Corporate and Instrument Rating BASF SE Germany, Specialty Chemicals

BASF SE is a chemicals company which also operates in related areas such as agriculture, nutrition, and the exploration and production of oil and natural gas. The company is organised into five business segments: Chemicals, Performance Products, Functional Materials and Solutions, Agricultural Solutions, and Oil & Gas. The five business segments comprise 13 divisions organised around sectors or products with over 300 production sites worldwide. About half of the company's revenues are generated by speciality chemicals while the remainder come from the commodity chemicals and Oil and Gas segments.

Rating rationale

On 12 September 2017, Scope affirmed the corporate credit rating of A for Germany-based chemicals company BASF SE and its financing subsidiary BASF Finance Europe N.V. Senior unsecured debt issued by either BASF SE or BASF Finance Europe N.V. is rated A. The short-term rating is S-1. The Outlooks are Stable.

Following Scope's affirmation of the BASF ratings, the group announced two acquisitions: the polyamide/nylon business of Solvay, and of significant parts of Bayer's seed and herbicide business.

Both acquisitions, as well as the expansion of the specialty chemicals business, are in line with Scope's earlier expectation that BASF will continue to realign its portfolio as it has over the past decade and will use financial headroom under the rating to complete larger bolt-on acquisitions. Both deals are also in line with BASF's public strategy of balancing its portfolio at around 50% specialty chemicals and 50% differentiated commodities. Although the deals add business in the economically more resilient specialty chemicals business, Scope has left its business risk assessment unchanged.

Scope believes the acquisitions are in line with BASF's longstanding acquisition criteria and business and financial strategy. While the Bayer deal is a larger bolt-on acquisition than originally considered in Scope's analysis of acquisition risks, the announced purchase price (EUR 5.9bn) and increase in financial debt is still consistent with the current ratings.

The Bayer acquisition complements BASF's Agricultural Solutions segment, adding patented products and expertise, notably in terms of seeds for canola, rape, soybean and cotton (key crops for growing regions such as the US). The acquired assets are highly cash-generative with substantial operating margins (>25% EBITDA margin) and involve limited capital expenditures. The deal's completion is still subject to the Bayer/Monsanto transaction being finalised (expected for early 2018) as well as regulatory approvals.

The Solvay deal (consideration of EUR 1.6bn) supports BASF's backward integration into the polyamide value chain and complements the group's product portfolio in this field. This deal is expected to be closed in Q3 2018.

Scope's financial forecast for 2018F now includes the purchase price for the Bayer assets (EUR 5.9bn) and the polyamide unit (EUR 1.6bn). Scope also assumes that both transactions will be closed as guided and has included both a pro-rata effect on revenues and EBITDA in Scope's forecast for 2018F. Overall, Scope believes both acquisitions will contribute about EUR 400m-450m of earnings (EBITDA) in 2018F and about EUR 600m in 2019F. Integration risks for both assets, notably regarding the Bayer deal, appear manageable and low in Scope's view.

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Related Research

Scope Ratings affirms BASF SE and BASF Finance Europe N.V. at A and S-1, Outlooks Stable
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BASF’s leverage will change only moderately from Scope’s standpoint, keeping in mind that the perceived deterioration of leverage metrics in 2018F effectively reflects the pro-rata consolidation of earnings and cashflows of the acquired assets. Scope also considers the intended acquisitions as being in line with the management’s stated financial policy and credible track record of maintaining a moderate leverage. Credit ratios such as Scope-adjusted debt (SaD)/EBITDA have been maintained below 2.0x over the past six years, with the exception of 2016 when SaD/EBITDA was 2.0x due to the Chemetall transaction. Going forward, and including acquisition effects, Scope expects leverage to continue to be below 2.0x.

In line with Scope’s more positive view on free cash flow in 2017F and 2018F, it is likely that incremental debt incurred for both acquisitions will be reduced in 2018E and beyond. Free cash flow (as defined and reported by BASF) was EUR 2.2bn in H1 2017.

For 2017F Scope expects free cash flow (as defined by BASF) of around EUR 4.8bn, followed by EUR 5.0bn in 2018F, slightly more than previously estimated. In Scope’s view, dividend payments will be EUR 2.8bn-3.0bn in each of these two years, i.e. considerably below the forecasted free cash flow.

