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Research Update:

Germany-Based Chemical Producer LANXESS AG Outlook Revised To Stable On Stronger Credit Metrics; Affirmed At 'BBB-/A-3'

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Overview

- LANXESS AG reported stronger-than-anticipated credit metrics for 2016 and a robust first-quarter 2017 performance. In addition, it anticipates record EBITDA for full-year 2017, boosted by its recently closed Chemtura acquisition.
- We therefore now expect the company can deleverage faster than we previously forecast.
- We are revising our outlook on LANXESS to stable from negative and affirming our 'BBB-/A-3' ratings on the company.
- The stable outlook reflects our view that LANXESS' credit metrics will continue to strengthen, with funds from operations to debt approaching the 30% we view as commensurate with the 'BBB-' rating by year-end 2017, as well as solid free operating cash flow of up to €300 million in 2017 and up to €500 million in 2018.

Rating Action

On July 31, 2017, S&P Global Ratings revised its outlook on Germany-based chemicals producer LANXESS AG to stable from negative.

At the same time, we affirmed our 'BBB-/A-3' long- and short-term corporate credit ratings on the company and our 'BBB-' issue ratings on its senior unsecured debt. We also affirmed our 'BB' issue rating on LANXESS' €500 million subordinated bond.

Rationale

The outlook revision reflects our revised forecasts for LANXESS, which indicate faster deleveraging than we anticipated. We believe this could allow LANXESS to restore its adjusted ratio of funds from operations (FFO) to debt by year-end 2017 toward the 30% we view as commensurate with the rating, one year earlier than previously expected.

In April, LANXESS closed its €2.4 billion (enterprise value) acquisition of U.S.-based Chemtura Corp., a producer of lubricant additives and flame retardants. We still expect LANXESS' leverage will increase as a result of the acquisition, owing to higher adjusted debt that we forecast at about €3.4

billion as of year-end 2017, up from €1.4 billion at year-end 2016. However, we now factor in faster deleveraging. We expect the company will report FFO to debt close to 30% in 2017 (pro forma the full-year contribution of Chemtura) and higher ratios in 2018 and 2019 on the back of strong free operating cash flow (FOCF) and a gradual increase in EBITDA. This compares with our previous forecast of adjusted FFO to debt of about 25% in 2017 and just below 30% in 2018. Accordingly, we now consider that LANXESS' financial risk profile has improved to intermediate from significant.

Our revised forecast stems from several factors, including LANXESS' markedly lower adjusted debt at year-end 2016 compared with our projection (including the 50% pro rata consolidation of the Arlanxeo joint venture), its strong start in 2017 with robust first-quarter results, and its guidance for record earnings for the full year 2017. In addition, management has expressed its high confidence in its guidance for synergies and implementation costs related to the Chemtura transaction over 2017-2019. We continue to factor in the company's public commitment to maintaining an investment-grade rating, the track record and financial discipline demonstrated by its current management team, and the flexibility it might have to lower capital expenditure or dispose of assets to strengthen its balance sheet.

We see a positive trend in LANXESS' business risk profile as a result of the continued transformation of the company's portfolio into a midsize, well diversified (by geography and end markets) specialty chemicals company with leading market positions in all of its core businesses, and reduced exposure to the volatile, lower-margin commodity synthetic rubber business. Important milestones such as LANXESS' sale of 50% of its rubber business in 2015, its acquisition of Chemours' clean and disinfect business in 2016, and the recent Chemtura acquisition should enable the company to gradually build a track record of higher margins and less volatile profitability, two important pillars of our assessment of a chemicals company's competitive position and business risk.

In our base case for LANXESS, we assume:

- World GDP growth of 3.6% in 2017 and 2018, and a euro-to-U.S. dollar exchange rate averaging $0.90 in 2017 and $0.88 in 2018.
- An average oil price of $50 per barrel in 2017 and 2018.
- 50% proportionate consolidation of Arlanxeo in 2017, which we expect to continue in 2018 and 2019 despite different treatment in LANXESS' accounts.
- A revenue increase of about 20% to €8.1 billion in 2017, mainly driven by the pro forma full-year contribution of the Chemtura acquisition, and a similar level in 2018.
- Adjusted EBITDA of about €1.2 billion in 2017 and €1.3 billion in 2018, reflecting a margin increase of about 150 basis points (bps) in 2017 and 100bps in 2018 mainly due to the integration of Chemtura and related synergies.
- Capital expenditure of €500 million-€600 million in 2017 and 2018.
- Dividends of €70 million in 2017 and a modest increase in 2018.
- No major acquisitions or share repurchases.

