FitchRatings

RATING ACTION COMMENTARY

# Fitch Rates Braskem's Proposed Issuance 'BBB-'

Mon 06 Feb, 2023 - 09:48 ET

Fitch Ratings - New York - 06 Feb 2023: Fitch Ratings has assigned Braskem Netherlands Finance B.V.'s proposed new issuance a 'BBB-' rating. The proceeds from the issuance will be used for general corporate purposes, including the repayment of debt. The notes will be fully, unconditionally and irrevocably guaranteed by Braskem S.A. (BBB-/Stable).

The ratings reflect Braskem's solid business diversification both geographically and in terms of product mix. Despite a challenging sector environment in 2023, Fitch expects the company's credit profile to improve over the medium term as demand for plastics and chemicals recover and prices normalize. Fitch forecasts Braskem's net debt/EBITDA ratio to be between 2.9x and 2.4x during 2023-2024, excluding the company's Mexican subsidiary, Braskem Idesa, and 3.9x and 3.4x on a consolidated basis, including Braskem Idesa.

Contingencies related to a geological event in Alagoas and its associated cash out flows remain sizeable but manageable, and Braskem has some flexibility to reduce capex and optimize working capital should difficult conditions persist.

## KEY RATING DRIVERS

**Spreads Tightening:** Fitch expects pressure on petrochemical spreads to continue in 2023, following challenging market conditions in 2H22. A combination of pent-up supply coming online, elevated raw material costs and concerns over demand due to a fragile global economy are contributing to a deteriorating sector outlook in 2023.

Polyethylene (PE)-naphtha spreads will be particularly tight at USD300/ton in 1H23 compared with USD514/ton in 2022 and USD1,073/ton in 2021. Declines in PE prices will outpace the decline in naphtha, a feedstock with prices that are closely linked to crude oil. In Brazil, naphtha will account for nearly 60% of variable costs in 2023. Fitch estimates a USD100/ton increase in PE price in 2023 would increase Braskem's consolidated EBITDA by USD360 million, or roughly 20%.

**Medium-Term Leverage to Moderate:** Fitch estimates net leverage excluding Braskem Idesa will be 1.9x in 2022, 2.9x in 2023, 2.4x in 2024 and 1.3x in 2025. Consolidated net leverage is expected to peak at 3.9x in 2023, an increase from 2.8x in 2022 and a low of 1.2x in 2021. As resin prices improve and feedstock costs moderate in 2024 and 2025, consolidated leverage will fall to 3.4x and 2.2x, respectively.

Fitch expects Braskem to remain committed to a strong credit profile and to maintain its conservative dividend policy that sets dividend payouts not to breach its target leverage ratio of 2.5x. Braskem has the ability to reduce capex and fixed costs, optimize working capital and monetize tax credits in 2023 if market conditions worsen more than anticipated.

**Solid Business Diversification:** Braskem's ratings are underpinned by its strong geographic and feedstock diversification and its leading market positions in polyethylene (PE) and polypropylene (PP). Fitch expects the company's operations in the U.S., Germany and Mexico to represent an estimated 43% of its consolidated EBITDA in 2022, and is expected to be around 40% over the medium term. Braskem's Brazilian operation (plus exports) accounts for the balance.

Braskem's feedstock is mainly balanced between propylene (38%), naphtha (36%), and ethane (21%) including its joint venture in Mexico, Braskem Idesa SAPI (BB-/Stable). The company's strategy of diversifying its feedstock matrix has reduced its exposure to one feedstock while decreasing its production cost and improving its long-term competitiveness.

**Medium-Term FCF Positive:** Fitch expects FCF to be slightly positive by 2025 due to a recovery in resin prices and lower Alagoas disbursements, and also expects consolidated EBITDA will be USD2.2 billion in 2022, USD1.8 billion in 2023 and USD2.1 billion in 2024 as resin prices recover. Cash flow from operations (CFFO) will be USD2.1 billion in 2022 reflecting a positive change in net working capital (NWC), USD600 million in 2023 and USD1.1 billion in 2024.

