Henkel AG & Co. KGaA Germany, Specialty Chemicals and Consumer Products

SCOPE A STABLE

Corporate profile

Henkel AG & Co. KGaA, based in Düsseldorf (Germany), manufactures adhesives and non-durable consumer products. In 2021, the company generated sales of about EUR 20.1bn and EBITDA of EUR 3.2bn. Its business segments are Adhesive Technologies, Beauty Care and Laundry & Home Care. Henkel's adhesives, including top brands like LOCTITE, TECHNOMELT and BONDERITE, are used in the automotive, metals, packaging and consumer goods markets, among others. Beauty Care and Laundry & Home Care products include hair care, soaps, shower gels, laundry detergents and dishwashing products. Schwarzkopf, syoss, Fa, Persil, Bref and Somat are just some of the brands offered by Beauty Care and Laundry & Home Care. In January 2022, Henkel announced the merger of Beauty Care and Laundry & Home Care into a newly created Consumer Brands division. The transaction should be completed by January 2023 and will also include divestments or the discontinuation of non-core brands and business acquisitions in categories across the non-durable space.

Key metrics

			Scope estimates	
Scope credit ratios	**2020**	**2021**	**2022E**	**2023E**
EBITDA/interest cover	41.5x	81.2x	76.7x	82.7x
Scope-adjusted debt (SaD)/EBITDA	0.6x	0.4x	0.6x	0.5x
Scope-adjusted FFO/SaD	139%	188%	125%	173%
Free operating cash flow (FOCF)/SaD	140%	124%	84%	122%

Rating rationale

Scope Ratings GmbH (Scope) has today assigned an A/Stable corporate issuer rating on German Henkel AG & Co. KGaA. Scope has also assigned an S-1 short-term rating and an A senior unsecured debt rating.

Given Henkel's company configuration, we have assigned a blended industry profile of A, reflecting specialty chemicals (the Adhesive Technologies division) and non-durable consumer products (the Beauty Care and Laundry & Home Care divisions). Henkel's issuer rating is based on its business and financial risk profiles of A- and AA- respectively, whereby we have overweighted the business risk profile and included our understanding that Henkel may initiate larger acquisitions in an opportunistic manner. We have made no adjustment for supplementary rating drivers.

Henkel's business risk profile is supported by its leading position in the global adhesive industry, benefiting from a strong orientation towards specialty adhesives, innovation and improving product sustainability. These factors afford good price setting power, which positively impacts the profitability (EBITDA margin) of Adhesive Technologies. In contrast, the position of Henkel's non-durable consumer product entities is weaker, especially Beauty Care in North America. Henkel's market position in Europe is much stronger, based on its roots as a German company and the high popularity of its brands in this geography. The company has sufficient price setting power, albeit lower than some competitors.

Ratings & Outlook

Corporate rating	A/Stable
Short-term rating	S-1
Senior unsecured debt	A

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Related Methodologies

Chemical Corporates Rating Methodology April 2022

Consumer Products Rating Methodology September 2021

Corporate Rating Methodology July 2021

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Bloomberg: SCOP

The diversification of the Adhesive Technologies division benefits from a stable end-market mix in the context of good overall diversification, including a portfolio of different customer types in multiple industries. However, we calculate that roughly 35% of sales are generated in cyclical end-markets. That said, this is only a negative rating factor to a limited extent, as the division's figures have been less cyclical in the past. Henkel's non-durable consumer products business is somewhat more diversified, despite more than 45% of sales being generated in Europe. The company has a broadly diversified supplier and customer portfolio as well as a well-established distribution network. Henkel's conglomerate structure, including unrelated businesses and a broad product portfolio addressing different end-markets and demand drivers, positively affects diversification.

While the EBITDA margin of the Adhesive Technologies division is rating supportive, measured against the thresholds in our sector methodology on chemicals, the opposite applies to Beauty Care and Laundry & Home Care. We see this as the direct consequence of the company's market position, especially as regards Beauty Care in North America. This region is commanded by non-durable consumer products of US-based companies. That said, the generally low volatility of Henkel's EBITDA margin is a positive rating factor. In the short term, we anticipate that operating profitability for the whole company will be weaker than the figures achieved in the last few years. This is primarily based on one-time expenses related to the merger of Henkel's Beauty Care and Laundry & Home Care into a new Consumer Brands division. In addition, higher energy and raw materials prices as well as higher logistics costs negatively affected operating profitability. This was especially the case for the company's non-durable consumer products activities, for which it typically takes longer to pass elevated costs on to customers, compared to Adhesive Technologies.

