

Mexichem S.A.B. de C.B.

Second Quarter 2018 Earnings

Thursday, July 26, 2018, 11:00 AM Eastern

CORPORATE PARTICIPANTS

Daniel Martinez-Valle - *Chief Executive Officer*

Rodrigo Guzmán Perera - *Chief Financial Officer*

PRESENTATION

Operator

Good morning, and welcome to the Mexichem second-quarter 2018 earnings conference call. Please follow the presentation that is available on Mexichem's investor website so you can follow along during the webcast.

All participants will be in listen-only mode. Should you need assistance, please signal a conference specialist by pressing the star key followed by zero. After today's presentation there will be an opportunity to ask questions. To ask a question you may press star then one on your touchtone phone. To withdraw your question please press star then two. Please note this event is being recorded.

I would now like to turn the conference over to Mr. Daniel Martinez-Valle, CEO of Mexichem. Please go ahead, sir.

Daniel Martinez-Valle

Thank you, Carrie. Good morning, and thank you all for joining us today to review Mexichem's second-quarter results and discuss our business outlook. I am very excited to share with you that we had a record-breaking quarter. This validates that the actions taken during 2016 and 2017 were in the right direction. And more importantly, it validates that A, Mexichem has a significant market position across all its different verticals, and B, that we are achieving a true global scale.

Let's move to slide four. Looking at the quarter's results now, I want to highlight the following: first, we reached double-digit growth in sales, EBIT, EBITDA, and triple digit growth in net income. Two, during this quarter we reached our highest historical EBITDA levels due to a balanced mix of organic and inorganic growth. Since the third quarter of 2017 we shared our plan to improve our net debt to EBITDA below the self-imposed ratio of two times by July 2019 after the completion of the Netafim acquisition. And very importantly--and this is a significant milestone for the company--our return on invested capital is higher than our weighted average cost of capital, 8.7% versus 7.5%. Thirdly, we achieved strong growth across all key segments due to many factors. Firstly, Netafim's consolidation in Fluent and Mexichem's results; secondly, continuous good trends in European and US market dynamics in both Fluent and Fluor; thirdly, signals of recovery in Fluent LatAm and AMEA; and lastly, positive market conditions in Vinyls, as well as geographic diversification of sales. All this helped to boost Mexichem's results.

Each of our three core business groups posted strong EBITDA results supported by a mix of organic and acquisition growth, and we are already seeing significant surpluses from the most transformative acquisition in our history, Israel-based Netafim. I'll talk more about some of these exciting developments from that acquisition in just a moment.

Turn to slide five. Our performance in the quarter demonstrated Mexichem's leadership in serving our diversified group of vertical markets, namely irrigation, building and infrastructure, and datacom. Our solutions address high growth markets. We are building out our global footprint and investing in our internal infrastructure to fully address all of these opportunities.

Next slide, number six. We are thrilled with Mexichem's financial performance, but we take even bigger satisfaction in knowing that our technologies and innovations are actually making a real impact all over the world.

Slide seven. Mexichem is delivering purpose-driven and human-centered solutions for intelligent ruralization. Netafim President, Ran Maidan, addressed the United Nations in New York this past May during the Israel at 70 Global Impact Through Innovation event. Ran talked about how precise irrigation is helping farmers worldwide produce more food with less water and how Netafim is working with local governments and communities on large projects in places like India and Africa where we help villagers there improve their lives, as well as their livelihood.

Next slide, number eight, also in May Netafim launched NetBeat, what we describe as the first irrigation system with a brain at the Agri-Tech international technology conference in Tel Aviv. In fact, as he Ran said in his presentation, this is the only system in the world that handles the three key steps for farmers; monitoring, analysis and optimization, and control. NetBeat lives in the cloud, enabling incredible flexibility for farmers. It features dynamic crops modeling where it's constantly updated and customized by crop, growth patterns and weather conditions. NetBeat is a culmination of more than 50 years of agronomic and hydraulic expertise and allows farmers to manage their crops from their smart phone, giving them information and fingertip control of irrigation and fertigation. This technology isn't just changing the world. It's actually improving it.