Fitch expects FCF to be USD540 million in 2022 and USD-850 million in 2023, reflecting Alagoas payments of roughly USD385 million in 2022, USD750 million in 2023 and USD330 million in 2024. Capex is expected be USD860 million in 2022, USD600 million in 2023 and USD870 in 2024 and no dividends apart from the BRL1.35 billion (~USD242 million) paid in 2022 based on 2021 results. Fitch expects FCF to be USD-185 million in 2024 and USD760 million in 2025.

**Alagoas Liability:** As of Sept. 30, 2022, Braskem had a provision of BRL7.23 billion (~USD1.38 billion) on its balance sheet related to the geological event in the state of Alagoas. BRL4.85 billion (~USD926 million) of this was considered current liabilities and BRL2.38 billion (~USD454 million) of which was non-current. This represents a decrease from BRL9.16 billion (~USD1.7 billion) at the beginning of 2021 following disbursements of BRL2.9 billion (~USD543 million) in 2021 and BRL2.0 billion (~385 million) in 9M22.

Fitch expects payments of USD750 million in 2023 and USD330 million in 2024 related to this liability and that any other contingencies would not be above BRL2 billion (USD350 million), disbursed over a long-term horizon. Material deviations from these amounts could be a rating concern.

**Rating Above Country Ceiling:** Braskem's ratings are not constrained by Brazil's 'BB' Country Ceiling in accordance with Fitch's Non-Financial Corporates Exceeding the Country Ceiling Rating Criteria. Braskem has strong operating cash flow generation from assets abroad in the U.S., Germany and Mexico (43% in 2022 and around 37% of its EBITDA historically). Other considerations include cash generated abroad by exports, cash held abroad and track record of having undrawn standby credit lines.

**Change in Control:** Fitch rates Braskem on a standalone basis, and a change in control event would not automatically lead to a rating action. Braskem is owned by Novonor Group (formerly Odebrecht), which owns 38.3% of its total capital and 50.1% of its voting capital, and Petroleo Brasileiro S.A. (Petrobras; BB-/Stable), which owns 36.1% of its total capital and 47.0% of its voting capital. Recently the shareholders have indicated their interest to sell its preferred shares and migrate the company to Novo Mercado, Bovespa's highest corporate governance level.

## 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+/Positive), 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-/Positive), in terms of scale, profitability and geographic diversification.

Around 43% of Braskem's EBITDA is generated outside Brazil moving to around 40% in the medium term. Its thermoplastic resin operations in Brazil are integrated, which reduces cash flow volatility. The company's strong 60%-65% market share in Brazil is also a competitive advantage, as it allows Braskem to better withstand higher raw material prices and pass-through strategies.

Braskem's leverage, excluding Braskem Idesa, is expected to be in line with its petrochemical peers at 1.9x in 2022. On a consolidated basis, leverage is higher relative to peers during the challenging environment at an expected 2.8x in 2022. The consolidated leverage is higher than Orbia's at 2.2x and Alpek's at 1.4x, as well as Dow's 1.2x leverage. All three Latin American players maintain strong cash positions, long-term debt-amortization profiles, and strong access to local and international debt markets.

## KEY ASSUMPTIONS

--A new bond is issued with the proceeds being used for general corporate purposes, including the repayment of outstanding debt;

--Medium-term utilization rates of Brazil PE 85%, Brazil PP 85%, Brazil PVC 75%, U.S. PP 85%, Germany PP 90% and Mexico PE 80%;

--Brazil PE realized revenue/ton of USD1,810, USD1,570 and USD1,575 during 2022-2024;

--Brazil PP realized revenue/ton of USD1,290, USD1,115 and USD1,140 during 2022-2024;

--Brazil vinyls realized revenue/ton of USD1,745, USD1,585 and USD1,520 during 2022-2024;

--Brazil ethylene/propylene realized revenue/ton of USD1,410, USD1,060 and USD1,290 during 2022-2024;

--U.S. and Europe PP realized revenue/ton of USD2,235, USD1,930 and USD1,975 during 2022-2024;

--Mexico PE realized revenue/ton of USD1,555, USD1,345 and USD1,350 during 2022-2024;

--PE-Ethane reference spreads of USD1,280/ton in 2022 and USD1,150/ton in 2023 and 2024;

--PE-Naphtha reference spreads of USD760/ton in 2022, USD625/ton in 2023 and USD630/ton in 2024;

--PP-Propylene reference spreads of USD970/ton in 2022, USD990/ton in 2023 and USD890/ton in 2024;

--Average capex of 4.5% of revenues;

--No dividends to shareholders in 2023 and 2024.

