بروج
Borouge

Borouge H1/Q2'23 Earnings Call

CORPORATE PARTICIPANTS

Samar Khan – *Borouge – VP Investor Relations*

Hazeem Sultan Al Suwaidi – *Borouge – Chief Executive Officer*

Jan-Martin Nufer – *Borouge – Chief Financial Officer*

Rainer Hoefling – *Borouge – Chief Marketing Officer*

Dr. Hasan Karam – *Borouge – Chief Operating Officer*

PRESENTATION

Samar Khan – *Borouge – VP Investor Relations*
A warm welcome to everyone, and thank you for joining us today. My name is Samar Khan, and I am the Vice President of Investor Relations at Borouge. With me today, I have Hazeem Al Suwaidi, our CEO; Rainer Hoefling, Chief Marketing Officer; Jan-Martin Nufer, Chief Financial Officer; and Dr. Hasan Karam, Chief Operating Officer.

We will now begin with a short presentation by the management team in respect to performance for the period, as well as our outlook for the second half of '23. We will then open the call to your questions. I'll hand over to Hazeem, our CEO, to discuss highlights from Q2 and the first half of the year.

Hazeem Sultan Al Suwaidi – *Borouge – Chief Executive Officer*
Thank you, Samar, and thank you all for joining us today. Q2 has been a challenging quarter. Yet, Borouge has managed to deliver a resilient performance supported by healthy sales volumes, premia above management guidance, and a strong impact from the Value Enhancement Program.

Borouge has posted a net profit of $231 million in Q2, representing an increase of 16 percent quarter-on-quarter. On a year-on-year basis, net profit was down 53 percent, primarily because of a 25 percent decline in average selling prices over the period. On a half-yearly basis, revenue is down 19 percent, to $2.8 billion in the first half of 2023, versus $3.5 billion in the first half of 2022, primarily due to a 22 percent decline in prices during this period.

The Value Enhancement Program continues to perform strongly, having contributed $253 million in the first half of 2023. And it is well-positioned to achieve its $400 million target by the year-end. Strong cash conversion and robust balance sheet support our commitment to pay $1.3 billion in dividends for 2023. The Board has recommended an interim dividend of $650 million, expected to be paid in the second half of '23.

I'll now hand over to Rainer, to discuss the market and provide an update on pricing and premia.

Rainer Hoefling – *Borouge – Chief Marketing Officer*
Thank you, Hazeem, and good afternoon, everyone. Average selling prices across polyethylene and polypropylene were down 25 percent from the exceptionally high price levels in Quarter 2 2022. On a quarter-on-quarter basis, average selling prices were down only 3 percent. Despite this challenging environment, Borouge was able to command healthy premia over benchmark prices, reflecting the company's strong market positioning in key segments. In Quarter 2, premia were maintained above the

over-the-cycle guidance for both polyethylene and polypropylene. The premia for polyethylene was $249 total per ton, down 6 percent on a quarter-on-quarter basis. Premia for polypropylene was $150 per ton, up 9 percent on a quarter-on-quarter basis.

The outlook for polyolefins for the remainder of 2023 remains cautious, and market analysts anticipate a narrow band of price volatility during this period. Global economic uncertainty remains, and a slow recovery in Chinese and Asian markets expected.

We reaffirm the existing through-the-cycle guidance for a premia of $200 per ton for polyethylene and $140 per ton for polypropylene, which is made possible by our differentiated product mix and our ability to capture tactical and regional pricing opportunities.

I will now briefly discuss sales for the period before I ask Hasan to take us through some operational highlights from the second quarter. Quarter 2 2023, sales volumes are up by 4 percent versus the prior quarter, following the completion of the Borouge 2 planned turnaround. Our sales volumes from energy and infrastructure solutions represents 40 percent of polyolefin sales volumes in Quarter 2. This is part of Borouge's strategy to focus on durable products for industrial applications. Specifically, sales volumes of PE-100 and XLPE, key premium products used in pipe, and wire and cable applications have contributed positively to the overall sales mix outcome. The Asia Pacific market continues to be the largest destination for sales, with 66 percent of total sales volume, followed by the Middle East and Africa, with 27 percent.

