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MEXCHEM*.MX - Q2 2019 Mexichem SAB de CV Earnings Call

EVENT DATE/TIME: JULY 25, 2019 / 3:00PM GMT



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PRESENTATION

Operator

Good morning, and welcome to the Mexichem Second Quarter 2019 Earnings Conference Call.

As we turn to Slide 2, (Operator Instructions). Please note this event is being recorded.

I would like to now turn the conference over to Mr. Gerardo Lozoya, Investor Relations Director of Mexichem. Please go ahead, sir.

Gerardo Lozoya Latapi - *Mexichem, S.A.B. de C.V. - IR Officer*

Thank you, Dave. Good morning, and welcome to our earnings results conference call. We're pleased to be here today to present our second quarter 2019 results. We appreciate your time and your participation in this conference. Our speakers today will be Daniel Martínez-Valle, Mexichem's CEO; and Rodrigo Guzmán, our CFO.

I will now turn the call over to Daniel for opening comments. Please, Daniel?

Daniel Martínez-Valle - *Mexichem, S.A.B. de C.V. - CEO*

Thank you, Gerardo, and welcome, everyone, to our second quarter 2019 conference call. Operator, please move to Slide 4.

In Q2, we continued to experience significant headwinds that began late last year, particularly in Vinyl and Fluor. We had a difficult quarter, associated to where we are in the business cycle and market situations that were unexpected. In Vinyl, we experienced a challenging quarter due to pricing pressures and the effect of a temporary force majeure at a key supplier in Germany as well as the longer-than-expected maintenance works in our VCM supplier's plant in the U.S.



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While in Fluor, we are seeing the impact from increasing illegal imports of refrigerant assets into the European Union. Thus, we're taking measures to mitigate the effect of challenging business conditions across all of our business groups.

Total revenue declined by 7% in Q2 compared to Q2 2018. Our EBITDA declined 12% on a reported basis in Q2 compared to the same period of last year. Rodrigo and I will give you more colors and details on the numbers later.

Looking at the broader environment, the global economy grew to its slowest pace in 3 years and economic activity in advanced economies, particularly in Europe as well as in some emerging markets, has been softer than previously anticipated. Also, after 10 years of slow growth, the global construction cycle may have reached its peak.

Despite a difficult quarter, we continue to build this company for performance over the long term. We are focusing on markets where we have higher profitability, and we continue improving operational efficiencies to control costs and better manage our working capital across each one of our businesses.

Operator, please move to Slide 5. I'd like to highlight several important factors regarding our business. First, we have a resilient company with a strong balance sheet, a healthy debt profile, strong cash conversion and a wide diversification in terms of geographies and products.

Two, we have been strengthening our organizational structure and bringing in seasoned executives on-board to the leadership team. We are convinced that we have the right team to both optimize for today and cultivate for tomorrow. This means not just building a company to achieve consistent results, but also building a company that is both relevant today and in the future.

Three, we're well on our way in our transformation to become a more customer-centric and future-fit organization. Since we kicked off our transformation in March of last year, we have accomplished work on a number of overarching initiatives, including restructuring our go-to-market organization to enhance customer centricity. Today, we have 5 global business groups; prioritizing capital allocation to continue improving return on invested capital; and executing company-wide efforts on talent, human-centered innovation, digital readiness, operational excellence and circular economy.

As part of this transformation, in a launch planned for early September, we intend to change our corporate name and brand, subject to shareholder approval. This effort is essential to defining our identity and reflects the spirit of our entire, profound and deep transformation.

Moving on to Slide 6. I want to highlight that Mexichem diversification, both geographically and in terms of our product offerings, helped mitigate the effect of a difficult quarter. While we're proud of our Mexican heritage, we have truly become a global company and less of a chemical company. Our largest market is Europe, with 37% of global sales; with our largest European countries being Germany, with 7% of global sales. Our second largest market is North America with 31% of global sales, in which the U.S. represents 18%; and Mexico, only 9% of our global sales.

It is important to note that regional sales diversification is valid across all our 5 business groups and across all the portfolio of products.

Additionally, the company continues to focus on downstream growth, in particular, in specialty solutions that carry higher margins, which in the first half of 2019, represented almost 70% of our total EBITDA versus 64% a year ago. Thus, Mexichem is increasingly global, increasingly diversified and solution-focused. This should make it clear why changing our name makes sense.

Looking now at Slide 7, and as I mentioned on our previous calls, we are increasingly transitioning to a returns-driven model. Our latest ROIC is negatively affected by a lower contribution of EBITDA, but we continue to be enthusiastic about our long-term strategy to drive higher return on invested capital.

In this context, we've developed, since early last year, our play-to-win strategy to create value in every single project we undertake. We have identified every dollar to be invested over the next 5 years to expand margins, increase the stickiness of customer relationships and ultimately improve ROIC. Our focus is to have a strict discipline and the right policy to deploy capital across all our 5 business groups.



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We remain excited about the company's long-term prospects and are committed to take whatever steps are necessary to unlock shareholder value, including exploring strategic alternatives for our Vinyls business.

