

Research Update:

Brazilian Petrochemicals Producer Braskem Downgraded To 'BB+' From 'BBB-' On Consistently High Leverage, Outlook Stable

July 8, 2020

Rating Action Overview

- S&P Global Ratings expects Braskem's leverage to remain higher than what it would expect for the 'BBB-' ratings, with net debt to EBITDA above 3.5x for the next 12 months and persistent downside risks.
- On July 8, 2020, we lowered our ratings on Brazil-based petrochemicals company to 'BB+' from 'BBB-'. We also assigned a '3' recovery rating to Braskem's senior unsecured notes.
- The stable outlook reflects that despite downside macroeconomic and industry risks, we believe that management would continue taking countercyclical measures to provide relief to the company's capital structure, leading to net debt to EBITDA at 3.0x-4.0x in 2021.

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Rating Action Rationale

Downside risks remain high given uncertainties coming from the pandemic. Demand for global chemicals products took a substantial hit this year, and the rebound to the 2019 levels remains uncertain amid our view of a likely uneven economic recovery across the globe. While our base-case scenario assumes a gradual increase in petrochemical volumes in 2021, risks remain on the downside. Also, given our view of an oil price rebound and continued market oversupply at least until mid-2021, mainly of the polyethylene (PE), Braskem's margins could again be pressured next year. As a result, we now expect the company to post net debt to EBITDA at 3.5x-4.5x by the end of 2020 and 3.0x-4.0x by 2021 compared with our previous expectation of 3.0x-3.5x for 2020.

Other company-specific risks might be partly compensated by management's commitment to reduce leverage. Potential for additional cash outflows stemming from the geological phenomenon at the state of Alagoas or some limited support the Mexican project finance unit could make it difficult for the company to reduce its net debt to EBITDA below 3.5x in the next 12 months. This could be the case despite possible countercyclical measures, such as non-core

asset sales. Our base-case scenario doesn't assume any asset sales, given the uncertainties about timing and proceeds, particularly because of currently volatile market conditions. Still, we incorporate management's commitment to reduce leverage in our stable outlook on the rating.

Lower feedstock costs and the Brazilian real's depreciation and new PP plant should help to mitigate the expected volumes contraction in 2020. Considering COVID-19 outbreak effects, Braskem's cracker utilization rates fell to 70%-75%. Therefore, we forecast volumes to be down 5%-10% this year. In the second half of the year, Braskem should benefit from the lower feedstock costs given the naphtha price collapse. In addition, the weakening real, with our expectation of R\$4.95 per \$1 in 2020 compared with R\$3.95 per \$1 in 2019 will contribute to cash flows because most of Braskem's cost structure is set in that currency. As a result, we expect EBITDA (without Braskem Idesa) at \$1.25 billion - \$1.35 billion, 20%-30% higher than in 2019.

Outlook

The stable outlook reflects our expectation of gradual increase in cash flows in the next 12 months and net debt to EBITDA around 4.0x by the end of 2020. The outlook also incorporates the downside industry and economic risks, combined with the company's likely countercyclical measures, which would reduce leverage to 3.0x-4.0x in 2021.

Upside scenario

A positive rating action in the next 12-18 months could result from a faster rebound in the company's volumes with consistently better PE and polypropylene (PP) spreads than we currently predict, along with countercyclical measures that reduce leverage. In such a scenario, EBITDA would rise, EBITDA margins reach 14%-16%, which along with noncore asset sales push down net debt to EBITDA to around 3.0x.

Downside scenario

We would downgrade Braskem if its net debt to EBITDA were to remain above 4.0x and funds from operations (FFO) debt below 20% in 2021. This could happen amid deeper erosion in volumes and prices stemming from persistently weaker economic conditions. In addition, any significant contingency that could damage the company's capacity to reduce leverage such as the rising costs from the Alagoas geological event or additional limited support to Braskem Idesa project could contribute to it.

Company Description

Braskem is the leading thermoplastic resins producer in the Americas and among the world's top 10 petrochemicals producers, with leading positions in PE (low density [LDPE], high density [HDPE], and linear low density [LLDPE]), PP, and polyvinyl chloride (PVC). The company integrates the first and second stages 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. Those companies have a shareholders agreement that dictates the company's cash flow related matters.

Our Base-Case Scenario

A 5%-10% volume contraction in 2020 followed by a 3%-5% increase in 2021.

An average exchange rate of R\$4.95 per \$1 in 2020 and R\$5.0 per \$1 in 2021, and average Brent prices at \$40 per barrel in 2020, increasing to \$50 per barrel in 2021.

