S&P Global Ratings

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Bulletin:

LANXESS' Acquisition Of IFF Assets Will Strengthen Its Consumer Protection Business But Exhaust Rating Headroom

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This report does not constitute a rating action.

PRIMARY CREDIT ANALYST

Renato Panichi
Milan
+ 39 0272111215
renato.panichi
@spglobal.com

SECONDARY CONTACT

Wen Li
Frankfurt
+ 49 69 33999 101
wen.li
@spglobal.com

MILAN (S&P Global Ratings) Aug. 25, 2021--S&P Global Ratings today said that German specialty chemicals company LANXESS AG's (BBB/Stable/A-2) acquisition of microbial control business from U.S.-based International Flavors & Fragrances Inc. (IFF) will more than double the earnings of its consumer protection business. However, the deal will lead to minimal headroom in LANXESS' credit metrics for the ratings. LANXESS signed the agreement to acquire this business on Aug. 23, 2021, for a total enterprise value of $1.3 billion (about €1.1 billion), or around 9.6x EBITDA after synergies. The transaction will be fully funded by debt. The acquired business still needs to be carved out from the IFF group and the transaction is subject to approval by various antitrust authorities. LANXESS expects the transaction to be completed in the second quarter of 2022.

IFF's microbial control unit is a leading player in industrial biocides, and LANXESS estimates that it generates normalized sales of around $450 million and EBITDA of about $100 million annually. LANXESS anticipates annual synergies of approximately $35 million (€30 million) by 2025, especially from insourcing formulation activities and streamlining the salesforce and supply chain.

In our view, the acquisition is a good strategic fit for LANXESS, enabling the company to shift toward more lucrative specialty chemicals products. It will reinforce LANXESS' position in the high-margin consumer protection end markets, such as disinfection, personal care, and material protection, where growth potential over the next few years exceeds that for GDP. LANXESS will also gain a leading position in the microbial control market with a global footprint. Furthermore, with EBITDA margins higher than 20% and an asset-light model, the acquired business should improve the group's profitability and cash conversion; LANXESS' adjusted EBITDA margin averaged 13%-14% in 2018-2020. We do not expect the transaction to result in significant integration risk, given IFF's complementary portfolio and LANXESS' track record of effectively integrating previous acquisitions.

LANXESS has secured bridge financing to pay for the acquisition, which it will replace with bond issuance in the coming months. As a result of a €1.1 billion higher debt burden, we expect its funds from operations to debt to decline to 27%-29% in 2022 from the 30%-32% we forecast for

2021, and recover to more than 30% in 2023. Although this is still commensurate with the 'BBB' rating, it provides a minimal buffer against potential deterioration of credit metrics, for example due to a weaker business environment or further debt-financed transactions in the near term.

However, we regard management's strong commitment to a solid investment-grade rating as positive. LANXESS has decided to terminate its share buyback program. In addition, we understand the company will focus on deleveraging in the next 12-18 months, and various measures--including asset disposals and equity-linked instruments--are available to support the current rating, if needed. Nevertheless, we expect the company will continue to pursue opportunities to upgrade and realign its business portfolio.