

Fitch Downgrades Braskem's IDR to 'BB+'; Outlook Stable

Fitch Ratings-Chicago-02 July 2020:

Fitch Ratings has downgraded Braskem S.A.'s Long-Term Foreign- and Local-Currency Issuer Default Ratings (IDR) to 'BB+', from 'BBB-'. At same time, Fitch has affirmed Braskem's National Long-Term Rating at 'AAA(bra)'. The Outlook is Stable.

The downgrade reflects Fitch's view that the deep global recession caused by the coronavirus pandemic and sharp economic contraction in Brazil, Mexico, the U.S. and Europe have elevated the challenges faced by Braskem as it seeks to deleverage through organic and inorganic measures. The weak macroeconomic backdrop has also increased uncertainty about the duration of the downturn in the petrochemical cycle that started in 2019 and the return to a balanced market for polyethylene (PE) and improved demand for polypropylene (PP). The timing of the pandemic was inopportune for Braskem because it coincided with additional liabilities of BRL2.7 billion related to a geological event in Alagoas.

Fitch's base case, excluding the operations in Mexico, forecasts Braskem's net debt/EBITDA ratio at 4.5x-3.6x during 2020-2021; if including the Mexican operations, which hold non-recourse debt, Fitch's base-case net leverage ratio is 4.9x in 2020 and 3.9x in 2021.

Braskem's ratings reflect its leading position in the Latin American petrochemical sector, strong business profile due to geographic and raw material diversification and a record of consistent FCF generation. The company's high leverage ratio is a weakness compared with investment-grade peers in Latin America. Factored into the company's ratings are its commitment to maintain a strong liquidity position and a manageable debt amortization schedule, with no refinancing risk in the medium term.

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 in the U.S., Germany and Mexico, which contribute around 45% of its EBITDA. The company's ratings are also supported by cash generated abroad by exports, cash held abroad and a record of retaining undrawn standby credit lines.

Key Rating Drivers

Weak Operating Results: Fitch is projecting that Braskem's EBITDA, excluding Mexico, will remain depressed in 2020 and 2021 at BRL5.7 billion and BRL6.5 billion, respectively, due to lower volume in Brazil, the U.S. and Europe and still weak petrochemical spreads. These figures compare with BRL4.3 billion in 2019 and BRL9.5 billion in 2018 and 2017. Braskem is attempting to limit the impact of the global downturn on its operating cash flow and FCF by reducing fixed costs, lowering capex and eliminating dividends distributions.

Fitch's base-case forecasts Braskem's consolidated recurring EBITDA cash flow from operation (CFFO) and FCF for 2020 at approximately BRL7.2 billion, BRL2.6 billion and negative BRL356 million, respectively. For 2021, Fitch projects BRL8.1 billion of recurring EBITDA, BRL3.8 billion of CFFO and BRL1.6 billion of positive FCF. This compares with BRL11.3 billion of EBITDA, BRL9.5 billion of CFFO and BRL5.3 billion of positive FCF, after BRL1.5 billion of dividends, in 2018.

High Leverage: The combination of weaker spreads, lower volume and legal contingencies has pressured Braskem's leverage. Fitch estimates consolidated net leverage will reach 4.9x in 2020; or 4.4x when excluding the operations in Mexico. For 2021, these ratios should be 4.0x and 3.6x, respectively. The incident in Braskem's salt mining operation (part of the PVC operations) in Alagoas have led to BRL2.7 billion of commitments; around BRL1.7 billion is already excluded from its cash position and the remainder will be amortized over four years.

Solid Business Diversification: Braskem's ratings are underpinned by its strong geographic and feedstock diversification, and leading market positions in PE and PP. The company's operations in the U.S., Germany and Mexico represent around 35%-45% of its consolidated EBITDA, while its Brazilian operation accounts for the balance. Braskem's feedstock is mainly balanced between naphtha 38%, 34% propeno and 22% ethane following the ramp-up of its joint venture in Mexico, Braskem Idesa SAPI (BB-/Negative). 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.

Exposure to PEMEX: Fitch's base case does not incorporated any material cash flow from the Mexican operation - where Braskem Idesa has a long-term raw-material supply agreement with Petroleos Mexicanos (PEMEX) (BB-/Stable) - until 2022. The agreement includes a supply of 66,000 barrels per day (bpd) of ethane, which PEMEX has been unable to deliver due to a drop in production caused by a lack of investment: it is able to only provide about 49,000 bpd. During February 2020 Braskem Idesa commenced its fast-track project to import ethane from the U.S., with capex of USD3.5 million, which should result in the importation of up to 16,000 bpd of ethane by 2022, out of a capacity of 25,000 bpd; this equates to 24% of total needs. We have not incorporated the construction of a new import terminal for ethane into our analysis.

