

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

Third Quarter Earnings Call

October 25, 2018 at 11:00 a.m. Eastern

CORPORATE PARTICIPANTS

Daniel Martínez-Valle – *Chief Executive Officer*

Rodrigo Guzmán Perera – *Chief Financial Officer*

PRESENTATION

Operator

Good morning, and welcome to the Mexichem Third Quarter 2018 Earnings Conference Call. As we turn to slide 2, 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 Martínez-Valle, CEO of Mexichem. Please go ahead, sir.

Daniel Martínez-Valle

Thank you, Phil. I want to welcome all of you to our third quarter conference call as we review and highlight another strong financial performance and our third consecutive quarter of double-digit growth in sales, operating income, EBITDA and net income. We'll go over those numbers closely in a few minutes, along with our business outlook, but I want to first tell you about how pleased I am with our performance, and the great work our 22,000 team members are doing around the world.

I strongly believe that the numbers we have been reporting, along with today's earnings news, continue to validate the actions we've taken to truly become a purpose-driven company that brings innovative solutions to our customers worldwide. Today, we are a completely diversified company in terms of geographies and products. For example, looking at our sales by region and destination, it breaks down to 39% of our business in Europe, 30% in North America, 19% in South America, and 12% for the rest of the world. This is precisely the kind of global scale I want to achieve at Mexichem and I'm pleased to report how we're moving in that direction.

Looking at slide 4 now, the quarter's results, I want to highlight the following. For the third quarter in a row, we're reporting double-digit growth in sales, EBIT, EBITDA and double-digit growth in net income. During this quarter, we posted a 25% year-over-year increase in EBITDA. We're clearly on track to continue achieving our most important goals, solving our customers' most significant challenges with best in the world, best for the world solutions, extending our strong financial performance, maintain our investment grade rating, and continuing our key focus on return on invested capital, which now is 9.5% and trending up.

Moving to slide 5, during the third quarter, we moved further along on a human-centered, innovative path, including first Netafim's "Irrigation-as-a-Service" model, providing farmers in the Americas the most advanced precision irrigation solutions available, and essentially digitizing an industry that is traditionally analog. Secondly, our Fluent business launched the world's first "PlasticRoad" in the Netherlands, a bicycle path made of recycled plastic and featuring sensors that will monitor temperature, usage, traffic and durability. And thirdly, in North America, Mexichem's Fluent business joined the City Innovate Technology Advisory Board to help governments address civic challenges and create the smart cities of the future. Mexichem proudly joins other innovation leaders including Oracle, Google, Microsoft, Visa and many others to bring about these real and significant changes.

To be clear, the challenges we solve are making a real difference to people, to communities, across cities, and throughout economies all over the world. This brings me enormous satisfaction, and personally, I am deeply gratified by the work we do and the impact Mexichem is having to improve lives. This is all about being a purpose-driven, future fit, human-centered company.

Irrigation-as-a-Service is a prime example. Not just technology for technology's sake, but making a real difference for farmers, resulting in better-quality yields, low water usage and risk reduction.

Going to slide 6, World Food Day 2018 was October 16th, a day we celebrated for the work we've been doing to solve global food shortages. Our Netafim business is working with India's Karnataka government to install the world's largest drip irrigation system in one of the most arid places in the world. We are helping to bring water to roughly 12,000 hectares of land used by 7,000 farmers from 22 villages. This required 2,200 kilometers of bulk water pipes, and 77,000 kilometers of drip irrigation line. This example of a large-scale precision irrigation model demonstrates that farming can pay a living wage in an emerging market.

Sometimes innovation isn't just about creating something new, but saving and restoring history. As you can see on slide 7, behind the walls of some of the world's most iconic historic buildings lies a real threat to their survival: a network of water pipes, waste systems and wires that haven't been touched in generations. We are stepping in to save one of these icons, the 130-year-old State Opera House of Prague, by repairing and replacing infrastructure while preserving its character and history. We used 3D modeling to scan and virtually demolish the building in order for our Fluent business to design new piping from our Wavin brand. The tricky part was to preserve the building and its pristine acoustics, but now the Opera House will re-open, fully restored, next year. And, we believe this kind of digital restoration can and will become a model to save many other landmarks around the world, preserving history with innovative, state-of-the-art solutions.

