

Research Update:

# Braskem S.A. Upgraded To Investment Grade On Stronger Profitability And Debt Reduction; Outlook Stable

September 2, 2021

## Rating Action Overview

- We expect Brazil-based petrochemicals company Braskem S.A. to continue benefiting from favorable market conditions in the short term, leading to strong credit metrics.
- Amid sound cash flow generation in the first half of this year, the company reduced its gross debt by about \$1.7 billion.
- As a result, on Sept. 2, 2021, we raised our issuer credit rating and unsecured issue-level ratings on Braskem to 'BBB-' from 'BB+'. We also raised our ratings on the company's subordinated notes to 'BB' from 'B+'. At the same time, we affirmed our 'brAAA' national scale rating on the company.
- The stable outlook reflects our view that the company will maintain leverage at about or below 2.5x in the next two to three years, despite expected lower petrochemical spreads going forward.

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## Rating Action Rationale

**A considerable improvement in profitability and operating cash flows.** We expect Braskem to continue benefiting from high petrochemical spreads over the next few quarters, although those will moderate. This should lead to much stronger EBITDA and cash flows until 2022 than our previous forecasts. We expect the company to maintain EBITDA margin above 20% until next year thanks to high utilization rates and amid relatively stable foreign-exchange (FX) levels. Our forecast incorporates some reduction in petrochemical spreads in 2022 and a deeper one in 2023, due to a full supply recovery in the U.S. (after the impact of the February winter storm on the domestic industry), resolution of logistics problems in Asia, allowing freight rates to return to more normal levels, and as new capacity comes online, mainly for polyethylene (PE). Therefore, we forecast EBITDA (excluding that of Braskem Idesa) close to \$4.7 billion in 2021, declining to \$3.0 billion - \$3.5 billion in 2022, and close to \$2 billion in 2023.

**The use of high cash flows for debt reduction will leave leverage close to historical levels of about or below 2x in the next few years.** The company has been using its cash flows to prepay debt, signaling its commitment to low leverage levels in line with an investment-grade rating. Until July 2021, the company reduced gross debt by about \$1.7 billion. We believe Braskem will post debt to EBITDA of about 1x at the end of 2021, similar to the level in the first half of this year, even assuming some dividend distribution before the year-end. This metric is much stronger than 3.6x in 2020 and 5.3x in 2019, and more in line the level close to 2.0x in 2015-2018.

**Cushion in credit metrics provides comfort to withstand an industry downturn or additional cash outflows.** Our forecast now indicates the company's leverage can be below 2.5x until the end of 2022 even if petrochemical spreads were about 15% below our base-case assumptions or if the company pays more than R\$15 billion as dividends. Also, Braskem might need to provision some additional amounts related to the geological phenomenon at the state of Alagoas, but we don't expect it to be material enough to pressure credit metrics.

## Outlook

The stable outlook reflects our expectation that Braskem will continue to post solid operating performance in the next quarters thanks to favorable industry conditions. We expect the company to generate strong cash flows, allowing it to maintain debt to EBITDA below 2.0x until 2022, not incorporating large dividend distributions. In the medium term, even assuming industry downturn cycles, we expect Braskem to maintain leverage at about 2.5x, with a prudent approach to dividend payments, as shown historically.

## Downside scenario

We could lower the ratings in the next two years if we were to expect debt to EBITDA at about 3.5x in a three-year moving average. This could result from one or more of the following factors:

- Significant contraction in petrochemical spreads amid weaker global demand;
- Substantial increases in dividend payments; and
- New sizable provisions related to Alagoas geological event, which we currently believe are unlikely.

## Upside scenario

An upgrade is unlikely in the medium term because the ratings on Braskem are constrained at one notch above our 'BB+' transfer and convertibility (T&C) assessment of Brazil. We could revise upward Braskem's stand-alone credit profile (SACP) in the next few years if we see lower volatility in leverage metrics. For that, we would expect commitment to a more prudent capital structure, even factoring in the volatility in commodity markets, with average mid-cycle debt to EBITDA at 1.5x-2.5x and funds from operations (FFO) to debt at 35%-45%. The upgrade would also depend on the maintenance of strong liquidity and a prudent approach to capital expenditures (capex), dividend payouts, or other debt-financed initiatives.

