TUESDAY, 27/06/2023 - Scope Ratings GmbH

Scope has today affirmed the BBB+ issuer rating of LANXESS AG and revised the Outlook to Negative

The Outlook change is driven by LANXESS reducing its forecasted FY 2023 EBITDA to EUR 600m-650m from previous estimate of EUR 900m due to slower-than-expected demand recovery.

The latest information on the rating, including rating reports and related methodologies, is available on this **LINK**.

Rating action

Scope Ratings GmbH (Scope) has affirmed the BBB+ issuer rating of LANXESS AG and revised the Outlook to Negative from Stable. Scope has also affirmed the senior unsecured debt rating at BBB+ and the short-term debt rating at S-2. The subordinated (hybrid) debt rating of BBB- has been withdrawn as the related debt instruments have been repaid in full.

Rating rationale

The affirmation is based on Scope's understanding that the current situation of longer-than expected customer destocking and weak demand is temporary and primarily influenced by external factors such as supply chain disruptions and inventory destocking. These factors are beyond LANXESS' control and are affecting other market players as well, with demand conditions expected to return to normal in the medium term. Consequently, in Scope's view, this industry-wide situation is inherent to the cyclical nature of the chemical industry. The revision of the Outlook to Negative from Stable stems from LANXESS' decreased EBITDA estimation, which places an additional burden on the company, as Scope understands that in response to these new estimations, the company will need to intensify its focus on cost reduction and prioritise investments accordingly.

The business risk profile (assessed at BBB+), takes into account the establishment of the Envalior joint venture with Advent, where LANXESS and Advent International partnered to acquire DSM's Engineering Materials division.

LANXESS's has a strong position in medium-sized segments of the specialty chemicals market, characterised by high barriers to entry, which contributes to its robust business risk profile. The company's well-diversified presence across various end-markets also has a favourable impact on business risk. However, one weakness is the company's low operating profitability with a Scope-adjusted EBITDA margin of 10.2% in 2022 (down 120bp YoY), partly explained by a margin dilution caused by price pass-through effects as well as by cost inflation. The relative weakness in terms of operating profitability in comparison to key competitors is expected to vanish gradually with the implementation of the measures the company is working on and the recovery of demand to normal levels.

Given the temporarily weaker credit ratios as measured by the Scope-adjusted debt/EBITDA (2022: 4.7x; up by 1.7x YoY) and the Scope-adjusted funds from operations/debt (2022: 18%; down 11pp YoY), Scope has lowered its assessment of LANXESS' financial risk profile (revised to BBB-). Scope's initial expectations on the speed of deleveraging have changed since the profit warning issued on 19 June 2023. Scope now anticipates a more gradual decline to 4.4x in 2023 and 3.3x in 2024. This is congruent with: i) LANXESS' commitment to deleveraging, considering that from the EUR 1.3bn HPM proceeds, EUR 200m have been provided as a loan to Envalior, the remainder, minus tax cash outflows, was used entirely for deleveraging; and ii) the current destocking situation, which is widespread across the entire market, is expected to return to normal in the medium term.

Financial policy remains a key supplementary rating driver. Scope understands the issuer to remain committed to a solid investment grade rating, as evidenced by debt repayments from HPM proceeds as well as other actions such as dividend reductions or asset disposals, including the exercise of the first exit possibility regarding the 40% stake in the joint venture with Advent International.

Liquidity remains adequate, given LANXESS' history of strong internal and external liquidity coverage, its well-structured debt maturity profile, and its access to a EUR 1.0bn credit facility, which remains undrawn. Additionally, LANXESS has access to bilateral committed credit lines amounting to EUR 750m, of which the largest portion remained undrawn after repayment of the hybrid bond. However, this is somewhat offset by historically poor free operating cash flow. That said, Scope understands that free operating cash flow could improve with the measures we understand the company is working on.

No key drivers of the credit rating action are considered ESG factors at present. Scope considers the main chemical industry risk to be environmental, as chemical companies usually have a heavy focus on production. There is also litigation risk in the chemicals industry, given possible toxic effects on end-users. Apart from the industry risks identified above, Scope sees no company-specific ESG factors at this stage.

Outlook and rating-change drivers

The Negative Outlook reflects the planned deleveraging (Scope-adjusted debt/EBITDA) which is now expected to be more gradual than previously anticipated - mainly due to destocking across the market, not specific to LANXESS - and is expected to affect the issuer's operating cash flow in the short to medium term. The company has shown a clear commitment to deleverage, by using most of the EUR 1.3bn proceeds from the divestment of HPM to pay down debt. Scope will continue to monitor the company's strategy to reduce costs and their willingness to reduce dividends, in order to reduce leverage to a level appropriate for the current rating.

