Orbia

Fourth Quarter 2023 Earnings Results

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CORPORATE PARTICIPANTS

Diego Echave – *Vice President, Investor Relations*

Sameer Bharadwaj – *Chief Executive Officer*

Jim Kelly – *Chief Financial Officer*

PRESENTATION

Operator
Welcome to the Orbia Fourth Quarter 2023 Earnings Results Conference call. All participants will be in listen-only mode. Should you need assistance, please signal the 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 than 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 Diego Echave, Vice President of Investor Relations. Please go ahead.

Diego Echave
Thank you, operator. Good morning and welcome to Orbia's Fourth Quarter and Full Year 2023 Earnings call. We appreciate your time and participation today.

Joining me today are Sameer Bharadwaj, CEO and Jim Kelly, CFO.

Before we continue, a friendly reminder that some of our comments today will contain forward-looking statements based on our current view of our business, and actual future results may differ materially. Today's call should be considered in conjunction with cautionary statements contained in our earnings release and in our most recent Bolsa Mexicana de Velores report. The company disclaims any obligation to update or revise any such forward-looking statements.

Now, I would like to turn the call over to Sameer.

Sameer Bharadwaj
Thank you, Diego. And good morning, everyone. Before we begin, I would like to welcome Diego, who recently joined Orbia as Vice President Investor Relations. Diego served as corporate director of business development at Kaluz, Orbia's largest shareholder for eight years. Previously, he held positions in banking, mostly dedicated to M&A advisory. Diego will lead the investor relations team, where he will continue to cultivate strong relationships with the global investment community.

Now, I would like to take the opportunity to thank all our employees for their unwavering commitment to our shared purpose: to advance life around the world. Through innovation and collective focus amidst a dynamic operating environment, we continue to develop products and solutions that address the world's toughest challenges, while also demonstrating the resilience of our operating results through economic cycles.

Now moving on to slide 3, I will share a high level overview of a fourth quarter and full year 2023 performance. For the full year, revenues of $8.2 billion decreased 15% and EBITDA of $1.46 billion decreased 24% compared to the previous year. Overall, our performance during the year was impacted by persistent high interest rates around the world, which affected demand for our products in key markets we serve, predominantly in global construction and infrastructure. In addition, the weakness of these markets in China led to significant PVC exports, which impacted global PVC prices. Finally, an uncertain geopolitical environment caused by the conflicts in Eastern Europe and the Middle East led to reductions in demand in certain regions.

Despite these challenges, we maintained or improved market positions across our businesses, generated strong operating cash flows, kept a healthy balance sheet, and continued driving cross business integration. We demonstrated our commitment and belief in the long term fundamentals of our strategy.

As an example, we advanced important growth projects, including the PVDF joint venture with Synsquo, formerly Solvay, and the technology licensing agreement with Kanto Denka Kogyo for LiPF6 production. We also continued focused capacity expansions, efficiency improvement projects, including plant optimization and the launch of innovative new products across our global operations to drive organic growth.

I will now turn the call over to Jim to go over our financial performance in further detail before we can address our outlook for the year.

Jim Kelly
Thank you, Sameer. Good morning, everyone.

I'll start by discussing our overall fourth quarter results. Turning to slide 4, on a consolidated basis, net revenues of $1.8 billion were down 16% year-over-year, reflecting lower sales in Polymer Solutions, Building and Infrastructure, and Connectivity Solutions. The results were impacted by weaker demand in pricing due to ongoing macroeconomic volatility. These factors were partially offset by higher revenues in Fluor and Energy Materials, formerly known as Fluorinated Solutions, as well as Precision Agriculture.

EBITDA of $226 million decreased 27% year-over-year due to softer demand and lower prices across Polymer Solutions and Connectivity Solutions, partially offset by EBITDA gains in Fluor and Energy Materials, Building and Infrastructure and Precision Agriculture.