Henkel's excellent financial risk profile supports its issuer rating. In addition to tuck-in acquisitions of up to EUR 500m per year, our rating base case also includes the first share buyback scheme in Henkel's corporate history and effects from the offloading or discontinuation of non-core brands. By 31 March 2023, Henkel plans to have acquired preferred shares and ordinary shares of up to EUR 800m and EUR 200m in the years 2022 and 2023, respectively. Despite our expectation of weaker operating profitability, free operating cash flow generation should remain sufficient in the context of robust internal and external liquidity coverage. The associated risk of potential jumbo mergers is mitigated by Henkel's commitment to the single A rating category and its ability to deleverage thanks to sound discretionary cash flow generation.

The most relevant supplementary rating drivers for Henkel are financial policy and ownership structure (the Henkel family is the main shareholder, holding roughly 62% of ordinary shares). Henkel's financial policy is conservative, based on: i) various financial targets, including multiple financial key performance indicators; ii) consistently ample discretionary cash flow generation; and iii) the commitment to a single A rating category. Henkel follows a sound dividend policy with a target dividend pay-out ratio of 30%-40% of adjusted net income after minority interest.

Outlook and rating-change drivers

Stable Outlook

The Outlook for Henkel's issuer rating is Stable. In the medium term, we foresee SaD/EBITDA of around 0.5x, reflecting: i) the focus on tuck-in and selected large acquisitions instead of jumbo mergers; ii) the continued commitment to a historically conservative financial policy; iii) financial impacts from the merger of Beauty Care and Laundry & Home Care; and iv) the complete execution of the share buyback programme.

Positive rating action

A positive rating action could be evaluated through an improved business risk profile, including a persistently higher EBITDA margin. Moreover, if the company indicate stronger credit friendly targets and move into a net cash position on a sustained basis.

Negative rating action

A negative rating action might be evaluated if we see indication that more shareholder friendly policies are adapted while SaD/EBTIDA move close to or above 2.0x on a persistent basis. A break with its conservative financial policy represents an example for leading to a negative rating action.

Rating drivers

Positive rating drivers	Negative rating drivers
• Blended industry risk profile of A (specialty chemicals, non-durable consumer products) • Very strong position in the global adhesive industry with strong innovation power • Conglomerate structure, including unrelated businesses and a broad product portfolio addressing different end-markets and demand drivers • Financial risk profile (assessed at AA-) • Sufficient free operating cash flow generation and sound discretionary cash flow generation • History of conservative financial policy reflected in our financial risk profile assessment	• Weaker position of Henkel's non-durable consumer product entities, especially Beauty Care in North America • Some geographical concentration on Europe (about 45% of sales), higher for Beauty Care and Laundry & Home Care • Weaker profitably (EBITDA margin) of non-durable consumer products arm, but strong profitability of the specialty chemicals division, measured against the thresholds in our respective methodologies

Rating-change drivers

Positive rating-change drivers	Negative rating-change drivers
• Generally improved business risk profile, including a higher EBITDA margin and/ or net cash position on a sustained basis	• SaD/EBITDA of above or close to 2.0x on a sustained basis

