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+++ presentation

Operator

Thank you for standing by and welcome to the Petronas Chemical Group's second quarter FY2016 analyst briefing. At this time, all participants are in a listen-only mode. There will be a presentation followed by a question and answer session.

Edward Ong, Head of Investor Relations

Good evening, good afternoon and good morning. Thank you very much for making the time to be on the call with PCG today. We have Datuk Sazali Hamzah, Chief Executive Officer; Rashidah Alias, Chief Financial Officer; Yusri Yusof, Head of Manufacturing; Akbar Thayoob, Head of Commercial; Abdul Aziz Othman, Head of Strategic Planning and Ventures. And my name is Edward Ong, I do Investor Relations for PCG. Without further ado, I'd like to turn this time over to Datuk Sazali Hamzah - Chief Executive Officer for his opening remarks.

Datuk Sazali Hamzah, Chief Executive Officer

Thank you, Edward. Good evening, everyone. I'll start with 2016 continues to be a challenging year for PCG. Brent crude oil price may have risen to \$46 per barrel in Quarter 2 2016 yet it remain 27% lower compared to Quarter 2 2015 at \$63 per barrel. The average for the first half of this year is about \$40 per barrel which was lower than \$59 per barrel in the same period last year.

The petrochemical market continued to see long supply particularly in the F&M sector and cautious buying in the O&D segment. Consequently, petrochemical product

price fell 25% compared to the same period -- same quarter last year which resulted to lower spread. On operation, PCG remained resilient and sustained our world-class utilisation as we delivered our production and sales target. In the second quarter this year, I am proud to inform that our operation performance has further improved to 95% plant utilisation.

More volume was available to the market with strategic shift being made to target industries hence driving higher margin. As a result, I am pleased to report that despite the lower product price affecting Group revenue, EBITDA for the quarter rose 11% year on year at MYR1.2 billion. EBITDA margin was also strong at 38%. Excluding the one-time Elastomers project write-off, profit after tax would also be 21% higher.

For more detail on the financials, I would like to pass the session to Rashidah. Rashidah.

Rashidah Alias, Chief Financial Officer

Thank you, Datuk Sazali. Good evening, everyone. For reference on the quarterly financial performance, please refer to slides 5 and 6 for the comparative quarter's performance. For your ease of reference, on slide 5, the patterned bar denotes revenue and the solid bar refers to EBITDA and boxed above the bars are their respective EBITDA margins. On the left is the Group performance and on the right are the segmental performances.

So moving on please refer to slide 5 for the comparison against the corresponding quarter, Quarter 2 2016 versus Quarter 2 2015. For Quarter 2 2016, Group revenue declined by 3% at MYR3.2 billion despite the higher sales volume mainly due to lower petrochemical product prices. However, EBITDA rose 11% against the corresponding quarter contributed by higher volume and stronger US dollar. EBITDA margin saw a 5 percentage point rise to 38%.

Breaking down to the segments, the O&D segment product prices were lower in Q2 2016 compared to Q2 2015, impacted by the decline in crude oil prices and softer market demand. Subsequently, revenue for the segment declined by 9% to MYR2.1 billion but EBITDA jumped 13% again supported by higher volume and stronger US dollar. EBITDA margin for the segment rose to 41%.

The F&M segment saw lower urea prices due to ample supply and weakening methanol prices. However, revenue for the segment increased by 11% to MYR1.1 billion on higher volume. EBITDA for the segment also jumped 12% supported by the stronger US dollar though EBITDA margin remain unchanged at 34%.

Next on performance against preceding quarter, which is Q2 2016 versus Q1 2015 still on slide 5. Now for the quarter under review, Group revenue increased 2% to

MYR3.2 billion on higher sales volume in line with the higher plant utilisation rate of 95%, which more than offset the impact of a weaker US dollar. EBITDA increased 5% to MYR1.2 billion with improved product spreads and higher volumes. Consequently, EBITDA margin rose to 38% from 36% in the previous quarter.

As to the segments, O&D product prices saw a slight improvement with firmer crude oil prices during the quarter. However, segment revenue declined by 5% to MYR2.1 billion on lower volume primarily due to turnaround activities at PC Aromatics. EBITDA increased 7% on improved product spreads and consequently EBITDA margin for the segment surged 5 percentage points to 41%.

With improvement in methane supply, the F&M segment saw higher sales volume. This translated to a revenue increase of 17% to MYR1.1 billion from MYR935 million. EBITDA for the segment grew by 10% to MYR373 million driven by higher volume. However, EBITDA margin declined 2 percentage points to 34%.

Moving on to our profits on slide 6, if you recall in the last quarter we announced the cancellation of the Elastomers project and will be taking a write-off in this -- in the second quarter. The final amount written-off is MYR241 million and as a result our profit after tax came in at MYR533 million, 17% lower than the same quarter last year. Excluding this write-off, profit after tax would have been MYR774 million, an increase of 21% year on year.

Now a quick run through of the half-year performance for the six-month period ended 30th June 2016. Please refer to slides 7 and 8. Compared to the corresponding period, plant utilisation rose 10 percentage points to 94% supported by higher feedstock for both methane and ethane, resulting in a 13% increase in production volume. Revenue for the period declined a marginal 1% to MYR6.3 billion as the higher volume and strong US dollar cushioned the impact of lower petrochemical product prices. Now despite the lower revenue, EBITDA increased 7% to MYR2.4 billion on higher sales volume and favorable foreign exchange impact. Consequently, EBITDA margin improved 3 percentage points to a strong 37%.

