Alpek 2Q23 Earnings Webcast Transcript

CORPORATE SPEAKERS

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WEBCAST PARTICIPANTS

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Antón Fernández:
[Slide 2] Good morning, and welcome to Alpek's Second Quarter 2023 Earnings Webcast.

[Slide 3] I'm Antón Fernández, Alpek's IRO, and today I'm glad to be joined by our CEO, Jorge Young, and our CFO, José Carlos Pons.

[Slide 4] Let's start by reviewing what we will be covering today:

- First, Jorge will provide context for the quarter results and elaborate on relevant events,
- Second, José Carlos will cover Alpek's second quarter financial performance,
- Third, updated guidance figures for the year will be discussed
- And afterwards, we will move on to Q&A

Please note that the information discussed today may include forward-looking statements regarding the Company's future financial performance and prospects, which are subject to certain risks and uncertainties. Actual results may differ materially, and the Company cautions the market not to rely unduly on these forward-looking statements. Alpek undertakes no obligation to publicly update or revise any forward-looking statements, whether it is as a result of new information, future events, or otherwise.

I'd like to remind everyone that this Webcast is being recorded and will be available on our website, at alpek.com. I will now turn the call over to Jorge.

Jorge Young:
[Slide 5] Thank you, Antón. Good morning, everyone, and thank you for joining us.

I'll start off by highlighting that we had a Comparable EBITDA of $201 million dollars in the quarter, and a significant improvement in Free Cash Flow reaching $216 million dollars in the quarter, primarily from Net Working Capital optimizations.

Now let me provide some context for the quarter's performance:

From an industry perspective, we are witnessing two particular factors:

- First, as China's economy continues to be softer than originally expected and with ocean freights back to historical levels, there is currently greater influence from Asian imports in the Americas, mainly for the PET and EPS businesses.
- And second, North American feedstocks such as paraxylene maintain a disconnection versus Asian prices. We are taking actions to mitigate these effects.

Meanwhile, from a market perspective, consumers primarily in the Americas are moderating certain expenditures impacting the packaged goods, appliances, and construction industries, thereby affecting purchases during what is normally the start of the peak season. These effects have led to lower-than-expected volumes. Notwithstanding, we are confident that our end-markets will continue to be resilient.

[Slide 6]
Now let's review the reference margins for our core products:
For Polyester, Asian integrated PET reference margins were 3% lower versus the previous quarter, averaging $332 dollars per metric ton, in line with our expectations for the year. However, I would like to highlight that Chinese reference margins are becoming more relevant, particularly for our Middle East operations. These margins averaged $225 dollars per ton, yet they closed at $203 dollars per ton in the month of June as more Chinese supply has entered the market.

[Slide 7]
As the new capacity in the region has been ramping up, Polypropylene reference margins have stabilized, still averaging 17 cents per pound, in line with our expectations for the quarter.

[Slide 8]
EPS Reference Margins have continued to normalize, now with an average of 44 cents per pound, a 10% reduction quarter-over-quarter.

[Slide 9]
And as mentioned earlier, reference ocean freight costs have returned to previous levels, resulting in a reduction in import parity pricing which particularly impacts PET and EPS.

[Slide 10]
Moving on, I would like to highlight an important event that occurred just this week. Alpek is refinancing the outstanding balance from the 2023 bond due in August with bank debt that includes a $200-million-dollar sustainability-linked loan maturing in 2028.

This represents Alpek's first transaction with an ESG component with KPI's on carbon emissions and safety targets. We reiterate our commitment to all the targets we have established.

[Slide 11]
Moreover, we have launched a project to add installed capacity to produce approximately 26,000 tons per year of expandable polystyrene with recycled content in North America. This will be mainly focused on medical & electrodomestic applications, as well as major appliances. The start-up is expected by the end of next year.

At this point, José Carlos will review the financial results.

José Carlos Pons:
Thank you, Jorge. Hello everyone, it's great to be here with you today.