Financial overview

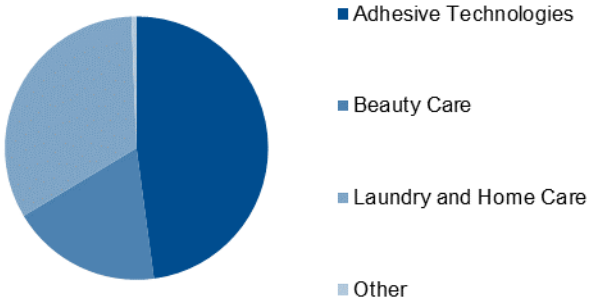
			Scope estimates	
Scope credit ratios	**2020**	**2021**	**2022E**	**2023E**
EBITDA/interest cover	41.5x	81.2x	76.7x	82.7x
Scope-adjusted debt (SaD)/EBITDA	0.6x	0.4x	0.6x	0.5x
Scope-adjusted FFO/SaD	139%	188%	125%	173%
Free operating cash flow (FOCF)/SaD	140%	124%	84%	122%
Scope-adjusted EBITDA in EUR m	**2020**	**2021**	**2022E**	**2023E**
EBITDA	3,116	3,191	2,810	3,150
add: other items	-22	-65	-50	-50
Scope-adjusted EBITDA	**3,094**	**3,126**	**2,760**	**3,100**
Scope-adjusted funds from operations (FFO) in EUR m	**2020**	**2021**	**2022E**	**2023E**
EBITDA	3,116	3,191	2,810	3,150
less: (net) cash interest as per cash flow statement	-63	-31	-31	-31
less: cash tax paid as per cash flow statement	-618	-651	-487	-572
less: pension interest	-11	-7	-11	-12
add: dividends received from equity-accounted entities	0	0	0	0
less: disposal gains on fixed assets included in EBITDA	-22	-65	-50	-50
less: capitalised interest	0	0	0	0
add: other items	-15	-44	0	0
Scope-adjusted funds from operations	**2,387**	**2,393**	**2,232**	**2,485**
Scope-adjusted debt (SaD) in EUR m	**2020**	**2021**	**2022E**	**2023E**
Reported gross financial debt	3,644	3,442	3,442	3,442
Hybrid debt	-	-	-	-
less: cash and cash equivalents	-2,135	-2,379	-1,872	-2,219
add: cash not accessible	200	200	200	200
add: pension adjustment	0	0	0	0
add: other items (contingent liabilities)	10	10	10	10
Scope-adjusted debt	**1,719**	**1,273**	**1,781**	**1,434**
Free operating and discretionary cash flow in EUR m	**2020**	**2021**	**2022E**	**2023E**
Free operating cash flow	2,410	1,577	1,493	1,747
Discretionary cash flow	1,599	768	793	1,047
Liquidity	**2020**	**2021**	**2022E**	***2023E***
Liquidity (internal)	1.9x	2.3x	2.6x	7.8x
Liquidity (internal + external)	2.6x	3.3x	3.7x	11.4x

Business risk profile: A-

Blended Industry risk profile: A

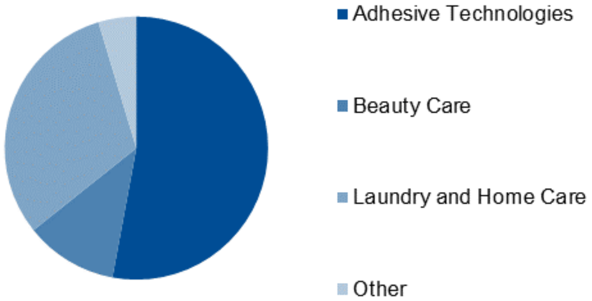
The specialty chemicals industry is characterised by a wide range of different-sized companies as well as factors such as production expertise and relationships with customers in aftermarkets. All of these factors serve as de-facto high entry barriers. Substitution risk is low, based on high technical production requirements and a lack of alternative production methods. We believe specialty chemicals companies face medium sensitivity to changes in GDP because aftermarkets require lower quantities of specialty chemicals in their product processes and prices tend to be negotiated individually. We rate the non-durable consumer products' industry at A, as it is characterised by low cyclicality. Despite the generally moderate capital investment needed, barriers to entry are medium in view of the efforts necessary to attain the required economies of scale and establish customer bases. At the same time, substitution risk is low, reflecting the generally non-discretionary nature of these products.

Figure 1: Revenue by segment (2021)



Source: Henkel, Scope

Figure 2: EBITDA by segment (2021)