Operating cash flow of $328 million decreased by $227 million or 41% compared to the prior year quarter driven by lower EBITDA and higher interest paid. The EBITDA to operating cash flow conversion rate for the quarter was 145%. Free cash flow in the quarter was $116 million, a decrease of $192 million year-over-year, due to the lower operating cash flow.

During the quarter, Orbia continued to maintain a healthy balance sheet, while continuing focused investments for growth and returning value to our shareholders. The company paid a total of $60 million as the fourth installment of the ordinary dividend approved at the Annual Shareholders Meeting held on March 30, 2023.

Turning now to slide 5, I'll review our full year results for 2023. On a consolidated basis, net revenues were $8.2 billion, down 15% year-over-year, with lower sales in Polymer Solutions, Building and Infrastructure, and Connectivity Solutions, partially offset by increased sales in Fluor and Energy Materials and in Precision Agriculture. The primary drivers of the decrease included lower PVC and caustic soda pricing and softer demand in Polymer Solutions; challenging market conditions across EMEA for Building and Infrastructure; and delays in fiber network deployment activity in Connectivity Solutions also drove the change.

EBITDA of $1.46 billion decreased 24% year-over-year, with an EBITDA margin of 18%, a decrease of 200 basis points. These decreases were due to lower prices and softer demand across most markets, particularly in the Polymer Solutions, Building and Infrastructure, and Connectivity Solutions businesses. These results were partially offset by higher profitability in Fluor and Energy Materials. Precision Agriculture EBITDA results were flat year-over-year. Overall foreign exchange effects negatively impacted EBITDA by $83 million for the year primarily due to the appreciation of the Mexican peso and the depreciation of the Turkish lira.

Operating cash flow and free cash flow were $931 million and $176 million during the year respectively, reflecting lower EBITDA, which was partially offset by effective working capital management and lower taxes paid, as well as positive impacts from currency fluctuations. The EBITDA to operating cash flow conversion rate for the full year was 64%.

Capital expenditures of $658 million were up 20% compared to the prior year, driven by investments in the focused growth initiatives and plant optimizations that Sameer previously mentioned.

For the full year, we returned $240 million in cash dividend payouts to our shareholders.

We closed the year with net debt of $3.4 billion and a net debt to EBITDA ratio of 2.35 times, an increase of 0.7 times compared to 1.65 times last year. This was driven by the decrease in EBITDA and an increase in debt as a result of the appreciation of the Mexican peso.

Our effective tax rate for the full year was 68%, which is an increase from the 36% in the prior year. This was largely driven by the appreciation of the Mexican peso and inflation in Mexico.

Turning to slide 6, I'll go through our performance by Business Group.

In Polymer Solutions, fourth quarter revenues were $577 million, a decline of 21% year-over-year, largely due to lower volumes from the scheduled plant turnaround and associated delay in our ethylene cracker joint venture. In addition, we experienced significantly lower specialty PVC and caustic soda prices driven by weaker demand and excess availability in the export markets. Fourth quarter EBITDA was $47 million, a decrease of 54% year-over-year, with EBITDA margin of 8%. In addition to the volume and pricing factors noted above, the translation effect of the stronger Mexican peso and Colombian peso on fixed costs contributed to the margin decline.

For the year, Polymer Solutions had an EBITDA of $382 million, 53% lower than the prior year, while EBITDA margin was 14%. The reduction was driven by lower volumes and prices due to weaker demand and increased exports from China, a raw material shortage in the Americas, and the cracker turnaround.

In Building and Infrastructure, fourth quarter revenues were $595 million, a decline of 10% year-over-year against a very strong quarter a year ago. The revenues were impacted by lower volume across EMEA, and lower prices driven by lower raw material costs, partially offset by continued solid demand across the majority of Latin America. Fourth quarter EBITDA was $59 million, an increase of 25% year-over-year, with an EBITDA margin of 10%. The improvement was driven primarily by higher material margin contributions and sustained cost optimization.

