

Research Update:

# Specialty Chemicals Producer SpecialtyCo Assigned Prelim 'BBB+' Rating On Proposed Spin-Off From Solvay; Outlook Stable

June 16, 2023

## Rating Action Overview

- On June 16, 2023, Solvay S.A. (BBB/Negative/A-2) announced the targeted initial capital structure and financial policies for SpecialtyCo, which will consist of Solvay's specialty business after its partial demerger.
- We expect SpecialtyCo will generate about €1.7 billion S&P Global Ratings-adjusted EBITDA in 2023 on a pro forma stand-alone basis, improving in coming years due to its focus on high-margin high-growth market segments with supportive underlying megatrends.
- The initial indicative leverage is low, resulting in SpecialtyCo's adjusted funds from operations (FFO) to debt standing at about 55% in 2023 pro forma, which we expect to progressively improve in 2024 and 2025.
- We also take into consideration management's public commitment to a disciplined capital allocation and maintaining a strong investment-grade rating for SpecialtyCo.
- We assigned our 'BBB+' preliminary long-term and 'A-2' preliminary short-term issuer credit ratings to Specialty Holdco Belgium, the parent company of the SpecialtyCo group.
- The stable outlook reflects our expectation that SpecialtyCo will continue to grow at an above-market rate while at least maintaining EBITDA margins above 20%. We expect our adjusted FFO to debt will remain comfortably above 35% in the next 24 months, which we view as commensurate with the 'BBB+' rating.

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## Rating Action Rationale

**Solvay has just announced the targeted capital structure and financial policy for SpecialtyCo, a milestone for the ongoing separation process.** In March 2022, Solvay announced the intention to separate the group into two independent publicly listed companies via a partial demerger to be completed by end of 2023. All assets and liabilities relating to the specialty business owned by Solvay (including Solvay's Materials and Solutions division except Special Chem) will be

contributed to SpecialtyCo pursuant to a universal succession regime. We understand that through the separation Solvay intends to unlock equity value by creating "pure-play" stand-alone companies, with the ability to pursue separate strategic paths for each entity with a better focus and execution of strategy. SpecialtyCo will focus on driving above-market profitable growth through innovation and become a leading two-legs, pure-player in Materials & Consumer markets.

**The preliminary rating reflects the low initial leverage at spin-off date.** We expect our adjusted FFO to debt to stand at around 55% for 2023 on a pro forma stand-alone basis, followed by a progressive improvement in 2024-2025. This indicates comfortable headroom given our expectation of at least 35% FFO to debt for the current rating. It reflects SpecialtyCo's solid balance sheet at the outset of the separation. The initial capital structure will mainly comprise of the existing bonds in the Solvay group totaling to about €2.5 billion (including €500 million hybrid), which will be transferred to SpecialtyCo before the separation conditional on bondholders' consent, about €0.2 billion of lease liabilities, slightly above €0.2 billion of pension obligations, and €45 million of other existing debt. Based on the indicative capital structure, we do not expect any structural subordination of senior unsecured debt to be transferred to SpecialtyCo. In addition, the company intends to repay the €500 million hybrid bond at the first callable date in December 2025. Due to the call, we view the hybrid as 100% debt. Our total adjusted net debt amounts to about €2.4 billion as of the end of 2023, the expected spin-off date, and will improve in 2024-2025 due to higher earnings and free cash flow generation.

**The business risk profile of SpecialtyCo is supported by the strong market position of its products, especially its global leadership in a broad range of high-performance polymers and composites.** SpecialtyCo has wide geographic diversification, and it benefits from diversified end markets with solid underlying growth driven by megatrends, including transition to electric vehicles (EV), light weighting, and electrification. SpecialtyCo is well positioned to continue its historical track record of delivering above-market growth, given the high share of its product portfolio that is dedicated to e-mobility, resource efficiency, and sustainable solutions for agriculture and the personal care industry.

**SpecialtyCo's business also benefits from an above-average EBITDA margin.** This is thanks to its effective pricing power linked to an innovative product offering and its market leadership in the premium segment of highly customized specialty polymers, as well as cost savings from efficiency measures implemented in 2020-2022 and continuous disciplined cost control. We expect the S&P Global Ratings-adjusted EBITDA margin to stand at about 21.5% in 2023, followed by a gradual increase in 2024-2025 supported by an improved product mix. Historically, our adjusted EBITDA margin for SpecialtyCo has been in the range of 17.5%-20.5% in 2020-2022, while the underlying EBITDA margin of the Materials division (before corporate and service costs), which makes up over half of SpecialtyCo's revenue, has been above 25% in the same period. The Materials division has historically displayed a strong ability to pass through increases in raw material, logistic, and energy costs to customers, as evidenced in 2022 with very high cost of inflation. Even in the first quarter of 2023 with a high-single-digit decline in volume, the company managed to increase EBITDA and margin year on year, which is stronger than many other industry peers.