For the first half of the year, our profit declined by 8% at MYR1.2 billion compared to MYR1.3 billion in the first half of last year primarily impacted by the write-off on the Elastomers project. Excluding the write-off, profit for first half of 2016 would be MYR1.4 billion which is a 10% increase compared to last year.

Moving on to our cash flow and cash balance, please refer to slide 9. For the six-month period this year, we saw a higher cash generated from our operating activity at MYR1.8 billion. Our cash balance decreased by MYR256 million mainly due to cash outflow related to the SAMUR and RAPID petrochemicals projects.

We also paid out our second interim dividend for year 2015 of MYR0.10 per share earlier in March this year amounting to MYR800 million. Currently, at MYR8.5 billion, our cash position remains strong and we are committed to continue investment in our growth plans.

And that concludes my presentation. I now hand over to Yusri for the key operational highlights.

M Yusri M Yusof, Head of Manufacturing

Thank you, Rashidah. Good evening, everyone, Yusri here. I'll take us through operational performance. You can refer to slide 10. Operationally, we have shown steady improvement in maximizing our plant capacity over the last few years. For the quarter, operational performance was better following good plant reliability and higher utilisation on the back of stable feedstock and flawless TA turnaround execution. Quarterly plant utilisation was 95% which was 3% better than preceding quarter and 22% better than corresponding quarter. In fact, Quarter 2 2016 was the best quarter plant utilisation since our listing in 2010.

Now if you move to slide 11 I'll share some highlights during the quarter. In the first diagram on the left, it's about recent turnaround activity. Following successful completion of turnaround in our PDH plant, propane dehydro plant in Quarter 1 we continued with the TA activities at our PC Aromatics in Quarter 2. In both turnarounds this year, systematic plan was successfully executed through better coordination strategy, improved contractor management which includes safety and competency readiness and assessment.

The level of competency among the teams has also improved. Thus, as they have matured along with our system enhancement it has improved in the -- we have improved in the execution of the turnaround. As a result, we recorded shorter execution days in both turnaround compared to the initial plan. Both quarterly and year-to-date results were 6% better than planned.

On plant utilisation, our focus on reliability strategy both internal and external has significantly improved the plant utilisation this last quarter. So operational transparency, we have a better avenue for collaboration, cooperation and collective decision making across the value chain for better production.

If you look at the middle diagram on our methanol production network, the commissioning of Dalak pipeline and higher reliability of our own methanol plant has resulted in methanol production improving by 24% from Quarter 1 and 20% as compared to the same period last year and this has greatly contributed to our stronger revenue stream.

While for ethylene, depicted in the last diagram of the page, the production volume was 8% higher than Quarter 2 and 27% higher as compared to the same period last year. With reliable gas plants and both cracker performance we were able to sustain better ethylene productivity throughout the first half of 2016.

As a conclusion, a healthy environment of feedstock supply and reliable processing assets are important for efficient productivity. The framework of our full operation excellence journey has significantly shaped our deliverables to suit the economic forces. Our journey will continue to strike a positive setting of Health, Safety and environment, operational management system and capability growth for sustainable production.

I believe we will continue to experience operational success in 2016 and meet our operational target. Moving forward, we are committed to execute our last scheduled turnaround planned for this year which is going to be at ABF and we hope to execute that successfully and accomplish what we have done in the recent two turnarounds.

That's all that I have for operational highlights. I would like to hand over to Akbar for the market performance and outlook.

Akbar Thayoob, Head of Commercial

Thanks, Yusri, and good evening, everyone. Akbar here. I'll first touch on the overall petrochemical market environment in Quarter 2 and how we at PCG see the overall market behaving in Quarter 3. Thereafter, I will share with you our reading of the market for each product under both the O&D and F&M segments as we enter Quarter 3.

Overall prices have improved in Quarter 2 2016. For O&D products, prices recovered and strengthened on the back of stabilizing crude oil and naphtha prices. This is supported by limitation of ethylene supply and restocking activities prior to Ramadan festivities, especially in Malaysia and Indonesia. Methanol has also gained from the firm ethylene prices as MTO or methanol-to-olefin producers ramped up their production. For urea and ammonia, prices have remained at similar levels given the restricted supply that offset the weak demand in China and limited inventory stocking in India.

Now moving into Quarter 3 2016 we anticipate the market for O&D to stabilize on the back of regional supply shortage despite the weakening demand and uncertainties of energy price movement. Meanwhile, fertilizer market is expected to be quite challenging in view of ample supply coupled with weaker demand. Methanol price, on the other hand, is anticipated to remain stable as we foresee firm -- the demand for MTO and MTBE to remain firm.

I will now proceed with our outlook under O&D business segment starting off with ethylene. Ethylene prices have strengthened in Quarter 2 2016 following limited supply availability in Asia caused by heavy turnaround season and strong demand from the derivative sectors. Going into Quarter 3 the average ethylene price is expected to stabilize at a slightly lower level as crude oil price is envisaged to remain weak. However, we anticipate the ethylene price will continue to be supported by tight supply from North East Asia producers.

Moreover, derivative demand in China is expected to pick up as manufacturers in the region will ramp up their production ahead of the G20 Summit in view of the blackout period that will be enforced by local authorities in some provinces. Nonetheless, these bullish factors will be dampened by expectations of increased supply from the South East Asia region upon the restart of two major crackers in Singapore.