Rodrigo will discuss quarterly results further in a few minutes. But first, I'd like to highlight some recent customer wins and partnerships and how we're accelerating our innovation to deliver differentiated value to our customers.

Turning to Slide 8. Our Dura-Line Datacom business is participating in a project to provide many of the ducts that will carry power and fiber optic cables for a greenfield city in Southeast India called Amravati. This will be built from the ground up. We plan to welcome residents around 2024. A fiber infrastructure will help provide cameras, sensors, traffic monitoring, lights and 5G to make the smart city work on multiple fronts.

Turning to Slide 9. Earlier this quarter, our Netafim business, the world's leader in precise irrigation solutions, entered an agreement with a Tanzania-based conglomerate to provide irrigation towards 2,000 hectares of sugarcane there. This project is among the largest of Netafim's projects in Africa and an example of its expansion on the continent.

We will provide a full solution to include design services, engineering and agronomic support and installations and operating services, including NetBeat, our advanced digital farming solution for remote digital analysis, monitoring and control. We estimate that we will be able to increase the yield of sugar cane up to 4x the average output while significantly reducing water consumption. The project is particularly complex due to soil salinity, and we aim to create rainwater reservoirs in an extremely dry area.

Now on Slide 10, our Wavin business is teaming with U.K.-based technology firm, StormHarvester, to help cities mitigate the waste of rainwater, especially in times of record heat, drought and flooding. This solution connects our Q-Bic Plus below ground, water and filtration plants to StormHarvester's real-time and historic weather data output. Machine learning algorithms [turn] the tanks off when rain is coming and when to automatically open a valve or alternatively when to hold on to its water so it can later be used for irrigation needs or for flushing toilets. This is one of the many solutions that we're working on and deploying to make livable and loveable cities all across the world.

Now moving on to Slide 11. We continue building a pipeline of innovative solutions. And to take on advantage of future opportunities, we are focusing many of our strategic investments around organic growth and cultivating a culture of innovation. I'd like to give you an update on where we are in terms of our activity to drive innovation across each one of our 5 business groups.

Just this week, we launched a \$130 million Corporate Venture Capital fund to invest over the next 5 years in early stage startups. We hope to begin making our initial VC investment in the next few months. We are also partnering with startups all over the world to expand our product offerings, decrease costs and enter new markets. As an example, we are now piloting an innovative system that significantly improves the air quality inside buildings. We installed the systems in Netafim's headquarters in Tel-Aviv. And if the pilot proves successful, we'll take it global. We have created a program to promote innovation internally by enabling each one of our employees, not only engineers and R&D, to suggest innovative ideas.

More than just collecting ideas, the program is designed to coach, train and monitor internal entrepreneurs and support them in commercializing each one of their ideas.

Finally, I want to share with you how excited we are that our Lighthouse Lab in San Francisco is now fully up and running, and we now have multiple teams across the globe working to develop new ventures.

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

Rodrigo Guzmán Perera - *Mexichem, S.A.B. de C.V. - CFO*

Thank you, Daniel.

Now turning to Slide 12. As Daniel mentioned, Q2 revenue totaled \$1.5 billion (sic) [\$1.84 billion], down \$129 million or 7% from Q2 2018. EBITDA totaled \$372 million, a decrease of 12%. Net majority income was \$84 million, down 48%.

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Operating cash flow before CapEx, share buybacks and dividends declined by 14% or \$36 million, mainly as a consequence of a decline in EBITDA of \$51 million.

As we noted in our last 3 quarter calls, we expected challenging market conditions in our Vinyl business this year, but are starting to see a slight improvement in some of the business volumes. Therefore, we saw a sequential improvement in Vinyl's EBITDA in Q2 compared to Q1 2019. However, Fluor's results in Q2 were materially negatively impacted by the illegal importation and selling of refrigerant gases into the EU in breach of the EU F-gas regulations.

Mexichem is actively working with industry and government stakeholders in order to facilitate the EU's efforts to combat this unlawful trade. Our Fluent business performed better on the EBITDA side, including IFRS, but was impacted by 2% without IFRS, reflective of economic conditions in Europe, which affect our building and infrastructure business but was offset by a double-digit and high single-digit EBITDA growth in our Datacom and precise irrigation businesses, respectively.

Going into further details on the numbers, as you see on Slide 12 -- on Slide 13, sorry, the 7% revenue decline to \$1.8 billion was led by lower sales in all business groups, mainly driven by a decline of \$55 million in Fluent as a result of lower sales in Europe, associated with a lower economic environment; and a \$53 million decline in Vinyl, mainly due to market conditions.

The combined revenue declines in the Fluent and Vinyl businesses represented 82% of the total revenue decline. Our Fluor business saw a decrease of 11% or \$27 million compared to the same period last year, mainly as a consequence of the illegal imports of refrigerant gases into the EU, as mentioned.