Next slide, number nine. At Mexichem we're increasing our focus to be able to deliver purpose-driven and human-centered solutions for intelligent urbanization, as well, and reimagining city infrastructure, focusing not just on cost, but actually on effectiveness and sustainability. During the quarter Mexichem celebrated our six-year anniversary of our acquisition of Wavin, and also the launch of Sentio, our new underfloor heating and cooling control system helping to drive a trend around the construction of smart homes.

Slide 10. Sentio is a family of integrated smart home products, including thermostats, sensors and a range of accessories. Sentio's intuitive smart home solutions are easy to install and are actually as good for our construction partners as they are for homeowners. What separates Sentio from other smart home offerings, aside from ease-of-use and installation simplicity, it has non-intrusive design. In other words, it actually looks as good as it works to create an energy efficient home.

Slide 11. Just recently we launched Wavin Spotlight in Europe. These solutions will help solve problems of aging sewer infrastructure and storm water drainage, both made worse by city congestion and climate change all across the world. We're seeing the effects of climate change across our natural environments and in our cities. It's changing precipitation patterns and causing larger stores across Europe, and indeed, all over the world. Each year rainstorms and flooding events, as you all know, are increasing in both frequency and severity. In other words, it has become the new normal.

Slide 12. According to a recent report by the University of Bristol and The Nature Conservancy, as many as 41 million Americans, or 13% of the population, are at risk from flooding rivers. As for Wavin, we will continue to play a leading role in the development and production of forward-thinking, sustainable storm water solutions to diminish the challenges of urban flooding and do our part to adapt to the reality that is climate change today.

Moving to slide 13, as part of our commitment to the communities we serve we are very focused on our efforts around sustainability and driving impact worldwide. It is not only the right thing to do, but a key requirement for long-term business success for our company. At Mexichem we are committed to making our cities more intelligent, safer and more sustainable so that we use fewer resources while supporting more people as cities around the world continue to grow.

Slide 14. Smart or intelligent cities are about a lot more than energy-efficient buildings and master planned communities. They are also about accessibility and flexibility. Just to give you an example, Wavin is today working with the city of Zwolle in the Netherlands to build a new kind of bicycle path. As you can see on slide 15, this is actually a sustainable bicycle path made of hollowed planks of recycled plastic that enables water drainage and telecommunication cables and pipes to be laid down. It's a far better alternative than laying just asphalt or concrete. These recycled plastic pathways not only provide better water drainage, but make it far easier to deploy cables and pipes and to make changes after the pathways are built. More details to come from Maarten Roef, Head of Fluent Europe, when we launch this pilot in September. Looking forward to that.

These are just some of the purpose-driven innovations that Mexichem is delivering today and how we are making the world better. We believe that we have the right talent, we have the right assets in place, and we are very well-positioned in the markets we serve globally. Let me just give you a few examples. We have the biggest fluorspar reserve globally with our mine in Mexico. We are the global leader in the production of specialty resins. We are one of the top global PVC producers in the top 10 list worldwide. We're the global leader in precise irrigation technology. We are the leader in data conduction in the US. And finally, we're a leader in water conduction solutions for building and infrastructure.

This is the beginning of a long-term journey. Our vision is marked by innovative solutions, and we are continuing in these directions towards a brighter future. Now I will turn it over to Rodrigo Guzman, our CFO, to review our financial results. Rodrigo.

Rodrigo Guzman Perera

Thank you, Daniel. On July 16 you can see that we achieved strong performance across all our business groups. As Daniel mentioned, we are proud of our Q2 and year-to-date 2018 results. They demonstrate that we made the right decisions and proved we are ready and we are very well-positioned with the right talent and assets in our portfolio.

For Q2 2018 revenues totaled \$1.97 billion, up \$505 million or 35% from Q2 2017, led by higher sales in all our business groups. Sales for our Fluent, Fluor and Vinyls Business Groups increased by 49%, 29% and 12%, respectively. Organically, and without the FX impact, revenues increased 24% year-on-year, or \$354 million to \$1.8 billion. Growth was driven mainly by improved sales performance in Fluent Europe, US and Canada, signs of recovery in LatAm and AMEA, consolidating Netafim's results into Mexichem's results, solid fluorspar demand and better pricing across the value chain due to the seasonality and supply market constraints in Fluor, and improved PVC pricing and caustic soda environment in Vinyls compared to last year's second quarter.