I hand over to you, Hasan, now.

Dr. Hasan Karam – *Borouge – Chief Operating Officer*
Thank you, Rainer. And good afternoon to everyone. In Quarter 2 2023, production operated at a very high utilization rate of 110 percent and 99 percent for both PE and PP, following the successful completion of our Borouge 2 turnaround which was being conducted in Quarter 1. However, the olefin conversion unit, which allowed Borouge to internally produce a large amount of the propylene from the ethylene, it also operated at a high utilization rate in Quarter 2. Ethylene is typically prioritized for used in maximizing the PE production, and additional quantities are sent to the OCU.

I will now hand over to Jan-Martin, to discuss our financials.

Jan-Martin Nufer – *Borouge – Chief Financial Officer*
Thank you, Hasan, and good afternoon, everyone. I'll be brief on this slide because we have already covered the main reasons for the impacts across our income statement metrics. As Hazeem mentioned, Q2 revenue increased by 2.5 percent quarter-on-quarter, to $1.4 billion, and declined on a year-on-year basis by 24 percent. Net income stood at $231 million in the second quarter, increasing by 16 percent versus Q1, but decreased by 53 percent compared to Q2 2022. On a half-yearly basis, revenue is down 19 percent, to $2.8 billion in the first half-year of 2023, versus $3.5 billion in the first half-year 2022, primarily due to a 22 percent decline in prices during this period.

While top and bottom-line performance in Q2 experienced pressure, on a year-on-year basis, due to significant lower comparative market pricing, we delivered a healthy EBITDA margin in Q2 of 37 percent, up 10 percent from Q1, reflecting improved operational efficiencies.

Pressures created by market weakness are partially offset by the positive impact of the Value Enhancement Program -- we will delve deeper into that in the upcoming slides -- as well as by healthy sales volumes and the resilience of our pricing premia versus product benchmarks.

Onto the next slide, then. We will now look at our costs, an area where we have made important and material progress. Our overall cost base declined by 9 percent as compared to Q2 2022. Cost of sales declined on both a quarterly and yearly basis. Despite higher volumes, we have been successful in reducing our selling and distribution expenses in Q2, recording a decline of 44 percent year-on-year, primarily because of lower freight costs. General and administrative expenses increased quarter-on-quarter, mainly attributable to one-off non-recurring items. Borouge's first quartile position on the cost curve is an important component that, when combined with improved premia against benchmarks, supports a strong margin profile.

I am happy now to discuss the progress on our Value Enhancement Program. As we have communicated at the beginning of the year, we have introduced a very significant $400 million.Value Enhancement Program to support future growth opportunities, enhance our competitive positioning, and to offset the impact of macroeconomic challenges and pricing pressures. In light of the current challenging market conditions, our focus is on managing proactively, conversion, logistics, and fixed costs, as well as revenue optimization.

I am pleased to report that we have achieved a total EBITDA contribution of $253 million in the first half-year of 2023. In terms of the areas where this has been realized, over one-half has been realized through the reduction of logistics-variable costs, almost one-third from revenue optimization, and the remaining from reductions to fixed costs and conversion variable costs.

This has been an excellent start of our highly ambitious program, and we look forward to providing you with further updates on the progress during the coming quarters.

Onto CapEx and cash flow. Cash conversion in Q2 increased to 96 percent, versus 82 percent in Q1, due to a lower maintenance CapEx following the successful completion of the Borouge 2 turnaround in Quarter 1. Net debt, as of the 30th of June 2023, stood at $3,167 million USD, versus $3,277 million USD as of the 31st of March 2023.

I am also pleased to share that Borouge 4, which is being built by the company's major shareholders at ADNOC and Borealis, has reached an important milestone in completing the project funding through a combination of equity, shareholder loans, and the recently-finalized long-term ECA financing.

I will now hand over to Hazeem to summarize and conclude.