Now slide 8, Mexichem is committed to demonstrating success across all of its business groups. In Vinyl and Fluor, we continue managing the challenges and opportunities we have there, improving our value proposition, backed by our great assets. This supports our strategy to enhance the key verticals we serve, including building & infrastructure, datacom and irrigation markets that we've identified as strategic and in which we want to fully address the global opportunities.

As you can see, purpose-driven inspires everything we do for the world innovations we're bringing to market. We mentioned this last quarter and it bears repeating because our lead in these areas only continue to grow. We have a unique position by controlling an element of the periodic table that makes us a stable, reliable, quality partner for the world's fluorine customers. We're the world's global leader in the production of specialty resins; we're one of the global top ten PVC producers; we're the global leader in precise irrigation; we're the leader in the data conduction market in the US; and finally, we are the global leader in water conduction solutions for building and infrastructure.

We are on a journey and this is still only the beginning. But our roadmap suggests that while we have already enjoyed dramatic success thus far, the best is yet to come. We are on a very exciting path and I'm thrilled that my colleagues, and all of you, are on this journey with us.

Now, I will turn the call over to Rodrigo Guzmán, our CFO, to review our financial results. Rodrigo?

Rodrigo Guzmán Perera

Thank you, Daniel. This third quarter was also a great quarter, which locked in our full year EBITDA growth of between 25% to 30% over the reported 2017 EBITDA, as we can see on slide 9.

It also marks the beginning of a series of very challenging quarters to come given the impressive growth the company experienced in 2017, and in the first nine months of 2018. This will be a time when market conditions in our Fluor business will continue to stabilize and our Vinyl business will face a tighter market, given the recent increase in ethane prices related to the start of operations of about 2.4 million new tons of ethylene in the US and the adjustment in PVC and caustic soda prices, given the worldwide trade

conditions.

As Daniel mentioned, we are proud of our Q3 and year-to-date 2018 results. They continue demonstrating that we made the right decisions. For Q3 2018, revenues totaled roughly \$1.8 billion, up \$282 million, or 19% from Q3 2017, led by higher sales in all our business groups. In constant currency and on organic basis, revenue increased 8% year-on-year or \$120 million.

Sales increased in Fluent 28%, in Fluor 18%, and in Vinyl 7%. In Fluent, growth was driven mainly by the consolidation of Netafim and double-digit growth in USA and Canada. In LatAm, reported sales declined 3%, but in constant currency basis, they grew by 8%, showing signs of recovery in Brazil and Mexico. In our Fluor business, revenue growth was due to better price conditions in the US, given the ITC resolution we announced in March 2017, and in Europe, growth was associated with the F-gas system supply-demand dynamics that are and will continue to be stable during the rest of this year and in 2019. And last but not least, in Vinyl, revenue growth was driven by the consolidation of Sylvin Technologies, by the improvement in PVC pricing due to supply constraints coming from Asia and the increase in oil prices, and the improvement in caustic soda market conditions.

The exchange rate translation effect for Q3 2018 in sales had a negative impact on a consolidated basis compared to Q3 2017 of \$54 million. This was due mainly to the depreciation of the Brazilian real, Argentina peso, Turkish lira, Indian rupee.

Reported EBITDA in Q3 2018 increased by 25% over a reported sales growth of 19%, while in a constant currency and on organic basis, revenue increased by 18% over a sales growth of 8%. This increased the profitability of the company which is reflected in our ROIC growth of 230 basis points from 7.2% in September 2017 to 9.5% in September of this year. Reported EBITDA margin improved by 107 basis points to 21% in Q3 '18, while the constant currency and organic basis EBITDA margin rose 210 basis points to 22%.

As I just mentioned and it's possible to see on slide 10, our ROIC of 9.5% continues to be higher than our WACC of 7.5%, which together with our ROE, continues evolving positively and backs our decisions for the past five years and validates our strategy. This strategy, as you can remember, is and has been based on reducing our cost of production as much as possible, taking out the risk of dependency on suppliers of one of our main raw materials and move more downstream with higher margin and specialty products.

The results of that strategy are now reflected in what we can see on slide 11. In Q3 2018, our specialty products EBITDA represented 60% of our total EBITDA, out of which 36% comes from Fluent, 12% comes from our Fluor downstream business and 12% from specialty resins and compounds. In the same quarter a year ago, the total weight of specialty products was 55%.

Mexichem Q3 2018 operating cash flow before capex and before dividends increased \$3 million to \$220 million, or up 1%, as shown in slide 12. Given our strong compromise to our investment grade rating, we deleveraged our company by reducing short-term financing debt which is reflected as an increase in our working capital needs by \$33 million. At the same time, taxes paid increased as long as EBITDA grew, while net interest paid increased as a consequence of the \$1 billion 144 RegS bond issued in September 2017 for the Netafim acquisition.