For the year, Building and Infrastructure revenues were $2.7 billion, a decline of 8%. The decrease in revenues was primarily driven by lower demand in EMEA, partially offset by volume improvements in Latin America, Asia and North America. Full year EBITDA of $284 million decreased 12% due to lower volumes, higher logistics and transportation costs, and finally one-time costs related to business optimization. EBITDA margin remained approximately flat year-over-year at 11%.

Moving on to Precision Agriculture, fourth quarter revenues were $250 million, an increase of 9% due to increased demand across India, Turkey, China, and parts of Latin America. Fourth quarter EBITDA was $30 million, an increase of $34 million year-over-year with an EBITDA margin of 12%. The increase in EBITDA was largely due to higher revenues and lower raw material costs, in addition to the lack of one-time costs that were included in the prior year.

For the year, Precision Agriculture reported revenue of $1.1 billion, a decrease of 2% driven by a slowdown in demand in Europe and Africa, and the impact of extreme weather conditions in the US, partially offset by stronger results in Mexico, Brazil, China, India, and Turkey. EBITDA remained flat year-over-year driven by favorable raw material prices and tight cost controls, as well as the lack of one-time costs included in the prior year.

Given Precision Agriculture’s global reach, with only approximately 5% of the business's revenues coming from Israel, the war in Gaza has had a minimal impact on its results.

In Connectivity Solutions, fourth quarter revenues were $188 million, a decline of 41% year-over-year. This was driven by lower volumes and prices, and an unfavorable product mix. Fourth quarter EBITDA decreased 60% to $34 million within EBITDA margin of 18%. This decline was driven by the reduction in volumes and prices, as well as lower absorption of fixed costs in plant operations, partly offset by favorable raw material costs and cost optimization.

For the year Connectivity Solutions revenues were $1.1 billion, a decrease of 18% due to lower demand driven by high interest rates, which have delayed customers’ projects, as well as excess inventory in the supply chain. For the full year, EBITDA of $327 million decreased 8% and EBITDA margin increased to 29%.

Finally, in Fluor and Energy Materials, fourth quarter revenues were $226 million, an increase of 12% year-over-year. These results were primarily driven by higher volumes and pricing conditions in refrigerants and medical propellants. Fourth quarter EBITDA was $69 million, an increase of 7% year-over-year due to higher volumes and prices, partly offset by increased labor costs and unfavorable currency fluctuations. EBITDA margin was 31% with unfavorable product mix, partially offset by lower fixed costs.

For the full year, Fluor and Energy Materials revenues were $918 million, an increase of 8%, and EBITDA of $354 million increased 16%, while EBITDA margin increased from 36% to 39%. Improvements in revenue and EBITDA were driven by disciplined pricing across the product portfolio and higher volumes.

In closing, our businesses made progress in strategic and growth initiatives last year, while focusing on operational efficiency in the midst of a challenging market environment, particularly in the second half of the year. We maintained strong cash flow and a solid balance sheet.

I'll now turn the call back to Sameer.

Sameer Bharadwaj
Thank you, Jim. On slide 7, I would like to review the progress made on a sustainability strategy.

Orbia continued to deliver on the three pillars of its sustainability strategy: low impact operations, sustainable solutions, and high impact ventures.

In 2023, we increased renewable energy consumption by 52% year-over-year and reduced our scope 1 and 2 emissions by 28% compared to baseline, making progress towards our 2030 commitments of 47% reduction. Additionally, we surpassed our commitment to the Sustainability Linked Bond Framework by 25%, decreasing Sulphur oxide emissions by 85%.

During the year, Orbia received recognition from several well-known third party's maintaining a position in the Dow Jones Sustainability Indices, receiving a rating upgrade from MSCI for the second consecutive year for sustainability performance, improved our Sustainalytics rating, and earned a gold medal from EcoVadis.

On slide 8, I will discuss our outlook for 2024.