**SpecialtyCo displays robust research and development (R&D) capabilities, reflecting its innovation- and customization-driven business model.** R&D expenses represent about 4%-5% of net sales, which is higher than the industry average. SpecialtyCo aims to accelerate profitable growth and further strengthen its leading positioning in the materials and consumer markets by, among others, investing in capacity expansions and innovation. Supplier and customer

concentration is limited, though some of its business segments display a high customer concentration, such as composites, which mainly serves the aerospace sector.

**Major risks in SpecialtyCo's business include exposure to some volatile end markets, such as auto, aerospace, oil and gas, and construction.** SpecialtyCo has relatively high exposure to the volatile auto and aerospace sector (nearly 30% of total sales in 2022). In addition, the oil and gas activities (about 7% of 2022 sales) have historically been more volatile than other segments. Nevertheless, this would be partly offset by other more resilient end markets including consumer goods, home and personal care, and healthcare markets (about 14%), agriculture, feed, and food (about 13%). We also note the strong growth potential of specialty polymers, especially for electric vehicle (EV) battery applications, and composites thanks to aerospace recovery post COVID.

**Moreover, the product portfolio shows some concentration on specialty polymers, which accounted for about 40% of total sales and a higher share of EBITDA in 2022.** We view SpecialtyCo's business as weaker than that of Solvay (under the current scope before spilt), since the latter benefits from a larger size and better business diversification. We also take into consideration that the high investments needed to pursue management's growth strategy will weigh on free operating cash flow (FOCF) for the next three to five years.

**We anticipate a progressive improvement of credit metrics post-split in 2024-2025, driven by earnings growth.** We expect our adjusted EBITDA to reach about €1.7 billion in 2023 and continue to grow thereafter. This is mainly driven by volume growth in Specialty Polymers, supported by the shift to EV, the large investments in PVDF (polyvinylidene fluoride) capacity expansion projects (high-growth battery applications), aerospace recovery post COVID, as well as volume and mix improvement in Novecare through next-generation solutions (for example, green solvents for agriculture).

**Despite of solid FOCF, cash conversion is likely to be weaker than many industry peers at a similar rating level due to the investment cycle ahead.** We expect FOCF to reach €200 million-€250 million in 2023 with FOCF to debt of about 10%, followed by a continuous strengthening in 2024 and 2025. SpecialtyCo displays higher capital expenditure (capex) than many of its peers, driven by the investment cycle to support growth. To accommodate for the strong market growth potential in the coming years, SpecialtyCo plans to invest in capacity expansions, primarily related to PVDF for battery materials (specialty polymers) and other products such as natural vanillin and green solvents. As a result, we expect the capex-to-revenue ratio to be higher than the historical range of 7%-9%. Given that a large share of its total capex relates to growth capex, we believe the company has ample flexibility to postpone or scale down its capex, if needed. Working capital does not exhibit significant cash absorption or seasonality within the year.

**We factor in that a track record of financial policy for SpecialtyCo still needs to be built and large acquisitions could lead to higher leverage in the future.** We anticipate possible deviation from our currently forecast metrics, given the company's dedicated growth strategy. We understand that management is committed to disciplined capital allocation and maintaining a strong investment-grade rating for SpecialtyCo. However, in absence of a specific leverage target and as we view mergers and acquisitions (M&A) as a potential driver to achieve SpecialtyCo's growth ambition, we take a conservative approach to the sustainability of the current forecast metrics, which provide the company some leeway for growth investments. In line with management assumptions, we assume about 40% of Solvay's current dividend level will be borne

by SpecialtyCo in 2023. We understand that the new dividend policy for SpecialtyCo will be defined to balance growth investments and shareholder remuneration, targeting positive free cash flow after dividends to preserve the capacity to deleverage over time.

**We take a holistic view on the rating and take into consideration that SpecialtyCo will be operating on a stand-alone basis and may exhibit greater volatility than Solvay currently does.**

We factor in SpecialtyCo's overall smaller size, higher product concentration, and greater exposure to cyclicality than larger and more diversified industry peers. In our view, there is also a relatively limited buffer under the FOCF-to-debt ratio to weather a potential underperformance if the company decides to undertake high growth investments at the same time.

