

Q3 2017 Earnings Call

Company Participants

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

Other Participants

- Felipe dos Santos, Analyst
- Hassan I. Ahmed, Analyst
- Sarah Leshner, Analyst

MANAGEMENT DISCUSSION SECTION

Operator

Good afternoon, ladies and gentlemen. At this time, we would like to welcome everyone to Braskem's Third Quarter of 2017 Earnings Conference Call. Today, with us we have Fernando Musa, CEO; 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 section. 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 (sic) [www.braskem-ri.com.br] (00:00:49) 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 the 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 Van Langendonck Teixeira de Freitas {BIO 19740578 <GO>}

Hello, everyone. Welcome to the third quarter 2017 earnings conference call of Braskem. Let's start our presentation in slide number 3, where we highlighted the operations in Brazil.

In the third quarter, the crackers operated at an average utilization rate of 92%. It was 1% down when compared to the second quarter 2017, mainly as a result of the scheduled shutdown in Rio de Janeiro cracker. The stoppage lasted for around 30 days and this was the key issue that impacted the production in this quarter, but excluding this shutdown in Rio de Janeiro, the utilization rate reached 97%, which is very positive.

In terms of Brazil demand, the message is positive for resins, PE, PP and PVC. The total market in the quarter reached 1.3 million tons. It was a growth by 6% in comparison with the second quarter 2017. In the aggregate of the nine months of 2017, the growth had accumulated already 3.5%, which is higher than we expected in the beginning of the year.

Regards Braskem sales, we grew even higher than the market. We increased our sales quarter-to-quarter by 10%. So, we gained market share in PE, PP and PVC and we sold in the Brazilian market 915,000 tons.

In terms of exports, the results were also positive. We exported 396,000 tons of resins, an increase by 8% when compared to the second quarter 2017. Between the main chemicals, the total amount exported was 175,000 tons in this quarter.

Moving on to slide number 4, still talking about Brazil, the international spread that affect the Brazilian region reduced by 4%, mainly as a consequence of decrease of naphtha international prices by 7% when we compare the third quarter with the second quarter. And the EBITDA in the region reduced to BRL 1.9 billion in this quarter when we compare it to the second quarter 2017.

As a consequence, mainly that in the second quarter of 2017, we recorded a non-recurring event as a consequence of the capital gain from the divestment that we made in quantiQ that was recorded in the second quarter 2017. The EBITDA, the EBITDA of the Brazilian region accounted - represented 67% of the consolidated EBITDA of all segments of Braskem.

Moving on to slide number 5, in this slide, we begin to track the results in U.S. and Europe. The utilization rate in this region amounted 94%, down 1 percentage point when compared to the second quarter 2017. We had some unscheduled shutdowns in Texas as a consequence of the passage of the Hurricane Harvey along the U.S. Gulf Coast.

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The demand in the region remained very strong, mainly for household items, food packaging, non-woven in U.S. and in Europe, the positive aspect was in the automotive sector. In terms of sales, Braskem sold in between U.S. and Europe 548,000 tons of polypropylene, an increase by 6% when we compare it with the second quarter 2017.

Moving to slide number 6, still discussing about the performance in U.S. and Europe. The international spread in this region - in these two regions increased. In U.S., the third quarter was higher by 2%, the difference between PP U.S. and international price. In propylene, international price was 2% higher and in Europe was even higher, 8% higher this quarter when compared with the prior quarter. The EBITDA, U.S. and Europe in aggregate amounted \$164 million, which accounted for 18% of the consolidated EBITDA of all segments of Braskem.

Moving to slide number 7 and here, we talk about our operations in Mexico, our projects at Braskem Idesa. The PE plant operated at an average utilization rate of 87%, which represented an increase by 4 percentage points when we compare it to the second quarter 2017. And here, we were able to see a higher ethane supply in this period when we compare it with the utilization rate that we achieved in the second quarter 2017, which is very positive.

In terms of production, the total amount produced was 230,000 tons in this quarter, 6% higher than the second quarter. And in terms of our sales, we sold a bit more than what we produced, 235,000 tons. The majority of this amount was placed in the domestic market, in the Mexican market and we reduced the amount that we exported by 25% quarter-over-quarter.

In terms of exports, we also placed the majority of our exports to regions like U.S., Europe and Central America and we reduced the amount that we exported to Asia. So, we increased the aggregate value in the exports that we made throughout Mexico.