Polymers, similar to ethylene, polymer prices saw a positive trend in Quarter 2 2016 resulting from tight supply amidst healthy demand in Asean, given inventory stocking prior to Ramadan festivities. In the earlier part of Quarter 3, buying activity is expected to slow down particularly in Indonesia and Malaysia as the market took a break for the Idul Fitri holidays. Thereafter, polymer prices is assessed to be largely stable to firm in view of seasonal demand supported by limited supply for certain grades of polymer and steady feedstock prices. The same ramp-up of production is expected in China in view of G20 Summit limitations and the anticipation of national holidays in the region.

MEG, in quarter 2, MEG prices have gained from supply tightness caused by a series of production woes at several ASEAN MEG facilities. Moving to quarter 3, MEG prices are predicted to be initially stable on the back of restocking activity, which is anticipated to take place prior to the G20 summit. However, it might be difficult to hold on to this level of prices as there do not seem to be any major turnarounds for MEG plants in August as well as the unclear market direction.

Moving on to aromatics, prices have gained ground in Quarter 2 as the result of huge capacity loss in the market from spring turnaround season at several North East Asia producers. And this is further reinforced by the resilient downstream demand. It is foreseen that prices will stabilize in Quarter 3 2016 on the back of stable run rates and downstream PTA. With a major part of the Chinese market being forced into either shutdown or reduced production in preparation for the G20 Summit in September, producers across the value chain are expected to improve the operating levels in July consequently improving demand.

However, this spike in demand is unlikely to hold up tracking increased supply availability due to the impending restart of a major Singapore producer in August. Additionally, there will be no major scheduled turnarounds throughout this period and production is likely to be ramped up in North East Asia and South East Asia.

Moving on to the F&M business segment and I shall start with urea. Despite turnaround activities at several producers in the Middle East, urea prices remain at similar levels in Quarter 2 due to lack of buying interest in China and limited inventory stocking in India. We anticipate prices to soften in Quarter 3 following global surplus that is close to about 2 million metric tons from July through September that provides limited possibility of price recovery. In addition, reduction of demand in China and cautious buying sentiment in the US due to the low planting season will further cap urea prices.

For ammonia, prices have stabilized in quarter 2 following supply tightness which gave upward pressure on ammonia prices as Middle Eastern producers underwent turnarounds alongside weak demand for downstream caprolactam.

The market for ammonia is predicted to be bearish in Quarter 3 as fears of oversupply in South East Asia and limited demand weigh heavy on the market. In addition, the July Tampa price fell below \$300 per metric ton which was previously considered as the floor in -- due to the Midwest low demand and new production facilities coming up.

On a similar note for methanol, prices have strengthened in Quarter 2 drawing support from tight supply conditions following shutdowns in the Middle East together with heightened demand for MTO application. We foresee prices to stabilize in Quarter 3 as demand for MTO applications and MTBE remain resilient although this sentiment is moderated by ample supply from all major plants within the South East Asia region.

Methanol downstream demand is predicted to be stable as formaldehyde and acetic acid plants are operating at rates hovering around 70%.

In summary, we anticipate the market for O&D to be stable as supply shortage continues to confront the region despite weakening demand on the back of continuous uncertainties in energy prices movement. Fertilizers market is expected to remain challenging in view of ample supply coupled with weaker demand. Methanol price on the other hand is predicted to remain stable as a result of firm demand for MTO and MTBE.

All in all, we are expecting a tougher market moving into Quarter 3 2016. However, we feel prepared for this as we have embarked on our commercial excellence initiatives that have ensured sustainable sales for PCG so far. And on that note I would like to share some of our achievements in the first half of 2016.

Against the uncertain market environment from Quarter 1 to Quarter 2 2016, we recorded good overall performance, mainly through focused execution of

commercial excellence initiatives that is in our strategic volume shift, price excellence and portfolio optimization.

In strategic volume shift, we have moved volume from a lower margin to higher margin geographic market. In pricing excellence, we now have a more disciplined price-setting mechanism as we benchmark our market prices for targeted products. We will continue to command good premium above benchmark prices as well as optimize our product within the business to bring better value to the overall portfolio.

Looking forward, while we continue to put efforts in delivering the earlier-mentioned initiatives we will also put emphasis on the following efforts to maintain our commercial excellence performance.

First, implementation of a more wholesome key account management where we will develop a -- customized account plans for identified key customers.

In indirect channel optimization, we are now looking at better management of our distributor performance to ensure value are not being left on the table.

Improvement in our cost to serve where we optimize our logistic rates through effective sourcing, reducing ancillary costs and delivery schedule optimization.

And, ladies and gentlemen, that concludes my update on the commercial front. Back to you Datuk on our key focus areas.

Datuk Sazali Hamzah, Chief Executive Officer

Thank you, Akbar. Ladies and gentlemen, PCG is committed to deliver the year-end operational and commercial excellence target despite the challenging business environment. As you can see, we have successfully sustained our financial performance this year so far leveraging on the excellent display of operational and commercial performance. Our aim is to sustain this good momentum until the end of the year and beyond.