On a constant currency basis, consolidated revenue would have been roughly \$1.9 billion, a decrease of 3% versus Q2 2018. During the first half of the year, revenues decreased to \$3.6 billion, a decline of 3% year-on-year by \$118 million. Out of that, 87% of that decrease was due to Vinyl and 22% to Fluor as a result of the issues mentioned above. On a constant currency basis, revenue in the first half would have increased 1% to \$3.8 billion.

In Q2 2019, reported revenues for our Fluent Business group decreased by 5% and remained flat on a constant currency basis. This decline, on a reported basis, mainly -- was mainly due to a high single-digit decline in our building and infrastructure business in Europe, related in part to lower revenues in the U.K. associated with the uncertainty generated by Brexit and for an economic slowdown in certain European countries.

Revenue in our Datacom business decreased 8% on a reported basis and 6% on a constant currency basis, mainly due to a change in the mix of products. These declines were partially offset by a 3% increase in reported revenues for Netafim or 6% on a constant currency basis.

In our Vinyl business, revenue declined this quarter by 8%, or 6% on a constant currency basis, mainly due to, as Daniel mentioned earlier, lower caustic soda and PVC prices as well as lower volumes, driven by a temporary force majeure in a key supplier in Germany, and longer-than-expected maintenance work in our main VCM supplier's plant in the U.S. While our reported revenue in Fluor decreased by 11%, or 10% on a constant currency basis, and even with our Fluor Upstream business continuing its double-digit sales growth, it was not enough to offset the decrease in our downstream business, mainly related to the illegal imports of refrigerant gases into the EU.

For Q2 2019, our reported EBITDA was \$372 million, a 12% decrease compared to the \$423 million from the same period last year, with an EBITDA margin of 20.2%. During the quarter, we had a positive effect of \$19.1 million on our reported consolidated figures due to the effects coming from the adoption of IFRS 16 and the FX effect on consolidated EBITDA of negative \$9 million.

On a constant currency and organic basis, EBITDA declined 14%, reflecting an increased EBITDA margin of 19%. For the first 6 months of 2019, reported EBITDA was \$690 million, a decrease of 8% compared with the same period last year.

EBITDA margin was 19.1%. EBITDA, on an organic and constant currency basis, declined 12% to \$677 million, reflecting an impressive EBITDA margin of 18%.



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Operating cash flow before CapEx, share buybacks and dividends, as we can see on Slide 14, decreased \$27 million, mainly affected by \$51 million lower EBITDA, higher need for working capital of \$20 million and higher bank commissions associated with a \$1.5 billion revolving credit facility renewal we announced on June 26, 2019. These effects were partly offset by lower taxes and lower FX losses. Capital expenditures decreased 13% to \$61 million.

Our total financial debt as of June 30 was \$3.6 billion, while cash and cash equivalents totaled \$591 million, resulting in net financial debt of \$3 billion, as shown on Slide 15. Our net debt-to-EBITDA and interest coverage ratios closed the second quarter at 2.31x and 4.62x, respectively.

Going on to Slide 16. We continue with a very sound balance sheet and very healthy financial structure of our debt. In the second quarter, we successfully closed the renewal of our \$1.5 billion revolving credit facility under favorable terms. We kept our weighted average cost of debt stable at 4.98% and a tenor of 13.9 years, which will mean lower interest, and therefore could increase cash flow.

Finally, I want to warmly thank each of you for the last 6 years, in which I had the opportunity to serve this fantastic company as the Chief Financial Officer. From the bottom of my heart, I want to thank our analysts, investors, shareholders and all of you, my dear friends, for your support. I hope I have been able to meet your expectations and generate value for you.

I will now turn the call back over to Daniel for closing remarks before we open up the call for questions. Daniel?

Daniel Martínez-Valle - *Mexichem, S.A.B. de C.V. - CEO*

Thank you, Rodrigo.

Now on Slide 17. For the full year, due to uncertainty in the global macroeconomic environment and market dynamics across our industries, Mexichem is adjusting its 2019 EBITDA guidance to reflect a 1% to 6% decline compared to 2018 reported EBITDA. We have a global organization with a strong management team and a clear vision of where we want to take our company. As we've discussed, we are managing our core businesses with a clear focus on operational excellence. We're also building new business models, entering new markets and creating new solutions and services to address the most pressing global challenges: food security, water management, urbanization, globalization. And as I mentioned before, we are committed to take whatever steps are necessary to unlock shareholder value.

On a personal note, Rodrigo has played an important role in bringing this company from where it was to where it is today. His hard work, commitment and passion for the job has always shined through in every single project he's taken on. We're not saying goodbye to Rodrigo as he'll continue to work with us on strategic projects. I want to take this opportunity to thank him for all he has contributed to Mexichem, and I am sure he will bring immense value to his new role.

I want to thank you all for being on the call today. Operator, we're now ready for questions.

QUESTIONS AND ANSWERS

Operator

(Operator Instructions) The first question comes from Frank McGann with Bank of America.

