

LANXESS AG

Germany, Specialty Chemicals


BBB+ STABLE

Corporate profile

LANXESS AG, based in Cologne, Germany, is a leading producer of specialty chemicals. The company is organised into five divisions: Advanced Intermediates, Performance Chemicals, Engineering Materials, Specialty Additives and ARLANXEO. After signing contract with Saudi Aramco on August 08, 2018 to sell its 50% stake in ARLANXEO, LANXESS will be purely focused on specialty chemicals. Closing is expected around year-end 2018.

Key metrics

Scope credit ratios	2017	Scope estimates		
		2018F	2019F	2020F
EBITDA/interest cover (x)	5.5x	8.2x	7.2x	7.9x
SaD/EBITDA	2.7x	0.8x	1.2x	1.3x
Scope-adjusted FFO/SaD	30%	89%	54%	53%
FOCF/SaD	10%	52%	18%	21%

Rating rationale

Scope Ratings has today upgraded its corporate issuer rating on German-based LANXESS AG to BBB+. Scope also affirms its S-2 short-term rating. Senior unsecured debt is upgraded to BBB+ and subordinated debt to BBB-. The Outlooks are Stable.

The upgrade is triggered by a significantly stronger financial risk profile. The company will receive funds of about EUR 1.4bn from the disposal of its ARLANXEO stake. Closing is expected to be around year-end 2018. Scope assess the risk that no regulatory approval will be granted as low. Our rating case includes debt reduction as well as investments in organic and inorganic growth, as we believe that LANXESS will maintain its conservative financial policy, balancing shareholder and debtholder interests.

With regard to LANXESS' business risk profile (unchanged at BBB+), Scope believes that specialty chemicals companies face medium sensitivity to changes in GDP and benefit from high entry barriers. The specialty chemicals industry is dominated by a wide range of differently sized companies. Factors such as production expertise and relationships with customers in aftermarkets act as de facto market entry barriers. Moreover, we consider substitution risk to be low. Specialty chemical products are often critical input materials, e.g. in the pharmaceutical or consumer goods industry, with few or no substitutes available. In 2016, LANXESS acquired US-based Chemtura in order to enlarge and diversify its position in the specialty chemicals industry. Former Chemtura products are among the top products in their respective markets. For instance, the company holds second position in global brominated flame retardants and third position in global phosphorous flame retardants production. Overall, we classify LANXESS' market position as strong, with end-market diversification deemed positive from a rating point of view. Dependency on the automobile sector is lower, compared with previous periods, thanks the company's exit from the synthetic rubber business.

Ratings & Outlook

Corporate Rating	BBB+/Stable
Short-term Rating	S-2
Senior unsecured debt	BBB+
Subordinated debt	BBB-

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Related methodology

Corporate Rating Methodology,
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Before 2017, LANXESS' profitability was markedly lower than that of close peers as well as being low for the specialty chemicals sector in general, due to high one-off costs caused by operational realignments as well as its dependency on raw materials, for example butadiene. Significantly reduced one-off costs, less dependency on raw materials and their price development, as well as tailwinds from former Chemtura divisions are likely to increase LANXESS' profitability. The financial results for Q1 and Q2 2018 already support this assumption. In conjunction with higher end-market diversity, we can therefore assume that profitability will be more resilient.

Scope believes that LANXESS' financial risk profile (upgraded to BBB+, formerly rated BBB-) is equivalent to its business risk profile from a ratings perspective. In 2013 to 2015 LANXESS' credit metrics remained weak, primarily caused by costs for realignments, M&A and a sluggish global synthetic rubber market. In the 2016/2017 period, LANXESS was in a state of transition as several M&A projects were carried out. Following the sale of LANXESS' remaining 50% stake in ARLANXEO, credit metrics are expected to be considerably stronger from this year, going forward. Despite the company's substantially stronger credit metrics, our upgrade also takes into account the late stage of the economic cycle and related downside risk. According to the company, the transaction is expected to close at around year-end 2018, pending regulatory approval. As the transaction includes a stake of 50% and the global market for synthetic rubber is not particularly concentrated, we consider the risk of no regulatory approval being granted to be low. In line with LANXESS' ongoing conservative financial policy, Scope's rating case includes deleveraging as well as investments in organic and inorganic growth. Together with solid economic growth but some headwinds from unfavourable exchange rates, Scope expects further strengthening of company's financial risk profile. LANXESS' financial risk profile continues to be supported by solid internal and external liquidity.