[Slide 12]
Let me go into greater detail regarding the quarter:

- Overall volume was 1.2 million tons, an increase of 3% quarter-over-quarter as the beginning of peak season partially offset other factors
- Comparable EBITDA was $201 million dollars, which is a reduction of 3% versus the previous quarter
- And there was a significant improvement in Free Cash Flow

Now if we delve deeper into each segment:

[Slide 13]

- For Polyester, volume was 984 thousand tons, 5% higher quarter-on-quarter due to a slight demand recovery, however, still not at the levels expected for the summer months
- While in Plastics and Chemicals volume was 213 thousand tons, a reduction of 4% quarter-on-quarter as demand across the portfolio was affected by lower consumer spending, as previously stated, and polypropylene dealing with more supply in the Americas. However, we expect to regain some momentum in the second half of the year

[Slide 14]
Moving on to raw material price dynamics:

- U.S. reference Paraxylene prices increased by 1% yet the disconnection between North American and Asian prices grew by 7% versus the previous quarter. This spread increased to $282 dollars which led to imports arriving in the Americas with more competitive pricing
- In the Plastics and Chemicals segment, average reference Propylene prices decreased to 40 cents per pound, a 20% decrease when compared to the previous quarter primarily due to the recently incorporated Propylene supply in the region

[Slide 15]
Switching over to the EBITDA breakdown:

Overall Comparable EBITDA was $201 million dollars; 3% lower than in the previous quarter. As previously explained, we saw greater influence from Asia which resulted in lower-than-expected volumes across our product portfolio and a decrease in reference margins particularly for PET and EPS.

Reported EBITDA was $148 million dollars, 21% lower quarter-on-quarter and this result also included the following:

- A combined carry-forward effect and an inventory adjustment of $40 million dollars as raw material prices have decreased
- A $13-million-dollar loss primarily related to a non-cash hyperinflation effect in Argentina
- And a slight impact to our fixed and utilities costs from the appreciation of the Mexican peso

If we take a closer look by segment, Polyester Comparable EBITDA was $127 million dollars, 4% lower versus the previous quarter.

And in Plastics & Chemicals, Comparable EBITDA resulted in $70 million dollars, a 9% decrease quarter-on-quarter.

[Slide 16]
Now in terms of Free Cash Flow generation:

- CAPEX totaled $75 million dollars and was mainly allocated towards the construction of the Corpus Christi Polymers project and for scheduled maintenance
- Net Working Capital investment was significantly improved by $284 million dollars, achieved from a strong focus on managing inventories and collecting receivables. This figure significantly surpassed initial expectations for the year and resulted in a positive Free Cash Flow of $216 million dollars for the quarter and $186 million dollars year-to-date

[Slide 17]
Regarding the Company's financial position during the quarter:

- Alpek's Net Debt decreased to $1.9 billion dollars.
- While last-twelve-months reported EBITDA was $827 million dollars, which led to a Leverage Ratio of 2.3 times Net Debt to EBITDA.

Thank you everyone, I will now turn the call back to Jorge.

Jorge Young:
[Slide 18]
Thanks, José Carlos. In terms of Guidance, we originally provided annual figures based on market conditions at the beginning of 2023, however, as industry outlook has changed, the Company now has a more conservative view for the second half of the year.

Regarding our assumptions:
We expect Asian Integrated PET Reference Margins at an average of $320 dollars per ton.

And although we did not provide Guidance for Chinese PET Reference Margins, we are foreseeing figures below our original expectations for the year that will continue affecting our annual performance.

Considering Alpek's Guidance figures, we are updating the following:

- Overall Volume of 4.65 million tons, slightly below from previous levels due to the market conditions visible at the moment
- A modified figure for Overall Comparable EBITDA of $770 million dollars
- Net Sales of $7.7 billion dollars
- CAPEX is now set at $300 million dollars as we continue to look for efficiencies in our investments

Alpek remains committed to maintaining its financial stability and a prudent leverage for the Company. As such, we do not expect an extraordinary Dividend payment later this year.

Additionally, we expect to continue with solid performance regarding Free Cash Flow generation.

Furthermore, we will continue progressing towards our long-term strategy, maintaining our competitiveness through cost improvement initiatives, footprint rationalization and continuing to evaluate optimizations of our portfolio.

Thank you for your attention, I will now turn the call back to Antón to open the Webcast for Q&A.