Hazeem Sultan Al Suwaidi – *Borouge – Chief Executive Officer*
Thank you, Jan-Martin. As mentioned earlier, we are currently navigating a challenging market environment. We expect polyolefin pricing to experience some continued volatility, looking ahead at the remainder of 2023. Despite this, we are well-positioned to maintain premia in our markets. As such, we reiterate our over-the-cycle premia guidance of $200 per ton for PE and $140 per ton for PP. We expect strong results from our Value Enhancement Program, to continue for the remainder of the year.

We remain focused on our differentiated product mix, which is one of our key competitive advantages and important value driver. We expect production volumes to remain at high utilization levels, and the OCU will be maintained at a high capacity to continue to support our margin enhancement.

As our results have shown, our business continues to be resilient within a challenging operating environment. Our ambitious Value Enhancement Program is tracking ahead of schedule, delivering strong cost savings and supporting efficiencies and margins. Our commitment to product innovations and differentiations continues to enable sustained premia over benchmark, despite a weaker pricing environment. We are pleased to reaffirm our dividend commitment of $1.3 billion for 2023, with an interim dividend of $650 million, recommended by the Board for payment in the second half of 2023.

I would like to refer to the recent report that our majority shareholders have entered into formal negotiations regarding a potential merger of Borouge and Borealis. Borouge will make the necessary disclosures to the market if and when required. In full compliance with regulatory obligations, any final decisions will be subject to the governance processes of Borouge and other relevant parties involved.

With that, we will open the floor for any questions.

Call Operator:
Thank you. If you would like to ask a question, you may do so by pressing star, followed by 1, on your telephone keypad. To revoke your question, please press star, followed by 2. When preparing for your question, please ensure your phone is unmuted locally.

Our first question comes from Waleed Jimma from Goldman Sachs. Your line is now open. Please go ahead.

Waleed Jimma– *Goldman Sachs*
Hello. Good afternoon, and thank you for your presentation. I just have a couple of questions that I would like to ask on behalf of Faisal First, we noticed that second quarter sales volumes were lower versus expectations. Our understanding that, during the first quarter of 2023, there was a 2,000-ton negative impact on volumes due to the B2 turnaround, but it seems that this was not fully reversed during Q2. Do you mind sharing some color on this and how do you think we should look at volumes, looking into Q3 and Q4? That's for my first question.

As for the second, the company's Value Enhancement Program contributed $253 million in EBITDA during the first half of 2023, versus $400 million expected for the full year. Do you expect any upside potential to this full-year target, now that it's already running ahead of schedule, as mentioned during the presentation? Thank you very much.

Hazeem Sultan Al Suwaidi – *Borouge – Chief Executive Officer*
Thank you for the question. I would like Rainer to answer the first question, please. And then, Rainer -- sorry, the first one is Rainer. And the second one is Jan-Martin, please.

Rainer Hoefling – *Borouge – Chief Marketing Officer*
Yeah. So, on the volume side, I think, first of all, when you talk about volume, when we talk about polyolefin volumes, right, the polyolefin volumes remained up, accordingly to the presentation, from Quarter 1 to Quarter 2, after the turnaround. So, here, we are fully on-plan, where we want to be, right? And going forward, we expect, nevertheless -- the market is difficult, and it's a tough sales process for the time being -- but that we can keep the volumes stable in Quarter 3 and Quarter 4, so that we are going to sell also, while targeting to produce.

But on the ethylene sale side, this went down because we would send the ethylene, of course, for our production, because it is not in our intention to sell ethylene, right? Only when something is left. The focus is on the polyolefin side. But here, stable sales.

Jan-Martin Nufer – *Borouge – Chief Financial Officer*
Yeah. Yeah. Thank you. Thank you, Rainer. And maybe, just from my side, a couple of words to the question related to the Value Enhancement Program. Indeed, I think we're very pleased that we have, first of all, started the program very early, with some immediate measures. And the $253 million contribution just for this year is already a very good start. So, the categories that we have been looking into the control of the OpEx are progressing well. So, indeed, I think there is a good chance that we reach and over-achieve the target of $400 million that we have been setting. It's work, obviously, on a large number of projects in the sub-categories that we're having, in terms of the logistics costs, the conversion costs, and the fixed costs.