Frank J. McGann - *BofA Merrill Lynch, Research Division - MD*

Okay. Just maybe to follow up on a comment you had made earlier, talking about the Vinyl business in terms of possible strategic alliances or looking at options for that business. I was just wondering how you are seeing that business from a competitive standpoint. What strengths and weaknesses, potentially, it has that you might be interested in potentially modifying?



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Daniel Martínez-Valle - *Mexichem, S.A.B. de C.V. - CEO*

Thank you for the question, Frank. So we have a fantastic business in the Vinyl business division. As you know, we are the first specialty resins producer worldwide, thanks to the acquisition of VESTOLIT and the businesses that we've been growing over the last several decades. We are the fifth largest general resins producer in the world.

We have a unique position in terms of our development of a cracker in Texas in collaboration and in partnership with Oxy. We believe this is a strategic asset in the Vinyls business worldwide. And again, as we said, both in the press release and in my earlier statement, we are actively evaluating every possible strategic option for this business moving forward. At this point in time, I cannot share any details. Every possibility is at this point is on the table, and we are committed to unlocking shareholder value moving forward for every single one of our shareholders.

Frank J. McGann - *BofA Merrill Lynch, Research Division - MD*

Okay. Maybe if I could follow-up then, just to discuss the trends that you're seeing. Well, you did see some improvement in the business in the second quarter, and you've indicated that things should continue to improve in the coming quarters. Are you seeing a continued benefit from lower ethane costs and caustic soda pricing that should lead to some improved profitability there?

Daniel Martínez-Valle - *Mexichem, S.A.B. de C.V. - CEO*

Yes. So as you well point out, there are several variables that affect this business: ethane costs, ethylene costs, PVC margins and caustic soda. We are seeing positive trends in the last few weeks, and we are more optimistic in terms of Q3 and specifically Q4. That's what gives us optimism for the business in the Vinyl Business division, in particular, for the last part of the 2019 fiscal year.

Operator

The next question comes from Nikolaj Lippmann with Morgan Stanley.

Nikolaj Lippmann - *Morgan Stanley, Research Division - Equity Analyst*

And Rodrigo, thanks for years of good debate and for your patience with me. First, on Netafim, if you can provide any color on sort of the demand outlook on regions. Any numbers you are prepared to give out there on demand and growth.

And also, if you can give any color on the working capital consumption and to what degree that, that has been consumed, increasing working capital comes from Netafim. So that's number one.

Number two, could you confirm or give color on the Fluor business? It looks like it suffers a bit this quarter, but upstream pricing appears to be doing very well. So would it be correct to assume that at least 100% of the decline comes from the Downstream business?

And finally, I'm sorry, Rodrigo, but could you help us reconcile the minority interest? You do about \$46 million in EBIT in the buildings division. But you have -- and the majority of minority interest comes from this division. It just seems that the minority interest, again, is very high. If you could help us put color on that, I would appreciate it.

Daniel Martínez-Valle - *Mexichem, S.A.B. de C.V. - CEO*

Thank you for your questions, Nick. So I'll start with the Netafim and the Fluor questions, and then I'll turn it over to Rodrigo. So we're seeing very positive demand trends all over the world. As you know, we're working actively on projects in Africa that are transformational as well as in India,



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countries like Rwanda, Tanzania, Ethiopia are countries where we see increasing demand for a large transformational project in different crops such as sugarcane. We are seeing very positive demand in developed economies such as the U.S. I cannot sort of mention any specifics around the different regions. We're very optimistic about the prospects of Netafim for this year and for the coming years. In terms of working capital, we've seen some impact associated to India, not only in terms of our precise agro business group but for the rest of our business group. As you know, we had elections in India, and there were some political considerations regarding payments and periods after the election where the government has to delay payments. That affected not only Mexichem's businesses but other businesses. We expect to see these trends improving over the next several months.

So we consider this definitely a one-off in terms of its impact on working capital. Again, not only for Netafim but for the rest of our businesses.

In terms of Fluor, you are correct. We are seeing positive trends in terms of pricing behavior in our upstream businesses, and that has more than offset -- that has offset the negative trend that we saw in downstream. Again, most of the downstream phenomenon has been associated with the illegal imports. We are working very actively with the consortium and our peers that are very active in this industry with the EU authorities. We cannot mention any specifics in terms of when we see this trend -- we can expect this trend to change. But we're optimistic in terms of the work that we're doing with the EU authorities.

Rodrigo Guzmán Perera - *Mexichem, S.A.B. de C.V. - CFO*

Thank you, Nik, for your comment about myself. And getting into the minority interest, if you are looking at the minority interest in the balance sheet -- in the income statement, sorry, minority interest declined 34% in the quarter and 58% -- and 24% in the first half.

All of it comes from the cracker and comes from the JV with Oxy. The margins between ethane and methane declined during the first half. Of course, in the second half the year, let's say, a little bit better. But in the first half, it was -- it was a big impact.

The decline in the first half -- in the first quarter -- sorry, in the second quarter was for \$15 million. In the first half, it was for \$18 million.

