FitchRatings

RATING ACTION COMMENTARY

Fitch Affirms Braskem's Ratings at 'BB+'; Removes Negative Watch; Outlook Negative

Wed 05 Jun, 2024 - 3:43 PM ET

Fitch Ratings - São Paulo - 05 Jun 2024: Fitch Ratings has affirmed Braskem S.A.'s Local and Foreign Currency Issuer Default Ratings (IDRs) at 'BB+' and National Scale at 'AAA(bra)'. They have been removed from Rating Watch Negative and the IDRs and National Scale assigned a Negative and Stable Outlook, respectively. In addition, Fitch has affirmed Braskem America Finance's, as well as Braskem Netherland Finance B.V.'s senior unsecured and subordinated bonds at 'BB+' and at 'BB-', respectively, and removed them from RWN.

The ratings were removed from RWN given our expectation that Braskem will not incur additional cash disbursements after the recommendations from the Senate's inquiry on the geological event of Alagoas. The Negative Outlook indicates our expectation that petrochemical spreads will remain below mid-cycle conditions, causing leverage to be above our triggers longer than anticipated. The combination of tightened margins with additional non-recurring cash disbursements not accounted for on 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: In this scenario, Fitch forecasts net leverage, excluding Braskem Idesa, of about 4.5x in 2024 and 2025. As spreads improve slightly, despite remaining below mid-cycle conditions, we expect leverage to decrease to about 3.5x 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 non-core 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 our base case scenario, consolidated EBITDA, should range between BRL 7.0 and BRL 8.0 Billion (USD 1.4 USD 1.6 Billion), while interest will increase because of the company's strategy of increasing cash balance by issuing debt to sustain strong liquidity.

We assumed annual maintenance capex of approximately BRL 2.0 billion (USD 400 million) with an additional BRL 1.0 billion (USD 200 Million) this year to finalize the construction of the Ethane Terminal in Mexico, all of which combined with the non-recurring disbursements, resulted in negative FCF of BRL 4.0 billion and BRL 1.1 billion, respectively. We did not consider any additional provision for Alagoas 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, keeping everything else constant, 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 6 years and the company has strong local market share, allowing them 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 4.5x in 2024 and 2025, but reduce close to 3.5x in the following years. This is higher than petrochemical peers, such as Orbia's at 3.0x, Alpek's at 2.0x and Westlake's 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 highlight 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 led to historically stronger EBITDA margins than Braskem.

KEY ASSUMPTIONS

--Brazil PE realized revenue of USD3.78 billion, USD4.13 billion and USD4.5 billion during 2024-2026;

--Brazil PP realized revenue of USD2.04 billion USD 2.22 billion and USD2.39 billion during 2024-2026;

--Brazil vinyls realized revenue of USD650 million, USD700 million and USD820 million during 2024-2026;

--Brazil ethylene/propylene realized revenue of USD770 million, USD1.15 billion and USD1.2 billion during 2024-2026;

--U.S. and Europe PP realized revenue of USD3.76 billion, USD3.77 billion and USD3.96 billion during 2024-2026;

--Mexico PE realized revenue of USD1 billion, USD1.13 billion and USD1.360 billion during 2024-2026;

--PE-ethane reference spreads of USD860/ton in 2024, USD840/ton in 2025 and USD880/ton in 2026;

--PE-naphtha reference spreads of USD400/ton in 2024, USD400/ton in 2025 and USD480/ton in 2026;

--PP-propylene reference spreads of USD440/ton in 2024, USD440/ton in 2025 and USD430/ton in 2026;

--PVC reference spreads of USD410/ton in 2024, USD410/ton in 2025 and USD460/ton in 2026;

--Annual maintenance Capex of approximately BRL 2.0 billion (USD 400 million) with additional BRL 1.0 billion (USD 200 million) to finalize the Ethane terminal in Mexico in 2024;

--No dividends to shareholders during the analysis horizon.

RATING SENSITIVITIES

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.

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.

