Research Update:

Solvay S.A. Ratings Lowered To 'BBB-/A-3' Following Partial Demerger Completion; Outlook Stable

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Rating Action Overview

- On Dec. 8, 2023, Solvay S.A. shareholders approved the partial demerger transaction by which the group will be separated into two separate legal entities.
- We are revising our business risk profile for Solvay to satisfactory, reflecting the company's retained commodity chemicals (namely soda ash, bicarbonate, peroxides, and silica) with leading market and cost positions, and our expectation of about €1.1 billion-€1.2 billion S&P Global Ratings-adjusted EBITDA in 2024.
- The debt structure at spin-off, in line with the company's capital allocation guidance, will result in about 30% adjusted funds from operations to debt in the coming years in our base case, pointing comfortably to a significant financial risk profile.
- We are therefore lowering our long-term issuer credit rating on Solvay S.A. to 'BBB-' from 'BBB', and our short-term rating to 'A-3' from 'A-2'. Instruments previously issued by Solvay are either no longer rated since being redeemed, or have been transferred to Syensqo (Specialty Holdco Belgium).
- The stable outlook reflects our expectation that Solvay will maintain adjusted funds from operations (FFO) to debt at the high end of the 20%-30% range from 2024, with adjusted EBITDA margins of 22%-23% under normalized business conditions, leaving comfortable headroom for the 'BBB-' rating.

Rating Action Rationale

Following the partial demerger, Solvay retains leading market positions in its key commodity chemicals. The company is now focused on being a global producer of soda ash and bicarbonate, peroxides, and silica, with the product portfolio also including rare earth minerals for auto catalysts and solvents (phenols and acetone). While we view the business as largely focused on commodity chemicals (85%), we consider that it has a dominant role in its key markets. This is notably the case for the soda ash segment (40% of sales) where Solvay benefits from a leading global market share (18%) and technological leadership, with production spread across natural

soda ash (43%) and synthetic soda ash (57%), with a fair diversification across Europe (57%) and North America (35%). The company is also leading in silica (11% of sales), and is the No.3 player in peroxides (14% of sales), where it has a dominant position for high-purity, electronic-grade hydrogen peroxide.

In our view, the overall business is well diversified in terms of geographies and end markets. Solvay's business is now split across the Americas (39% of sales), Europe (33%), and the Asia-Pacific region (28%). The company is largely present in automotive (19% of sales) through silica used in tire manufacturing, and in buildings (11%) through soda ash in the production of glass. The chemicals industry represents 17% of sales. Soda ash also serves the packaging glass manufacturing industry, providing exposure to the food packaging market (11% of sales), while the consumer and personal care market (18%) is addressed through most segments in several ways. Although markets are somewhat diversified, we view them as still skewed toward relatively cyclical markets, somewhat mitigated by the high portion of recurring business from replacement tires in the tire industry and exposure to renovation in the glass-for-construction segment.

That said, we view the business as materially less diversified than the pre-separation Solvay group. We view the shift of concentration of the product portfolio toward commodity chemicals as a relative weakness because of its exposure to supply and demand patterns, making it sensitive to GDP growth, although the balance has been consistently a favorable driver of these operations over recent years. We also factor in some level of customer concentration with significant players in the glass and tire manufacturing segments. We believe Solvay's still-material size in these key segments provides it with strong pricing power, which is visible in the company's resilient operating track record.

The strong cost position on the global curve for the company's key products is a key strength, in our view. This translates into above-average margins for a commodity producer. We view favorably the significant vertical integration into key raw materials along the value chain, its fairly flexible cost base with 60% of total costs being variable, and multiyear selling contracts embedding cost-to-price adjustment features that have supported consistently high and stable margins in recent years.

The capital intensity for the retained business is reasonable in our view. Our 8%-10% capital expenditure (capex)-to-sales assumption embeds a significant portion of growth capex (40% of total) dedicated to capacity expansion, notably in soda ash in the U.S., in peroxides, and in energy transition to manage the sizable environmental footprint of the group's main operations. In that context, we view as realistic the company's strategy to reduce carbon dioxide emissions by 30% by 2030 from 2018, by switching boilers to gas/electrification and phasing out coal usage. We think discretionary capex should not burden free operating cash flow (FOCF) generation too much, providing leeway for the wider capital allocation policy.

The debt structure at closing is aligned with the company's guidance. Our debt figure includes about €1.8 billion long-term debt, while we factor in adjustments for lease obligations (€332 million), environmental provision (€98 million), pension obligations (€487 million), and litigation provisions (€52 million), and consider €40 million of cash as not immediately available for debt repayment. We forecast Solvay's S&P Global Ratings-adjusted FFO to debt at about 30% in 2024-2025, placing it at the higher end of the 20%-30% range we view as commensurate with a significant financial risk profile.

We anticipate strong cash flow generation and prudent dividend policies will support the company's credit profile. We estimate that FOCF of about €300 million-€350 million per year in 2024-2025, equating to about 15% adjusted FOCF to debt, is comfortable for the financial risk profile targets. With about €260 million-€270 million dividend distribution annually in these years, we would still expect discretionary cash flow (DCF) to remain positive, albeit at a weak level. Our base case points to about 2%-3% DCF to debt when the significant financial risk profile would typically require 5% as a minimum, which is a relative weakness in our view. We view positively the company's financial policy, which includes flexibility in capex and dividends and a strong commitment to an investment-grade rating. As a result, we consider overall rating leeway as comfortable, and we estimate that pressure on the rating would arise if FFO to debt approached 20% or DCF turned negative.