## RATING SENSITIVITIES

Factors that could, individually or collectively, lead to positive rating action/upgrade:

Although unlikely in the near term, a positive rating action could be considered if:

--Net debt/EBITDA, excluding Braskem Idesa, is consistently below 1.5x and consolidated net debt/EBITDA is below 2.5x;

--Ethane supply sustainability for Braskem's operations in Mexico, including successful construction of the ethane import terminal;

--Sustained consolidated net debt of less than USD5 billion.

Factors that could, individually or collectively, lead to negative rating action/downgrade:

--Net debt/EBITDA above 2.5x, on average through the cycle, excluding Braskem Idesa or consolidated net debt/EBITDA above 3.5x;

--Higher than expected shareholder dividends;

--A change in Braskem's management strategy that alters its adequate financial profile with a robust liquidity position and long-term debt schedule.

--Major additional contingent claims for the Alagoas incident;

--Major financial support for its subsidiary in Mexico.

## BEST/WORST CASE RATING SCENARIO

International scale credit ratings of Non-Financial Corporate issuers have a best-case rating upgrade scenario (defined as the 99th percentile of rating transitions, measured in a positive direction) of three notches over a three-year rating horizon; and a worst-case rating downgrade scenario (defined as the 99th percentile of rating transitions, measured in a negative direction) of four notches over three years. The complete span of best- and worst-case scenario credit ratings for all rating categories ranges from 'AAA' to 'D'. Best- and worst-case scenario credit ratings are based on historical performance. For more information about the methodology used to determine sector-specific best- and worst-case scenario credit ratings, visit https://www.fitchratings.com/site/re/10111579.

## LIQUIDITY AND DEBT STRUCTURE

**Adequate Liquidity:** Braskem adopts a conservative and proactive financial strategy to limit the risks associated with exposure to the cyclical and capital-intensive nature of its business. The company has a strong cash position, with BRL12.1 billion of readily available cash and marketable securities as of Sept. 30, 2022, excluding Braskem Idesa (BRL2.1 billion). As of Sept. 30, 2022, Braskem had BRL51.6 billion of total consolidated long-term debt, including BRL11.8 billion of debt at Braskem Idesa. Braskem had BRL1.7

billion of consolidated short-term debt as of Sept. 30, 2022, including Braskem Idesa's BRL141 million of short-term debt.

Braskem's strong cash position and its extended debt-amortization profile lead to manageable refinancing risks in the medium term. Between 2023 and 2025, the company faces debt amortization on average of BRL1.5 billion per year. This includes Braskem's 2024 bond, which had BRL1.62 billion (~USD300 million) outstanding as of Sept. 30, 2022. As of Sept. 30, 2022, about 93% of the company's total debt was denominated in U.S. dollars. Braskem has a record of strong access to local and international debt markets. The company's financial flexibility is enhanced by a USD1 billion unused stand-by credit facility due 2023.

**ESG Considerations**

Braskem has an ESG Relevance Score of '4' for Waste & Hazardous Materials Management; Ecological Impacts due to the geological event in Alagoas that affected its salt mining operations, which 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 '4' for Governance Structure due to a past history of corruption scandals and shareholders' financial stress, which has a negative impact on the credit profile, and is relevant to the ratings in conjunction with other factors.

Unless otherwise disclosed in this section, the highest level of ESG credit relevance is a score of '3'. This 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. For more information on Fitch's ESG Relevance Scores, visit www.fitchratings.com/esg

## 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

30 January 2023

## 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.

## RATING ACTIONS

| ENTITY / DEBT | RATING | | |
|---|---|---|---|
| Braskem Netherlands Finance B.V. | | | |
| senior unsecured | LT | BBB- | 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. 28 Oct 2022) (including rating assumption sensitivity)

## 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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Chemicals and Fertilizers Corporate Finance Europe Netherlands