Scope has downgraded the issuer rating of LANXESS AG to BBB with Negative Outlook

The downgrade is due to the ongoing destocking in the chemicals sector, which has led to a significantly weaker Scope-adjusted EBITDA in 2023 compared to LANXESS' guidance.

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

Rating action

Scope Ratings GmbH (Scope) has downgraded the issuer rating of LANXESS AG to BBB from BBB+ and maintained the Negative Outlook. Scope has also downgraded the senior unsecured debt rating to BBB from BBB+ and affirmed the short-term debt rating at S-2.

Rating rationale

The downgrade is due to the ongoing destocking in the chemicals sector, which has led to a significantly weaker Scope-adjusted EBITDA of EUR 460m for 2023 compared to LANXESS' guidance[1]. The extended recovery period is due to slower-than-expected demand recovery, impacting LANXESS' cost structure. As such, historically low-capacity utilisations of around 55% as of 2023 compared to a utilisation of 80%, typically desired in the chemical industry, contributed to the challenges, especially in terms of cost absorption. Despite the situation being considered temporary, the prolonged recovery is putting further pressure on LANXESS' profitability and leverage, keeping it at a level that is not commensurate with the rating.

The Negative Outlook reflects continued pressure on profitability and leverage, as there is still lack of full visibility of when the markets will recover as well as on the timing of the Urethanes disposal.

The business risk profile has been revised to BBB from BBB+, as from Scope's perspective, the ongoing industry-wide destocking process, anticipated to conclude relatively soon, is adversely impacting LANXESS's profitability. This is due not only to a lower revenue base but also to a cost base that cannot be absorbed as efficiently as it is intended to, given historically low-capacity utilization. While it is true that the measures taken by the company to counteract the impact on profitability through the FORWARD! plan are expected to have a mitigating effect, Scope does not expect them to fully mitigate the loss of profitability. Furthermore, Scope believes that the destocking prolongation itself will cause the company to reach back “cruise speed” later than originally expected. Nevertheless, Scope continues to maintain a positive assessment of LANXESS's market position, highlighting its strong position in medium-sized segments of the specialty chemicals market, contributing to a well-diversified presence in various end markets.

The financial risk profile remains at BBB-, continuing to reflect the prolonged destocking situation and its impact on the credit metrics. Although Scope still sees the situation as temporary, a return to normality is not expected before 2025, with credit metrics gradually improving until then. Taking into account the current status and expected recovery trend, the key leverage ratios of Scope-adjusted debt /EBITDA (peaking at 6.3x in 2023, expected to improve to below 3x in 2024) and Scope-adjusted funds from operations/debt (down to 7% in 2023, expected to improve to around 30%) indicate that a gradual improvement is to be expected, mainly thanks to a normalization of capacity utilization as well as a timely execution of the asset divestment strategy.

Scope also considers positively the 40% stake in the JV with Advent International, which serves de facto as a significant financial reserve, given the fact that in 2026 LANXESS will have the earliest possibility to sell its stake in the joint venture to Advent. While the leverage ratios may suggest that the 2023 peak is a one-off event and a return to Scope-adjusted debt/EBITDA of below 3x is expected, Scope does not overly emphasize this view as the inclusion of EUR 500m of proceeds from the sale of the Urethanes division in 2024 is critical to the base case, while the timing and amount of which seems very likely but not certain.

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 the dividend reduction declared in 2023, the willingness to dispose the Urethanes division, and reductions of capital expenditures, the latter at least until the market conditions return to more favourable ones.

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.

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 and matures in December 2026. Additionally, LANXESS has access to bilateral committed credit lines amounting to EUR 750m.

Outlook and rating-change drivers

The Outlook remains Negative, as the limited visibility on the timing, extent and pace of the recovery in underlying market fundamentals keeps the risk high that leverage will remain at levels that are not commensurate with the assigned rating, i.e. Scope-adjusted debt/EBITDA above 3x. Nevertheless, the Outlook reflects a gradual reduction in leverage over the next few months, supported by the company's clear commitment to deleveraging, as evidenced by the fact that most of the EUR 1.3bn proceeds from the sale of HPM have been used to pay down debt as well as a further debt reduction linked to the expected EUR 500m proceeds from the sale of the Urethanes division. Scope will continue to monitor the company's strategy to reduce costs and their willingness and capability to reduce dividends and dispose assets, 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 3.0x (Scope-adjusted debt/EBITDA) or below 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/or by the positive effect on leverage should the divesture of the Urethanes division takes place.

A downgrade could occur if the Scope-adjusted debt/EBITDA stays above 3.0x 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 BBB/Negative issuer rating, the 'better-than-adequate' internally and externally provided liquidity coverage as well as its good banking relationships and standing in capital markets.

The senior unsecured debt rating has been downgraded to BBB, the level of the issuer.

1. The company's initial EBITDA estimates (not Scope-adjusted EBITDA) were EUR 900m, with a subsequent intermediate adjustment down to EUR 600-650m that was later revised.

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 Outlook, (General Corporate Rating Methodology, 16 October 2023; 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, third parties 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 these 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 Outlook and the principal grounds on which the Credit Ratings and/or Outlook are based. Following that review, the Credit Ratings and/or Outlook were not amended before being issued.

Regulatory disclosures

These Credit Ratings and/or Outlook are issued by Scope Ratings GmbH, Lennéstraße 5, D-10785 Berlin, Tel +49 30 27891-0. The Credit Ratings and/or Outlook are UK-endorsed.
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Potential conflicts

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