If you are looking -- but if you are looking at the cash flow, in the cash flow -- and if you are taking dividends as a minority interest, that is not correct. Minority -- the increasing dividend is coming from the increase in dividends from the holding companies, not from the cracker. So basically, in the minority side, we have a decline of 24% and 34% again in the second half in the second quarter and 24% in the second quarter and none of it comes from the cracker.

Operator

The next question comes from Leonardo Marcondes with Itaú.

Leonardo Marcondes - *Itaú Corretora de Valores S.A., Research Division - Research Analyst*

So on the Fluor segment, you guys mentioned that you are working with the industry and the government to eliminate these illegal imports in Europe. Could you provide a little bit more color on what are the steps of this process? And also, a bit more color on the time for you guys to come up with a solution on this?

Daniel Martínez-Valle - *Mexichem, S.A.B. de C.V. - CEO*

Thank you, Leonardo. So as I mentioned to Nik, at this point in time, we cannot share specifics, neither in terms of timing. This is a very complex situation in which the EU authorities are trying to deal with an issue that was unexpected for them. Most of the imports that are coming into Europe are coming from China, both through the borders of EU countries and non-EU countries.



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In terms of the timing, it's difficult to predict when we can see the needle moving to the right sort of direction. But we have sort of a full team dedicated to these efforts. We have full collaboration with our peers, and we have a very positive sort of contribution from every single one of the members of the EU authorities.

Our government affairs team, our General Counsel, and the rest of the members of the Fluor team are working with investigators, and we're raising the public awareness around this issue. As we mentioned in the press release, this implies, in terms of volume, 30% of the size of the European market in terms of refrigerant gases. So this is a very significant issue that the EU authorities and us as a consortium have to deal with, and we hope to be able to give you news in the next few months. So we cannot share any specifics in terms of timing.

Operator

The next question comes from Luiz Carvalho with UBS.

Luiz Carvalho - UBS Investment Bank, Research Division - Director and Analyst

First, Rodrigo, thanks very much for all the partnership during the period. I really wish you all the best luck in your position. I'd like to keep in touch.

I have basically 2 questions here, and I'd like to start with a bit more strategic, maybe, Daniel, if you can help us. Since you arrived, I mean, you have been supporting about a transformation of the company from, I would say, a more commoditized to a client-centric focus. And we do like to see all the ideas in the presentation, like the VC fund, innovation and so on. However, at least over the next, I'd say over the past year or so, I mean, looking through the numbers, we understand that the scenario was a bit more challenging with all the externalities that we saw. But I mean, the numbers do not pretty much reflect, I mean, you'd say this kind of this path, right? And the other day, at least this quarter, I mean, 2 of the company businesses, EBITDA dropped more than 25% year-over-year. Returns are also dropping, right?

So my first question here is quite simple. When do you believe that the returns and numbers will start to present some improvements based on the strategy that you're implementing within Mexichem?

Second question is potentially a bit more strategic as well about capital allocation, right? I mean, looking to the leverage of the company now, you're close to 2.5x net-debt-to-EBITDA. And of course, that is reflecting actually the weak quarter recently. But that's a level that most of the credit rating agencies see as the ceiling, right?

And looking to the debt profile, you have almost \$1 billion that's expiring by 2022, which is, I don't know, 2.5 years from now, right? I mean how should we see dividends and potential acquisitions versus the leverage and then 1.5 years from now?

Daniel Martínez-Valle - Mexichem, S.A.B. de C.V. - CEO

Thank you, Luiz. Very good questions. So first of all, in terms of the transformation journey. Again, this has been an all-encompassing journey that has included many, many different fronts, ranging from changing the go-to-market organizational structure, working on a strategy that we call play-to-win to identify, a, what is the winning aspiration of each one of our 5 business groups? Where do we want to play? Do we want to play in businesses like building and infrastructure in countries where we have traditionally not operated like India, Indonesia and the U.S.? Or do we not want to play? How do we make sure that we win every time we want to play? We don't want to have an insignificant presence in significant countries like China. What are the systems, capabilities and tools that we need to have in place in order to win every time we decide to play in a specific space or market? We have worked diligently over the last 18 months to identify, as I mentioned in my introduction remarks, every single dollar that will have to be invested to execute our play-to-win strategy over the next 5 years.

Again, the challenge is to prioritize capital allocation to drive return on invested capital moving forward.



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Early last year, we announced that we were not going to do any major acquisitions moving forward, and we were focusing our efforts on organic growth, on building a world-class team and on delivering the right results to our shareholders. We have experienced headwinds that were unexpected in terms of our Vinyls business, in particular, the caustic soda, ethane, ethylene prices have not been favorable to us. We have experienced one-offs that are beyond our control, such as the shutdowns and the force majeure, both in Europe and in the U.S. and Gulf Coast.

We are working very actively and very diligently with every single one of our business groups to control costs, to take every single measure in terms of expenses and working capital. So again, this is a transformation that will continue over the long term. We should not expect short-term results. This is a big transformation that goes well beyond sort of the superficial level of what a name change could be perceived as. We have a world-class team in place. We have a clear strategy in terms of where we need to take the company moving forward. And as I mentioned a couple of times in my introductory remarks, we are going to take every step that we need in order to unlock value for our shareholders.