For 2024, full year EBITDA is likely to be in the range of $1.35 billion to $1.45 billion, with market weakness expected to continue in the first half of the year and potential recovery in the second half of the year.

Orbia will continue to diligently control costs and tightly manage capital expenditures, giving priority to spending related to safety and integrity of operations, as well as investment in a limited number of critical growth projects, such as the announced Fluor and Energy Materials PVDF and LiPF6 projects. Total capital expenditures are expected to be in the range of $600 to $700 million. Maintenance capex is expected to be in the range of $300 to $350 million, with the remainder consisting of growth capex where we can control the timing of the investments depending on market dynamics.

We would also like to update our views on PVC supply and demand, and the impact on our current view on potential capacity expansion investments. Given the weak real estate and construction markets in China, more than 2 million tons of PVC are being exported annually, which could continue for two to three years. In that context, after we complete the current phase of engineering, we will pause PVC capacity expansion investments until we see the markets supporting strong investment economics.

Now, looking ahead in each of our business segments for the year.

Beginning with Polymer Solutions, we expect marginal improvement driven by a recovery of PVC volumes and a slight improvement in prices expected during the year, which is likely to be partially offset by lower caustic soda prices. We anticipate the weak market environment to continue due to soft housing demand and oversupplies export markets with possible improvement in the second half of the year as interest rates begin to decline.

In Building and Infrastructure, we expect continued market weakness across parts of EMEA, particularly in Western Europe, partially offset by demand recovery due to expected lower interest rates. We expect profitability improvements from cost optimization initiatives, maintaining and growing our market share, and continued product portfolio expansion.

In Precision Agriculture, we expect continued strength in China, India and Latin America, and an improvement in EMEA. We will continue to focus on developing growth initiatives, cross business integration, and further penetration in extensive crops and digital farming.

In Connectivity Solutions, we expect volumes to improve as fiber deployment activity restarts, supported by lower interest rates and as US government programs are funded in the second half of 2024, and onward.

And finally, in Fluor and Energy Materials, we expect somewhat lower volumes as a result of quota step-downs in certain regions. We are working to optimize the value of our quota in regulated markets and remain focused on maximizing value realization across the chain. We will continue growing the sales of new, lower global warming potential refrigerants and medical propellants.

In order to maintain the flexibility to invest in critical growth projects, especially in energy materials, while preserving a healthy balance sheet, the company's board of directors has approved and intends to recommend to its shareholders for their approval at Orbia’s next annual general meeting of shareholders an aggregate ordinary dividend payment of $160 million for 2024. The company's board of directors has also approved and intends to recommend for shareholder approval the establishment of a fund for the repurchase of shares for an amount equal to the total balance of the company's net profits as of December 31, 2023, and including those withheld from previous years.

Despite the challenging market environment that we are currently experiencing, our long term fundamentals remain solid and our commitment to organic growth remains unchanged. We will invest in profitable growth and innovation to bring differentiated solutions to the market, maximize the value of integration across Orbia and the value chains we participate in, and as always, create value for our shareholders by being good stewards of capital and disciplined operators. Based on our success in maintaining or growing market share across business groups, and the actions we have taken to improve efficiency, we are well positioned to benefit once the market environment rebounds. We are currently performing our annual strategy update and we'll be conducting a webcast later this year to share the results of this effort.

Thank you for joining us today and for your continued interest in Orbia as we advanced life around the world together. Operator, we are ready to take questions at this time.

QUESTIONS AND ANSWERS

Operator
We will now begin the question and answer session. To ask a question, you may press star one on your touchtone phone. If you're using a speakerphone, please pick up your handset before pressing the keys. If at any time your question has been addressed and you would like to withdraw your question, please press star then two.

Our first question comes from Pablo Monsivais with Barclays. Please go ahead.

