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Ratings

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LANXESS AG

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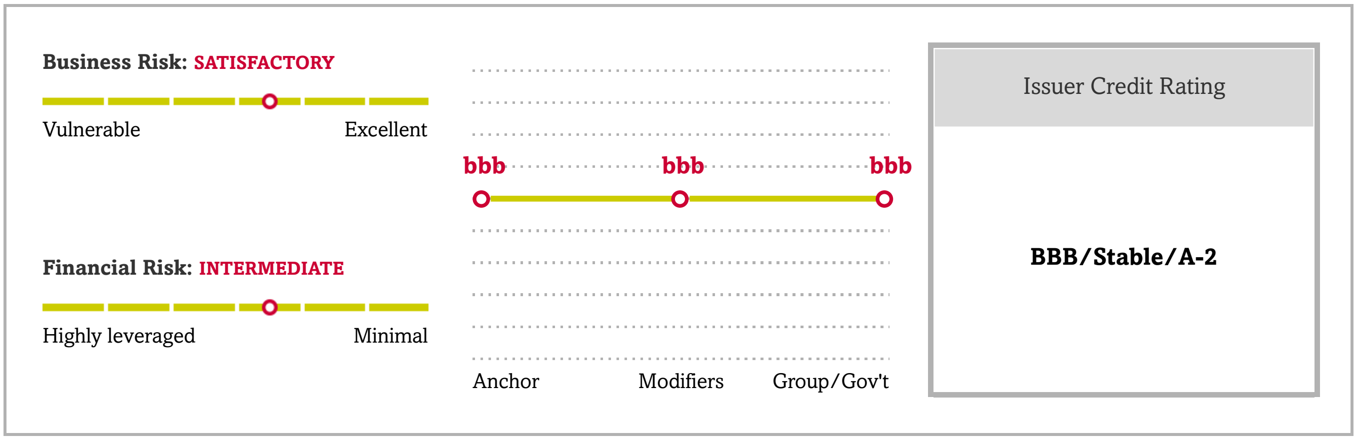
LANXESS AG



Credit Highlights

Overview

Key strengths	Key risks
Portfolio realignment has resulted in less volatile margins and better risk profile during the COVID-19 pandemic than in past economic downturns.	Exposure to some cyclical end markets, such as the auto industry, though partially offset by more resilient segments such as consumer protection.
Solid market position among the top-three players in the niche and midsize specialty chemicals business.	Decline in margins, which still lag the average for investment-grade specialty chemical peers.
Well-diversified exposure by geography, with six key end markets accounting for 75% of revenue.	Debt-funded acquisitions related to the business portfolio realignment strategy.
Public commitment to maintaining a solid investment-grade rating.	Credit metrics are exposed to currency movements.

Portfolio realignment and asset disposal are helping LANXESS navigate through the COVID-19-related downturn. In our base case, we do not expect any categorical shift in our key credit metric, funds from operations (FFO) to debt. We expect LANXESS to maintain FFO to debt at about 30%-32% in 2020-2021—that is, higher than our downside trigger of 30%. An improved risk profile with reduced exposure to the auto industry, deferral in some portion of capital expenditure (capex), operating expense saving initiatives, and proceeds from the sale of chemical site service provider Currenta are supporting the metrics during the pandemic.

The portfolio realignment is also bringing higher and more stable margins. LANXESS' risk profile has significantly improved as result of the portfolio realignment made in the past five years. Taking the midpoint of the guidance EBITDA provided for 2020, we expect a 17% reduction compared with 2019. This is significantly better than the 36% reduction the company suffered during the 2009 financial crisis, and the 40% reduction experienced during the 2013 rubber crisis. In 2016, LANXESS acquired Chemours' clean-and-disinfect business, and lubricant additives producer Chemtura in 2017, and it exited the volatile and lower-margin synthetic rubber market following the ARLANXEO disposal in 2018. Furthermore, LANXESS is focusing on certain organic growth projects and manufacturing-excellence initiatives. We believe these factors should enable LANXESS to gradually build a track record of higher and less-volatile profitability over the next few years.

S&P Global Ratings believes LANXESS' management is committed to preserving its leverage metrics after the ARLANXEO and Currenta disposals. The company has made a public commitment to maintaining a solid investment-grade rating. Furthermore, the current management team has a track record of financial discipline and balance-sheet protection. For example, in 2016, LANXESS issued a €500 million hybrid bond and suspended share buybacks to lessen the effect on debt from the €2.4 billion acquisition of Chemtura.