But as I said, you know, the program is running very well, and we're going to continue to give updates on a regular basis. Well on-track to achieve or overachieve towards the end of the year.

Waleed Jimma– *Goldman Sachs*
Thank you. Thank you very much.

Call Operator:
Thanks, Waleed. Our next question comes from Ricardo Rezende from Morgan Stanley. Your line is now open. Please go ahead.

Ricardo Rezende– *Morgan Stanley*
Hi. Good morning, all, and thanks for taking my question. My first question -- and I don't want to be -- sound too repetitive, as I made the same question in the first quarter call. Well, it's related to the premia. And we've just seen quite -- some healthy product premia, even though the overall market is quite challenging. So, if you could please elaborate a little bit more on -- why do we keep seeing such a good premia, even though the benchmark prices are still struggling, and how should we think about the relationship between the premia and the benchmark prices?

And then, the second question is a follow-up, just on the ethylene volumes. And when we see that -- you mentioned that we should continue to see the plants running at very high utilization rates for the rest of the year. Does that mean that, probably, we won't have a lot of ethylene volumes to be sold to the third parties? Thank you.

Hazeem Sultan Al Suwaidi – *Borouge – Chief Executive Officer*
Thank you, sir. I suggest the first question go to Rainer, and the second one to Dr. Hasan, our Chief Operating Officer. Go ahead, Rainer.

Rainer Hoefling – *Borouge – Chief Marketing Officer*
Yeah? Okay. Thank you very much for the question. But first of all, the benchmark prices, they refer to the most common-grade produced and transacted in the market in Asia, in Asia North. Right? And what you see is that we can maintain over-the-cycle guidance, the $200 and then -- $140 on polypropylene and $200 on polyethylene. Right? It was good in the quarter -- in Quarter 2, with $249, $150. And even polypropylene, then, went a little bit up.

There are several reasons for this, why we can give, also, this guidance. There's -- but there's, of course, no guarantee. That is on a month-on-month basis, always. Over -- the guidance is a guidance over the cycle. But there is different reason. Right? What we've elaborated, already, several times -- it's the technology. We have good technology, a robust, unique technology that we can produce differentiated products. So, we have good innovation capability.

And in the differentiated products, we go into market. We list in durable markets. It's around 40 percent of the sales. This is pipe. And it's also the wire and cable business. And in the packaging -- if you go in agriculture, healthcare, and these elements, we try to differentiate so that these products don't go so fast down with the market, as the commodity prices go down.

On the other hand, when the price goes up -- also, these products go a little bit slowly up. But then, perhaps, the commodity prices, they are not so volatile. And this is the reason why, over the cycle, we can also keep these premia available.

And secondly, sir, we have also on our innovation portfolio, [untranslated] in 2022, and now looking forward to 2023. Around 20 to 25 percent of our products are new products. Right? So, when a product is at end-of-life, we come with a new innovation, right? Sometimes it's incremental improvement. Sometimes it's change improvement, just to keep this differentiation high.

Then, you have the regional set-up. We can also decide -- little bit technically, in which regions the shipping our material and where we get the higher price levels. And with this development based on the technology, based on how they go into the market with the direct sales and the logistic capabilities, then at the input we have, we can achieve these premia.

And you look a little bit in Quarter 3, if to see -- to say now they're -- the price is coming up a little bit on the commodity side. You will see a little bit of compression on the premium in this time because we need to then catch up also on the prices on the differentiated and the specialty prices. That takes a little bit longer than -- to catch up again. But over the cycle we can keep these this premia.

[audio break]

Dr. Hasan Karam *– Borouge – Chief Operating Officer*
Thank you. I think for the second question with regard to the ethylene exportation versus the -- sending it to the downstream I think we are -- given that we are margin and value driven, so what you want is the ethylene molecules available, our target to maximize to all PE and PP and look into our Reliability Enhancement Program where we can be proven in Quarter 2 that was PE and PP, are 110% and 99% respectfully.