During the first nine months of 2018, cash flow before capex increased 16% mainly due to our EBITDA growth. Working capital needs increased by \$87 million between the first nine months of 2017 and the first nine months of 2018, due to the reduction in short-term financing in the Vinyl Business Group.

We continued to maintain our net debt to EBITDA ratio below 2, far ahead of what we compromised during the bond issuance a year ago, which was to be below that level in at least 18 months after Netafim's closing, as it's possible to see in slide 13. Our total financial debt as of September 30 was \$3.6 billion, while cash and cash equivalents totaled \$879 million, resulting in net financial debt of \$2.8 billion. Our net debt-to-EBITA ratio declined to 1.91x as of September 30, 2018, while our interest coverage closed at 6.19x as third quarter 2018 ended. These data points continue the positive debt trajectory to which Mexichem is committed, and we are extremely gratified by this performance.

We continue with a very sound balance sheet as shown on this slide 14, and with a very healthy financial structure in our debt, including Netafim. Our tenor is 14.1 years, our weighted average cost of debt is 5.09%, and our debt profile is matched with our revenue currency

Finally, I'd like to mention that our highest season of capex related to the cracker investment ended in 2017, and we are now in a more normalized capex period. Our capex for the first nine months of 2018 was \$199 million, but we expect to close the year between \$280 million and \$320 million, including Netafim.

Now, I will turn the call back over to Daniel for some remarks about the remainder of 2018 before we open up the call for questions. Daniel?

Daniel Martínez-Valle

Thank you, Rodrigo. This year, Mexichem has achieved very strong results with a very strong balance sheet, and we expect yet another quarter of strong growth. As Rodrigo mentioned, we are maintaining our guidance of EBITDA growth of 25% to 30% year-over-year. This is possible only thanks to our customers, our team members, and their dedication to our purpose.

Once again, I want to thank you all for being on the call today and joining us on our journey in bringing to others purpose-driven solutions to help solve global challenges. We are in the midst of building a global company that is not just changing lives but making them better. From farmers to families, historical buildings to entire cities, these are the things we're making better to improve this planet one community at a time.

Phil, we're ready for questions.

QUESTIONS AND ANSWERS

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 comes from Leonardo Marcondes, with Itaú B.B.A. Please go ahead.

Leonardo Marcondes

Hi, guys. Congrats on the results. My first question is on the leverage. While the leverage has been reducing, it is fueling [ph] at higher levels than the 1.2x that we saw in the end of last year. What, in your view is the ideal level of it, and how should we think about this going forward?

My second question is about the scenario that you guys flagged that should be more challenging, in both the [indiscernible] and caustic soda markets. How should this impact the results during the last quarter of this year, and more importantly, how should we think about the next two years' results? Thank you.

Daniel Martínez-Valle

Thank you. Thank you for your question. Let me take one by one. In terms of the leverage of the company, as you remember, our internally imposed limit of 2x net debt to EBITDA has been maintained over many years in the company. We're still maintaining that, and we expect to finish yearend at approximately 1.96%, 1.96x net debt to EBITDA.

Regarding the question for the next quarter, specifically taking into consideration caustic soda, and the Vinyl division, and other commodity prices, we expect a stable quarter in relation to the third quarter of this year. For the next year we expect mostly organic growth for the full year.

Leonardo Marcondes

Okay, that's fine. Thank you, guys.

Operator

Okay, the next question comes from Frank McGann, with Bank of America Merrill Lynch. Please go ahead.

Frank McGann

Okay, two questions if I might; one is just in terms of operating expenses. There seemed to be a notable reduction in this quarter versus the second quarter. And, I just didn't know what were the key drivers of that, if it's some seasonality in cost, or if it's some reduction that's been achieved.

And, then secondly, just to follow up on the last question, in terms of the outlook as you're looking into 2019, if the growth is going to be organic do you think that the net EBITDA or earnings can grow next year, or is that going to be tough with these other challenges that you're seeing?

Rodrigo Guzmán Perera

Okay. How are you, Frank? It's Rodrigo Guzmán speaking. The operating expenses has two effects during the third quarter. The first one, of course, is our focus in a continuous reduction of costs. The second one is you should remember that we have a devaluation of currencies, and when that happens, and when that happens into the Mexican peso, our cost of production, for example, extraction in the mine and also in the highest plants for vinyls are denominated in Mexican pesos. So, when the currency devaluates, then the cost of our costs reduces; that is the explanation of the reduction, mainly.