## Company Description

Braskem is the leading thermoplastic resins producer in the Americas and among the world's top 10 sector players, with leading positions in PE (low density [LDPE], high density [HDPE], and linear low density [LLDPE]), polypropylene (PP), and polyvinyl chloride (PVC). The company integrates the first and second generations of the Brazilian petrochemicals industry, consisting of the naphtha or ethane cracking function (basic petrochemicals) and thermoplastics production (polyolefin and PVC). Odebrecht S.A. (not rated) controls 38.3% of Braskem's shares and Petroleo Brasileiro S.A. - Petrobras (BB-/Stable/--) owns 36.1% of shares. The company's remaining shares trade on Bovespa and Latibex and NYSE.

## Our Base-Case Scenario

- Volume growth of 3%-5% in the next two to three years.
- An average exchange rate of R\$5.30-\$5.40 per \$1 until 2023.
- Brent crude prices of about \$65 per barrel (bbl) in 2021, \$60 in 2022, and \$55 in 2023.
- Spreads for most of Braskem's products to remain at high levels until the end of 2021. For 2022, we assume spreads to be 15%-20% lower than in 2021, with deeper declines in PE and PP spreads in the U.S. For 2023, we assume a decline of 25%-30% from the 2022 level.
- Annual capex of R\$4.0 billion - R\$4.5 billion, consisting mainly of maintenance capex and some small investments to increase capacity and for efficiency projects.
- We assume dividend payments of about R\$2 billion until the end of 2021 and R\$1.5 billion - R\$2.0 billion in 2022. These distributions will depend on management's evaluation of future industry conditions, so the figures may vary significantly.

Table 1

### Braskem--Key Metrics\*

	--Fiscal year ended Dec. 31--				
	2019a	2020a	2021e	2022f	2023f
<b>(Bil. R\$)</b>					
Revenue	49.96	55.78	94.0-98.0	80.0-90.0	70.0-80.0
EBITDA	4.39	9.05	24.0-26.0	15.0-20.0	8.0-13.0
EBITDA margin (%)	8.8	16.2	25-27	20-24	11-16
Funds from operations (FFO)	1.56	5.84	15.0-20.0	10.0-15.0	5.0-10.0
Debt	23.06	32.29	26.0-30.0	24.0-29.0	23.0-29.0
Debt to EBITDA (x)	5.3	3.6	1-1.5	1.2-1.8	2.3-2.9
FFO to debt (%)	6.8	18.1	60-70	45-55	20-30
FOCF to debt (%)	(9.3)	14.9	40-50	30-40	0-15

\*All figures adjusted by S&P Global Ratings. a--Actual. e--Estimate. f--Forecast.

## Liquidity

We assess Braskem's liquidity as strong. We expect sources to exceed uses by more than 2.0x in the next 12 months and more than 1.5x in the next 24 months. This is thanks to the company's robust cash position, including its committed credit line and strong cash flows, which are more than enough to cover short-term debt, capex, and working capital needs. Braskem has access to diversified funding sources, which support its smooth debt maturity profile.

### Principal Liquidity Sources

- Cash position of R\$11.3 billion as of June 30, 2021;
- Stand-by credit facility totaling about R\$5.3 billion (\$1 billion); and
- Cash FFO of R\$16 billion - R\$18 billion in the 12 months after June 2021.

### Principal Liquidity Uses

- Short-term debt maturities of R\$2.5 billion as of June 30, 2021;
- Annual capex of about R\$4 billion;
- Working capital outflows of about R\$3.5 billion including seasonal peaks;
- Cash outflows related to Alagoas of about R\$4.5 billion in the 12 months after June 2021; and
- Dividend payments close to R\$2 billion.