Q&A

[Slide 19]
Antón Fernández:
Thanks, Jorge. At this time, we'll be receiving your questions.

To ask your question live, please raise your hand. We will call on participants as they appear.

You may also type your question through the Q&A function. We will attempt to cover as many questions as time allows.

Our first question comes from Leonardo Marcondes with Bank of America. Hi, Leo, please proceed.

Leonardo Marcondes, Bank of America:
Hi guys, hi everyone, thank you for picking my question, Jorge, José, and Antón. So, my first question is regarding the guidance.

We saw that your expectations for PET remained unchanged but was there any change in PP and EPS spreads in your forecast?

My second question is regarding net working capital, the company released a good amount of working capital in this quarter, right? And according to you, it was due to several optimizations and improvements in inventory management. So, I was wondering if you guys could provide a bit more color on this? Thank you.

Jorge Young:
Leonardo, thanks for your question. I think in terms of the guidance, I don't think we did provide a breakdown by business.

I think both of our businesses are facing similar influence from the current market conditions. So, I wouldn't characterize as only one segment is influenced by the current market conditions. I think both of them and, again, we didn't provide the very specific by business unit but in general both have some influence.

And on working capital optimization, we did reduce the number of days outstanding of working capital much closer to our target. I mean we are very close to the target, still probably, a couple of days above our target and we will continue to evaluate but that's mainly the reason. As markets were softer in the first half, we had been preparing our production plans for somewhat higher volumes and we naturally took the adjustments during the first half of the year, and they were more visible in the second quarter.

Leonardo Marcondes, Bank of America:
Maybe just follow up from the first question here. Was the decrease in the EBITDA guidance mainly due to volumes and also due to the FX appreciation we have been seeing over the past months and weeks or it’s the petrochemical spreads have also changed in your view for the remainder of the year, particularly for PP and EPS? Thank you.

Jorge Young:
Yes, as I mentioned earlier, I think that is a combination of volumes below our original expectations for the year and, generally speaking, as we have in this year in particular, more influence from Asia, I think there is some impact on our margins, so it's a combination of both.

Now on the peso, a strong peso, yes, it also provides some headwinds for resources, it influences some of our costs in dollars, especially fixed costs, and certain energy costs like electricity.

Leonardo Marcondes, Bank of America:
Okay, very clear. Thank you.

Jorge Young:
You're welcome.

Antón Fernández:
Thank you, Leo. The next question comes from Luiz Carvalho from UBS. Hi Luiz, please go ahead.

Luiz Carvalho, UBS:
Hi Jorge, José Carlos, Antón. Thank you for taking the question. I have basically 2 from here.

The first one is about capital allocation, right. I mean, you basically reduced the EBITDA guidance for the year on the industry dynamics. You also, in a certain extent, trimmed the CAPEX for the year. Jorge already mentioned in the call that probably dividends in the second half will be lower than initially expected. So, just trying to understand with these current dynamics, how are you seeing, you know, the priorities in terms of keeping the investments/dividends? So, just trying to get a bit more color on this.

And the second, if I may, it's basically if you can provide a bit more update on the Corpus Christi development, Mainly with regards to the new or current industry dynamics, how you're seeing returns and the development of the project? Thank you.

Jorge Young:
Yeah, Luiz, thanks for your questions. Yes, I think we have slightly adjusted our CAPEX. That doesn’t reflect fundamental changes in our strategy. I mean, we normally continue to optimize our capital expenditure, sometimes it takes more time to prepare the projects.

Right now, I think it's important also to be careful with our leverage. Right now, it's 2.3, but you know, it will likely increase as we go through the year once we factor 12 months of the current EBITDA and that's why working capital remains an area of focus. But as a company we are very committed to keeping our leverage no more than 2.5 times. So, I think we will have, again, some, short term pressure on that index and I, that's why it's more appropriate right now to have a significant focus on the cash flow because we are again very committed to maintaining very healthy financial ratios and you know that's pretty much the context of our decisions.

On Corpus Christi progress, I mean we continue to monitor the progress of the project. No, nothing in particular to report that is different from our last quarter. I think that project has, you know, we continue to watch it and follow up and monitoring the progress and expect it for some time in 2025.