In terms of your second question, we are aware that we are a little bit above our internal threshold of net debt-to-EBITDA of 2x. We are working with the management teams in every single thing that I mentioned before to maximize cash generation capability for the company.

And moving forward, we don't expect to engage in major M&A transactions. We believe that we have, today, the right assets that will deliver the right returns. We need to increase our asset intensity, and we really need to move our return on invested capital. So again, we don't expect to see major transformation, M&A transactions moving forward, and we'll manage the dividend policy, as we've done in the past, in a very prudent way in which we can guarantee to rating agencies, investors, and analysts that we will be as close as possible for our 2x net debt-to-EBITDA internal measure.

Luiz Carvalho - UBS Investment Bank, Research Division - Director and Analyst

If I may just come back to the first question. I understand that, potentially, the transformation might take longer than the potential -- I mean, we imagined before, at least, I mean, from our end here.

But looking to the leverage and crossing with the transformation path that you are trying to implement. What are the odds, say, the potential -- how can I put this way, blockages or stopping these process? Because let's say that because of the results and the challenging environment, you end the year above the 2.5x and potentially due to a short course, you need to come back to be more focused about the commodity and potentially stop about some projects. Is it something that you're already considering? Or I mean, it's a no turning back decision of really becoming a more customer-centric company. I'm just trying to get a bit more information, a bit of your view on the decision-making process, whether to really go to the, I'd say, this direction, I mean, independently of the short-term results.

Daniel Martínez-Valle - Mexichem, S.A.B. de C.V. - CEO

So let me be very clear about this. This is a great question, Luiz. And I want to have a very unequivocal position in this regard. We are staying the course. We are transforming this company into a customer-centric, purpose-driven, future-safe organization. We will continue to manage our core business with operational excellence. This is a business that has delivered results in the past to a tune of having a \$7 billion organization that generates 20-plus percent EBITDA margins.

On top of this, we will cultivate for tomorrow, driving innovation, driving a customer-centric business model that will deliver higher gross margins, higher EBITDA margins, higher stickiness in terms of our relationship with our customers. There is no way in which we will deviate from this path. We are convinced that we have the right strategy. We have the right vision. We have the full support and commitment from our Board of Directors, and we have a management team that is completely passionate and fully dedicated to making this transformation journey happen.

Luiz Carvalho - UBS Investment Bank, Research Division - Director and Analyst

Pretty clear. Just -- yes, sorry.



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Rodrigo Guzmán Perera - *Mexichem, S.A.B. de C.V. - CFO*

Luiz, I want to add a couple of things that are very relevant for you in order to have in mind what we have been developing in the last year. If you look at how we are going to evolve in this in the play-to-win that Daniel mentioned, which is how we are going to invest any single dollar of this company and where we want to have -- and where we're going to go with that dollar, with that specific dollar. We are putting a lot of attention on do not increase our leverage at all to maintain the leverage we have today. Also to maintain the investment grade, that is one of the main things we are in our top of mind.

And if you look at the models and everything we are doing, we are taking care of everything. We are taking care of doing the transformation in the right way. We are taking care of doing the play-to-win in a correct way, being sure that we are going to invest every single dollar to increase our ROIC. And at the same time, taking care of our debt. So everything is under those limits. And we are not going to do anything that could guide us to higher risk or to lose our investment grade.

Luiz Carvalho - *UBS Investment Bank, Research Division - Director and Analyst*

No, it was pretty clear. I mean if I just -- I mean, maybe come back, Daniel, I'm sorry to take a bit longer than expected. But I understand that the strategy -- so it's really to transform the company and move towards this direction. But over the next, maybe, I would say, year. I mean since you started, I mean, we're going to be talking about almost 2 years. What should we be looking at? Or how do we now know, looking at the company results that the strategy is really working, and you're going to be, I'd say, achieving what you expected?

Is there any metric that we should be a bit more -- I mean, are the returns, the EBITDA growth, the -- what should we look over the next couple of quarters in order to try to track -- I mean, the company path through this transformation?

Daniel Martínez-Valle - *Mexichem, S.A.B. de C.V. - CEO*

Yes. So we have a long-term view for this company. We have a clear objective of meeting every single one of our short-term objectives. Rodrigo mentioned leverage. He mentioned free cash flow generation. He mentioned EBITDA. You should track both our short-term metrics and our long-term metrics. You should track what kind of business models we're putting out there in places like Africa, India, U.S., Latin America, developed, developing countries. Everything that we're doing is aligned to our strategy in terms of building new ways of engaging with customers, building new ways in which we can create value, building new ways in which we can address pressing global challenges, such as food security, water management, scarcity, abundant storm water management solutions.

We will continue, as I said, managing our core businesses that have made us so successful in the past 30 years. We will not stop managing and operating these businesses. On top of this, we are developing all the business models that I just mentioned.