Moving on to slide number 8, the spreads in the region also, the difference between PE international price and the U.S. Gulf Coast and the same price and the volume (00:09:18) remained stable around \$950 per ton. And the EBITDA of our project in Mexico reached \$136 million and represented 50% of the company's consolidated segments.

Moving on to slide number 9 and here, we got to the consolidated figures of Braskem. The EBITDA in U.S. dollars reached \$868 million in this quarter, equivalent to BRL 2.7 billion, which was down by 6% when compared to the third quarter 2016, mainly as a consequence of the shutdowns in the PP and the United States plants, also Rio de Janeiro and there was a short decrease in the spread in the international market by 13% when compared to the two quarters in each of those respective years.

The company recorded a free cash flow of BRL 1.068 billion in the third quarter 2017, which was up 6% from the prior quarter and the coverage leverage of Braskem reached in this quarter 1.65 times or 1.8 times when we include as a debt the amount of penalties due to be paid under the Global Settlement.

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In October, the company raised an extraordinary amount of new capital we accepted at the international capital market and we were able to issue two transactions. One, a five-year bond in the amount of \$500 million and another 10-year bond in the amount of \$1.25 billion. The demand for these two transactions were great, 8.2 (00:11:33) times higher than the amount offered issued, and it represented the largest financial transaction with the lowest cost ever obtained by the company.

In terms of compliance and keeping our commitments to act ethically, with transparency and integrity, the third quarter, 27 new initiatives were concluded in line with our compliance plan.

Moving on to slide number 10, here there is a chart that shows the comparison between the EBITDA of the third quarter 2016 with the EBITDA of the third quarter 2017. A more appreciated FX impacted negatively and there were higher volumes this quarter when we compare it to the prior quarter, mainly because of Brazil and also because of Mexico. So, this was the reason of this higher amount of volumes. The spreads were smaller in this quarter when compared with the same quarter of the prior year. And also, we had some additional fixed costs, SG&A and other factors - things that impacted this quarter and had an impact the prior quarter, the third quarter of 2016.

Moving to slide number 11, here, it shows the debt profile of Braskem. We have an average debt term of 17 years and we ended the quarter with a total cash balance of \$2.2 billion. If we included as availability the two standbys that the company had and was not disbursed, one of that \$750 million and another of BRL 500 million, the total availability reached around more than \$3 billion. The total cash and equivalent is sufficient to cover debt service by the end of the quarter by 26 months. And the average cost of the debt, of Braskem's debt, in U.S. dollars is 5.7% per year.

In the chart that - it is in the lower left side of the slide shows that the leverage of the company is very much stable, under control. The net debt of the company has reduced by \$100 million quarter-over-quarter and the net debt to EBITDA ratio, including the Global Settlement, has reduced from 1.85 times to 1.82 times.

In terms of corporate ratings, no big change here, the company remains investment graded by Fitch and S&P.

Moving on to slide number 12, here it shows the investments of the company. The company had already invested about BRL 1.2 billion. The majority of these investments were directed to the plants in Brazil. And this amount is not considered the amount that was invested in the new PP plant in the U.S. The company had already invested BRL 364 million.

In August, the project was granted the environmental provision, which allowed the company to begin its construction. Linde Group was also contracted to lead the projects, EPC. And in September, the project completed 45% of the engineering phase and 27% of the procurement of the major equipments.

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The highlight here, I think, is the feedstock flexibility project in Bahia. By September, the company, this project achieved 90% of completion. Investments in the year-to-date reached BRL 158 million and since the start of the project, the Braskem had already invested BRL 278 million. So, it's an important project in the year that will give flexibility for Braskem to run a portion of Bahia's cracker, whether by gas or by paint or naphtha.

Moving to slide number 13 and here, it shows the evolution of the entrance of new capacity in the PE market. And as you can see on the graph, on the left side of the slide, the total amount of new PE capacity were expected for 2017 - in the end of 2016 were around 7.5 million tons. We are obviously in the end of the year and the total amount expected to enter is a bit - much lower than that, 6 million tons of PE are expected to enter in the globe this year.

