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

07 Jul 2021

New York, July 07, 2021 -- Moody's Investors Service ("Moody's") has today 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 was changed to stable from negative.

Ratings Affirmed:

..Issuer: : Braskem S.A.

LT Corporate Family Rating, Affirmed Ba1

..Issuer: Braskem America Finance Company

GTD Global Senior Unsecured notes due 2041, Affirmed Ba1

..Issuer: Braskem Finance Ltd

GTD Global Senior Unsecured notes due 2024, Affirmed Ba1

GTD Global Senior Unsecured notes due 2022, Affirmed Ba1

Outlook Actions:

.. Issuer:: Braskem S.A:

....Outlook, Changed To Stable from Negative

..Issuer: Braskem America Finance Company:

....Outlook, Changed To Stable from Negative

..Issuer: Braskem Finance Ltd

....Outlook, Changed To Stable from Negative

RATINGS RATIONALE

The change in Braskem's ratings outlook to stable from negative reflects the company's strengthened cash generation and credit metrics that resulted from a historically strong operating performance during 2020 and 2021. The stronger operating and financial performance provide a cushion to Braskem's credit quality against potential future financial impacts of existing overhangs, namely the supply issues in Mexico and the geological event in Alagoas.

Risks associated to the existing overhangs have diminished after Braskem settled lawsuits in Alagoas in December 2020 and announced that Braskem Idesa has signed a memorandum of understanding with Petroleos Mexicanos (PEMEX, Ba2 negative) setting out respective understandings for the discussion of potential amendments to the Ethane Supply Contract, but are not completely extinguished. Until the company reaches a definitive agreement to resolve all social and environmental aspects of the geological event in Alagoas, Braskem remains exposed to existing and new potential lawsuits that were not covered by the agreements signed with Brazilian authorities in December 2020. Additionally, the resulting capital structure, cash flow generation profile and timing for dividend upstream from the Braskem Idesa joint-venture remain uncertain and subject to the final terms and conditions of the ethane supply agreement negotiation with PEMEX. However, Braskem's strong cash generation mitigates the risks that could trigger a negative rating action in the short term, including potential additional liquidity calls coming from the existing overhangs.

Braskem's consolidated EBITDA increased to BRL16.9 billion (\$3.1 billion) in the LTM ended March 2021 from BRL6.5 billion (\$1.6 billion) in 2019 when petrochemical spreads were weak and the company's operations were negatively affected by Alagoas and Mexico, while free cash flow rose to BRL3.8 billion from BRL1.4 billion in the same period. For 2021, Moody's expects EBITDA to peak at \$4.5-5 billion and free cash flow to remain positive even after the cash outflows for the provisions at Alagoas. To date, Braskem paid out BRL710 million in liabilities related to the provisions and will disburse additional BRL4.23 billion in the next 12 months. The remaining BRL4.23 billion in provisions are due in the long term, but Moody's expects most of the payments to be skewed toward 2022-23.

Braskem's adjusted gross leverage fell to 3.5x in the LTM ended March 2021 (including Mexico and 100% of the hybrid notes) from the 10.8x peak in Q2 2020. Moody's expects the leverage ratio to decline further to about 2x at year-end 2021 before gradually returning to more normalized levels of 3x-3.5x (including Mexico) in 2022-23. Excluding Mexico, adjusted gross leverage would stand at 2.7x in the LTM ended March 2021. The fast deleveraging was a result of strong EBITDA coming from high petrochemical spreads, additional sales volumes coming from a new 450kty polypropylene plant in the US, high sales volumes in Brazil, US and Europe and an approximately \$700 million debt reduction during the first quarter of the year, all of which more than offset the low capacity utilization in Mexico (67% in the LTM ended March 2021).

In 2022-23, petrochemical spreads will likely soften from current high levels as oil prices rise and supply for resins normalizes after several COVID-19 and weather related disruptions, but Braskem is proactively working on other initiatives to strengthen its balance sheet to withstand future downcycles, such as the additional \$235 million gross debt reduction announced in the second quarter of 2021. Through commodity cycles, assuming an EBITDA ranging between \$2-3.5 billion, Braskem's gross leverage would hover around 3x-4x (Moody's adjusted, including Mexico) and with a recurring \$2 billion cash position, net leverage would stand at 2x-3x, even considering the full phase-out of the special tax regime (REIQ) in Brazil.

