FitchRatings

RATING ACTION COMMENTARY

Fitch Rates Braskem's Senior Notes 'BB+'

Mon 07 Oct, 2024 - 3:59 PM ET

Fitch Ratings - São Paulo - 07 Oct 2024: Fitch Ratings has assigned a 'BB+' rating to proposed senior unsecured notes due in 2034 to be issued by Braskem Netherland Finance B.V. and guaranteed by Braskem S.A. (Braskem). Proceeds from the issuance will be used for the repayment of debt, which may include the repurchase of the 2081 notes validly tendered and accepted for purchase in the Tender Offer, as well as the remainder, if any, for general corporate purposes. Fitch currently rates Braskem S.A. Foreign Currency (FC) and Local Currency (LC) Issuer Default Ratings (IDRs) 'BB+'/Negative and National Scale Long-Term Rating 'AAA(bra)'/Stable.

Braskem's ratings underscore its dominant market position and global operations in the cyclical and volatile petrochemical industry. A competitive cost structure and feedstock diversification play an important role in sustaining Braskem's business profile. The ratings also incorporate the company's strong liquidity profile and the expectation that FCF will be positive from 2025 on.

The Negative Outlook on Braskem S.A.'s ratings reflect Fitch's expectation that petrochemical spreads will remain below midcycle conditions, causing leverage to be above the rating triggers longer than anticipated. Tightened margins and additional nonrecurring cash disbursements not accounted for in our base case scenario could result in a negative rating action.

KEY RATING DRIVERS

Prolonged Petrochemical Sector Downturn: The industry faces unprecedented adversities due to a slow global economy, uncertain geopolitical events and excess production. With China's heavy investments altering the balance the market is oversupplied, leading to continuously low or even negative profit margins. This threatens the viability of numerous facilities, especially in Asia and Europe, where costs are high. Spreads could remain tightened until 2027, deterring new investments, and as supply growth outpaces demand the industry will be pressured to consolidate and rationalize.

Medium-Term Leverage Above Triggers: Fitch forecasts net leverage of about 5.5x in 2024 and 4.0x in 2025, excluding Braskem Idesa. As spreads improve slightly, despite remaining below midcycle conditions, we expect leverage to decrease to about 3.0x in the following years. Braskem needs to preserve cash and reduce debt, which can be done by postponing strategic investments, reducing costs and optimizing working capital, or by divesting noncore business.

FCF Constrained by Non-Recurring Cash Outlays: Braskem's operating cash flows remained positive despite compressed spreads, but payments provisioned for the geological event in Alagoas and the leniency agreement will still affect FCF in 2024 and 2025. In the base case scenario, consolidated EBITDA should range between BRL6.0 billion and BRL7.0 billion (USD 1.24 billion and USD1.4 billion), while operating cash flow generation will remain pressured by high interest expenses.

Projections consider annual maintenance capex of approximately BRL2.0 billion (USD400 million), with an additional BRL1.0 billion (USD200 million) in 2024 to finalize the construction of the ethane terminal in Mexico, all of which when combined with the nonrecurring disbursements resulted in negative FCF of BRL3.0 billion in 2024 and positive BRL1.0 billion in 2025. Additional provisions for Alagoas were not considered going forward.

Solid Business Profile: Braskem continues to have a leading market position with robust operations throughout the globe, conferring important competitive advantages such as cost leadership, feedstock diversification and autonomy to any specific economic segments. It lies on the second quartile of the global petrochemical cost curve and is a reference in sustainable developments, being the first company to produce green PE.

Fitch acknowledges that the petrochemical sector is highly volatile and that Braskem possesses the resilience and strategic capability to manage its challenges effectively. In our projections, a 2.5% change in PE and PP average prices, while keeping everything else the same, could result in a 1.0x change in net leverage.

DERIVATION SUMMARY

Braskem's leading position in the Americas in its core products, PE and PP, is a key credit strength, mitigating the commodity nature of its products which are characterized by volatile raw material prices and price-driven competition. Braskem has medium scale compared with global chemical peers such as Dow Chemical Company (BBB+/Stable) and Westlake Corporation (BBB/Stable), but it is well positioned relative to Latin American peers such as Orbia Advance Corporation, S.A.B de C.V. (BBB/Stable) and Alpek, S.A.B. de C.V. (BBB-/Stable) in terms of scale and geographic diversification.

Around 35% of Braskem's EBITDA was generated outside Brazil in the past six years. The company has strong local market share, allowing it to better withstand higher raw material prices and commercial strategies.

Braskem's leverage, excluding Braskem Idesa, under Fitch's base case is expected to be around 5.5x in 2024 and 4.0x in 2025, but decline close to 3.0x in the following years. This is higher than its petrochemical peers, such as Orbia at 3.0x, Alpek at 2.0x and Westlake at 0.7x. All of these players maintain strong cash positions, long-term debt-amortization profiles, and strong access to local and international debt markets.

Westlake's higher degree of cyclical exposure relative to its larger, more integrated peers highlights the company's need to operate with lower levels of leverage at a given rating category. Nevertheless, it is the third-largest global chlor-alkali and PVC producer, having added scale to its PVC resin and vinyl-based building products through recent acquisitions. The company's cost-advantaged feedstock and a generally strong pricing environment has led to historically stronger EBITDA margins than Braskem.

