17 February 2021 Corporates

LANXESS AG Germany, Specialty Chemicals



Corporate profile

LANXESS AG, based in Cologne, Germany, is a major producer of specialty chemicals with sales of about EUR 6.8bn and an EBITDA of EUR 910m 2019. The company is organised into four divisions: Advanced Intermediates, Specialty Additives, Engineering Materials, and Consumer Protection. Chemical intermediates, additives, specialty chemicals and polymers are consumed by companies operating in areas including automotive, construction, agricultural, industrial manufacturing.

Key metrics

	Scope estimates			
Scope credit ratios	2019	2020F	2021F	2022F
EBITDA/interest cover	9.6x	8.0x	10.1x	11.6x
Scope-adjusted debt (SaD)/EBITDA	2.3x	1.8x	2.5x	2.0x
Scope-adjusted FFO/SaD	30%	41%	31%	39%
Free operating cash flow (FOCF)/SaD	4%	8%	5%	12%

Rating rationale

On 14 February 2021, LANXESS announced to purchase US-based Emerald Kalama Chemical for an enterprise value of USD 1,075m. Given LANXESS' solid credit metrics and ample liquidity, Scope expects only a moderate impact on key credit metrics. Metrics should continue to be in line with Scope's rating case for LANXESS' BBB+/Stable issuer rating.

This publication does not constitute a credit rating action. For the official credit rating action release click here.

Emerald Kalama Chemical (Emerald) produces specialty materials for sectors such as food and beverage, personal and house care. It also produces phthalate-free plasticisers for adhesives, coatings and sealants. For instance, Emerald has a powerful position in the production of various preservatives for the food industry. Most of the activities will be grouped in LANXESS' Consumer Protection division, widening its existing solutions portfolio in water purification, preservatives, disinfectants and active ingredients. In mid-January 2021, the company already made two small acquisitions – Theseo (a disinfection and hygiene solutions provider) and Intace (a manufacturer of specialty fungicides for the packaging industry). Both companies are located in France. The communicated phase III to realign the company structure continues.

We believe the impact of the Emerald acquisition on LANXESS' business risk profile will be limited considering Emerald's size (sales 2020E: USD 425m; EBITDA USD 90m versus our projection of an EBITDA of EUR 745m for LANXESS in 2020). However, it should positively affect LANXESS' end-market diversification, increasing the share of non-cyclical end-markets in sales and improving the resilience and granularity of its portfolio. If the deal is executed, LANXESS will have exposure to human and animal nutrition ingredients as well as the adhesives and sealants industry.

Ratings & Outlook

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

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Related Methodologies

Rating Methodology Chemical Corporates

Corporate Rating Methodology

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Positive effect on profitability

We anticipate that LANXESS' profitability (EBITDA margin) will hover around 15% from 2022 onwards. This will strongly support management's communicated target of an EBITDA pre-margin (before exceptional costs and through-the-cycle) of 14%-18% by year-end 2021.

Updated projections for 2021 and 2022

Following the public announcement of the transaction, which is expected to be completed in the second half of 2021 (pending regulatory approval), we have updated our rating case for 2021 and 2022. We expect Emerald to deliver a high double-digit amount to earnings per year and have trimmed our assumption for bolt-on acquisitions to EUR 100m in 2022. Based on our understanding that LANXESS continues to be fully committed to its existing rating level, we do not expect considerable shareholder remuneration in the foreseeable future as deleveraging is a higher priority.

Transition year 2021 – moderate deterioration of credit metrics expected

We project that SaD/EBITDA (the most relevant credit metric for the rating) will trending up to 2.5x in 2021 but strengthen towards 2.0x in the medium term. This is supported by our assumption of positive effects on the company's free cash flow generation. Thanks to LANXESS' considerable cash cushion (cash and cash equivalents amount to about EUR 1.7bn at 30 September 2020) the Emerald acquisition will be completely financed with cash.

Low execution and integration risk

Emerald operates in total three production sides: Kalama (USA), Rotterdam (Netherlands) and Widnes (Great Britain). Regarding the numerous acquisitions made in the past, especially the Chemtura acquisition in 2016, execution and integration risk are low.

Lifted guidance for Q4 2020 provides confidence in sector-wide recovery

In line with serval European chemicals companies, LANXESS has lifted its guidance for the final quarter in 2020 (EBITDA pre is now expected to come in at around EUR 200m in the 4th quarter 2020). We take this as a sign that the sector-wide recovery is accelerating and will continue in 2021.