Our aim is to maximize it all the ethylene molecules to all the PE and PP. That can generate more value and can generate more margin rather than spotting. Looking to the coming quarters with the very successful completion of our recent Borouge 2 . I think -- and I believe that our PE and PP downstream can sustain the high reliability which can convert all the ethylene molecules to the PE and PP. Thank you.

Ricardo Rezende*– Morgan Stanley*
Thank you very much.

Call Operator:
Thanks, Ricardo. Our next question comes from Prateek Bhatnagar from HSBC. Your line is now open. Please go ahead.

Prateek Bhatnagar*– HSBC*
Yeah. Thanks for taking my question. I have three. The first one is basically on demand. Do you see any improvement in demand from China on polyolefins? The second is basically on -- for modeling purpose. Going forward, should we as you -- your polyolefins conversion unit will continue to operate at hundred percent of capacity? So that's your second question. And third one is the elephant in the room on the Borouge Borealis merger. Has there been any consultation with you on this? We've seen your boss announcement, but has there been any development because of consultation with you on the merger? Thanks.

Hazeem Sultan Al Suwaidi *– Borouge – Chief Executive Officer*
Thank you, sir. So the first question to Rainer.

Rainer Hoefling *– Borouge – Chief Marketing Officer*
Yeah.

Hazeem Sultan Al Suwaidi *– Borouge – Chief Executive Officer*
On demand? And the second one, olefins, to Dr. Hasan, please, the converting of olefins. And then -- I will take that up, the last question. Okay.

Rainer Hoefling – *Borouge – Chief Marketing Officer*
So let's take the first question and give a little bit then, perhaps not only on demand, a market update. So first of all, obviously, of course, what you also see that the global economy remains soft. So flood inflation, high interest rates up. And when you look closely at the PMI indexes globally by the June manufacturing PMI, they showed that in the U.S., in Eurozone was in China and APAC. They are still in a contraction. Still, when you look at the activity in both those core regions, the markets, they are better than the others but still a soft spot and slower than expected. China is recovering slower.

The economy data fell short those when the expectation of the PMI index on the 49,weak growth. This is accompanied also with the uncomfortable inflation in the world. With all said, then this limits then the export activities in China with impact also on South East Asia. So the consumer spending is still relatively cautious in China. And China pledged some consumer stimulus to boost the consumer spending. But nevertheless, there is still some reservation of the stimulus impact in the second half year. And we don't see yet a really big bang stimulus package out in the market for the time being. So the expectation is that on the demand side, it's very slow - It's a slow growth but slower than what we would have expected. But it's still growing at little bit.

So on the -- this has of course then had an impact on the price side. The combination with feedstock what we have seen in the last couple of months, then the prices came down. We see a bit of a dip on prices now in July. Going forward, oil coming up a little bit, naphtha coming up a little bit, propylene coming up a bit, propane coming up a bit. Also, you will see, I think that the dip is -- should be reversed then in July, coming up from a price by a little bit, but not too much. Right? This will -- associated with the volatile in a relatively narrow band.

The marginal producer coming under pressure now because the feedstock prices are getting too high. So they will see some stepping out of production, but that has helped pricing ramping up a little bit. But as soon as they are up, then they start producing again, and it's coming down. So it has its limits.

So we are quite cautious. It is not a step change demand growth to be expected. The supply remains healthy, so we'll be better in our capability. On the differentiation, how we were setting up our marketing and then sales organization and our logistics, combined with a good production that they keep the volume stable and keep generating premium. That's a little bit of an overall market perspective.

Dr. Hasan Karam – *Borouge – Chief Operating Officer*
Yeah. Thank you. Rainer, I think for the second question with regard to the OCU maximization? The target of which is to maximize the OCU in order to produce the propylene internally, which can push back expensive propylene And looking forward for the -- our OCU reliability, which we are more than 96%. With the available ADNOC Gas ethane we will ensure that the OCU for the next process will be at maximum capacity to the end of the year. Thank you.