Outlook: Stable

The stable outlook reflects our expectation that LANXESS will keep FFO to debt comfortably above 30% over 2020-2022, which we consider commensurate with a 'BBB' rating.

We anticipate that available rating headroom will be limited in the short term, as result of the pandemic's effects on profitability and credit metrics. Positively, LANXESS' balance sheet is benefiting from the €780 million equity value achieved plus the €150 million profit participation (both pretax) from the disposal of its stake in Currenta. In addition, the decision to suspend its €500 million share buyback program launched in March--of which the company has spent €37 million so far--should support its credit metrics. In our view, management's actions in the current difficult economic environment are consistent with the company's commitment to maintaining an investment-grade rating.

Downside scenario

We might lower the rating if the ratio of FFO to debt fell below 30% without the short-term prospect of a quick recovery. We believe this could happen if the effects of the coronavirus pandemic and the resulting global recession extend through all of 2020, with prolonged shutdowns of sites and depressed volume sold, leading to a significant reduction of S&P Global Ratings-adjusted EBITDA margin to below 13%. However, we believe that, in such a scenario, the group would likely protect its credit metrics in light of its commitment to maintaining an investment-grade rating.

Rating pressure may also arise if LANXESS pursued a large debt-financed acquisition, which we see as the main risk to the rating.

Upside scenario

We could consider an upgrade if LANXESS improved its credit metrics, specifically with FFO to debt comfortably exceeding 45% and free operating cash flow (FOCF) to debt above 25% on a sustained basis. However, we view such a scenario as unlikely, since we believe that the company would most likely use any financial flexibility it gains to increase capex, acquisitions, or shareholder returns.

Our Base-Case Scenario

Assumptions

- GDP decline in the eurozone of 7.8% in 2020 and rebound of 5.5% in 2021; overall global GDP to decline by 3.8% in 2020 and then grow by 5.3%, supported by steep recovery in emerging economies.
- Steep decline in revenue of about 11%-15% in 2020, then recovery at 8%-10% in 2021. The pace of recovery will be dependent on growth in demand from key end markets such as auto and construction. We believe that the increasingly difficult operating environment makes it tough for the company to increase prices. We acknowledge the

group's resilient performance in consumer protection in first-half 2020. Currency movements could also weigh on reported revenue.

- Lower volumes to lead to marginal decline in EBITDA margin in 2020, though cost-cutting measures mitigate the drop. We expect EBITDA margin to improve and almost reach 2019 levels as early as 2021.
- Limited or neutral working capital cash absorption in 2020-2021.
- Capex of about €450 million in 2020, increasing to about €550 million in 2021.
- €780 million equity value plus the €150 million profit participation (both pretax) from the disposal of its stake in Currenta in 2020 and inflow from sale of Leather business in 2021.
- Suspension of its €500 million share buyback program launched in March.
- No acquisitions, but we acknowledge that LANXESS may pursue external growth in some business segments.