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 USD3.3billion of readily available cash and marketable securities as of March 31, 2024, excluding Braskem Idesa (USD357 million). Gross debt, excluding Braskem Idesa, stands at USD8.5 billion, USD277 million of which is due in 2024 and USD132 million in 2025.

The company's financial flexibility is enhanced by a USD1 billion unused revolving credit facility due in 2026. We expect 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 in 2024.

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.

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.

ESG CONSIDERATIONS

Braskem has an ESG Relevance Score of '4' for Waste & Hazardous Materials Management, revised from '5', due to the operations' disruption and large cash outflows triggered by the geological event in Alagoas. This has a negative impact on the credit profile, and is relevant to the ratings in conjunction with other factors.

Braskem S.A. has an ESG Relevance Score of '3' for Exposure to Environmental Impacts, revised from '5', because the rating is more affected by the cash outflows linked to the geological events covered in the preceding paragraph, rather than by direct physical impacts resulting from climate change.

Braskem S.A. has an ESG Relevance Score of '4' for Human Rights, Community Relations, Access & Affordability, revised from '2', due to the reparation costs incurred following the geological event in Alagoas, to relocate over 14,000 families from neighboring areas. This has a negative impact on the credit profile, and is relevant to the ratings in conjunction with other factors.

Braskem S.A. has an ESG Relevance Score of '3' for Exposure to Social Impacts, revised from '5', because the rating is affected more significantly by the financial consequences of indemnification of harmed local communities covered in the preceding paragraph, rather than by the social resistance or pressure.

Braskem S.A. has an ESG Relevance Score of '3' for Governance Structure, revised from '4', because the company has improved its practices and has been compliant with regulators since the car-wash probe.

The highest level of ESG credit relevance is a score of '3', unless otherwise disclosed in this section. A score of '3' means ESG issues are credit-neutral or have only a minimal credit impact on the entity, either due to their nature or the way in which they are being managed by the entity. Fitch's ESG Relevance Scores are not inputs in the rating process; they are an observation on the relevance and materiality of ESG factors in the rating decision. For more information on Fitch's ESG Relevance Scores, visit https://www.fitchratings.com/topics/esg/products#esg-relevance-scores.

RATING ACTIONS

ENTITY / DEBT	RATING			PRIOR
Braskem Netherlands Finance B.V.				
senior unsecured	LT	BB+	Affirmed	BB+ Rating Watch Negative
subordinated	LT	BB-	Affirmed	BB- Rating Watch Negative

Braskem America Finance Company				
senior unsecured	LT	BB+	Affirmed	BB+ Rating Watch Negative
Braskem S.A.	LT IDR	BB+ Rating Outlook Negative	Affirmed	BB+ Rating Watch Negative
	LC LT IDR	BB+ Rating Outlook Negative	Affirmed	BB+ Rating Watch Negative
	Natl LT	AAA(bra) Rating Outlook Stable	Affirmed	AAA(bra) Rating Watch Negative
senior unsecured	Natl LT	AAA(bra)	Affirmed	AAA(bra) Rating Watch Negative

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 (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

Dodd-Frank Rating Information Disclosure Form

Solicitation Status

Endorsement Policy

ENDORSEMENT STATUS

Braskem America Finance Company	EU Endorsed, UK Endorsed
Braskem Netherlands Finance B.V.	EU Endorsed, UK Endorsed
Braskem S.A.	EU Endorsed, UK Endorsed

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The complete span of best- and worst-case scenario credit ratings for all rating categories ranges from 'AAA' to 'D'. Fitch also provides information on best-case rating upgrade scenarios and worst-case rating downgrade scenarios (defined as the 99th percentile of rating transitions, measured in each direction) for international credit ratings, based on historical performance. A simple average across asset classes presents best-case upgrades of 4 notches and worst-case downgrades of 8 notches at the 99th percentile. For more details on sector-specific best- and worst-case scenario credit ratings, please see Best- and Worst-Case Measures under the Rating Performance page on Fitch's website.

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