

# Spotlight: Braskem S.A.

## Financial Strain Mounts Amid Tough Market Conditions

“Increased ESG risks and potential new claims associated with the geological event in Alagoas could worsen the company’s credit profile.”

Marcelo Pappiani, Fitch Ratings

### Negative FCF and High Leverage

The ratings of the Brazil-based petrochemical firm, Braskem S.A. (BB+/Rating Watch Negative) were downgraded and placed on Rating Watch Negative in December 2023. This followed rising environmental, social and governance (ESG) risks and potential new claims associated with a salt mine collapse in the north eastern state of Alagoas, which could worsen the company’s credit profile.

Fitch Ratings projects negative free cash flow (FCF) through to 2025 amid higher net debt from Braskem’s exposure to a prolonged petrochemical sector downturn. Braskem has low rating headroom, with an average negative net leverage sensitivity of 3.5x through the cycle, excluding its 75% subsidiary, Braskem Idesa SAPI (B+/Negative). The negative sensitivity for interest coverage is 1.0x.

### Strong Liquidity Amid Adversities

Braskem adopts a conservative financial strategy to limit the risks associated with the cyclical and capital-intensive nature of the petrochemical business.

We expect continued pressure on petrochemical spreads, following the challenging conditions in 2023. However, Braskem’s strong cash position and extended debt-amortization profile, with manageable refinancing risk, supports its rating.

### Elevated Environmental Risks

We lowered several of the company’s ESG Relevance Scores in December 2023 following the collapse of cavity 18 to incorporate the risk of reparation costs and monetary fines. We believe the geological event could cause financial deterioration from rising liabilities, as the number of cases levied upon the company could increase.

### Global Chemicals Face Poor Conditions

We forecast weak demand and oversupply to continue to pressure volumes and margins at global chemical issuers in 2024. Demand for chemical products is likely to be softened by the slowdown of major economies from high inflation and rising interest rates, while China’s recovery remains slower than we expected.

Significant new global capacity built in recent years has increased competition and has further pressured the operating rates of global chemical producers. This is likely to lead to the closure of uncompetitive assets, especially in regions that are disadvantaged by higher energy or feedstock costs.



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Introducing ESG Relevance Scores for Corporates (January 2019)

Government-Related Entities Rating Criteria (January 2024)

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## Events that Would Trigger the Negative Watch

The December 2023 downgrade of Braskem’s ratings and the Rating Watch Negative reflected the potential financial impact of the cavity 18 collapse in the context of sinking land around Alagoas. Braskem has low rating headroom and the geological event could further worsen its credit profile.

Its net leverage ratio has exceeded 3.5x since 2022 and we calculate that its FCF was negative, at USD1.1 billion in the last twelve months. Concurrently, EBITDA interest coverage, which has previously appeared ample, is under substantial strain and there is uncertainty around the liabilities associated with the geological event. Braskem provisioned about USD200 million in 4Q23 in relation to the event.

Factors that could lead to negative rating action include:

- Additional contingent claims for the Alagoas incident.
- Net debt/EBITDA averaging at above 3.5x 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.

### Financial Summary

(USDm)	2020	2021	2022	2023
EBITDA	1,931	5,283	1,789	410
EBITDAR margin (%)	17.1	28.5	9.5	2.9
Cash flow from operation (Fitch-defined)	447	2,412	1,737	219
Capex	-533	-601	-942	-921
FCF	191	757	-1	-1,236
Cash	3,122	2,139	2,869	3,892
Debt	10,339	8,125	9,328	11,037
Net debt	7,217	5,986	6,458	7,145
EBITDA leverage (x)	5.4	1.5	5.2	26.7
EBITDAR net leverage (x)	3.7	1.1	3.6	17.3
EBITDA interest coverage (x)	3.7	10.4	3.2	0.6

Source: Fitch Ratings, Fitch Solutions

Braskem’s weak performance in 2023 can be attributed to the considerable contraction in global petrochemical margins since late 2022, which show little signs of rebounding. Revenue from second-generation products, such as polyolefins and vinyl, in Brazil dropped by about 30% since the 2021 peak, while EBITDA declined by almost 90%.

Net debt increased by about USD380 million during 2023, pressured by negative FCF, although it remains close to the average of USD7.3 billion in the past seven years. However, Braskem has demonstrated the ability to secure funding from financial markets and possesses substantial liquidity to navigate tough economic conditions.