Another popular subject on ethane supply contract. PCG has renewed the ethane supply agreement within PETRONAS and PCG Group via its wholly owned subsidiary PETRONAS Chemical Marketing Labuan for further 20 years effective October 1, 2016. The contract renewal ensures the continuous supply of ethane and therefore will guarantee the sustainability of PCG operations. The key term and condition of this ethane supply agreement will maintain PCG competitiveness against other players. This will not have a material impact to the earning or net asset of the Group in the current financial year.

Next, I also would like update on the status of SAMUR and Aroma projects. On the Group front, we are fully focused on getting SAMUR and Aroma Complex ready for commercial operation. SAMUR is currently at 99.6% completed and progressing well towards urea commercial production.

I am very glad to inform you that we have achieved our first on-spec ammonia on July 7, 2016 and follow up with that our first drop of urea has been achieved on August 6, 2016. We are now gearing up to ramp up the plant to achieve a commercial production very soon. The Aroma ingredient complex meanwhile is also undergoing commissioning towards citral commercial production. So we hope we will achieve that by end of the year.

Let me also talk about RAPID petrochemical project progress. At this moment the RAPID petrochemical project consisting of polymers and glycol are also on track at the early start of 4.5% of overall completion.

With that, ladies and gentleman, there may be more uncertainties to come in the second half of the year. PCG will remain resilient and stay focused on reaching our target. I would like then open the floor for question and answer. Edward.

Edward Ong, Head of Investor Relations

Thank you, Datuk. At this time we will be taking questions and answers. We would really appreciate it very much if you could help us by identifying yourself as well as your institution when you ask your question. Fiona.

+++ q-and-a

Operator

(Operator instructions) We will now take our first question from Mohshin Aziz from Maybank. Please go ahead, your line is open. Please go ahead, caller, your line is open.

Mohshin Aziz, Research Analyst, Maybank

Sorry about that. With regards to the ethane supply contract, could you give us information with regards to the price escalation? Was there once-off adjustment followed by any annual escalation? That would be the first question.

Datuk Sazali Hamzah, Chief Executive Officer

Okay, as I mentioned the new supply agreement is effective for the duration of 20 years starting from October 1, 2016. The major part of the key terms remain as the previous contract. The revised term does not have a material impact to PCG. I can't

disclose how much the percentage -- percentage increase as it is a -- remain as confidential. But I would like to highlight here that there will be no material impact to our PCG bottom line.

Mohshin Aziz, Research Analyst, Maybank

What's your definition on material? More than 10% or less than 10%?

Rashidah Alias, Chief Financial Officer

Mohshin, for this year obviously because this will -- take impact or rather start from October 1 so the impact to 2016 is very-very minimal. But for 2017 we expect that to be less than 3% EBITDA impact.

Mohshin Aziz, Research Analyst, Maybank

Okay, thanks for that. Now I'd like to ask a bit on the SAMUR project. Could you refresh us what's the total Capex for the entire project since there was some delays due to the equipment delivery. And then also things like what's the depreciation policy on this particular facility? What sort of annual Capex, maintenance Capex we can expect from this? And also how much natural gas you will consume for every product of urea you produce? That's it from me, thank you.

Datuk Sazali Hamzah, Chief Executive Officer

I think on the Capex side I think we have announced last time it's about--

Rashidah Alias, Chief Financial Officer

One--

Datuk Sazali Hamzah, Chief Executive Officer

MYR1.9 billion .

Rashidah Alias, Chief Financial Officer

1.8

Datuk Sazali Hamzah, Chief Executive Officer

MYR1.89 billion, something like that. And this Capex remain within our target upon the completion of this project despite the extension of this project. And we -- our focus is to make sure that this plant generates revenue as soon as possible in order to

dampen the impact of early operational costs for this project. On the second question just now is --

Rashidah Alias, Chief Financial Officer

Depreciation policy.

Datuk Sazali Hamzah, Chief Executive Officer

Oh the depreciation policy, can you--

Rashidah Alias, Chief Financial Officer

Well, our depreciation policy is similar to other plants, Mohshin. So that on a straight-line basis over the useful life of the plant and typically that carries about 20-25 years useful life because it's componentized depreciation policy. So the component varies. But those are the range of depreciation periods. In terms of annual maintenance, considering that this plant is a new plant so we don't expect it to have a major maintenance Capex during these early years. So maybe Yusri want to say a bit more on that one.

M Yusri M Yusof, Head of Manufacturing

I think a typical rule of thumb if you look at maintenance and maintenance costs it would fit between 1.5% to 2% of the total plant value annually. But obviously as Rashidah mention the early years will be lower as the plant is fairly new.

Datuk Sazali Hamzah, Chief Executive Officer

Another thing also to take note, Mohshin, is that the SAMUR project is designed based on the latest technology available in the market. And with the size of a world-class size we believe that it can be much more competitive with the existing urea plant that we have in PETRONAS portfolio.

Mohshin Aziz, Research Analyst, Maybank

Okay, that's great. Thanks a lot. Just a final question. What sort of natural gas consumption from SAMUR?

Datuk Sazali Hamzah, Chief Executive Officer

Actually it's a range around about 60 mm -- 90 -- about 90 mm standard cubic foot per day for the capacity of about 1.2 million urea per year.

Mohshin Aziz, Research Analyst, Maybank

Okay, thank you.

Operator

(Operator Instructions).We will now take our next question from Alex Goh from AmBank Group. Please go ahead, your line is open.

