Research Update:
Braskem S.A. 'BBB-' Ratings Affirmed, Removed From CreditWatch Negative; Outlook Negative

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Table Of Contents

Overview
Rating Action
Rationale
Outlook
Ratings Score Snapshot
Related Criteria And Research
Ratings List
Research Update:

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Overview

• On Sept. 10, 2015, we placed Brazil-based petrochemical company Braskem on CreditWatch with negative implications (after we lowered the foreign currency sovereign ratings on Brazil to 'BB+' from 'BBB-') in order to test the company's resilience to a potential sovereign distress and its potential to be rated above the sovereign level.
• We are affirming our 'BBB-' global scale and 'brAAA' national scale ratings on the company and removing all ratings from CreditWatch. The outlook is now negative.
• The negative outlook reflects the challenges Braskem faces in sustaining its sound operating efficiency and strong liquidity under an environment of slower economic activity in Brazil and potentially lower financial flexibility.

Rating Action

On Dec. 4, 2015, Standard & Poor's Ratings Services affirmed its 'BBB-' global scale and 'brAAA' national scale ratings on Braskem S.A. (Braskem). At the same time, we removed the ratings from CreditWatch with negative implications, on which we placed them on Sept. 10, 2015. The outlook is now negative.

Rationale

The ratings affirmation primarily reflects Braskem's current and expected strong liquidity position, cash held outside Brazil, expected solid cash flow generation and increasing geographic diversification that, in our view, creates a cushion against the weak domestic economy and could prevent it from defaulting at the same time as the sovereign, considering a hypothetical stress scenario that we expect to accompany a sovereign default.

We expect the company to maintain its current market position as the sole producer of polyethylene and polypropylene in Brazil. This would continue to allowing the company to pass through the bulk of cost inflation and currency swings to customers, which partially mitigates the effects of the weakened economy in Brazil. The depreciated Brazilian real also boosts the company's cash flow generation because its revenues are pegged to the dollar (Braskem's products reference prices are based on international markets) while 20%-25% of costs are in local currency. Furthermore, exports and international operations has been increasing, accounting for about 45%-50% of the company's revenues.
Amid lower oil prices, naphtha-based producers' competitiveness against their gas-based peers has improved, and petrochemicals spreads have widened. Braskem's EBITDA margins are expected to remain relatively stable for the next year, supported by healthy petrochemical spreads and a favorable cost structure that benefits from lower oil prices and a weaker Brazilian real. Our main assumptions include:

• Year-end inflation in Brazil of 6.5% in 2016 and 6.0% in 2017;
• An average exchange rate (per U/S. dollar) of R$4.1 in 2016 and R$4.35 in 2017. End-of-period exchange rate is assumed at R$4.2 in 2016 and R$4.5 in 2017;
• Brent prices of $55 per barrel (bbl) in 2016 and $65 per bbl in 2017;
• Healthy petrochemical spreads, given our expectation for a supply-demand balance across polyethylene and polypropylene. From 2017 onward, we anticipate important supply additions in petrochemicals, especially in the U.S. Gulf Coast, potentially putting pressure on prices globally;
• Domestic volumes will be relatively flat in 2016 (after an approximately 6% drop during 2015) followed by a 1.5%-2.0% increase in 2017, with different trends across products. We see an increasing negative trend from polyethylene (more resilient given its focus to nondurables industries), polypropylene (with the high exposure to automotive segment partially mitigated by some modest growth in agribusiness), and polyvinyl chloride (mainly exposed to infrastructure);
• Braskem's international operations and exports will benefit from demand growth in the developed markets at rates that are the same or slightly higher than GDP and industrial production growth rates;
• Revenue growth in local currency terms of 14%-15% in 2016 and 10%-11% in 2017, highly influenced by increased exports and international operations and the depreciated Brazilian real;
• Annual capital expenditures (capex) of about R$3.0-R$3.5 billion in 2016, which incorporates the maintenance stoppage in Bahia plant and some additional equity contributions to the Mexican project for working capital needs and reserve account constitution. For 2017, we are assuming capex at about R$2.0-R$2.5 billion.

Under those assumptions, we expect Braskem to post the following credit metrics for the next two years:

• Reported EBITDA margins of about 20%;
• Net debt to EBITDA around 2.0x in 2016 and 1.7x-2.0x in 2017; and
• Funds from operations (FFO) to net debt close to 35%-40%.

Including the company's project in Mexico (Ethylene XXI project; EXXI) in our calculations, net debt to EBITDA would be around 2.5x. The EXXI project is structured with limited-recourse to Braskem and with a strong security package. Nevertheless, we believe this project is highly strategic to the company and Braskem could provide, under certain circumstances, support beyond what is legally required to maintain the project. As such, in our view,
potential support could likely be significantly lower than the project's total
debt. Although we focus our financial analysis on Braskem's figures and
exclude the project, we'll monitor contingent obligations that might arise
from it.