Daniel Martínez-Valle

And, regarding the outlook for 2019, we'll be sharing the specifics in the next following months. Let me remind you all that we are focusing keenly over the last six months on oiling the engine of organic growth in the company. You've seen the organic growth that we've been showing over the last three quarters. For the next year, again we'll be sharing the details in the coming months, but you can expect an increase in sales, an increase in EBIT, and an increase in EBITDA, and the specifics will be shared shortly.

Frank McGann

Okay, great. Thank you very much, very helpful with both of those.

Daniel Martínez-Valle

Thank you, Frank.

Operator

Okay, the next question comes from Vicente Falanga, with Bradesco. Please go ahead.

Vicente Falanga

Good morning, Daniel; good morning, Rodrigo. I had two questions. First of all, regarding the temporary higher easing prices that we're having in the US, is Mexichem seeing room to pass through part of this raw material cost to PVC prices or not?

And, then and regarding the irrigation project, Daniel, that you mentioned in India, very interesting project, congratulations. Is there any estimate of how much this could add to net [indiscernible] EBITDA?

And, then if I may, one last one, Mexichem once again generated solid cash flow in the quarter. Any acquisitions in the radar? Thank you very much.

Rodrigo Guzmán Perera

Hi, how are you, Vicente? This is Rodrigo Guzmán speaking again. In relation with the hiking prices for ethane, we believe that they are temporary, given that they are building infrastructure.

The biggest issue that happened during the quarter is that the distribution infrastructure for natural gas is so limited in the US, and then as the new ethylene crackers start operating they demand ethylene, and then that is the one that creates the hike in the ethane prices. But, as we are foreseeing the following year, we believe that those prices are going to decline again a little bit, given that the new infrastructure will enter online. And, then the market will be normalized on the ethane side.

Daniel Martínez-Valle

Regarding the India project, the one I described is just one of the three projects that we're working on. The first one is already up and running. I cannot comment on the specifics of the EBITDA contribution of these projects but let me tell you that we're very focused on making these projects scalable, and sustainable, and replicable.

Again, we're already doing three [audio disruption] in the same province of Karnataka in India. We're exploring additional projects that are already starting in Africa, and other emerging countries, including Latin America. India, today is one of our key geographies for Netafim, and we continue to be very optimistic about India for the coming years.

Operator

Okay, the next question comes from Rodrigo Veruzco, with GBM. Please go ahead.

Rodrigo Veruzco

Hello, guys. Thank you for the call. My question is regarding the HFC regulation in the USA. We know that there have been some appeals for the Environmental Protection Agency in the US, and that you have won. We were wondering about the [indiscernible] cover the price hike that might lead to [ph]. When shall we start to expect any effects from these regulations?

Rodrigo Guzmán Perera

Okay, I think you are meaning about the fluorine gasses regulation in the US. Is that correct?

Rodrigo Veruzco

Yes. Yes, the HST—yes.

Rodrigo Guzmán Perera

Okay, the regulation, as you may remember, last year, the US introduced the—our gas into the SNAP list. They, at the end of the year, they de-listed that application from that SNAP list. And, then our competitors [audio disruption] list our gas for the SNAP list. Today, we win the case that specific case.

Our gas will be definitely de-listed from the SNAP list even though we are seeing some reactions from some governments like the California one, trying to introduce that regulation into their law. But, at least that will be very difficult, because imagine that you will have a California law, and then you have another law in the other state. And, when you have a car with the gas, you cannot regulate that gas in one state and regulate the gas in the other one. So, I think this will evolve, but we do not believe that will hit us too much in the following years in the US because of this regulation.

Rodrigo Veruzco

Perfect, thank you very much.

Operator

Okay, the next question comes from Liliana de Leon, with GBS. Please go ahead.

Liliana de Leon

Hi, hello. Good morning. My question is related with Netafim profitability. Could you please give us some normalized margins? I mean, this quarter we saw margins below 10%, and last past quarter about 15%. What is the seasonality or what margin is the base for Netafim?

Rodrigo Guzmán Perera

Okay, we should remember that Netafim has some seasonality in the third quarter, given the monsoon season in India; that is relevant. It went for around let's say three weeks. The second thing is in a normal way, the seasonality in Netafim is the second quarter is the best quarter, then is the third quarter, and then the first quarter, and then the fourth quarter; normally that is the seasonality.

