

## Evonik Industries AG

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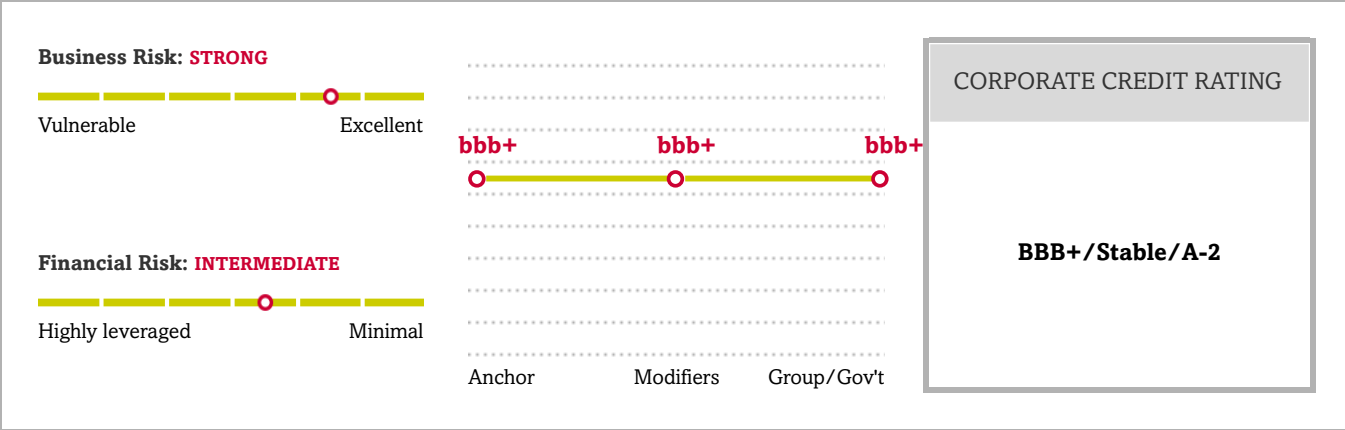
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# Evonik Industries AG



## Rationale

Business Risk: Strong	Financial Risk: Intermediate
<ul style="list-style-type: none"> <li>• Leading global specialty-chemicals manufacturer, with healthy market positions.</li> <li>• Stronger-than-peers' end-market diversification, with a high share of sales from the nutrition and health care industry, as well as resource-efficient solutions.</li> <li>• Average but resilient profitability overall, with potential improvement over the medium term thanks to cost saving initiatives.</li> <li>• Some concentration risk in the product portfolio that could lead to more-volatile profit generation, notwithstanding strategy to further increase the share of specialty chemical products.</li> <li>• Cyclical nature of chemical activities and exposure to volatile raw material prices.</li> </ul>	<ul style="list-style-type: none"> <li>• Our expectation of ongoing positive free cash flow generation based on moderate capital expenditure (capex) and working capital.</li> <li>• Significant postretirement obligations.</li> <li>• Supportive financial policy and management's commitment to a solid investment-grade rating, most recently demonstrated by issuance of an intermediate equity content hybrid to support an acquisition.</li> <li>• Strong liquidity.</li> </ul>

**Outlook: Stable**

S&P Global Ratings' stable outlook on global specialty chemicals group Evonik Industries (Evonik) reflects our expectation that the group will generate solid adjusted EBITDA of about €2.6 billion in 2018 and at least €2.6 billion-€2.7 billion in 2019. We also factor in Evonik's financial policy commitment to a solid investment-grade rating and anticipate that dividends and acquisitions (if any) will be financed prudently. We view a ratio of adjusted funds from operations (FFO) to debt of 30%-40% as commensurate with the rating.

**Downside scenario**

We could lower the ratings if we anticipated that S&P Global Ratings' adjusted FFO to debt would decline below 30% without near-term prospects of recovery. This could be caused, in our view, by a significant drop in profits due to a weaker market environment, or if Evonik pursued material debt-funded acquisitions.

**Upside scenario**

Upside rating potential could emerge over time, depending on Evonik's ongoing resilient performance thanks to a higher share of specialty chemicals in the product portfolio, visible EBITDA contributions from acquisitions and expansion projects, and a financial track record of adjusted FFO to debt in the 40%-45% range, including increased free cash flow after dividends. Financial policy commitment to a higher rating would be important in any upgrade considerations.