Key Metrics

LANXESS AG--Key Metrics*

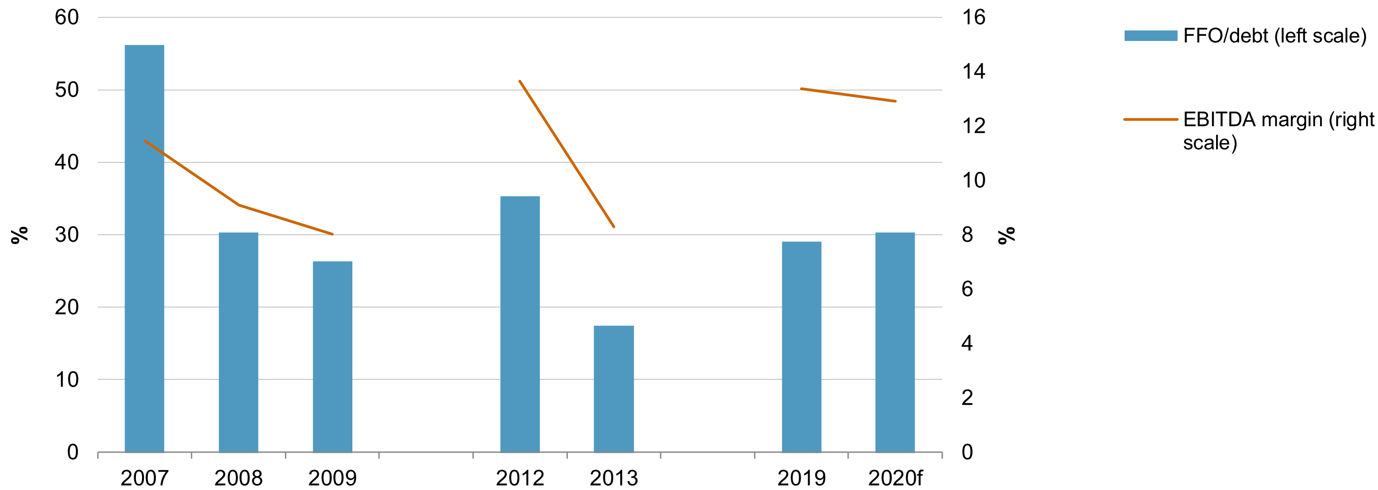
	--Fiscal year ended Dec. 31--				
(Mil. €)	**2018a**	**2019a**	**2020e**	**2021f**	**2022f**
EBITDA	969.0	910.0	750-800	850-900	900-950
EBITDA margin (%)	13.5	13.4	12.5-13.5	13-14	13-14
Debt to EBITDA (x)	2.1	2.5	2.4-2.6	2.4-2.6	2.4-2.6
FFO to debt (%)	36.3	28.9	30-32	30-32	30-32
FOCF to debt (%)	(2.1)	4.2	<0	<0	<0

*All figures adjusted by S&P Global Ratings. a--Actual. e--Estimate. f--Forecast. FFO--Funds from operations. FOCF--Free operating cash flow.

We expect EBITDA margin growth to be limited but less volatile in 2021-2022. Given sale of volatile segments such as ARLANXEO, the business is more resilient than it was during previous crisis, leading to less volatility in the profitability. Taking clues from economic development forecast, we expect growth in EBITDA margin to be gradual beyond 2021. This also reflects our assumption of late recovery of some end markets such as the auto industry.

Chart 1

LANXESS Is Better Positioned In Current Crisis



f--Forecast. FFO--Funds from operations. Source: S&P Global Ratings.

Company Description

LANXESS is a German specialty chemicals company that develops and manufactures chemical intermediates, additives, specialty chemicals, and plastics. At year-end 2019 it reported €6.8 billion of revenue and had about 15,400 employees.

Recently, the company has realigned its business segments following the decision to sell all the operations of its leather business, and the acquisition of biocide manufacturer IPEL. The business is now aligned within the following four segments:

- Advanced intermediates, which includes advanced industrial intermediates and the inorganic pigments business unit;
- Specialty additives, which includes the additives manufacturing business, including Rhein Chemie;
- Consumer protection, a new segment which includes material-protection products, the liquid-purification technology business unit, and Saltigo; and
- Engineering materials, which offers a range of engineering plastic compounds and hot-cast prepolymers, specialty aqueous urethane dispersions, and polyester polyols.