## Sensitivity Analysis

### Scenario 1: Potential Downgrade on Narrower Spreads

(USDm)	2024F	2025F	2026F	2027F
EBITDA	700-800	700-800	1300-1,400	1,700-1,800
EBITDAR margin (%)	5-6	5-6	8-9	9-10
CFO (Fitch-defined)	300-400	300-400	800-900	1,000-1,100
Capex	700-800	700-800	700-800	700-800
FCF	(400)-(300)	(400)-(300)	0-100	200-300
Cash	2,000-3,000	2,000-3,000	2,000-3,000	2,000-3,000
Debt	9,000-10,000	9,000-10,000	9,000-10,000	9,000-10,000
Net debt	7,000-8,000	7,000-8,000	7,000-8,000	7,000-8,000
EBITDA leverage (x)	12-13	12-13	7-8	5-6
EBITDAR net leverage (x)	9-10	9-10	5-6	4-5
EBITDA interest coverage (x)	0-1	0-1	1-2	2-3

Source: Fitch Ratings, Fitch Solutions

Fitch could take a negative rating action if the capital structure remains pressured by negative FCF, such that financial debt remains high and financial flexibility decreases. This could stem from petrochemical margins staying in near-trough conditions. In this exercise, we do not assume any additional provisions for the Alagoas incident, but will review the ratings should any further incidents or liabilities arise.

### Scenario 2: Potential Removal of Negative Rating Watch

(USDm)	2024F	2025F	2026F	2027F
EBITDA	1,900-2,000	1,900-2,000	1,900-2,000	2,200-2,300
EBITDAR margin (%)	12-13	12-13	12-13	12-13
CFO (Fitch-defined)	1,200-1,300	1,200-1,300	1,300-1,400	1,600-1,700
Capex	700-800	700-800	700-800	700-800
FCF	500-600	500-600	600-700	800-900
Cash	3,000-4,000	3,000-4,000	4,000-5,000	4,000-5,000
Debt	9,000-10,000	9,000-10,000	9,000-10,000	9,000-10,000
Net debt	6,000-7,000	6,000-7,000	5,000-6,000	5,000-6,000
EBITDA leverage (x)	5-6	5-6	5-6	4-3
EBITDAR net leverage (x)	3-4	3-4	2-3	2-3
EBITDA interest coverage (x)	2-3	2-3	2-3	2-3

Source: Fitch Ratings, Fitch Solutions

Fitch could remove the Negative Rating Watch upon a clear trend of sustainable leverage reduction, combined with a recovery in cash flow generation and operating margins. This could stem from consistent average price increases in polyethylene, polypropylene and polyvinyl chloride of around 10%-15% versus 2023 that bring the market to mid-cycle conditions. In this exercise, we do not assume any additional provision for the geological event in Alagoas.

## Liquidity and Financial Flexibility

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 USD3.3 billion 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, USD377 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.

## Outcomes of Congressional Investigation

The congressional investigation into the geological event in Alagoas, which is scheduled to conclude on May 22, 2024, aims to determine Braskem's socio-environmental legal responsibility. However, the congress does not have authority to enforce penalties or fines on Braskem. Its role is limited to conducting inquiries and recommending measures regulatory bodies may choose to adopt.

Uncertainty about current and upcoming lawsuits is high, with negative outcomes potentially pressuring cash flow and adversely impacting the company's financial results. We have no visibility of possible new claims connected to the mine collapse in Alagoas.

## Possible Change of Control Scenarios

Abu Dhabi National Oil Company (ADNOC) (AA/Stable) has announced that it is not interested in proceeding to acquire Braskem from Novonor. However, we understand that Novonor remains engaged in finding a buyer to its stake in the company.

We see negative implications for Braskem's rating should Petróleo Brasileiro S.A. (Petrobras) (BB/Stable) exercise its right of first refusal to acquire Novonor's share in Braskem and take control. Under this scenario, we might consider Braskem as a state-owned entity, similar to Petrobras, which, despite its 'bbb' Standalone Credit Profile, is capped at 'BB' by Fitch's Government-Related Entities Rating Criteria. This cap could extend to Braskem if it becomes a fully owned subsidiary of Petrobras.

We believe the prospect of Novonor selling its stake in Braskem hit an impasse after the December 2023 salt mine collapse, with ongoing uncertainty regarding the repercussions of the geological event.

## Fitch's Near-Term Sector Expectations

The inherently unstable nature of the petrochemical market means various factors can rapidly alter the market landscape. Events in the EMEA region, including excess supply, logistical challenges, inventory reductions, the introduction of carbon taxes, declining production activity and geopolitical conflict, could result in challenging market conditions persisting beyond our initial expectations and further compress profit margins.

Lacklustre demand and pricing fundamentals continue to weigh on sales and earnings. We do not anticipate an immediate upturn and for commoditized chemical producers, like Braskem, to face continued difficulties, despite its competitive cost position.

## Relative Analysis

Braskem remains highly competitive through innovation and by devising value solutions for decarbonisation, bio-based products and circularity. The company's new business models range from energy transition to green ethylene and recyclable packaging.