**Our Base-Case Scenario**

We estimate that Evonik's ratio of FFO to debt will be about 35%-37% in 2018, well in line with the 30%-40% range that we view as commensurate with the rating. We anticipate that Evonik will generate positive free operating cash flow (FOCF) of about €0.7 billion-€0.8 billion and that it will sufficiently cover dividends of about €0.5 billion-€0.6 billion.

Assumptions	Key Metrics			
<ul style="list-style-type: none"> <li>Global GDP growth of 2.9% in 2018 and 2.6% in 2019.</li> <li>Adjusted EBITDA of about €2.6 billion in 2018 and at least €2.6 billion-€2.7 billion in 2019.</li> <li>Capex of about €0.9 billion-€1 billion per year.</li> <li>Dividends of about €0.5 billion-€0.6 billion.</li> <li>No acquisitions and no disposals. In particular, we have not factored in the divestment of methacrylates business because the timing and proceeds of this transaction are uncertain.</li> <li>No increases in cash contributions to the pension fund.</li> </ul>	<b>2017A</b>	<b>2018E</b>	<b>2019E</b>	
	EBITDA (bil. €)	2.4	About 2.6	At least 2.6-2.7
	FFO (bil. €)	1.9	About 2.0	At least 2.0-2.1
	FFO/debt (%)	32.7	35-37	38-40
	A--Actual. E—Estimate. FFO--Funds from operations. Fully adjusted by S&P Global Ratings.			

## Company Description

Evonik is one of the leading specialty chemical companies, with about €14.4 billion revenues reported in 2017, presence in over 100 countries, and more than 36,000 employees.

The group's activities comprise three segments: nutrition and care, resource efficiency, and performance materials. Evonik serves a range of diversified end markets including food and animal feed, consumer and personal care, automotive and mechanical engineering, construction, and others.

**Nutrition and care (28% of 2017 EBITDA, excluding corporate and others):** Evonik is the world's largest producer of methionine, used in animal (mainly poultry) feed, and the group considers this to be one of its most important profit contributors. The segment also makes superabsorbent materials for diapers, cosmetic ingredients, and household products such as fabric conditioners and specialty surfactants.

**Resource efficiency (43% of 2017 EBITDA, excluding corporate and others):** This segment produces inorganic materials, such as silica and silanes for tires, coatings and adhesive resins, oil additives for the automotive and industrial end markets, crosslinkers, Polyamide 12, and hydrogen peroxide used in pulp and paper bleaching and other applications.

**Performance materials (24% of 2017 EBITDA, excluding corporate and others):** This segment produces naphtha-based C4 derivatives, methacrylates used in coatings and automotive components, and acrylic monomers and polymers for the construction and automotive industries.

The specialty additives business of Air Products acquired in January 2017 has been integrated into the nutrition and care and resource efficiency segments. The key products of the acquired business are high-value-added specialty chemicals and include specialty additives, curing agents, and polyurethane additives.

Huber Silica business, acquired in September 2017, was integrated into the resource efficiency segment, further diversifying Evonik's portfolio of silica products into medical and life science specialties.

## Business Risk: Strong

Evonik's business risk profile is underpinned by the size and strong market position of its specialty chemicals activities, as well as global market reach. Evonik benefits from greater diversity in terms of end markets and product range than most of its peers. For instance, about one-third of its sales come from animal nutrition and care products, while its shares in the more cyclical auto and construction end markets are less than 30%, with well-diversified exposure to other end markets. The group also has a good track record in research and development, which accounts for 3.0%-3.5% of its annual sales.

We view Evonik's profitability as average within the specialty chemicals industry, supported by the strong profitability of its methionine business even in low cycle conditions, and efficiency programs, with most recent initiatives targeting savings of €200 million by 2021.

Amino acids and C4 derivatives represent an estimated one-quarter of Evonik's EBITDA. We see this as a weakness for the group, given the higher volatility of these products compared with the rest of the group's offerings due to their sensitivity to economic cycles and supply-demand balances. We also consider it a weakness that a relatively high (although declining) proportion of Evonik's profits still come from one product, methionine. We note that Evonik is in the process of building a second methionine complex in Singapore, doubling its production capacity in the country to 300,000 metric tons per year by 2019. The decision to expand reflects GDP growth in demand for methionine of 5%-6%, fueled by professionalization of meat production. However, Evonik's key competitors and new entrants, notably Zhejiang NHU and Addiseo, also announced capacities expansions, which in our view could lead to downside risk to prices. That said, we recognize Evonik's first quartile cost position thanks to its backward integration and technological expertise in complex methionine production, both of which support the high profitability of the methionine business, even at the low point in the cycle.