Alex Goh, Analyst, AmBank

Okay, thank you, I have three questions. First, it's regarding your operating costs. Just looking at your first-half results, your revenue was down by about MYR96 million, but your EBITDA is up, so clearly your operating costs have come down. I'm just trying to figure out what exactly -- where that operating cost saving came from.

The other -- second question would be the plant utilisation guidance which you gave about 90% for the full year. Well, for the second quarter you've said 95%, I just want to see if excluding SAMUR, what would be the shape of your utilisation trend going into third and fourth quarter. And I'm just trying to figure out for your SAMUR plant, what would be your expected utilisation for the first year and later, subsequently the second year of operation? Thank you.

Datuk Sazali Hamzah, Chief Executive Officer

I think the first question is basically the cost saving, why you look at EBITDA is higher, is our profit higher, despite the revenue is lower. I think that's a true observation. As you know, that in the production front the main key ingredient is to run as maximum as possible, because when you do that your production costs will be much lower, the unit production costs because all the fixed costs remain the same, except variable costs that will in tandem with the volume that we produce. So the higher your production is, then the unit production costs will be lower.

Typically -- Yusri can share how many percent on that.

M Yusri M Yusof, Head of Manufacturing

I think if you look at the rough rule of thumb, you compare to last year, we were at 85% utilisation. Year to date we are at 95%, so per metric ton of production because I think we are between 15% to 20% better in terms of production cost efficiency. So that, in addition to other cost saving measures, contributes to the lower production costs that we have this year so far.

Datuk Sazali Hamzah, Chief Executive Officer

And your next question is what is the key contributor of higher utilisation, which we are generally saying around 90%, but it goes to 95%. One of the key factors is not because of SAMUR additional; it's mainly because we managed to retrieve much more ethane from our supply chain. This is part of our continued collaboration with upstream supplier, where the reliability as well as we look at all the possibilities to generate more ethane. As a result O&D products -- production is higher. That's one.

Secondly, with the stable operation of methanol 2 and availability of Dalak pipeline it also have further improved more than what we have targeted for. The question is since this is the first time that we've pushed the unit to the maximum, it's whether we can sustain the maximum operation until end of the year. We at this moment will try as much as possible to keep this performance intact. And in the guidance for end of the year of utilisation, we are saying that we are targeting low 90%.

For SAMUR utilisation first year you know that we only left about Quarter 4, which is only one quarter, normally at this current rate, we ramp up, because we expect there will be a few hiccups here and there while we are doing the performance test run. So we are targeting roughly about close to 70%.

So if you look at -- it's at 70% for one quarter, if you look at total quarters, probably around 25% of the whole quarter -- the whole year. And the second year we will ramp probably be between 70% to 80%, I think that's the range that we are looking at.

M Yusri M Yusof, Head of Manufacturing

I think just to add, for SAMUR (multiple speakers) we do have a warranty shutdown. After 12 months we will be under warranty period, so we have to shut down to inspect and do any necessary activities. So we expect the second year to be, as Datuk mentioned, in the region of 70% to 80% utilisation only.

Alex Goh, Analyst, AmBank

How long would that shutdown take after your warranty of one year?

M Yusri M Yusof, Head of Manufacturing

We are expecting between 40 to 50 days, depending on the scope that we need to undertake. So it will get more defined as the operation goes along over the next couple of quarters.

Alex Goh, Analyst, AmBank

Okay, just to go back to my second question on the plant utilisation, if you exclude SAMUR, I'm just wondering, you mentioned in your guidance of low 90%, I'm just trying to figure out what would bring your plant utilisation lower than say around 95% currently?

M Yusri M Yusof, Head of Manufacturing

Alex, remember I mentioned in -- this is Yusri -- I mentioned in my briefing just now, we still have one turnaround to go, which is at our ABF plant. This is a regulatory turnaround, so that is an activity that is planned and that's also a risk that still remains on our operational plate for the rest of the year. So hence we don't expect to go beyond 95% for the next Quarter 4 and so on. So that's why our year-end guidance still remains around the same level in the low 90s.

Alex Goh, Analyst, AmBank

Okay and for next year in financial 2017, is there any major turnaround activities or planned maintenance that can bring your utilisation below the 90% level?

M Yusri M Yusof, Head of Manufacturing

If you have been following our performance, next year is our major TA activity year. So we are going to have quite a heavy turnaround activity in Kerteh next year. And not to mention we are also going to have our SAMUR warranty shutdown next year. So next year is a heavier turnaround year than this year, we have yet to firm up our plan for next year, but we expect it to have some effect on our facility utilisation.

Alex Goh, Analyst, AmBank

Any guidance? What would you be expecting in terms of 85% range?

M Yusri M Yusof, Head of Manufacturing

I think because if I say something now it will change again next quarter, so let's wait for next quarter as we firm up our plan and then we'll provide the guidance then.

Alex Goh, Analyst, AmBank

Okay, thank you so much.

Operator

Our next question comes from Mayank Maheshwari from Morgan Stanley. Please go ahead, your line is open.

Mayank Maheshwari, Analyst , Morgan Stanley

Thank you for your time today, I had two questions. Firstly, related to the change in the tax rate that you've seen this quarter. Why has this been a bit high, towards the 30% level?

And the second question was related to the new contract on gas supply. Has there been any change in the volume side as well in the new contract so that it helps you expand a bit on the cracker side? Thanks.

