LANXESS AG
Germany, Specialty Chemicals

SCOPE BBB STABLE

Monitoring Note

LANXESS performance in Q1 2018 in line with rating case

LANXESS (including full contribution from ARLANXEO from 1 April 2018 to 31 March 2019)		Scope estimates	
Scope credit ratios	2017	2018F	2019F
EBITDA/interest cover (x)	5.5x	8.7x	8.2x
Scope-adjusted debt (SaD)/ EBITDA	2.7x	2.2x	2.3x
Scope-adjusted FFO/SaD	30%	36%	34%
Free cash flow/SaD	10%	13%	3%

LANXESS got off to a good start in the first three months of 2018, supported by a rise in prices and volumes. Scope acknowledges the increased contribution which more non-cyclical business has made to EBITDA thanks to the solid growth experienced by 'New LANXESS' (excluding ARLANXEO). In Q1 2018, New LANXESS divisions accounted for up to 70% of EBITDA, compared to 59% for the same period in the previous year. Furthermore, as global economic growth continued, the acquisition of Chemtura, Phosphorus Additives from Solvay (Specialty Additives segment), together with a single-digit rise on the price and volume side, increased sales by about 24% compared to Q1 2017. Scope considers this to be a significant achievement, since the company has faced headwinds of a strong euro since Q4 2017. Lastly, the constant gross margin confirms the company's considerable ability to pass higher raw material prices on to its customers. In contrast to LANXESS' specialty materials divisions, ARLANXEO has had to contend with tougher business conditions, due to a combination of pre-buying in 2017, the maintenance shutdown of its Singapore plant and the strong euro.

The ARLANXEO division will be disclosed as a discontinued operation from 1 April 2018 to 31 March 2019 and as an at-equity item from 1 April 2019. From 2018 onwards, financial reporting will only be based on New LANXESS. As these accounting treatments have substantial effects on the company's credit metrics – and in order to better reflect economic reality – Scope has assessed LANXESS' financial risk profile including the full contribution from ARLANXEO until 1 April 2019. EBITDA guidance provided by LANXESS consequently deviates from that provided by Scope.

We believe that this approach also increases overall transparency and comparability. In its evaluation for 2018, Scope sees upcoming pressure from the commodity and currency side as well as limited one-off costs; SaD/EBITDA should be slightly weaker compared to Scope's former estimate of 1.9x for 2018. With regard to the company's liquidity and maturity profile, Scope believes that LANXESS will disclose very comfortable liquidity coverage and maintain its conservative approach to maturity transformation as a result.

In our updated rating case for 2018, LANXESS should benefit from a full-year contribution from Chemtura as well as continuing room for higher prices and volumes in most regions. Furthermore, Scope expects LANXESS' Saltigo business unit to recover somewhat in H2 2018, because of improving prospects in Latin America. However, Scope believes that LANXESS will face ongoing headwinds from the strong euro, limited one-off costs as well as higher commodity prices. For 2018, Scope therefore estimates EBITDA of up to EUR 1,272m, including the full contribution from ARLANXEO.

Ratings & Outlook

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

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Related Methodology

Corporate Ratings, January 2018

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As shown in Q1 2018, Scope believes that New LANXESS should be well positioned to increase its operating results until the end of 2020, balancing missing ARLANXEO contribution in its EBITDA or free cash flow. This assumption is justified by the continuation of present market conditions, allowing LANXESS to grow in its specialty material divisions. Scope also thinks that the company's margins should increase on sustainable basis due to its strong market position. Scope's rating case excludes proceeds from the divestment of the remaining 50% stake in ARLANXEO. LANXESS would be in a position to deleverage further if it were to fully exit ARLANXEO.

Based on the above-mentioned factors, guided SaD/EBITDA of 2.2x and Scope-adjusted FFO/SaD of 36% for 2018 are fully in line with our rating case. No rating action is triggered.

This publication does not constitute a credit rating action. On 18 December 2017, Scope assigned LANXESS AG an issuer rating of BBB. Senior unsecured debt issued by the company is rated BBB. Subordinated debt issued by the company is rated BB+. The short-term rating is S-2. The Outlooks are Stable.

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Scope-adjusted EBITDA in EUR m			
EBITDA	1,072	1,272	1,168
add: operating lease payments in respective year	73	73	46
Other			
Scope-adjusted EBITDA	1,145	1,345	1,214
Scope-adjusted funds from operations (FFO) in EUR m			
EBITDA	1,072	1,272	1,168
less: (net) cash interest as per cash flow statement	-28	-76	-76
less: cash tax paid as per cash flow statement	-183	-175	-198
add: depreciation component operating leases	60	60	39
add: dividends received from at-equity			
less: disposal gains fixed assets included in EBITDA	-1		
less: capitalised interest	-3	-2	-2
Scope-adjusted funds from operations	917	1,079	932
Scope-adjusted debt in EUR m			
Reported gross financial debt	2,312	2,312	2,312
Hybrid bond	250	250	250
less: cash, cash equivalents	-621	-754	-711
Cash not accessible			
add: pension adjustment	578	745	620
add: operating lease obligations	258	258	130
Other	227	114	114
Scope-adjusted debt	3,066	2,988	2,778

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