2020F: SaD/EBITDA now to stand at 1.8x

Thanks to the EUR 100m voluntary pension funding in September 2020, we now expected leverage, defined as SaD/EBITDA to stand at 1.8x at the year-end 2020, slightly stronger than previous base case.

Stable Outlook

Outlook

Ratings upside

The Stable Outlook incorporates our opinion of LANXESS' conservative financial policy, coupled with some vulnerability due to the Covid-19 pandemic, and solid liquidity. we expect SaD/EBITDA of around 2.0x over the medium term, based on a less volatile EBITDA margin thanks to improved end-market diversification and limited spending on M&A to further upgrade the portfolio.

Ratings downside

A higher rating may be triggered if SaD/EBITDA persistently falls below 1.5x. This could be achieved via a sustained improvement in the company's EBITDA margin e.g. by the exertion of higher price setting power.

The rating could come under pressure if SaD/EBITDA increases to above 2.5x on a sustained basis. This could be triggered by an aggressive financial policy, for instance.

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Rating drivers

Positive rating drivers

- Strong position in medium-sized markets with considerable barriers to entry
- Increased, more resilient end-market mix as a consequence of portfolio clean-up and latest acquisitions
- Conservative financial policy, with selective M&A strategy and commitment to maintaining a credit rating in the 'BBB range'
- Attractive innovation projects in the pipeline (e.g. cooperation with Standard Lithium, CheMondis start-up)

Negative rating drivers

- Positive trend in profitability (EBITDA margin 2019: 13.4%), but still weak compared to key competitors and the thresholds for profitability and efficiency set out in our methodology
- Highly cyclical end-markets at around 40% of sales
- Weaker free operating cash flow and cash flow cover (FOCF/SaD 2019: 4%) than other key credit ratios due to organic growth programme in 2019/2020
- Mature product portfolio and weak spending on product innovations relative to the specialty chemicals industry

Rating-change drivers

Positive rating-change drivers

SaD/EBITDA of below 1.5x on a sustained basis

Negative rating-change drivers

 SaD/EBITDA above 2.5x on a sustained basis

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Financial overview

	l	Scope estimates		
Scope credit ratios	2019	2020F	2021F	2022F
EBITDA/interest cover	9.6x	8.0x	10.1x	11.6x
Scope-adjusted debt (SaD)/EBITDA	2.3x	1.8x	2.5x	2.0x
Scope-adjusted FFO/SaD	30%	41%	31%	39%
Free operating cash flow (FOCF)/SaD	4%	8%	5%	12%
Scope-adjusted EBITDA in EUR m	2019	2020F	2021F	2022F
EBITDA	910	745	947	1,095
Operating lease payments in respective year	-	-	-	-
Other items	1	0	0	0
Scope-adjusted EBITDA	911	745	947	1,095
Scope-adjusted funds from operations (FFO) in EUR m	2019	2020F	2021F	2022F
EBITDA	910	745	947	1,095
less: (net) cash interest as per cash flow statement	-40	-40	-40	-40
less: cash tax paid as per cash flow statement	-193	-101 ¹	-119	-153
less: pension interest	-56	-56	-56	-55
add: depreciation component operating leases	-	-	-	-
add: dividends received from equity-accounted entities	0	0	30	30
less: disposal gains on fixed assets included in EBITDA	1	0	0	0
less: capitalised interest	-3	-3	-3	-3
Other items	0	0	0	0
Scope-adjusted funds from operations	619	545	729	844
Scope-adjusted debt (SaD) in EUR m	2019	2020F	2021F	2022F
Reported gross financial debt	2,343	2,343	1,843	1,843
Hybrid debt ²	250	250	250	250
less: cash and cash equivalents	-1,064	-1,742	-237	-392
Cash not accessible	0	0	0	0
add: pension adjustment	388	338	326	326
add: operating lease obligations	-	-	-	-
Other items (contingent liabilities)	153	153	153	153
Scope-adjusted debt	2,070	1,342	2,334	2,179

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 $^{^{\}rm 1}$ Taxes from the Currenta transaction were deducted from the cash proceeds. $^{\rm 2}$ The figures on this row were corrected to remove the minus sign (-) on 11 March 2021.



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