So again, you should look at the short term. You should look at the long term, and you should be fundamentally convinced that the management team and the Board of Directors will do everything we can to unlock value for our shareholders.

Operator

The next question comes from Christian Landi with Scotiabank.

Christian C. Landi - *Scotiabank Global Banking and Markets, Research Division - Deputy Director of Metals and Mining & Analyst*

I have a couple of questions. I do believe that the margin that you delivered in the Fluent division was the highest ever. If you can confirm that.



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And I was also wondering where, apart from the things that you mentioned in the press release, of favorable mix and Datacom, was there any other driver, maybe some synergies with Netafim there?

And the second question would be if there are any updates on the piece of information that you gave last quarter regarding the Colombian antitrust authority investigation on the anticompetitive practice there?

Rodrigo Guzmán Perera - *Mexichem, S.A.B. de C.V. - CFO*

Okay. Christian, the first question you did, on margin. No, it's not -- it's not the highest margin ever put in our Fluent business. The last year, we have the same margin. And this depends on the way in which you are looking at the numbers. If you take out IFRS, you are going to get the same number as in the last year. But what I can assure you is that we are working on moving or moving higher our margins in EBITDA because our highest priority, as Daniel mentioned during his exposition, it's about increasing ROIC at this time.

And in the case of the anti-trust issues, as we saw -- and as we said during -- in our annual report, we are working in all of them at this time. And we cannot disclose more information other than the one that is included in the annual report, given that it's -- that they have processes ongoing. They are investigating -- the governments are investigating different things. We have, basically, 3 antitrust. One in the U.S., one in Germany and the other one in Colombia, as we mentioned in the annual report. But we cannot disclose more information about that, given that they are ongoing investigations.

Operator

The next question comes from Vicente Falanga with Bradesco.

Vicente Falanga Neto - *Banco Bradesco BBI S.A., Research Division - Research Analyst*

Rodrigo, I wish you plenty of success in your new ventures.

I had a couple of questions, Daniel. We have been seeing some activity data points suggesting a slowdown in some European countries, especially countries like Germany, which seems to be slowing down very quickly and then the U.K., with Brexit. Is the company's Fluent business somehow feeling the impact of this slowdown? Is this something that you feel could have a meaningful impact to the [X1] investor with assets?

And then my second question, at what point of leverage would Mexichem consider buying back more shares if at that point, obviously, shares are still below the levels of your last buyback, which, if I'm not mistaken, was at 47 pesos.

Daniel Martínez-Valle - *Mexichem, S.A.B. de C.V. - CEO*

Thank you for your question. So regarding the European macroeconomic conditions and recent slowdowns both in Germany and U.K. and other markets. Our team in Wavin has been very actively, over the last several years, been performing cost mitigation and expense management measures and every single operation in the Nordics, Germany, U.K., France. As you know, we've rationalized in a significant way, over the last decade, our manufacturing footprints in those countries.

We believe we have a lean structure. And at the same time, we have increasingly focused our product offerings into higher-margin products, which are less elastic in terms of demand in times of sort of recessive or slower-growth environment. We believe that we will continue to see the growth in all these sort of countries in Europe. We are prepared for this restructure. We are prepared, focusing on selling higher profitability and higher-margin products across all these regions. As I said, part of our play-to-win-strategy is to really have a global perspective for our B&I business and to have a diverse sort of position across the different regions and across the different continents. We are actively looking at opportunities in India, in places like Indonesia and the U.S. for our B&I business. We believe that we will fall by the end of this year, within the expectations that we had at the

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beginning of the year for the whole B&I business group. So we are optimistic in terms of how we see the next 6 months moving forward for Wavin and Amanco in Europe and Latin America and elsewhere.

Regarding the second question that you raised in terms of our share buyback program. We can't share with you details in terms of levels or in terms of timing. This is one of our sort of capital allocation sort of areas that we have. Our focus, as Rodrigo mentioned, is to delever the company and to have the leverage at the levels in which we commit ourselves to internally, which I insist is 2x net debt-to-EBITDA. And the most important thing is we are committed to maintaining our investment-grade status in every single scenario that you can entertain your models.

Operator

The next question comes from Andres Cardona with Citi.

Andres Felipe Cardona Gómez - Citigroup Inc, Research Division - Research Analyst

I have 2 questions. The first one has to do with the new guidance that you provide. Can you walk us through the main assumptions that have changed with the earlier guidance? And if you can explain if there is any segment that is driving this downward revision?

And the second question has to do with the force majeure event that you have in the second quarter. If you can let us know if it is fully normalized already and how much it took from second quarter EBITDA?

Daniel Martínez-Valle - Mexichem, S.A.B. de C.V. - CEO

So regarding the guidance, we are factoring in this new guidance -- the one-offs that were not expected. If you look at the impacts associated to the refrigerant gas illegal imports from China into EU, we did expect some impact for 2019. But we and our peers never expected to have 30% of the total market associated to illegal imports in a region such as the European Union. We had force majeure, both in Europe and in the U.S., as we mentioned during our introductory remarks. The U.S. operation was associated to our VCM raw material supply. In Europe, it was also associated to raw material that is supplied to our VESTOLIT plant. That is over.