Luiz Carvalho, UBS:
Okay, very clear. Thank you, thank you very much.

Antón Fernández:
Thank you Luiz. Our next question comes from Sofía Martín from GBM. Hi Sofía, please go ahead.

Sofía Martín, GBM:
Hi. Thank you for taking my question. I just wanted to know would we be seeing an outstanding dividend for the rest of the year? Thank you.

Jorge Young:
Hi Sofía, I just mentioned that at this moment, we don't expect a second or an extraordinary dividend for later in this year.

Antón Fernández:
Thank you Sofía.

Sofía Martín, GBM:
Thank you.

Antón Fernández:
Our next questions come from Edward Palma from BICE Investment Asset Management. Hi Edward, please go ahead with your question.

Edward Palma, BICE Inversiones:
Hi guys, first of all, thank you for this presentation. I have 2 questions mainly related to CAPEX and also the cash flows of the Company.

For the cash flow, I would like to know if you can talk about the higher feedstock that you mentioned in the press release?

And for the CAPEX question is about the physical progress about the Corpus Christi?

Jorge Young:
Hi Edward, thanks for your questions. On Corpus Christi we don't report the very specific details of the progress of the project, as I mentioned, we continue to monitor its progress and we don't have significant updates from what we shared the last time, right now, the timeline remains for 2025.

The other part of the question on the feedstock, I think that's less related to working capital. I think that's more related as a headwind we have currently in our competitiveness and as I mentioned, I think we have concrete plans to start reverting those effects and normalizing. It will take some time, but that's, I would say that's more an EBITDA impact rather than a material impact on cash flow.

Edward Palma, BICE Inversiones:
But the higher cost in feedstocks is related to problems with the contracts that you have with the current parties?

Jorge Young:
I think it's more related that the feedstocks in the North American market where we have some of our supplies coming from, we have other sources of supply from overseas but the ones in particular in the North American market have additional cost pressures that are not experienced by other regions on alternative values for the feedstocks needed to produce Paraxylene which is the key petrochemical we buy. So that's what we call the disconnect.

Edward Palma, BICE Inversiones:
Okay, thank you.

Antón Fernández:
Thank you, Edward. Our next questions come from Jean-Baptiste Bruny from BBVA. The questions come from the Q&A function, Jean has 3 questions.

The first one is, at the end of last year, management was seeing a bottom cycle EBITDA of 1 billion dollars probably challenged by new guidance. We are aware that there are many moving parts, effects, volumes, etc. but can we see the $770 level as the "new cycle" bottom?

Second question is, understand that you are mentioning CCP deployment and still expect the startup in 2025. But can market current conditions imply some delays?

And the third question is related to Octal, I know you don't comment on performance of acquired businesses, but if you could just mention if its performance since consolidation is in line, better or weaker than what we have been anticipating?

Jorge Young:
Okay, on the first question. Yeah, I think we would characterize the 1 billion dollars, perhaps that's closer to mid cycle and I mean, today, based on some of the key variables that we follow we think our number is closer to the lower end of the cycle. I think it would be very difficult to characterize what is exactly the

bottom, but right now I think we have some of the macro variables like the reference margins and especially the Chinese reference margins.

This more recent issue of the Paraxylene disconnect, I would say much closer to what we would call the bottom of the range that impacts us. And again, the 1 billion, I would characterize that more as a mid-cycle level or target that we still keep. Nothing really to add on the Corpus Christi from what I just answered recently in the previous 2 questions.

On Octal, yes, we don't disclose those numbers specifically but so far it has been a positive performance on our system.

Very competitive asset, very committed people and it's been delivering according to our original expectations and the first year was significantly above because it was in the peak of the cycle but even today still delivers above our expectations.

It has, again, reliable, and very competitive operation and outstanding feedstock position.

Thank you, Jean.

Antón Fernández:
That was the last question in the queue. As always, I'd like to remind you that you can find both a video recording of today's webcast as well as a transcript on our website at alpek.com.

Thank you all for participating in today's Alpek webcast. Have a great day.