As announced by BASF, the Bayer transaction will be funded by a combination of bonds, cash, and possibly draw-downs under the commercial paper programme. Scope continues to view BASF’s liquidity and financial flexibility as strong. In view of BASF’s solid standing in public-debt markets, Scope expects the long-term funding of the Bayer transaction via new bonds to be manageable.

Rating drivers

Positive	Negative
Strong market position, holding between first and third position for about 70% of its business	High dependence on general economic environment and on economic development in emerging markets in particular
Large share of speciality chemicals that are less subject to cyclicality risks and changing feedstock prices	Risks of sudden negative changes in feedstock prices and exposure to changes in global commodities and food prices
Broad and globally diversified business; one of the largest integrated chemical companies globally; diversification benefits from presence in agrochemicals, bulk and speciality chemicals	Still some overrepresentation of business in Europe, a region that is projected to show lower growth rates for chemicals
History of solid, resilient free cash flow generation, high financial flexibility and proven management commitment to rating	Exposure to very cyclical end markets, such as transportation (automotive) and construction, in the Functional Materials and Solutions segment
Benefits from large integrated sites worldwide providing higher product yields ('Verbund' concept)	Dependence on oil price changes for highly cash-generative Oil & Gas division; oil and gas operations not fully controlled and subject to political risks
Substantial coverage of future pension payments with accumulated pension plan assets covering payments for far more than a decade	

Rating-change drivers

Positive	Negative
Sustainable improvement of debt protection measures to levels of about 1.5x (SaD/EBITDA) and 50% (FFO/SaD)	Sizeable debt-funded acquisitions leading to a material deterioration in debt protection measures
Substantial increase in share of speciality chemicals or agrochemicals and reduction in oil-production exposure – we view this as unlikely	Risks of global oversupply of commodity Chemicals, leading to price pressure and margin squeeze in chemicals division
	Deterioration in credit protection measures such as SaD/EBITDA to levels of about 2.5x and FFO/SaD of roughly 30%

Financial overview

		Scope estimates		
Scope credit ratios	**2015**	**2016**	**2017F**	**2018F**
EBITDA/interest cover (x)	12x	12x	14x	14x
SaD/EBITDA	1.7x	2.0x	1.4x	1.7x
Scope-adjusted FFO/SaD	45%	39%	56%	45%
FOCF/SaD	29%	27%	35%	27%

		Scope estimates		
Scope-adjusted EBITDA in EUR m	**2015**	**2016**	**2017F**	**2018F**
EBITDA	10,445	10,259	12,014	12,713
Operating lease payment in respective year	471	446	360	360
less: disposal gains fixed assets included in EBITDA	-525	-667	-500	-500
Scope-adjusted EBITDA	**10,391**	**10,038**	**11,874**	**12,573**

		Scope estimates		
Scope funds from operations in EUR m	**2015**	**2016**	**2017F**	**2018F**
EBITDA	**10,445**	**10,259**	**12,014**	**12,713**
less: (net) cash interest as per cash flow statement	-458	-459	-450	-460
less: cash tax paid as per cash flow statement	-1,550	-1,495	-1,896	-2,063
less: pension interest	-199	-190	-195	-195
add: depreciation component operating leases	405	381	297	297
add: dividends received from equity	219	225	225	225
less: disposal gains fixed assets included in EBITDA	-525	-667	-500	-500
less: capitalised interest	-149	-92	-150	-150
Change in provisions	-221	-183	-150	-150
Scope funds from operations	**7,967**	**7,779**	**9,194**	**9,717**

		Scope estimates		
Scope-adjusted debt (SaD) in EUR m	**2015**	**2016**	**2017F**	**2018F**
Reported gross financial debt	15,197	16,312	15,912	19,412
less: cash, cash equivalents	-2,262	-1,911	-4,628	-2,869
Cash not accessible	400	400	400	400
add: pension adjustment	2,121	2,773	2,422	2,422
add: operating lease obligation	1,316	1,270	1,270	1,270
add: asset retirement obligations	950	973	973	973
Scope-adjusted debt	**17,721**	**19,816**	**16,347**	**21,606**

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