We also had a one-off associated to longer-than-expected maintenance programs, again associated to raw material supply in our Vinyl division. These were one-offs that were not expected and were very difficult, if not impossible, to predict before year-end 2018. This is the basic -- these are the basic drivers that made us move the guidance. Again, we are seeing positive trends in the caustic soda prices. We are seeing positive trends in the resins margins. We believe that we will see upward trends as we move along the year, and we are not including in this guidance range any one-offs associated to any antitrust or settlements associated to your question.

Operator

The next question comes from Vanessa Quiroga with Crédit Suisse.

Vanessa Quiroga - Crédit Suisse AG, Research Division - Head of Mexico Equity Research & Co-Head of the Housing & Infrastructure in LatAm excluding Brazil

My first question is regarding the Datacom business. We saw a decline in sales year-over-year. Was weather a factor there? Or can you explain how you're seeing more recent trends?

And the other question would be regarding the Fluor business. Can you provide a breakdown of EBITDA between the upstream, downstream? And how much EBITDA you are generating from any sales of gas credits?

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Rodrigo Guzmán Perera - *Mexichem, S.A.B. de C.V. - CFO*

Okay. How are you, Vanessa? Rodrigo speaking. In relation with Datacom, effectively the decline in sales is because of product mix and the kind of clients we are tending with that product mix. There are some clients that reduced the mix of the products and then sales declined. But at the same time, the products that we are selling have better margins. So even when there is a decline, if you look at how Datacom EBITDA has been developing, we have today a better margin than in the last years. So it's -- everything is in relation with the mix of products and the mix of price.

And in the case of Fluor, we cannot break down the number between upstream and downstream. And the basic reason is because of commercial reasons. We don't want to show those numbers openly in the market. But what I can tell you is that in the case of downstream, the reason why the EBITDA margin declined is because basically, EBITDA's rise did not have volume and then do not have cost of goods sold at all. And also the SG&A is very small. So each dollar we sell on [this] gas means 100% of EBITDA margin. So that's why the margin declined so aggressively in the upstream business from mid-40s up and up to the high-30s.

Vanessa Quiroga - *Crédit Suisse AG, Research Division - Head of Mexico Equity Research & Co-Head of the Housing & Infrastructure in LatAm excluding Brazil*

Okay, okay, Rodrigo. And can I add a question there on Netafim? Do you see Netafim on track to reaching the targets in terms of margin?

Rodrigo Guzmán Perera - *Mexichem, S.A.B. de C.V. - CFO*

Yes. We are seeing Netafim going in the good direction. You should remember that during this first half of the year, we have been saying that our guidance -- the guidance that we did back in February of the last year or in the second quarter of the last year, do not include any FX impact because we cannot forecast FX.

So -- but if you take out the impacts we had in the last year -- in the second half of last year, in the first half of this year about FX, for sure, we are going to get into the target.

Operator

The next question comes from Liliana De Leon with GBM.

Liliana De Leon Meza - *GBM Grupo Bursátil Mexicano, S.A. de C.V. Casa de Bolsa, Research Division - Research Analyst*

I think you already answered. But could you please give more color and why -- we saw the price performance? And could you please share with us if you are planning to increase your buyback plan?

Rodrigo Guzmán Perera - *Mexichem, S.A.B. de C.V. - CFO*

Could you repeat the question? If we will use the buyback share program?

Liliana De Leon Meza - *GBM Grupo Bursátil Mexicano, S.A. de C.V. Casa de Bolsa, Research Division - Research Analyst*

Yes. Increase it or develop more in...

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Rodrigo Guzmán Perera - *Mexichem, S.A.B. de C.V. - CFO*

As Daniel mentioned, we cannot disclose that information. It depends, of course, on the key metrics on the company, basically, of course, leverage, and the cash position. But we cannot disclose more information than that.

Operator

This concludes our question-and-answer session. I would like to turn the conference back over to Daniel Martinez-Valle.

Daniel Martínez-Valle - *Mexichem, S.A.B. de C.V. - CEO*

So thank you all for participating in this Q2 call. I just wanted to finish by saying that we all look forward to seeing you and to meeting you personally in the beginning of September and in the last part of this year.

We'll be sharing the details with each one of you in terms of our new name; our new corporate identity; the details around our play-to-win strategy, which is our 5-year plan in terms of where we want to allocate capital, what kind of returns, EBITDA margins we should be expecting over the next 5 years.

We look forward also for you to meet our new management team members, both at the functional level and at the business group level. Again, we are convinced about the long-term prospects of the company. And we are working to unlock value in everything that we do from a capital allocation, people allocation and risk-mitigation measure.

With that, let me turn it over to you, Jake, and thank you all. And again, Rodrigo, thank you. I will look forward to continue working with you.

Operator

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

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