Peer Comparison

Table 1

LANXESS AG--Peer Comparison					
Industry sector: Chemical companies					
	LANXESS AG	**Arkema S.A.**	**Clariant AG**	**Evonik Industries**	**Solvay S.A.**
Ratings as of July 29, 2020	BBB/Stable/A-2	BBB+/Stable/A-2	BBB-/Stable/A-3	BBB+/Stable/A-2	BBB/Stable/A-2
	--Fiscal year ended Dec. 31, 2019--				
(Mil. €)					
Revenue	6,802.0	8,738.0	4,047.5	13,108.0	10,244.0
EBITDA	910.0	1,443.0	765.5	2,126.0	2,164.0
Funds from operations (FFO)	662.1	1,206.5	569.5	1,802.3	1,719.4
Interest expense	90.0	87.5	85.6	131.7	260.6
Cash interest paid	55.0	80.5	84.6	114.7	181.6
Cash flow from operations	605.0	1,282.5	404.8	1,287.3	1,361.4
Capital expenditure	508.0	631.0	265.0	872.0	716.0
Free operating cash flow (FOCF)	97.0	651.5	139.9	415.3	645.4
Discretionary cash flow (DCF)	(193.0)	(16.0)	(55.2)	(155.0)	(533.0)
Cash and short-term investments	1,160.0	1,407.0	866.7	2,368.0	809.0
Debt	2,290.0	2,389.0	2,081.2	4,483.5	6,470.6
Equity	2,892.0	4,977.0	2,463.1	9,308.5	8,724.0
Adjusted ratios					
EBITDA margin (%)	13.4	16.5	18.9	16.2	21.1
Return on capital (%)	8.7	11.6	10.0	8.3	7.5
EBITDA interest coverage (x)	10.1	16.5	8.9	16.1	8.3
FFO cash interest coverage (x)	13.0	16.0	7.7	16.7	10.5
Debt/EBITDA (x)	2.5	1.7	2.7	2.1	3.0
FFO/debt (%)	28.9	50.5	27.4	40.2	26.6
Cash flow from operations/debt (%)	26.4	53.7	19.5	28.7	21.0
FOCF/debt (%)	4.2	27.3	6.7	9.3	10.0
DCF/debt (%)	(8.4)	(0.7)	(2.7)	(3.5)	(8.2)

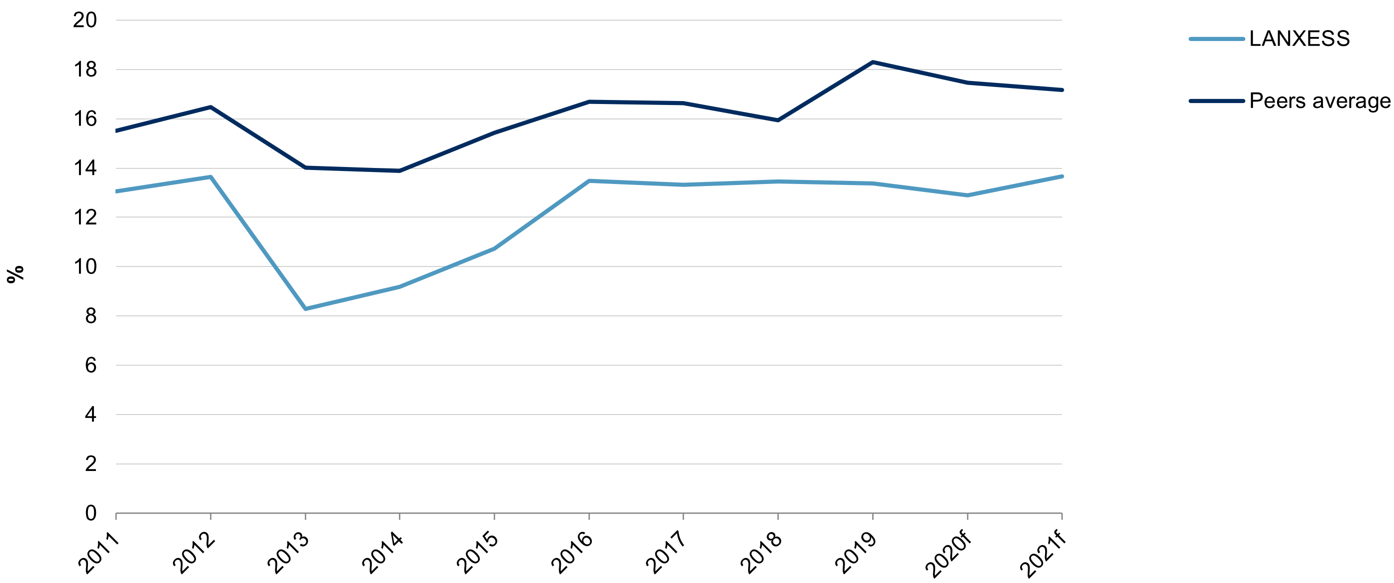
LANXESS' peers include Arkema S.A., Clariant AG, Evonik Industries, and Solvay S.A. Arkema and Clariant are more comparable with LANXESS than Solvay and Evonik, which are larger and have more diverse end markets.

In our view, LANXESS has a better market position than Clariant, which displays greater geographic diversity. LANXESS has a track record of weaker profitability than both Clariant and Arkema, due to lower margins in the synthetic rubber business and significant restructuring costs. Positively, we expect LANXESS' EBITDA margin to progressively improve, but remain below the peer average (see chart below).

