

LANXESS AG

Germany, Specialty Chemicals



Corporate profile

LANXESS AG, based in Cologne (Germany), is a producer of specialty chemicals. In 2020, it had EUR 6.1bn in sales and EBITDA of EUR 757m. The company is organised into four divisions: Advanced Intermediates, Specialty Additives, Engineering Materials, and Consumer Protection. The product portfolio includes chemical intermediates, additives, specialty chemicals and polymers used in industries such as automotive, construction, agricultural, nutrition and industrial manufacturing.

Key metrics

Scope credit ratios	2020	Scope estimates		
		2021E	2022E	2023E
EBITDA/interest cover	6.6x	8.1x	9.1x	9.4x
Scope-adjusted debt (SaD)/EBITDA	1.8x	2.4x	2.7x	2.4x
Scope-adjusted FFO/SaD	48%	34%	28%	32%
Free operating cash flow (FOCF) ¹ /SaD	4%	3%	8%	10%

Rating rationale

On 24 August 2021, LANXESS announced its acquisition of the Microbial Control business unit of International Flavors & Fragrances (IFF) for an enterprise value of up to USD 1.3bn. The transaction is expected to be closed in Q2 2022, subject to approval from the relevant antitrust authorities. While we expect the most relevant ratio, Scope-adjusted debt (SaD)/EBITDA to deteriorate to 2.7x in 2022, it should strengthen to 2.4x in 2023, the first year of the target's full earnings contribution. This is based on: i) the company's commitment to a solid investment grade rating and anticipated focus on lowering financial leverage; and ii) the contribution to earnings from the acquired entity. Consequently, we expect key credit metrics to remain in line with our requirements for a BBB+/Stable issuer rating.

This publication does not constitute a credit rating action. For the official credit rating action release click [here](#).

IFF's Microbial Control business unit produces IFF biocides, which are used to protect against harmful micro-organisms and pests in multiple industries, such as energy, water, paints and coatings, as well as home and personal care. The company achieves sales of roughly USD 450m and an EBITDA margin above 20%. In view of its historical roots, a large share of business is conducted in North America and Latin America.

We believe the tuck-in acquisition to significantly reinforce the market position of LANXESS' Material Protection business unit, part of the Consumer Production division. In addition to an increased market share, LANXESS will have the widest product portfolio in the industry, including many applications in various industries and geographies. This will provide a considerable moat in a business characterised by technical expertise/knowledge and the regulatory framework.

¹ adjusted for lease amortisations according to our Corporate Rating Methodology

Ratings & Outlook

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

Analyst

Olaf Tölke
+49 69 6677389 11
o.toelke@scoperatings.com

Related Methodologies

[Chemical Corporates Rating Methodology](#)
April 2021

[Corporate Rating Methodology](#)
July 2021

Scope Ratings GmbH

Neue Mainzer Straße 66-68
60311 Frankfurt am Main
Tel. +49 69 6677389 0

Headquarters

Lennéstraße 5
10785 Berlin
Phone +49 30 27891 0
Fax +49 30 27891 100

info@scoperatings.com
www.scoperatings.com



Bloomberg: RESP SCOP

Acquisition fits perfectly into LANXESS' M&A playbook

As mentioned in our last rating report (see: **Scope affirms BBB+/Stable issuer rating of German LANXESS AG**), IFF's Microbial Control unit fits perfectly into LANXESS' blueprint for M&A, based on our understanding of the company's corporate development strategy. This includes developing its Consumer Protection division to a core pillar of the whole entity.

Marginal but positive effects on diversification

From a diversification point of view, we foresee marginal positive effects on LANXESS' revenue generation by end-market diversification and geography. The acquired division is exposed to multiple industries, predominantly energy, paints and coatings, home and personal care, together with a large share of business in North America and Latin America.

Positive effect on profitability

The strong, resilient profitability generation of the acquired business and targeted synergies of up to EUR 30m by 2025 also supports management's communicated target of an EBITDA pre-margin (before exceptional costs and through-the-cycle) of 14%-18%.

Updated, extended rating case indicates greater deterioration of credit ratios in 2022...

Following the public announcement of the deal, which is anticipated to be completed in Q2 2022 (pending regulatory approval), we have updated our rating case for 2022 and extended our rating scenario for the year 2023. This indicates a deterioration of key credit ratios in 2022, including SaD/EBITDA moving to 2.7x at year-end 2022. LANXESS intends to finance the tuck-in acquisition by issuing two bonds, but maintain a well-structured maturity profile, including healthy ratios on internal and external liquidity coverage.