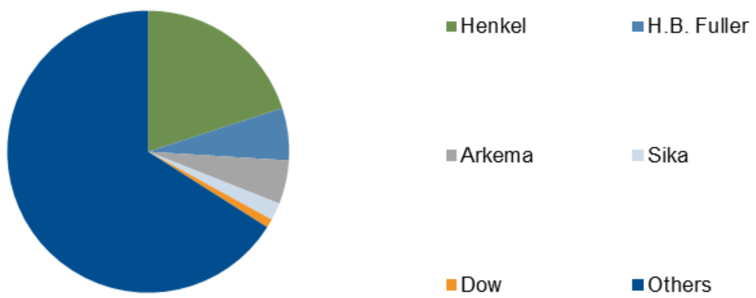


Source: Henkel, Scope

Global number one in adhesives

Henkel's market position is supported by its leadership of the global adhesive industry, benefiting from its strong focus on innovation and improving product sustainability. Henkel's share in the global adhesive industry amounts to roughly 15%. The proportion of bulk products in the company's portfolio is thus modest. In contrast to many competitors, Henkel has a global configuration, offers a broad range of adhesives and serves various industries. This also incorporates multiple well-known brands, such as LOCTITE, TECHNOMELT and BONDERITE, Pritt and Pattex. On the negative side, Henkel's position in sealants and adhesives applied in the construction industry is weaker, in our opinion.

Figure 3: Global adhesives landscape



Source: Scope

Beauty and Laundry & Home Care: powerful position in Europe but weaker position globally

The position of Henkel's consumer products arms is strong in Europe. Henkel's stronger position in Europe is primarily based on its roots as a German company, leading to the high popularity of its brands (consumer products are often tailored to local consumer preferences and culture). We understand this figure would be considerably higher at the level of the Beauty Care and Laundry & Home Care division. In contrast, Henkel's Beauty and Laundry & Home Care divisions are weaker in other geographies, especially in North America. The company has sufficient price setting power, albeit slightly lower than some competitors.

High consumer awareness and loyalty in Europe

Based on its lighthouse brands Persil and Schwarzkopf, consumer awareness is high, especially in Europe. For instance, brand awareness of Persil is nearly 100% in Germany and about 5.2m loads of laundry are washed with Persil every day. Henkel's growth strategy involves spending on marketing, branding in line with the non-durable consumer products industry, innovation and sustainability. This includes various sustainability targets, such as green products.

Diversification is supported by conglomerate structure

Henkel's conglomerate structure, including unrelated businesses and a broad product portfolio addressing different end-markets, demand drivers and geographies (Henkel is active in about 150 countries around the globe), is very positive for diversification.

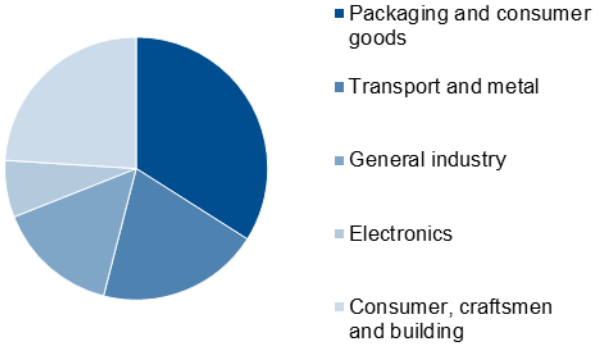
Stable end-market mix in Adhesive Technologies…

The diversification of the Adhesive Technologies division benefits from a stable end-market mix in the context of good overall diversification. This is underpinned by a portfolio of different customer types in multiple industries, also including craftsmen and individual customers. Moreover, the division's product mix also includes sealants.

…against the background of a resilient business

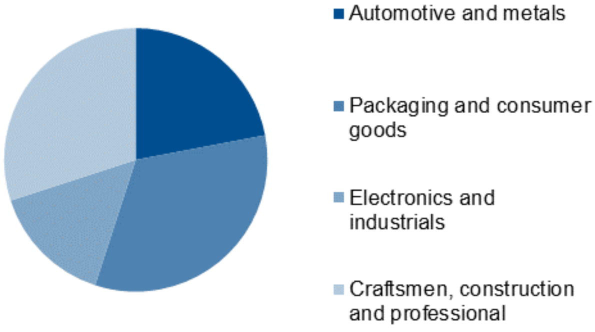
Roughly 40% of sales are generated in cyclical end-markets. That said, this is only a negative rating factor to a limited extent, as the figures achieved by the division have been less cyclical in the past.