In terms of cash flows, the weaker real partly offsets the impact of lower volumes, particularly in 2020.

Overall global spreads for PE to remain weak until mid-2021. We highlight that Braskem benefits from its cost structure base, mainly naphtha based, mitigating the impact of the petrochemicals' cycle trough.

EBITDA margin of 12%-14% in 2020 and 2021.

Capital expenditures (capex) of \$600 million in 2020, which will be significantly lower in next years because of the completion of the construction of the new PP plant in the U.S.

No dividend payments.

Based on these assumptions, we arrive at the following credit metrics:

- Adjusted net leverage at 3.5x-4.0x by the end of 2020, improving to 3.0x-3.5x by the end of 2021; and
- Adjusted free operating cash flow (FOCF) to debt in the low-teen percentage area in 2020 and 2021.

Liquidity

We assess Braskem's liquidity as strong. We expect sources to exceed uses by more than 1.5x in the next 12 months and to be higher than 1.0x in the next 24 months. The company reported sound cash reserves of \$2 billion as of March 2020 and a committed credit facility of \$1 billion, compared with short-term debt of roughly \$200 million. Moreover, Braskem has access to diversified funding sources, which supports its smooth debt maturity profile.

Principal Liquidity Sources

Short-term cash and cash equivalents of R\$10 billion;

Undrawn committed lines of \$1 billion; and

FFO of about R\$4.5 billion for the next 12 months.

Principal Liquidity Uses

Short-term debt maturities of approximately R\$1 billion; and

Capex of R\$3 billion.

Issue Ratings - Recovery Analysis

We're assigning a '3' recovery rating to Braskem's existing senior unsecured notes. These notes are either issued or guaranteed by Braskem.

Key analytical factors

- Our simulated default scenario assumes a payment default in 2025 due to persistent weak petrochemical spreads, causing revenues and margins to decline, primarily related to a prolonged deterioration in macroeconomic conditions, increased competition, and operational issues.
- Our simulated default scenario assumes the company is restructured as a going concern, rather than liquidated, because of its solid market position in the markets it operates.
- We derive our distressed enterprise value for Braskem by applying a 5.5x multiple to our estimated emergence EBITDA of about \$4.7 billion. The 5.5x multiple is in line with company's peers that have a solid competitive position.

Simulated default assumptions

- Year of default: 2025
- EBITDA at emergence: R\$4.7 billion
- Implied multiple: 5.5x
- Gross enterprise value: R\$26 billion
- 5% of administrative expenses: R\$1.3 Billion

Simplified waterfall

- Net enterprise value: R\$25 billion
- Senior unsecured debt: R\$30.4 billion
- Recovery expectations for senior unsecured debt: 50%-70%(rounded estimate: 65%)

Ratings Score Snapshot

Issuer Credit Rating:

- Global Scale: BB+/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
- Capital structure: Neutral
- Financial policy: Neutral
- Liquidity: Strong
- Management and governance: Fair
- Comparable rating analysis: Negative (-1 notch)

Related Criteria

- 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
- Criteria | Corporates | General: Recovery Rating Criteria For Speculative-Grade Corporate Issuers, Dec. 7, 2016
- General Criteria: Guarantee Criteria, Oct. 21, 2016
- Criteria | Corporates | General: Methodology And Assumptions: Liquidity Descriptors For Global Corporate Issuers, Dec. 16, 2014
- Criteria | Corporates | General: Corporate Methodology, Nov. 19, 2013
- General Criteria: Country Risk Assessment Methodology And Assumptions, Nov. 19, 2013
- General Criteria: Ratings Above The Sovereign--Corporate And Government Ratings: Methodology And Assumptions, 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
- General Criteria: Use Of CreditWatch And Outlooks, Sept. 14, 2009

Ratings List

Downgraded; CreditWatch/Outlook Action

	To	From
Braskem S.A.		
Issuer Credit Rating	BB+/Stable/--	BBB-/Negative/--

Ratings Affirmed

Braskem S.A.

Issuer Credit Rating	
Brazil National Scale	brAAA/Stable/--

Downgraded; New Rating

Braskem S.A.

Senior Unsecured	BB+
Recovery Rating	3(65%)

Braskem America Finance Company

Senior Unsecured	BB+
Recovery Rating	3(65%)

Braskem Finance Ltd.

Senior Unsecured	BB+
Recovery Rating	3(65%)

Braskem Netherlands Finance

Senior Unsecured	BB+
Recovery Rating	3(65%)

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