Change in Control: Braskem is owned by Odebrecht Group, which owns 38.3% of its total capital and 50.1% of its voting capital, and Petroleo Brasileiro S.A. (Petrobras) (BB-/Negative), which owns 36.1% of its total capital and 47.0% of its voting capital. Odebrecht has offered its Braskem shares as collateral for some of its debt to a group of Brazilian banks. These shares are under the control of Odebrecht's creditors, given the default by Odebrecht on its financial obligations, which could trigger a change of control at Braskem. Fitch rates Braskem on a standalone basis and thus, a change in control event would not automatically lead to a rating action.

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 a medium-size scale compared with global chemical peers, such as Dow Chemical Company (BBB+/Negative), yet is well positioned relative to Latin America peers, such as

Orbia Advance Corporation, S.A.B de C.V. (BBB/Negative) and Alpek, S.A.B. de C.V. (BBB-/Stable), in terms of scale, profitability and geographic diversification.

Around 35%-45% of Braskem's EBITDA is generated outside of Brazil. Its thermoplastic resin operations in Brazil are integrated, which reduces cash flow volatility, while in Mexico, we expect its profitability to remain above industry average due to its long-term raw-material supply agreement with PEMEX. 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 compares negatively with the around 2.5x of Orbia and Alpek and is much higher than the 2.0x leverage of Dow Chemical Company (BBB+/Negative).

Key Assumptions

Fitch's Key Assumptions Within Our Rating Case for the Issuer

- Volume to decline in 2020 as result of the pandemic and gradually recover to 2019 levels by 2022
- Spreads to remain pressured due to weaker demand, despite lower raw material prices
- Annual capex of around USD600 million in 2020 and 2021
- No dividends from Braskem Idesa in 2020-2022
- No dividends payments during 2020-2021

RATING SENSITIVITIES

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

- Consolidated net debt/EBITDA at 3.0x, excluding Braskem Idesa at 2.5x on average through the cycle;
- Positive FCF generation across the cycle;
- Maintenance of a strong liquidity position with no exposure to refinancing risk.

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

- Consolidated net debt/EBITDA at 4.0x, excluding Braskem Idesa at 3.5x on average through the cycle;
- Higher than expected request of dividends by the shareholder;
- A change in Braskem's management strategy that alters its adequate financial profile with a robust liquidity position and long-term debt schedule.

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

Robust 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 BRL7.2 billion of readily available cash and marketable securities as of March 31, 2020, excluding Braskem Idesa (BRL1.1 billion) and BRL1.7 billion of restricted cash related to Alagoas.

Braskem's readily available cash was sufficient to cover debt amortization until mid-2023. On April 1, 2020, the company drew down the standby credit facility by USD1 billion. Braskem has a record of strong access to local and international debt markets. As of March 31 2020, Braskem had BRL53.3 billion of total debt and BRL3.9 billion of short-term debt, or BRL40.4 billion and BRL2.8 billion, respectively, excluding Braskem Idesa.

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.

ESG Considerations

Braskem has an ESG Relevance Score of 4 for governance structure due to a still-recent record of corruption scandals and shareholders' financial stress. Positively, during May 2020, the company announced that the U.S. Department of Justice (DOJ), Securities Exchange Commission (SEC) and local authorities in Brazil (Ministerio Publico Federal) confirmed the conclusion of the independent compliance monitoring of Braskem. The authorities certified that the company had implemented all the recommendations regarding the structure and execution of its compliance program meeting the standards set out in the DoJ plea agreement and the SEC consent. This has a negative impact on its credit profile, and is relevant to the rating in conjunction with other factors.

The company also has a Score of 4 for ecological impact due to the geological event in Alagoas that affected its salt mining operations. This has a negative impact on its credit profile, and is relevant to the rating in conjunction with other factors.

Except for the matters discussed above, the highest level of ESG credit relevance, if present, is a score of 3 - ESG issues are credit neutral or have only a minimal credit impact on the entity(ies), either due to their nature or the way in which they are being managed by the entity(ies). For more information on Fitch's ESG Relevance Scores, visit www.fitchratings.com/esg

Braskem S.A.; Long Term Issuer Default Rating; Downgrade; BB+; RO:Sta
; Local Currency Long Term Issuer Default Rating; Downgrade; BB+; RO:Sta
; National Long Term Rating; Affirmed; AAA(bra); RO:Sta

Braskem Netherlands Finance B.V.

----senior unsecured; Long Term Rating; Downgrade; BB+

Braskem America Finance Company

----senior unsecured; Long Term Rating; Downgrade; BB+

Braskem Finance Limited

----senior unsecured; Long Term Rating; Downgrade; BB+

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Applicable Criteria

[Corporate Hybrids Treatment and Notching Criteria \(pub. 11 Nov 2019\)](#)

[Corporate Rating Criteria \(pub. 01 May 2020\),\(including rating assumption sensitivity\)](#)

[National Scale Rating Criteria \(pub. 08 Jun 2020\)](#)

[Non-Financial Corporates Exceeding the Country Ceiling Rating Criteria \(pub. 25 Feb 2020\)](#)

Applicable Model

Numbers in parentheses accompanying applicable model(s) contain hyperlinks to criteria providing description of model(s).

Corporate Monitoring & Forecasting Model (COMFORT Model), v7.9.0 ([1](#))

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