There were several postponements, delays in projects that were expected to enter in this year. They should enter in the years of 2018 and 2017. As a result of that and as a result of the Harvey, the spreads in the PE, Naphtha spreads remains very robust. The initial forecasts were around \$700 per ton in the first and second quarter of 2017. Now, the forecast for the whole year of 2017 is 8% higher, \$750 per ton, and it's important to note that the new capacities in the U.S. are already in the process of starting up from Chevron Phillips, Dow and Exxon Mobil.

Moving to our last slide of our presentation, here, it shows our views on each of the regions, the behavior, how we think those regions will behave in the following quarter in comparison with the third quarter 2017. We think in terms of demand, the demand seems to be higher in the fourth quarter, of course, adjusting by the seasonality of the period, but we are positive in terms of the (00:19:05) domestic demand in Europe, the demand - the market remains - in Europe and U.S., the market remains very much strong and same for Mexico.

In terms of the spreads, we see positive spreads for PE, PP and basic petrochemicals. The only concern we have, in Brazil, is PVC. The market is still down by around 4% in the nine months of 2017. That's why we do think that we don't expect a recovery in the spreads of PVC by the end of this year.

In Europe, we see the demand is very positive, pushing up the spread. And Mexico also, impact of Harvey should also push the spreads up in the region for the fourth quarter 2017.

In terms of the FX, we had faced a lot of volatility in the Brazilian FX rates. So, it's hard to predict what's going to be the impact for the next quarter. U.S. and Europe, U.S. dollars is neutral and in Mexico, there was an appreciation of the Mexican peso. So, this should weigh negatively on our EBITDA.

So, thank you very much for viewing the presentation. I will turn it to the Q&A session.

Q&A

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Operator

Thank you. The floor is now open for questions. Mr. Felipe Santos from JPMorgan would like to make a question.

Q - Felipe dos Santos {BIO 16391255 <GO>}

Hi, Pedro. Just one follow-up question from your contract years (00:21:32). First one, do you have an update on the PDH plant of enterprise in U.S., if this (00:21:41) plant has started production and the idea of the spreads in U.S. going forward? Thank you.

A - Fernando Musa {BIO 17592170 <GO>}

Good afternoon, everybody. Hello, again, Felipe. The enterprise PDH has started commissioning. It has been impacted by Harvey and so the commissioning is delayed. So, they are in the process of ramp-up. And our contract has provisions for utilization rate to be reached until it fits in (00:22:23). So, we are waiting for the ramp-up process, which is going on as we speak.

From a spread point of view, going forward, we do expect to continue to have good margins in the U.S. The challenge - given the recent volatility in propylene price, largely induced by Harvey, is to understand what it can mean for the shape of the curve of propylene prices and therefore, its impact into the short term, but the expectation is for the spreads to continue very strong with a light improvement for next year in the U.S. for the PP business.

Q - Felipe dos Santos {BIO 16391255 <GO>}

Excellent. Thanks so much.

Operator

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

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

Afternoon, Fernando. Two questions if I may. First on the polyethylene side of things, obviously a bunch of moving parts in Q3, the impact of the hurricanes, then some of these sort of new builds or Greenfield facilities taking longer to start up primarily because of hurricanes and the like. So, obviously I would imagine that contributed to some of the pricing strengths that we saw, but part and parcel with that was it seemed that there was a large comonomer outage as well.

So, the question to you is, as I sort of do a compare and contrast, Harvey versus Katrina, the water damage - so precipitation wasn't that high when Katrina happened - 11, 12 inches of rain versus over 50 with regards to Harvey. Yet post-Katrina, it took around three quarters for things to normalize in terms of North American operating rates. So, do you see that being repeated this time around? So, that's the first question.

And the second question is what sort of role do you see in terms of these comonomer shortages playing in terms of the tightness we're seeing in polyethylene? Is that behind us or do you see that lingering on at least for the next several months?

A - Fernando Musa {BIO 17592170 <GO>}

Hello, Hassan. I think the question you're asking on Katrina versus Harvey is a good one, but it is important to understand that the impact has been very different. Even though Harvey actually hit more of the core of the production compared to Katrina, therefore one could imagine that Harvey would take even longer to recover.

At the same time, I think the overall industry is at a different situation now from a preparedness point of view to deal with it. Therefore, yes, it's going to take some time to normalize, not sure it's going to be three quarters. It seems a long time for it to go back to normal, especially given the fact that from a supply point of view, this is happening at a time where you have a lot of new supply coming in, right?