Based on these assumptions, we arrive at the following credit measures:

- FFO to debt of close to 30% in 2017 (including the pro forma full-year contribution of Chemtura and €25 million of one-time expenses related to the transaction that we add back to FFO) and exceeding 30% in 2018; and
- FOCF of up to €300 million in 2017 and €300 million-€500 million in 2018.

Liquidity

We view LANXESS' liquidity as strong because we expect sources of liquidity will exceed its uses by more than 1.5x over the 12 months from March 31, 2017, and by at least 1.0x for the 12 months thereafter. We factor in the company's track record of access to debt markets and bank financing. LANXESS has no financial covenants to comply with.

We estimate that liquidity sources for that period include:

- €2.5 billion of cash and short-term investments.
- Full availability under an undrawn €1.25 billion credit line maturing in May 2022.
- €0.9 billion-€1.0 billion of cash FFO.

We estimate that liquidity uses during the same period include:

- €0.1 billion of short-term debt maturities.
- Moderate €0.1 billion of working-capital related outflows.
- Up to €0.6 billion of capital expenditures.
- €2.2 billion of outflow for the Chemtura acquisition and related costs.
- Dividends of about €70 million.

Outlook

The stable outlook reflects our expectation that LANXESS' FFO-to-debt ratio will be close to 30% by year-end 2017, which we consider commensurate with the current rating, and exceed 30% in 2018 and 2019. At the same time, we forecast FOCF of up to €300 million in 2017 and €300 million-€500 million per year in 2018-2019.

Upside scenario

Ratings upside would depend on further improvement of profitability, not least through the integration of Chemtura, related synergies, and debt reduction, resulting in the ratio of FFO to debt strengthening sustainably above 35%.

Downside scenario

We might lower the rating if we were to believe that the company would not be able to achieve FFO to debt of about 30% by year-end 2017 and higher in 2018, and if FOCF did not improve to about €300 million. We could also consider a downgrade if the company did not take measures to counteract weakening performance if the market or competitive environment deteriorated.

Ratings Score Snapshot

Corporate credit rating: BBB-/Stable/A-3

Business risk: Satisfactory
- Country risk: Intermediate
- Industry risk: Intermediate
- Competitive position: Satisfactory

Financial risk: Intermediate
- Cash flow/leverage: Intermediate

Anchor: bbb-

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

Related Criteria

- 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 Commodity Chemicals Industry, Dec. 31, 2013
- Criteria - Corporates - Industrials: Key Credit Factors For The Specialty Chemicals Industry, Dec. 31, 2013
- General Criteria: Group Rating Methodology, Nov. 19, 2013
- General Criteria: Country Risk Assessment Methodology And Assumptions, Nov. 19, 2013
- General Criteria: Methodology: Industry Risk, 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 And Assumptions: Assigning Equity Content To Corporate Entity And North American Insurance Holding Company Hybrid Capital Instruments, April 1, 2013
- General Criteria: Methodology: Management And Governance Credit Factors For Corporate Entities And Insurers, Nov. 13, 2012
- General Criteria: Criteria Clarification On Hybrid Capital Step-Ups, Call Options, And Replacement Provisions, Oct. 22, 2012
- Criteria - Financial Institutions - General: Methodology: Hybrid Capital Issue Features: Update On Dividend Stoppers, Look-Backs, And Pushers,

Feb. 10, 2010
- General Criteria: Use Of CreditWatch And Outlooks, Sept. 14, 2009
- Criteria - Insurance - General: Hybrid Capital Handbook: September 2008 Edition, Sept. 15, 2008
- Criteria - Corporates - General: 2008 Corporate Criteria: Rating Each Issue, April 15, 2008

Ratings List

Ratings Affirmed; Outlook Action

	To	From
LANXESS AG		
Corporate Credit Rating	BBB-/Stable/A-3	BBB-/Negative/A-3
Senior Unsecured	BBB-	BBB-
Subordinated	BB	BB

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Certain terms used in this report, particularly certain adjectives used to express our view on rating relevant factors, have specific meanings ascribed to them in our criteria, and should therefore be read in conjunction with such criteria. Please see Ratings Criteria at www.standardandpoors.com for further information. Complete ratings information is available to subscribers of RatingsDirect at www.globalcreditportal.com and at spcapitaliq.com. All ratings affected by this rating action can be found on the S&P Global Ratings' public website at www.standardandpoors.com. Use the Ratings search box located in the left column. Alternatively, call one of the following S&P Global Ratings numbers: Client Support Europe (44) 20-7176-7176; London Press Office (44) 20-7176-3605; Paris (33) 1-4420-6708; Frankfurt (49) 69-33-999-225; Stockholm (46) 8-440-5914; or Moscow 7 (495) 783-4009.