Datuk Sazali Hamzah, Chief Executive Officer

On the volume side, it's actually remained the same, in fact we are much more flexible to have a bit higher rate as compared to the previous contract. On the tax rate --

Rashidah Alias, Chief Financial Officer

On the tax front, Mayank, for this quarter we have taken a write-off on the elastomer project. That's about MYR241 million that is in non-tax deductible items. So that pushes up our ETR, or the effective tax rate higher. So excluding that item, that adjustment, it will bring it down -- back down to about, if I'm not wrong, 24%, 25% and that's comparable to the corresponding period.

Mayank Maheshwari, Analyst , Morgan Stanley

I was just thinking if you include SAMUR, I'm assuming they will have the tax breaks of about eight years on this. So how much will be your tax rate going ahead now that SAMUR has started up?

Rashidah Alias, Chief Financial Officer

For SAMUR we have taken some tax break on the pre-operating expenses that was recognized from Quarter 1 of this year. But in terms of the remaining tax break, for example like capital allowances, on the initial capital allowances, that will only commence when we start what we call commercial production, which will happen during the second half of this year. So not yet in Quarter 2 results, so we'll probably see some in the second half.

Mayank Maheshwari, Analyst , Morgan Stanley

So any guidance in terms of when SAMUR is basically fully operational, what could be then new tax rate for you guys?

Rashidah Alias, Chief Financial Officer

The tax rate is the same that we have investment tax allowances incentive and also capital allowances incentive. But in terms of tax rate, it's the same corporate tax rate.

Mayank Maheshwari, Analyst , Morgan Stanley

Yes, but effective tax rate I'm assuming should be lower.

Rashidah Alias, Chief Financial Officer

Yes, precisely.

Mayank Maheshwari, Analyst , Morgan Stanley

Okay, thank you.

Operator

(Operator Instructions).

Our next question comes from Cheong Mun Wai from EPF. Please go ahead, your line is open.

Cheong Mun Wai, Analyst Employee's Providence Funds

Hello, good evening, thanks for the call. I have five questions. The first question is regarding the -- under the MYR56 million of credit in the operating profit relating to the reversal of provision for plant decommissioning and onerous contract. Just wondering if this relates to the elastomer project.

Second question is on the share of associates, the numbers still look very weak, just wondering what is your outlook for the contribution from the associates. When will it pick up again?

On the third question, you say in the notes that for the olefins and derivative division the sales volume was slightly lower, even though the production volume was higher, because mainly due to the higher intermediary products. Can you guide what was the sales volume for the O&D, how much was it lower? And the F&M as well, how much was it higher?

And also can you give some guidance or color in terms of how did these -- I mean how were the key customers in key markets from your -- were they actually ordering more? What kind of volumes were they ordering? Was there softening demand in key markets in China, in India? Maybe you can give some guidance, some range of numbers.

And the last question is for the slide number 13, this one was just now was Akbar mentioned it, but I didn't really catch some of the things. For example, the three focused execution for commercial excellence, the first one is on the strategic volume shift, shifting a lower margin to a higher margin market. Can you give some examples of which markets that you moved out from and which you shifted to and what kind of the volumes?

And on the price excellence, sorry, I didn't really get that and portfolio optimization as well. What kind of products that you have in so more and optimize? Thanks.

Akbar Thayoob, Head of Commercial

As far as the O&D, basically in terms of sales volume, we have a slight decline of about 5%. And that is mainly due to the fact that basically China has now moved from focusing on production as part of their -- or rather industrial output as part of their GDP into more services. We foresee there was some reduction.

And as far as F&M is concerned, there is a slight increase. But mainly this is due to the fact that in moving away from the fact that Thailand is having some issue with their drought season, we have moved more products towards Australasia, as well as the American market.

However, our production in F&M has increased a little bit, due to the fact that we have now better plant utilisation at both the ABF, as well as our PFK. Did I answer your question?

Cheong Mun Wai, Analyst Employee's Providence Funds

You did. On the O&D, the China, what was the reduction in the volume for the O&D?

Akbar Thayoob, Head of Commercial

The O&D is slightly lower from last year, I think mainly because of number one is like I mentioned, we have foreseen that the market in China has come down a little bit. And for fertilizers--

Datuk Sazali Hamzah, Chief Executive Officer

For O&D -- so I think basically O&D, what we do essentially is just we increase the inventory for the time being just playing for the timing bit, while we are also looking at the shift market to Asian region. So that's why I think I our sales is slightly lower than the volume that we produced.

On the second one, it's on the -- you asked about the commercial excellence.

Akbar Thayoob, Head of Commercial

For commercial excellence we have moved away from lower net back market, especially from areas in China, where we have moved to ASEAN in moving away from lower net back to higher net back. Such example is that if you look at volume of products, we have done rationalisation, where certain grades are better being served in Indonesia rather than in China. So what we have done is rationalize that product and optimized the market more towards higher net back volume in Asean region, especially in Indonesia. (Multiple Speakers)

Cheong Mun Wai, Analyst Employee's Providence Funds

So just to reconfirm, so you will be gradually moving your volumes away from China and maybe towards the Asean region, where there's better net back pricing? For example, in Thailand the situation should be recovering already and in Indonesia where you have a better (background noise).

Akbar Thayoob, Head of Commercial

Not just targeting China, but if China, for example, is giving us a better market for the long term, we will be moving. But I think the basis is basically more from lower net back to higher net back, be it China or Asean, but generally Asean is giving us a better net back for our products.