Outlook

The stable outlook reflects our expectation that Solvay's adjusted FFO-to-debt ratio would be at the high end of the 20%-30% range from 2024, with adjusted EBITDA margins at 22%-23%, which we expect to be sustained under normalized market conditions. We consider FFO to debt of 20%-30% as commensurate with the 'BBB-' rating. As such, we believe that Solvay's credit metrics under the spin-off debt structure provide headroom to absorb some business deterioration or debt-funded acquisitions.

Downside scenario

We could lower the rating if Solvay's adjusted FFO-to-debt ratio approached 20% for a sustained period. This could most likely happen if there were a significant business deterioration or setbacks in the operations of the entity post-spin-off, or in case of unexpected debt-funded acquisitions. A DCF-to-debt ratio turning negative would also likely put the rating under pressure.

Upside scenario

Rating upside would require the adjusted FFO-to-debt ratio to remain consistently and comfortably above 30%, together with management's commitment to maintain the metrics at that level. A stricter financial policy, including for dividend distribution such that adjusted DCF to debt would be more in line with the intermediate financial risk profile (10%), could also result in potential rating upside.

Company Description

Following the partial demerger of the group's most specialized chemicals operations in December 2023, Solvay is a global chemicals company mostly focused on commodity products, with leadership positions in the production of soda ash and bicarbonate, peroxides, silica, rare earth for auto catalysts, and solvents. We expect the company to report about €5.8 billion of revenue and €1.1 billion-€1.2 billion of adjusted revenue pro forma for 2023.

Solvay is present in North and Latin America, Europe, and Asia with about 45 manufacturing plants in 19 countries. We expect the company's shareholding structure to mirror that of Solvay S.A. before the partial demerger.

Our Base-Case Scenario

Assumptions

- Revenue decline of close to 10% pro forma in 2023 reflecting lower demand across markets including construction, a moderate rebound in 2024, and 5% growth in 2025.
- Adjusted EBITDA margin of about 21%-22% in 2024-2025, after very strong margins in 2023, capturing flat restructuring costs of about €70 million per year in our base case. This captures normalization after strong margin of about 29% pro forma in 2023, reflecting mainly lowering energy prices and variable cost proportion.
- Capex of close to €400 million per year.
- Dividends of about €260 million-€270 million per year.

Key metrics

- Adjusted EBITDA of about €1.1 billion-€1.2 billion in pro forma 2023, and €1.1 billion-€1.2 billion in 2024.
- Free cash flow of €300 million-€350 million per year in 2024-2025.
- Adjusted FFO to debt of close to 30% in the coming years.
- Adjusted debt to EBITDA of about 2.0x-2.5x.

Liquidity

Solvay's strong liquidity position reflects our assumption that the company's ratio of liquidity sources to uses would be more than 1.5x in 2024 and in 2025. Solvay's liquidity profile benefits from committed credit facilities of more than €1.3 billion and a solid operating cash flow generation, which offsets high capex and dividends. We believe that Solvay's financial risk management is in line with a strong liquidity assessment.

Principal liquidity sources over the 12 months following the split completion will include:

- About €500 million of cash balance pro forma post-split completion;
- €1,100 million of undrawn committed credit lines and €275 million of confirmed bilateral lines; and
- Our estimate of cash FFO of about €750 million-€800 million.

Principal liquidity uses over the same period will include:

- Working capital requirement of about €100 million;
- About €400 million of peak intra-year seasonal working capital requirements;
- Capex of about €400 million; and
- Dividends of €262 million.

Environmental, Social, And Governance

Environmental factors have an overall negative influence in our credit analysis of Solvay after the partial demerger, as is the case for most commodity chemical companies we rate. We view soda ash (40% of the company's sales) as a highly energy-intensive business leading to a sizable carbon dioxide footprint. We estimate that synthetic dense soda ash carbon intensity was about 1.1 tons of carbon dioxide (scope 1 and 2) per ton produced in 2018. Still, the company targets 30% reduction in its absolute scope 1 and 2 emissions by 2030 versus base-year 2018, and aims for carbon neutrality by 2050 on its operations. This strategy relies on a medium-term coal phaseout to natural gas and biomass, and a shift toward decarbonized energy, and we understand that a large portion of the company's capex over 2023-2026 will be dedicated to sustainability initiatives. Governance factors have an overall neutral impact on our credit analysis with the newly formed governance structure and management team. In line with Solvay's track record, we expect the company to continue to show resilient operational effectiveness and good balance of different stakeholder interests, which we believe will enable it to pursue a long-term sustainability strategy.

Ratings Score Snapshot

Issuer Credit Rating	BBB-/Stable/A-3
Business risk:	Satisfactory
Country risk	Low
Industry risk	Moderately high
Competitive position	Satisfactory
Financial risk:	Significant
Cash flow/leverage	Significant
Anchor	bbb-
Modifiers:	
Diversification/Portfolio effect	Neutral
Capital structure	Neutral
Financial policy	Neutral
Liquidity	Strong
Management and governance	Satisfactory
Comparable rating analysis	Neutral

Related Criteria

- 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
- 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

Downgraded

	To	From
Solvay S.A.		
Issuer Credit Rating	BBB-/Stable/A-3	BBB/Negative/A-2
Not Rated Action		
Solvay S.A.		
Subordinated	NR	BB+

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.spglobal.com/ratings for further information. A description of each of S&P Global Ratings' rating categories is contained in "S&P Global Ratings Definitions" at https://disclosure.spglobal.com/ratings/en/regulatory/article/-/view/sourceId/504352. Complete ratings information is available to RatingsDirect subscribers at www.capitaliq.com. All ratings affected by this rating action can be found on S&P Global Ratings' public website at www.spglobal.com/ratings. Alternatively, call S&P Global Ratings' Global Client Support line (44) 20-7176-7176.

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