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Rating Action: Moody's affirms Braskem's Ba1 ratings; changes outlook to negative

13 Jul 2020

New York, July 13, 2020 -- Moody's Investors Service, ("Moody's") affirmed Braskem S.A. ("Braskem")'s Ba1 corporate family rating and the Ba1 ratings on the foreign and local currency debt issuances of Braskem Finance Ltd and Braskem America Finance Company, respectively, fully guaranteed by Braskem S.A. The outlook for the ratings was changed to negative from stable.

Ratings Affirmed:

..Issuer: : Braskem S.A.

LT Corporate Family Rating, Affirmed Ba1

..Issuer: Braskem America Finance Company

USD 750 mm GTD Global Senior Unsecured notes due 2041, Affirmed Ba1

..Issuer: Braskem Finance Ltd

USD 289 mm GTD Global Senior Unsecured notes due 2022, Affirmed Ba1

USD 750 mm GTD Global Senior Unsecured notes due 2024, Affirmed Ba1

USD 500 mm GTD Global Senior Unsecured notes (perpetual), Affirmed Ba1

Outlook Actions:

.. Issuer:: Braskem S.A:

....Outlook, Changed To Negative from Stable

..Issuer: Braskem America Finance Company:

....Outlook, Changed To Negative from Stable

..Issuer: Braskem Finance Ltd

....Outlook, Changed To Negative from Stable

RATINGS RATIONALE

The change in Braskem's ratings outlook to negative follows the company's announcement on July 9th of an additional BRL1.6 billion (\$300 million) provision related to a geological event in Alagoas. The new provision include BRL850 million in possible assistance measures for residents and BRL750 million in additional expenses to fund the definitive shutdown of the salt mining activities in Maceió, the operation management and the relocation of properties, among others. The additional provision reduces the visibility over potential future liabilities coming from the agreement Braskem ratified with authorities on January 6th until a definitive agreement covering all social and environmental aspects of the incident is reached.

While Braskem's robust financial position provides a good cushion against the financial impact of the new provision, the additional call on the company's liquidity comes at a time of strained credit metrics due to the petrochemical downcycle, supply issues in Mexico and uncertainties surrounding the full impact of coronavirus on the company's operations and on the industry's downcycle in 2020-21. The new provision adds to the existing BRL3.4 billion, bringing total liabilities related to this incident to BRL5 billion. The provisions do not immediately jeopardize Braskem's sound liquidity since the payments will likely be made in installments in the coming years, but reduce the company's cushion to ride through the downcycle. At the end of March 2020, Braskem had total cash of BRL12.3 billion, plus a \$1 billion (BRL5.2 billion) committed credit facility that was

fully drawn in April, and only BRL5.2 billion in debt coming due until the end of 2021, including Mexico's debt.

Braskem's credit quality remains mainly supported by its large cash position, lack of financial covenants that could threaten the company's short-term liquidity amid a rising leverage, and track record of positive free cash flow generation even under adverse market conditions. Moreover, the company announced measures to reduce costs and cash outflows during the pandemic -- namely a 10% reduction in fixed costs, the reduction of capital spending to \$600 million from \$721 million and suspension of dividend payments for 2020. Still, with the resurgence of the uncertainties related to the liabilities of Alagoas, continued supply issues in Mexico and Pemex' rising delinquency on the liquidated damages payments (currently at \$40 million), Braskem's cushion to withstand the industry's weakness in the next few years is diminishing. Low used capacity levels in Mexico are preventing the formal physical and financial completion of the project-finance and led to the issuance of a letter of credit to cover an equity call of \$200 million for Braskem.

Braskem's adjusted gross leverage peaked at close to 9.0x at the end of March 2020 (including Mexico's project finance debt) as a consequence of the translation of Brazilian real's depreciation to debt and weaker downcycle EBITDA. Gross debt will rise further during 2020 with the withdrawal of Braskem's committed facility in April 2020. But adjusted gross leverage will decline to around 5.0-6.0x by early-2021 as the company repays the facility, and while EBITDA catches up with the depreciated currency and improves with current petrochemical spreads, and additional volumes coming from the new polypropylene plant in the US and the fast track solution to increase capacity utilization in Mexico. Low oil prices have flattened the industry's ethylene cost curve, supporting low feedstock costs and higher spreads for Braskem's mostly naphtha-based Brazilian operations in 2020 and helping offset lower short-term demand. But, long-term industry fundamentals still point to an oversupply and downcycle that will strain prices for polyethylene, polypropylene and basic chemicals. As such, if the depth of the strain on global demand and prices for Braskem's key products make current naphtha-based spreads less sustainable, Braskem's leverage ratios would remain under stress without an asset sale or another external liquidity event.