Among the supplementary rating drivers, we believe that the company will maintain its previous financial policy. Furthermore, we consider LANXESS' strong rating commitment to be a positive factor. According to LANXESS, one of its main strategic objectives is to maintain an investment-grade rating in the BBB range.

Outlook

The Stable Outlook reflects Scope's expectation of ongoing solid growth in the company's revenue and EBITDA, mainly based on the solid, favourable economic environment as well as the closing of the ARLANXEO transaction around year-end 2018. A higher rating may be triggered if the company is able to improve its business risk profile, raising its EBITDA margin above 19% combined with Scope-adjusted debt/EBITDA of less than 1.5x, on a sustained basis. A negative rating action could result from the initiation of large, debt-funded M&A; or a sustainable increase in Scope-adjusted debt/EBITDA to above 2.5x.

Rating drivers

Positive rating drivers	Negative rating drivers
<ul style="list-style-type: none"> • Strong position in medium sized markets • Diversified end-market split • Revenue is solid diversified by region • Moderate payout policy • Financial Policy (i.e. selective M&A strategy, commitment to maintain rating in BBB category) 	<ul style="list-style-type: none"> • Lower profitability compared to closest peers and specialty chemicals sector, in general • Historically weak Free Cashflow and Free Cashflow margin

Rating-change drivers

Positive rating-change drivers	Negative rating-change drivers
<ul style="list-style-type: none"> • EBITDA margin sustainable above 19% • SaD/EBITDA of less than 1.5x, on a sustained basis 	<ul style="list-style-type: none"> • SaD/EBITDA of above than 2.5x, on a sustained basis • Large Inorganic growth projects financed with debt



Financial overview

		Scope estimates		
Scope credit ratios	2017	2018F	2019F	2020F
EBITDA/interest cover (x)	5.5x	8.2x	7.2x	7.9x
Scope-adjusted debt (SaD)/EBITDA	2.7x	0.8x	1.2x	1.3x
Scope-adjusted FFO/SaD	30%	89%	54%	53%
FOCF/SaD	10%	52%	18%	21%
Scope-adjusted EBITDA in EUR m	2017	2018F	2019F	2020F
EBITDA	1,072	1,272	1,071	1,189
Operating lease payments in respective year	73	73	40	40
Other	0	0	0	0
Scope-adjusted EBITDA	1,145	1,345	1,111	1,229
Scope-adjusted funds from operations (FFO) in EUR m	2017	2018F	2019F	2020F
EBITDA	1,072	1,272	1,071	1,189
less: (net) cash interest as per cash flow statement	-28	-76	-67	-67
less: cash tax paid as per cash flow statement	-183	-175	-212	-249
less: pension interest	-100	-85	-85	-85
add: depreciation component operating leases	60	67	33	33
add: dividends received from at-equity	0	0	0	0
less: disposal gains fixed assets included in EBITDA	-1	0	0	0
less: capitalised interest	-3	-2	-2	-3
Change in provisions				
Scope-adjusted funds from operations	817	1,001	739	819
Scope-adjusted debt in EUR m	2017	2018F	2019F	2020F
Reported gross financial debt	2,375	2,375	1,375	1,375
Hybrid bond	250	250	250	250
less: cash, cash equivalents	-621	-2,182	-945	-779
Cash not accessible				
add: pension adjustment	578	453	453	453
add: operating lease obligation	258	116	130	130
Other	227	114	114	115
Scope-adjusted debt	3,066	1,125	1,376	1,544



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