We understand Braskem's products have high sensitivity to country risk and
domestic economic activity, even though its commodity nature could partially
offset a local slowdown through increased exports. We stressed the company
under a Brazilian sovereign default scenario assuming:

- A GDP decline of 10% in 2016 for Brazil. International operations in the
  U.S. and Germany were not stressed;
- Petrochemicals spreads decline by 30%;
- Double inflation rates and interest rates, raising general expenses and
  floating-rate debt. We also assumed that under this scenario, Braskem
  would not be able to fully pass on cost inflation to clients;
- A currency devaluation of 50%, which doubles debt service costs related
to foreign currency debt (in local currency terms);
- A 35% haircut in cash holdings held in Brazil; and
- A drop in capex to maintenance levels and reduced dividend payout given
  sizable losses.

Even under this hypothetical scenario, the company would have sufficient cash
flow generation to cover its needs and would maintain liquidity sources over
uses of more than 1x for a one year simulated stress scenario. As a
consequence, we believe Braskem is able to be rated up to two notches above
the sovereign.

Liquidity

We assess Braskem's liquidity as "strong". We expect sources to likely exceed
uses by about 2.0x in the next 24 months. Besides the sizable cash position, we
assume that the company's cash generation will continue to provide a
significant liquidity source. Braskem has access to a diversified funding
source and solid relationships with banks, which supports its smooth debt
maturity profile, with no financial covenants under its debt agreements. The
company has generally prudent risk management and the ability to absorb
high-impact, low-probability events without refinancing.

Principal Liquidity Sources:
- Reported cash reserves of about R$6.4 billion as of September 2015;
- FFO of R$7.0–R$8.0 billion annually;
- R$500 million and $750 million in undrawn committed credit lines with no
  material adverse clauses due 2019 that could also be used by offshore
  subsidiaries.

Principal Liquidity Uses:
- Short-term maturities of about R$2.2 billion as of September 2015;
• Annual capex of about R$ 3.0–R$3.5 billion for 2016 and $2.0–R$2.5 billion in 2017;
• Dividends payout at the minimum level of 25% of net income.

Outlook

The negative outlook is based on Braskem's challenges to sustain its current sound operating efficiency and strong liquidity under an environment of weaker economic activity in Brazil and potentially lower financial flexibility (given that the company's main shareholders are exposed to higher reputation risks), which could impact Braskem's business strengths.

Downside scenario

A negative rating action may follow a weaker-than-expected economic environment in Brazil that could reduce demand for Braskem's products, while raw material costs could rise after the naphtha contract negotiation with Petrobras, accompanied by competition from imports that could squeeze the company's revenues. These factors could weaken the company's ability to continue to pass through cost increases to customers. A downgrade could follow weakening credit metrics, if it posts net debt to EBITDA of more than 3.0x-3.5x and FFO to net debt below 25% on a sustained basis (excluding the EXXI project debt). Any contingent risk related to the EXXI project or negative developments from the allegations of undue payments related to the feedstock supply agreement with Petrobras, including eventual penalties or weaker operating efficiency, could pressure the ratings as well.

Upside scenario

We could revise the outlook back to stable if Braskem sustains its sound operating efficiency and improves its free cash flow generation during the next few quarters. Under this scenario, we expect the company to continue posting net debt to EBITDA below 2.5x on a consistent basis, with FFO to net debt higher than 35% (excluding the EXXI project debt). The stable outlook also considers the maintenance of strong liquidity and fewer uncertainties related to the undue payments allegations (mainly in regard to potential penalties to the company).

Ratings Score Snapshot

Corporate Credit Rating
Global Scale         BBB-/Negative/--
National Scale       brAAA/Negative/--

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 (no impact)
Capital structure: Neutral (no impact)
Liquidity: Strong (no impact)
Financial policy: Neutral (no impact)
Management and governance: Satisfactory (no impact)
Comparable rating analysis: Neutral (no impact)

Related Criteria And Research

Related Criteria
Methodology And Assumptions: Liquidity Descriptors For Global Corporate Issuers, Dec. 16, 2014
Criteria: Standard & Poor's National And Regional Scale Mapping Tables, Sept. 30, 2014
Criteria: National And Regional Scale Credit Ratings, Sept. 22, 2014
Corporate Methodology, Nov. 19, 2013
Corporate Methodology: Ratios And Adjustments, Nov. 19, 2013
Key Credit Factors For The Commodity Chemicals Industry, Dec. 31, 2013
Ratings Above the Sovereign – Corporate and Government Ratings: Methodology and Assumptions, Nov. 19, 2013
Group Rating Methodology, Nov. 19, 2013
Use of CreditWatch and Outlooks, Sep. 14, 2009
2008 Corporate Criteria: Rating Each Issue, April, 15, 2008

Ratings List

Ratings Affirmed; CreditWatch/Outlook Action

<table>
<thead>
<tr>
<th>To</th>
<th>From</th>
</tr>
</thead>
<tbody>
<tr>
<td>Braskem S.A.</td>
<td></td>
</tr>
<tr>
<td>Corporate Credit Rating</td>
<td></td>
</tr>
<tr>
<td>Global Scale</td>
<td>BBB-/Negative/--  BBB-/Watch Neg/--</td>
</tr>
<tr>
<td>Brazil National Scale</td>
<td>brAAA/Negative/--  brAAA/Watch Neg/--</td>
</tr>
<tr>
<td>Senior Unsecured</td>
<td>BBB-</td>
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</tbody>
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Braskem America Finance Company
Senior Unsecured                     BBB-                     BBB-/Watch Neg

Braskem Finance Ltd.
Senior Unsecured                     BBB-                     BBB-/Watch Neg

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