The exchange rate translation effect for Q2 2018 in sales had a negative impact of \$135 million, including Venezuela and positive impact of \$31 million excluding Venezuela on a consolidated basis compared to Q2 2017. This was mainly because of the depreciation of the Venezuelan bolivar by more than 6,000% and the Brazilian real by almost 12%, which

was partially offset by the appreciation of the euro by almost 8% and the British pound by 6%. All of them against the US dollar.

EBITDA in Q2 2018 was \$423 million, our quarterly highest historical EBITDA, representing a 29% increase from \$323 million in Q2 2017 with [unintelligible] EBITDA margin of 21.5%. On an organic basis and without the negative impact of \$152 million FX translation effect, EBITDA would have been \$522 million or a 60% increase with an implied EBITDA margin of 29%.

During the first half of the year we reported on an organic basis excluding the FX translation effect, revenues increased by 30% to \$3.7 billion and 15% to \$3.3 billion, respectively. EBITDA increased 42% to \$753 million with an implied EBITDA margin of 20.2%, and 59% to \$842 million with an implied EBITDA margin of 25.6%, respectively. This compares with an EBITDA margin of 19% during the first half of 2017, an increase of 170 basis points and 710 basis points, respectively.

As you may remember, five years ago we said we wanted to continue growing downstream into specialties with higher margins and at the same time convert it into one of the lowest cost of uses of our raw materials. In slide 17 we can see the consequences of [indiscernible] in Q2 where our specialty products EBITDA represented 67% of our total EBITDA, out of which 60% comes from Fluent, 21% from our Fluor downstream businesses, and 19% from specialty resins and compounds. In the same quarter a year ago the total weight of specialty products was 57%. It is also important to highlight that with the Netafim acquisition total EBITDA weight of our petrochemical business declined from 43% to 33%.

Mexichem's Q2 2018 operating cash flow before CapEx and before dividends increased \$84 million and \$74 million, respectively, as we can see in slide 18, mainly due to the EBITDA increase of \$96 million. During Q2 we received a \$268 million payout from the insurance company related to the \$323 million settlement reached in mid-April with PMV. This was related to the accident that occurred in our PMV VCM plant two years ago and includes property damages, assembly insurance and business interruption policies.

During the first six months of 2018 working capital mix increased by \$261 million compared with the same period a year earlier that increased by \$233 million. The increase of \$28 million between the first half of '17 and the first half of '18 was due to the consolidation of Netafim into Mexichem results and higher sales across the company's business groups.

As we can see in slide 19, and as Daniel mentioned during his remarks, we are very pleased to announce that our total financial debt as of June 30, 2018 was \$3.6 billion, while cash and cash equivalents totaled \$905 million, resulting in net financial debt of \$2.7 billion. Our net debt to EBITDA ratio was 1.98 times as of June 30, 2018 while interest coverage was 6.2 times. This implies two [indiscernible] milestones achieved during Q2. First, the recovery of 100% of the accounts receivables related to the property damages, business interruptions and assembly policies linked to PMV accident. And second, reaching our self-imposed net debt to EBITDA ratio limit of two times a year earlier after the Netafim acquisition.

We continue with a very strong balance sheet and with a very healthy financial structure in our debt, including Netafim. As shown in slide 20, our [indiscernible] is 14.3 years. Our

weighted average cost of debt is 5.11%. Our debt profile is matched with our revenue currency, and as mentioned previously, our net debt to EBITDA ratio is less than two times. ROE and ROIC from continuing operations increased 670 and 190 basis points to 14.4% and 8.7%, while our WACC is at 7.5% as slide 21 shows. As we can be seen, the trend in both metrics have been evolving positively.

As we have been explaining to the street and have shown in slide 22, the peak of our CapEx cycle ended in Q1 2017 when we completed the investment in our cracker JV in Texas. During 2018 we expect our CapEx cash out of between \$350 million and \$400 million including Natali.

Now I will turn the call back over to Daniel for remarks about our 2018 guidance and some closing remarks before we open up the call for questions. Daniel?