KEY ASSUMPTIONS

--Brazil PE realized revenue of USD3.6 billion, USD3.6 billion and USD3.5 billion during 2024-2026;

--Brazil PP realized revenue of USD2.0 billion USD 2.1 billion and USD2.2 billion during 2024-2026;

--Brazil vinyls realized revenue of USD640 million, USD660 million and USD820 million during 2024-2026;

--Brazil ethylene/propylene realized revenue of USD810 million, USD1.1 billion and USD1.2 billion during 2024-2026;

--U.S. and Europe PP realized revenue of USD3.7 billion, USD3.6 billion and USD3.9 billion during 2024-2026;

--Mexico PE realized revenue of USD1 billion, USD1.1 billion and USD1.2 billion during 2024-2026;

--PE-ethane reference spreads of USD920/ton in 2024, USD850/ton in 2025 and USD850/ton in 2026;

--PE-naphtha reference spreads of USD440/ton in 2024, USD420/ton in 2025 and USD390/ton in 2026;

--PP-propylene reference spreads of USD460/ton in 2024, USD470/ton in 2025 and USD480/ton in 2026;

--PVC reference spreads of USD360/ton in 2024, USD350/ton in 2025 and USD530/ton in 2026;

--Annual maintenance capex of approximately BRL2.0 billion (USD400 million) with an additional BRL1.0 billion (USD 200 million) to finalize the ethane terminal in Mexico in 2024;

--No dividends paid to shareholders during the analysis horizon.

RATING SENSITIVITIES

Factors that Could, Individually or Collectively, Lead to Negative Rating Action/Downgrade

--Additional material contingent claims for the geological event in Alagoas;

--Net debt/EBITDA above 3.5x, on average through the cycle, excluding Braskem Idesa;

--Sustained negative FCF at the bottom of the cycle that results in incurring additional debt;

--Sustained EBITDA interest coverage below 1.0x;

--Material financial support to Braskem Idesa.

Factors that Could, Individually or Collectively, Lead to Positive Rating Action/Upgrade

--Net debt/EBITDA below 2.5x on average through the cycle, excluding Braskem Idesa;

--Sustained consolidated net debt of less than USD5 billion on average through the cycle.

LIQUIDITY AND DEBT STRUCTURE

Adequate Liquidity: Braskem adopts a conservative financial strategy to limit the risks associated with its exposure to the cyclical and capital-intensive nature of the petrochemical business. The company has a strong cash position, with USD2.8 billion of readily available cash and marketable securities as of June 30, 2024, excluding Braskem Idesa (USD309 million). Gross debt, excluding Braskem Idesa, stands at USD8.3 billion, USD306 million of which is due in the second half 2024 and USD127 million in 2025.

The company's financial flexibility is enhanced by a USD1 billion unused revolving credit facility due in 2026. Fitch expects Braskem to remain committed to preserving its liquidity by maintaining a conservative dividend policy, particularly while leverage is above 2.5x. The company has the ability to reduce capex and fixed costs, optimize working capital and monetize tax credits if market conditions remain worse than anticipated.

ISSUER PROFILE

Braskem S.A. produces and sells chemicals, petrochemicals, fuels, steam, water, compressed air and industrial gases. The company has plants in Brazil, the U.S., Germany and Mexico that produce thermoplastic resins such as polyethylene, polypropylene and polyvinyl chloride.

DATE OF RELEVANT COMMITTEE

04 June 2024

REFERENCES FOR SUBSTANTIALLY MATERIAL SOURCE CITED AS KEY DRIVER OF RATING

The principal sources of information used in the analysis are described in the Applicable Criteria.

MACROECONOMIC ASSUMPTIONS AND SECTOR FORECASTS

Click here to access Fitch's latest quarterly Global Corporates Macro and Sector Forecasts data file which aggregates key data points used in our credit analysis. Fitch's macroeconomic forecasts, commodity price assumptions, default rate forecasts, sector key performance indicators and sector-level forecasts are among the data items included.

RATING ACTIONS

ENTITY / DEBT	RATING

Braskem Netherlands Finance B.V.			
senior unsecured	LT	BB+	New Rating

VIEW ADDITIONAL RATING DETAILS

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APPLICABLE CRITERIA

Corporate Hybrids Treatment and Notching Criteria (pub. 12 Nov 2020)

National Scale Rating Criteria (pub. 22 Dec 2020)

Corporate Rating Criteria (pub. 03 Nov 2023) (including rating assumption sensitivity)

Sector Navigators – Addendum to the Corporate Rating Criteria - Effective from 3 November 2023 to 21 June 2024 (pub. 03 Nov 2023)

APPLICABLE MODELS

Numbers in parentheses accompanying applicable model(s) contain hyperlinks to criteria providing description of model(s).

Corporate Monitoring & Forecasting Model (COMFORT Model), v8.1.0 (1)

ADDITIONAL DISCLOSURES

Solicitation Status

Endorsement Policy

ENDORSEMENT STATUS

Braskem Netherlands Finance B.V.	EU Endorsed, UK Endorsed

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