Figure 4: End-market mix of Adhesive Technologies (2013)



Source: Henkel, Scope

Figure 5: End-market mix of Adhesive Technologies (2020)[2]



Source: Henkel, Scope

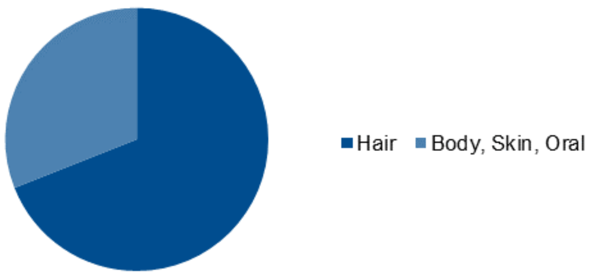
Various elements in Beauty and Laundry & Home Care support diversification

Henkel's non-durable consumer products business is somewhat more diversified than its Adhesive Technology division. This is because Beauty Care and Laundry & Home Care have broadly diversified supplier and customer portfolios together with well-established distribution channels. Henkel's consumer products are sold by numerous retailers, online shops and drug stores, among others. This translates into various sales channels through which customers are reached. In 2020, Beauty Care generated 76% of sales via consumers and 24% via 'professionals', e.g. hairdressers and stylists.

Some concentration on Europe and product families

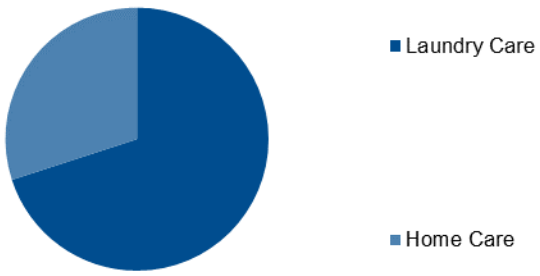
On the negative side, diversification is held back by Henkel's slightly concentrated product portfolio (at a product family level). The top 10 brands account for around 85% of total sales in Beauty Care and around 65% in Laundry & Home Care. Furthermore, lighthouse brands Schwarzkopf and Persil achieve annual sales of around EUR 1.7bn and EUR 1.5bn, respectively. Based on our assessment of the company's market position, sales generated in Europe are higher for Beauty Care and Laundry & Home Care. This constrains Henkel's diversification of its non-durable consumer product activities. On total sales level around 45% of sales are achieved in Europe.

Figure 6: Sales by business area: Beauty Care (2020)



Source: Henkel, Scope

Figure 7: Sales by business area: Laundry & Home Care (2020)



Source: Henkel, Scope

[2] Henkel underwent a divisional reorganisation in 2019. It now runs three divisions (2013: five divisions).

Strong and stable profitability of Adhesive Technologies

In accordance with our Chemical Corporates Rating Methodology, we focus on through-the-cycle profitability when assessing profitability and operating efficiency. From 2010 to 2021, Henkel's EBITDA margin averaged around 18.9%. This underpins Henkel focus on specialty adhesives and innovation, including strong pricing power. Henkel's EBITDA margin also compares favourably to figures achieved by key competitors and strongly supports the company's operating profitability.

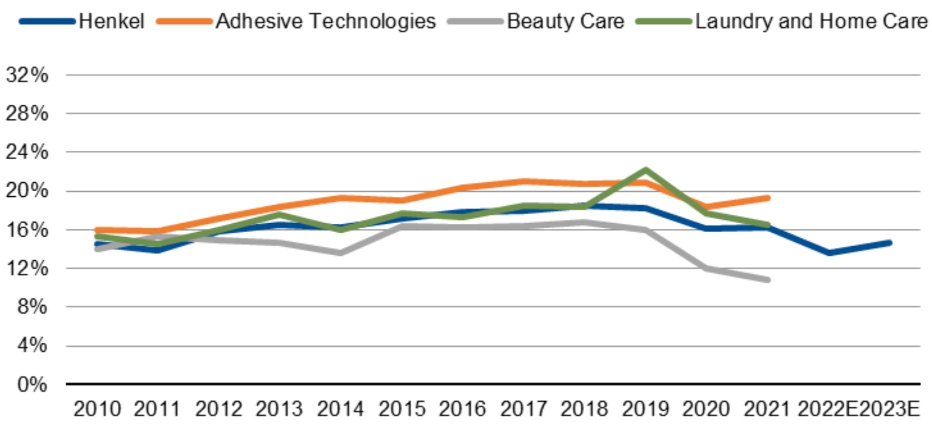
Weaker margin profile of consumer products divisions…

The profitability of Beauty, Laundry & Home Care is lower in comparison, which is a negative rating driver. In our view, this is due to Henkel's market position, especially as regards Beauty Care in North America. We expect the ongoing realignment (i.e. the merger of Beauty Care with Laundry & Home Care and respective one-off costs) to positively impact profitability in the medium term. However, this will not be immediately visible given the EBITDA margins achieved, particularly in Beauty Care.

