - Pedro Teixeira {BIO 19489140 <GO>}

Yeah. Just to reinforce that this leverage of 2.5 times is a ceiling reference, it's not anywhere close to where we are right now. We are roughly 1.9 times. And even with dividend payments, we will get maybe closer to 2 times, but nowhere close to 2.5 times.

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

And I would also add, Fernanda, that these penalties, it partially offset the margins, especially because now the ethane price is very low. It's close to \$100 - \$200 per ton and in a situation where the ethane prices goes up, of course, the margin would be more compensated by this deliver-or-pay penalty.

Q - Fernanda Perez da Cunha {BIO 20784520 <GO>}

Okay. Actually, so, basically you have the range of how much you would be compensated for the ethane not supplied by Pemex, right?

A - Pedro Teixeira {BIO 19489140 <GO>}

Yeah

A - Fernando Musa {BIO 17592170 <GO>}

Pedro, do you want to.

We don't provide the exactly percentage. But it's a percentage over the same price. So if this same price is higher, the absolute value of the compensation will be higher as well. That's the rationale behind it.

Q - Fernanda Perez da Cunha {BIO 20784520 <GO>}

Okay, okay. Thank you very much.

Operator

Our next question comes from Mrs. Sarah Leshner from Barclays.

Q - Sarah Leshner {BIO 15039127 <GO>}

Hi. Thanks very much for taking my questions. So, most of what I wanted to ask has been answered. But I just have one small question remaining which is whether you are aware of negotiations continuing or not continuing between your shareholders in particular as it relates to Petrobras' stated interest in divesting its stake? Thanks.

A - Fernando Musa {BIO 17592170 <GO>}

So, the information I have is that the dialog between Petrobras and Odebrecht is ongoing. As I mentioned in previous calls, we're not directly part of it. This is a discussion between the shareholders. As of today, I have not been informed of either concrete progress or

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the stop of the conversations. So I would say the dialog is still happening between the shareholders, given the fact that I did not receive any information to the contrary.

Q - Sarah Leshner {BIO 15039127 <GO>}

Perfect. And I just have one very, very small confirmation. So, I recall that for 2018, the guidance for utilization of (01:01:34) Mexico operations was 90% and you came in right around 90%, up to 88%. But you mentioned that for 2019, it was 85% to 90%. So I'm just wondering is it your intention that those numbers should be considered flat, like we should expect to see relatively similar utilization from 2018 to 2019 or is it a deliberate change in your guidance from 90% in 2018 to a lower range in 2019?

A - Fernando Musa {BIO 17592170 <GO>}

I would say then, given all the actions that Pemex is taking including the start of import of ethane, our expectation is to have similar type of performance on the Pemex side. So that's why we have this range of 85% to 90%. And we fluctuated during the year and ended the year at 88% on average for the year. This is a range for where we expect. It will depend a lot on - weigh more on Pemex' performance and the amount of imports that we will be doing. They tested their system for the imports over the last month, month and a half. And it's going to be now their decision to increase that import rate or not based on how well the production side and the midstream side of their systems operates. They have the reserves, they have the capabilities to produce more ethane locally, so let's see how they manage the system overall and how much imports they will bring.

Q - Sarah Leshner {BIO 15039127 <GO>}

Okay. Thank you. That's perfect.

Operator

Our next question comes from Mr. Vicente Falanga from Bank of America.

Q - Vicente Falanga Neto {BIO 18277588 <GO>}

Thank you for taking one more question. It will be quick one I promise. Could you remind us what is Braskem's naphtha importing capacity to Brazil today in a smooth way without having to pick any supply timing risks. And if you were to import your naphtha, would you likely get similar pricing conditions as a contract that you have with Petrobras? Thank you.

A - Fernando Musa {BIO 17592170 <GO>}

So, today we already import a significant part of our demand of naphtha in Brazil. We have the ability to import a little more than we're currently importing. The large part of the infrastructure for the naphtha import is in Petrobras' hands and control, so this is part of our daily dialog from an operational point of view with Petrobras to facilitate our imports of naphtha.

As far as price is concerned and it varies along the year depending on the supplier, the quality of the naphtha and naphtha has different types of naphtha and depending on the

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olefins and aromatic contents of different naphtha, it could yield to different pricing. I would say in the scenario we have been living over the last few months, we end up with pretty similar price points for the naphtha, between the imported naphtha and the Petrobras contract, with the naphtha fluctuating in the \$500 per ton to \$600 per ton range, given the fact that our Petrobras contract is a percentage of the reference and some of the other landed cost would be more and reference plus the fixed amount typically related to freight.