Daniel Martinez-Valle

Thank you, Rodrigo. Now let's please move to the next slide, number 23. Last year Mexichem achieved record results, and we expect another year of strong growth in 2018. We are raising our guidance to 25% to 30% growth in EBITDA for 2018. That is from the 20% to 25% range we set last quarter. This is the result of the continued strength in 2018 of all our business groups, Fluent, Fluor and Vinyls. We also want to announce that our Board of Directors has decided to call for a general shareholders meeting in which a one-time extraordinary dividend of up to \$150 million will be proposed. This comes from the back of our solid financial performance and encouraging business outlook.

For the second half of 2018 we continue to see favorable market conditions for our Vinyls Business Group, enabling us to further expand our opportunities and strengthen our business position. Our Fluent business group continues to benefit from the organizational de-layering we executed during 2017 and favorable market conditions in both Europe and the US, as well as Canada, while LatAm market conditions are continuing to improve.

The supply constrained environment and seasonality that benefited our Fluor Business Group during the first half of 2018 will start to moderate. Additionally, we are overhauling our Japanese and US Fluor plants in the second half of this year. For these reasons we are cautiously guarding our Fluor business for the remainder of the year.

Next slide, 24. I want to thank you all for joining the call today and following Mexichem as we excitedly continue to build a global company that's helping to solve some of the world's biggest challenges, from feeding the planet to dealing with climate change. Our partners and employees are committed to developing and delivering purpose-driven and human-centered solutions to the market. Together we are cultivating a more intelligent and sustainable tomorrow. Operator, we're ready for questions.

QUESTION AND ANSWER

Operator

We will now take any questions. To ask a question you may press star then one on your touchtone phone. To withdraw your question please press star then two. The first question will come from Frank McGann of Bank of America Merrill Lynch. Please go ahead.

Frank McGann

Yes, good day. Thank you. I was wondering if you could maybe expand a little bit more on the guidance because the numbers would seem to be fairly conservative, suggesting a pretty sharp slowdown in growth in the second half, although growth would still be up and decent, but much slower than the first half. I was wondering, is most of that related to the slowdown in Fluor, or are you seeing perhaps less robust comparisons in the second half in some of the other segments as well?

Daniel Martinez-Valle

Thank you, Frank, for your question. No, I think we're basically, as I mentioned in my remarks, we're seeing a strong second half for all our business groups, and we are being a little bit cautious about Fluor. And there's two reasons why we're being a little bit cautious. The first one has to do with seasonality, and the second one, as I mentioned, we are overhauling both our Japanese and US Fluor plants during the second half of the year. But the rest of the business units we expect a strong business outlook for the remainder of the year.

Frank McGann

Okay, if I could follow up, perhaps, just in terms of the growth that you're seeing, I mean you mentioned the US and Europe and Canada being very strong. Latin America you said is improving. How are you seeing Latin America improving? Any specific countries where the results are picking up? Any surprises that you're seeing in that region?

Daniel Martinez-Valle

We're seeing overall very positive results, and we're very optimistic across the board in LatAm countries. We have significant runway in specific countries like Mexico and Brazil, but overall we're optimistic for LatAm in general.

Frank McGann

Okay, thank you very much.

Daniel Martinez-Valle

Thank you, Frank.

Operator

The next question will come from the Nikolaj Lippmann of Morgan Stanley. Please go ahead.

Nikolaj Lippmann

Thank you. Congratulations on the numbers, and thank you very much for taking my question. First on strategy, Daniel, could you provide a little bit more--thanks for providing a little color here--could you provide a bit of color on how to think about R&D going forward? And perhaps in a different or deeper way, how are you thinking about developing a culture where innovation is sort of the [indiscernible] has sufficient irrigation to grow within the company because that's clearly the road you're going down that road? So that's question number one, how do you create a culture of innovation? Question number two on Netafim, it's been a very hot summer in the northern hemisphere. Is that something that we should think of as a catalyst for demand? And are you thinking, in terms of changing the distribution model, do you feel that you have the right distribution model for the growth that you're expecting? And then finally--sorry for all these questions--on Fluor, what exactly are you doing to that Fluor business? Are you moving from R134a towards HFOs, or how should we think about that? Thank you very much.