Cheong Mun Wai, Analyst Employee's Providence Funds

Okay, got it, thanks.

Rashidah Alias, Chief Financial Officer

I'll take the first two questions. Your first question on the reversal of provision, MYR56 million, that is not really due to elastomer; that is pertaining to provision for decommissioning for our VCM plant. If you recall, we are decommissioning that plant.

This is relating to reinstatement of site. Earlier on when we decided to decommission this plant, we have also made a provision for reinstatement of site and it's really pertaining to removal of sub-structure equipment. However, after further work that we have done, there is really no statutory requirement for us to undertake this removal of sub-structure equipment. And therefore, we have decided to reverse this provision, because it made certain that we do not have any statutory obligation to do so. So we're just going to leave the structure below the sub-structure. So that's on the MYR56 million.

The other bit on share of associates, the primary contributor to the drop in share of associate profit is BPC, that's our 40% venture with BASF Petronas. This company produces primarily acrylic acid and oxo and those are their main products and for these two products, the market has come down substantially. I think as high as about 44% for some of the products.

In terms of the outlook, BPC expect it to be better in the second half, slightly better than the first half of the year.

Cheong Mun Wai, Analyst Employee's Providence Funds

I see, okay, got it, thanks. Sorry, just one question on the -- I can't remember whether I asked it, it's on the EBITDA margin for the second quarter 2016 O&D division. So close to 41% EBITDA margin, I think, is a record number. If you exclude the Forex impact, can you just give a rough guidance, how much will be the EBITDA margin, assuming year on year the Forex doesn't change.

Rashidah Alias, Chief Financial Officer

In actual fact right, Mun Wai, for exchange rate we should not look at it in isolation of the prices, because typically they have a strong coordination between the two. So in actual fact, when we look at the FX together with the product prices, it kind of cancels off each other. So in actual fact the EBITDA margin performance is really driven by the plant reliability and also the -- or rather the plant utilisation increment.

But as also a guide, if you look at exchange rate in isolation, which again I would caution that strongly, but if you look at it in isolation, then any \$0.01 movement will result in around about 5% to 7% EBITDA impact.

Cheong Mun Wai, Analyst Employee's Providence Funds

So is this--

Rashidah Alias, Chief Financial Officer

\$0.10, so sorry, \$0.10

Cheong Mun Wai, Analyst Employee's Providence Funds

So is it fair to say that the EBITDA margin for the O&D division can be maintained at around the 40% level? Because you will have higher feedstock from the supplier already and then, of course, you are doing a lot of the cost-optimization also product optimization. Barring any plant shutdown--

M Yusri M Yusof, Head of Manufacturing

I think if you look historically at higher plant utilisation numbers, because remember this is half-year, there are still a lot of activities that have yet to be executed. And some of the activities, they are done in Quarter 2 in terms of the charges, costs have not come into factor yet. So we don't expect 40% EBITDA margin for O&D is going to stay for the whole year.

Cheong Mun Wai, Analyst Employee's Providence Funds

Sorry, what are some of the charges that have not come into the picture yet?

M Yusri M Yusof, Head of Manufacturing

Some intercompany charges, sorry , some of the activities that happen in Quarter 2, for example, some of the activities in the turnaround and maintenance at PC aromatics are not 100% yet. So there are still some lagging impact that will happen in Quarter 3.

Datuk Sazali Hamzah, Chief Executive Officer

We also have some -- well, we call it pit-stop for short maintenance of some of the equipment. So those normally have some lagging impact on the costs.

Rashidah Alias, Chief Financial Officer

The other last point I would just add, because PC aromatics we had a turnaround for PC aromatics, so that pushes up the composition of ethane-based product under the O&D because O&D we've got the same base, we've also got the paraxylene and benzene. So since we had that turnaround in aromatics, we had a higher composition at ethane so that also pushes up the EBITDA margin.

Cheong Mun Wai, Analyst Employee's Providence Funds

Because your O&D side -- I mean your ethane chain has a higher margin than your aromatics, but the sales volume was down for the O&D, so that is actually -- is it more towards the aromatics side, or is it more towards the ethylene side?

M Yusri M Yusof, Head of Manufacturing

I think in totality you see the production volumes increases mainly because of the ethane-based production. But the ethane-based production are basically used internally ethylene to produce polymer and chemicals. So from that point of view the production increases.

But we do have two turnarounds in Quarter 1 and Quarter 2 in the O&D segment. The first in Quarter 1 was the PDH plant, so that was down for 30-odd days and the second was PC aromatics in Quarter 2 that was down for 40 days. So those two are basically direct sales, there's the product from those two plants are not used internally for further processing. So that has some impact on overall sales versus overall production for O&D.

Cheong Mun Wai, Analyst Employee's Providence Funds

Okay, got it, thanks a lot.

Operator

The next question comes from Piyanan Panichkul from UBS. Please go ahead, your line is open.

Piyanan Panichkul, Analyst, UBS

Hi, thanks for the call, I have two questions. The first question is regarding your new ethane contract. I wonder if you can share a bit more color. You said that the new contract remains very competitive, I just wonder how competitive it is. For example, if you compare to the US ethane price and just want to make sure that I understand this right, is it a fixed price contract over 20 years? Or is there any escalation factor? Shall we think of it as a steady price contract over 20 years? So that was the first question.