So today, as I said we're pretty close to 50/50, our imports compared to the naphtha contract with Petrobras, and we could import a little bit more depending on the access to logistics, but other than the contract with Petrobras, I mean the local supply makes a lot of sense for them to serve us and for us to buy from them to facilitate logistics.

Q - Vicente Falanga Neto {BIO 18277588 <GO>}

Great. Thank you very much.

Operator

Our next question comes from Pedro Medeiros from Citigroup.

Q - Pedro Medeiros {BIO 16187063 <GO>}

Hey, good morning guys. Thank you so much for taking this last question. I apologize if this was somehow already answered on the call. I had some connection issues. But do you mind to comment on the maturity of your supply contract for ethane with Petrobras today, how it's currently working and whether there could be any negotiations on that side?

And as a follow-up to that in, light of the de-risking in the outlook for availability for ethane with Petrobras now confirming the construction to expand the fractionation capacity and that to start by 2020, what are the conditions required for you to consider an expansion (01:07:20) and when should we be discussing this topic as a part of the investment in Braskem? Okay. Thank you.

A - Fernando Musa {BIO 17592170 <GO>}

So the ethane supply with Petrobras expires - the current contract goes to 2021. So it expires after the naphtha contract. As mentioned before, the dialogue with Petrobras and all suppliers of feedstock is a constant dialogue. As we get closer to the end of the most relevant contracts like the naphtha contract or the ethane/propane supply for the Rio de Janeiro cracker, we will start the dialogue. We have over three years - more than three years for the ethane and propane supply in Rio de Janeiro. So when it's the right time, this dialogue will happen with Petrobras.

As far as additional feedstock for a potential expansion of the Rio de Janeiro cracker, this is something that we have been evaluating for quite a long time. It's going to be dependent on the development of the pre-salt reserves first. And second, the midstream infrastructure, the fractionation and separation units. There are multiple players now, it

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goes beyond Petrobras, and all those players are making their investment decisions and their investment evaluations.

As this progress, we will have more clarity from their ends on future availability and we will certainly engage with both Petrobras and the other players around additional feedstock for our complex in Rio de Janeiro where we do have an opportunity at a very competitive CapEx to basically double capacity there.

But - so I mean, the big question is around the feedstock availability, which depends on not only the midstream, but also the production wells development by Petrobras and the other players in pre-salt.

Q - Pedro Medeiros {BIO 16187063 <GO>}

Okay. Thank you so much.

Operator

I'll turn over the conference back over to the company for closing remarks.

A - Fernando Musa {BIO 17592170 <GO>}

Okay. So, thank you very much for all the questions and the attention. As discussed in the presentation and during the question's session, 2017 was a very strong year for Braskem. We had very positive operational results from a production point of view, from a commercial point of view around the world with several production records that we delivered.

We also had a set of important value-adding projects either starting or being completed, the UTEC new plant that started early in the year, the approval of the PP plants construction in the U.S. and the conclusion of the ethane flexibility for the Bahia cracker, which will help us to continue our drive to making Braskem a very competitive company going forward.

On the financial side, three highlights, I mean, the liability management with \$1.75 million raised in the two bonds with a very competitive cost and really helping the liability management and helping us push the maturity after that and reducing the amount of debt we need to repay over the next two, three years. The rating agencies looking at us and seeing all this positive results and therefore maintaining our investment grade by two of them.

Despite the downgraded Brazil has been suffering, I think it's a clear indication that the rating agencies and the market in general is finally perceiving that Braskem is not a Brazil story, it's a global story. The company even though still has a strong base of its business in Brazil, now really has a global footprint and is more exposed to the overall global economy with a bias towards the Americas side. But it's less dependent on Brazil, as clearly the rating being so much above the Brazil rating demonstrates.

And finally, the dividend payout, the BRL 1.5 billion on top of the BRL 1 billion that we paid out late last year, I think is another indication of the covenants that the management and the board has on the solid results that we expect over the next few years and our ability to continue to find good investment opportunities while returning value to our shareholders in the process.

So, once again, thank you very much and looking forward to talking to all of you in month, month-and-a-half when we will publish the first quarter results. Thank you. 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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