…negatively affects Henkel's EBITDA margin together with higher energy and raw material prices

The generally low volatility of Henkel's EBITDA margin is a positive rating factor. However, we anticipate that operating profitability for the whole company will be weaker in the short term compared to the figures achieved in recent years. In addition to one-time costs related to the realignment of the company's non-durable consumer products activities, higher energy and raw materials prices as well as higher logistics costs are likely to negatively affect operating profitability.

Figure 8: Profitability (EBITDA margin)



Source: Henkel, Scope estimates, Bloomberg

Financial risk profile: AA-

Key adjustments of the rating case include:

- Net present value of operating lease obligations added to SaD (pre 2019, as Henkel implemented IFRS 16 as of 01 January 2019)
- 80% of provisions for asset retirement obligations (contingent liabilities) are included in SaD and 5% of contingent liabilities included in Scope-adjusted interest expense to reflect the interest proportion of these liabilities
- No consideration of the company's unfunded pension provisions from 2020 onwards, given the high coverage of annual pension payments through dedicated pension assets;
- Interest adjusted for the (estimated) interest component of pension provisions, operating leases (pre 2019) and contingent liabilities
- Netting of cash on the balance sheet, except for restricted cash of EUR 200m

History of strong deleveraging, helped by satisfactory free operating cash flow generation

Key credit ratios improved significantly after the acquisition of Sun Products (around EUR 3.2bn) in 2016, Darex Packaging Technologies (around EUR 1.0bn) in 2017 and several small to medium-sized acquisitions in the same period. We view positively Henkel's focus on medium-sized bolt-on acquisitions, the only moderate dividend increase and the deployment of satisfactory free operating cash flow to reduce debt.

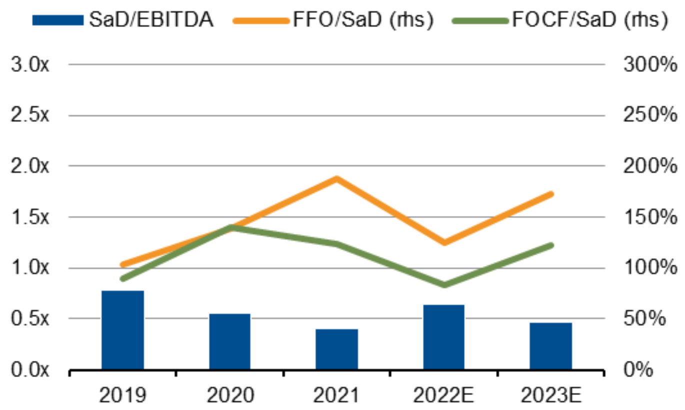
Key assumptions of our rating scenario

Our rating scenario is based on the following key assumptions: i) capex of around EUR 750m per year; ii) tuck-in acquisitions of up to EUR 500m per year; iii) the repurchase of preferred shares and ordinary shares of up to EUR 800m and EUR 200m in the years 2022 and 2023, respectively; iv) a dividend pay-out ratio of 30%-40% of net income; and v) return to a higher level of working capital after the larger release in 2020.

M&A strategy is mitigated by elements from Henkel's conservative financial policy

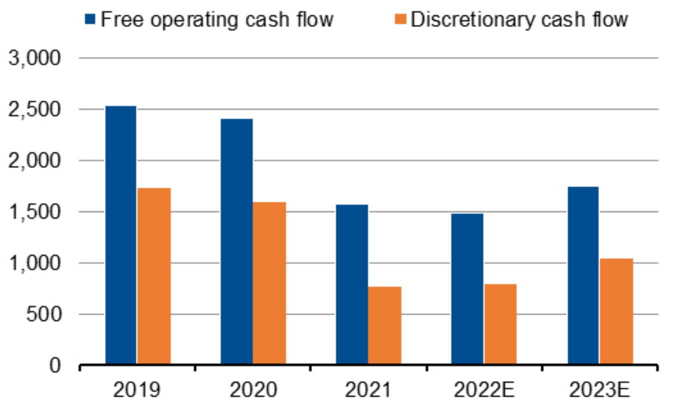
We understand that Henkel initiates large acquisitions in an opportunistic manner. The company will also assess whether or not large external growth opportunities would compromise its credit profile. The associated risk is mitigated by Henkel's commitment to the single A rating category and ability to deleverage provided by sound discretionary cash flow generation. As far as the latter is concerned, the company's dividend policy supports its financial risk profile.