We currently consider Evonik's business risk profile to be constrained by some product concentration and higher earnings volatility compared with peers in the strong category, such as BASF and Du Pont. However, we note the enhancements to diversity thanks to recent acquisitions, and recognize Evonik's strategy to accelerate growth and attain a sustainable EBITDA margin of 18%-20% on average over the cycle as the group reinforces cost efficiencies and further weighs the portfolio toward specialty chemicals. We view the planned disposal of the methacrylates business as an important step in delivering this strategy.

## Peer comparison

Table 1

Evonik Industries AG -- Peer Comparison				
Industry Sector: Chemical Cos				
	Evonik Industries AG	BASF SE	Solvay S.A.	Eastman Chemical Co.
Rating as of June 7, 2018	BBB+/Stable/A-2	A/Stable/A-1	BBB/Stable/A-2	BBB/Stable/A-2
--Fiscal year ended Dec. 31, 2017--				

Table 1

Evonik Industries AG -- Peer Comparison (cont.)				
Industry Sector: Chemical Cos				
	Evonik Industries AG	BASF SE	Solvay S.A.	Eastman Chemical Co.
<b>(Mil. €)</b>				
Revenues	14,419.0	64,475.0	10,891.0	7,951.7
EBITDA	2,361.0	12,819.0	2,145.0	1,846.8
FFO	1,890.1	10,103.0	1,629.3	1,422.4
Net income from cont. oper.	717.0	6,078.0	820.0	1,152.5
Cash flow from operations	1,808.1	9,493.0	1,241.3	1,414.1
Capital expenditures	1,036.0	3,928.0	717.0	534.6
Free operating cash flow	772.1	5,565.0	524.3	879.4
Discretionary cash flow	219.4	2,692.0	72.8	627.1
Cash and short-term investments	1,163.0	6,547.0	992.0	159.1
Debt	5,783.6	20,497.5	6,754.7	6,260.3
Equity	8,118.0	34,756.0	8,646.2	4,719.2
<b>Adjusted ratios</b>				
EBITDA margin (%)	16.4	19.9	19.7	23.2
Return on capital (%)	11.0	14.7	6.2	11.2
EBITDA interest coverage (x)	14.1	15.2	6.8	7.5
FFO cash int. cov. (X)	16.2	23.0	6.3	7.4
Debt/EBITDA (x)	2.4	1.6	3.1	3.4
FFO/debt (%)	32.7	49.3	24.1	22.6
Cash flow from operations/debt (%)	31.3	46.3	18.4	22.5
Free operating cash flow/debt (%)	13.3	27.1	7.8	14.0
Discretionary cash flow/debt (%)	3.8	13.1	1.1	9.9

FFO--Funds from operations.

## Financial Risk: Intermediate

Our view of Evonik's financial risk profile takes into account the group's FFO-to-debt ratio of 35%-37% in 2018 under our base-case scenario, which is in the 30%-40% range commensurate with the ratings. Over the course of 2018-2019, we anticipate Evonik will generate strong FOCF of €0.7 billion-€0.9 billion, allowing the company to deleverage gradually over time. However, this assumption does not factor in sizable debt-financed acquisitions, which represent an event risk to the forecast. Equally, we assume that Evonik may use the proceeds from the planned disposal of the methacrylates business to support the company's strategy of further increasing the share of specialty chemicals within its product portfolio. Therefore, any strengthening in the credit metrics would most likely be of temporary nature.

We note Evonik's financial policy commitment to a solid investment-grade rating and assume that the capex, dividends, and future acquisitions (if any) will be balanced appropriately. We take a positive view on the issuance of a €500 million intermediate equity content hybrid to finance the acquisition of Huber Silica business.