Daniel Martinez-Valle

Thank you, Nik. Let me take one by one. They're very good questions. The first one is on innovation and how we're going to build out these capabilities. We have actually already partnered with IDEO. As you know, IDEO is a world-renowned design and innovation consultancy. We're starting to create an innovation ecosystem within Mexichem, and this will help us build an innovation lab. We're starting to look at forming a venture capital corporate fund, and also we're already exploring partnerships in the Bay area. In Tel Aviv we're already exploring potential partnerships with companies that will help us be more innovative, and our plan in general with IDEO is to build these new capabilities in both innovation, operations for vertical integration, as well as other [indiscernible] systems associated to innovation capabilities. That's the first one.

Regarding Netafim, we do expect the same tendency for the remainder of the year. We don't expect any major change in our distribution channels or in our distribution strategy. And lastly, in terms of Fluor, we believe there is still a significant runway for 134a. We are, as you know, in general, operating in a supply constrained environment. We do have, as I mentioned in my remarks, a significant sort of global market position based on our world reserves associated to the mine in San Luis Potosi, and there's also the phenomenon associated to the [indiscernible] rights in Europe, which again has some runway moving forward.

Nikolaj Lippmann

Got it. Thank you very much.

Daniel Martinez-Valle

You're welcome, Nik.

Operator

The next question will come from Luiz Carvalho of UBS. Please go ahead.

Luiz Carvalho

Hi, Daniel. Hi, Rodrigo. Thanks for taking the questions. The first one, how should we think about capital location looking forward? Now your net debt [indiscernible] is below two times, and you do have some highly strong cash generation looking forward. And we know that, I mean, on the D&A of Mexichem, at least in the past, I mean you had some being very active in terms of acquisitions. So I just would like to have a bit more color on how should we think looking forward from a capital allocation angle? Should we think about dividends at least for the short to midterm, or are we going to--are you going to more acquisitions, maybe on Netafim? That's going to be the number one.

The second part is, I mean, you had been discussing about this shift from a product to a more customer- or solution-centric company, right? And the start of that, we already started to see some improvements on the--mainly on the ROE front. So how should we think about ROE and ROIC in a three-year period from the current levels that we're seeing?

And if I may, just a third question, from the start point of this, how can I say, cultural or focus change in the company, one of the main challenges that you have been facing is this cultural, human capital uncertainty internally to people. If you can share some more color about this, that would be great. Thank you very much.

Daniel Martinez-Valle

Thank you for your questions, Luiz. Let me take one by one. In terms of capital allocation, as you know, we do have a strong focus on having a very strong balance sheet. Again, we are very pleased to see that our net debt to EBITDA ratio is down to less than two well before July 2019, which is the timeline that we communicated to the market. The second thing is we have been very keen for the past many, many months on driving increased return on invested capital. And again, this is the first time that we are able to announce that our return on invested capital is above the weighted average cost of capital. We want to continue this tendency, moving forward. In terms of capital allocation we have to bear in mind that we will continue to have a strong balance sheet. We do believe that we will have to have a capital allocation policy that benefits both organic and inorganic growth moving forward. We are being extra keen on driving organic growth for the several--next several months and 2019. As we've mentioned in the past calls, you should not expect any acquisition for the remainder of the year. We are focused on integrating Netafim, and that integration, as you've seen, is well underway. So in general we have to have a very balanced mix moving forward in the next couple of years between organic and inorganic growth. There are significant opportunities in places like Mexico, Brazil, Turkey, India and China. There are significant opportunities both on an organic level and expansion of capacity lines across most of our business units. So that's what we should expect moving forward.

In terms of return on invested capital and return on equity for the next two years, our aspiration is to deliver low double-digit figures, again 2019 and moving forward, obviously on the back end of 2019. And finally, associated to a cultural change and a transformation in terms of making Mexichem a more purpose-led future fit organization, we are indeed facing much more opportunities in terms of the stuff that we can do in the market to help address all the issues around food safety, water scarcity, storm water management solutions and intelligent urbanization. The team is very much involved. The Board of Directors is enthusiastic about the prospects of a company in this direction. So by far we're facing much more opportunities than challenges. We are, as I mentioned to address Nik's question, we are working diligently with partners like IDEO on building innovation capabilities both on an organic basis and inorganic basis moving forward, and we're very enthusiastic about the prospects on this angle.