We expect LANXESS' FFO to debt will stand above 30% in the foreseeable future, which is better than Clariant's credit metrics, and explains the one-notch rating difference between the two companies. Similarly, Arkema's credit metrics are better than LANXESS', explaining the one-notch difference between the two.

Chart 2

LANXESS EBITDA Margin Versus Peers



f--Forecast. Source: S&P Global Ratings.

Business Risk: Satisfactory

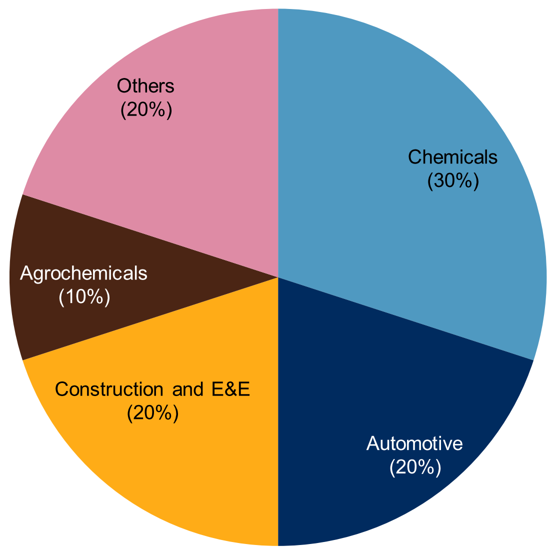
In our view, LANXESS benefits from its continued transformation into a midsize, well-diversified (by geography and end markets) specialty chemical company, with market positions among the top-three players in most of its core businesses. LANXESS' exit from the volatile and lower-margin commodity synthetic rubber business, through the disposal of the remaining 50% of ARLANXEO, is a key milestone in its transformation journey. We also consider the Currenta sale and its timing as positive for LANXESS, as it supports the company's balance sheet in current testing times.

The 2016 acquisition of Chemours' clean-and-disinfect business, and the 2017 acquisition of lubricant additives and flame retardants producer Chemtura, are two key steps in LANXESS' transformation. The decision to sell of all the leather business is also positive, as this business has shown higher-than-average margin volatility. Furthermore, LANXESS' continuous debottlenecking and cost-cutting measures will support profitability.

We believe that these factors should enable the company to gradually build a track record of higher and less volatile profitability in the medium term. However, we forecast limited improvement in our adjusted EBITDA margin in the short term, reflecting the effects of COVID-19 and headwinds from pre-COVID-19 organic softness in some key end markets. As a result, we believe it is unlikely that LANXESS' profitability gap with investment-grade specialty chemical peers will further close in 2020-2021. Like most specialty chemical companies, LANXESS has exposure to some cyclical end markets, such as the auto and construction industries, though partially offset by less volatile segments such as consumer protection.

Chart 3

LANXESS' 2019 Group Revenue By End Market



E&E--Electrical and electronics. Source: S&P Global Ratings.

LANXESS is also exposed to volatile raw-material prices, such as oil-derived products, which may result in margin volatility through the cycle. However, this is partly mitigated by the company's good track record of passing through input costs to product prices.

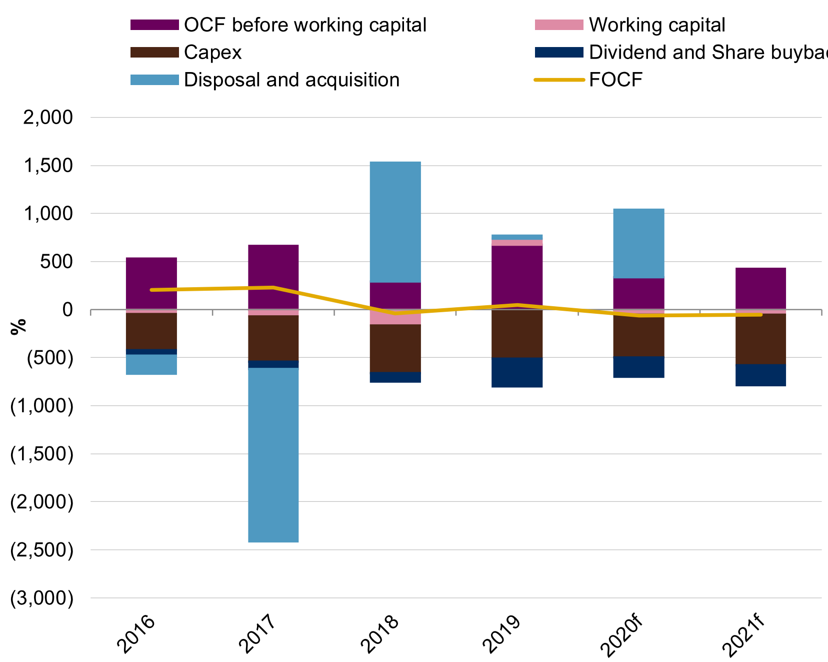
We understand the company may pursue midsize acquisitions to strengthen its business position. We see this as the main risk to our ratings if the acquisitions were sizable and the company funded them through debt.