## Issue Ratings - Subordination Risk Analysis

We raised our ratings on the company's senior unsecured debt to 'BBB-' from 'BB+' and our rating on its subordinated notes to 'BB' from 'B+'. At the same time, we removed our recovery ratings on company's debt because the issuer credit rating is now 'BBB-'.

## Capital structure

- We rate several senior unsecured notes, either issued or guaranteed by Braskem.
- We also rate the company's subordinated notes issued in 2020. We categorize these notes as having intermediate equity content, because they're subordinated in liquidation to Braskem's senior debt obligations, can't be called for at least 5.5 years, and aren't subject to features that could discourage or considerably delay deferral.

## Analytical conclusions

We rate Braskem's senior unsecured debt at the same level as our issuer credit rating because the company has limited secured debt. Even if the senior unsecured debt ranked behind the debt issued by subsidiaries in the capital structure, we believe the risk of subordination is mitigated by a priority debt ratio that's far less than 50% and the material earnings generated on the parent level. We rate the financing vehicles' unsecured debt the same as our issuer credit rating on Braskem, based on its guarantee of this debt.

We raised our rating on Braskem's subordinated notes by two notches to 'BB' from 'B+'. This is

because we apply two notches down to reflect subordination when the credit rating on the company is 'BB+' or below (speculative-grade), and only one notch down when it's 'BBB-' or above. As a result, the two-notch difference between the subordinated notes rating and credit rating reflects our deduction of:

- One notch to reflect subordination to the company' senior debt obligations; and
- One notch for loss absorption or cash conservation features. Braskem's coupon deferral is discretionary and not limited in time.

## **Ratings Score Snapshot**

### Issuer Credit Rating

- Global scale: BBB-/Stable/--
- National scale: brAAA/Stable/--

### Business risk: Satisfactory

- Country risk: Moderately high
- Industry risk: Moderately high
- Competitive position: Satisfactory

### Financial risk: Significant

- Cash flow/leverage: Significant

### Anchor: bbb-

### Modifiers

- Diversification/portfolio effect: Neutral (no impact)
- Capital structure: Neutral (no impact)
- Financial policy: Neutral (no impact)
- Liquidity: Strong (no impact)
- Management and governance: Fair (no impact)
- Comparable rating analysis: Neutral (no impact)

## **Related Criteria**

- General Criteria: Hybrid Capital: Methodology And Assumptions, July 1, 2019
- General Criteria: Group Rating Methodology, July 1, 2019
- Criteria | Corporates | General: Corporate Methodology: Ratios And Adjustments, April 1, 2019
- Criteria | Corporates | General: Reflecting Subordination Risk In Corporate Issue Ratings, March 28, 2018
- General Criteria: Guarantee Criteria, Oct. 21, 2016

- Criteria | Corporates | General: Methodology And Assumptions: Liquidity Descriptors For Global Corporate Issuers, Dec. 16, 2014
- General Criteria: Ratings Above The Sovereign--Corporate And Government Ratings: Methodology And Assumptions, Nov. 19, 2013
- General Criteria: Country Risk Assessment Methodology And Assumptions, Nov. 19, 2013
- Criteria | Corporates | General: Corporate Methodology, Nov. 19, 2013
- General Criteria: Methodology: Industry Risk, Nov. 19, 2013
- General Criteria: Methodology: Management And Governance Credit Factors For Corporate Entities, Nov. 13, 2012

## Ratings List

### Upgraded

	To	From
<b>Braskem S.A.</b>		
Issuer Credit Rating	BBB-/Stable/--	BB+/Stable/--
<b>Braskem America Finance Co.</b>		
Senior Unsecured	BBB-	BB+
Recovery Rating	NR	3(65%)
<b>Braskem Finance Ltd.</b>		
Senior Unsecured	BBB-	BB+
Recovery Rating	NR	3(65%)
<b>Braskem Netherlands Finance</b>		
Senior Unsecured	BBB-	BB+
Recovery Rating	NR	3(65%)
Subordinated	BB	B+
<b>Ratings Affirmed</b>		
<b>Braskem S.A.</b>		
Issuer Credit Rating		
Brazil National Scale	brAAA/Stable/--	

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