...but not on a sustainable basis

On the positive side, we anticipate that SaD/EBITDA will move back below 2.5x in 2023. This is based on: i) the company's commitment to a solid investment grade rating and anticipated focus on lowering financial leverage, including no exploration of further external growth at least in the next 6-12 months as well as no share buybacks in the foreseeable future; and ii) the contribution to earnings by the acquired entity from the expected completion in Q2 2022, in the context of attractive free operating cash flow generation thanks to cash conversion ratio of around 90%. If necessary, LANXESS' leadership team has stated that it will explore potential asset sales in order to repair the balance sheet. Such a step would strongly support the credit rating if the current positive economic momentum slows noticeably.

Low execution and integration risk

Similar to the acquisition of Emerald Kalama Chemical (see: **LANXESS: Acquisition of Emerald Kalama Chemical**), we believe the purchase of IFF's Microbial Control unit involves low execution risk, due the fairly simple line-up of the target, which includes only two manufacturing sites in St. Charles (USA) and Institute (USA).

Rating drivers

Positive rating drivers	Negative rating drivers
<ul style="list-style-type: none"> • Industry risk profile – specialty chemicals (assessed A) • Powerful position in medium-sized markets with considerable barriers to entry • Increased, more resilient end-market mix due to portfolio clean-up and acquisitions • Attractive innovation and growth projects in the pipeline (e.g. with Standard Lithium and Tinci Materials Technologies, CheMondis) • Financial risk profile (assessed BBB+), driven by improved credit profile following portfolio realignment • Conservative financial policy, reflected in financial risk profile assessment 	<ul style="list-style-type: none"> • Mature product portfolio and comparably weak spending on product innovation relative to the specialty chemicals industry • Highly cyclical end-markets generating around 40% of sales (based on our calculations) • Positive profitability trend but still weak compared to key competitors' as well as profitability and efficiency thresholds under our methodology • Weak free operating cash flow resulting in weak FOCF/SaD ratio against the specialty chemicals industry

Rating-change drivers

Positive rating-change drivers	Negative rating-change drivers
<ul style="list-style-type: none"> • SaD/EBITDA of below 1.5x on a sustained basis 	<ul style="list-style-type: none"> • SaD/EBITDA above 2.5x on a sustained basis



Financial overview

		Scope estimates		
Scope credit ratios	2020	2021E	2022E	2023E
EBITDA/interest cover	6.6x	8.1x	9.1x	9.4x
Scope-adjusted debt (SaD)/EBITDA	1.8x	2.4x	2.7x	2.4x
Scope-adjusted FFO/SaD	48%	34%	28%	32%
Free operating cash flow (FOCF)/SaD	4%	3%	8%	10%
Scope-adjusted EBITDA in EUR m	2020	2021E	2022E	2023E
EBITDA	757	915	1,131	1,195
Other items	1	0	0	0
Scope-adjusted EBITDA	757	915	1,131	1,195
Scope-adjusted funds from operations (FFO) ² in EUR m	2020	2021E	2022E	2023E
EBITDA	757	915	1,131	1,195
less: (net) cash interest as per cash flow statement	-74	-60	-71	-73
less: cash tax paid as per cash flow statement	-131	-54	-148	-151
less: pension interest	-42	-56	-56	-56
add: dividends received from equity-accounted entities	150	0	0	0
less: disposal gains on fixed assets included in EBITDA	1	0	0	0
less: capitalised interest	-3	-3	-3	-3
Other items	-20	0	0	1
Scope-adjusted funds from operations	638	742	852	912
Scope-adjusted debt (SaD) in EUR m	2020	2021E	2022E	2023E
Reported gross financial debt	2,331	1,831	2,931	2,931
Hybrid debt	250	250	250	251
less: cash and cash equivalents	-1,794	-455	-655	-913
Cash not accessible	0	0	0	0
add: pension adjustment	407	407	407	407
Other items (contingent liabilities)	143	143	143	143
Scope-adjusted debt	1,337	2,176	3,076	2,819

² adjusted for lease amortisations according to our Corporate Rating Methodology



Scope Ratings GmbH

Headquarters Berlin

Lennéstraße 5
D-10785 Berlin

Phone +49 30 27891-0

Oslo

Karenslyst allé 53
N-0279 Oslo

Phone +47 21 62 31 42

Frankfurt am Main

Neue Mainzer Straße 66-68
D-60311 Frankfurt am Main

Phone +49 69 66 77 389 0

Madrid

Edificio Torre Europa
Paseo de la Castellana 95
E-28046 Madrid

Phone +34 914 186 973

Paris

23 Boulevard des Capucines
F-75002 Paris

Phone +33 1 8288 5557

Milan

Via Nino Bixio, 31
20129 Milano MI

Phone +39 02 30315 814

Scope Ratings UK Limited

London

111 Buckingham Palace Road
London SW1W 0SR

Phone +44020-7340-6347

info@scoperatings.com
www.scoperatings.com

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