Financial Risk: Intermediate

Our assessment of LANXESS' financial risk profile reflects the company's improved credit metrics since 2018, fueled by the disposal of ARLANXEO. This is supported by the company's portfolio realignment. The sale of stake in Currenta that the company finalized in the second quarter of 2020 is providing a key support to credit metrics during the current pandemic. We expect LANXESS to keep FFO to debt at about 30%-32% in 2020-2021, largely reflecting limited FOCF in the period. This, however, does not leave significant rating headroom in the short-term in case of unexpected adverse developments.

Chart 4

LANXESS' Evolution Of Cash Flow Generation



Capex--Capital expenditure. FOCF--Free operating cash flow. f--Forecast. OCF--Operating cashflow.
Source: S&P Global Ratings.

We believe LANXESS' top management is committed to preserving leverage metrics, including FFO to debt above 30%. The company has made a public commitment to maintain a solid investment-grade rating. Furthermore, the current management team has shown financial discipline, including through the issuance of a €500 million hybrid bond in 2016 to protect credit metrics, and more recently the suspension of share buy-back program announced in March 2020, cut-back on capex & other expenses to manage current pandemic crisis.

Financial summary

Table 2

LANXESS AG--Financial Summary

Industry Sector: Chemical Cos					
	--Fiscal year ended Dec. 31--				
	2019	**2018**	**2017**	**2016**	**2015**
(Mil. €)					
Revenue	6,802.0	7,197.0	8,041.8	6,655.5	7,902.0
EBITDA	910.0	968.7	1,070.3	896.9	848.1
Funds from operations (FFO)	662.1	735.3	875.9	637.0	655.1
Interest expense	90.0	103.4	125.4	121.8	129.9
Cash interest paid	55.0	77.4	83.3	88.8	94.9
Cash flow from operations	605.0	454.5	732.2	580.5	653.1
Capital expenditure	508.0	497.0	472.0	377.5	434.0
Free operating cash flow (FOCF)	97.0	(42.5)	260.2	203.0	219.1
Discretionary cash flow (DCF)	(193)	(127.8)	185.0	148.5	173.1
Cash and short-term investments	1,160.0	1,395.0	459.2	2,480.5	466.0
Gross available cash	1,160.0	1,395.0	459.2	2,480.5	466.0
Debt	2,290.0	2,028.2	3,313.4	1,405.3	2,520.3
Equity	2,892.0	3,023.0	2,538.9	2,562.0	2,323.0
Adjusted ratios					
EBITDA margin (%)	13.4	13.5	13.3	13.5	10.7
Return on capital (%)	8.7	9.4	11.3	10.7	8.2
EBITDA interest coverage (x)	10.1	9.4	8.5	7.4	6.5
FFO cash interest coverage (x)	13.0	10.5	11.5	8.2	7.9
Debt/EBITDA (x)	2.5	2.1	3.1	1.6	3.0
FFO/debt (%)	28.9	36.3	26.4	45.3	26.0
Cash flow from operations/debt (%)	26.4	22.4	22.1	41.3	25.9
FOCF/debt (%)	4.2	(2.1)	7.9	14.4	8.7
DCF/debt (%)	(8.4)	(6.3)	5.6	10.6	6.9

Reconciliation

Table 3

LANXESS AG--Reconciliation Of Reported Amounts With S&P Global Ratings' Adjusted Amounts (Mil. €)