Braskem's Ba1 rating continues to be supported by its size as the largest petrochemical company in Brazil and largest thermoplastic resins producer in the Americas, 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 geographic diversification, with operations in the US, Mexico and Europe. Finally, the company's sizable cash position, history of positive free cash flow generation even under adverse market conditions and liability management initiatives support its adequate liquidity and are additional credit positives.

The rating is constrained by the company's high exposure to the volatility in petrochemical spreads. The rating also takes into consideration the company's exposure to Petroleo Brasileiro S.A. -- PETROBRAS (Ba2 stable) and PEMEX for the supply of naphtha and ethane in Brazil and Mexico, respectively. Additional credit concerns include the current supply issues in Mexico, potential additional liabilities related to Alagoas and Braskem's shareholders' intention to divest the business.

LIQUIDITY

Braskem has strong liquidity, with total cash of BRL16.4 billion at the end of March 2021 (of which BRL1.3 billion is restricted cash related to the provisions in Alagoas), plus a \$1 billion committed credit facility available until 2023. The company's total short-term debt includes BRL8.3 billion related to the acceleration of the joint-venture project finance debt due to a technical failure to achieve the project's physical and financial completion and BRL3.2 billion in other debt instruments maturing until year-end 2022. Although Moody's has always incorporated Braskem Idesa in the credit analysis and credit metrics of Braskem, the rating agency believes that current liquidity risks related to the supply issues are contained at the joint-venture level, with Braskem's maximum exposure being the \$350 million in contingent equity call and reserve accounts.

Braskem has a solid track record of positive free cash flow generation through commodity cycles, a conservative financial management evidenced by proactive liability management initiatives and flexibility to quickly adjust cash outflows to its own internal cash generation, and no financial covenants that could threaten the company's liquidity in times of rising leverage. Additionally, Braskem has other liquidity sources, such as potential \$300 million in insurance claim and BRL2 billion in tax monetization.

RATING OUTLOOK

The stable outlook reflects Moody's expectations that Braskem's credit metrics and liquidity will remain adequate in the next 12-18 months, thus mitigating potential risks and additional liquidity calls coming from the overhangs in Alagoas and Mexico.

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% (17.3% for the 12 months ended March 2021) on a sustained basis.

An upgrade of Braskem's rating would require a full resolution of the current overhangs related to the geological event in Alagoas and the supply issues in Mexico, or further sustained improvements in liquidity, financial flexibility and credit metrics that would mitigate any residual risks coming from such overhangs under various stress scenarios. An upgrade would also require a continued track record of a conservative financial policy, sound liquidity and positive free cash flow generation, and 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.moody.com/researchdocumentcontentpage.aspx?docid=PBC_1152388. Alternatively, please see the Rating Methodologies page on www.moody.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 9.3 million tons. Braskem also has a production capacity of 10.7 million tons of basic petrochemicals such as ethylene, propylene and gasoline, among others; and about 1.4 million tons of caustic soda, EDC and chlorine. For the 12 months that ended March 2021, the company reported consolidated net revenue of BRL69 billion (\$12.5 billion), with EBITDA margin of 24%.

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.moody.com/researchdocumentcontentpage.aspx?docid=PBC_79004.

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Carolina Chimenti
Vice President - Senior Analyst
Corporate Finance Group
JOURNALISTS: 0 800 891 2518
Client Service: 1 212 553 1653

Marcos Schmidt
Associate Managing Director
Corporate Finance Group
JOURNALISTS: 0 800 891 2518
Client Service: 1 212 553 1653

Releasing Office:
Moody's Investors Service, Inc.
250 Greenwich Street
New York, NY 10007
U.S.A.
JOURNALISTS: 1 212 553 0376
Client Service: 1 212 553 1653

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