In relation with the profitability of the quarter, the way in which the market is normalizing that number is wrong. Let me tell you why. As we mentioned, in Fluent, our normalized EBITDA in an organic basis and in constant currency basis is \$123 million.

But, you are comparing that number with \$140 million reported. But, really what you need to do is to add up to the \$140 million, the \$7 million we have an impact in exchange rates, and then you are going to get in a margin of 12%, or roughly 11.5%. But, what we can say is that the margin in Netafim continues being the one—if you look at our margin year-to-date, it's around 14%, and that's the one that it's guiding us, and the one that we want to improve the following years.

Liliana de Leon

Okay, perfect. Thank you.

Operator

Okay, the next question comes from Gabriel Barra, with UBS. Please go ahead.

Okay, the next question comes from Andres Cardona, with Citi Group. Please go ahead.

Andres Cardona

Good morning, guys. I just have two quick questions. The first one is if you can, talk about the plans you have for PMB. Is there something that you are planning to do with this asset that you had acquired the stake from PEMEX?

And, the second one is if you can talk about the performance of OxyChem during the third quarter versus the first half performance. Thank you very much.

Rodrigo Guzmán Perera

Andres, could you repeat the last question, please?

Andres Cardona

Sure, sure. The question is about the performance of OxyChem cracker versus the—during the third quarter versus the first half of the year, just to try to understand if it has been really affected by a thin [ph] spike in prices.

Daniel Martínez-Valle

So, yes, regarding the PMB, we're expecting to close that in the coming days and weeks, in line with the last announcement that we made in the last quarter.

In terms of the Oxy cracker, in which we have a joint venture with a company in Texas, we did see slight slowdown in the performance during the last quarter associated to the ethane prices changes that you've been mentioning. But, we expect that to be stabilized in Q4, and we're looking forward to stability for the remainder of 2019.

Andres Cardona

Okay, thank you.

Daniel Martínez-Valle

You're welcome.

Operator

Again, if you have a question, please press star then one. This concludes—okay, we have a question from Manuela Echavarría, with Credicorp Capital. Please go ahead.

Manuela Echavarría

Yes, hi. Thank you so much for the time. My question is regarding the impacts if you have seen any of the trade war over feedstock prices, and now maybe what you're expecting going forward.

Rodrigo Guzmán Perera

In relation with the trade war, what is happening basically in balance is that the PVC that previously was exported from the US into Asia, roughly, did not stop, but they declined in volumes. The US is allocating that those tons to other markets and that is creating a little reduction in PVC prices. But, we believe that in the following months that will be normalized, and then the PVC prices went up again. We expect also that all prices will rise a little bit in 2018, for the rest of 2018 and 2019, and that will increase again PVC prices, while our expectation is that the ethane prices will decline a little bit from the prices we saw at least during September of this year.

Manuela Echavarría

Okay, very clear. Thank you so much.

Operator

Okay, the next question comes from Julia Park, with UBS. Please go ahead.

Gabriel Barra

Hi, guys. Sorry about that, it's Gabriel, from UBS, I have some problem with my telephone. I have one question here, it's more of regarding the shifting of the company focus to the customer and valued-add products from being command [ph] producer. How has been this transition during this process? Thank you for the question.

Daniel Martínez-Valle

Thank you, Gabriel, for your question. So, regarding this transition, this is a journey that will be a long-term journey. We're seeing very strong performance that you've seen all across our different business divisions. We will continue to sell all of our existing product lines, all of our solutions, but we will continue having an increased focus on customer-centered innovative solutions going forward.

So, the relevant thing that you need to understand is that we will not lose any focus on the historical product lines that have been giving us such a good success over the several decades. We will continue performing along those lines, but on top of that we will be keen on delivering innovative high value-added solutions to our customers worldwide.

Gabriel Barra

Great, thank you.

Daniel Martínez-Valle

You're welcome.

Operator

Again, if you have a question, please press star then one.

CONCLUSION**Operator**

This concludes our question-and-answer session. I would like to turn the conference back over to management for any closing remarks.

Daniel Martínez-Valle

Well, I want to thank you all for participating on the call. And, we really look forward to talking to you on one-on-ones and talking to you in our next quarterly call. Thank you, all.

Operator

The conference has now concluded. Thank you for attending today's presentation. You may now disconnect.