Pablo Monsivais
Hi, good morning. Thanks for taking my question. Just a quick question on your guidance. For the growth capex that you're budgeting in your guidance, can you please lay out the key projects that you're looking at right now? I assume that these are coming from Fluor and Energy Materials. Right? Thank you.

Jim Kelly
Hello Pablo, hope you're doing well. Yes, that is correct. The vast majority of the growth capex is coming from Fluor and Energy Materials with the projects we've discussed on LiPF6 and PVDF. We also still have the completion of some growth projects that began previously in Connectivity Solutions. As you know, we've been expanding capacity in North America, we have the completion of a couple of plants there that’s part of the growth capex for 2024. And then there's also the completion of the Indonesia plant within Building and Infrastructure that's included there. Those would be the major things.

Sameer Bharadwaj
Yes. I think if I were to clarify, Jim, as of now the board has approved the PVDF project and that is well underway. The engineering on that is well underway. And on LiPF6, we are still in engineering phase and we will seek final approval from the board within the next quarter.

Pablo Monsivais
Thank you very much.

Operator
The next question comes from Basso Sousa with UBS. Please go ahead.

Basso Sousa
Hi, Sameer. Hi, Jim. Hi, Diego. Maybe a follow up question here on the guidance, the long term guidance. Actually, the company provided two years ago for a long term plan. And there was an update last year pretty much delaying one year the initial plan. And now we view a much tougher environment and market

conditions, and the company actually now said it's halting this project. I think the question I wanted to ask is, how can the company prepare itself to go through the cycles without much impact on such announcements? And if the company's planning to give an overall update on its plan, how should we look into this assuming the market challenge and possible adjustments during this period until we reach the final of the plan? Those are my questions. Thank you.

Sameer Bharadwaj
Very good, Basso, and really good question. And as you can see, since we provided the strategic plan update in May of last year, things have changed significantly with respect to the market. And we now have a completely different situation with respect to PVC supply and demand. I mentioned on the last earnings call that we had sent a team to China to better understand these dynamics, and after having understood the dynamics, we felt that it was appropriate to pause until we see market conditions approved for that project.

Having said that, in terms of long term strategic plan, the key messages that we had given were that more than 80% of our growth will come from organic growth investments. And the key projects, besides the PVC project, included significant opportunities in Fluor and Energy Materials; it included expansion in our Connectivity Solutions business given the significant infrastructure spending on Telecom; it included investments in the US, India and Indonesia in Building and Infrastructure, the growth in urban climate resilience in indoor climate system solutions; as well as growth in extensive crops and digital farming. None of that changes. And if anything, we are finding more and more opportunities in Fluor and Energy Materials that are even more compelling from an organic growth standpoint, particularly with respect to our work in the pharma space, where we are developing the next gen medical propellants, the work with next gen refrigerant gases, as well as additional opportunities in battery materials.

So, our long term commitment to our organic growth strategy remains intact and we will provide greater details on how this journey will pan out sometime in late spring or early summer when we usually have our annual webcast with the strategy update.

Does that answer your question, Basso?

Basso Sousa
Yes, it does. Thank you very much.

Sameer Bharadwaj
Thank you.

Operator
Again, if you have a question, please press star then one. Our next question comes from Andres Cardona with Citi. Please go ahead.

Andres Cardona
Hello, Sameer. Good morning. I have two questions. The first one is certainly interesting update about capital allocation. I totally understand the delay of the PVC plant, but I'm more confused with the message of the lower [indiscernible 28:38]. So, can you please help me to walk me through the rationale to reduce the dividend in the current context?

And the second one is how to reconcile the message you have been sending about the PVC market on a structural basis, on the supply versus the short term dynamic. Does it somehow change the longer term of the message for the market or doesn't it? Thank you, guys.

Sameer Bharadwaj
Very good. Both are excellent questions, Andres, and let me take both of these questions.