Hazeem Sultan Al Suwaidi – *Borouge – Chief Executive Officer*
Thank you, Rainer and Dr. Hasan. In regards to the merger with Borealis, these discussions are currently being carried out between our major shareholders: Adnoc and Borealis. Major shareholder, OMV. But we will make the necessary disclosures for the markets if and when required in full compliance with the regulatory obligations. Any final decisions would be subject to the governance processes of Borouge and other relevant parties involved. And this is what we would like to communicate for now.
Female Speaker:
Thanks, Prateek. As a reminder, if you would like to ask a question, please press star followed by one on your telephone keypad. My next question is from Shadab Ashfaq from Al Ramz. Please go ahead when you're ready.

Shadab Ashfaq– *Al Ramz*
Hello. Thank you for the presentation. My first question is regarding the Chinese market. So currently the recovery in China is lower than what it was expected and -- but at the same time, how the recovery will improve, the Chinese capacities are coming online. So how will it play out that the Borouge 4 is also coming. So will it yield oversupply or the demand is sufficient to control this thing? And on the second question, in the international expansion, so the company is excluding any international opportunities because over the next two years we are looking at the -- already the utilization is close to 100% and the new capacity will be added in 2025. So for the next two year, we are not expecting any significant increase in the capacity. So is the company looking at international expansion to give inorganic jump in the volume? Thank you.

Hazeem Sultan Al Suwaidi – *Borouge – Chief Executive Officer*
Thank you, sir. Rainer, you can take the first one. I'll take the second one.

Rainer Hoefling – *Borouge – Chief Marketing Officer*
Yeah. So as, if you look at the short term, they were significant capacity coming on stream, specifically also on China, polyethylene but also in the U.S. This will continue still this year, right, coming as next year, and then it's slowing down. With this, I have to agree that the -- combined with the demand operating rates were coming down and that puts pressure on the market. And this is what you'll see also on the price side versus last year, same period. And it's a significant difference.

So towards '24, I think we need to still accept that will be a stretch year. But then in '24, beginning '25, the operating rates start to get better. So in the longer run, later on in the next couple of years, this is a -- this will be a good industry to be in and further to be in and to push for work. I've always said in 2026 is coming. It's coming to the right time. Right? Where the demand is there. And so supply is not sufficient to satisfy the demand. And so all over the cycle, I think it's good short term to be a stretched market.

Shadab Ashfaq– *Al Ramz*
Thank you.

Hazeem Sultan Al Suwaidi – *Borouge – Chief Executive Officer*
And just on the question on international expansion, I think we made a statement on this. Basically, we in Borouge, we continue to explore growth opportunities through international expansion as mandated by our board of directors. Thank you.

Shadab Ashfaq– *Al Ramz*
Thank you.

Call Operator
Our next question comes from Afaq Nathani from international securities. Your line is now open. Please go ahead.

Afaq Nathani– *International Securities*
Hi, good afternoon. Thanks for taking my question. Just want to understand the overall, motivation behind this potential Borealis and Borouge merger. And I know this is something being dealt by ADNOC directly, but just what is the idea behind it and what benefits are the management looking at? Will Borealis have access to cheaper ethane? Is it even possible to ship it that far? If it's in terms of synergies, then what kind of synergies can we potentially see, considering that, you know, the operations are continents apart? Just an overall idea on how this entire thing could pan out would be very helpful. Thank you.

Hazeem Sultan Al Suwaidi – *Borouge – Chief Executive Officer*
Thank you, sir. And I wish I can give more details on this question. But as we made a statement, this is still under discussion, and we will be definitely able to share with you more details in due time that we feel that is clear. More details to be shared. Thank you.

Afaq Nathani– *International Securities*
Thank you.

Call Operator:
We have no further questions registered at this time. So with that, I'll hand back to Hazeem Sultan Al Suwaidi, CEO, for final remarks.

Hazeem Sultan Al Suwaidi – *Borouge – Chief Executive Officer*
I just would like to thank everyone for engaging with us in this Q2 earnings results. And looking forward to see you and hear from you on InshAllah in the near future. Thank you.

[end of transcript]