## Financial summary

Table 2

Evonik Industries AG -- Financial Summary					
Industry Sector: Chemical Cos					
	--Fiscal year ended Dec. 31--				
	2017	2016	2015	2014	2013
Rating history	BBB+/Stable/A-2	BBB+/Stable/A-2	BBB+/Stable/A-2	BBB+/Stable/A-2	BBB+/Stable/A-2
<b>(Mil. €)</b>					
Revenues	14,419.0	12,732.0	13,507.0	12,917.0	12,708.0
EBITDA	2,361.0	2,194.0	2,433.0	1,879.0	1,744.0
FFO	1,890.1	1,789.7	1,789.5	1,489.2	1,232.3
Net income from continuing operations	717.0	748.0	1,008.0	577.0	626.0
Cash flow from operations	1,808.1	1,970.7	2,344.5	1,183.2	1,149.3
Capital expenditures	1,036.0	942.0	908.0	1,044.0	1,033.0
Free operating cash flow	772.1	1,028.7	1,436.5	139.2	116.3
Discretionary cash flow	219.4	483.7	959.5	(331.8)	(318.7)
Cash and short-term investments	1,163.0	4,940.0	2,733.0	1,370.0	2,275.0
Debt	5,783.6	2,199.8	1,829.1	2,959.6	2,410.0
Equity	8,118.0	7,824.0	7,685.0	6,636.0	6,903.0
<b>Adjusted ratios</b>					
EBITDA margin (%)	16.4	17.2	18.0	14.5	13.7
Return on capital (%)	11.0	12.7	14.5	10.7	9.6
EBITDA interest coverage (x)	14.1	13.4	14.0	8.2	6.1
FFO cash int. cov. (x)	16.2	18.8	27.3	11.5	8.1
Debt/EBITDA (x)	2.4	1.0	0.8	1.6	1.4
FFO/debt (%)	32.7	81.4	97.8	50.3	51.1
Cash flow from operations/debt (%)	31.3	89.6	128.2	40.0	47.7
Free operating cash flow/debt (%)	13.3	46.8	78.5	4.7	4.8
Discretionary cash flow/debt (%)	3.8	22.0	52.5	(11.2)	(13.2)

FFO--Funds from operations.

## Liquidity: Strong

We view Evonik's liquidity as strong based on our estimate that the group's ratio of liquidity sources to liquidity uses will exceed 2.2x over the next 12 months from March 31, 2018 and 2.6x over the subsequent 12 months. Evonik's debt documentation does not include any covenants and the group has a track record of addressing its maturities well ahead of time. However, our liquidity assessment is capped at strong because Evonik provides no commitment to maintaining exceptional liquidity at all times.

Principal Liquidity Sources	Principal Liquidity Uses
<ul style="list-style-type: none"> <li>• At March 31, 2018, about €1.1 billion of estimated cash and liquid investments, excluding €0.1 billion which we view as restricted.</li> <li>• A €1.75 billion undrawn revolving credit facility maturing in 2023, with one extension option by one year. The facility is not subject to any financial covenants.</li> <li>• FFO of €1.7 billion-€1.8 billion over the next 12 months, according to our base-case credit scenario.</li> </ul>	<ul style="list-style-type: none"> <li>• Short-term debt of €0.5 billion at March 31, 2018.</li> <li>• Assumed capex of about €1 billion, but with maintenance capex seen as closer to €0.5 billion.</li> <li>• Dividends of about €0.5 billion-€0.6 billion.</li> <li>• Moderate working capital outflows of about €0.2 billion in the next 12 months, including €0.1 billion of peak intra-year working capital needs.</li> </ul>

### Debt maturities

As of Dec. 31, 2017:

- 2018: €332 million
- 2019-2020: €617 million
- 2021-2022: €1,220 million
- Thereafter: €2,044 million

## Ratings Score Snapshot

### Corporate Credit Rating

BBB+/Stable/A-2

### Business risk: Strong

- **Country risk:** Low
- **Industry risk:** Intermediate
- **Competitive position:** Strong

### Financial risk: Intermediate

- **Cash flow/Leverage:** Intermediate

Anchor: bbb+

### Modifiers

- **Diversification/Portfolio effect:** Neutral (no impact)
- **Capital structure:** Neutral (no impact)
- **Financial policy:** Neutral (no impact)



- **Liquidity:** Strong (no impact)
- **Management and governance:** Strong (no impact)
- **Comparable rating analysis:** Neutral (no impact)