A positive rating action, i.e. a return of the Outlook to Stable, could be warranted if the company shows a clear path to deleveraging to below 2.5x (Scope-adjusted debt/EBITDA) in the short to medium term, measured by a significant year-on-year improvement in this ratio. This could be triggered by higher visibility when the destocking situation recedes, and which specific measures LANXESS could implement to offset its temporary effect on leverage.

A downgrade could occur if the Scope-adjusted debt/EBITDA stays above 2.5x for a longer period than currently expected. This could be caused by a lagging recovery of the market, or a less conservative financial policy which reflects less importance being attached towards debt reduction, as evidenced by the Scope-adjusted debt/EBITDA not declining significantly year-on-year.

Long-term and short-term debt ratings

Scope has affirmed LANXESS' short-term debt rating at S-2. This is grounded on its affirmed issuer rating, the 'better-than-adequate' internally and externally provided liquidity coverage as well as its banking relationships and standing in capital markets.

The senior unsecured debt rating has been affirmed at BBB+, the level of the issuer.

Scope has withdrawn the subordinated (hybrid) debt category rating. The outstanding hybrid bond of EUR 500m was repaid in H1 2023 (ISIN: XS1405763019).

Stress testing & cash flow analysis

No stress testing was performed. Scope Ratings performed its standard cash flow forecasting for the company.

Methodology

The methodologies used for these Credit Ratings and/or Outlooks, (General Corporate Rating Methodology, 15 July 2022; Chemical Rating Methodology, 17 April 2023), are available on https://scoperatings.com/governance-and-policies/rating-governance/methodologies.
Information on the meaning of each Credit Rating category, including definitions of default, recoveries, Outlooks and Under Review, can be viewed in 'Rating Definitions – Credit Ratings, Ancillary and Other Services', published on https://www.scoperatings.com/governance-and-policies/rating-governance/definitions-and-scales. Historical default rates of the entities rated by Scope Ratings can be viewed in the Credit Rating performance report at https://scoperatings.com/governance-and-policies/regulatory/eu-regulation. Also refer to the central platform (CEREP) of the European Securities and Markets Authority (ESMA): http://cerep.esma.europa.eu/cerep-web/statistics/defaults.xhtml. A comprehensive clarification of Scope Ratings' definitions of default and Credit Rating notations can be found at https://www.scoperatings.com/governance-and-policies/rating-governance/definitions-and-scales. Guidance and information on how environmental, social or governance factors (ESG factors) are incorporated into the Credit Rating can be found in the respective sections of the methodologies or guidance documents provided on https://scoperatings.com/governance-and-policies/rating-governance/methodologies.
The Outlook indicates the most likely direction of the Credit Ratings if the Credit Ratings were to change within the next 12 to 18 months.

Solicitation, key sources and quality of information

The Rated Entity and/or its Related Third Parties participated in the Credit Rating process.
The following substantially material sources of information were used to prepare the Credit Ratings: public domain, the Rated Entity and Scope Ratings' internal sources.
Scope Ratings considers the quality of information available to Scope Ratings on the Rated Entity or instrument to be satisfactory. The information and data supporting the Credit Ratings originate from sources Scope Ratings considers to be reliable and accurate. Scope Ratings does not, however, independently verify the reliability and accuracy of the information and data.
Prior to the issuance of the Credit Rating action, the Rated Entity was given the opportunity to review the Credit Ratings and/or Outlooks and the principal grounds on which the Credit Ratings and/or Outlooks are based. Following that review, the Credit Ratings were not amended before being issued.

Regulatory disclosures

These Credit Ratings and/or Outlooks are issued by Scope Ratings GmbH, Lennéstraße 5, D-10785 Berlin, Tel +49 30 27891-0. The Credit Ratings and/or Outlooks are UK-endorsed.
Lead analyst: Ivan Castro Campos, Director
Person responsible for approval of the Credit Ratings: Philipp Wass, Managing Director
The Credit Ratings/Outlooks were first released by Scope Ratings on 30 January 2018. The Credit Ratings/Outlooks were last updated on 27 June 2022.

Potential conflicts

See www.scoperatings.com under Governance & Policies/Regulatory for a list of potential conflicts of interest disclosures related to the issuance of Credit Ratings.

Conditions of use/exclusion of liability

SHARE

CONTACT INFO

Ivan Castro Campos

Analyst

i.castro@scoperatings.com

Olaf Tölke

Team leader

o.toelke@scoperatings.com

Press contact

press@scopegroup.com

ISSUERS 1

INSTRUMENTS 7