So, there was an expectation that the new supply would disrupt the overall scenario. And I think what we're going to see here is actually a little bit different and positive from a market point of view, that at the end of the day, the fact that the new plants are coming at a time after Harvey impact and things are going to balance each other and we might be going back to normal sooner and the normal is better than the previous scenario where we were anticipating the deterioration of margins faster than they actually are going to happen.

In a weird way, Harvey versus new builds will compensate each other, will go back to normal sooner, but will go back to the old normal, not necessarily to the new normal. So, the new normal, which is the consequences of the new builds, might take a little bit longer to happen.

As far as the comonomer outage, I think this is an important impact that happens in the industry. It's going to take a while for everybody to adjust production, inventories, as the comonomer production ramps up. I have not followed the comonomer details over the last few weeks. So, I'm not updated with the returns production of the plants in the U.S. to be very transparent, but if it takes a long time and some of the - one of the plants, one of the suppliers was badly hit. So, if it takes a long time, this could continue putting a challenge in for some of the products, of course the ones that use is more significantly will take a hit and increase the shortness. So, let's see how it plays out. I think it's all about how fast and how well the comonomer plants will get back towards that.

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

Understood. Understood. Very helpful. Now, as a follow-up, I mean, you obviously sound quite positive in terms of polypropylene sort of spreads and margins going forward and I completely understand as I take a look at polypropylene supply demand balances, they seem to be tight - getting tighter.

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Question is more on the feedstock cost side of things. Not just propylene, I mean as I take a look at U.S. propane prices, I mean they have jumped up quite majorly. Inventory levels seem to be quite low, exports seem to continue to rise. So, not surprisingly propane has run up as much as it has. So, on the back of that, again, not surprisingly, we're not seeing - going back a couple of quarters, the name of the game was propane and ethane, sort of toggling between the two. A fair bit of propane sort of cracking going on, which obviously is not happening now, I would imagine a lot of the PDH units are scaling back their utilization rates as well.

So, all of this, said differently, I mean higher propane, less economic propane cracking and the like, I just want to sort of understand your views about how you see that impacting the propane to propylene side of things, propylene availability and what sort of impact that may have on the polypropylene to propylene spread, understanding polypropylene is tight.

A - Fernando Musa {BIO 17592170 <GO>}

As you mentioned, this is a very complex system. And my personal view is the PDHs will run. With the propane prices going up, we're still seeing positive margins when you look at the propane to propylene spreads for typical propane. I mean if you look at the consultants and the data they publish, an average PDH will still have positive margins and therefore an incentive to run as this propane price goes up.

If propane price is going much, much higher in the near future, the most likely scenario is because oil prices are going up and then I mean, feedback loop starts to kick in, right. More drilling, more associated gas, more associated NGL, increase of supply, inventory is going to go up. So, there's a balancing effect that would positively impact PP prices going up, right, globally. And if price goes up, propane availability might go down.

So, I'm confident that, going forward, we will see volatility, as we saw with Harvey given the fact that propane has multiple sources and crackers, PDH, the refinery, a lot of that was shut down during Harvey, propylene really skyrockets and is starting to slowly come back. This back and forth will happen next year, but at a level that makes propylene globally competitive.

PP supply and demand in the U.S. is getting tighter and tighter and demand growth seems to continue to be quite healthy. There's no new plants until we build and we start our own in the first quarter of 2020. So, I'm confident we'll continue to have good margins going forward with some volatility, with the source of propylene flipping from PDH, refinery, crackers, depending on cracker, propane is actually the same feed.

The complexity of the system will probably work in favor towards globally competitive propylene on average with once in a while like we saw, because of Harvey, an inversion and propylene in the U.S. becomes the most expensive in the world. But after a while, when the bottleneck are removed, it goes "back to normal."

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

Bloomberg Transcript

Very helpful. Very clear. Thank you so much.

Operator

Mrs. Sarah Leshner from Barclays would like to make a question.

Q - Sarah Leshner {BIO 15039127 <GO>}

Hi. Thanks for taking my question. I had one very specific question, which is about Mexico. It sounds like the ethane supply has improved and you were able to increase the capacity utilization rate close to your full year 90% target, which is great. So, I was wondering to what extent the project is still ramping up and working out the kinks versus to what extent the ethane supply is still posing a challenge for you, albeit less than last quarter. When we think about this 90% capacity utilization rate, to what extent is that 10% discount attributable to the natural kinks of ramping up versus the challenges of ethane? Thanks.