Braskem has a vast global footprint, with plants in Brazil, the U.S., Mexico and Germany. Nonetheless, second-generation plastics, like Polyethylene and Polypropylene, face declining revenue. Orbia Advance Corporation, S.A.B. de C.V. (BBB/Stable) has the most diverse product portfolio, with strong positions in vinyl, chlor-alkali and fluorine as well as in data communication, precision agriculture, building and infrastructure. Meanwhile, Alpek, S.A.B. de C.V. (BBB-/Stable) has boosted its diversification via asset acquisitions from Petrobras, Octal Holding SAOC and M&G Polimeros Mexico, S.A. De C.V., but remains exposed to the same consumer end-markets.

Braskem is Brazil's only petrochemical company with integrated operations in the first and second generation basic chemicals, plastic resins and polymers. Despite its position in the second quartile of the global cost curve for ethylene, its plant in Brazil still depends on naphtha, a more expensive feedstock than ethane and propane. Orbia's vertical integration extends from its salt mine and ethylene cracker in its vinyl division, as well as from the fluorspar mine in its fluorinated solutions. This boosts its business flexibility and cross-selling opportunities, supporting long-term cash flow sustainability and higher operating margins within the industry.

Profit margins have been squeezed by weak demand from certain industries and new production capacity in Asia. Moreover, Braskem has been contending with substantial cash outlays since the first subsidence in 2018 and escalating financial risk from these environmental events.

Rating History					
	2019	2020	2021	2022	2023
Alpek	BBB-/ Stable	BBB-/ Stable	BBB-/ Stable	BBB-/ Positive	BBB-/ Stable
Braskem	BBB-/ Negative	BB+/ Stable	BBB-/ Stable	BBB-/ Stable	BB+/ Rating Watch Negative
Orbia	BBB/ Stable	BBB/ Negative	BBB/ Stable	BBB/ Stable	BBB/ Stable

Source: Fitch Ratings

## Environmental and Social Factors

We believe the environmental and ecological impacts of the salt mine collapse in the context of sinking land in Alagoas could damage Braskem's financial position. The company could also face social impacts from new claims and reparation costs to victims and neighbouring communities, in addition to the 14,446 families relocated to other areas. These factors could damage the company's reputation and jeopardize its FCF, resulting in a negative impact on its credit profile.

Braskem has been assisting the people affected by the incident. Since 2019, it has disbursed approximately BRL10 billion (USD2 billion) on relocations, compensation, the closure and monitoring of salt cavities, environmental and other technical matters, as well as on social and urban measures.

**ESG CONSIDERATIONS**

Braskem has an ESG Relevance Score of ‘5’ for Waste & Hazardous Materials Management; Ecological Impacts, due to the geological event in Alagoas that affected its salt mining operations. This has a negative impact on the credit profile and is highly relevant to the rating, resulting in one notch downgrade.

Braskem has an ESG Relevance Score of ‘5’ for Exposure to Environmental Impacts, due to the collapse of cavity 18 in the context of the geological event in Alagoas. This has a negative impact on the credit profile and is highly relevant to the rating, resulting in one notch downgrade.

Braskem has an ESG Relevance Score of ‘5’ for Exposure to Social Impacts, due to the possibility of further relocation of local communities. This has a negative impact on the credit profile and is highly relevant to the rating, resulting in one notch downgrade.

Braskem has an ESG Relevance Score of ‘4’ for Governance Structure, due to a history of corruption scandals and financial stress at shareholders, which has a negative impact on the credit profile and is relevant to the ratings in conjunction with other factors.

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 [www.fitchratings.com/topics/esg/products#esg-relevance-scores](http://www.fitchratings.com/topics/esg/products#esg-relevance-scores)

**ESG Considerations**

		<b>Braskem S.A.</b>
Environmental	GHG Emissions & Air Quality	3
	Energy Management	3
	Water & Wastewater Management	3
	Waste & Hazardous Materials Management	5
	Exposure to Environmental Impacts	5
Social	Human Rights, Community Relations, Access & Affordability	2
	Customer Welfare - Fair Messaging, Privacy & Data Security	1
	Labour Relations & Practices	3
	Employee Wellbeing	3
	Exposure to Social Impacts	5
Governance	Management Strategy	3
	Governance Structure	4
	Group Structure	3
	Financial Transparency	3

- 5. Highly relevant, a key rating driver that has a significant impact on the rating on an individual basis. Equivalent to "higher" relative importance within Navigator.
  - 4. Relevant to rating, not a key rating driver but has an impact on the rating in combination with other factors. Equivalent to "moderate" relative importance within Navigator.
  - 3. Minimally relevant to rating, either very low impact or actively managed in a way that results in no impact on the entity rating. Equivalent to "lower" relative importance within Navigator.
  - 2. Irrelevant to the entity rating but relevant to the sector.
  - 1. Irrelevant to the entity rating and irrelevant to the sector.
- Source: Fitch Ratings

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