**The final ratings will depend on our receipt and satisfactory review of all final documentation and final terms of the transaction.** The preliminary ratings should therefore not be construed as evidence of final ratings. If we do not receive final documentation within a reasonable time, or if the final documentation and final terms of the transaction depart from the materials and terms reviewed, we reserve the right to withdraw or revise the ratings. Potential changes include, but are not limited to, utilization of the proceeds, maturity, size and conditions of the facilities, financial and other covenants, security, and ranking.

## Outlook

The stable outlook reflects our expectation that SpecialtyCo will continue to grow at an above-market rate while at least maintaining EBITDA margins above 20%. We expect our adjusted FFO to debt will remain comfortably above 35% in the next 24 months, which we view as commensurate with the 'BBB+' rating.

## Downside scenario

We could lower the rating if SpecialtyCo failed to deliver continuous growth while maintaining margins. Downward pressure will also emerge if adjusted FFO to debt drops below 35%. This could occur if there were unexpected severe and prolonged weakening in market conditions, substantial operational or split-related setbacks, or a large debt-funded acquisition that translated into much lower cash flow generation or much higher debt.

## Upside scenario

Any rating upside would require a supportive financial policy and management's strong commitment to a higher rating, for example, as reflected in maintaining FFO to debt sustainably above 40% and FOCF to debt above 20%.

## Company Description

Headquartered in Belgium, SpecialtyCo is a global leading manufacturer of high-performance materials, including specialty polymers and composite materials, and of specialty formulations used in diverse end-markets. In 2022, SpecialtyCo generated net sales of €7.9 billion and our adjusted EBITDA amounted to about €1.7 billion with an EBITDA margin of 20.4%. In 2022, 28% of SpecialtyCo's net sales were attributable to the automotive and aerospace markets, 15% to resources and environment, 15% to industrial and chemical applications, 14% to consumer

goods, home and personal care, and healthcare markets, 13% to agriculture, feed, and food markets, 8% to electronics, and 7% to other end markets. SpecialtyCo has a well-balanced exposure to global markets, with Europe accounting for about 23% of 2022 net sales, North America 32% (mainly from the U.S.), Latin America 9%, Asia and the rest of the world 36%.

SpecialtyCo's businesses are organized into two segments:

- Materials (52% of net sales in 2022): The business unit Specialty Polymers (77% of Materials segment net sales in 2022) is a leading producer of high-performance polymers used in the automotive, electronics, healthcare, and industrial end markets.
- Consumer and Resources (48% of 2022 net sales): The segment provides specialty formulations used in agriculture, feed and food, home and personal care, and industrial applications. The segment comprises four business units: Novocare (50% of 2022 segment net sales), Technology Solutions (20%), Aroma Performance (15%), and Oil & Gas (15%).

We understand that after the spin-off from Solvay, new shares of SpecialtyCo will be issued and allocated directly to Solvay's shareholders and listed on Euronext Brussels and Euronext Paris.

## **Our Base-Case Scenario**

### **Assumptions**

- Europe: GDP growth of 0.6% in 2023, 1.8% in 2024, and 2.2% in 2025, and 2.1% in 2026; North America: GDP growth of 0.7% in 2023, 1.2% in 2024, and 1.8% in 2025; APAC: GDP growth of 4.6% in 2023, 4.6% in 2024, and 4.7% in 2025; Latin America: GDP growth of 1.1% in 2023, 2.1% in 2024, and 2.4% in 2025.
- Sales growth of 2%-5% in 2024, which accelerates to 5%-10% in 2025, supported by large growth capex. The growth will be driven by Specialty Polymers (especially for EV batteries) and composite materials due to aerospace recovery.
- Our adjusted EBITDA margin of above 21.5% in 2023, improving from 2024 on positive mix effects (especially higher specialty polymer volumes with a high margin) and the recovery of composite materials in the civil aero end market.
- Capex above historical levels, which we expect to be in the €0.9 billion-€1.0 billion range in 2023-2025, including high growth capex mainly in PVDF for EV batteries, vanillin capacity expansion, and green solvents expansion.
- Dividends of €170 million-€180 million in 2024-2025.
- No acquisitions assumed in our base case. However, we note that acquisitions might weigh on its credit metrics.

### **Key metrics**

- Our adjusted FFO to debt of about 55% in 2023, up to comfortably above 55% in 2024-2025; and
- Our adjusted FOCF to debt of about 10% in 2023, followed by a progressive improvement in 2024-2025.