A - Fernando Musa {BIO 17592170 <GO>}

Hello, Sarah. I think it's a combination of the two factors you mentioned. As one would expect with a greenfield project with the size and complexity of our project in Mexico, we have a lot of learnings as we operate, ramp-up, set the limits of the plants. We had a fantastic first quarter as far as utilization rates, where all the stars aligned positively, both externally and internally.

Externally, the supply availability was very good and internally we were running - we're in the beginning of the ramp-up, we were running a much simpler product slate, longer run, not testing a lot of transitions from one product to another. So, it was a very simple - it, was the industrial manager's dream as far as product portfolio. So, it led to a very positive first quarter.

In the second quarter, we go back to "normal" with, let's say, the business manager nightmare, where the supply gets sticky, the product portfolio needs - starts to be more complex, we need to try to do new products that have not been produced before. There is always a learning curve when you start a new product in those large new plants.

So, the combination of moving to a more sophisticated, complex product portfolio was hitched with challenges from the Pemex side. When we go to the third quarter, we continued to work on our kinks and our learning curve and we do expect this to continue for a while. And Pemex has been working on its own kinks as well, learning about how to manage the system with a fairly new consumer of ethane starting up and impacting its own system.

And the good news, I think, is that the supply in third quarter was clearly better than in the second quarter and within the third quarter, it's a positive trend. I mean, every single day, we are seeing that the frequency and the duration of any upsets on the supply is decreasing. And we see that trend in October continuing.

So, that's why we're confident we'll hit our 90% expected operating rates. It's natural that the first year, full year of operation, you have more volatility. Next year, we do expect that this volatility is going to be lower, but it's still a new plant and there are still learnings and fixes that will take some time to be incorporated by the team and in some cases more investments to adjust some of the learnings we had during this last 12 to 18 months of running the plant.

Q - Sarah Leshner {BIO 15039127 <GO>}

Great. That's perfect. Thanks.

Operator

Thank you. I'll turn over to the company for closing remarks.

A - Fernando Musa {BIO 17592170 <GO>}

I would like to thank everyone for joining us for our third quarter results. And I want to end with a couple of remarks. First, this was another quarter where the results have been in line with our strategy, continued focus on operational and commercial efficiency, as seen around the world in multiple plants, and the team's ability around the world to deal with the upsets.

The third quarter was one where not only we faced Harvey in the U.S., but two earthquakes in Mexico that luckily didn't impact significantly our assets in the plants, but did impact our offices in Mexico City. From an infrastructure point of view, the city was in chaos for several days, but I'm glad to report that all our team members are safe, accounted for and no one had any major impact from that and we dealt with this pretty well.

The second aspect of our strategy, that clearly saw an advance in this third quarter was our quest towards diversification and flexibility in all of our feedstock metrics with the commissioning that is, as we speak, in the middle of the project to create the flexibility to import ethane into the Bahia cracker.

This project - the first shipment is already at the port and we're commissioning all the logistics and the infrastructure to send the ethane to the cracker in Bahia. So, we should be seeing ethylene being produced with U.S.-imported ethane in the next several days, couple weeks.

And, I mean, we continue to advance in our global presence, diversification. The confirmation by the board of the decision to go forward with our new polypropylene plant in the U.S. was an important milestone. And in the third quarter, we've seen significant advancements with the PC contracting, the start of the detailed engineering, the start of some of the construction-related activities.

So, this is an important milestone, as we continue to work in creating the right balance between different regions, the right balance between the different products, so that we

can create a more sustainable, strong cash flow generation, which leads to the very positive financial results from a cash flow, EBITDA generation, but also enable us to realize a very successful bond that we did several weeks ago with a very large interest for our investors, significant reduction in the yields and I believe - and a better comprehension by the market that Braskem is a global company, is competing with global companies, is present globally and therefore should be viewed as a global company and valued and assessed as a global company.

So, thank you all for joining us and since we're hitting the end of the year, I wish all of you a happy end of the year and holiday season and looking forward to talk to you in the next call early next year with the full-year results. Thank you.

Operator

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

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