On capital allocation, we believe that we need to maintain a healthy dividend that is commensurate with the earnings of the business. And as you've seen historically, as the earnings power of the business went up, we increased the dividend payments. We even had a special dividend payment in 2021. And given the challenging market environment, and more importantly, the excitement we have around our growth projects and to maintain the flexibility to invest in these growth projects and maintain a healthy balance sheet at the same time, the board felt it was prudent to bring the dividend back to in line with the earnings power of the business for this year. And as the markets recover and the earnings power of the business goes up, we will adjust the dividends accordingly going forward.

Now, your question on PVC. And, as we have always said before that long term we believe the PVC markets are tight, are going to be tight and that doesn't change. In that context, the long term is five to seven years. What has happened is what we've learned from our visits to China and getting a better understanding of the supply demand situation, just to put it in context, the world demand for PVC is around 48 million tons. And capacity in China is around 28 million tons and they are available capacity. 28 million tons is nameplate; available capacity is around 24 million tons, and they are operating at about 80% utilization at 20 million tons. Their domestic demand is 18 million tons. And so today, 2 million tons or more is being exported.

And surprisingly, if you look at their manufacturing costs and logistics costs many of these exports are happening at or below cash costs. Having said that, they do have excess capacity, total capacity about 22 million tons. And given the real estate bust in China and declining construction activity in China, we don't see that changing for the next two or three years.

So, what that does is it pushes out the peak of the cycle by a few years. And in that period, the prudent thing for us to do from a capital allocation standpoint is until we see good reinvestment economics, and we see PVC prices stabilizing above $1000 a ton, let's say $1,200 a ton or more, it would not be a good capital allocation decision to continue with the project at this point of time. So hopefully it gives a clear understanding of the supply demand dynamics.

Now long term, within a few years, let's say five to seven years, the world PVC market at 48 million tons, it's still growing at 3% a year, which means the world needs anywhere from 1.3 to 1.5 million tons of PVC more every year. And so, this excess will be absorbed over the next several years, and then the markets will go back in balance.

Operator
The next question comes from Regina Carrillo with GBM. Please go ahead.

Regina Carrillo
Hi, good morning, Sameer and Jim. I have two questions. First, with the change in PVC outlook that you just mentioned, do you think there will be any relevant changes to your 2028 EBITDA guidance range? Are there any preliminary numbers that you can share with us for EBITDA for the next few years?

And my second question is more short term just related to the expected water shortages in Mexico. Is there any strategy being enforced to attend this emergency? Thank you.

Sameer Bharadwaj
Thank you, Gina. Let me take your question on the 2028 EBITDA guidance. Naturally, with a significant change in our capital allocation plan were one of the major projects is now on hold or delayed, it will

change our 2028 guidance. What I can tell you, though, is our pipeline of opportunities is getting more and more exciting, particularly in Fluor and Energy transition. And we will share more with you in the coming months about some of these opportunities, which will replace the PVC project in terms of contribution to long term EBITDA guidance. And we're in the process of updating our strategy plans in each of the businesses. And as I said earlier, typically in late spring or early summer, we have a webcast where we will give a more accurate update on what our long term EBITDA guidance will be.

Now, in terms of addressing water opportunities, our teams are continually engaged you with the relevant customers and authorities on addressing these water shortages. We can get you more information on any specific projects that are going on at this time. We have done a successful project this year. This is both a combination of Building and Infrastructure, and Precision Agriculture business, where we've been involved in a 14 kilometer long pipeline that provides water for drip irrigation to farms along the way to Mexico City, and prevents loss of water, allowing more water to come into Mexico City. So that's an example of a project that we have successfully executed last year. But we can get you more information and details on the other projects that are in the works.

Regina Carrillo
Yes, that would be great. Thank you so much.

CONCLUSION

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

Sameer Bharadwaj
Thank you. I would like to thank everybody who joined the earnings call and thank you for your continued interest and faith in Orbia. We look forward to talking to you again at the end of the first quarter, and during the strategy update later in the year. Thank you very much.

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