

ISSUER COMMENT

7 January 2020

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RATINGS

Braskem S.A.

CFR	Ba1
Outlook	Stable

Source: Moody's Investors Service

KEY METRICS:

Braskem S.A.

	FY2017	FY2018	LTM Sep-19
Revenue (\$ bn)	\$15.4	\$16.0	\$14.1
EBITDA Margin	25.4%	20.1%	12.3%
Debt/EBITDA	2.8x	3.2x	6.3x
EBITDA/Interest	3.8x	4.1x	2.1x

Source: Moody's Financial Metrics

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Braskem S.A.

Agreement in Alagoas reduces liquidity risks and uncertainty, a credit positive

On 6 January, [Braskem S.A.](#) (Ba1 stable) and Brazilian authorities ratified an agreement they reached on 3 January to support the relocation and indemnification of residents of certain areas of Maceió, the Alagoas state capital. The agreement is credit positive because it reduces liquidity risk and uncertainty related to future lawsuits and liabilities as Braskem faces a tough operating environment. The lawsuits claim that the company's mining operation caused environmental and social damages in Maceió.

Braskem will provision approximately BRL2.7 billion (\$675 million) in proceeds to support the relocation and indemnification of the local population and to close certain salt wells. This provision does not jeopardize Braskem's sound liquidity, which includes total cash of BRL13.2 billion (of which BRL3.8 billion was restricted) pro forma for liability management measures concluded after September 2019, plus a \$1 billion committed credit facility that remains fully available, and only BRL2.8 billion in short-term debt.

Furthermore, Braskem will disburse the proceeds over the coming years, which reduces immediate liquidity pressure, even if the amounts change with any new and material developments. Braskem expects to disburse approximately BRL1.7 billion for the implementation of the Financial Compensation and Support for Relocation Program, and BRL1 billion for the closure of certain salt wells. The program supports the relocation and indemnification of approximately 17,000 residents of the areas at risk within the districts of Mutange, Bom Parto, Pinheiro and Bebedouro of Maceió. We expect the disbursements to match Braskem's future cash generation since the company will likely adjust other cash outflows (e.g., capex and dividend payments) to its weaker operating performance amid tight polyethylene and polypropylene spreads during 2020.

The settlement also frees surety bonds and approximately BRL3.7 billion of cash that Braskem provided to authorities and which authorities held frozen since June 2019. The authorities agreed to release Braskem's cash, reducing the risk of future liquidity calls. Of the BRL3.7 billion of freed cash, BRL1.7 billion will fund the Financial Compensation and Support for Relocation Program, which needs a minimum BRL100 million of working capital. Braskem will substitute the BRL6.4 billion surety bonds it already presented to the courts with two new surety bonds totaling BRL3 billion. Therefore, Braskem's unrestricted cash position will increase with the release of the frozen cash to BRL9 billion (or BRL11.5 billion pro forma for the liability management) from BRL7 billion at 30 September 2019, while its potential liabilities related to the surety bonds will decline by BRL3.4 billion.

The agreement involves the Alagoas State Public Defender's Office, the Federal Prosecution Office, the Alagoas State Prosecution Office and the Federal Public Defender's Office, which were the main authorities filing lawsuits against Braskem, thus reducing the risks associated with additional liabilities coming from future lawsuits. The agreement settles the BRL7.1 billion lawsuit filed by the Alagoas State Prosecution Office and the Alagoas State Public Defender's Office for reparation for residents. As part of the agreement, Braskem also will provide a BRL1 billion surety bond for the BRL28.7 billion lawsuit filed by the Alagoas State Federal Prosecution Office for social and environmental reparation. However, the Labor Prosecution Office is not part of the agreement, and the existing BRL3.6 billion lawsuit filed by this office still exists.

With the closure of its salt wells and the repair of environmental damage, Braskem can also pursue its plans to buy salt from other regions to recover at least part of its integration in the vinyl business. In early 2019, authorities alleged that Braskem's mining operations had caused an earthquake in the northeast of Brazil, and the company proactively suspended its salt extraction, chlorine and caustic soda activities in Alagoas. Since May 2019, the company has operated under a less competitive and non-integrated business model, importing around 12,000 tons of caustic soda to serve the domestic market, implying an annual EBITDA of BRL120-BRL160 million less than the integrated model (3% of total recurring EBITDA as reported for the 12 months that ended September 2019).

Braskem is the largest producer of thermoplastic resins (PE, PP and polyvinyl chloride) in the Americas, with an annual production capacity of 8.9 million tons. Braskem also has a production capacity of 10.7 million tons of basic petrochemicals such as ethylene, propylene and gasoline, among others; and 1.5 million tons of caustic soda, ethylene dichloride (EDC) and chlorine. For the 12 months that ended September 2019, the company reported consolidated net revenue of BRL54.5 billion (\$14.1 billion), with an adjusted EBITDA margin of 12%.

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