We will assess the evolution of Braskem's current operating environment, particularly the trend of oil prices, resin prices and foreign exchange rate, and the company's ability to increase its financial flexibility and generate positive free cash flow during 2020. A reversal in the current deleverage and positive free cash flow generation trend would lead to additional negative rating actions in the next few quarters.

Braskem's Ba1 rating continues to be supported by its size as the largest petrochemical company in Brazil and in the Americas in terms of production capacity of resins, with historically above-industry-average operating margins because of high capacity utilization rates, long-term client relationships and product customization. The rating also reflects the company's dominant market position in Brazil and its geographic diversification, with operations in the US, Mexico and Europe. Finally, the company's sizable cash position, track record of positive free cash flow generation even under adverse market conditions and liability management initiatives support its adequate liquidity and are additional positive credit considerations.

The rating is constrained by the sharp deterioration in credit metrics since late 2019, weak industry conditions globally stemming from the coronavirus outbreak and global overcapacity as well as the company's high exposure to the volatility of petrochemical spreads. The rating also considers the dependence on Petroleo Brasileiro S.A. - PETROBRAS (PETROBRAS, Ba2 stable) and Petroleos Mexicanos (PEMEX, Ba2 negative) for the supply of naphtha and ethane in Brazil and Mexico, respectively. Additional credit concerns include the current supply issues with Pemex in Mexico, potential additional liabilities related to Alagoas and Braskem's shareholders intention to divest the business.

The negative outlook reflects the significant overhangs on Braskem's credit quality coming from the incident in Alagoas and the supply issues in Mexico at a time of weakened operations and credit metrics. The outlook also reflects our expectations that Braskem's credit metrics will remain weak for its rating category in the next 12-18 months, but that the company will continue to prudently manage liquidity to preserve its credit profile through the downcycle.

FACTORS THAT COULD LEAD TO AN UPGRADE OR DOWNGRADE OF THE RATINGS

The rating could be downgraded if Braskem's liquidity profile deteriorates because of additional material liabilities from litigations and class actions, weaker than anticipated sales volumes or petrochemical spreads that results in higher leverage or cash burn, or more aggressive financial policies, including dividend payout consistently above the minimum level established by the law. Furthermore, negative rating pressure could result from weaker operating results on a sustained basis or persistently high leverage through the cycle, with total adjusted debt/EBITDA of 3.5x or above and retained cash flow/total debt lower than 15% (3.4% for the 12

months ended March 2020) on a sustained basis.

An upgrade of Braskem's rating is unlikely in the short-term, but the rating outlook could be stabilized if the company resolves the current overhangs related to Alagoas and Mexico, while improving its liquidity, financial flexibility and credit metrics. Longer term, the rating could be upgraded if Braskem shows a continued track record of a conservative financial policy, maintaining sound liquidity and positive free cash flow generation. Quantitatively, an upgrade would also require leverage (as measured by total adjusted debt/EBITDA) sustained below 3.0x.

The principal methodology used in these ratings was Chemical Industry published in March 2019 and available at https://www.moodys.com/researchdocumentcontentpage.aspx?docid=PBC_1152388. Alternatively, please see the Rating Methodologies page on www.moodys.com for a copy of this methodology.

Braskem is the largest producer of thermoplastic resins (polyethylene, polypropylene and polyvinyl chloride) in the Americas, with an annual production capacity of 8.9 million tons. Braskem also has a production capacity of 10.5 million tons of basic petrochemicals such as ethylene, propylene and gasoline, among others; and about 500 thousand tons of caustic soda, EDC and chlorine. For the 12 months ended March 2020, the company reported consolidated net revenue of BRL52 billion (\$12.6 billion), with EBITDA margin of 11%.

REGULATORY DISCLOSURES

For further specification of Moody's key rating assumptions and sensitivity analysis, see the sections Methodology Assumptions and Sensitivity to Assumptions in the disclosure form. Moody's Rating Symbols and Definitions can be found at: https://www.moodys.com/researchdocumentcontentpage.aspx?docid=PBC_79004.

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At least one ESG consideration was material to the credit rating action(s) announced and described above.

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