## Reconciliation

**Table 3**

### Reconciliation Of Evonik Industries AG Reported Amounts With S&P Global Ratings Adjusted Amounts

--Fiscal year ended Dec. 31, 2017--

#### Evonik Industries reported amounts

	Debt	Shareholders' equity	EBITDA	Operating income	Interest expense	EBITDA	Cash flow from operations	Dividends paid	Capital expenditures
Reported	4,077.0	7,439.0	2,260.0	1,219.0	61.0	2,260.0	1,551.0	550.0	1,040.0
<b>S&amp;P Global Ratings adjustments</b>									
Interest expense (reported)	--	--	--	--	--	(61.0)	--	--	--
Interest income (reported)	--	--	--	--	--	56.0	--	--	--
Current tax expense (reported)	--	--	--	--	--	(359.0)	--	--	--
Operating leases	456.6	--	104.0	29.6	29.6	74.4	74.4	--	--
Intermediate hybrids reported as debt	(250.0)	250.0	--	--	(2.7)	2.7	2.7	2.7	--
Postretirement benefit obligations/deferred compensation	2,434.0	341.0	(5.0)	(5.0)	77.0	(82.0)	184.0	--	--
Surplus cash	(952.0)	--	--	--	--	--	--	--	--
Capitalized interest	--	--	--	--	3.0	(3.0)	(3.0)	--	(3.0)
Capitalized development costs	--	--	(1.0)	(1.0)	--	(1.0)	(1.0)	--	(1.0)
Dividends received from equity investments	--	--	11.0	--	--	11.0	--	--	--
Nonoperating income (expense)	--	--	--	15.0	--	--	--	--	--
Noncontrolling interest/minority interest	--	88.0	--	--	--	--	--	--	--
Debt - guarantees	37.0	--	--	--	--	--	--	--	--
Debt - other	(19.0)	--	--	--	--	--	--	--	--
EBITDA - gain/(loss) on disposals of PP&E	--	--	(71.0)	(71.0)	--	(71.0)	--	--	--
EBITDA - Foreign Exchange gain/(loss)	--	--	63.0	63.0	--	63.0	--	--	--
D&A - impairment charges/(reversals)	--	--	--	118.0	--	--	--	--	--
Total adjustments	1,706.6	679.0	101.0	148.6	106.9	(369.9)	257.1	2.7	(4.0)

Table 3

### Reconciliation Of Evonik Industries AG Reported Amounts With S&P Global Ratings Adjusted Amounts (cont.)

S&P Global Ratings adjusted amounts									
	Debt	Equity	EBITDA	EBIT	Interest expense	Funds from operations	Cash flow from operations	Dividends paid	Capital expenditures
Adjusted	5,783.6	8,118.0	2,361.0	1,367.6	167.9	1,890.1	1,808.1	552.7	1,036.0

### Related Criteria

- General: Reflecting Subordination Risk In Corporate Issue Ratings, March 28, 2018
- General Criteria: Methodology For Linking Long-Term And Short-Term Ratings, April 7, 2017
- General: Methodology And Assumptions: Liquidity Descriptors For Global Corporate Issuers, Dec. 16, 2014
- Industrials: Key Credit Factors For The Specialty Chemicals Industry, Dec. 31, 2013
- Industrials: Key Credit Factors For The Commodity Chemicals Industry, Dec. 31, 2013
- General Criteria: Country Risk Assessment Methodology And Assumptions, Nov. 19, 2013
- General Criteria: Group Rating Methodology, Nov. 19, 2013
- General: Corporate Methodology, Nov. 19, 2013
- General Criteria: Methodology: Industry Risk, Nov. 19, 2013
- General: Corporate Methodology: Ratios And Adjustments, Nov. 19, 2013
- General Criteria: Methodology: Management And Governance Credit Factors For Corporate Entities And Insurers, Nov. 13, 2012
- General Criteria: Use Of CreditWatch And Outlooks, Sept. 14, 2009

### Business And Financial Risk Matrix

Business Risk Profile	Financial Risk Profile					
	Minimal	Modest	Intermediate	Significant	Aggressive	Highly leveraged
Excellent	aaa/aa+	aa	a+/a	a-	bbb	bbb-/bb+
<b>Strong</b>	aa/aa-	a+/a	<b>a-/bbb+</b>	bbb	bb+	bb
Satisfactory	a/a-	bbb+	bbb/bbb-	bbb-/bb+	bb	b+
Fair	bbb/bbb-	bbb-	bb+	bb	bb-	b
Weak	bb+	bb+	bb	bb-	b+	b/b-
Vulnerable	bb-	bb-	bb-/b+	b+	b	b-

### Ratings Detail (As Of June 7, 2018)

#### Evonik Industries

Corporate Credit Rating

BBB+/Stable/A-2

**Ratings Detail (As Of June 7, 2018) (cont.)**

Senior Unsecured	BBB+
Short-Term Debt	A-2
Subordinated	BBB-
<b>Corporate Credit Ratings History</b>	
09-May-2012	BBB+/Stable/A-2
06-May-2011	BBB/Stable/A-2
21-Sep-2010	BB+/Positive/B

\*Unless otherwise noted, all ratings in this report are global scale ratings. S&P Global Ratings' credit ratings on the global scale are comparable across countries. S&P Global Ratings' credit ratings on a national scale are relative to obligors or obligations within that specific country. Issue and debt ratings could include debt guaranteed by another entity, and rated debt that an entity guarantees.

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