My second question is regarding the progress, construction progress of your RAPID plant and if you can share the progress of the cracker and the refinery as well, that would be great. Thank you very much.

Datuk Sazali Hamzah, Chief Executive Officer

Okay, I answer the second one first, which is construction of RAPID for cracker and refinery. As far as our understanding at this moment, they are still as per plan. We don't see any major issues in terms of the progress of those two projects, refinery and cracker which later on will follow up by our petchem project.

Bear in mind we are still at the -- I think overall roughly probably about close to 30% of the RAPID, we are still at the early stage, so we don't see any concern in terms of project delay at this moment. We are still on track, that's what we try to say.

The next one is on the ethane contract. As I mentioned just now, majority -- mostly the terms and conditions are remained the same as what we have in previous contract. So in terms of escalation also, it's roughly about the same. There is some escalation that we have put in, but the escalation, as we mentioned, will not have material impact to PCG as Rashidah has mentioned earlier. I think that's the thing that we can share with you on it. So basically we are quite comfortable with the agreement that we have achieved with Petronas and it is actually on arm's-length negotiation and finally that actually we get what we are aiming for.

Piyanan Panichkul, Analyst, UBS

Thank you.

Operator

Our final question comes from the Ajay Mirchandani from JP Morgan. Please go ahead, your line is open.

Ajay Mirchandani, Analyst, JP Morgan

Yes, thank you so much, Ajay here, JP Morgan. Three questions from me. The first question is I just wanted to confirm with regards to RAPID's Capex, given the fact that you now had a cancellation of the elastomer project and there has potentially some more upside for you to actually spend more, is it possible that you now go back and review the refinery and cracker Capex, where you could potentially take up some of the Capex on the cracker side, which previously you highlighted would only be done by the parent? That's my first question.

The second question was specifically on the F&M division. Given urea prices were actually higher Q on Q, utilisation was also higher Q on Q, why have we actually seen margins drop Q on Q? That's my second question.

And the third and last question is specifically on the newspaper reports about a partnership potentially with Aramco for the RAPID project. Any color and commentary on that would be helpful, thanks.

Datuk Sazali Hamzah, Chief Executive Officer

Let me answer first on the RAPID. You talk about elastomer deletion, yes, we have deleted that and as a result we have quite sizeable Capex that we are not going to spend. So by having that actually our aim is looking into further petchem options. So on top of polymer and glycol we are currently evaluating a few other options on polymer as well.

We are not intend -- we have no intent to move into the RC part. The RC part still with Petronas as a part of the deal, we will buy all the cracker and refinery -- what we call the excess molecule for us to look into several other options on petchem side. So we are now at the stage of evaluating all our other options, that's number one.

Number two you are asking about Aramco. Petronas position is at this moment we are evaluating all the potential JV partners and we are still in the discussion, but we have made a firm position with or without partner we are going to move in. That's why if you look at the project progress, so far we progress as what we planned, assuming that we are doing alone. But of course, there are two interested parties and we are evaluating along the way.

If we can merge into an agreement we may have partner and we will announce when the time comes. So that's number two. Number three, F&M just now.

Rashidah Alias, Chief Financial Officer

On the F&M.

Datuk Sazali Hamzah, Chief Executive Officer

Anybody can help me, because I'm not very clear on the--

Rashidah Alias, Chief Financial Officer

Ajay, on the F&M margin of 34%, if we compared it against Quarter 1, you were talking about urea just now, but in actual fact we face some margin compression for urea in Quarter 2 compared to Quarter 1. If En. Akbar could also validate this, now you were also talking about that in your presentation, right?

Akbar Thayoob, Head of Commercial

Yes, I think in Quarter 2 the urea market has further taken a beating as far as price is concerned. The fact that, like I mentioned, that there was a prolonged drought in Thailand that has caused the supply to be in excess of demand and that has actually constrict the urea margins for our business.

Ajay Mirchandani, Analyst, JP Morgan

But sorry, Akbar, just to clarify, I thought urea prices at Q2 versus Q1 were actually slightly higher. Again not massively so, but just slightly higher versus Q1. You also had the increase in methanol production Q on Q, so hasn't that actually helped -- I would have expected that to actually help the blended margin number.

Akbar Thayoob, Head of Commercial

But from our sales and also looking at the benchmark prices, the urea prices for Quarter 2 have actually gone down, has declined, in fact to a level lower than the \$200 per metric tonne in the region. But methanol prices have gained a little bit of momentum from the increase in demand for the MTO --

(technical difficulty)

Operator

Ladies and gentlemen, please stand by, we're just experiencing a momentary interruption. Please go ahead.

Edward Ong, Head of Investor Relations

Hello. Is anybody on?

Operator

That caller has stepped away.

(Operator Instructions).

There are no further questions from the phone. I'll now turn the call back to your host for any additional or closing remarks.

Edward Ong, Head of Investor Relations

Right, sorry about the technical problems. I think we got cut off from the conference just now and I think we're still having some problems. So I'm really sorry about this, but we might have to call it a day and if you've got any further questions, maybe you could email it to me or call me directly on my mobile which is country code 60172923600. Again, that's country code 60172923600.

I'm sorry about this, but the management team's actually offsite at this point in time and we can't seem to get them back at this point in time. So thank you very much, ladies and gentlemen, and we'll see you next quarter.

Operator

That concludes today's conference call. Thank you for your participation, ladies and gentlemen. You may now disconnect.

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