Figure 9: Credit metrics



Source: Henkel, Scope estimates

Figure 10: Free operating and discretionary cash flow (EUR m)



Source: Henkel, Scope estimates

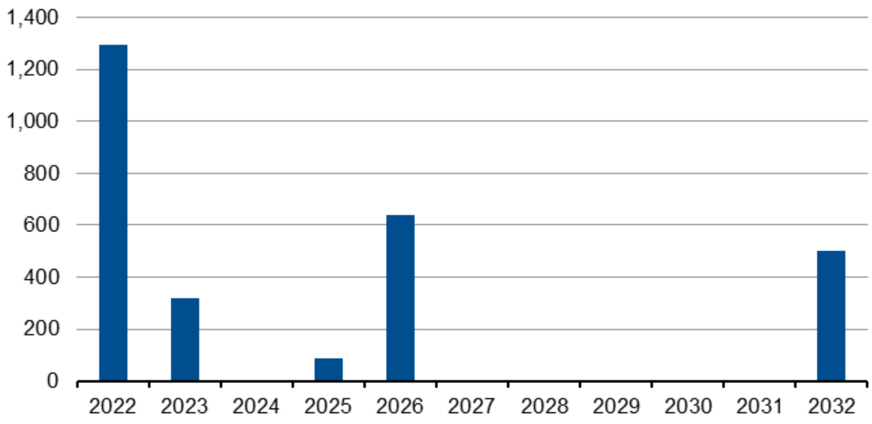
Credit ratios expected to remain strong

Given these key assumptions, Henkel's key credit ratios will remain very strong in the foreseeable future. The low cyclicality of Henkel's business should limit the cyclicality of its debt ratios.

Liquidity: adequate

Henkel has consistently strong ratios on internal and external liquidity coverage. In addition to satisfactory free operating cash flow generation, an ample amount of unrestricted cash remains on the balance sheet every year. Henkel also has committed credit facilities of roughly EUR 1.6bn and active commercial paper programs with volumes of EUR 2.0bn and USD 2.0bn, respectively.

Figure 11: Maturity profile (EUR m; December 2021)



Source: Henkel, Scope

Well-diversified debt maturity profile including green debt instruments

In addition to adequate liquidity, Henkel has a well-diversified debt maturity profile, with no large maturities in a single year. Only the minority of debt relates to leasing liabilities. Senior unsecured bonds make up the largest share of Henkel's SaD. Following the issuance of a green bond earmarked for reducing plastic waste in 2020, Henkel has further diversified its debt structure by placing two sustainabilitiy-linked bonds (USD 250m maturing in 2026 and EUR 500m maturing in 2032). Interest costs for these instruments are linked to the achievement of the company's sustainability targets.

Financial risk profile: AA-

We assess Henkel's financial risk profile at AA-, strongly supported by favourable key credit ratios and sufficient free operating cash flow generation in the context of robust internal and external liquidity coverage. Our assessment of the company's financial risk profile also reflects our understanding Henkel's opportunistic M&A strategy.

Supplementary rating drivers

Conservative financial policy and family ownership with long-term ambitions

The most relevant subcategory in this section is financial policy and ownership structure (the Henkel family is the main shareholder, holding roughly 62% of ordinary shares). We view Henkel's financial strategy as conservative. This is based on the following: i) a dividend pay-out ratio of 30%-40% of net income; ii) ample discretionary cash flow generation; iii) no share buybacks until recently (the ongoing share buyback scheme of up to EUR 1.0bn compares to free operation cash flow of about EUR 1.5bn in 2021); iv) operational control includes several financial key performance indicators, e.g. net adjusted debt/EBITDA from 2021 onwards; and v) Henkel's commitment to a single A rating.

Long-term and short-term debt ratings

Short-term rating: S-1

We have assigned an S-1 short-term rating. This is based on Henkel's issuer rating of A and better-than-adequate internally and externally provided liquidity cover, banking relationships and standing in capital markets.

Rating for unsecured debt: A

All senior unsecured debt has been rated A, the same level as the issuer rating.

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