	--Fiscal year ended Dec. 31, 2019--							
LANXESS AG reported amounts								
	Debt	**Shareholders' equity**	**EBITDA**	**Operating income**	**Interest expense**	**S&P Global Ratings' adjusted EBITDA**	**Cash flow from operations**	**Dividends**
Reported	2,702.0	2,669.0	910.0	407.0	76.0	910.0	634.0	79.0
S&P Global Ratings' adjustments								
Cash taxes paid	--	--	--	--	--	(193.0)	--	--
Cash interest paid	--	--	--	--	--	(66.0)	--	--
Reported lease liabilities	141.0	--	--	--	--	--	--	--

Table 3

LANXESS AG--Reconciliation Of Reported Amounts With S&P Global Ratings' Adjusted Amounts (Mil. €) (cont.)								
Intermediate hybrids reported as debt	(245.0)	245.0	--	--	(11.0)	11.0	11.0	11.0
Postretirement benefit obligations/deferred compensation	776.0	--	(1.0)	(1.0)	22.0	--	--	--
Accessible cash and liquid investments	(1,085.0)	--	--	--	--	--	--	--
Capitalized interest	--	--	--	--	3.0	--	--	--
Share-based compensation expense	--	--	2.0	--	--	--	--	--
Nonoperating income (expense)	--	--	--	42.0	--	--	--	--
Reclassification of interest and dividend cash flows	--	--	--	--	--	--	(40.0)	--
Noncontrolling interest/minority interest	--	(22.0)	--	--	--	--	--	--
Debt: Guarantees	1.0	--	--	--	--	--	--	--
EBITDA: Gain/(loss) on disposals of PP&E	--	--	(1.0)	(1.0)	--	--	--	--
Total adjustments	(412.0)	223.0	0.0	40.0	14.0	(248.0)	(29.0)	11.0
S&P Global Ratings' adjusted amounts								
	Debt	**Equity**	**EBITDA**	**EBIT**	**Interest expense**	**Funds from operations**	**Cash flow from operations**	**Dividends paid**
Adjusted	2,290.0	2,892.0	910.0	447.0	90.0	662.1	605.0	90.0

Liquidity: Strong

We view LANXESS' liquidity as strong because we expect its sources of liquidity will exceed its uses by 1.8x over the next 12 months and by 1.5x over next 24 months from April 1, 2020. We factor in the company's demonstrated access to debt markets and bank financing, as well as prudent liquidity risk management, which enable it to anticipate potential setbacks and take action to ensure continued strong liquidity. LANXESS has no financial covenants.

Principal Liquidity Sources	Principal Liquidity Uses
• €2.1 billion of cash and cash equivalent at the end of first-quarter 2020 • €0.4 billion of FFO available in next 12 months from April 1, 2020 • €0.8 billion-0.9 billion of inflow from sale of assets in next 12 months	• €1.1 billion of short-term debt maturity (including drawn revolving credit facility). • €450 million capital expenditure. • Limited seasonal and non-seasonal working capital outflow.

Debt maturitiesas of Dec. 31, 2019

- 2020: €55 million
- 2021: €555 million
- 2022: €654 million
- 2023: €37 million
- 2024: €37 million
- >2024: €2,797 million

Environmental, Social, And Governance (ESG)

We see LANXESS' ESG-related exposure as similar to the broader industry. The company's exposure to the more sensitive product areas such as seeds and pesticides represents less than 10% of revenue. As of year-end 2019, LANXESS' environmental protection provisions, mainly related to soil contamination, stood at a limited €191 million. At the same time, LANXESS is investing in research and innovation to meet present sustainability demands in key areas, such as lightweight and electric mobility solutions, protection against diseases, and membranes for water purification, which we expect to be the main drivers of volume growth for next few years.

Climate protection and energy efficiency are central to the company's sustainability strategy. Even before the Paris climate agreement, LANXESS had formulated concrete environmental goals.

By 2030, the company aims to reduce its CO2 (Scope 1+2) emissions by 50% versus 2018 levels. The company significantly reduced its emissions of non-methane volatile organic compounds, largely through the disposal of ARLANXEO in 2018. LANXESS recently set new targets to become carbon neutral by 2040.

We believe LANXESS has a good safety record. The company's lost time injury frequency rate (LTIFR) per million hours worked stood at 1.6 at year-end 2019, down from 2.0 at year-end 2016. The group aims to reach a LTIFR of less than 1.0 by 2025.