## Liquidity

The strong liquidity position reflects the company's ratio of liquidity sources to uses being comfortably above 1.5x in 2024. These ratios illustrate the company's solid cash position post-split, significant undrawn revolving credit facilities (RCF), good operating cash flow generation, and manageable debt maturities. Furthermore, we believe that SpecialtyCo's financial risk management will be in line with a strong liquidity assessment, considering Solvay's solid track record of maintaining strong liquidity.

Principal liquidity sources over the 12 months following the split completion as of end-2023 will include:

- Our assumption of €0.7 billion-€1.1 billion of cash;
- Significant undrawn long-term RCF; and
- Cash FFO of €1.4 billion-€1.6 billion.

Principal liquidity uses over the same period will include:

- Our expectation for about €100 million annual working capital outflow, in addition, about €300 million of peak intra-year seasonal working capital requirements;
- Our estimate of €0.9 billion-€1.0 billion of capex; and
- Dividends of more than €170 million.

## Covenants

We expect no financial covenants.

## Environmental, Social, And Governance

### ESG credit indicators: E-2, S-2, G-2

Environmental and social factors are an overall neutral consideration in our credit rating analysis of SpecialtyCo, although we see the company as somewhat better positioned than many companies in the chemicals industry. SpecialtyCo is a pure specialty chemicals producer, which is less energy intensive and has lower CO<sub>2</sub> emissions compared with commodity chemicals companies. SpecialtyCo has limited environmental liabilities, which comprise of about €85 million of our asset-retirement obligation adjustments related to PFAS provisions (representing less than 4% of our total adjusted debt at the end of 2023). Moreover, a high share of its product portfolio is dedicated to sustainable mobility and resource efficiency. We view this as credit positive given the growing demand for such products. As an example, in its Materials segment, SpecialtyCo is focused on solutions for light weighting and electrification, benefiting from the rising demand for electric and hybrid vehicles, which is expected to be above that of the general automotive market.

## Ratings Score Snapshot

Issuer Credit Rating	BBB+(Prelim)/Stable/A-2(Prelim)
Business risk:	Strong
Country risk	Low
Industry risk	Low
Competitive position	Strong
Financial risk:	Modest
Cash flow/leverage	Modest
Anchor	a
Modifiers:	
Diversification/Portfolio effect	Neutral (no impact)
Capital structure	Neutral (no impact)
Financial policy	Negative (-1 notch)
Liquidity	Strong (no impact)
Management and governance	Satisfactory (no impact)
Comparable rating analysis	Negative (-1 notch)
Stand-alone credit profile:	bbb+

## Related Criteria

- General Criteria: Hybrid Capital: Methodology And Assumptions, March 2, 2022
- General Criteria: Environmental, Social, And Governance Principles In Credit Ratings, Oct. 10, 2021
- General Criteria: Group Rating Methodology, July 1, 2019
- Criteria | Corporates | General: Corporate Methodology: Ratios And Adjustments, April 1, 2019
- Criteria | Corporates | 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
- Criteria | Corporates | General: Methodology And Assumptions: Liquidity Descriptors For Global Corporate Issuers, Dec. 16, 2014
- Criteria | Corporates | General: Corporate Methodology, Nov. 19, 2013
- General Criteria: Methodology: Industry Risk, Nov. 19, 2013
- General Criteria: Country Risk Assessment Methodology And Assumptions, Nov. 19, 2013
- General Criteria: Methodology: Management And Governance Credit Factors For Corporate Entities, Nov. 13, 2012
- General Criteria: Principles Of Credit Ratings, Feb. 16, 2011

## Ratings List

### New Ratings

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#### Specialty Holdco Belgium

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Issuer	Credit Rating
Specialty Holdco Belgium	BBB+(Prelim)/Stable/A-2(Prelim)

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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](http://www.standardandpoors.com) for further information. A description of each of S&P Global Ratings' rating categories is contained in "S&P Global Ratings Definitions" at [https://www.standardandpoors.com/en\\_US/web/guest/article/-/view/sourceId/504352](https://www.standardandpoors.com/en_US/web/guest/article/-/view/sourceId/504352) Complete ratings information is available to subscribers of RatingsDirect at [www.capitaliq.com](http://www.capitaliq.com). All ratings affected by this rating action can be found on S&P Global Ratings' public website at [www.standardandpoors.com](http://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; or Stockholm (46) 8-440-5914



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