Luiz Carvalho

Okay, perfect. Thank you very much.

Daniel Martinez-Valle

Thanks, Luiz

Operator

The next question will come from Liliana de Leon of UBS. Please go ahead.

Liliana de Leon

Hi, hello. Thank you, and congratulations on the results. I had a quick question. Could you please give us more color regarding EBITDA margins in Netafim? I mean, it seems that they're improving even above what we were expecting, so could you please share with us the year-over-year increase?

Daniel Martinez-Valle

Thank you, Liliana. Yeah, as I mentioned in the previous remarks we are well underway in terms of our Netafim integration. We are very happy with our results and the prospects for the next six months and 2019 for the company. As we mentioned in previous calls, we expected Netafim to deliver \$200 million in EBITDA for 2020, and that includes the margin expansion, and you should expect the company to have EBITDA margins of around 17% by 2020. And we're in the right direction, and we're on the right track.

Liliana de Leon

Perfect. Thank you.

Daniel Martinez-Valle

Thank you, Liliana.

Operator

The next question will come from Vanessa Quiroga of Credit Suisse. Please go ahead.

Vanessa Quiroga

Yes, hello. Can you hear me well? Hello?

Daniel Martinez-Valle

Yes, Vanessa, we can hear you.

Vanessa Quiroga

Okay, great. Are you ready to provide synergy guidance for Netafim?

Daniel Martinez-Valle

Yeah, sorry. If you can provide synergy guidance for Netafim.

Rodrigo Guzman Perera

Vanessa, that sound comes from your line.

Operator

Vanessa, this is the conference operator. We're getting a message coming from your line. I've muted Vanessa's line at this time. If there are any other questions you can press star then one on your phone.

Daniel Martinez-Valle

So let me answer Vanessa's question. In terms of synergy guidance we are very well on track in terms of synergies that we expected in terms of raw materials, procurement in general, management, as I mentioned in the previous call. We're very well-integrated, and we actually have a couple of senior executives from Netafim working on Mexichem overall transformational initiatives. So you can expect what we mentioned in the previous calls moving forward, Vanessa.

Operator

Our next question will come from Hernan Kisluk of MetLife. Please go ahead.

Hernan Kisluk

Good morning. Thank you for taking my questions. Speaking on the longer-term, let's say five years down the road, how do you envision Mexichem [indiscernible] for example the mix of products moving--will it be more away from commodity products into more

consumer-oriented products? And also if down the road you would also consider not only acquisitions, but also selling some businesses.

Rodrigo Guzman Perera

As you can see in our rights and this is the way in which we have been moving in the last years, we continue seeing our growth in an organic way in terms of a mix of new mix of products or--not a new one--it's a--let's say we are going downstream more than upstream and probably higher margins. That is what I mean when I said that to date our downstream products represent 67% of our EBITDA. And we continue seeing that in the trend in the following years.

Daniel Martinez-Valle

And regarding potential sale of assets, we do not expect significant sales of significant assets. We are obviously continuously reviewing our asset base. If and when we find that there is something that is not tightly linked with our vertical approach along the lines of datacom, building and infrastructure, irrigation and our chemicals business, we will divest those assets on time, but again, we do not expect to see any major assets or any major sales moving forward.

Hernan Kisluk

Thank you.

Daniel Martinez-Valle

Thank you

CONCLUSION

Operator

And this concludes our question-and-answer session. I would now like to turn the conference back over to Mr. Daniel Martinez-Valle for any closing remarks

Daniel Martinez-Valle

I just wanted to thank you all for following Mexichem. Again, we're very excited about the prospects of the company. We do believe we are in a unique moment with unique assets, and we actually have the opportunity to go from a good to a great company. Thank you very much, and look forward to our next discussion.

Operator

The conference is now concluded. Thank you for attending today's presentation. You may now disconnect your lines. Have a great day.