From a governance standpoint, LANXESS is fully in line with global best practices and our assessment is neutral to the rating. Some first- and second-level management variable compensation (below the board level) depends on the extent to which certain ESG targets are achieved.

Issue Ratings - Subordination Risk Analysis

Capital structure

The majority of LANXESS' interest-bearing debt comprises senior unsecured bonds. All of the debt is issued by the parent company LANXESS. The company issued one hybrid bond in 2016 with a first call date in 2023. Cash and cash equivalents of about €2.1 billion support the group's liquidity position as of March 31, 2020.

Analytical conclusions

We continue to align our issue ratings on LANXESS' senior unsecured debt with the issuer credit rating. With no material priority obligations ranking ahead of the group's senior unsecured obligations, we rate its senior unsecured debt 'BBB', the same as the issuer credit rating. We rate the subordinate hybrid bond at 'BB+', two notches below the issuer credit rating, and assign it intermediate equity content.

Ratings Score Snapshot

Issuer Credit Rating

BBB/Stable/A-2

Business risk: Satisfactory

- **Country risk:** Intermediate
- **Industry risk:** Low
- **Competitive position:** Satisfactory

Financial risk: Intermediate

- **Cash flow/leverage:** Intermediate

Anchor: bbb

Modifiers

- **Diversification/portfolio effect:** Neutral (no impact)
- **Capital structure:** Neutral (no impact)
- **Financial policy:** Neutral (no impact)
- **Liquidity:** Strong (no impact)
- **Management and governance:** Satisfactory (no impact)
- **Comparable rating analysis:** Neutral (no impact)

Related Criteria

- Criteria - Corporates - General: Reflecting Subordination Risk In Corporate Issue Ratings, March 28, 2018
- General Criteria: Methodology For Linking Long-Term And Short-Term Ratings, April 7, 2017
- Criteria - Corporates - General: Methodology And Assumptions: Liquidity Descriptors For Global Corporate Issuers, Dec. 16, 2014
- Criteria - Corporates - Industrials: Key Credit Factors For The Specialty Chemicals Industry, Dec. 31, 2013
- General Criteria: Methodology: Industry Risk, Nov. 19, 2013
- General Criteria: Country Risk Assessment Methodology And Assumptions, Nov. 19, 2013
- General Criteria: Group Rating Methodology, Nov. 19, 2013

- Criteria - Corporates - General: Corporate Methodology, Nov. 19, 2013
- Criteria - Corporates - General: Corporate Methodology: Ratios And Adjustments, Nov. 19, 2013
- General Criteria: Methodology: Management And Governance Credit Factors For Corporate Entities And Insurers, Nov. 13, 2012
- General Criteria: Use Of CreditWatch And Outlooks, Sept. 14, 2009
- Criteria - Insurance - General: Hybrid Capital Handbook: September 2008 Edition, Sept. 15, 2008

Business And Financial Risk Matrix

	Financial Risk Profile					
Business Risk Profile	Minimal	Modest	**Intermediate**	Significant	Aggressive	Highly leveraged
Excellent	aaa/aa+	aa	a+/a	a-	bbb	bbb-/bb+
Strong	aa/aa-	a+/a	a-/bbb+	bbb	bb+	bb
Satisfactory	a/a-	bbb+	**bbb/bbb-**	bbb-/bb+	bb	b+
Fair	bbb/bbb-	bbb-	bb+	bb	bb-	b
Weak	bb+	bb+	bb	bb-	b+	b/b-
Vulnerable	bb-	bb-	bb-/b+	b+	b	b-

Ratings Detail (As Of July 29, 2020)*

LANXESS AG	
Issuer Credit Rating	BBB/Stable/A-2
Senior Unsecured	BBB
Subordinated	BB+
Issuer Credit Ratings History	
09-Aug-2018	BBB/Stable/A-2
31-Jul-2017	BBB-/Stable/A-3
26-Sep-2016	BBB-/Negative/A-3
24-Sep-2015	BBB-/Positive/A-3

*Unless otherwise noted, all ratings in this report are global scale ratings. S&P Global Ratings' credit ratings on the global scale are comparable across countries. S&P Global Ratings' credit ratings on a national scale are relative to obligors or obligations within that specific country. Issue and debt ratings could include debt guaranteed by another entity, and rated debt that an entity guarantees.

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